511

ECONOMIC PROSPECTS AND POLICIES

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

FIRST SESSION

PART 1

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CONTENTS

WITNESSES AND STATEMENTS

Friday, January 22, 1971

Monday, January 25, 1971

Tuesday, January 26, 1971

SUBMISSIONS FOR THE RECORD

FRIDAY, JANUARY 22, 1971

MONDAY, JANUARY 25, 1971

TUESDAY, JANUARY 26, 1971

ECONOMIC PROSPECTS AND POLICIES

FRIDAY, JANUARY 22, 1971

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

The committee met, pursuant to notice, at 10 a.m., in room G-308, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Jordan, and Percy; and Representatives Patman, Moorhead, and Widnall.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; and George D. Krumbhaar, Walter B. Laessig, and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

We are going to have to start before some of the other members who told us they would be here can arrive. We have three witnesses and we have a great deal of material to cover this morning.

This morning, the Joint Economic Committee opens its special hearings on "Economic Prospects and Policies." Because of the late convening of Congress, the President's budget and Economic Report have not yet been presented. It is unusual for the Joint Economic Committee to begin its hearings before these documents become available, but we are confronted with an unusual situation—a situation too urgent to permit any further delay in finding effective responses.

The combination of inflation and unemployment which the Nation experienced in 1970 was unique in this committee's experience. Never before in the years since the committee was established under the Employment Act of 1946 have we experienced a year in which so much unemployment was accompanied by so much inflation. Our most comprehensive price measure, the GNP deflator, went up 5.3 percent in 1970. This rate of inflation has been exceeded only three times since 1946—in 1947, 1948, and 1951, but these were years of full employment. The unemployment rate was below 4 percent in each of these years.

There have been a number of years since 1946 in which unemployment exceeded the 1970 average of 4.9 percent—far too many such years. This in itself is an indictment of the failures of economic policy, but in none of the high unemployment years did inflation approach its 1970 proportions. In none of them did the increase in the GNP deflator exceed two and a half percent—less than one-half the 1970 rate.

The experience of 1970 was something new in modern economic history. Even so, we might tolerate the distress of 1970 if we had clear evidence that things are getting better. But where is this evidence? Unemployment increased steadily during 1970, from 3.9 percent in January to 6 percent in December. It is widely agreed that even higher unemployment lies ahead.

But what about inflation? Is it tapering off? The GNP deflator went up at a 5.7 percent rate in the fourth quarter, compared to 4.6 percent in the third. Try as I will, I cannot find the clear evidence that inflation is tapering off.

Aggregate statistics on inflation and unemployment are useful. This committee has worked throughout its existence to develop more and better statistics. But statistics are not enough. We need also to know what inflation and unemployment are doing to individuals and families throughout the country. We need to know what effects inflation and unemployment are having on the ability of State and local governments to provide essential public services.

For this special set of hearings, we are fortunate in having a group of witnesses extraordinarily well qualified to bring home to us the widespread effects of deteriorating economic conditions.

Among our witnesses will be some of this country's most distinguished public officials. We look to them for information on how inflation and recession have affected their own localities. Far too little is known about the impact of changing economic conditions on State and local budgets. I am convinced that the impact is far greater than is generally recognized.

Inflation causes the prices paid by State and local governments to go up faster than it causes their tax receipts to increase. One estimate I have seen is that this budget gap caused by inflation increased by at least $3 billion in 1970. To this inflation gap we must add the depressing effect on tax receipts of unemployment and falling incomes. This effect, according to one estimate, reached $4 billion in 1970. And to these two effects we must add the increased outlays for welfare and unemployment compensation due to rising unemployment. I can find no quantitative estimate of this cost, but it must surely be very large.

These three effects combined, a $3 billion or more inflation cost, a $4 billion or more revenue shortfall, and a large but unknown increase in welfare costs, together give us some comprehension of the burden placed on State and local government by inflation and recession. I would be surprised if the sum of these costs, if they were fully and accurately estimated, did not reach at least $10 billion in 1970.

In other words, what I am saying is that the recession-inflation combination caused as much loss as would be compensated by a $10 billion grant, unrestricted grant, by the Federal Government to the States and localities. It is that serious.

So I am led to conclude that, whatever else the Federal Government may undertake in the way of aid to States and localities—and there are many alternatives worthy of serious consideration—the single most important thing the Federal Government can and must do is to restore full employment and price stability. Only if we restore the healthy economic climate in which rational planning can take place can we expect any program of assistance to States and localities to meet with success.

Some of the, I think, most cruelly suffering victims of the double calamity of inflation and unemployment are the cities. They are the victims of the program of economic slowdown in a double way: too severe a monetary policy keeps the interest rates painfully high on capital they must borrow for investment in schools, for sewer and water, for hospitals and other urgent capital needs.

It also slows down the economy. In doing so, it cuts city income, the cities are the victims of a fiscal policy that plays its part in slowing the economy and adding hundreds of thousands to relief rolls of the cities, while at the same time not providing a Federal program of relief assistance that can help.

It is the combination—I repeat, the combination—that is killing. When the Federal Government spends its funds for military purposes, for SST's, for space, and not for welfare or educational needs, that space and military spending is inflationary and, when the economy is permitted to stagnate, the cities' problems become a crisis.

Because we really know so little about what inflation and recession have done to State and local government, I am especially happy to welcome this morning three distinguished witnesses who come to us "from the front lines," well-qualified to describe the problems faced by our great urban areas.

Before I introduce Mayor Gibson, I understand that Senator Jordan has a statement, and perhaps also Congressman Widnall has a statement.

So I yield first to Congressman Widnall and then to Senator Jordan and then to Mr. Moorhead if he has a statement. If he has not, I will go then to Mayor Gibson.

Opening Statement of Representative Widnall

Representative Widnall. Thank you, Mr. Chairman.

We are passing through a very difficult period in our Nation's economy. Many of our economic experts feel that the worst is behind us, that the responsible, although painful, economic policies of the administration applied over the last 2 years are beginning to yield the desired results. The recent high interest rates are now dropping sharply. This, coupled with a moderately expanding money supply and selectively stimulative Government spending, should act in 1971 to revive a slowed economy and reduce an unacceptably high rate of unemployment.

The ending of the economic downturn and the beginning of recovery notwithstanding, many problems remain. Viable wage-price policies must be developed if we are to deal effectively with the wage-price spiral worsened in the highly inflationary period through which we are passing. Wages and prices, which are continuously rising, with little regard to changes in productivity, are destructive of a stable economy. The very crisis in our States and cities in fiscal, housing, welfare, educational, and other matters must be met.

It is my hope that these hearings and those following the delivery of the President's 1971 Economic Report will be conducted in the spirit of attempting to profit from the testimony of the witnesses who are to appear in seeking solutions to those pressing national problems.

It would be a great loss if these hearings were to be used for nothing more than a tax on the administration for the present economic difficulties, difficulties which have resulted in part from the strong measures which the administration was forced to take as a result of the previous administration's irresponsible monetary and fiscal policy during the extended period of heavy domestic and military spending.

Chairman PROXMIRE. Senator Jordan.

OPENING STATEMENT OF SENATOR JORDAN

Senator JORDAN. Thank you, Mr. Chairman.

For Americans, 1970 was a year of trial. I look forward to 1971 as a year of achievement. Economic activity in 1970 fell short of both desired and anticipated levels. Unemployment was and is a matter of urgent national concern.

Our real gross national product was basically unchanged from 1969; industrial production fell during the year; high interest rates brought depression conditions to the homebuilding industry. On top of all this, inflation continued to erode the value of the dollar at an unacceptable rate. Nevertheless, 1971 shows every sign of improvement. This is no bland hope, but the considered opinion of virtually every professional economist.

Interest rates have already posted one of the steepest declines in history. Wholesale prices have recently declined and the rate of consumer price increases has shown signs of easing. Housing is posting a strong recovery and the crisis of corporate liquidity has eased in the past 6 months.

Developing an economic policy for 1971 will be no easy matter, for there are no perfect solutions to the obvious problems of today.

Despite my optimism for the future, I believe that this committee must examine very carefully the economic policy objectives and proposals of the administration. Under such conditions—that is, the beginnings of an economic upturn and the changes in store for economic policy—I believe it is self-defeating for this committee merely to recount the hardships of the past year or prior years. We must look ahead, pressing for solutions which we believe warranted in the light of testimony at these hearings and developing economic conditions.

Perhaps the major gap in economic policy at the present time is in the area of wage and price policies, and I am interested to see that the chairman has invited a number of witnesses who are particularly well-qualified to enlighten us here.

The administration and the Congress together must also agree on a constructive manpower policy in order to ease today's intolerable unemployment situation. I believe the issues of overriding concern to America stem from deterioration in the conditions of everyday life. Environmental issues, the concern with crime in our city streets, demand for quality education, and the current debate on reordering the national priorities all reflect the economic problem of how to provide the services necessary to sustain and improve our quality of life.

In large part, the burden of providing these services rests on State and local governments, whether the job at hand is clearing up pollution, improving the court system or merely collecting trash.

Today we welcome the mayors of two of our most populous cities. We welcome, also, I understand, the new Governor of the State of Pennsylvania. I welcome your testimony and your recommendations for the future.

Chairman PROXMIRE. I would like to say, gentlemen, before we continue, that Mr. Moorhead is going to forgo a statement in the interest of time.

I would like to recognize the presence here of Congressman Joe Minish, who is a very fine and able and distinguished member of the House Banking and Currency Committee.

Before I recognize my good friend, Pete Rodino, who I understand will introduce Mayor Gibson, I would just like to say something myself about Mayor Gibson. Then I will present Congressman Rodino.

Our first witness is Kenneth A. Gibson, mayor of Newark, N.J., who will be followed by Mayor John V. Lindsay, of New York, and then Gov. Milton J. Shapp, of Pennsylvania.

Mayor Gibson, in taking over the office of mayor 7 months ago, you took on some of the most serious urban problems that anyone has ever had to face and you took them on in the middle of a recession. The typical urban dilemma of declining tax base, rising expenditure requirements, and an urgent demand for better public services can certainly be found in full measure in Newark. In your own prepared statement for this hearing, you described Newark as perhaps, and I quote you, "the most decayed and financially crippled city in the Nation."

Mayor Gibson, I have read your prepared statement with great interest. It is eloquent and compelling. We are most grateful to you for your willingness to come and discuss your problems with us this morning.

I am happy to recognize Congressman Rodino, an excellent Congressman and a very able Member of the House, to introduce the mayor.

STATEMENT OF HON. PETER W. RODINO, JR., A REPRESENTATIVE IN CONGRESS FROM THE 10TH CONGRESSIONAL DISTRICT OF THE STATE OF NEW JERSEY

Representative RODINO. Mr. Chairman, thank you very much for this opportunity.

I come here this morning, along with my colleague, Congressman Joe Minish, who, together with me, represents the city of Newark. My sole and single purpose today is to introduce the mayor.

I would like to say, though, prior to introducing him, that as a resident of the city of Newark and as one who has lived all his years in the city of Newark, I think that bringing before your committee our able, distinguished mayor, who has taken on this very onerous, tremendous job in a very trying and critical time, will certainly shed the kind of light you need to have as a committee to search out, through these hearings, the problems that face us in the cities.

As the mayor has indicated in his prepared statement, this is a city that is now decaying because it is old and fraught with many problems. Now it is also confronted with the picture of hopelessness because no aid seems to be forthcoming in a time when we are faced with the dual problems of inflation and unemployment.

I know as a Member of Congress for the past 22 years that this city has the kind of problems that merit your committee's learning and attention. I think that our able mayor is certainly undaunted and determined, and has tried desperately within the period of months he has been mayor to bring to the attention of the people and our Government the need to reach out and do something now.

So, Mr. Chairman, I am delighted to be here to present the able and distinguished mayor, whom we are very proud of and who we hope will be able to give this committee the kind of information that will be helpful in its searching deliberations.

Thank you very much.

Chairman PROXMIRE. Thank you, Congressman Rodino.

Mayor Gibson, go right ahead.

Before you start, if you want to abbreviate your prepared statement in any way, your entire prepared statement will be included in the record, including the tables and the profile in the front. That whole thing will be printed in full.

STATEMENT OF HON. KENNETH A. GIBSON, MAYOR OF NEWARK, N.J.

Mayor GIBSON. Thank you very much, Mr. Chairman.

I do not intend to read that prepared statement. I understand that it will be entered into the record so that each of the distinguished members of the committee will have an opportunity to study it.

I first of all would like to thank you very much for my being invited to testify. This is very important to me. When we discuss the changing economic conditions in our country and its impact on our city, Newark, N.J., I would like to mention some very important facts which are mentioned in the first pages of our prepared statement, because I think this will set the stage for the very brief verbatim statement I will make today.

First of all, the city of Newark is the largest city in New Jersey, which is our Nation's most urban State. The population of Newark is approximately 400,000 people. Our population distribution, which is also important, is 60 percent black, 11 percent Spanish-speaking, 20 percent white. We have 80,000 schoolchildren—80,000. Eighty-five percent of those are black and Spanish speaking.

I must point out here that 25 percent of our high school students drop out of school. This is one of the highest dropout rates in the country.

Our land area is 24 square miles and we are very different than most urban centers in that only 60 percent of our land area—let me put it the other way—only 40 percent of our land area is taxed. Newark Airport comprises about 8 miles of Newark's land area. The rest of it that is nontaxable is composed of streets, highways, institutions, and churches.

Our unemployment rate is 11.1 percent.

Public assistance recipients are 114,000 as of January this year, 30 percent of Newark's population.

We have the highest per capita crime rate in the Nation. We have the highest per capita incidence of venereal disease and infant mortality in the Nation.

We have an annual budget of $161 million. That will increase to approximately $210 million for the coming year.

Our real estate property tax rate is $8.44 per $100 of assessed values. This again is one of the highest tax rates in the Nation.

Our anticipated deficit for the coming year is $70 million—that is 43 percent of our proposed operating budget.

I think that these facts give us the basis to discuss Newark's condition and, we believe, the Nation's conditions.

You have asked me to address myself to four questions, the first of which deals with the financial problems faced by my city.

To briefly summarize again the detailed prepared statement which I have filed with you, Newark is faced with a budget crisis that threatens to bankrupt the city of Newark. Upon taking office in July of 1970, I found an anticipated or estimated deficit for 1971 of over $70 million, more than 40 percent of the budget, again. The budget crisis was brought first by a 10-percent decrease of city revenues and an increase of $50 million in spending. The additional $50 million, largely the result of mandated appropriations for essential municipal services, raised the city's total expenses for 1971 to $210 million. To fill this gap through increased property taxes, we would have to raise the present rate, the $8.44 rate, we would have to raise that rate by 50 percent to about $13 per $100 of assessed valuation.

Now, after months of study and consultation, we finally opted for a series of taxes on Newark's businesses and consumers, in the form of occupancy, payroll, and sales taxes.

I must point out here that we had to go to the State legislature to get enabling legislation to impose these taxes. We still have not imposed these taxes as yet. I still have a fight in my city to have these taxes imposed. We have the enabling legislation, though, that passed the legislature.

We are aware that these proposed taxes are highly discriminatory and regressive and that they will further inhibit the economic growth potential of our city. But we have no alternative. Our deficit may run even larger than estimated. The teachers' union has presented demands which we estimate would more than double the already skyrocketing school budget of $90 million. Police and firemen are also demanding more in contract negotiations. We must also pay about 30 percent of county expenses, and the county has budget requests for 1971 which amount to a one-third increase over 1970.

We must deal with these problems despite a depression-level unemployment rate of over 11 percent, brought on in part by current fiscal policies; and a business community which has curtailed capital expansion due to an uncertain economic future facing the city of Newark.

If we meet our deficit needs, we will only be providing for the most basic of city services. I want to emphasize that. If we just meet our deficit needs, we will only be providing for the most basic of city services—schools, public safety, health, welfare, and sanitation. Even if we succeed in filling the budget gap, we still will be left with the problems of arresting physical deterioration and strengthening our people's faith in the ability of our institutions to respond in hours of greatest need.

Our $210 million city budget does not begin to solve the problems of the 40 percent of our labor force which is unemployed or underemployed, or the 30 percent on welfare. Neither does it rebuild the

30 percent of Newark's housing stock which is officially substandard, or the 50 percent of Newark's schools which were built over 60 years ago.

These are the facts. It is said quite often that facts do not lie. But all too often facts do not compel one to action. Yet action is what is needed.

When all the witnesses before this distinguished committee have concluded their testimony, you will not have heard anything that you have not heard many times before. All of the major areas of concern have been endlessly studied.

I have before me on this table copies of our model cities proposals, copies of our community renewal program, copies of the Report of the President's Commission on Civil Disorders, copies of the Governor's Commission on Civil Disorders, and literally hundreds of other studies and official commission reports which fully document Newark's problems and suggest immediate and long-range solutions—immediate when these reports were submitted and prepared, and long-range at this time.

Information and knowledge of conditions and problems are not what is needed. The information has been available for years, yet the decline of America's urban centers has continued at a relentless pace. What is needed now is the will to do something about it.

In 1968, for instance, Congress set a 10-year goal of 26 million new and rehabilitated dwelling units. Two years later, we find ourselves already 650,000 units short—or 15 percent—and talk is spreading of holding back $200 million in previously committed urban renewal funds. I want to relate Newark's urban renewal problem through its housing shortage here, very briefly.

We have been authorized and have in discussion many urban renewal projects. We have cleared acres and acres of land in Newark in preparation for housing construction. We can stand 1 mile away and look at buildings across acres of clear land in Newark, a mile away. Now we face the prospect of not being able to construct those housing units because of a hold on urban renewal funds—in a city which has some of the worst housing conditions and other conditions in the Nation.

Efficient and balanced urban mass transportation which would stimulate desirable economic and social trends was another lofty goal; and yet of $7.7 billion which the administration requested for Federal aid to transportation in 1971, only 2 percent—$0.15 billion—was devoted to urban mass transit. The list of goals and the scorecard on performance is a shocking indictment of this Nation's failure to respond to the urgency of the crisis. What is lacking is the resolution of the House, the Senate, the President, the State legislatures, the Governors, local officials, and private industry to act before it is too late.

I am not anxious to make this the first of many annual appearances before congressional committees to ask for money handouts—and I think I should repeat that; I am not anxious to come here to ask for money handouts—or to appeal for a recognition of the crisis of urban America. In fact, it grieves me as mayor of the city of Newark to lay bare before the Nation and the world the ills of our city; the city for whose health and welfare I am responsible. The only reason I come here today is to petition you again, as so many others have done in the past, to recognize the obligation of the Federal Government to meet the needs of the people of this country, the majority of whom now live in urban areas. If this testimony helps to convey the needed sense of urgency concerning the crisis of our city, in fact all cities, then this trip has been worthwhile—provided that sense of urgency is quickly followed by appropriate action.

Again I would like to refer you to the stack of studies and committee reports which are before me.

The areas of action are clear. They include revenue sharing, Federal assumption of welfare in the form of an adequate family maintenance program, expediting the construction of housing, providing increased aid for education, passage of a bold manpower bill, and other well-known programs.

Lost in the national debate on welfare reform and revenue sharing is this needed sense of urgency—of aggressive and affirmative national commitment. Lost in the rhetoric of debate is the simple truth that cities across the Nation are fighting just to stay alive—to pay the police, the firemen, the teachers, and the basic service employees. America's priorities must reflect a commitment to urban America. They must reflect the simple truth that human resources are America's greatest asset, and that our greatest hope lies in the healthy development of all our people.

The scope of urban problems has been well-documented. I have before me countless reports which analyze the problems of our urban centers—crime, infant mortality, substandard housing, unemployment, welfare, miseducation. These thousands of pages of expert study and evaluation of the deterioration of our cities indicate a national recognition of the crisis. One need not be an expert, however, to realize that all the studies in the world will not give one child the proper education, one unemployed man a decent job, or one welfare family safe housing and a hope for the future.

Without the commitment of massive public and private resources dedicated to the physical and human revitalization of our cities, millions of Americans will continue to live in despair and poverty.

America's greatness has been its ability not only to recognize problems and accept challenges, but to commit the American will and the vast American resources to achieve a common goal. When America made a commitment to be the first nation to land a man on the moon, we devoted $25 billion to reaching that objective.

To begin to realistically confront the urban challenge, we as a nation must be prepared to expend the tens of billions of dollars necessary to do the job. The urgency of the problems demands action now; the magnitude of the problems demands vast reallocation of resources.

I caution you, distinguished Congressmen and Senators, do not misunderstand the implications of urban decay and collapse. As I have said many times before, "Wherever America's cities are going, Newark will get there first."

We are not talking only of saving the Newarks of America; we are talking of saving America itself.

Chairman PROXMIRE. Thank you, Mayor Gibson, for a powerful and effective statement.

(The prepared statement of Mayor Gibson follows:)

PREPARED STATEMENT OF HON. KENNETH A. GIBSON

NEWARK, NEW JERSEY—A STATISTICAL PROFILE

1. The largest city in the nation's most urban state.
2. Population: 400,000 (approximately).
3. Population distribution: 60% black; 11% Spanish-speaking; 29% white largely ethnic).
4. 80,000 school children: 85% black and Spanish-speaking.
5. Land: 24 square miles (Newark Airport occupies nearly 8 sq. miles). 60% of land area is tax-exempt.
6. Unemployment: 11.1% (January 1971).
7. Public Assistance Recipients: 114,000 (January 1971) 30% of Newark's population.
8. Highest crime rate in the nation.
9. Highest per capita incidence of venereal disease and infant mortality in the nation.
10. Annual budget: $161,000,000. (1970).
11. Real estate tax rate: $8.44 per $100 of assessed valuation (among the highest in the nation).
12. Anticipated deficit: $70 million (1971), 43% of the operating budget.

These are just a few of the important statistics which comprise Newark's two-dimensional profile. These are a few of the facts which suggest that the commercial, industrial, social and cultural hub of the State of New Jersey may also be the most decayed and financially crippled city in the nation.

To fully comprehend the reasons for Newark's present state of decay, one must first examine Newark's past. Newark was a central point of development in one of the oldest and most highly urbanized areas in the country. The City began as a sub-region of the New York metro-trade region. In the nineteenth century it rose as a manufacturing center, specializing within the region in certain industries. In the first half of the twentieth century it became a white collar office center again specializing in certain activities, primarily the insurance business, government and non-profit industries.

Newark is a sub-regional center with a weak "pull" on its hinterland. Newark suburbs are close to the center of the city and they are highly developed. The City, however, never established a sufficient concentration of skilled labor or a monopoly on professional and business services, retail sales, or employment in any sector to give it dominance in the sub-region or allow it to exert any strong centralizing influence. Consequently, we now find that people and industry show no reluctance to move out of the city. In 1968 the outlying areas led Newark in rate of industrial growth not only in the manufacturing sector (a typical urban growth phenomenon), but also in all other sectors except transportation. Whereas New York City and other large cities have established sufficient regional dominance to survive decentralizing trends, Newark apparently has not. This situation tends to make national economic downturns especially hard-felt in terms of the city's competitive economic position and absolute economic standing.

Throughout the post-war period, Newark, like most other large cities in the Northeast, has functioned as a processing and service center for the economically deprived. While population has remained relatively constant, the affluent and middle classes have moved out of Newark in large numbers. They have been replaced by migrants with lower employment skills who require additional social services which strain the city's financial resources. Those who acquire skills and become absorbed into the economy of the area often move out of the city, only to be replaced by others, less skilled, who quickly begin, once again, the struggle for economic status and self-sufficiency. The process of continual turn-over in the semi-skilled and unskilled, highly transient population results in constant transfer of properties and further compounds the problems of urban deterioration.

The City of Newark has been able to provide fewer and fewer employment opportunities for its residents. The manufacturing industry, long the source of training for the unskilled and semi-skilled, has declined almost 25% in the past twenty years and is now at a point where it can no longer provide an adequate pool of employment. The only appreciable increase in employment has been in the service sector, but even in this area Newark's growth rate is only one-half that of the other cities in the region. It is important to note that whatever the increase in this sector, it has had little effect on the total employment picture in Newark since little effort has been made to train the unskilled and semi-skilled for employment in this field.

National economic policies, particularly credit stringency and the high cost of borrowing, have seriously impaired the city's ability to reverse or even stabilize this declining trend. *Newark has now reached a critical point in terms of maintaining its position as an industrial and commercial center.* Non-residential construction starts in the city during 1970 were 30% lower than they were in 1969, as compared to a national decrease of only 4%. To further illustrate this decline, according to a recent Chamber of Commerce study, 41% of the businesses in Newark found it necessary to curtail expansion of capital facilities during 1970. Finally, and perhaps most significant of all, of the businesses included in the Chamber's study, only 38% showed an increase in profit during the past year. The national economic downturn, which comes at a time when many of the city's businesses are at a marginal profit level, when capital expansion is at a dangerously low rate, and when the city's employment growth rate is considerably lower than that of the surrounding area, seriously threatens the possibility of any future economic recovery.

The employment picture in Newark is equally dismal. Traditionally, city residents have found the greatest employment opportunities in the manufacturing industry. Yet manufacturing has steadily declined in Newark. The service field, on the other hand, has grown over the past two decades. The new positions in this sector, however, require a degree of skill found mostly among the suburbanites. Consequently, although employment within the city has remained relatively constant, an ever increasing percentage of those employed in Newark are commuters. Current statistics reveal that 15,000 people, or over 11% of the resident labor force, are presently unemployed. Another 35,000 people are employed either full-time or part-time at a rate of under $3000 per annum. Still another 17,000 are being underutilized. Hard statistics reflect a human tragedy: *One out of every two people in Newark interested in jobs cannot find adequate employment.*

It is difficult to conceive of a more drastic situation that what has just been described, yet it should be pointed out that youths aged 16–22 make up 30% of those without adequate employment. Further, unemployment for youths of that age is at an alarming 34%. The futre of Newark and every other city is in their hands!

Newark's financial difficulties extend beyond the private sector into the public sector. The present budget crisis, which threatens to bankrupt the city, was brought on by a 10% decrease in city revenues coupled with an increase of $50 million in expenditures, bringing the total deficit to $70 million. The additional $50 million in expenditures, largely mandated appropriations for essential municipal services, raised the city's total expenses for 1970 to $211 million. Tragically, even this sum will not begin to slow the physical decay of the city, or measurably improve the quality of life of the city's residents.

Upon taking office, I was faced with three alternatives to solve our financial dilemma. The first alternative was to raise Newark's property tax by 50%. I rejected this possibility for many reasons, primarily because Newark's property tax is presently among the highest in the nation, and considered confiscatory by experts. Property owners are already abandoning property in such large numbers that the city can only collect 88% of what its levies (compared to 97% for New York City). When the city takes over property and attempts to sell it for taxes, no one wants to buy it. (A recent sale of 400 properties had buyers for less than a dozen). As a result, the city is forced to collect rents on abandoned properties to cover taxes, and is fast becoming the biggest landlord in the city.

The second alternative was to enact an earnings tax which would have required suburbanites who work in Newark to share in its financial burdens. I considered this alternative the most equitable because Newark provides employment for more non-residents than residents, giving the city one of the highest commuting rates in the country. This influx results in an overtaxing of the city's physical facilities—roads, police, hospitals, and fire departments—which is extremely difficult to finance with our meager tax base. Unfortunately, this proposal was summarily rejected by the suburban-dominated New Jersey legislature.

The third alternative was a self-help program whereby the city of Newark would impose a series of taxes on payroll, occupancy, and sales. We realized that these temporary measures were regressive and discriminatory and would further inhibit the economic growth potential of the city, but they were preferable to the destruction of Newark through increases in the confiscatory property taxes or municipal bankruptcy.

If we were to adopt these measures, we would still face a $35 million deficit. And this deficit, to repeat, merely reflects mandated increases in services and decline in revenues, and does not reflect any new or innovative programs or any significant improvement in the living conditions within our city.

Our deficit for 1971 may be even larger than estimated. The teachers union has presented demands which we have estimated would more than double the already skyrocketing school budget of $90 million. Police and firemen are also demanding more in contract negotiations. (Contracts with municipal unions were recently required by state law.) Furthermore, we must pay about 30% of county expenses and the county has budget requests for 1971 of $120 million, a one-third increase over 1970. More importantly, and to place this discussion in its proper framework, let me point out that even if we succeed in filling this budget gap, we will still be left with the problems of arresting the physical deterioration of our city and strengthening our people's faith in the ability of our institutions to provide essential services. That we have thus far failed to fulfill our obligation to the citizenry of Newark is evident in every aspect of urban life.

For instance, in education, which I have personally declared my number one priority item, we are saddled with an ancient physical plant and an inadequate per pupil municipal expenditure. In an area where it is generally agreed the need for compensatory and innovative programs for the inner-city resident is most badly needed, Newark has not been able to match suburban areas in per pupil average expenditures: we spend less than $650 in educating each pupil, as compared to an average expenditure of over $800 in suburban Jersey districts. Our physical structures were allowed to deteriorate for many years—between 1930 and 1955, for instance, only three new elementary schools were constructed. Of Newark's eighty-four schools, almost half were built over sixty years ago. And while there is no direct correlation between drop-out rates and new school buildings, it seems clear to me that a city with one of the highest high school drop-out rates in the country (24%) must be able to utilize enormous resources for physical rehabilitation and innovative programs if the classroom is to become once again a meaningful and productive learning environment for all our inner-city children.

In housing, Newark's needs appear even more staggering. Nearly eighty per cent of our dwelling units are at least forty years old (and the great majority of these are wooden frame dwellings). As of 1967, thirty per cent of the city's housing supply, or about 41,000 units, were clearly sub-standard; that is, they could not be rehabilitated and had to be totally replaced. And while the process of physical deterioration continues largely unabated, and while the demand for shelter increases sharply, substantial resources have not yet been harnessed to make an impact on the problem. A dramatic illustration is that residential construction in Newark declined from $3,982,000 in 1969 to only $165,000 in 1970.

The unemployment crisis which has plagued Newark has had a marked effect on welfare programs. Presently over 114,000 of Newark's 400,000 residents, fully 30% of its population, is receiving some form of public assistance. Both the percentage and the absolute numbers are increasing. Welfare costs in the city have risen from $42 million in 1966 to $87 million in 1970.

The list of problems, the areas which are in desperate need of new money, runs the full spectrum of city services and basic urban institutions. In recreation, Newark has less acreage per 1,000 population than any other "old" city within the New York region. The streets and sidewalks of Newark are in desperate need of renovation. 54% of Newark's sewers are 75 to 100 years old. Effective law enforcement may be impaired without considerable expansion of the city's 1400-man department, and the Fire Department is handicapped by deficient maintenance and the lack of a fire training center. Finally, in the all-important fight against pollution, Newark has been forced into the role of spectator.

What began in Newark 25 years ago as an almost imperceptible decline of its educational facilities and other essential services has resulted in a physical, social and financial atrophy unmatched in the post depression era. The resources with which to provide safe, efficient new schools, to assure every citizen an adequate, sound dwelling unit, and to support all our people at adequate maintenance levels, are simply not to be found within the confines of the City of Newark.

The cry from Newark is becoming the all too familiar appeal for national solutions to urban problems. The cry can only be answered by the Congress, the Senate, the President, the State Legislatures, the Governors, local officials, and private industry—and the answer must be a bold, affirmative commitment to act before it is too late.

I caution you: do not misunderstand the implications of urban decay and collapse. As I have said many times before, "Wherever America's cities are going Newark will get there first." We are not only talking about saving the Newarks of America, we are talking of saving America itself.

Recommendations

To remedy the ills which afflict Newark and the other urban centers of our country, I propose the following:

A. Employment

1. The present system of unemployment compensation should be modified so as to provide higher benefits and a longer period ef eligibility during inflationary and high unemployment periods and/or in areas of high unemployment.

2. The Comprehensive Manpower Training Act of 1970 should be enacted so as to provide the needed employment and training for many disadvantaged city dwellers.

B. Welfare reform

1. The Federal Government should assume the full cost of all public assistance programs, thus insuring equal treatment throughout the country.

2. The present proposed minimum support levels should be dramatically raised so as to recognize the increased cost of providing a decent and adequate standard of living.

3. Welfare reform should be coupled with a universally-available network of day care centers.

C. Housing

1. Congress should declare "Housing Disaster Areas" for various sections of the country, specifically in urban areas. This would include massive infusion of monies for land acquisition and assembly, housing development, mortgage subsidies, employment training, etc.

2. All future federally funded housing should be available for sale, not rental. This would eliminate absentee landlord problems and instill a sense of "pride in ownership" which is now totally lacking.

3. All federal housing programs should strive to recreate the neighborhood concept, once indigenous to the nation's urban centers.

D. Revenue sharing

1. The Congress should enact immediately a revenue sharing program. This should not replace existing categorical programs but should be "new" money with a committee of Congressmen and Senators appointed to oversee the expenditure of funds.

E. Health

1. A national health insurance plan should be enacted as soon as possible.

F. Private industry

1. Congress should enact legislation whereby businesses are encouraged, through tax incentives, to locate in the urban centers. This will allow the cities to restore their tax bases and encourage industry to take a more energetic role in the revitalization of our cities.

TABLE I.—EMPLOYMENT OF NEWARK RESIDENTS

[A 5-year comparison]

	1967	1968	1969	1970	1971 (projected)
CITY OF NEWARK					
Adequately employed	76,071	73,621	71,171	67,270	63,420
Underemployed	16,700	16,900	17,100	17,350	17,700
Low-income employed	34,000	34,250	34,500	35,000	36,000
Unemployed	15,000	14,500	14,000	15,000	16,000
Not in the labor force but 16 years of age or older	106,862	106,862	106,862	106,862	106,865
Under 16 years of age	139,435	139,935	140,435	140,935	141,435
Total population	388,068	386,068	384,068	382,417	381,417
Unemployment rate	10.6	10.4	10.2	11.1	12.0

TABLE II.—NEWARKS REAL ESTATE TAXES

[A 5-year comparison]

	1966	1967	1968	1969	1970
Land	$313,000,000	$289,000,000	$285,000,000	$283,000,000	$277,000,000
Improvements on land	954,000,000	958,000,000	941,000,000	936,000,000	890,000,000
Taxable base	1,267,000,000	1,247,000,000	1,226,000,000	1,219,000,000	1,167,000,000
Rate	5.97	7.76	7.90	8.30	8.44
Tax imposed	$74,000,000	$97,000,000	$97,000,000	$101,000,000	$98,000,000
Tax collected	65,000,000	84,000,000	85,000,000	87,000,000	86,000,000

TABLE III.—PUBLIC ASSISTANCE IN NEWARK

[A 5-year comparison]

	1966	1967	1968	1969	1970
Dollars expended in Newark	$42,400,000	$52,100,000	$60,000,000	$78,400,000	$87,000,000
Number of people receiving benefits	47,000	58,000	67,000	89,000	114,000
Cost to Newark	$5,800,000	$7,900,000	$9,100,000	$7,400,000	$7,000,000

Chairman PROXMIRE. I would like to suggest to the committee that we confine our questioning, unfortunately, to 5 minutes. We are going to have to do that.

Mayor Lindsay is now here. He will be followed by Governor Shapp. We will not be able to get through unless we abbreviate our questions.

Mayor Gibson, of course, you are absolutely right that information alone will not solve the problem. I am glad you put the emphasis you did on that. At the same time, I think it is important that it is not misunderstood.

Your presence here is an indication that hitting hard at these facts is the only thing that will solve the problem. We have to realize—I know it is very clear to you and to the Congressmen and others with you here—but to many in the Congress, it is not as familiar as it should be. We did not realize, I am sure, the tremendous scope and depth of this problem, certainly did not as it hits Newark.

You have said that you have 11 percent unemployed and 30 percent of your population on welfare; is that correct?

Mayor GIBSON. Yes, sir.

Chairman PROXMIRE. So you have three times as many in proportion on welfare as you have unemployed?

Mayor GIBSON. That is right.

Chairman PROXMIRE. You must have a large number of pepole on welfare who are working; is that correct?

Mayor GIBSON. I am sorry; I did not understand.

Chairman PROXMIRE. You must have some people on welfare who are working, is that correct, some families on welfare, some member of which is gainfully employed?

Mayor GIBSON. We have partial welfare payments to deal with some very specific needs, but very few people we can say across the city basis who are on welfare and working.

Chairman PROXMIRE. I understand, and I do not want to get into that aspect of the welfare problem.

Let me ask you this: New Jersey is the sixth richest State in the Nation in terms of per capita income, yet they have no State income tax, and their average tax effort ranks 47th of 50 States, their per capita income ranked sixth in the country. They turned down your proposal to tax suburbanities who work in Newark. A large part of your problem seems to be maldistribution of the wealth within the State.

Can Newark ever become a financially viable government unit unless New Jersey gives it some new tax source or, alternatively, unless you move toward a regional form of government which broadens your tax base to include suburban areas?

Mayor GIBSON. No, sir; you are right and those figures are correct. New Jersey does not have the kind of tax you are speaking of. We have only the State sales tax as a broad-based tax.

I have proposed for many years a State income tax, graduated income tax, for the State of New Jersey. I believe New Jersey will have a graduated income tax after the elections of 1971. But we must have that kind of broad-based tax in order to deal with Newark's problems, with the proper distribution of funds, of course, from this kind of broad-based tax.

Chairman PROXMIRE. Your problem is so great, it is greater than almost any other city. I know other cities have many problems, as Mayor Lindsay is going to remind us, but your problem is so compelling, unless you get the cooperation of the State government and the surrounding suburbs, it seems to me utterly hopeless and that it is going to deteriorate.

Mayor GIBSON. I do not want to use the word "hopeless."

Chairman PROXMIRE. I say unless you get that.

Mayor GIBSON. I agree with you there.

I relate back to the fact that in my opinion, since we do live in the richest country in the world, we can deal with Newark's problems of 400,000 people because we have the natural resources and the State resources to do so. Of course, whether or not we can stimulate State people to do their job and, of course, stimulate a national reordering of the Nation's priorities, I do not know.

Chairman PROXMIRE. The President vetoed the Manpower Training Act of 1970 because it would have provided for what he called dead end public service jobs. Suppose this Congress enacts similar legislation to provide public service employment. And of course, we may have to override a Presidential veto to do it. Do you have jobs to put people on in Newark that will not be dead end jobs?

Mayor GIBSON. Yes; and we are dealing not only with public service jobs in Newark, we are dealing with the insurance industry, the community, with the airlines. These jobs are not dead end. Even public service jobs are not dead end, because we need public service jobs in Newark.

Chairman PROXMIRE. So if this bill that was before the Congress last year had passed, you could have used it, you could have provided jobs?

As I understand it, if the Federal Government provided about 80 percent of the cost of jobs in the city, you would have had to come up with about 20 percent. Do you feel this would have been a feasible approach you could have used?

Mayor GIBSON. Yes, sir.

Chairman PROXMIRE. Putting people to work on jobs constructively, not leaf raking, but in other areas?

Mayor GIBSON. Yes, sir; our problems in Newark are not leaves.

Chairman PROXMIRE. My time is up. I have other questions.

I ask unanimous consent that any questions any members would like to ask and do not have time to ask can be filed in the record so when you correct your remarks you can answer them.

Mayor GIBSON. Yes, sir; and I would like to say, if you submit any questions, we have a very dedicated staff and they will submit answers to you.

Chairman PROXMIRE. Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mayor Gibson, I want to congratulate you on a very forthright, very honest statement, and a hard one for you to make, because as the head of a great city, Newark, you would like to present us with more optimistic figures than you do today. I think that what you have said in your oral statement portrayed very clearly the plight of Newark and some of the other cities throughout the United States.

I am convinced of the urgency of the matter and the fact that we have to be more helpful than we have been. Your suggestions and the ideas that you have will certainly be welcomed by the members of this committee.

You recommend that Congress enact legislation giving tax incentives to businesses that locate in urban centers. Do you believe this to be a truly effective form of incentive? That is, do you know of businesses that would locate in Newark today if they were given such incentives?

Mayor GIBSON. Yes, sir; we have for many years used the Fox-Lanty Act in the State of New Jersey, which is permissive legislation for cities to give tax abatement to industries and other users to come into the city. We have used this tax incentive or tax abatement effectively in the city of Newark and we have been able to attract many profitable businesses, businesses which, in the final analysis, would not have come to Newark, who do many things. One is that they do pay taxes, not the total tax that they would pay under normal assessment, but they do pay taxes.

Also, they provide for employment in the city of Newark which we sorely need. That employment generates capital and that kind of thing on a nationwide basis, in my opinion, would help other cities and again help Newark.

Representative WIDNALL. Mr. Chairman, I think for the record, I ought to correct the impression of taxation in New Jersey. You have mentioned something that is commonly talked about through the United States, that we are 47th among the States in connection with our aid. Actually, it is aid to education, because we have a different means of financing education in New Jersey than in any of the other States. It is all done directly through the real estate tax. Therefore, there is a very high penalty placed on ownership of real estate because you are carrying the educational load. We are actually third in the whole United States in amount spent on education, and our school system can certainly stand up well against any of the other school systems in the country.

Chairman PROXMIRE. Will the Congressman yield for a brief response?

Representative WIDNALL. Yes.

Chairman PROXMIRE. I was not talking about that. What I was talking about is the tax effort which I understand is measured by the ratio between the amount of taxes collected by the State and the income of that State. That area of Newark ranks 47th out of 50.

Representative WIDNALL. Not that area of Newark.

Chairman PROXMIRE. I beg your pardon, New Jersey ranks 47th out of the States.

Representative WIDNALL. Mayor Gibson, if the legislation for block grants to State and local governments should be enacted, what type of State and local controls at the local level would be used to insure that the funds are used to combat local problems and are not used or consumed through excessive redtape or through misallocation or misappropriation?

Mayor GIBSON. We have in our approach to the State suggested controls—I guess that is not the right word. We have suggested the establishment of a task force, and the task force has been established in the State of New Jersey to deal with funds which will be received for the State. I guess the best word is "accountability" here. We subscribe to the principle of accountability.

We believe that accountability has to be built into, whether it be a State program or a Federal program, the expenditure of funds. We are not attempting to deal with money to just increase salaries in the city of Newark. What we are trying to do is maintain situations and, hopefully, in the future, improve services to the public.

I believe that if Federal grants or similar measures are passed through the Congress, or enacted, we should have built into these measures accountability funds.

Representative WIDNALL. You recommend in your prepared statement that a national health insurance plan be enacted. Could you describe how this would help Newark's fiscal situation?

Mayor GIBSON. We believe that Newark has, and we have outlined the statistics, some of the worst health problems in the Nation. We have a health and welfare department in the city of Newark which, on this present funding, cannot deal with the health problems of the city. If we can in some way transmit a part of this problem to the State and Federal Government, we will be able to reduce the costs, even though minor, in the health and welfare department in the city of Newark, which is really not doing the job.

We do not believe we should spend money if it is not really doing the job. We could remove some of those operating expenses from that department and deal effectively with the things that we can do, with sanitation and sanitation problems in our city. We cannot in the city of Newark deal with our health problems, because they are too great for our budget.

Representative WIDNALL. Thank you, Mayor Gibson. My time is up.

Just before I close, I would like to acknowledge the presence here of Congressman Rodino and Congressman Minish, who are distinguished Congressmen and my colleagues from the State of New Jersey. They have made outstanding contributions in the Congress to the State of New Jersey.

Chairman PROXMIRE. Congressman Patman.

Representative PATMAN. Mr. Mayor, you are welcome to our committee. You have given us some disturbing and shocking facts. I think it is very fair of you and courageous to give us those facts involving your own home town, for it will help not only the State of New Jersey, it will help all the States in our Nation. I agree that something must be done.

The information in this committee, I think, will be very helpful to this 92d Congress. I commend Senator Proxmire, the committee's chairman, for arranging for such a distinguished group of people from all over the Nation to attend and testify. I know it will be very helpful and I congratulate him on this first move of the new year.

In order to cooperate with the chairman, I will not take further time at this time.

Chairman PROXMIRE. Senator Jordan.

Senator JORDAN. Thank you, Mr. Chairman.

Mayor Gibson, you have painted a very sorry picture for your city. It takes a lot of courage to do that, and I commend you for it. But I have one or two questions.

I think you stated that 30 percent of Newark's population are public assistance recipients. How do you define public assistance recipients? Does this mean that 30 percent of the people in Newark are on welfare?

Mayor GIBSON. In general terms, yes. We have two categories of welfare. We have the general assistance category, which deals with our own city welfare situation, and we have the county welfare agency, which deals primarily with aid to dependent children. This is generally a family welfare problem.

We deal with the situation, we pay the costs of our city welfare, and these are usually individuals who are disabled for one reason or another, and these are the county people, where you pay 30 percent of the county's welfare budget.

Now the important thing is, there are 112,000 people who are on county welfare who live in the city of Newark. In the general assistance or the individual, we have about 2,600 people. This is the breakdown.

Senator JORDAN. It comes to my mind that New Jersey is the highest State in the Union in the level of welfare payments. To what extent is your problem of a high incidence of welfare due to an influx of welfare recipients from other states?

Mayor GIBSON. I do not have the exact figure on that. I believe that we are affected by recipients coming into the city of Newark. I think that we are not as affected as other cities. I think about New York City, but I am sure that Mayor Lindsay can deal with that. I do not feel we have the same problem in that degree.

But I think that it is important, if we are going to talk about the influx of welfare recipients or potential welfare recipients, to consider whether or not we should have a national program to deal with aid so that we do not have this mobility of potential welfare recipients.

Senator JORDAN. You would favor nationalizing the welfare responsibilities with the Federal Government taking over the total welfare load?

Mayor GIBSON. Yes, sir.

Senator JORDAN. Would the cities then quit knocking on the doors of the Federal Government for assistance in education and health and so on?

Mayor GIBSON. No; I would not. I think it is important to recognize that we are dealing with the needs of people, whether it be welfare or education. I consider education the most important factor. But we cannot just take one need of 400,000 people and say, we are going to deal with that and not deal with the others. I think we have to deal with them all.

Senator JORDAN. Let's get down to the nuts and bolts of the case, Mayor.

New Jersey, according to the figures just read to me, is fourth in the Nation in the level of per capita income. You just suggested a revenue-sharing remedy for the dire plight you are in. Where is the money coming from? When your State is No. 4 in per capita income, are you going to take money away from States of lower per capita income?

Mayor GIBSON. Let me point out that I have also proposed, not only in this discussion this morning but to the State Legislature in New Jersey, a State income tax for a proper distribution of those funds to the cities. But in the meantime, I believe, we are talking about whether or not we can deal with the needs of the people not only in Newark, but in America. I believe personally that if we can send rockets to the moon to bring back rocks to study, we can educate children to do it.

Senator JORDAN. All right, but it seems to me that on any kind of revenue sharing, you might be sending $7 to the Federal Government to get $6 back, because your State is way above the average in per capita income. Is that a favorable point for revenue sharing?

Mayor GIBSON. I believe that we deal with what exists now. We talk about that total $7 going to the Federal Government to get back $6. That may be the way that Newark is benefited, but I do not believe we are getting back $6 for $7 now.

I think we have to discuss how we deal with the needs of the largest portion of our population, which presently resides in urban areas.

Senator JORDAN. If you were getting a fairer distribution of money from the State, you would be much better off, would you not?

Mayor GIBSON. Yes, sir.

Senator JORDAN. That is a better source for you to tap than the Federal Government, is it not, when you are way above the national average in per captia income?

Mayor GIBSON. Yes, sir; I went there first.

Senator JORDAN. Thank you.

Chairman PROXMIRE. Thank you, Senator.

Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

First, I would like to welcome my colleagues, Congressman Rodino and Congressman Minish, to the committee.

Mr. Mayor, I can say Newark is fortunate in one respect, to have such able Representatives in Congress, and I am sure they are going to carry your message to all the Members of the Congress, as we are going to do in this committee.

Mr. Mayor, what haunts me is in your statement where you say, "Wherever America's cities are going, Newark will get there first," because I see to a lesser degree the same symptoms and ills in my own city of Pittsburgh. We have the same problems. Fortunately, they are not quite yet as bad as your problems are, but that haunting statement of yours will remain with me.

Mr. Mayor, in your prepared statement, you say that future federally funded housing should be available for sale, not rental. What has been the experience of people in Newark with the so-called section 235 housing, the interest subsidy housing under the Housing Act of 1969?

Mayor GIBSON. Congressman Widnall is the expert in this area as far as I am concerned.

We have just begun to deal with, effectively, those sections. I believe that the subsidies can be effective in the city of Newark, because we have some new buildings and we do not have a history of these buildings yet so I can fairly say how well we will do.

Representative MOORHEAD. Thank you, Mr. Mayor.

In your oral statement, you talk about this woefully unbalanced Federal aid to transportation, of which only 2 percent is devoted to urban transportation. I agree with you 1,000 percent that this is an awful distortion. But I wonder how would this, how would additional urban mass transit programs help Newark?

Mayor GIBSON. Newark, N.J., I think unlike most cities, has really no transit system to speak of. We have the remnants of some old railroads.

One of the things that we have talked about in the city of Newark for years is the fact that we have one of the busiest and soon will be one of the largest and most modern airports in the world, with very little access between downtown Newark and the airport—not only downtown Newark and the airport, but downtown Newark and urban centers. We have rights-of-way for one subway. We have proposed for many years that there be a loop system emanating from the center of Newark, and I can specify we have already central railroad facilities right in the heart of Newark, on Broad Street, which has not been used for many, many years. Emanating from this point will be a help to develop the system. But we would not have the problem many cities have in trying to acquire rights-of-way. This is the kind of thing—as you probably recall, I am a civil engineer. I have been dealing in this area for many, many years.

For us to allow that to stagnate, to allow weeds to grow up on the rights-of-way, poking up in our major facility, in my estimate is wastefulness.

Representative MOORHEAD. In your prepared statement, you state that all Federal housing programs should strive to recreate the neighborhood concept. Again, I agree with you, as I do with everything in your prepared statement. But I wonder if you have any suggestions as to how?

Mayor GIBSON. We have one area in the city of Newark where we have developed cooperative housing through the urban renewal program, I must point out, where the residents own their houses. It is a neighborhood, High Park apartments. It is very well maintained, people are proud to live where they are. They live in the heart of central Newark—I might point out, Congressman Minish's area. They do a great job. They feel this is their neighborhood, this is their property. This is what we would like to have throughout Newark.

Representative MOORHEAD. Does it have self-contained shopping areas so that they——

Mayor GIBSON. We are on our way to the shopping areas. That is a block away, under construction.

I must point out, we have additional acres and acres of land where we can develop what is commonly referred to as new towns in the city. I think that people, based on their experience, will have a real positive feeling about their neighborhood if we can recreate the same situation in other parts of Newark.

Representative MOORHEAD. Thank you, Mr. Mayor. My time has expired.

Chairman PROXMIRE. Thank you very much, Mayor Gibson. I see that the length of your oral statement was perfect, the timing is just right. It is just about 11 o'clock.

I would like to ask you, Mayor Gibson, if you would do this, if you would remain at the table. The other gentlemen may leave and we would like to ask Mayor Lindsay to come up and question him, then we would like to ask Governor Shapp to come up. Then, if possible, if time permits, we might like to question all three of you gentlemen, because your problems are interrelated and we think the responses would be helpful to us.

Senator JORDAN. Mr. Chairman, may we send questions to the witnesses?

Chairman PROXMIRE. Yes, let me repeat that all members may send questions which will be relayed to the mayor so, when he corrects his remarks, he will have a chance to answer them for the record.

Senator JORDAN. Thank you.

(The following information was subsequently supplied for the record:)

RESPONSE OF MAYOR GIBSON TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR JORDAN

Question 1. You have recommended that Congress declare "Housing Disaster Areas" for various sections of the country, especially in urban areas. You have suggested that this program would include employment training. What specific types of training do you envision in connection with such a program? Also in connection with housing, you have proposed that all future federally funded housing should be available for sale, and not for rental, on the grounds that this would create "pride in ownership." Do you feel that this approach would be fruitful in the case of large family housing units and developments?

Answer. The type of employment training would reflect the needs in the housing industry should such a program be enacted. We would foresee a need for training programs to provide additional construction workers, electricians, carpenters, masons, steel workers, etc. Additionally, any such effort would almost necessarily rely on new housing systems. Location of prefab and modular housing factories near construction sites would provide opportunities for employment training in this area. Any program of this nature should offer incentives for housing manufacturers to locate within the cities affected.

Question 2. In your recommendation that the comprehensive Manpower Training Act of 1970 be enacted, do you include a recommendation for a public sector job program? If Newark had the money, could it hire more city employees so as to bring better services to Newark's citizens?

Answer. In my recommendation that the Comprehensive Manpower Training Act of 1970 be enacted, I do include a recommendation for a public sector jobs program. I recommended that salaries be supported by 80% federal and 20% municipal funds. If Newark had the money, it could hire more city employees so as to bring better services to its residents. We are currently in need of more health workers, sanitation workers, policemen, firemen, community relations personnel and a variety of other types of service-oriented positions.

Question 3. Statistics show that current noneducational expenditures in central cities greatly exceed noneducational expenditures for suburban areas. In Newark, for example, per capita educational expenditures in the central city and the suburbs are approximately the same, but noneducational per capita expenditures in the central city are twice as great as in the suburbs. This pattern is repeated throughout our large cities. Could you comment on this phenomenon, and suggest what can be done about it?

Answer. The phenomenon which you describe can best be explained by an analysis of the character of the urban populace and the native of urban problems.

Many groups now inhabiting central cities arrived from other areas of the country with little preparation for the complexities of urban living. Unlike wealthier, better educated counterparts in the suburbs, residents of the urban core are often unable to secure basic services on their own. The responsibility for the provision of these services falls upon the municipality. Transportation and health, for example, usually obtained privately by middle class suburbanites, must be supplied by the public sector to a large portion of city dwellers.

The city, too, provides many services to the suburbanite, specifically the commuter, for which it receives no compensation. Additional costs in road maintenance, law enforcement and other public services can be directly attributed to the morning influx and evening exodus of suburbanites.

Certainly, one has only to look at the urban center to realize why so much money is needed. Instead of the relatively new buildings of suburbia, we are faced with the decaying edifices of years past. Instead of building on open land, we must first pay for demolition of existing structures. And, instead of minor upkeep, we are faced with major rehabilitation. The list of reasons for this phenomenon could go on and on, but the above are clear enough.

I might also comment on the similarity of educational costs. I do not find this phenomenon enlightening or encouraging. The results of educational expenditures in the suburbs far surpasses that in the city. Our children are faced with many factors that inhibit education. Much more money is needed to meet the needs of a youngster going to school in Newark or in any other city.

The answers to this phenomenon are also quite clear. First, suburbanites must realize their responsibilities toward the city from which their income is derived. Second, both the federal and state governments must begin to lift the burdens of welfare and education from the city. Lastly, in our state, an income tax must be enacted to provide additional revenue for municipal operations. There are other measures to be taken, but these are a necessary beginning.

Question 4. Has Newark drawn up projections of estimated spending and revenues for more than a one-year period? If so, what do these projections show?

Answer. We have attempted to make some estimates for future years; however, this is very difficult considering the fact that an authorization to collect certain taxes is temporary (2 years) and that the state is likely to impose an income tax next year.

The following is a very rough approximation:

[In millions]

	1970 actual	1971	1972	1973
Expenditures (includes city, school, and county share)	160	210	210	220
Revenue:				
Property tax	110	110	110	110
Miscellaneous	45	40	45	45
Hospital reimbursement		9	9	0
State urban aid	5	5	(1)	(1)
Taxes now before council		20	33	11
Total	160	184	197	[1] 166

[1] Hopefully increased due to aid from income tax proceeds.

Question 5. Is there a misprint in your prepared statement, "residential construction in Newark declined from $3,982,000 in 1969 to only $165,000 in 1970"?

Answer. The statement in my prepared statement, "residential construction in Newark declined from $3,982,000 in 1969 to only $165,000 in 1970" is correct. These figures represent the worth of construction permits taken out during the year. Our high property tax rate does little to encourage residential building.

Question 6. You state that Newark has an unemployment rate of over 11%. Do you believe that there is anything the city government can do to lower this statistic?

Answer. There is much that Newark could do to lower the unemployment rate if it had the resources. Education and health services should be drastically improved so that Newark residents can become eligible for the primarily white-collar jobs which are becoming the predominant type of occupation in Newark. Public transportation, too, should be improved to permit access to manufacturing jobs outside of the city.

A massive effort must be made to prevent the increased flow of industry away from the city. Provision of decent housing and improved public facilities would promote business in Newark by making it a desirable place to live and work.

Unfortunately, these measures cost money which the city does not have. Until the city's financial situation is improved, there is little it can do to lower its unemployment rate. It can be said that at the present time when our nation is in a recession, the unemployment picture in Newark is similar to that of a very deep depression. Only through federal grants and revenue sharing can the city hope to overcome its unemployment problems. First, of course, the national unemployment status must be changed.

Question 7. While the effects of the administration's revenue sharing bill have not yet been made public, there has been speculation that funds for programs such as Model Cities may be cut back as revenue sharing takes over. What success has Model Cities had in Newark? What would happen to your Model Cities program if some funds were lost?

Answer. Model Cities in Newark is only approaching the completion of its first action year. Still it is possible to see vast improvements in planning and coordination in the city. A reduction in the program would hurt Newark badly. We are hoping, however, to be named a Model Cities Planned Variations City in the near future. The impact of Planned Variations on the City of Newark is looked forward to with great anticipation.

Question 8. Do you see any connection between the high school dropout rates and the crime rates in your city?

Answer. I do see a definite correlation between the high school dropout rate and the crime rate. However, there is more than one interrelationship here; a host of other factors provide the context in which both school attrition and crime take place. Substandard housing, youth unemployment, broken families and drug addiction are only some of the problems that cause children both to drop out of school and to commit crimes. As a result, it is difficult to delineate precise cause and effect patterns between the two rates.

Chairman PROXMIRE. Our next witness is Mayor John V. Lindsay, of New York City.

Mayor Lindsay, I believe you are now in your sixth year as mayor of New York. This very fact says a great deal about your ability to endure and to operate under continuous pressure.

Mayor Lindsay, you need no introduction except to say we all admire the tremendous efforts you are making to cope with the problems of the Nation's largest city, called the second most difficult job in the country. There are times when it must seem, without any question, to be the most difficult. At any rate, we do not envy you your job. In some ways, I would rather be in the Senate.

We feel very fortunate that you have been able to find time to be with us this morning. You may proceed the way you wish. If you abbreviate any part of your prepared statement, the full prepared statement will be printed in the record.

You may proceed.

STATEMENT OF HON. JOHN V. LINDSAY, MAYOR OF NEW YORK CITY, ACCOMPANIED BY EDWARD HAMILTON, DIRECTOR, BUREAU OF THE BUDGET, NEW YORK CITY

Mayor LINDSAY. Thank you very much, Mr. Chairman, members of the committee. I appreciate the opportunity to talk about this subject and I would like to express my thanks to you for continuing the great tradition of this committee in addressing yourselves to the central economic problems of the day.

It also is a pleasure for me to be testifying today in the company of my colleague in the mayoring business, Mayor Gibson, of the neighboring city of Newark, and also of the Governor of our neighboring State of Pennsylvania, Governor Shapp.

I am accompanied today by the director of our bureau of the budget, Mr. Edward Hamilton, of New York City.

Chairman PROXMIRE. That is Edward Hamilton?

Mayor LINDSAY. Edward Hamilton.

Chairman PROXMIRE. Thank you.

Mayor LINDSAY. Mr. Chairman, I am, as I said, grateful for this opportunity to appear before the Joint Economic Committee of the Congress. Your inquiry, prompted by our current inflationary recession, will help to focus attention on the impact of national economic policies and especially the Federal fiscal system on my city and the other cities and States of this Nation.

New York is so large and so diverse that in some ways it is an economy unto itself. This strength and diversity have shielded the city from some of the worst effects of the disaster we call inflationary recession. On a percentage basis, personal income, corporate profits, and sales have held up a little better than the national average. And unemployment—though very high for New York at just over 4 percent—is well under the national rate now running above 6 percent.

Nevertheless, the damage has been severe. Some trends, particularly inflation, have been more pronounced in New York than elsewhere—and the impact on city finances has been especially harsh.

New York City, like most States and cities, does not have a single, consolidated budget. It has two sets of accounts—a capital budget for investment-type expenditures, and an expense budget for current operations. All construction, all equipment purchase, all land acquisitions are paid for through the capital budget, which is supported by borrowing. The expense budget—supported by local taxes and grants from other sources—contains only employee salaries and benefits, debt service, and some consumable supplies.

It is this expense budget which we must, by law, balance each fiscal year. There is no room for deficits, planned or unplanned. There are only the wages and salaries of people—of 32,000 policemen, 14,000 firemen, and 11,000 sanitation workers, of the teachers of more than 1 million schoolchildren, and the doctors and nurses in 18 municipal hospitals, and all the others who make the city fit to live in. Presidents choose whether and how to balance budgets. Like most mayors and Governors, we in New York only choose which vital services to do without.

A few simple numbers tell the story in New York. Our expense budget for the current fiscal year estimated expenditures of $7.7 billion. These were to be financed from four sources: City property taxes, $2.1 billion; other city taxes, $2.5 billion; State aid, $1.6 billion; Federal aid, $1.3 billion; and other receipts, $0.2 billion; for a total of $7.7 billion.

However, it is now clear that the recession will deny us about $150 million of this revenue, while inflation is driving our costs $100 million higher. Additional shortfalls in receipts expected from the State lottery and the new off-track betting corporation will bring our total deficit in the current year to more than $300 million.

It is difficult to convey the meaning of a current-year deficit of this size in a city expense budget. It is less than 4 percent of our total budget and only 7 percent of city tax revenues. But consider it in human terms. It equals the salaries and benefits of 25,000 to 30,000 employees over a full fiscal year. They are employees who depend on the city for a living and upon whom the city depends for its life. When the deficit climbs into the hundreds of millions, the remedies multiply in pain and risk to the point that the quality of urban life hangs in the balance.

Moreover, there is no consolation in the outlook for next fiscal year, beginning July 1. Our next budget is only beginning to take shape, but it is clear even now that the gap between mandatory expenditures and anticipated revenues may approach a billion dollars.

This fiscal crisis has forced us to make drastic cutbacks.

In October, we clamped a freeze on filling vacant city jobs.

In November, we made extensive cuts in many city programs, including postponement of hiring of new policemen and firemen.

Later the same month, we laid off 500 employees, the first layoffs of city workers in New York since the depression.

In December, we announced that the city could not finance salary or benefit increases in new contracts with our police, fire, and sanitation unions except where justified by projected increases in the cost of living or measurable increases in productivity.

These were hard but necessary steps. At every stage, we made clear that more would be required unless the Federal and State Governments met their responsibilities.

There is a clear limit to the capacity of any community—no matter how determined—to deal with problems forced upon it by national conditions beyond its control. We have reached that limit in New York City. Just since 1965 we have absorbed a 100-percent increase in welfare rolls—equivalent, I may say, with the rest of the Nation—and in some parts of the country, it was substantially higher than that.

And we have taxed ourselves heavily:

A city tax on personal income with progressive rates up to 2 percent, and a lesser rate on the earnings of commuters;

A tax on transfers of stocks through all three exchanges; and

A substantial increase in assessed valuation, and thereby ineffective property tax rates.

These and other measures have doubled our taxpayers' contribution to the city budget. That contribution now stands at $4.4 billion.

Yet, even this is not enough. For our fixed expenditures tend to grow at 15 percent each year while our local revenue base grows at 5 percent. And we have virtually exhausted our taxing powers.

Here in Washington, this might sound like just another version of the same old story. You have all heard the pleas of the cities and their mayors before.

But this year things are different. This year the mayors have been joined by the Governors in an almost universal appeal for assistance. And this year we are not just asking for help to solve specific problems—housing, schools, mass transit. This year we have the more fundamental concern of survival itself, and I believe that survival is not too strong a word to describe our stake in the crisis that confronts us.

Across the Nation, cities, counties, and States face a widening gap between demands for services and available funds. Inflation has aggravated the problem. But each day brings increasing evidence that the fiscal system itself, which has served our Nation since its founding almost two centuries ago, is failing to meet the needs we face today. Financial collapse and the breakdown of basic services loom as a clear and present danger in 1971.

The primary resource for local governments is still the property tax, which was once the keystone of all governmental revenue. But the income tax yields far more—with almost all of that elastic revenue source going to the National Government.

At the turn of this century, State and local governments controlled some two-thirds of the revenue in the total Federal system. Today, the ratio has been reversed, with two-thirds of all moneys flowing to the National Government in Washington. Washington takes the Nation's most powerful financial resources, while the problems remain at the State and local level.

Our survival depends on ending this mismatch of revenues and responsibilities. This year we must be prepared to reshape the fundamental relationship between the Federal Government and its States and localities. That is the challenge of the current crisis—to provide a new framework for financing the States, cities, and suburbs of the Nation for many years to come.

We can accomplish that goal with the combined effect of two separate measures—revenue-sharing and welfare reform. Revenue sharing at a significant level would provide an elastic source of money to bolster local budgets. Nationally financed welfare reform would release local tax revenues to meet local needs. With welfare costs removed and revenue sharing added, State and local budgets might, for the first time, reflect an adequate match between revenues and responsibilities.

Much has been said about these programs. There is little time left to act upon both.

First, at least $10 billion in Federal revenues must be returned to our States and cities in unrestricted form beginning in 1971.

Many believe that $10 billion is too ambitious a figure.

Let's examine it for a moment.

It amounts to less than 5 percent of total Federal collections.

It adds about 10 percent to total States and local collections.

It translates into about $50 per user of the services State and local agencies provide.

It is less than half of the additional funds that States and localities will almost certainly need simply to maintain service levels in a sluggish, inflation-ridden economy.

Some ask whether we can afford so much. But can we afford to risk less? A revenue-sharing program financed at a lower level will not provide the stability we so desperately need. Neither will a program achieved by money-shuffling or empty numbers games do the job. To be meaningful, sharing must be real and it must be in addition to existing Federal programs.

Second, the Federal Government must move immediately to relieve States and localities of the crushing financial burden of welfare.

New York City is ordered by the State and National Governments to spend more than $600 million of its own tax dollars to support the Federal-State welfare system. And that amount is growing at about 20 percent per year. We have no choice. Eligibility requirements and benefit levels are mandated upon us. The law orders us to appropriate enough money to meet set levels, regardless of effects on other priority programs. Our role is purely that of harried clerk and unwilling banker.

That is why I recently rejected the welfare budget request mandated on us by the State and Federal Governments for the next fiscal year, which would have added more than $100 million to New York City's contribution to this disastrous program. That is also why I have instructed the city's corporation counsel to sue the State and Federal Governments to stop them from mandating welfare costs on our city's taxpayers.

Only the Federal Government can take the positive steps necessary to create a reasonable and effective national welfare program. This must include Federal takeover of the total costs of welfare and the establishment of uniform levels for benefit payments.

Mayors who testify in Washington have often been dismissed as chronic Cassandras. They always predicted disaster, but the cities always muddled through. But now there are new warning voices. In every part of America, Governors are talking like mayors.

This year, as never before, we look to Washington for there is no other place to go. The crisis of the Federal fiscal system has overcome traditional rivalries between States and their localities and has inspired us to do battle together for our common survival. Mayors and Governors will stand together, for all of us know we cannot survive alone.

(The prepared statement of Mayor Lindsay follows:)

Prepared Statement of Hon. John V. Lindsay

I very much appreciate this opportunity to appear before you to discuss the worst fiscal crisis in the states and cities of America since the Great Depression. Your concern about this crisis is a responsible—and I might say refreshing—recognition of the Federal role with respect both to our problems and to possible solutions.

I will begin with a discussion of our problems in New York, relating them from time to time to similar difficulties in other cities and states. I will try to explain enough about New York's revenue structure and expenditure dynamics to clarify our budget problem in the current year, and to explain the longer-term trend affecting the city's budget. I will then relate both long-term and short-term problems to the effects of Federal action and inaction.

My basic conclusion will be that New York City has five primary needs which only the federal government effectively can meet. First, we need a new national economic policy to restore a stable prosperity. Second, we need direct and untied sharing of federal revenues on a scale meaningful to a city with the second largest budget in the nation. Third, we need welfare reform, reform that not only ends some of the fundamental injustices of the present system, but also lifts from states and cities the crushing financial burden unfairly imposed upon our taxpayers by this profoundly national problem. Fourth, we need national health insurance to pay the growing and increasingly expensive costs of medical care for all our citizens. Finally, we need significant reform of the present federal system of categorical grants-in-aid.

This agenda underscores the unprecedented gravity of our situation and the plight of most states and cities. We are faced with bankruptcy—not a bankruptcy of credit but a bankruptcy of services and ultimately a bankruptcy of credibility, as our citizens grow more dissatisfied and disenchanted with the capacities of government. We are faced with a clear inability to support the basic services which are the fundamentals of urban civilization.

Some of you may feel you have heard this story before. You may be tempted to believe that this year, as always, we can survive with Federal help on a scale far less than we say we need. If this is your inclination, I ask only that you examine the facts with care before making up your minds. As my distinguished colleagues and I will try to make clear, the survival of the American city is in the balance. The day is very near when our only option will be sharply curtailed services.

As a former Congressman, I find it painful to acknowledge that much of the current urban crisis is rooted in the indifference of the Federal Government. For despite the flood of rhetoric about urban problems and the welter of new Federal programs which characterized the 1960's, I must report to you that the Federal contribution to the solution of the national problems centered in the cities remains weak, unsoundly based, absurdly difficult to use, and pathetically small. In a rapidly growing national economy in which State and local taxes rose very rapidly, Federal failure was barely tolerable. In a stagnant national economy ravaged by inflation, Federal inaction spells disaster. I think that an analysis of our situation in New York will bear this out.

I. The Fiscal Trap of the Cities

The problem that New York City faces today is simply a much-aggravated version of the fiscal trap in which all cities have found themselves for a decade. Here in the District of Columbia, Mayor Washington has often referred to the "15–5 problem," by which he means that the cost of city services tend to grow by roughly 15% per year while the natural growth in the local revenue base tends to be on the order of 5% per year. These numbers vary in detail from year to year but over a decade they have been approximately accurate for most large cities across the country including New York. Thus, even in a "normal" year the cities have been made to run faster and faster—to Washington, to the State capitals, or to their already over-burdened taxpayers—just to stand still.

The crisis of 1971 is rooted in more than a year of inflationary recession brought on by failing Federal fiscal and monetary policy. This crippling economic disease has stunted the growth of state and local revenues while at the same time swelling the welfare and Medicaid rolls, virtually destroying the residential construction industry, and multiplying the costs of ministering to the needs of all citizens. The annual drama in which Mayors and Governors struggle to make ends meet for one more year threatens to turn from farce to tragedy. For inflationary recession has moved the urban fiscal problem beyond the reach of the local tax hike or the Mayor's begging bowl.

In New York this translates into a deficit of approximately $300 million in our operating budget for the current fiscal year, the year ending June 30, 1971. It further translates into a gap between anticipated revenues and expenditures in the following fiscal year—even after ruthless paring of expenditure proposals—which may well approach $1 billion. I cannot tell you as I sit here today how we can possibly balance the budget, as our City Charter requires.

In order to grasp the depth of the problem facing states and cities, it must be recognized that most of us do not enjoy the financial flexibility of the Federal budgetary system. First, our budget is split into two parts:

—a *capital* portion, financed through borrowing, which supports construction, equipment purchase, and all other projects and goods with a useful life of several years.

—an *expense* portion, financed through local taxes and State and Federal aid, which provides for employee salaries and benefits, consumable supplies, debt service, and other short-term operating costs.

Second, the expense budget must achieve a balance between revenues and expenditures in every fiscal year regardless of needs or economic conditions.

In short, unlike the Federal government, states and localities are not permitted to run current-account budget deficits; savings achieved through construction slowdowns, procurement cuts, or other Federal-style economies are not relevant to the current-account balance. Our problem is to balance a budget—in my case a $7.7 billion expense budget—in which the only substantial items that can legally be reduced are the amounts paid to employees in salaries and other current benefits. In the end—as you have seen in New York, Philadelphia, Detroit, Baltimore, Cleveland, and in cities across the country—this means layoffs and cutbacks in vital services.

Of course, every city's situation is unique in some respects. In many ways we in New York have fared better than most because of the size and diversity of our economic base. And other factors besides sheer magnitude also tend to distinguish New York:

Our municipal structure and budget include virtually all of the public services which are independent in many cities, including education, a large share of higher education, the court system, and responsibility for a large portion of the cost of the largest mass transit system in the world.

The City of New York has a long tradition of large-scale activity in many areas which other cities leave to the states and the federal government. We have, for example, 18 municipal hospitals run by a public benefit corporation; we have an extensive housing program for low-and middle-income people. And we now offer open enrollment in the City University system to all graduates of our high schools.

We have what is probably the most extensive system of public employee unions and collective bargaining agreements in the country. Many of these agreements extend beyond salaries and economic benefits to questions of manning standards, seniority rights, and work rules which greatly affect the City's flexibility in choosing among operating techniques. We are also perhaps more experienced than most with the pressures of activist groups concerned with poverty, welfare rights, and other social causes.

Yet despite these and other distinguishing factors, we have found again and again that New York is the bellwether of America's large urban centers. Our achievements as well as our problems are mirrored in cities across the country. And everywhere today the story is the same: States and localities are asked to provide most of the services of domestic government—schools, police and fire protection, sanitation services and all the rest—but are denied the revenue base necessary to support such services at the levels our population demands. This is the fundamental fiscal dilemma of our time and it is being further compounded every day by the in-migration of the poor to the central city and the out-migration of the well-to-do to the suburbs. Until this dilemma is solved, there can be no durable answer to the problems we are discussing today.

II. THE REVENUE CRUNCH IN NEW YORK

Let me focus for a moment on the revenue side of the equation.

Our budget for current operations—called the expense budget—authorizes $7.7 billion in expenditures during the fiscal year ending in June. As I have said, the City Charter requires that this total be balanced by equivalent revenues. These revenues were expected to come from five sources:

(i) The City property tax—$2.1 billion.
(ii) City taxes other than the property tax—$2.5 billion.
(iii) State aid—$1.6 billion.
(iv) Federal aid (mostly welfare and medicaid)—$1.3 billion.
(v) Other receipts—$200 million.

The category of special interest here is category (ii), revenue from City taxes other than the property tax. We refer to these revenues as the General Fund. Most of the other sources are now projected to yield approximately the amounts estimated in our budget. Yet the General Fund is projected to suffer a shortfall of $100–$150 million compared to the budget estimates.

The reason is quite simple. The General Fund contains taxes which respond to general economic conditions—personnel income, business income, stock transfers, sales, and other similar indicators. Obviously, when the economy is stagnant these revenues fail to grow. Thus, we have projected the shortfalls detailed in Table I.

TABLE I.—SELECTED MAJOR TAX SOURCES: COMPARISON OF ESTIMATED AND ACTUAL YIELDS OF MAJOR GENERAL FUND TAXES

[Dollars in millions]

Tax	Fiscal year— Fiscal year 1969–70 actual	Fiscal year 1970–71 budget estimate	Fiscal year 1970–71 revised estimate	Shortfall
Personal income:				
Gross	$221.4		$235	
Refund	−27.6		−23	
Net	193.8	$258	212	$46.
Stock transfer	243.5	275	233	$42.
Business income:				
Gross	218.9			
Refunds (estimate)	−8.9			
Net	210	229	189 to 210	Between $19 and $40.

The situation of our General Fund is the key to the financial crisis facing most states and cities. For it is through so-called "income responsive" taxes that urban taxpayers have made their huge contributions to the spiralling costs of public services. Imposition of these taxes was widely applauded by economists and financial experts who had long decried the cities' dependence on a slow-growing property tax. Yet everyone recognized that increased growth potential also meant increased vulnerability to the effects of recession.

Ten years ago, the General Fund looked quite different. In the first place it yielded less than $800 million, compared to the $2.5 billion we had expected from it this year. The low yield reflected the fact that there were no city taxes on personal income, commercial occupancy, or stock transfers, and that other tax rates were substantially lower than they are now. Secondly, the General Fund made up only 43% of city revenues at that time. Despite the fact that property tax yields doubled during the 1960's, the General Fund has increased to 54% of total city tax revenues.

Thirdly, it must be recognized that these tax revenues grew much faster than the personal incomes of city residents. Personal incomes grew by an average of 5.4% per year over the decade, while City tax revenues grew by 9%. In other words, for every additional 1% of income our citizens have earned, City tax revenues have risen by 1.7%.

In my judgment, this adds up to a story of extraordinary self-help, even sacrifice, by city dwellers to meet a large share of the costs which reflects national problems over which they have almost no control. It is not the fault of the bricklayer in Queens or the office worker in Staten Island that the welfare rolls have doubled in the last four years and are now rising by 15,000 new persons a month. It is not their fault that unemployment in the nation is at the highest level in a decade. They are not responsible for the fact that interest rates have been so high that city borrowing has become much more expensive and the incentive for private housing construction in the city has virtually disappeared, forcing the City government to choose between unbelievable rents for public wards on the one hand or high construction subsidies on the other. Nor can they be blamed for the rampant price inflation which drives up all city costs and enormously increases the pressure within employee unions to demand exorbitant salary increases.

Yet the taxpayer in New York and surrounding areas has borne much of the financial burden of these problems. Just in the last five years, in addition to increases in State and some Federal taxes, he has absorbed:

(i) A City tax on personal income with progressive rates up to 2%.

(ii) A tax on the city earnings of commuters amounting to one quarter of one percent.

(iii) A tax on hotel occupancy of $1 per room per night.

(iv) A tax on transfers of stock through all three exchanges.

And as the New York City taxpayer bears this discriminatory burden, he watches his State and Federal tax dollar disappear with only a fractional return. The city now yields over $11.9 billion in Federal tax revenue every year, but receives only $1.5 billion in Federal aid. It pays $3.2 billion in State taxes and receives only $1.7 billion in return. Thus, the city taxpayer is not only forced to pay a larger share of the costs created by State and national social problems, he must also pay more than his community receives to deal with these problems at the State and national level.

To sum up the revenue situation in the current fiscal year, we now expect a shortfall in our General Fund of $100–150 million. The exact amount is still uncertain because we have experienced only half the fiscal year, but it now appears that it will be toward the upper end of that range. We also expect deficiencies in revenues expected from the New York State Lottery and the new New York City Off-Track Betting Corporation. These will probably add up to a further shortfall on the order of $60 million. Taken together, the projected revenue shortfalls from all sources amounts to $160–$210 million in Fiscal Year 1970–71. And we expect things to get worse before they get better.

III. THE PRESSURE OF EXPENDITURES

A recession always puts more strain on government budgets than on the average corporation because public activities are more intimately linked to the plight of low-income people. And it is these people—the poor, the minorities, the young, the old, the unskilled—who are the last to be helped by a booming economy and the first to be hurt by a slump. A very large share of City expenditures are directly dependent upon the economic health of this most vulnerable segment of society.

Therefore, it is not surprising that the main expenditure pressures in our current budget in New York arise from the explosion in legitimate applications for welfare, medicaid, and related benefits which have accompanied the inflationary recession. A quick look at the history of our budget over the last decade (Table II) confirms that welfare has grown many times more rapidly than any other item, and now stands 22% of total expenditures from all sources, more than double the percentage of ten years ago. One out of every eight residents of New York City is now receiving some form of welfare.

TABLE II.—SELECTED MAJOR EXPENSE BUDGET APPROPRIATIONS

	1970–71		1969–70		1965–66		1960–61	
	Millions	Percent	Millions	Percent	Millions	Percent	Millions	Percent
Social services (welfare)	$1,712	22	$1,519	23	$494	13	$246	10
Education	1,489	20	1,203	18	752	20	440	19
Health services	687	9	570	9	352	9	199	8
Police	477	6	446	7	272	7	168	7
Environmental protection	256	3	226	3	157	4	109	5
Fire	214	3	192	3	133	3	85	4
Debt service	778	10	676	10	545	14	402	17
Pensions	547	7	466	7	343	9	215	9
Other	1,549	20	1,281	20	827	21	481	21
Total	7,709	100	6,579	100	3,875	100	2,345	100

Source: Citizens Budget Commission, Pocket Summary of New York City Finances, for the fiscal year 1970–71

As I shall point out later in this statement, it is much more surprising, indeed incomprehensible, to New Yorkers that they, unlike the residents of our other largest cities, are required by law to contribute hundreds of millions of their own tax dollars to the support of a hopelessly outmoded welfare program dictated to the smallest detail by the State and Federal governments. We are now challenging in court the right of the Federal and State governments to impose these discriminatory hardships upon urban taxpayers in response to what are clearly national problems.

However, the problem of mandated costs—costs levied on the City by external authorities—does not end with welfare. In our case the State sets the fees we must pay for nursing home and similar care; the State sets the rates at which hospitals will be reimbursed for Medicaid patients, forcing the City to pay a residual share; the Federal government sets the limits on unit costs supportable by Federal housing assistance, no matter how much the resulting shortfall below market costs may impose on the City in subsidy. Again and again, in virtually every area of governmental activity, the cities find themselves bound by law or regulation to pay costs mandated from afar by authorities who refuse to accept responsibility for the financial burden involved.

In the past few years this problem of mandated costs, together with the effects of collective bargaining agreements, have reduced city budgeting to a crisis negotiation between mayors and governors—not about new, innovative, imaginative programs, but about how to finance cost increases in present programs which we are legally or contractually compelled to pay. As long as the financial situation in the state was sounder than in the cities, these confrontations—difficult as they sometimes were—could and did lead to some kind of solution. However, the advantage of the states generally flowed from their greater dependence on income—responsive taxes which produced fast-growing yields in a fast-growing national economy. That advantage becomes a disadvantage in a recession. Thus, as I am sure you will hear in the next few days, most states are feeling the financial pinch the cities have lived with for years.

The cities can still ask for more state help. In New York, the "Big Six" cities have already requested substantial new assistance from Albany. But there is obviously a limit to what New York and the other states can do in this year of inflationary recession.

IV. REDUCTIONS IN MUNICIPAL SERVICES

My city is doing as much as it can to help itself. We have taken several painful steps to cut expenditures in areas where federal and state regulations do not mandate expenditure levels. Basically, there are two areas where substantial savings can be realized: salaries and essential services. After a painstaking review of the alternatives, the city has cut back on municipal services and hiring.

A job freeze was put into effect on October 1, 1970; it will remain in effect for at least the balance of this fiscal year. The job freeze limits the huge majority of our agencies to filling, on a dollar basis, only 25% of the job slots that become vacant. The Sanitation Department is the only major exception to this rule; they are filling slots up to a limit prescribed during the last budget year. In New York City, policemen and firemen are inducted directly into the departments' respective training programs. We have now postponed the induction of 500 police trainees scheduled to replace men who are leaving their present jobs. They are sorely needed. But we cannot afford them.

We have taken other painful steps.

—We have closed one World War II incinerator, thus saving the costs of upgrading it to meet state standards, and reducing the manpower level in our disposal operations.

—We have sharply limited our contributions to vital cultural institutions and to the library system. The cutback has led to a reduction in the number of hours such services are available to the public—a reduction that creates a special kind of hardship for students, scholars, and senior citizens.

—We have been forced to reduce the number of trips the Staten Island Ferry makes between Staten Island and Manhattan. Customers now have to wait as long as an hour at certain times of the day.

We have decided not to purchase new automobiles for the municipal fleet this year. Cost analysis favors a two year replacement cycle for city automobiles. But the budget crunch, coupled with a severe reduction in the City's ability to secure competitive bids on replacement vehicles, has forced us to change our policy. Of course, the temporary saving from not purchasing replacements will be partially offset by increased maintenance costs and lower trade-in values.

But the most painful measure was the layoff of 500 provisional city employees. They were not laid off because of poor performance. Or because they were not needed. They were laid off because the city simply did not have sufficient funds to continue paying their salaries. We may describe events with impersonal phrases like expenditure cuts and budgetary savings, but we cannot mask the real agony those actions inflict on real people. I am sure you understand the problems that layoffs create for the city and for those laid off in a time of increasing unemployment.

There is not much else we can do to reduce expenditures. Cutting the budget is severely limited by law. Welfare, debt service, and pension benefits—three items the city legally cannot control—along with municipal salaries, account for 82% of our expense budget. There is very little room to maneuver. We need help—and so do most of America's cities. We need it now—but in 1971 the states themselves are becoming beggars for survival in Washington.

The prescription for survival—and for progress—must be written here.

V. A PRESCRIPTION FOR FEDERAL ACTION

I believe five steps are crucial. Together, they deserve the highest federal priority.

First: Washington must rebuild the prosperity and stability of the American economy.

There is no local cure for national economic sickness. The only thing we can do about it is suffer along.

The federal government can do a lot. But, in the last two years, it has done very little—and what it has done has not worked. In 1969, Washington set out to trade six percent inflation for six percent unemployment. It has ended up giving us both. Millions of workers are out of work—and prices are still climbing out of sight.

Now, after two years of economic failure, virtually everyone concedes the need for new and effective economic policies.

There is danger as well as hope in that concession. In its anxiety to reduce unemployment, the federal government may decide to abandon the battle against inflation. It would cruelly betray those who hope for enough real work by depriving them of enough real wages. And it would constitute an utterly unnecessary confession of economic impotence.

I think we can do better than that. And I also think that the administration missed a vital chance when it refused to exercise the authority Congress granted it to impose wage and price controls. It may now be very late to gain maximum impact from direct controls. In my judgment, they should have been instituted long ago. But they remain the only viable way to hold down inflation while other economic tools are used to generate new employment. I believe we can have both full employment and price stability. I believe we must settle for nothing less.

Second: Washington must distribute an additional $10 billion a year in the form of revenue sharing to our cities and our states.

There is remarkably broad support for the idea of revenue sharing. From a mayor's perspective, the idea is an urgent necessity. But, by itself, it will rescue no cities or states. What is essential—what Congress must approve in 1971—is a revenue sharing program worth more than its name.

The Administration took an important and significant step last year when it introduced the first Administration-supported proposal for federal revenue sharing. By calling for revenue sharing over a number of years, independent of the annual appropriating process, a number of the bill's provisions were responsive to both the immediate and chronic crises in the cities, and would provide a measure of stability too often absent from federal programs. The other principal strength of the legislation was the absence of restrictions on the way states and cities spend their revenue shares. This would give them a flexibility almost always withheld by programmatic grants-in-aid. Revenue sharing, independent of the annual appropriating process, with local discretionary authority, combined with the continuation of grants-in-aid, would go far in returning fiscal stability to our cities.

One major issue in the debate about the bill was the formula for funds distribution to states and localities. The basic formula would have taken into account the relative tax effort of each state as well as its share of total population. This kind of formula is absolutely necessary to insure that the high tax effort in states with major urban problems, such as New York, Michigan and California, will be reflected in the relative shares each receives of the total amount of available assistance. Less desirable, however, was the so-called "pass through" provision in the administration bill. This would have provided for intrastate distribution to all general units of governments, based on a formula which failed to account for differences in size or for the presence of a large low-income population. I believe the distribution formula must recognize the special problems faced by America's urban areas. I believe there are alternative ways to achieve that purpose which would command substantial support, and I am working with the National League of Cities and U.S. Conference of Mayors and other interested groups to develop such options for congressional consideration.

But the major deficiency in last year's Administration bill was its proposal to grant to cities and states only ⅕ of 1% of the federal personal income tax base during the first year, a percentage equal to only $500 million. That level of funding would have almost no impact on the crisis in New York City and New York State, and would be almost negligible when spread thinly across the nation.

Five years ago, the mayors and governors then proposing federal revenue sharing might have been able to live with a small start and a gradual buildup. But today, New York City is projecting a "budget gap" roughly five times as large as in 1966. For cities and states, time has run out. Ten billion dollars in the first year is our minimum need.

Finally, and this cannot be stressed too strongly, revenue sharing must be an addition to present federal domestic programs, rather than a substitute for them. Revenue sharing built on cutbacks in existing federal commitments would be a cruel hoax. Our cities and states cannot sustain the loss of vital programs such as Model Cities and Manpower Retraining. Were these federal commitments eliminated, we would just have to replace them with our own costly efforts, putting us back where we started in the grip of a dangerous fiscal crisis. Revenue sharing that takes from Peter to pay Paul would mock its own purpose. It is not what the cities need. And we will not settle for it.

Third: The Federal government must enact a federally financed program of income maintenance which reflects regional differences in the cost of living.

Poverty is clearly a national problem. But our attack on poverty too often becomes a heavy local burden. The fact that the American population is extraordinarily mobile means that states which do the most to meet the needs of the poor also run the risk of incurring even greater responsibilities. Moreover, the current formula for federal support of welfare payments insures that those states which do least to meet the problems are those which obtain the most in the way of federal assistance. Those states which *do* assume responsibility for assuring that minimum income standards and grant levels bear some relationship to the real cost of living, must make do with smaller proportionate federal contributions. The fiscal consequences of this are little short of disastrous. In the majority of states, these consequences are felt at the state level. But in sixteen states, the local share of non-federal welfare costs is in excess of 20%; in these states—New York is one of them—rising costs and rising caseloads translate into significant new burdens at the local as well as the state levels.

New York City and other units of local government in New York State are in a particularly difficult position: the proportion of total public assistance costs covered by federal funds is among the lowest for any state in the nation. At the same time, the proportion of non-federal costs passed on to local government by the state is among the highest.

The fiscal burden of welfare plays a significant role in New York City's financial crisis. We have 4% of the nation's total population and spent 14% of all the money spent by localities on welfare. We cannot go on this way. Three weeks ago, I had to reject a budget of $2.1 billion for public assistance and Medicaid costs mandated against the city's will by Albany and Washington. I have directed the City's Corporation Counsel to institute legal action asking for federal and state takeover of welfare costs.

If New York State paid only the average of what all states contribute for local welfare, New York City would save a minimum of $300 million a year. We are seeking relief in the courts—and we are asking for it in the state legislature.

State takeover of welfare costs is essential, but is only a short-term solution. Within a few years, a state like New York, with its relatively high benefits, would face the same frustrating fiscal disaster the city has so long endured. The real solution is a federally financed program of income maintenance which reflects regional differences in the cost of living.

The Family Assistance Plan was a hopeful, but flawed step in the right direction. Congress should have passed it last year. It must approve an improved version this year.

Specifically, two major improvements are absolutely necessary.

1. The legislation should freeze state/local payments at a maximum equal to their present level. As costs rise the federal government would make up the difference through supplementary appropriations. This reform would provide real fiscal relief to high-benefit as well as low-benefit states, and would be the first stop toward a gradual federal takeover of all welfare costs.

2. A new system of income maintenance must guarantee adequate benefits at a uniform national level, adjusted for regional differences in the cost of living. The economic and social dislocations created by welfare migration will be corrected only when it is no longer profitable to move in pursuit of a higher welfare check. Decent benefits everywhere are the only sensible policy. And they are also the only right policy.

In discussing welfare, I have necessarily concentrated on its fiscal impact. But no mayor—and no congressman or senator—can afford to ignore the other outstanding defect in the current program: It is a complete and total human failure. The ranks of welfare recipients have not declined. They are rising. The next generation has not earned its own prosperity. They, too, have learned to live in continued poverty. A new system of income maintenance is an urgent necessity. And, this time, we must fashion a system that will work, instead of a system that encourages or forces dependency. It must be a rational system financed by federal funds. And we must begin now—in this session of the Congress.

Fourth: The federal government must establish a comprehensive and universal national health insurance plan.

Our present system of medical care is ineffective and inefficient. It costs too much and it delivers too little. President Nixon has described it as "on the verge of collapse." And it has driven our cities to the verge of bankruptcy.

Since 1966, New York City's municipal expenditures for health care have doubled. Inflation is pushing costs up, while federal and state cutbacks in medicaid are putting heavier pressures on already strained local resources. Private hospitals are looking to public treasuries for financial help.

Health insurance is now a timely prospect. I expect that it will be the subject of intensive debate in this Congress. Rather than propose a detailed program today, I wish to outline six major goals national health insurance must meet.

1. It must protect every American. Universal federal coverage is the only sure way to make equal access to health care for all a reality, and to protect our citizens from the staggering costs of both catastrophic illness and the mounting costs of day-to-day medical care.

2. The program must provide adequate benefits for out-of-hospital medical services and for long-term medical care. It must eliminate the incentives now built in most private and public insurance mechanisms which treats patients in the high-cost setting of a short-term general hospital.

3. The program must pay for mental health services for the needy and provide mental health co-insurance for the more affluent. Mental health can no longer be treated as the step-child of medical care.

4. The program must provide preventive dental services for all children under the age of 12. A dollar spent for children in their formative years will return itself many times over in later years.

5. The program must include meaningful wage and price controls which do not interfere with either the patient's right to choose his doctor or the doctor's right to prescribe the proper course of treatment. Until we find a way to change the method of reimbursement which gives a strong incentive for proper use of resources, we will not solve the problem of health care inflation in this country. Wage and price controls, as part of national health insurance, are the only alternative.

6. The program must provide incentives to economize the use of health care resources. In particular, encouragement should extend to the use of pre-paid group practices. Such organization is still relatively unfamiliar to many American doctors and to the public at large. While not forcing this organization, we should be aware that experience in various parts of the country does suggest con-

sidering its ultimate adoption on a national basis. A national health insurance plan must provide a mechanism to pay for initial costs and to finance further development of pre-paid group practices.

Three additional problems in this area require federal attention:

First is the issue, particularly acute in New York City, of obsolete facilities. A study conducted in 1965 estimated the cost of replacing obsolete hospital and other health facilities in the city at approximately $705 million. Today, following the inflation in construction costs and a half decade of additional obsolescence, that cost would probably be at least double that figure. The reconstruction we need dwarfs the resources of private contributors, the traditional mainstays of major capital financing in health. These costs are beyond the capacity of state and local government. We need a well-funded Federal program, which, unlike the present Hill-Burton arrangement, does not require heavy local or private matching for project grants—a provision which now penalizes institutions that are less well off financially, but may have the greatest need for new facilities.

Second, we need a national health insurance program comprehensive enough to assure future income flows to institutions for depreciation and debt services. With such assistance, construction loans raised from the private market, by state or local governments, or provided or guaranteed by a Federal source, would become more workable possibilities than they are today.

Finally, our medical schools are in deep financial trouble. In the post-war period, and especially in the past decade, medical schools have survived on rapidly increasing research funds from the Federal government. With this growth now halted, the fiscal situation of our medical schools is not promising. New forms of federal aid are essential. Care must be given, however, to insure that such support be used for the purposes of training more physicians and intermediate level health-care professionals.

In conclusion, let me indicate my concern with the fact that many of these essential provisions have apparently not been included in the Administration's discussions of health insurance. Indeed, the Administration proposes a plan which would cover all Americans, which would not effectively control costs, and which would probably place a major financial burden upon millions of American middle and lower-middle income families.

National health insurance deserves the highest national priority. We must remove the prohibitive dollar sign from the present cost of medical care. And this Congress must do it.

Fifth: The federal government must reform the grant-in-aid structure.

Categorical grants are a vital part of the federal system. We must maintain and enhance their role. But there are significant problems in the existing system. Hundreds of programs have been set up to accomplish very specific, nationally defined purposes, each with its own administrative structure, objectives and rules.

But several specific features of the system create problems for cities. Funds are divided between agencies and programs by a variety of federally determined allocation formulas. Keeping track of how these formulas spread the money is almost as difficult as determining the rationale for any given formula in the first place. Once a formula is established, it tends to become locked in by a protective bureaucracy and a self-interested constituency.

The standards limiting who is eligible to receive grants are markedly different among federal agencies even when they fund the same kind of programs. Sometimes one agency will have bureaus refusing to recognize or use each others' local grantees. In some cases, only general local units of government are eligible to receive grants; in other cases only private organizations are eligible. All too often, a new quasi-public agency and a new board of directors must be created to administer the program, each with its own requirements as to composition and powers of the governing boards.

Moreover, each agency administering categorial grant programs issues different regulations on program planning. In some cases, agency input is stressed; in some cases, resident input is stressed; and sometimes City Hall input is stressed. Some federal agencies push the city to work closely with the state, while other federal agencies tend to ignore the state and work directly with the community. The city is caught squarely in the middle.

Each agency administering categorial grant-in-aid programs often has its own requirements for bookkeeping and auditing, for purchasing furniture and equipment, for hiring, firing, promoting, and transferring the staff. Each federal agency has different information systems and different reporting requirements, and often has different eligibility requirements for individual participants.

Most categorical grant programs have different requirements about the size, composition and location of the sub-city areas in which their program can operate.

States and cities also experience their own special problems. Most now pay overhead and indirect costs for many federal programs, despite the system of reimbursements developed by the federal government. New York City was one of several cities and states submitting an indirect cost statement, but Congress has not yet provided funds to fulfill this obligation.

Local governments also encounter additional financial difficulties. Maintenance of effort requires the city to demonstrate that local expenditures for a general purpose do not decrease when the new federal grant money arrives.

These requirements are rigidly enforced, and often have the effect of Balkanizing and freezing the city's budget. Local efforts to respond to new priorities or to redirect existing programs are met with federal warning that existing levels of expenditure in a program area must be maintained or the city may lose its eligibility to receive federal money. In this way the federal government creates significant pressure on the city to seek new revenue sources when addressing a new need, rather than meeting it by redirecting resources. And the financial difficulties don't stop there. Congress also generally requires that a city pay, through matching requirements, for a portion of the cost of a program in order to be eligible for the federal grant. Each program has its unique matching requirements. A change in matching rules in one program often requires the City to shuffle people and money in a variety of other programs and the effects are felt throughout city government.

Furthermore, there are strikingly different opinions within and between federal agencies about what constitutes legitimate program objectives. Conflicts between OEO, Department of Labor, and HUD-Model Cities are only the most visible of these debates: the tip of the iceberg. Again, the cities are caught in the middle. If a community is going to exercise its responsibilities, it must have the support of the entire federal government in meriting local problems. Multiple agency pressure works against the local objective.

I believe deeply in a high degree of citizen participation in the planning, operation, and evaluation of public programs. I also believe in a single federal standard for resident participation in all federally supported programs—a standard that requires resident involvement at the neighborhood level in the conduct of program operations. The right to influence governmental decisions is difficult enough to maintain in a small town with few programs; it requires constant effort to preserve that right in larger communities and great cities. The federal grant-in-aid system must support local efforts to preserve that right, and must stimulate people to use it.

I have described some of the problems that flow from the present categorical grant-in-aid system. I have suggested some remedies. Now, I would like to review some specific legislative recommendations.

1. The Joint Funding Simplification Act (H.R. 14517/S. 2479 Title IV) left over from the last Congress should be passed in this Congress. Grouping a variety of programs in a unified application system would permit the program coordination necessary to provide integrated service systems at the neighborhood level.

2. The Grant Consolidation Act (H.R. 10945/S. 2479 Title VIII) should also be approved now. The authority of the executive branch to merge existing programs in closely related functional areas should be broadened. The limitations the last Congress thought of placing on this proposed broadening would be sufficient to guard against presidential abuse. Implementation of this proposal would reduce the number of agencies a city would have to deal with, and we could reasonably expect a corresponding reduction in the number of conflicting regulations.

3. The modifications in the Intergovernmental Cooperation Act of 1969 considered in the last Congress (H.R. 19933/S. 2479) should be enacted in this one. Establishment of more uniform accounting and management systems would greatly facilitate both program planning and operations.

4. The Intergovernmental Personnel Act signed by the President on January 5, 1971, should be implemented as rapidly as possible. This Act provides a number of mechanisms for strengthening state and local personnel administration.

5. The Federal Government should establish one resident participation standard requiring that citizens participate in the planning, operation, and evaluation of all federally funded programs. This would produce several benefits. First, it would clearly establish the federal commitment to the principle that every citi-

zen has the right and the obligation to participate actively in the complicated business of democratic self-government. Second, it would reduce conflict in communities because it would reduce conflicts between the policies and practices of different federal agencies.

6. Maintenance of effort requirements must be modified to eliminate the fragmenting effect they currently have on city budgets.

7. Agency requirements that force programs to operate through unique sets of sub-city districts should be eliminated. Our commitment to citizen participation cannot be fully realized when the resident participation group in one program must fight the resident participation group in another because they represent overlapping but different geographic areas. Competition between program approaches and strategies can help sharpen program quality and city policy, but that competition should not be overlaid with a set of conflicts induced by externally imposed and arbitrarily defined sub-city boundaries. The Federal Government should work through locally defined sub-city districts, and should support local efforts to harmonize district boundaries.

8. Congress should provide funds to reimburse states and cities for the indirect costs of grant programs.

The reforms I have suggested here would improve the existing system of highly specialized and fragmented federal programs by combining them into more broadly defined grant categories. The balance between federal regulation and local need would be shifted to permit greater local determination about how funds would be used. The administrative requirements would be simplified so that uniform management systems could be applied to all public programs.

A warning note: reforms in the categorical grant-in-aid system must not make it more difficult for cities to address their problems—they must make it easier. Reforms should not reduce the level of federal support to cities in their attempts to address local problems—they must provide more support. Reforms in the categorical grant system are not a substitute for revenue sharing, and revenue sharing cannot be a substitute for categorical grants. It would be a cruel hoax to take funds from categorical grant programs to finance a revenue sharing proposal. We need community action—we need Model Cities—we need the Elementary and Secondary Education—we need broadly defined grants—and we need revenue sharing.

Chairman Proxmire. Thank you, Mayor Lindsay, for an excellent, clear statement, and a very responsive statement, this is precisely what we wanted to secure from you as a witness.

In view of the fact that Senator Percy, I understand, has to leave and had no chance to question either Mayor Gibson or Mayor Lindsay, I ask unanimous consent to ask Senator Percy to question out of turn.

I yield to Senator Percy first.

Senator Percy. Thank you very much, Mr. Chairman.

First of all, I did send to Mayor Gibson the same type of congratulatory message I sent to Mayor Lindsay some years ago, but I also send my prayers to you as I did to Mayor Lindsay.

Mayor Gibson, your testimony corroborates the full day I spent with you in Newark as I did with Mayor Lindsay in New York trying to understand the problems. They look almost insurmountable. We appreciate this testimony to analyze what we can do to help you.

On Monday, a bipartisan bill will be introduced in the Senate by Senators Nelson and Javits. This will be an emergency bill for the employment of people in any kind of capacity where there is a demonstrated need to answer the needs directly of cities and States. They could employ under present levels of unemployment—the bill is geared to levels of unemployment—about 200,000 people. About a billion dollars will be available in this emergency legislation.

I will be proud to be a cosponsor of that legislation. I believe in this type of employment for unemployed people.

Can you, as mayors, tell us whether this kind of emergency fund would be useful and helpful, whether you can find jobs that will not be dead-end jobs, as the Chairman mentioned, and whether it is urgently needed at the present time to meet the crisis that you are facing with the unemployment levels that you have in your respective cities?

Mayor LINDSAY. Let me take part of that first, Senator Percy.

I congratulate you on what you are doing. Any public service employment legislation that the Congress can produce will help us in the cities.

In New York City, we are spending at the present time approximately $50 million a year of our own local resources on public service jobs. About 45,000 poor people who would otherwise undoubtedly not be employed are working because of this type of employment activity. They are working in the field of schools and community development in health and housing authority work, housing and development, sanitation, police, fire, and in hospitals.

We are persuaded that but for this type of public service employment, these productive citizens would probably be on welfare. They represent, indeed, that really minimum portion of those on public assistance who are capable of training for public service type work. They provide services that are needed in hospitals and community patrols connected with police and various other activities.

These figures, incidentally, do not include the Neighborhood Youth Corps, which is for the most part a summertime program only.

Senator PERCY. Mayor Gibson.

Mayor GIBSON. Yes, Senator. This kind of program, even though emergency, would be of great assistance to the city of Newark. I would emphasize that any such program should include provisions for supportive services for the necessary training so that the individuals involved could be a part of the firm base for public service careers in the future. In other words, they should be able to qualify after——

Senator PERCY. The bill does provide such provision.

Mayor GIBSON. Fine. It will be great for us.

Senator PERCY. If there is a moment left, I would like you to comment on one phase of revenue sharing. I firmly support revenue sharing, certainly at a minimum of $5 billion. I do not know if we can go for $10 billion or not, but it at least ought to get to $5 billion on the floor of the Senate.

I have heard on the floor of the Senate and in the press that the cities and the State legislatures cannot be trusted to spend these moneys without control. Would you speak to that subject, as to whether you really do know your needs and can wisely spend funds without strings attached?

Mayor Gibson, do you want to comment on it?

Mayor GIBSON. Yes.

I said earlier that I really subscribe to the theory of accountability and I think we all should be accountable for public funds. But it is in my opinion illogical to assume that the man who is closest to the problem cannot deal with it and does not know what the problem is.

We as mayors of cities in America are very close to the problems. We are living with them every day. We live with the people who have them and we know how to deal with them. What we are talking about is the necessary resources to make some changes.

Senator PERCY. Mayor Lindsay.

Mayor LINDSAY. I agree very strongly on the concept of accountability. I think it is very essential. I agree both as a former Member of Congress and as a mayor.

Let's be clear that Federal categorical grants for special priority programs must continue. It would be simply disastrous were they to be cut back, and normal levels of accountability should always be built into them.

What we are talking about in revenue sharing is the ability to survive, indeed, just to stand still on present basic services and the cost of doing business in State and local governments—the cost of police, fire, sanitation, nurses, hospitals, parks, maintenance, and the rest of those ordinary things which in past years people have always believed would always be there without change. They are changing and we are in serious trouble.

In view of the fact that local governments have literally wrung their tax bases dry, what you are really facing is a choice between two disastrous alternatives: Cutting local budgets so drastically that you are literally cutting back on police, fire services, nursing services, and park maintenance and recreation across the country; or adding to the current recession, in effect, by crippling local economic bases with higher regressive taxes—taxes that stifle any possibility of growth, obviously add to the problem of competition between cities and suburbs for revenues, and further complicate the runaway problems that revenue competition already brings out.

That is really the choice that you are faced with.

Senator PERCY. I thank you, Mr. Chairman.

Chairman PROXMIRE. Mayor, you asked for, or rather, you asked your city to increase their taxes substantially, and you spelled out how burdensome and large were the tax increases which you had to request and secure. You also indicated how you had to cut back spending sharply in the city. I understand you cut your salary, and other top officials in New York reduced theirs as one of the most impressive and dramatic indications of your concern.

But, in addition, you cut other services well below what you think they should be. It is clear, you have done the job of making tough priority decisions. My problem is that the Federal Government is, for the first time, I think, getting into a position where there is a broad agreement among conservatives and liberals, between Nixon and Humphrey or Connally and Heller—any way that you want to put it—that the amount we should spend in the coming year—it is amusing that there is the kind of agreement that there is—that the amount we should spend in the coming year is the so-called full employment surplus budget of $230 billion.

So we have to make some hard, cruel choices in our position on where to spend the money. We cannot just have an unlimited Federal deficit. We have to cut somewhere and cut sharply if we are going to provide what you have asked.

You have asked us a whale of a lot this morning: $10 billion for revenue sharing; you asked us to enact the welfare reform bill which would, depending on what figure you set it at—would you have a $1,600 level or $3,200 level?

Mayor LINDSAY. In our city, a $1,600 level is low, obviously.

Chairman PROXMIRE. What do you think would be reasonable under present circumstances?

Mayor LINDSAY. Well, the level in New York that is fixed by all reasonable standards as the poverty base is $3,900 for a family of four.

Chairman PROXMIRE. You would expect the Federal Government to come in at something about that level? Is that about what you think would be right this year?

Mayor LINDSAY. Well, we agreed in our lobbying efforts during the last Congress on the family assistance plan for a percentage division of costs above the $1,600 level. The higher the percentage, of course, the Federal Government on a matching basis picks up, the better. But the closer you can get to $3,900, the better, as far as we are concerned.

Of course, we in New York City have been engaged in a very substantial and very costly program of help to the working poor, to keep them out of——

Chairman PROXMIRE. As I understand, that is part of the so-called welfare reform program.

Mayor LINDSAY. That is correct, and a key part of it, too.

Chairman PROXMIRE. If you go at all above the $1,600 level, you come very close to $10 billion in welfare reform. That is $10 billion for revenue sharing, $10 billion for welfare reform, another $2 billion for this job program, which I think is a highly commendable program. That is $22 billion. Where is the money coming from? You were a Member of Congress, and a very distinguished Member of Congress. You know the problems we have on excessive military spending, space, SST, some of these other areas which I think are unnecessary.

Where, in your view, should we make the cuts if we are going to have a budget in balance and full employment?

Mayor LINDSAY. First, on your figure of the non-Federal share of the welfare burden, the non-Federal share that is mandated by Congress to the local governments is now $6 billion. So under the current program, the current program without any major reforms of any kind, if Congress consented to lift that off the backs of the State and local governments, that would be an addition to the Federal Government of $6 billion.

If you are talking, on the other hand, about something that has vast elements of reform in it through the whole structure, then, depending on the level of payments, you are talking about somewhat more than $6 billion.

Chairman PROXMIRE. You would not argue about the $10 billion as the reasonable level of relief?

Mayor LINDSAY. No; I would not argue with it, and it does not trouble me, either. I do not think it should be thought of as a shocking figure when you put it alongside the dimension of the problem that the country is faced with. All you have to do is live with that problem to see how ghastly it is.

Here we are in a recession economy. What is the Federal Government going to do as the regulator and governor of that economy to distribute resources that are available to the problems and priorities that the country has before it? That is the basic question. The argument that we make is that, given a recession economy plus the fiscal collapse of State and local governments around the United States, with all of the horrendous implications of that for the health and well-being of our citizens in this country, Federal resources must be distributed to cope with our most urgent domestic problems.

In my judgment, an additional $10 billion can be immediately recovered. First, to reach toward full employment, Congress should add $5 billion to the projected level of Federal expenditures. After all, the Government's obligation now is to get the country moving toward a full employment economy rather than a recession economy.

The essential thing is that you start adding to your current expenditure levels; $5 billion is not a shocking figure for that. And I do not think another $5 billion is a shocking amount to be pared from other Federal programs which have to do with defense and space and related subjects. Even current witnesses before the Congress who have been Pentagon officials in the past have suggested that this is not too horrendous a job to face.

So there are real opportunities to redirect energies of the federal system to cope with the clear and present danger of local fiscal collapse—a danger which is just as clear and present as any the country has abroad which calls for massive allocations to missiles and rockets.

We are suggesting just a modest—and I mean modest—diversion of that into the disaster areas of the country, which are not just the central cities any more, but rapidly becoming the suburbs and now the whole of State governments.

Chairman PROXMIRE. My time is up.

Congressman Widnall.

Representative WIDNALL. Mayor Lindsay, to the extent that funds for revenue sharing would be a substitute for other grant-in-aid programs such as model cities, the State and local governments will be relieved of the problem of applying for and administering the Federal grants. However, grant-in-aid programs such as model cities usually require such features as local participation in decisionmaking, comprehensive planning, and strict accountability for funds. Do you foresee less comprehensive planning, less citizen participation, and less accountability for funds within the city government if categorical grant-in-aid programs are cut back as a result of revenue sharing?

Mayor LINDSAY. First, it is impossible for me to accept the proposition that categorical grants should be cut back. That would be robbing Peter to pay Paul. You know, the cities are going backward now. The mayors, out of frustration, have gotten to the point where they can sleep a few hours a night if they can simply stand still, tread water but not drown.

If you are to have revenue sharing and, at the same time, cut categorical grants, you start drowning again quite rapidly.

What I think has to be understood is that the categorical grant-in-aid programs are for various purposes that have been assigned by Congress as priority items. Congress has decided—and I think on the whole wisely—to meet those purposes with categorical grants. For the most part, the areas in which Congress has created grants are areas of real need, and continuing ones, whether it be special attention to education or certain aspects of health or certain portions of shelter, like housing.

What you are talking about in revenue sharing is something different: The ability to keep ongoing governments strong; the ability to see to it that the basic services that you expect, Congressman Widnall, when you go back to your district you expect to have an adequate police department around your home. You expect to have your sanitation taken care of and your garbage picked up. You expect to see the parks reasonably maintained.

And when you go to the municipal hospital, you expect to see a nurse and a laboratory technician. Those are the ongoing aspects of local government that local government has been handling.

As to participation in the model cities and other programs, you must have planning, and that planning must provide for people to participate in it. We have found through tests and experiment and every other thing that efficient and effective government goes hand in hand with participation in planning. The notion that you must have a kind of colonial form of government to have efficiency and to deliver bricks and mortar is not true.

There is not time to go into that now, but I would be delighted to explore that with you on some other occasion.

We also find increasingly that popular participation can go with revenue-sharing type service activities, whether it be sanitation or whether it be hospitals or maintenance of parks. We have found that they can go hand in hand. In New York City, we just got through spinning off all our 18 municipal hospitals and related facilities to a $600 million new health and hospitals corporation, with a mixture of moneys in it—$130 million or so in city money, and the rest of it in collections from various sources.

That corporation is now in a position to form subsidiary corporations, ultimately to so decentralize its system as to get the delivery of health services out into the neighborhood, with an appropriate participation on the part of the people.

Let me add this: We now have an experience of revenue sharing because the mayors of the big six cities of New York State were able to persuade the State legislature last year to enact a revenue-sharing program for the localities of the State of New York. Twenty-one percent of the State personal income tax is now returned to local governments—on a tax effort basis, the same type of formula that Congress is considering—for the maintenance of governments and services in those communities. And we find, on the basis of only a half year's experiment or experience with it, that it does work.

Representative WIDNALL. Mayor, I just have one other question. You have, like many of the other cities, experienced a great increase in welfare costs during the last year or two. To what, mainly, is the increase due, the increase in number of families on welfare—the expense for caring for them, or a different approach to welfare, or what is the increase in welfare mainly due to?

Mayor LINDSAY. Our increase in the caseload of welfare has been very big in the last 5 years. It has doubled in the past 5 years in New York in number of persons, but the costs have tripled. Those are the figures. That is not different from any other major urban area in the United States; indeed, in some cases, it is less.

The gross numbers in New York are vastly larger than any other community, because of its size. But you should take note of the fact that the rate of increase in welfare is now higher in Westchester, Suffolk, and Nassau Counties around us than it is in the central city of

New York, indicating that the suburban areas are entering into the urban problem in a very, very big way.

I would like to point out also that the rate of increase in New York City is about half of that of the Nation at the moment. California's is almost double what it is in New York City. So our problem in New York City, although big, is not special to our city.

I think when I talk about New York, I am talking about what is common to urban America in general. Now, the cause of it is multifold. It has to do with base and deep-core poverty, for the most part. Welfare in New York City—you can see what it comes down to in the end. Sixty percent of our welfare load in terms of people is children. The aged, the disabled, and the blind are another 11 percent. Then, women who have children, who are caring for those children, are 21 percent; women without children are 2.8 percent; and men are 4.5 percent of the caseload.

Men, incidentally, because this question always comes up about men—why don't you do something about it—that 4.5 percent, out of a million persons on some sort of welfare assistance in New York, translates itself to 48,000 persons, 48,000 men. Of that 48,000 only 4,000 are employable and that total turns over once a year.

In other words, the employable men come in and out as they find and lose jobs. And they have to take those jobs or go off welfare. The balance of the men are unemployables—sick, addicted, or some other problem.

Now, the problem with children, which is 60 percent of our problem—I dare say that is pretty close to the level in Mayor Gibson's community—and with women caring for children, which is 21 percent—has to do with the whole history of poverty and minority problems in America.

Read several reports, Federal Commission reports like the Kerner Commission, and you will see the whole sad history traced.

It is often suggested that people come to New York today and wind up on welfare because the rates in New York State, by State law, are higher than they are in other States. We doubt that. First, our data shows that less than 3 percent of those persons on any category of welfare have been in New York City for less than a year.

We also are able to conclude from the best tests that we can gather that the reason that poor people migrated to New York over the years is to find employment or to find better jobs. If they did not find work, yes, they wound up on some form of relief.

We also find that the mandated federal system of welfare that we have to live with, as you well know, Mr. Chairman, throws all kinds of barriers into the possible ways in which the cycle of welfare can be broken. That is why this tremendous effort has been launched throughout the country to change the system. We would like to see it junked. It does not work.

We have had enough experience to know, and we are in the best position to know in New York City government, because we are forced by the State and forced by the Federal Government to pick up a third of the cost of this whole wretched system. We are not consulted on that process. We are forced at the same time to manage the whole system in accord with a plethora of rules and regulations that would not even fit into this chamber. We can't even undertake the most modest experiments to get people off welfare without going through a half dozen layers of bureaucracy in the State and the Federal Government.

That is why we are about to file in the Federal courts major constitutional litigation to force the State and Federal Governments to stop mandating $600 million of costs to our city which we have, under law, no choice but to pay. In fact, we can't even judge welfare priorities as against police, fire, sanitation, or anything else. We are not given that right under Federal and State law.

Small wonder that blue-collar workers, particularly firemen and policemen, are as outraged as they are about the welfare system, when we do have the right under State and Federal law to cut nonwelfare spending and, indeed, are forced to because of the priorities that we have to live with. Yet the Federal Government and the State government will not allow us to make any adjustment in welfare. In fact, we are subject to taxpayer suits if we try.

Representative WIDNALL. Thank you very much. My time is up. I want to say I thoroughly agree with you as to the priority that welfare reform has in our Nation right now. I certainly hope the Congress does something about it during this coming session.

Chairman PROXMIRE. Congressman Patman.

Representative PATMAN. Mayor Lindsay, your speeches and statements in recent months have dramatized the tremendous need of the cities for a new source of funds. You have made an excellent case. And I might add that these matters extend across the country to include both rural and urban areas.

I am convinced that we need a new source of funds rather than a reshuffling of existing tax money, and legislation will be introduced to provide for a broad national development bank in the 92d Congress.

The bank would be used to finance, one, bonds of local and State governments for necessary projects, including pollution control, water and sewer plants, housing; two, new development to provide job opportunities in areas of substantial unemployment; three, new development where the economy is changing rapidly, such as in areas where defense agencies are closing or in rural areas where farming is declining; four, housing, to purchase bonds of local housing authorities, and provide financial assistance to various nonprofit housing organizations.

How would you feel about that approach, Mayor Lindsay, for providing additional funds?

Mayor LINDSAY. Congressman Patman, I regard that as an innovative and interesting approach which ought to be looked at very carefully.

Representative PATMAN. Do you think it would be a good approach or a bad approach. Of course, I should not ask you that question, because you testified on a very similar bill I introduced a year ago, and as I remember you looked upon it very favorably.

Mayor LINDSAY. Very favorably; I recall that very well indeed. I think it is an approach which is worthy of examination and, depending on its details and its impact on local governments, one of which I speak for, it would be something that would be a hopeful sign. I have long learned not to get too heavily committed to broad generalities until we see the whites of the eyes on what it is going to do to us.

Representative PATMAN. Something very similar, the Reconstruction Finance Corporation, was in existence for 21 years. It was first enacted under Mr. Hoover's administration, intended then only for banks, railroads, and insurance companies. But later in the Roosevelt administration it was expanded to include practically everyone who had an application for a loan that was considered deserving and worthy.

The RFC would consider such a loan if the applicant were unable to secure consideration at his local bank; in other words, it operated as a bank of last resort.

There were about a billion and half dollars of these funds by RFC that relate to almost exactly the plight that the cities are in right now. The capital of the RFC was really low in comparison to what it should have been even for those days. If we were to capitalize the new development bank at $1 billion and permit the expansion of that capital by 20 to 1, it would provide sufficient credit for the foreseeable future. It could do a great deal for the problems you are talking about today.

Now, the 20-to-1 ratio on loans is not high in comparison to the way the private financial system operates today. In fact, it is less. So there should be no problem with allowing the development bank to make loans 20 times its capitalization.

I hope that you would be willing to give consideration to this suggestion, Mayor Lindsay. Then we would be getting a new source of funds instead of reshuffling old funds. A source of new funds is very necessary in housing. We can talk about new housing all we want to, but unless we have the funds we are not going to meet the problem.

Mayor LINDSAY. We are desperate for new housing and capital developments. The RFC addressed itself at a very important time in America to such problems. But I think things are different now. What we are talking about here is the disastrous imbalance of operating revenues. That is really what we are talking about.

For example, in New York City, our capital budget, with which we build things—hospitals, schools, police stations, fire houses, and some housing, too, out of our own capital funds—is very tight and very squeezed. But it is not a disaster area the way the ongoing expense pressures and operating budgets are.

The RFC essentially addressed itself to a loan and capital problem. Our problem is the imbalance of expense budget moneys.

The RFC in its time was a key, critical thing. I remember my late father was, for a short period of time, employed by it, working with Mr. Jesse Jones and Mr. Arthur Ballantine, way back in the thirties.

Representative PATMAN. I ask unanimous consent, Mr. Chairman, to extend my remarks by inserting several statements and articles relating to the new development bank legislation I will be introducing as well as material relating to a similar bill introduced in the 91st Congress by Senator Sparkman and myself. I also ask unanimous consent to insert material relating to the operation of the RFC.

Chairman PROXMIRE. Without objection, it is so ordered.

(The material referred to follows:)

EXCERPTS FROM SPEECH BY HON. WRIGHT PATMAN, CHAIRMAN, HOUSE BANKING AND CURRENCY COMMITTEE, TO THE NATIONAL ASSOCIATION OF HOME BUILDERS, JANUARY 17, 1971, HOUSTON, TEX.

In addition to a broad and imaginative allocation of the nation's credit resources, we badly need a bank of last resort. A development bank which can make large scale credit available on reasonable terms for projects which the commercial banking system either will not or cannot finance. This should be an institution modelled along the general outlines of the old Reconstruction Finance Corporation which served this nation very well in the 1930's, 1940's, and the early 1950's.

This development bank could be used for a variety of financing. It could purchase the bonds of school districts, state and local governments, and similar governmental entities. Thus we could assure a permanent and stable market for bond issues to finance educational facilities, water and sewer plants, community development and like projects.

A national development bank could also be used to finance new developments and industry in areas of high unemployment and in communities where there is a major technological change in employment. The National Development Bank could be used to alleviate some of the massive problems we are sure to encounter as we move from a war-time to a peace-time economy. Our needs in defense have required the training of thousands of engineers, technicians, and scientists, and it is important that we keep this brain power at work. A development bank could finance many needed projects which would employ this talent—much of which today is standing idle in the unemployment lines.

A national development bank certainly could be used to finance housing—particularly the low and moderate income housing which private lenders have abandoned in recent years. It could be used to help finance local housing organizations willing to back and manage low income housing projects. The bank could give the housing industry a steady source of funds.

Such a National Development Bank would be used only as a "bank of last resort." The borrowers who applied to the bank would be required to show that they had sought and failed to receive the necessary loan funds from private sources. They would also be required to show that the project had a public interest character and that it was needed to meet the basic goals of the community and the nation.

[From the Daily Bond Buyer, July 3, 1970]

BANK BILL TO AID INDUSTRY, LOCAL GOVERNMENTS

(By Conrad Christiano)

Washington, July 30.—The Chairmen of the Senate and House Banking and Currency Committees have introduced legislation to create a Federal National Development Bank to make or guarantee long-term loans to States and localities for public work facilities and to businesses and commercial concerns for expansion.

The companion bills were introduced by Sen. John Sparkman, D-Ala., and Rep. Wright Patman, D-Tex.

The proposed Bank would be able to issue taxable notes, debentures, bonds, guarantees and other evidences of indebtedness and Congress would appropriate the money needed to cover the difference between the interest paid by the Bank on its obligations and the interest received by the Bank on its loans, and to reimburse the capital of the bank to the extent of any defaults. Congress would also provide an initial $500 million for subscription to the bank's capital stock.

COMMENDS JAVITS

Sen. Sparkman commended Sen. Jacob K. Javits, R.-N.Y., for introducing earlier this week a bill to guarantee loans to aid businesses caught in the liquidity squeeze. Mr. Sparkman said he shares the concern for the financial stability of the large corporations, but added that "I am not convinced that our legislative efforts should be solely for the purpose of assisting necessitous borrowers."

He continued, "Very frankly, I have equal concern for our towns and cities, for our small businessman—corporations, partnerships and individuals—and for the people in rural and urban areas who find themselves in just as great a personal financial dilemma as does Penn Central."

Mr. Patman said, "week by week and month by month, both the public and private capital needs for national priority purposes are increasingly unmet. The result is the steadily mounting failure of State and local governments to obtain the funds necessary for streets, water, sewers, schools, hospitals, airports, mass transit systems, and air and water pollution control facilities.

"ABSOLUTELY VITAL"

"It is also the rising inability of businesses and industries to acquire adequate capital at a cost they can afford in order to finance the expansion and development that is absolutely vital to remain competitive and to assure achievement of a full-employment economy."

Mr. Patman added that the proposed Federal Bank is in no way meant to compete with conventional lending institutions because no loan would be made or guaranteed by the Federal Bank if the borrower is otherwise able to obtain funds on reasonable terms.

The bills provide that the interest rate on loans to States and localities and public agencies "would not exceed per annum the Federal Reserve discount rate which presently is 6 per cent." Loans made or guaranteed to businesses and commercial concerns would be made at an interest rate "no less than the Federal Reserve discount rate" and "no more than 1.5 percentum added to that rate."

DEBT LIMIT ON BANK

Outstanding indebtedness of the Bank at any one time, including contingent liabilities on outstanding guarantees, could not exceed 20 times the paid-in capital stock of the Bank.

The Bank could purchase obligations of State and local governments and guarantee loans from conventional lending institutions to provide capital for the States and localities' public works.

Mr. Patman pointed out that, whenever possible, the public facilities and public works financed through the Bank "are to be of direct, substantial benefit to residents of slum and depressed rural areas."

The bill specifies that financial assistance to the private sector from the bank would be available on condition that borrowers agree to fill a specified number of job openings and to conduct training programs when these are considered necessary by the Bank's board of directors.

In the private sector, loan guarantees would be available too, and the Bank could purchase obligations of business and industries. Direct loans, guaranteed loans and the purchase of obligations would apply to both existing and new industry and business.

The Bank funding would have "minimum impact" on the Federal budget and most of its capital would be raised in the open market with obligations fully guaranteed by the Federal Government.

The Bank's board of directors would be the Secretaries of Treasury, Commerce, Labor and Agriculture, and State and local governments.

[From the Congressional Record, Aug. 4, 1969]

THE RFC MODEL SHOULD BE USED IN TODAY'S ECONOMY

(Mr. PATMAN asked and was given permission to extend his remarks at this point in the RECORD and to include extraneous matter.)

Mr. PATMAN. Mr. Speaker, earlier today, in a 1-minute speech I announced plans to introduce legislation to reestablish a Federal credit institution modeled after the successful Reconstruction Finance Corporation—RFC. Another homeowners loan corporation should also be considered.

Mr. Speaker, the tremendous work of this agency between 1932 and 1954 is a matter of public record. It financed thousands of public facilities and helped provide badly needed funds for small businessmen throughout the Nation.

This same type of credit—based on reasonable interest rates and terms—is badly needed today.

Mr. Speaker, a look at the history and the operations of the Reconstruction Finance Corporation shows how it could work in today's economy to provide credit for worthy projects, particularly for schools, parks, water and sewage facilities, and like public undertakings.

SCOPE OF OPERATIONS

The Reconstruction Finance Corporation was a public lending agency with unlimited authority to borrow funds from the U.S. Treasury. In addition to its loan authority, it subscribed for, purchased, and traded in the securities of private business enterprises; State and local government agencies, and other agencies of the Federal Government; and, through its subsidiaries, purchased and sold mortgages on both residential and income-producing properties. Until 1947, it used its retained earnings to extend various authorized programs, often utilizing income from one program to expand operations in another, at the discretion of its management. Thus, despite reductions in its original capital of $500 million, RFC disbursed more than $40 billion in direct loans during its life of succession and was conditionally committed to disburse many billions more under guarantees of loans and investments made by private financial institutions.

Its authority to borrow from the Treasury defined RFC as unique among Government agencies and made it more flexible than agencies operating under traditional Government appropriation procedures. Recognizing this flexibility, Congress frequently authorized advances and allocations of RFC funds to other Government agencies, subsequently reimbursing the Corporation with appropriated funds or by authorizing cancellation of the notes issued by RFC to the Secretary of the Treasury to obtain the funds. On one occasion, in 1941 when the public debt was approaching its limit, RFC ceased borrowing from the Treasury and issued its notes to the public. Part of these funds were then used to buy the stock of the Federal home loan banks from the Secretary of the Treasury as a means of providing the Treasury with additional funds. Other operations for the Federal Government include RFC's services as fiscal agent for the Defense Production Administration and its services as a liquidating agent for discontinued Government agencies and programs.

Beginning in 1940, RFC organized a group of subsidiaries to handle national defense and war programs. These subsidiaries developed sources for, manufactured, procured, stockpiled, and sold a long list of strategic materials and commodities; built and operated industrial facilities for war production; collected and salvaged scrap materials; conducted preclusive buying operations abroad, designed to handicap enemy powers; made subsidy payments to domestic producers and transporters, of essential materials, both to encourage production and to help control prices; provided insurance against loss due to enemy action; and for a short period after the war, undertook to dispose of surplus war property.

These programs were of types totally unrelated to RFC's normal financial activities and, while financed by the parent corporation with funds obtained from the Treasury, are not included in the $40 billion tabulation of RFC's disbursements since, as in the case of RFC's allocations to other Government agencies and to States for relief, Congress canceled the notes issued by RFC to the Secretary of the Treasury to obtain the funds so used.

Within the scope of RFC's "normal" lending operations, however, there was a requirement that there be a reasonable assurance of repayment. Some programs are not recorded as generally solvent. For instance, more than one-fourth of all amounts disbursed on loans to mining enterprises were charged off as losses. However, much of the expense incurred in administering small loans was absorbed in income from large loans and investments, and records show that, taken as a whole, interest income and other revenues exceeded losses and expenses.

The value of RFC's role in the economy has been questioned by those who argue that, after 1940, it ceased to be a countercyclical device, its operations being permitted to expand during a period of inflation. Nevertheless, RFC provided innovations in lending operations and filled notable gaps in the existing credit structure. For instance, RFC may be said to have effected a permanent extension in the term of business loans. Traditionally, commercial banks had limited such loans to a maturity of 1 year or less. By contrast, nearly 70 percent of the total disbursed by RFC for direct business loans from 1934 to 1951 had a maturity of 5 years and over. When RFC business loans declined as a result of its World War II activities, commercial banks took up the slack and, for the first time, began to engage actively in the extension of term credits. Similarly, with the dissolution of the corporation, other programs and types of lending operations were taken over by other financial institutions, both public and private. RFC as a concept, however, has not been replaced. No single type of financial institution, private or public, possesses either the flexibility or scope of operations exhibited by RFC in its lending programs.

BACKGROUND

Patterned on the War Finance Corporation, whose activities during World War I provided a precedent for Government assistance to private enterprise, the Reconstruction Finance Corporation was organized and began operations on February 22, 1932, a month after approval of the enacting legislation. Its primary purpose was to extend aid to agriculture, industry, and commerce through the medium of direct loans to banks, trust companies, and other financial institutions. Loans to smaller institutions were emphasized. The initial legislation also provided for assistance to railroads in the process of construction and to receivers of railroads.

Originally, RFC had a life of succession of 10 years, with the initial lending authority limited to a 2-year period. The remaining 8-year period was envisioned as necessary for an continuation of the initial programs. The various emergency programs enacted in 1933, however, made use of RFC as a funding agency and, in June 1934, an amendment to the original act permitted the Corporation to extend aid to small business firms. RFC was authorized to make loans directly or in cooperation with other lending institutions to solvent firms unable to obtain credit through normal channels. While the authorization of a maximum maturity of 5 years, an aggregate amount of loans outstanding of $500 million, and an aggregate amount to one borrower of $500,000 were reasonably liberal provisions, the limitation with respect to collateral hampered the volume of applications. The original language of this provision was interpreted to mean that the security offered must be equal to the principal of the loan. When extended in 1935, the business loan provisions of the act were liberalized to provide that loans be secured so as "reasonably to assure repayment." In addition, the maximum maturity of loans was extended to 10 years and the limitation of $500,000 to any one borrower was removed.

In subsequent years, RFC's lending authority was extended and broadened to include authority to purchase the capital stock of banks, insurance companies, agricultural credit corporations, and national mortgage associations. Authority was also given to make loans to agricultural improvement districts, disaster victims, public school authorities, and to assist in financing the construction of public works. In 1938 the business loan provisions were broadened to permit the Corporation to purchase the securities and obligations of any business enterprise, and thus to provide both credit and capital when either or both were not available from private sources. In addition, the limitation on maturities of loans was removed altogether and authority given to set maturities by administrative decision.

In 1940, RFC was given new responsibilities in connection with the national defense program and, subsequently, with wartime programs. For the most part, these programs were conducted by RFC subsidiaries. Nevertheless, relatively little lending was done under the regular programs.

RFC's life of succession had been extended in 1940 to January 22, 1947. It was subsequently reextended several times until, in 1948, it was extended to June 30, 1956. In 1947 and 1948, RFC was given a new charter under which its wartime powers were repealed and some of its functions curtailed. On the principle that the emergency had passed and that RFC must not compete with private sources of credit, RFC was required to have tangible evidence that a borrower could not obtain credit elsewhere. In addition, the capital stock of the Corporation held by the Treasury was reduced to $100,000, and its borrowing authority was limited to $2 billion outstanding on loans, investments, purchases, and commitments made after June 30, 1947. While this limitation on loans outstanding was subsequently increased—up to $3.75 billion in April 1950, primarily as a result of the increased mortgage activity of the Federal National Mortgage Association, an RFC subsidiary—other limitations were imposed by Congress as to the amount of loans outstanding for specific programs. Further, it was stipulated that loans should serve the public interest, and that activities should be curtailed in times of inflation. Subsequent amendments in 1950, 1951, and 1952 added special lending powers with respect to defense production and gave priority to defense loans.

On July 30, 1953, the RFC Liquidation Act was approved as part of the legislation which authorized creation of the Small Business Administration, and the Corporation's lending powers were terminated effective on September 28, 1953. Under the provisions of this legislation, RFC continued as an independent agency until June 30, 1954. Thereafter for further liquidation, the Secretary of the Treasury succeeded to and exercised all powers, duties, and authority previously lodged in the Administrator of the Corporation. On June 30, 1957, the Reconstruction Finance Corporation was abolished as provided by Reorganization Plan No. 1 of 1957.

RFC FINANCING—CAPITAL STOCK

The original Reconstruction Finance Corporation Act provided for capital stock in the amount of $500 million. Subscription was made and paid for by the Secretary of the Treasury. Under amendments to the act approved June 25, 1940, $175 million of the capital stock of the Corporation was retired in conjunction with provisions for RFC to issue its notes to the public. At the time the public debt was approaching its limit and these amendments served to ease the strain on the Treasury of RFC's enlarged responsibilities under the National Defense Act. An additional $225 million was retired under the provisions of the amendment approved May 25, 1948 in conjunction with curtailments of RFC's lending functions. The remaining $100 million of capital stock was outstanding until abolition of the Corporation on June 30, 1957.

LIMITATIONS ON OUTSTANDING OBLIGATIONS

Under the original act, RFC's outstanding obligations were not to exceed three times the amount of its capital stock, or $1.5 billion. This authority was enlarged in 1932 and 1934 to a total of $3.75 billion, and various amendments after 1940 increased the total authority to issue obligations to $14,089,528,165 as of June 30, 1947. An additional borrowing authority for specific purposes—primarily for loans and advances to and purchases of the securities of other Government agencies—was utilized to the extent of $4,977,500,000 as of June 30, 1947.

Effective July 1, 1947, most of RFC's wartime functions were terminated and its borrowing authority limited to $2 billion outstanding on loans, investments, purchases, and commitments made after June 30, 1947. This limitation was subsequently increased—to $2.5 billion in July 1949, to $3.5 billion in October 1949, and to $3.75 billion in April 1950—primarily as the result of the increased activity of RFC's mortgage subsidiary, the Federal National Mortgage Association.

Within this general authority of $3.75 billion, there were the following limitations imposed by Congress:

For construction by public agencies	$200,000,000
For catastrophes	40,000,000
For the capital of insurance companies	15,000,000
For civil defense loans	250,000,000

In addition to the above, RFC was authorized to utilize $50 million of its funds for assistance to prefabricated housing under the Housing Act of 1948. Other special programs after June 1947, included $2,176 billion, borrowed from the Treasury and disbursed to provide temporary financing for foreign aid programs, these advances being repaid out of subsequent appropriations.

Under Reorganization Plan No. 22 of 1950, the Federal National Mortgage Association was transferred from RFC to the Housing and Home Finance Agency, and RFC's lending authority was reduced by $2.75 billion, this amount being transferred to the Housing and Home Finance Agency. At that time, the remainder of RFC's housing authority under the 1948 act and its prefabricated housing program were also transferred to the Housing and Home Finance Agency. As a result, RFC's lending authority was reduced to $993 million outstanding on loans, investments, and commitments made after June 30, 1947, and remained at this figure until liquidation of the Corporation.

BORROWINGS OF RFC

The following breakdown of RFC's borrowings covers the entire period of its life of succession:

Notes issued to the Secretary of the Treasury	$51,346,850,497
Notes issued to the public	3,072,634,547
Total	54,419,485,044

NOTES ISSUED TO THE TREASURY

The initial issue of notes to the Secretary of the Treasury matured in 6 months and bore 3½ percent interest. Subsequent issues prior to 1947 were negotiated between RFC and the Treasury as to maturity and interest. The maximum maturity during this period was 3½ years and rates ranged from ⅛ to 3½ percent. The average annual rate on RFC's notes steadily declined from the 3½ percent maximum in 1932 to 1.072 in 1939. Thereafter, with the exception of two specific Government programs, the notes bore 1 percent interest. In 1947, Congress enacted an amendment requiring that interest on notes issued by RFC to the Secretary of the Treasury be set in relation to current average rates on Government bonds. Subsequent rates on notes ranged from 1⅞ to 2⅛ percent, the large majority being at the lower figure.

NOTES ISSUED TO THE PUBLIC

In relation to the provisions of the Emergency Act of 1933 devaluating the dollar, the first notes issued by RFC to the public were given in payment for gold. Between October 1933 and January 1934, the Corporation issued a total of $134,482,713 to acquire 695,027 ounces of domestic, and 3,418,993 ounces of foreign gold. The notes were turned over to the Treasury for cash and retired at maturity on February 1, 1934. RFC took a discount of $81,763 in exchanging its notes for gold.

Other notes issued to the public under the provisions of the 1940 amendments previously noted were taken primarily by banks and other financial institutions from which RFC had purchased preferred stock, debentures, or capital notes. In some cases, the notes were retired by crediting the amount against the principal of the loan made by RFC to the institution. Interest rates on these issues ranged from ⅞ to 3 percent.

RETAINED EARNINGS

Prior to 1948 there were no statutory provisions which required RFC to relinquish earnings. Such earnings were used by the Corporation to finance its operations, and, frequently, income from one program was used to fund other programs. For instance, funds obtained from the liquidation of the Smaller War Plants Corporation, an independent agency, were utilized by RFC to expand operations under its general lending authority.

Under the 1947 amendments, RFC was required to pay as a dividend to the Treasury any amount earned in excess of $250 million and a reasonable reserve for losses. The effect, in line with other provisions of the amendments, was to curtail RFC's lending authority. In December 1948, RFC paid the Treasury a dividend of $307,391,555, based on its accumulated net income of $557,391,555 for the year ending June 30, 1948. From 1949 to 1954, the Corporation paid a total of $82,946,891 to the Treasury as dividends on earnings in excess of $250 million per annum. After 1954, liquidation of the Corporation was underway and all excess cash was turned over to the Treasury. Accumulated net earnings for the years 1955, 1956, and 1957 totaled $223,154,595.

RFC LENDING FUNCTIONS

RFC authorized a total of $46,468,722,698 for allocations, loans, and other investments during the period from February 2, 1932, to September 28, 1953, excluding loans, advances, purchases, and contract authorizations authorized by subsidiaries of RFC and financed with funds secured from the parent organization. Actual disbursements during this period amounted to $40,555,894,138, with recoveries of amounts disbursed in the form of repayments, notes canceled, and foreclosures totaling $39,881,414,031.

Of the total of over $46 billion authorized by RFC, $7,235,248,449 was authorized for loans and allocations to other Government agencies under congressional directives, and $692,299,251 was authorized for purchases of securities from the Federal Emergency Administrator of Public Works, subsequently entitled the Public Works Administrator. The remaining $38,541,174,998 was authorized for loans and investments at the discretion of RFC's management. The composition of the latter type of authorization and disbursement is as follows:

	Amount authorized	Disbursements to Sept. 28, 1953
Loans to and investments in financial institutions	$4,815,324,697	$3,906,201,681
Loans to business enterprises	5,153,294,815	2,637,329,690
Loans to agricultural financing institutions	2,454,133,430	1,452,502,107
Loans to railroads	1,059,867,787	938,440,875
Loans to and investments in public agencies	1,024,203,892	793,600,115
Investments in RFC mortgage loan subsidiaries	1,831,551,598	1,778,093,357
Loans to foreign governments	495,000,000	460,000,000
Investments in Government agencies	391,991,000	391,933,000
Other loans and investments	97,507,778	77,098,982
Investments in RFC's wartime subsidiaries	21,218,300,001	20,877,617,233
Total	38,541,174,998	33,312,817,040

A breakdown by periods indicates that, during the first 3 years of operations, RFC loans and investments were concentrated in the area of providing assistance to financial institutions, railroads, and agencies providing financial assistance to agriculture. After 1935, aid to financial institutions diminished and loans and investments to business enterprises and public agencies, as well as mortgage loans, assumed greater importance. Between 1940 and 1945 more than 80 percent of all amounts authorized by RFC were to its wartime subsidiaries, with loans to business enterprises making up the bulk of the remainder. After the war, RFC's lending and investment activity was largely concentrated in the fields of business loans and residential mortgages, with loans to business enterprises reaching a peak in 1949 and mortgage activity at its highest level during 1949 and 1950. A breakdown of individual lending programs follows:

LOANS TO AND INVESTMENTS IN FINANCIAL INSTITUTIONS

While RFC's lending operations expanded greatly during the more than 20 years of its life of succession, loans to financial institutions under the provisions of the initial RFC Act represents the single largest category of loans disbursed under RFC's normal lending authority. The extent of financial assistance provided by RFC to the various types of financial institutions is shown in the following table:

	Authorized	Disbursed
Banks and trust companies	$3,981,365,688	$3,265,450,731
Mortgage loan companies	494,636,731	354,149,576
Building and loan associations	178,989,560	140,158,068
Insurance companies	159,689,750	145,843,210
Credit unions	642,968	600,096
Total	4,815,324,697	3,906,201,681

More than three-fourths of the total disbursed for these loans was paid out in the first 2½ years of the Corporation's existence. Nevertheless, when the Corporation began liquidation in 1953, there was still $44.6 million outstanding in these loans and investments, loans in only two categories—to building and loan associations and to credit unions—having been repaid in full.

As noted, the authority for loans to credit unions was little used, only 10 loans to seven credit unions having been disbursed. The bulk of RFC's authority for loans to financial institutions was used to provide assistance to banks and trust companies. A summary, according to the nature of these loans, is as follows:

LOANS TO BANKS AND TRUST COMPANIES UNDER SEC. 5 OF THE RFC ACT, AS AMENDED

	Number of authorizations	Number of institutions	Amount authorized
Loans to open banks	10,592	4,922	$1,335,047,661
National	2,224	813	360,439,541
State	8,368	4,109	974,608,120
Loans to closed banks, to aid in reorganization or liquidation	4,817	2,421	$1,181,774,129
Conservators, national and District of Columbia	197	181	129,813,204
Conservators, State	38	19	33,030,264
Receivers national and District of Columbia	2,915	955	537,738,731
Receivers, State	1,631	1,233	464,603,947
Liquidating agents-national	9	9	10,028,664
Liquidating agents-State	27	24	6,559,319
Total	15,409	7,343	2,516,821,790

As the summary indicates, RFC gave preference to the smaller State banks which were still open. However, in handling assistance to closed banks, applications of conservators, receivers, and liquidating agents of national banks were treated on a par with those of State banks. Of the total disbursed, $21,447,380 was charged off, all but $1,262,600 of it being in connection with losses on loans to State banks.

BUSINESS LOANS

Loans and investments in business enterprises constitute one of RFC's most significant lending programs, both in terms of the volume of loans and continuity of operations. Initiated in 1934, the program was subsequently enlarged and liberalized to permit RFC to make loans to, and purchase the obligations of any business enterprise, with both maturities and amounts to any one borrower being determined at the discretion of its management. While commercial loans to business enterprises were necessarily curtailed during the period from 1940 to 1945, the program was expanded after the war, nearly three-quarters of the loans, by both number and amount, being disbursed after February 1945, and almost half of the total disbursed after June 1948.

RFC's business loans were of three types; direct loans, immediate participation loans, and deferred participation loans. Direct loans were authorized, disbursed, and serviced by RFC. Immediate participation loans were authorized in cooperation with a participating financial institution. Part of a loan was disbursed by RFC and the balance by the participating institutions. In some cases, RFC disbursed the entire amount and immediately sold part of it to the participating institution, or alternatively, RFC purchased a part of the loan at the time of disbursement by the participating institution. Servicing of loans was provided by either party as agreed on. Deferred participation loans were serviced by the financial institution with an agreement under which RFC would purchase a stated portion of the outstanding loan on request.

Prior to 1947, RFC's business loan statistics treated participation loans—both immediate and deferred—in a manner different from that of subsequent periods. During the earlier period, sales of participations were treated as direct loans and purchases of participations grouped with deferred participations. After July 1, 1947, both types of immediate participations were grouped in a single class, with direct loans and deferred participations each making up separate categories. In a limited number of cases, loans made to business enterprises took the form of purchases of capital stock and other obligations issued by concerns and were treated as direct loans for statistical purposes. With these qualifications as to type of loan, the following summary indicates the numbers and amounts of RFC's business loans in the various categories:

	Number	Authorized	Disbursed
Loans under authorities other than national defense	52,932	$3,300,846,049	$1,718,642,480
Direct loans and sales of participations (through June 30, 1947)	14,041	797,072,135	554,508,269
Deferred participations and purchases of participations (through June 30, 1947)	16,355	684,167,370	33,078,651
Mining loans (through June 30, 1947)	352	20,659,800	10,118,109
Loans to the fishing industry (through June 30, 1947)	27	809,700	719,675
Direct loans (July 1, 1947 to Sept. 28, 1953)	11,333	1,142,836,250	819,545,185
Immediate participation loans (July 1, 1947 to Sept. 28, 1953)	1,047	216,512,534	152,891,528
Deferred participation loans (July 1, 1947 to Sept. 28, 1953)	5,595	265,771,750	48,386,291
Direct mortgage loans classified as business loans	4,182	173,016,510	99,394,772
Loans under national defense authorities (June 25, 1940 to June 30, 1947)	10,595	1,852,448,766	918,687,210
Direct loans and sales of participations	4,391	1,261,473,769	839,059,796
Deferred participations and purchases of participations	2,326	382,071,384	17,422,595
Security purchases for automobile financing	153	132,143,106	
Loans and purchases of rationed articles and commodities	3,673	75,652,157	62,158,719
Contract settlement loans	6	1,108,350	46,100
Total	63,517	5,153,294,815	2,637,329,690

SPECIAL BUSINESS LOAN PROGRAMS

VETERANS LOANS

Under section 5(d) of the Servicemen's Readjustment Act, RFC authorized 3,525 direct loans to veterans up to June 30, 1947, and disbursed $8692,829 with the guarantee of the Veterans' Administration. The Corporation also authorized 170 direct loans to veterans which were not guaranteed by VA, disbursements amounting to $918,689.

THE BLANKET PARTICIPATION AGREEMENTS PROGRAM

The BPA was a 2-year program to aid reconversion under which RFC agreed to take up to 75 percent in deferred participation in loans made to business enterprises. Unlike other participation agreements authorized by RFC, the Corporation relied entirely on the banks' opinion of a borrowers' credit standing. A limitation of $350,000 was placed on the aggregate amount outstanding to one borrower. Bank disbursements on BPA loans totaled almost $500 million and RFC's agreed participation was $360 million, or over 70 percent. However, requests by banks for RFC to take up its share of loans aggregated only about $30 million, with $4 million charged off as uncollectible. About 2,400 banks or 21 percent of the Nation's total—made loans under the BPA program.

SMALL LOAN PARTICIPATION PROGRAM

The SLP program was, in a sense, a continuation of the BPA program which it succeeded. It was, however, limited to participation in loans of $100,000 or less and FRC was required to approve each request individually. A total of 6,328 loans in an aggregate amount of $151,323,284 were authorized, and a total of $12, 617,807 disbursed by RFC.

INDUSTRIAL CLASSIFICATION OF BUSINESS LOANS

The preponderance of RFC loans to business enterprises were made to manufacturing concerns. A breakdown by periods indicates that, prior to December 31, 1941. FRC authorized a total of $347,492,046 to 4,347 concerns engaged in manufacturing, and a total of $135,928,680 to 3,777 concerns which were engaged in nonmanufacturing enterprises. From June 25, 1940, to June 30, 1945, most of the business loans authorized by RFC were to assist in financing the acquisition of plant facilities. During this period, the majority of funds went to manufacturers of basic materials and military equipment, with manufacturers of products—such as textiles, food, lumber, machine tools, machinery, and so forth—receiving allocations of only $155,936,998 of the $1,402,961,584 authorized. Between January 1, 1950, and February 28, 1953, RFC authorized a total of 3,542 loans in the amount of $361,955 to nonmanufacturing industries; and a total of 3,606 loans in the amount of $630,175 to manufacturing industries.

SIZE OF BUSINESS LOAN AUTHORIZATION

The following table indicates the distribution of the number and amount of business loans authorized by RFC, by size and type of loan:

	Direct loans and immediate participations		Deferred participations	
	Number	Amount	Number	Amount
$5,000 or less	11,028	$29,630,483	2,198	$5,363,664
$5,001 to $10,000	5,789	45,279,454	3,326	19,266,651
$10,001 to $25,000	7,424	130,617,683	6,459	82,799,687
$25,001 to $50,000	4,743	181,802,146	5,010	136,839,622
$50,001 to $100,000	3,613	282,915,218	3,911	222,392,609
$100,001 to $200,000	1,396	210,934,136	1,333	145,407,043
$200,001 to $500,000	1,127	358,287,319	1,056	235,936,746
$500,001 to $1,000,000	370	270,189,762	171	91,505,773
Over $1,000,000	362	2,070,424,287	159	348,828,028
Total	35,852	3,579,980,488	23,263	1,288,339,823

LOANS TO AGRICULTURAL FINANCING INSTITUTIONS

Under the original RFC Act, the Corporation was authorized to make loans to various types of institutions engaged in providing credit for agricultural purposes. To a great extent, the loans made by RFC under this authority were to Government or quasi-Government institutions but differed from the loans and allocations made to other Government agencies in that RFC could prescribe the terms and conditions of the loan and that loans were required to be "fully and adequately secured." Subsequently, RFC was authorized to make loans to help finance the sale of agricultural surpluses abroad, to finance the carrying and marketing of commodities and livestock, and to make loans to the Secretary of Agriculture for the purpose of acquiring cotton. The loans authorized by RFC to agricultural financing institutions under the various authorities are summarized as follows:

	Authorized	Disbursed
Under sec. 5, RFC Act:		
Federal land banks	$399,636,000	$387,236,000
Joint-stock land banks	33,055,359	26,194,970
Federal intermediate credit banks	9,250,000	9,250,000
Regional agricultural credit corporations	178,840,453	173,243,641
Other agricultural credit corporations	6,120,867	5,643,618
Livestock credit corporations	14,511,328	12,971,599
Under Emergency Relief and Construction Act, 1932:		
Commodity Credit Corporation	1,604,712,665	767,716,962
To finance agricultural commodities	86,061,513	19,544,492
To finance exports of agricultural surplus	98,445,245	47,300,825
Under the Agricultural Adjustment Act, 1933: Secretary of Agriculture	23,500,000	3,300,000
Total	2,434,133,430	1,452,502,107

RFC MORTGAGE SUBSIDIARIES

While the original RFC Act authorized the Corporation to make loans to mortgage loan companies, it did not provide authority to subscribe to the capital stock of such companies. The act of January 31, 1935, added a new section 5c to the RFC Act which authorized such subscriptions in order to assist in the reestablishment of a normal mortgage market. "Although the power to do so was implied rather than specific," as the final report of the Corporation comments—page 93—RFC used the authority to create two subsidiaries to deal in real estate mortgages, the RFC Mortgage Co. and the Federal National Mortgage Association, and disbursed a total of $1,705,001,899 to these subsidiaries.

THE RFC MORTGAGE CO.

Incorporated in March 1935 under the laws of the State of Maryland, the RFC Mortgage Co. was, however, a division of RFC with three officials of the Corporation serving as incorporators, its capital stock purchased by RFC, and the administration of its affairs conducted through the same organization and offices as those of the parent corporation. Under provisions of the act of June 30, 1947, the assets and liabilities of the company were transferred to RFC and the RFC Mortgage Co., was subsequently dissolved. From 1935 to 1947, RFC provided the company with funds amounting to $334,910,020, $25 million through subscriptions for capital stock and the balance through loans. At the time of the company's merger with RFC, the Corporation's investment was $80,352,871, including the $25 million subscribed for capital stock.

A summary of the RFC Mortgage Co's lending and purchasing activities is provided by the following table:

	Authorized		Disbursed to June 20, 1947	
	Number	Amount	Number	Amount
Large-scale housing projects—FHA insured	46	$38,098,000	19	$7,466,833
Other FHA-insured mortgages	74,108	293,989,550	63,402	244,764,820
Mortgages insured by VA	25,102	148,537,930	11,367	67,681,262
Direct loans on income-producing properties	4,182	173,016,510	2,820	99,394,772
Purchases of property	15	7,259,591	15	3,228,815
Total	103,525	660,901,581	77,623	422,536,502

The company acted to provide a secondary market for VA-insured mortgages from August 7, 1946, to June 30, 1947. In July 1948 the authority for RFC to purchase VA-insured mortgages was reactivated by legislation and the function undertaken by the Federal National Mortgage Association. FNMA also undertook to administer the remaining obligations of the FRC Mortgage Co. in the Corporation's fortfolio when RFC was liquidated in 1954.

THE FEDERAL NATIONAL MORTGAGE ASSOCIATION

The FNMA was chartered by the Federal Housing Administrator, as authorized by title III of the National Housing Act, on February 10, 1938. RFC subscribed for and paid in $10 million for the capital stock of the Association, and also paid in $1 million to surplus. In 1948, FNMA's capital stock was increased by $10 million, also paid in by RFC. Staffed by RFC personnel and operating through the Corporation's field offices, FNMA functioned as a division of RFC until September 7, 1950 when, under Reorganization Plan No. 22 of that year, it was transferred to the Housing and Home Finance Agency. Prior to transfer, RFC had made loans to FNMA totaling $1,349,091,869, of which $1,007,226,308 was outstanding at the time of transfer, in addition to the $21 million in capital stock and paid in surplus which RFC had provided. Repayment for RFC's investment was provided from funds borrowed by FNMA from the Secretary of the Treasury.

During the period in which FNMA was a subsidiary of RFC it authorized the purchase of 414,449 mortgages as follows:

	Total	VA mortgages	FHA mortgages
Authorized	$3,084,211,324	$1,891,014,451	$1,193,196,873
Canceled	345,497,165	101,549,900	243,947,265
Disbursed	1,851,042,483	1,096,881,372	754,161,111
Repayments and sales	709,178,636	172,259,012	536,919,624
Other reductions	12,172,121	1,282,302	10,889,819
Transferred to HHFA:			
Commitments	887,671,676	692,583,179	195,088,497
Mortgages	1,129,691,726	923,340,058	206,351,668

RAILROAD LOANS AND INVESTMENTS

The original RFC Act authorized loans to railroads for temporary financing, to railroads in the process of construction, and to receivers of railroads where funds could not otherwise be obtained at reasonable rates. All loans required the approval of the Interstate Commerce Commission, maturities were limited to 3 years, and the act stipulated that loans be adequately secured. The maximum maturity of such loans was extended to 5 years in 1934 and, in 1935, the loan authority was extended and RFC was authorized to purchase the obligations of railroads engaged in interstate commerce with the approval of the Interstate

Commerce Commission. The limitation on aggregate funds outstanding of $350 million was increased to $500 million in June 1940. In 1947 and 1948 RFC's authority to provide financial assistance to railroads was further extended but few loans were made under the extension.

Under the original limitations, RFC authorized 139 loans to 70 borrowers and disbursed $450,941,524. After 1935, under its new authority, RFC made 248 loans to 98 railroad companies in the amount of $1,059,867,787. In addition to these loans, the Emergency Appropriation Act of 1934 authorized RFC to purchase railroad obligations from the Federal Emergency Administrator of Public Works—subsequently, Public Works Administrator—in order to provide the PWA with funds to make additional loans. This authority existed up to 1947 but was not exercised after 1941. Prior to 1941, RFC authorized the purchase of 54 issues of railroad securities and disbursed $199,290,500 to PWA. The premium of $6,889,202 which was collected was not considered to be income by RFC and was credited to PWA.

LOANS TO PUBLIC AGENCIES

In September 1932, an amendment to the original act authorized RFC to purchase the securities of, or make loans to States and Territories and their political subdivisions; municipalities; public corporations, boards, and commissions; drainage, levee and irrigation districts; and public municipal instrumentalities formed in more than one State. RFC's activities in this area are summarized as follows:

	Authorized	Disbursed
Self-liquidating projects, under the Emergency Relief and Construction Act of 1932	$398,873,884	$339,533,641
Drainage, levee, and irrigation districts under the Emergency Farm Mortgage Act of 1933	150,127,449	101,787,683
Public bodies under sec. 5(d) of the RFC Act	475,202,559	[1] 385,262,291
Securities of public agencies purchased from FERA and PWA	493,854,288	452,181,084
Total	1,518,085,180	1,278,764,699

[1] Includes $32,983,500 disbursed on outstanding commitments subsequent to Sept. 28, 1953; does not include disbursements for advances related to care and preservation of collateral.

RFC loans for self-liquidating projects—those whose construction costs would be returned in time by means of tolls, fees, rents, and other charges exclusive of taxation—were not limited as to maturity and funds could be used to finance public projects authorized by Federal, State, or municipal law. In addition, loans could be made to private corporations formed solely for the purpose of providing low-cost housing and reconstruction in slum areas where such projects were regulated by State or municipal law; to private corporations engaged in constructing or improving bridges, tunnels, and other facilities devoted to public use; and to private corporations to aid in financing projects for the protection and development of forests and other renewable natural resources. Mostly, however, the self-liquidating projects financed by RFC were entirely public in nature. More than three-fourths of the total authorized was disbursed in the State of California, representing an investment by RFC in $208 million in bonds issued by the Metropolitan Water District of Southern California and and $70 million advanced for the San Francisco-Oakland Bay Bridge.

While the original authority for loans to drainage, levee, and irrigation districts was limited to refinancing completed projects, RFC's authority was broadened in 1936 to include loans for the acquisition or construction of such projects. Maturities of up to 40 years were permitted but loans were required to be "fully and adequately secured" and RFC was required to appraise each project to determine that it would prove economically sound. A total of 1,318 loans were authorized in 671 districts primarily concentrated in Southern and Western States. Activity in this field was highest between 1933 and 1937, but continued at a lower rate into 1947.

RFC's original authority to make loans to, and purchase the securities of all types of public agencies and bodies was transferred to the Federal Emergency Administrator of Public Works in 1933, in conjunction with the authorization for RFC to purchase securities from FERA. RFC's authority in this field was, however, subsequently reactivated in 1938 and retained throughout the life of the Corporation. There was not statutory limitation as to maturity, but loans were required to be of such sound value or so secured as to reasonably assure retirement or repayment. Assistance was given broadly among the States but there were certain concentrations in dollar amounts for large projects. Among these were the $136 million authorized for the State of Arkansas Highway Department; the $37 million for the Pennsylvania Turnpike Commission; $20 million for the city of Philadelphia Gas System; $28,885,000 for the city of Cleveland Transit Authority; and $22,450,000 for the hydroelectric project of Public Utility District No. 1 of Pend Oreille County, Wash.

FINANCING OTHER GOVERNMENT AGENCIES

Aside from loans to agricultural financing institutions and in addition to loans and allocations to other Government agencies at the specific direction of Congress, there were several instances in which RFC funds were used to finance Government agencies within the discretion of the executive branch.

The Export-Import Banks was one such instance, with RFC providing the original capital and subscribing to the initial issue of preferred stock. In all, RFC disbursed a total of $201,500,000 to the Export-Import Banks, consisting of $176,500,000 in subscriptions for preferred stock and $25 million in loans.

The Defense Homes Corp. was also financed by RFC under Executive order. RFC lent a total of $65,692,000 to DHC, of which $40,870,411 was outstanding when DHC was dissolved in 1949 and its assets transferred to RFC for liquidation. With the dissolution of RFC these assets, reduced to $27,307,358, were transferred to FNMA.

The original RFC Act had authorized the Corportion to assist in financing the Federal home loan banks by providing up to $125 million out of its capital to enable the Secretary of the Treasury to subscribe the stock of the banks, and $124,741,000 had been disbursed for this purpose. Subsequently, in 1941 when the public debt was approaching its limit, RFC ceased borrowing from the Treasury and issued its notes to the public, and with part of these funds bought the stock of the Federal home loan banks from the Secretary of the Treasury as a means of providing the Treasury with additional funds. RFC continued to hold this stock until 1947 when a portion of RFC's notes payable to the Secretary of the Treasury, equal to the amount of the stock involved was cancelled and the stock of the banks returned to the Treasury.

LOANS TO FOREIGN GOVERNMENTS

Several specific authorizations for loans to foreign governments were enacted, beginning with the Emergency Relief and Construction Act of 1932 which authorized loans to finance sales of agricultural surpluses in foreign markets. Under this authorization, a loan of $17,105,386 was disbursed to the Republic of China in 1933. In 1941, RFC was authorized to make loans for the purpose of achieving the maximum dollar exchange value in the United States for the securities or property of any foreign government, and $390 million was disbursed to Great Britain in the only instance in which this authority was used. In 1946 RFC was authorized to lend up to $75 million to the Philippine Republic after consultation with the National Advisory Council on International Monetary and Financial Problems, and $70 million was disbursed under this authorization.

DISASTER LOANS

RFC was first authorized to make disaster loans in March 1933 and its authority to make such loans—amended and broadened in 1934, 1937 and 1945—remained continuous until 1953 when, under the RFC Liquidation Act, its authority in this area was transferred to the Small Business Administration. The following table summarizes the activities of RFC and its affiliate, Disaster Loan Corporation, in this area according to legislative authority:

	Authorized		
	Number	Amount	Disbursed
Act of Mar. 23, 1933, as amended	13	$10,450,232	$8,529,108
Act of Apr. 13, 1934, as amended	705	5,734,289	3,473,947
Act of Feb. 11, 1937, as amended (DLC)	24,088	37,361,660	31,354,550
Act of June 30, 1945, as amended	5,579	35,439,075	25,468,048
Total	30,385	88,985,256	68,825,653

CIVIL DEFENSE LOANS

The Federal Civil Defense Act of 1950 authorized the RFC to make loans for civil defense purposes financed by borrowings from the Treasury. Seven loans were authorized in the amount of $5,568,000, all for assistance in financing the construction of hospitals. In 1953 the program was transferred to the Secretary of the Treasury.

MINOR LENDING FUNCTIONS

LOANS FOR PAYMENT OF TEACHERS' SALARIES

For a period of 7 months in 1934, RFC was authorized to make loans to public school districts for teachers' salaries due prior to June 1, 1934. The authority was used only once. A loan of $22,300,000 was disbursed to the Chicago Board of Education, all of which was repaid in 1934.

LOANS TO REFINANCE PUBLIC SCHOOL DISTRICT OPERATIONS

In 1935, RFC was authorized to make loans to tax-supported public school districts to reduce or refinance outstanding indebtedness incurred for construction, operation, and maintenance of public school facilities. The act required that such loans be allocated equitably among the States and that maturities be limited to 33 years. Under this authority, RFC authorized 35 loans to 31 school districts. Disbursements in the amount of $957,175 were made in only two States, Arkansas and Texas, and were repaid in full.

LOANS TO PROCESSORS OR DISTRIBUTORS SUBJECT TO PROCESSING TAXES

The provisions of the Agricultural Adjustment Act of 1933, which provided for the payment of taxes by processors or distributors of various agricultural products, also provided that processors or distributors subject to the taxes were eligible for loans from RFC in order to avoid the imposition of "any immediate undue financial burden." Only seven such loans were authorized and $14,718 disbursed, all of which was repaid.

LOANS TO STATE FUNDS FOR SECURING REPAYMENT OF DEPOSITS OF PUBLIC MONEY

In 1933, RFC was authorized to make adequately secured loans to States creating funds to insure repayment of deposits of public moneys. The only authorizations were for loans to the Board of Deposits of Wisconsin. All of the $13,064,631 disbursed was repaid.

FINANCING RFC'S WARTIME SUBSIDIARIES

Beginning in 1940, RFC's responsibilities were greatly enlarged by the creation of eight subsidiaries to aid the Government in its national defense program. Through these subsidiaries, the Corporation was authorized to engage in financing plant conversion and construction, to acquire and construct and to own and operate war plant facilities, to make subsidy payments, to deal in and to stockpile strategic and critical materials, to administer the war damage insurance program, and to conduct a great variety of other activities unrelated to its normal lending operations. For the duration of the war, these operations overshadowed RFC's other functions, as much as 80 percent of its activity being related to the war effort.

Under the provisions of the act of June 30, 1945, RFC's wartime subsidiaries were merged with the parent organization. RFC received the assets of these corporations, but the original investments of $7.6 billion were charged off and the Act of June 30, 1948 canceled the Corporation's notes payable to the Secretary of the Treasury in an amount equal to the unrecovered costs of its national defense, war, and reconversion activities. Three of the production programs which had been undertaken by RFC subsidiaries were, however, continued on an active basis after the war: The program for the production and sales of synthetic rubber undertaken by the Rubber Reserve Corp., the program for the production and sale of tin undertaken by the Metals Reserve Corp., and the program for the production and sale of abaca fiber undertaken by the Defense Supplies Corp.

The operations of RFC's wartime subsidiaries were conducted in conjunction with programs of other Government agencies administering national defense and wartime functions. They were, however, financed through the purchase of capital stock and loans by the parent corporation. While RFC was repaid for advances with funds provided by the operations of its subsidiaries, more than one-third of the amounts advanced were recovered by cancellation of RFC's notes payable to the Secretary of the Treasury.

Chairman PROXMIRE. Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

In the interest of brevity, I shall just ask one double-headed question.

Before I do that, I want to welcome Mayor Lindsay as an old friend and fellow Member of the 86th Congress club to the committee.

My question is on the subject of welfare reform. Forgetting the dollar limit, the $1,600 limit, what is your opinion of the administration's family assistance program?

And, two: You have called for the establishment of uniform levels for benefit payments. How can that be achieved when the cost of living varies so much from area to area within a State, or from State to State?

Mayor LINDSAY. Well, the second question first.

It is desirable to shoot for that as much as you can. The more you can even this thing out across the country the better possibility you have of cutting into the base problem here, which is how are you going to make it possible for all of our people to live decently? In those areas which have disastrously low levels of support, I think it is highly desirable to encourage higher levels of support. That kills several birds with one stone.

It may tend to discourage migration. Certainly, it is going to energize communities to undertake social adjustment and reform where they are needed.

There are ways also to adjust for the cost of living problem and, in fact, that was the House version. The Senate bill included incremental percentages above the $1,600 level that, in a sense, were addressed to the problem, too.

In answer to your first question about the family assistance program that steered its way through the House, which in the most part was an administration bill, I think it was basically a good bill. We would like to have another shot at it. Throughout that whole process we sought to change it, develop it, and to introduce into it things that we thought, from our end, at least, would be improvements.

We think the bill can be improved this year. We think it is most unfortunate that it failed in the last Congress—but we still believe that the principles which it sought to establish were sound.

I want to add that the House bill, in itself, from a fiscal point of view, was not of great benefit to New York City. We estimate somewhere in the nature of $50 million would have been our relief, which, when you compare it to the $600 million out of our own city budget that we have to commit to welfare by State and Federal law, is very small.

That is one reason why we were pressing for adjustments to it that would give us the kind of fiscal relief that we also need. But the principles that are contained in the bill, however, we think are good, and we hope very much that the 92d Congress will move on it.

Representative MOORHEAD. I hope so, too. I think even if it is not adequate, it is a first step, and we should take that first step.

Chairman PROXMIRE. Mayor Lindsay, I do want to ask you one question. The time is late and Governor Shapp has been most patient to wait. I apologize to him. But I cannot resist asking about this very serious problem of a limit on Federal spending that we are likely to get approved by either the administration or by the Congress this year.

As I understand it, all the talk has been that the Nixon administration will come in with a budget calling for $230 billion of spending, and revenues of about $215 billion, a calculated deficit of about $15 billion. This is justified by those who advocate it on the grounds that if the economy were operating at full employment, revenues would rise and, at the same tax rates, to $230 billion. As I understand it, as I said, Walter Heller and most people in political life and the economists who support the views that he has, feel that this is a great triumph and feel that it is good to have President Nixon on the side of a full employment budget concept.

President Nixon said he was a Keynesian, and this is the meaning of it. What this means, and the reason I am asking you this question is we have to come down very, very hard on where the money is coming from out of the Federal budget. You suggested about $5 billion, I recall, perhaps out of reducing defense spending. There is no leeway going much above that $230 billion. So the $5 billion out of defense spending, in my view, would fall far short of financing what you are asking us, in addition to what we are expecting to get from the administration's request.

Maybe in space, maybe in public works, maybe in some of these other areas, we can make some cuts. But because you were a very able Member of Congress and a brilliant man, I thought maybe you could help us.

Mayor LINDSAY. Thank you for both of those compliments.

Again, I do not know what the administration is coming forward with in its budget requests in February. What I do suggest is that a $5 billion reallocation from current on-going defense-related activities is not going to endanger the country in the slightest. I think that there is qualitative support for that view among knowledgeable defense experts.

Second, in today's economy, which is a recession economy—and we feel it in New York desperately, even though less so than in most other parts of the country—an additional $5 billion spending rise is not inappropriate. If the President and the members of this committee regard themselves as Keynesians, there is nothing at all amiss or wrong—in fact, it is highly desirable—to add to your present levels of spending. That, in our judgment, is probably necessary.

Chairman PROXMIRE. You see, this is what I understand the President to be saying he is going to do in asking for the moneys he is going to ask us for in 10 days or so. He is going to come in with a request of $230 billion, which will do exactly that: it will ask for more for spending than he expects to raise in revenue. He is going to do what Mayor Lindsay has suggested to us here this morning.

But the $5 billion, it seems to me, is unlikely to be enough.

Well, I think you have done a fine job throughout the years in pointing to softness in our budget. I hope you continue that. I understand you are an opponent of SST, which makes me very happy.

I understand you are also an opponent of other programs which I consider low-priority programs. It is a great help to us in Congress, who are fighting what we feel is a misallocation of our limited resources, to know that.

Thank you very much, Mayor Lindsay. You have been most helpful.

Mayor Gibson, I want to apologize. We thought we would have more time to have a go-around with you and Mayor Lindsay and Governor Shapp. But we have only half an hour left and Governor Shapp has been most patient in waiting this long. So we will dismiss you, with many thanks for an excellent job which will be of great help to us.

Mayor GIBSON. Thank you.

Mayor LINDSAY. Thank you.

Chairman PROXMIRE. We shall ask Governor Shapp to come forward.

Governor Shapp, we want to welcome you to the committee, congratulate you on your election. I have heard many very fine things about you and your colleagues and friends in Pennsylvania. Joe Clark is one of my dearest friends. We named our boy after Joe Clark and Senator Douglas—Douglas Clark Proxmire.

Governor Shapp, you have been in office 3 days now, and I understand that at the moment you are a Governor without a cabinet. Of course, we know that is a temporary situation.

You are also, we know, Governor of a State with a tremendous financial problem which will not go away easily. We appreciate your taking time to meet with us this morning. We want to hear more about your financial problems because, unfortunately, they typify problems found throughout the country.

We want to know both what you propose to do about these problems and what you feel the Federal Government should do toward contributing to their solution.

I am going to call on Congressman Moorhead, who is a senior member of this committee, to introduce you.

STATEMENT OF HON. WILLIAM S. MOORHEAD, A REPRESENTATIVE IN CONGRESS FROM THE 14TH CONGRESSIONAL DISTRICT OF THE COMMONWEALTH OF PENNSYLVANIA

Representative MOORHEAD. Thank you, Mr. Chairman.

As a member of the committee and as a Representative from the Commonwealth of Pennsylvania, I am proud to present to the committee the No. 1 citizen of the Commonwealth of Pennsylvania. I am proud particularly because I know the kind of testimony that Governor Shapp will present to the committee.

Governor Shapp is not only a student and a scholar of the economy of the Commonwealth of Pennsylvania, he has also proven himself a very practical and very successful businessman in Pennsylvania. So I think the testimony he will give us is not only going to be scholarly but practical. He has been a Governor just a few days, but he has been a student of the economy of Pennsylvania for a great many years.

I am sure that this committee will benefit greatly from the testimony of Governor Shapp.

Chairman PROXMIRE. Governor Shapp, proceed in your own way. If you abbreviate any part of your prepared statement, the full prepared statement will be put in the record.

STATEMENT OF HON. MILTON J. SHAPP, GOVERNOR OF THE COMMONWEALTH OF PENNSYLVANIA, ACCOMPANIED BY JERRY TUECHE, AIDE TO THE GOVERNOR; AND PAUL J. SMITH, SPECIAL ASSISTANT TO THE GOVERNOR FOR LABOR

Governor SHAPP. Thank you, Mr. Chairman.

First, I want to thank Congresman Moorhead for his very kind remarks. I hope that I live up to the promises that he has made for me.

I am delighted, Mr. Chairman, to appear before this committee to express my views on the fiscal problems of the States and their subdivisions, and for my own State in particular.

We have long heard eloquent words about the glory of our federal system and the need to strengthen it. We have heard Presidential pleas for creative federalism and new federalism. Unfortunately, they have remained words without substance.

Today many of our States and cities face serious financial crises and are in danger of bankruptcy. Unless the Congress of the United States directs its attention immediately to the financial problems confronting local and State government, we risk national chaos. No lip-service to federalism of any brand, no matter how eloquent, can alter this stark reality by one iota.

On Tuesday of this week, January 19, I was inaugurated Governor of Pennsylvania. Our situation is so serious that within 30 days the Commonwealth will be out of money and unable to meet some of its obligations.

Pennsylvania will be short $65 million in cash by the end of February and $331 million by the end of June unless new revenue of a nonloan type is in hand by that date.

I have already taken steps. Yesterday I started on my austerity program in the State and started to make cuts in the budget.

Because of our constitution, we are not permitted to have a deficit or owe money at the end of our fiscal year which is June 30.

However, just to maintain existing programs already mandated—no new programs of any sort included—projections indicate that Pennsylvania faces a revenue deficit of $476 million by the end of June 1971, and $1.55 billion by June 1972. Our two major cities—Philadelphia and Pittsburgh—are pressed for funds, as are many of the smaller cities within the State.

The cash and revenue deficits may rise even higher. Actual income continues to lag projections while expenditures rise to meet increased costs of welfare and education. Also, we face new public employee salary demands.

The financial stringency we face in Pennsylvania has already affected the education provided to the State's children. We will be forced by February 1 to postpone State subsidies to our public schools. Our assistance program for the medically indigent—Pennsycare—no longer is able to meet its bills.

We talk here not only about dollars but also about the people who suffer from their lack; the very fabric of our federal system is endangered by the threatened breakdown of State and local government.

Because our States are unable to find adequate revenues, our communities face disaster. The city of Philadelphia has been scrounging for new sources of revenue for public education and the schools of that city may be forced to close early unless some $85 to $90 million in new school operating funds are found. Compounding the financial problems of Pennsylvania cities is a recent State court decision holding that local governments may not tax in certain areas where there is State preemption.

We recognize that Pennsylvania has an obligation to help itself. We intend to do just that to the limit of our ability. As Governor, I shall soon propose a tax program to meet our constitutionally mandated fiscal responsibility. We are still among those States without a personal income tax and we recognize that we can no longer raise needed revenues without such a tax. We recognize the need for major tax reform and the program proposed by my administration will seek a just and equitable program limited, of course, by the constitutional prohibitions with which we must live.

I would point out, however, that even after these things are done, Pennsylvania will continue to face fiscal crises and that the financial problems of our cities will remain as acute as ever. I point out also that the enactment of an income tax and the imposition of local and State sales taxes as well as a whole hodge-podge of business and other taxes have not solved the fiscal crisis in other States and cities.

Pennsylvania has recently enacted the most advanced public employee collective bargaining law in the Nation. Our State seeks to be an enlightened employer, and it is our view that public employers have an obligation to be good employers.

We know that State employees' salaries in Pennsylvania lag, and that schedule must be modernized if we are to have effective government. State workers feel the same pangs of inflation as do those in private employment.

I indicated though that the deficits I mentioned would prevail without any new programs. Yet there are unmet needs. Pennsylvania needs to upgrade its educational system and to provide modern mass transportation. Our health care delivery system must be strengthened, particularly our preventive programs. We face appalling problems of air and water pollution control, and of solid waste disposal. The list of what must be done by our State is formidable. We have the will, but the tax base upon which we must depend is too narrow. We give to the Federal level much more than is returned; our people already groan at the increasing load of State and local taxation.

The chairman of your Joint Economic Committee, in announcing these hearings clearly outlined the problem. In listing the areas to be covered by your hearings, he pointed to:

"The sharply deteriorating State and local financial situation which now threatens local governments' ability to provide even minimum services."

Clearly, steps must be taken at the Federal level to restore viable State and local government. We have a number of proposals which, if legislated by the Congress and approved by the President, would do much to alleviate the ills that presently afflict the sovereign States and their subordinate units.

We propose first that the public assistance programs of the Nation shall be completely federalized. We would propose a role for the States and protection for present State employees in the administration of these programs. We point out that now the State employment services are contracted by the Department of Labor to the States and that the State employees involved are paid with Federal dollars. We propose options, permitting a similar arrangement for federally supported welfare.

Next, a hard look at assistance programs is in order. These are federally established programs, but in those States seeking to provide a minimum standard of health and decency to people on welfare, the States alone or the States and their local governments together now bear the lion's share of the load.

Economic recession, low wages in the face of inflation, greater understanding of rights under law, suspension of residency requirements, population growth and other factors have combined to increase Pennsylvania's assistance load by monumental proportions. In November 1970, some 735,000 persons received cash welfare grants, and an average load of 752,000 is projected for the current fiscal year. This will rise to over 850,000 by next year.

There is fearful ignorance concerning the nature of the welfare recipient. For many in Pennsylvania, present welfare programs are already a family assistance plan. Actually, welfare in Pennsylvania, as in some other major States, provides a subsidy to low-wage industry. In November of 1970, 35 percent of all welfare recipients in Pennsylvania earned wages. They applied for welfare assistance and received it because their earnings were too small to support their families at the standard set by our State as a minimum needed for health and decency.

The current recession has deepened markedly since fiscal 1969 and, as your chairman has noted, there are currently 5 million jobless and another 2.5 million able to find only part-time employment. In fiscal 1969, nearly 200,000 Pennsylvanians applied for public help as a last resort because of loss of jobs or because of reductions in earnings due to such factors as part timing.

Some 387,430 of those depending upon public assistance in Pennsylvania were children under 18 years of age. Some 60,500 were persons over 65 seeking to subsist on meager social security payments or other retirement benefits or ineligible for such payments. Some 36,000 received payments because they were permanently and totally disabled and generally unable to work. There were 162,000 adults between 18 and 64 who received ADC benefits, almost all others unable to work, even if they desired to do so, because they are tied down to care for their small children.

Clearly, this Nation would face a massive increase in crime and social unrest without its welfare programs. These programs were established by the Federal Government because misery knows no State lines and the problem is national.

Public assistance, including medical assistance, will cost a billion dollars in Pennsylvania during the present fiscal year. The Federal contribution will cover less than half the cost, $467.5 million; the State must raise $563.7 million to meet the costs of essentially Federal programs.

We welcome the concept of the family assistance plan which, as we pointed out, has long existed in substance in our State. But the plan, as put forth by the Nixon administration, is woefully inadequate. The $1,600 minimum income proposed for a family of four is less than half of our average assistance for such a family wholly dependent upon public funds. Pennsylvania's costs would be little affected. It seems incongruous that one agency of the administration should establish poverty level incomes and yet Congress should be considering aid to the poverty stricken at a mere fraction of this poverty level.

We are also opposed to the no-work, no-eat concept in the FAP as an uncomfortable approach to involuntary servitude. We do not believe that any child should go hungry because his parents cannot or will not work at any job offered. I know that there has been a denial that this would happen, but I must point out that there have been proposals to pay FAP recipients as little as $1.20 per hour. I raise my voice along with the many who oppose any attempt to use a welfare program to create a cheap labor pool that must inevitably undermine national living standards.

There are two conditions for a successful FAP: a national goal of adequacy based upon a minimum standard of decency and full Federal payment. We are for reform of the present welfare system, but are of the view that major reform means full federalization of costs.

Pennsylvania would have upward of $600 million annually through federalization of public assistance. In this event, I would propose, as Governor, that the Commonwealth of Pennsylvania move quickly to relieve local communities of almost all costs of public education. This, in turn, would permit the municipalities to use their limited available revenues for the other essential services they must supply.

With the State assuming payments of all or about all of public education costs, there will be a fairer distribution of funds as between the inner city and the suburb. Rural areas, now shortchanged by limited tax base, would also benefit. There would be more State money for such essential human resource upgrading as adult education, occupational training, and vocational education. More money could go to the community college which, in many instances, represents the hope for the future for youth from blue-collar families and from minority groups.

As Governor of a State with a monumental fiscal problem and a limited ability to tax, I endorse meaningful revenue sharing. However, I do not endorse such sharing as a substitute for categorical programs.

I must emphasize that no proposal will be effective if the intention is to introduce a new program at the expense of one already in existence. I am deeply disturbed by reports indicating that the Nixon administration is considering drastic cutbacks in its fiscal 1972 budget for urban renewal, model cities, Appalachia, and other programs in an apparent move to provide funds for the President's forthcoming $2 billion revenue-sharing plan.

These programs to be eliminated are necessary and Congress is entirely within its rights in determining the purpose for which categorical grants shall be made. If anything, categorical grants in education, health, transportation, urban renewal, and the like must be substantially increased during the coming months.

Nonetheless, our States and cities will require substantially added revenues for general State and local government purposes. There are many specific areas that categorical grants cannot or do not reach.

Some States require funds to meet special needs, and Pennsylvania is a case in point.

For example, we need public money to retrieve and restore our vast acreage of stripped-out coal lands. New York, Delaware, et cetera, have no such problems. Revenue sharing for general State government purposes will help us to solve a myriad of such problems, and permit us to meet State priorities. Categorical programs, on the other hand, are needed to meet national priorities in all States.

I would like now to get to the guts of this program. As Congressman Moorhead had said, I have a business background, and I have usually found it is one thing to discuss problems and another thing to develop programs to deal with the problem. I wish to present some things I think the Federal Government can do and should do in helping to solve these problems.

STATE DRAWING RIGHTS

We need greater flexibility in the distribution of Federal funds, whether as revenue sharing or as categorical grants.

Importantly, when needed, States should be able to obtain in advance—in the form of Federal drawing rights—moneys that are due us under Federal grant formulas in any given fiscal year. This, in effect, will provide a fiscal shock absorber for State and local governments to permit better fiscal planning of their finances, and to prevent chaos when they run out of money. Most cities and States have no shock absorber at present because, unlike the Federal Government, even in cases of dire emergency, they cannot resort to deficit financing.

Without such a special drawing rights plan patterned after International Monetary Fund agreements and quite similar to Federal Reserve arrangements to rescue hard-pressed banks, many States and cities within the rather near future may be forced to severely slash vital services to their citizens. The resultant chaos could rock the structure of our society.

We already have rescue plans for private industry.

Congress recently agreed to guarantee loans made by banks to private corporations such as Penn Central and Lockheed. If guarantees are provided by the Federal Treasury to the Penn Central, why not to Pennsylvania? If they are provided to Lockheed, why not to Lock Haven?

The Federal Government can help our cities and States in still another way and save enormous sums of operating funds for them.

Our States and cities today pay ever higher interest rates because of inflation, but because the lenders look upon States and cities as increasingly poorer risks, the interest rates are not prime. Our States and cities must borrow billions upon billions over the next decade.

I propose that a Federal agency shall be established either to make loans or preferably to fully guarantee loans made by our cities and States. This would lower the interest rate and save millions of dollars for State and local taxpayers. We have such a guarantee plan for steamship lines under the Federal Maritime Act. Certainly our States and cities are at least equally worthy of similar support. As a Governor, I would be happy to accept Federal guidelines on the kinds of loans that would be guaranteed.

I might add that in the 1940's a Federal fund was set up to make loans to States to aid their unemployment compensation funds. In

1958, Michigan, Alaska, and Pennsylvania were eligible and took advantage of this. Pennsylvania borrowed $112 million from the Federal Government for its U.C. fund at no interest. This money was paid back during the sixties.

This is the type of flexibility that I think has to be added in our present system to aid cities and States.

HOUSING FUNDS

This Nation now suffers a serious housing crisis and the experts advise that at least 2.5 million new moderate- and low-cost housing units are now needed annually. Money is available already to solve at least part of the problem.

The Nation's middle and upper income families increasingly are turning to such devices as condominiums—single-family home groupings and apartment units—to solve their housing problems. It is my belief that this kind of approach can be used to solve the housing needs of our poorer citizens.

Pennsylvania today pays $140 million annually as rent for families receiving public assistance. Most of this money goes to owners of substandard housing. Of this, $77.5 million represents State funds and $63.5 million is Federal.

Given Federal mortgage guarantees, these funds could be used to pay for condominiums and other low-cost housing. With homeownership there will be a stake in our society for the working poor and, yes, even the welfare recipient now entirely dependent upon public funds.

This and other housing programs are urgently needed to answer the Nation's needs and to stimulate employment. I urgently plead for action in the Congress to develop programs to carry out the promise of the Housing Act of 1949.

IMPACT OF INFLATION

Two years ago—in March 1969—I appeared before the House Banking and Currency Committee as a private citizen. I then warned that we would obtain the worst of all possible worlds from then existing fiscal and monetary programs. I warned that tight money and high interest rates would not stop inflation but would instead fuel the fires of inflation and that result would be both rising unemployment and rising prices. Pennsylvania and all America has since suffered these twin evils.

Inflation and unemployment can be curtailed only by once again resorting to programs of full employment and maximum production.

Money costs have recently come down, only because of a decline in the demand for funds resulting from record interest costs and a serious slump in business activity. However, it would be folly to believe at this time that the monetary and fiscal policies by themselves can induce greater business activities. You can brake a car and stall the economy. But, it must be fully understood that you can't start a car again merely by removing the foot from the brake pedal.

Further, it is my contention that the $2.5 billion tax benefits recently granted to business will not by itself induce new plant expansion. This plan will merely result in an additional deficit of $2.5 billion in our Federal budget. Corporations expand plant facilities when there is a demand for their products. Business will take advantage of all tax breaks tossed their way but will not decide to build new facilities because of tax gifts.

To really stimulate the economy we need programs of investment in people, and in the development of resources and transportation. These types of investment would lead to full employment and increased productivity and lower the cost of government.

These programs would also increase tax revenues for cities and States as well as for the Federal Government.

The Nixon administration now makes a virtue of a budget deficit resulting largely from the slack economy of the past 2 years. It is my hope that the President means it when he talks about a full employment Federal budget. Meanwhile, I urge the Congress to help the process through full funding of authorized programs. Nobody is fooled any longer by authorizations in the billions but appropriations that are mere tokens.

Lastly, I urge Federal standards of unemployment compensation and modernization of the entire unemployment compensation program. In August 1965, I testified in this regard before the House Ways and Means Committee. It is next to criminal to permit the States to compete with each other for industry at the expense of jobless workers. We have a national minimum wage; surely, we need national standards for workers deprived of wages through no fault of their own.

It is my hope that the hearings of this committee will lead to action that will help those of us responsible for State and city government to meet the needs of our people. There is much we can and must do for ourselves, but we need Federal help.

I come here today to plead for it.

Thank you very much.

Chairman PROXMIRE. Thank you, Governor Shapp. I can see why you won the election. I can also foresee some exciting and stormy years in Pennsylvania in the next few years. You are a very imaginative Governor and you have, of course, this excellent business background, a smashing success in business, with all kinds of interesting proposals.

This drawing rights proposal I have never heard of before for States. I think it makes a lot of sense. And the guarantee of loans from the Federal Government, use of condominiums for housing—a number of programs that I think are going to be very useful.

Pennsylvania does not have a State income tax, does it?

Governor SHAPP. At the present time, no. It will have by late spring.

Chairman PROXMIRE. And the tabulation we have here shows that it is in the same position, pretty much, as New Jersey in terms of tax effort. In fact, it is rated, as I recall, 46 out of the 50 States in tax effort. Do you feel that if Pennsylvania had an adequate revenue system by itself, and if we had a recovery of the economy so that there were fewer unemployed and so that businesses were able to pay more in taxes to the State government, your problems would be generally solved?

Governor SHAPP. No; for several reasons.

First of all, I think we have to look at what is really happening today with the use of taxes. Industry uses each State in a whipsaw type of arrangement, trying to get all kinds of special tax loopholes. For example, last year the city of Philadelphia passed a 5-cents-per-share tax on all transactions at the Philadelphia-Camden Stock Exchange. Industry—the exchange—responded by moving their headquarters to nearby Montgomery County, where they would no longer be subject to the Philadelphia tax.

Now, if Harrisburg—the capital of Pennsylvania—should have passed such a tax, the exchange could have moved to Camden, N.J. Only the Federal Government has uniform taxing powers, and only the Federal Government, by its taxing powers, can provide funds that are necessary and distribute them back to the States.

Chairman PROXMIRE. That has a lot of merit. I have been familiar with that argument. When I was in the State legislature in Wisconsin, and running for Governor—unsuccessfully—in Wisconsin, I ran into that problem there. We are a high-tax-effort State. We have a very progressive income tax. But as I recall, most of those who were experts in the location of industry argued that this was one of the last elements in locating an industry. More important are the services—educational services, transportation services, and other things largely supplied by the tax revenues.

Governor SHAPP. You are absolutely right. But when you have a State that has historically been controlled by big business, like Pennsylvania, you find all sorts of loopholes in the tax structure. So we have not had the funds to develop a modern transportation system, to develop our education system and other needs.

As a result, when we get hard times like we now have, we do not have the tax base, nor do we have the educational system. So we have to start off with trying to achieve both. This is a very difficult problem.

At this particular moment, even if we pass an income tax, and I expect to put through major tax reform in our State and have an income tax sometime early, it is desperately needed, because without it——

Chairman PROXMIRE. Did you campaign on an income tax program?

Governor SHAPP. Yes; during my campaign I leveled with the people on what the problems were, and indicated that there would be an income tax. My opponent promised that there would be no new taxes. The people recognized that they had a responsibility and responded accordingly.

Chairman PROXMIRE. You put a lot of emphasis on the Federal Government moving in much more constructively and helpfully in welfare, and you spelled that out in detail. You put somewhat less emphasis on the revenue-sharing area, and indicated that you are not interested in a program that will simply take money out of categorical aids and put them into revenue sharing.

How would you relate federalizing of welfare, revenue sharing, and perhaps a Federal job program—those three approaches—in terms of priorities? Which would you rate first, second, or third? I know you want them all, but if you could have any of them?

Governor SHAPP. On a priority basis, the first thing is for the Government to take over welfare.

Chairman PROXMIRE. That is No. 1?

Governor SHAPP. It would be No. 1, for this reason: Welfare costs are out of our control. Welfare costs rise with unemployment. And when the Nation catches an economic cold, Pennsylvania gets pneumonia. With our heavy industry we feel the impact of unemployment first, and we are the last to respond when there is an upsurge in the national economy. As I indicated in my statement, we have no control over these Federal policies that are causing a national recession, yet these Federal policies are creating severe hardship in our State and astronomically increasing the welfare load. They are driving the welfare load up, and we cannot control it.

So I would rather have a situation where something that is uncontrollable in our State is assumed by the Federal Government, and that is our reason why assumption of the welfare load is the No. 1 priority.

If the Federal Government takes that off our hands, then we can control some of the other things. We will be back asking for more money, but I would not come back for more money then for what I call an expense credit.

In operating my business, I separated capital items and operating costs in my budget. I wish the Federal Government would do that and that we would start doing that more in the States. For example, we talk about this $230 billion budget that the President is going to propose. It is not really a budget; it is a cash expense sheet.

Until we start putting the Government on an operating basis that separates out those items that are indeed investment from expense items, we will not be operating on a businesslike basis.

Chairman PROXMIRE. I could not agree with you more. We need a capital budget, a capital, and then a separate expense budget; but, of course, as Mayor Gibson said—and I am sure you realize as successful and practical businessman—you have to deal with what you have.

Governor SHAPP. Yes. You asked for my "druthers"; I gave you my answer.

Chairman PROXMIRE. Congressman Moorhead, let me ask just one more question. My time is about up.

Representative MOORHEAD. Surely.

Chairman PROXMIRE. How do you feel about the Federal jobs program that has been proposed? We had one bill last year before us which would provide training, job training, as its heart. Then it would also provide jobs in State and local government, primarily in local government, for those who are trained so that you do not have a situation of unemployment during this period, where you train people and there is nothing for them to do.

This would be phased out when you get to below 4½ percent in unemployment.

Governor SHAPP. I believe that the more we train people, the more productive they become, the less they demand of Government services. We have proved that, I think, in the Manpower and Training Acts of the early Kennedy administration. These were investments in people, and they paid off.

I was disappointed to see the veto of the bill recently that eliminated these manpower training provisions, because I think they are absolutely essential.

In Pennsylvania, recent studies showed that 78 percent of our welfare load came from people who had not gone past their eighth grade in school. Another 25 percent on welfare were those people who had finished high school, but only 3 percent of the people on welfare had had any post high school education of any kind—vocational training, technical training, or academic training in greater continuing sums.

I think those statistics are alarming, but they also show that if we put the money into education, we are not going to have to pay out in welfare.

Chairman PROXMIRE. Of course, the crux of it, the heart of the problem in Congress was that the Congress wanted a job-training program that was keyed to jobs in periods of unemployment, and put a lot of emphasis on that. Our feeling is that in a period of high employment and very low unemployment, you do not need a job-training program so much, because industry will go out and get people and train them.

Where you have unemployment, you must have the jobs, or you are going to have heartbreak. You are going to have people spend the time and the discipline of going through a training program and having nothing for them to do.

Governor SHAPP. This is true, but I think if you get a trained work force and, as I indicated here, make major investments in developing our people, make major investments in transportation and developing and protecting our resources, you are going to be stimulating the economy and you are not going to get these types of situations that we have at the present time.

Our present problem is caused by our failure to do these things in recent years.

Chairman PROXMIRE. Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

Governor, this is an excellent statement, very imaginative and very helpful. I might say that your comments about guaranteeing loans to Penn Central and Lockheed fall upon sympathetic ears in the members of this committee here present.

Governor, Mayor Lindsay referred to our current economic situation as an inflationary recession. I think most people understand how it affects them as individuals, but I do not think it is as well known how this affects State and local governments.

What has been the effect on the financing of State and local governments that has resulted from national economic policies that have brought us this inflationary recession?

Governor SHAPP. There are several ways. I shall name two.

First, because of our failure to maintain what should be a normal rate of increasing productivity over the recent years, certainly since 1965, our productivity has sagged to such an extent that a serious revenue gap is developing between what we should have had with the normal productivity and what we are now getting.

If you take that back into Pennsylvania alone, you find that the Commonwealth and cities are suffering a loss in annual revenue at existing tax rates of almost $600 to $700 million because of the reduction in corporate net income, reduction in sales tax increases that should have been incurred because of the failure of the State to grow and find greater job opportunities, because of the adverse impact this has had upon real estate valuations, and matters of this sort.

Then, second, you have the other side of this coin, which is the fact that because we have not maintained programs leading to full production, full employment, and higher productivity, we have greater costs on government. Our welfare costs soar. Our programs for health services soar because more people have to depend on government to furnish health services. So it costs us double: higher costs and lower revenue.

As soon as we realize that the fiscal and monetary policies we are following at the present time are going to lead to not solving a depression, not solving anything, but just creating problems, the better off we are going to be.

Chairman PROXMIRE. Will the gentleman yield?

Representative MOORHEAD. I have been called to the floor of the House, so I shall yield to you permanently, Mr. Chairman.

I regret I have to leave, Governor.

Chairman PROXMIRE. Governor, I just have to reinforce what you answered to Congressman Moorhead. I calculated in my opening statement, before you came, that the cost of the recession to State governments, all things considered, the additional prices they have to pay, the diminution in their revenues, and so forth, added up to about $10 billion.

To the best of my knowledge, Pennsylvania has about what, 6 percent of the national welfare population?

Governor SHAPP. Yes.

Chairman PROXMIRE. Six percent of $10 billion is about $600 million. So it comes out just about the same. So it is clear that the contribution of a more prosperous America, a full employment economy, with reasonably stable prices, would be equivalent to a revenue-sharing program of $10 billion. You tell us that would not be enough, because you do have serious problems.

It would be a big help, obviously. We have concentrated so much attention on whether or not we can have this revenue-sharing program, which I think many people would like to have, that there has been very, very little attention given to the very salutary effect of a vigorous program of economic expansion. This could have as salutary an effect on the States and localities as revenue sharing.

Governor SHAPP. I think if you just go through the Nation right now, you can tick off some of those counties and communities that do not feel the impact of these conditions, because for whatever reason, they are still in a stimulated economy and they are not facing a problem. But it is in our major cities and rural areas alike that we really feel the major impact of this.

Now, I think that we have to recognize that when a business does not make proper investments, operating costs rise. We have not been making proper investments in Government, so our operating costs are rising. I can give a specific example of this.

I think one of the reasons our cities are in such dire straits today is because we failed to recognize a major premise of business economics: no business firm, A.T. & T. or whoever it may be, can long stay in business if it tries to finance its major expansion programs out of current operating revenues. Education is an investment in our young people that takes 15 to 20 years to pay off before they start to earn money to contribute back to society.

We are financing all of the education in our cities out of taxes that are collected on a yearly basis, but making this long term investment. As a result, with over half of our current revenue going into education, we do not have any money left for other needs an so we are cutting down on our investment in education.

I think what we have to do is start looking at some of these long-term investment programs and finance them on that sort of basis, not out of tax collections. I shall be very glad to prepare some information on this particular subject of education, on how we can have a program of financing education that will be self-sustaining, through a surtax.

Chairman PROXMIRE. That will be helpful.

Governor, I think liberal men like you who are deeply committed to programs of assisting your fellow man and deeply committed to humanitarian programs of all kinds have been inclined over the years to assume that the Federal Government can expend money without a financial disaster. I think you were here when I questioned Mayor Lindsay on the limitation on the amount the Federal Government is likely to be able to raise.

You may agree or disagree with that. But on the assumption that the Federal Government is not going to raise more than, say, $230 billion, and on the assumption that both you and Mayor Lindsay and Mayor Gibson have asked for programs that would greatly exceed what the President is likely to provide in his budget, where would you suggest to us in Congress that we could make reductions in Federal spending that would be responsible and, at the same time, free funds for these vital purposes for which you are asking?

Governor SHAPP. I would say, first of all, before we start talking about reductions, why do we not do what I plan to do in Pennsylvania, plug some of the loopholes in taxes? When you are talking about $230 billion, if you plug some of those loopholes without increasing taxes on your ordinary citizens——

Chairman PROXMIRE. Governor, I have been here 13 years. I have been trying to do that, as you know; a number of us have been. We passed a bill last year that tried to help some. But it was very limited. Many Senators feel it will be a number of years before we get another big loophole-plugging bill.

In fact, we are likely to suffer in the next few years from some attrition in that.

Governor SHAPP. Then the answer here is you have to start thinking in terms of priorities. I think you have to do this in two ways; one is to establish priorities to take care of the urgent needs of our citizens to prevent a complete breakdown of government.

I think you have seen in New York recently, and in Pittsburgh, that the people there are demanding more services and those who are performing the services are demanding higher pay. The Pittsburgh mayor had to go on the garbage line himself and discuss this with the people. I do not know if we are going to resolve the problems of our cities, but unless we do, we are going to have a complete breakdown.

The welfare people are not going to take cutbacks the way they have before. You have all of your public employees unionizing now, and so on. So we have to think in terms of having the funds put into these programs to prevent the breakdown of government services, or we shall have chaos in this Nation.

Second, there has to be a certain amount of funds put aside for an investment program. As you say, we are not going to have capital budgeting. OK, if we do not have a capital budget, let us recognize the principle of capital budgeting by taking a certain amount of money and putting it into programs that will develop our people and our transportation.

We are crippling this Nation's economy by failing to recognize that we need railroads, and we have to put transit systems in better operation. We have to put railroads back into efficient operation in this country. Until we do this, no matter what we do at the Federal Government, we are not going to solve our problems. By not investing properly we just add to the cost of business. So if we are going to have a better economic base in this country we must invest. If we do not do that, we are going to have problems.

This is my answer: Funds are necessary to prevent chaos, and funds are necessary for investment.

Chairman PROXMIRE. Do you think you can give me a responsible answer to a question I would like to ask you on how much you think we should cut defense? Should we have the SST? Should we continue apace with the manned space program?

Governor SHAPP. I am not in favor of the SST. I do not think, from the standpoint of economics, we would ever get back out of that what it is costing. I think there are serious dangers of pollution.

On the space program, I have been in favor of it and in favor of it for perhaps a different reason than most people have been. I think the research program is absolutely essential. To continue with the development of new products, we first have to have basic research. The space program represents the first time in American history that we have financed basic research, mathematics, and everything else in peacetime.

Chairman PROXMIRE. I agree that we should have a space program with a lot of research, but the question is whether we have instrumented exploration in the next 10 years or manned exploration. The difference is $6 billion a year.

Governor SHAPP. My concern is not with whether we put a man on the moon or put an instrument on the moon. My concern is strictly economics and the development of this Nation through consistent programs of basic research.

Chairman PROXMIRE. So would it be fair to say, in terms of priorities, that you would put a lower priority on manned space exploration than you would on instrumented space travel, and a lower priority on manned space exploration than on welfare relief and some of these other things?

Governor SHAPP. I would not want to answer the question the way you have posed it. I would say part of this investment is in research. You have to have research going on in a country that is going to go forward. I cannot answer the question the way you phrased it.

I can say this, that unless we continue with programs that are of more benefit to the people rather than those being continued just because we are doing it, and there I mean the defense program—we are in trouble. I think we should continue to cut back on Vietnam. I have long been an opponent. I have been saying for many years that I would rather see this money come into southeastern Pennsylvania than being put into Southeast Asia.

It would do a lot more for us in building a stronger country, because we can decay from within easier than we can be attacked from without.

Chairman PROXMIRE. Mayor Lindsay suggested a $5 billion cut in defense. Would you suggest any figure?

Governor SHAPP. You can name your own figure. I think we should be moving in that direction. We can cut back, particularly, on our involvement overseas that is so costly.

Chairman PROXMIRE. Governor, I want to apologize for detaining you and keeping you so long. You are an excellent witness. You have made a fine statement. It will be most helpful to the committeee.

Thank you very much.

Governor SHAPP. Thank you.

Chairman PROXMIRE. The committee will recess until Monday, when we will hear from Governor Gilligan of Ohio; Governor Rockefeller of New York; and Mayor Gribbs of Detroit.

(Whereupon, at 12:40 p.m., the committee adjourned, to reconvene at 10 a.m., Monday, January 25, 1971.)

58-512 O—71—pt. 1——6

ECONOMIC PROSPECTS AND POLICIES

MONDAY, JANUARY 25, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room G-308, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Bentsen, Javits, Miller, and Percy; and Representatives Griffiths, Widnall, and Conable.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Courtenay M. Slater, economist; and George D. Krumbhaar, Walter B. Laessig, and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

This morning we continue our special hearings on the problems of our economy. Last Friday we heard from three eminent public figures thoroughly knowledgeable in one of the most disturbing problems of the Nation—the financial plight of State and local governments. These witnesses—the mayor of New York City, the mayor of Newark, and the Governor of Pennsylvania—presented budgetary pictures bordering on bankruptcy; they face serious and immediate cutbacks in high-priority services—particularly education, police protection, welfare, and housing.

All of the witnesses testified that the intolerable financial bind was in large part fostered by the economic slowdown through which this country is now crawling—excessively high unemployment and continuing inflation, outgrowths of completely inadequate policies now being pursued by the Federal Government.

The stagnating state of the economy is causing serious revenue losses which States and communities cannot afford. Meanwhile, the continuing virulent inflation is causing local government costs of services to climb sharply. Combined, these conditions probably account for $10 billion. In other words, if we were operating at high employment and had inflation under control, the combined budgetary position of State and local communities would be improved $10 billion over their present status. To restore full employment and price stability would be the same as an unrestricted grant of $10 billion to State and local governments.

The witnesses last Friday called for greater financial support by the Federal Government to the State and local governments—far greater, I might add, than was indicated in the President's message—which calls for only $5 billion in new money. This sum has to be considered in the context of the $10 billion shortfall of the States and a Federal budget in deficit to the tune of $15 billion or more.

I listened carefully to the President's state of the Union message and I am sad to say I found it vague on two of the most fundamental issues: economic recession, and aid to sorely distressed State and local governments.

On the depressing economic situation, the only proposals were the full employment budget and a plea to business and labor to make their wage-price decisions in the national interest and their longrun best interest. A deficit alone is not going to get us out of a recession. And the President earlier discarded generalized pleas to labor and management as a cure for the inflationary spiral.

It is obvious to me, as it was, I think, to our witnesses on Friday, that the Federal Government has to revamp its own spending priorities, something that the administration and Congress has never seriously undertaken. I believe that we could unquestionably cut military spending back substantially, as well as spending on the SST, and the manned space effort. Our spending priorities are so twisted that they are placing the country in jeopardy. I don't think we have any time to lose.

The full employment budget would amount to approximately $230 billion, we are told. I don't see how this can provide for an increase in military outlays, continuation of public works and public road construction, SST, plus increased expenses for the other Government programs by reasons of inflation—and, at the same time, provide funds to meet the urgent needs of the States and localities.

Our first witness is Gov. John J. Gilligan of Ohio. He will be followed by Mayor Roman S. Gribbs of Detroit. Both of these officials are from industrialized areas of the country, and, therefore, are most keenly aware of the financial difficulties occasioned by the inflationary spiral, high interest rates, and a recession-plagued economy.

Our third scheduled witness, Governor Rockefeller, will not be able to appear today. I am sorry to have to report that his stepmother died and the funeral services are being held this morning.

Governor Gilligan, newly elected Democratic Governor of Ohio, fought a magnificent campaign against great odds and now he faces even greater odds as he tries to get Ohio's finances back in sound order. He is a former Member of Congress where he served with distinction and he is, therefore, in a position to know what problems we face here in Congress as we struggle with the economic problems of society.

Governor Gilligan, we are very happy to have you and please proceed in your own way.

I might say that we would like to question you and you might abbreviate your remarks if you wish to do so, and your entire prepared statement will be printed in full in the record.

Before you start, Senator Javits has arrived. He is the ranking minority member of this committee and he would like to make a brief statement.

Opening Statement of Senator Javits

Senator Javits. Mr. Chairman, I would like to say that Governor Rockefeller communicated to me personally his regrets at being unable to appear today, which I thought was very gracious of him, and subject to arrangements with the Chair he will appear and testify. I think his testimony will be very important.

Secondly, Mr. Chairman, I think attention should be called in connection with these hearings—and perhaps the Governor would give us the benefit of some thinking on the subject, as will others—to what I consider to be the most alarming piece of news opening this week; that is, the tremendous imbalance between joblessness in the slums and joblessness outside our urban ghettos of America. We need to know how it bears on youth, both white and minority group youth, and even now on white residents of the slums and ghettos.

It seems to me that this phenomenon could pose to us, if it doesn't already, one of the gravest social problems of our time, and we have a most urgent need to do something about it.

I know of nothing, Mr. Chairman, that is more basic than jobs from the point of view of the tranquility of our Nation. It has disturbed our tranquility before and history tells us that it is probably the single greatest reason for the disturbance of the tranquility of any nation in all of history.

And so, I hope very much, that the unusual timeliness of these hearings upon which I greatly compliment the Chair, will be characterized by a very specific attention to this problem.

Last Friday, Mayor Lindsay testified before us on the plight of the cities and the administrative machinery of government at the level at which it touches the citizen most directly. But I am sure he would agree that without a substratum of proper jobs and employment we face an even bigger problem in a lot of cities: lack of public order and lack of structure of society which is indispensable to any kind of order in this Government.

I thank the Chair.

Chairman PROXMIRE. Thank you, Senator Javits.

I might say that the steering committee last week designated—of course the Senate has to act—designated two new Senators as members of this committee. We are losing—appear to be losing—Senator Symington and Senator Talmadge, and we are getting Senator Hubert Humphrey as a new member of the committee, and we are delighted that Senator Lloyd Bensten of Texas, a man with a splendid business background and a man of unusual competence, has also agreed to serve on our committee.

I have invited Senator Bentsen to be here this morning and will be delighted to have him take part in the questioning, too.

Senator BENTSEN. Thank you, Mr. Chairman.

Chairman PROXMIRE. We are also happy, of course, to have Congresswoman Griffiths.

Governor Gilligan, go right ahead.

STATEMENT OF HON. JOHN J. GILLIGAN, GOVERNOR OF THE STATE OF OHIO, ACCOMPANIED BY HAROLD A. HOVEY, DIRECTOR OF FINANCE; DAVID C. SWEET, DIRECTOR OF DEVELOPMENT; AND BRUCE L. NEWMAN, DIRECTOR OF URBAN AFFAIRS

Governor GILLIGAN. Mr. Chairman and distinguished members of this committee, I am honored to have this opportunity to appear before the committee to express my concern over the impact of national economic conditions on the people of Ohio, and their government, and to urge this committee to seek ways to improve the national economic climate.

I would say at the outset, Mr. Chairman, that I have with me today Mr. Harold A. Hovey, finance director of Ohio, who has achieved the age of 32, Mr. David Sweet, head of our department of development, who is 31, and an older man, Bruce Newman, 34, who is head of our department of urban affairs.

The idea is to bring in young people who won't be terrified as those of my generation are by the problems that confront our States today. They approach with a wonderful innocence some of the things that Governors and mayors have been wrestling with for a very long time.

I have brought a prepared statement and will offer it for the record, but in deference to your request, Mr. Chairman, I will summarize it and perhaps then answer your questions or engage in what may be a helpful dialog with the members of this committee.

I have summarized in the opening paragraphs of this statement the impact on the State of Ohio of the declining economy, what it has meant to Ohio to be caught in the vise of an economy which is turning downward, thus placing new demands upon the services of Government—the more obvious ones being in the field of welfare, but there are many others—and at the same time depriving Ohio of the revenues that we need, so we are caught two ways because of this decline.

Senator Javits has asked the specific question on the problem of inner city unemployment. It is a problem I spoke about last week in Cleveland before their growth association because the former administration in Ohio used to boast that Ohio's unemployment rate was 3.8 percent. They used to maintain that that was as low or lower than any State in the Union.

There are various ways of using statistics, but the important fact is that unemployment in Ohio has been going up and has reached alarming proportions in certain areas, particularly in the 28 counties of southeast Ohio which are in Appalachia, and in the inner cities. We have more major cities in Ohio than any State in the Nation. We have eight communities of 100,000 population or larger and in those inner cities we have an unemployment rate running from 13 to 15 percent, and in the younger black population, under 26 years old, unemployment runs as high as 40 percent.

This, as Senator Javits has suggested, leads to stresses and strains within the society which—it seems—we will be hard put to handle.

It is one thing, if you will remember, that unemployment rates throughout the Nation in the great depression of the 1930's ran about 15 percent. We had in those days something close to a revolution on our hands. Today that kind of economic distress is concentrated in certain pockets of the inner city and some of the rural areas and the contrast between that kind of economic distress and the relative affluence of other areas of the State is all too painfully evident to the people who are out of work.

In the current recession, unemployment has reached new levels in other fields. There were articles in the Cleveland papers last week, for instance, that unemployment in the building trades in Cleveland has reached 50 percent. Fifty percent of the building trades people there who are carrying union cards are out of work today. This is going to have obvious repercussions when efforts are made to broaden the membership of those unions to admit minority groups who have been traditionally excluded from membership, because with great justification now the union members and officers can say that they cannot broaden their membership because they can't find work for the men who have carried cards for years in those unions.

We are also having unemployment in white-collar areas that, since the end of World War II, have not known such unemployment—men in $30,000 and $40,000 and $50,000 a year jobs suddenly being turned out of work, men in their fifties who can't qualify for retirement or social security or anything else who were living at a very comfortable level for a very great many years, now totally unable to find work. Under our Ohio laws, they are being offered unemployment compensation of $66 a week, having been laid off from a $35,000-a-year job.

So we are having new kinds of unemployment which we are totally unused to handling. If the economy continues on its present downward spiral, the sociological stresses that result will be extremely difficult to contain.

I wanted to comment a little further about some of the things that were mentioned in the President's state of the Nation address the other night. He was talking about a number of proposals affecting the States and affecting the Federal Government. One of my disappointments in the President's state of the Union message was that no proposals were made for new economic development legislation. Much of this legislation expires this year.

To accomplish many of the goals the President has outlined we will need new measures to encourage economic development in our currently depressed inner city and rural areas. Hopefully the proposed creation of a Department of Economic Development will consolidate many of the programs that are currently scattered throughout the Federal Government. However, legislation will be required to reestablish and redesign these programs. I hope the Congress will act swiftly and decisively in this field.

I would comment as well about the proposal the President made on revenue sharing. President Nixon returned to the subject of Federal revenue sharing last Friday night in his state of the Nation address and referred to a plan which he described as being historic in scope and bold in concept. Upon closer examination of the proposal, however, it is revealed that he proposes a $16 billion investment in renewing State and local governments with $5 billion of this in new and unrestricted funds to be used as the States and localities see fit and with the other $11 billion of new funds converting one-third of the money from the present narrow aid programs into Federal revenue sharing.

In other words, the total of new funds made available to State and local governments would be $5 billion, or under some calculations, perhaps as much as $6 billion.

Compared to current and rapidly escalating levels of spending for State and local government purposes of more than $140 billion, that represents less than a 3-percent increase, while the inflationary spiral of the costs of goods and services continues to rise at more than 5 percent a year.

Thus, even if this bold new program of the President were to be adopted by the Congress, State and local government would continue to fall farther and farther behind, still tied as we are to hopelessly archaic and inadequate tax structures. An altogether different approach must be used, in my judgment, one that I believe will be acceptable to Congress because it assigns the responsibility both for raising revenues and spending those revenues to the same levels of government. It is an approach that reasonably can be expected in the years ahead to yield the amounts of new money which State and local government must have to keep abreast of the demand for public services which only they can provide with reasonable efficiency and effectiveness.

This alternative approach has been suggested by the Advisory Commission on Intergovernmental Relations and by the Committee on Economic Development. They have suggested that some level of State income taxes be allowed as a credit against Federal income tax liability. Such an approach would provide an incentive for States to use income tax more extensively and rely less on property taxes than they have in the past.

Because it is in the "tax expenditure" form, the credit proposals would appear to be politically more feasible to enact. The Congress would not have to worry about taking responsibility for whatever units of State and local government might do with shared Federal dollars. The individual States would have to take the responsibility for raising the new money as well as spending it.

If the Congress were to amend the present Internal Revenue Code to allow full credit of up to, let us say, 10 percent of Federal corporate and personal income tax liability for taxes paid at State and local level, and if Ohio were to enact an appropriate tax reform legislation, we would have available over $700 million in additional resources for our State and local governments, without increasing by one penny the present tax burden borne by our citizens. That compares with less than $300 million that we might receive under the President's proposal if it were somehow to win congressional approval.

The new administration of the State of Ohio asks for nothing more than the opportunity to meet its responsibilities to bear its full share of the problems, to do the job that only State government can do in cooperation with government at the local and Federal levels. We don't want to come to you as mendicants but as full partners in a new and vigorous Federal-State relationship.

In Ohio as well, we can seek to solve some of our structural unemployment problems through good management of available manpower training programs and through targeting our educational system toward work areas offering prospects of secure employment. We can also use government employment itself as one vehicle for opportunities and training for those who otherwise would be unemployed.

I am presently developing appropriate budget and legislative proposals for the consideration of our general assembly. In those proposals I hope to take many steps toward dealing with the economic problems in Ohio. One step we will be seeking to take is the reorganization of State government in order to tackle our economic problems more effectively.

For example, in Ohio we have 23 departments and 110 boards and commissions which can and should be restructured into a more modern and efficient executive establishment. We are currently evaluating how we can more effectively carry out the functions of State government and reduce the duplication of effort which results from the proliferation of governmental units.

I commend President Nixon for his proposal to reorganize the overlapping functions of his Cabinet positions and we hope to do the same job in Ohio.

We will do the best we can in Ohio but our prospects rest largely in national hands. As a former Member of Congress I can sympathize with your problems in trying to get something done about the national economic situation. At the same time I cannot stress too strongly the urgent necessity to get this Nation's economy moving again.

Now, Mr. Chairman, I will try to answer whatever questions you or the other members of your committee may have.

Chairman PROXMIRE. Thank you, Governor Gilligan, for an excellent, brilliant statement. I think this is most enlightening and helpful.

(The prepared statement of Governor Gilligan follows:)

PREPARED STATEMENT OF HON. JOHN J. GILLIGAN

Mr. Chairman and distinguished members of the Committee: I am honored to have this opportunity to appear before this Committee to express my concern over the impact of national economic conditions on the people of Ohio, and their government, and to urge this Committee to seek ways to improve the national economic climate.

As I begin the third week of my term as the newly elected Governor of Ohio, I find the economy of Ohio seriously weakened by national economic forces over which our State has little, if any, control. Unemployment has risen to serious levels; earnings are lower than they should be, because of shorter workweeks and unemployment; interest rates remain high; and consumer and business confidence low. Inflation continues to be a serious problem. In Ohio, as elsewhere, the burdens of these national economic trends fall most heavily upon those who can least afford to bear them.

This situation, coupled with the many pressures driving State expenditures upward, means that the State of Ohio faces a serious fiscal crisis in the months and years ahead. By comparison to other states, Ohio's short term problem is probably less severe, but our long term problem is much more severe.

In our current fiscal year, we have been hit by declining tax revenues that have failed to attain the levels estimated when my predecessor's budget was enacted. Reversing a trend of substantial annual growth, our sales and use tax receipts in the first nine months of 1970 were almost exactly the same as the receipts one year earlier. The fiscal impact of the national economic downturn is even more serious when we consider the July 1, 1970 to December 31, 1970 situation. Estimated general revenue fund sales and use tax receipts were more than $10 million below original estimates, even though those estimates assumed no substantial increases over the prior year. Many of the other general revenue income sources are also showing signs of weakness.

These problems on the revenue side are matched by recession-caused problems on the expenditure side. Inflation has caused escalation in the costs of purchased goods and services and triggered demands by our state employees for pay increases to match increases in costs of living. Our welfare program costs, including Medicaid, are estimated to be over 20% higher in fiscal 1971 than in fiscal 1970 even though Ohio's Medicaid participation, and welfare payment levels, are dismally low, compared to those of other industrial states. Our general fund expenses in the first half of fiscal 1971 increased some 13.5% over expenses of the preceding year.

As a result of these pressures my predecessors instituted an "austerity" program last fall to prevent the state from running out of funds before the end of the fiscal year. This program included a freeze, with limited exceptions, of new hiring and promotions in the State's civil service, and cutbacks of purchasing and printing in order to ensure that the State finishes the fiscal year in solvent condition, I have been forced to continue many of these controls and to institute some new ones. Despite the fact that I campaigned on the basis of my willingness to seek new taxes to get the state moving. I find myself adopting procedures to cut the use of state cars, to avoid printing new forms and letterheads, and even to avoid customary expenditures for printing pictures of the new Governor. With these and other measures, we expect to finish the fiscal year with about enough money in the bank to pay for one day's operation of the State of Ohio, despite continuing uncertainties about two major revenue sources—the sales tax and liquor profits—and concern over continuing increases in welfare costs.

I feel fortunate about this situation—bad as it is—because I know that many of my fellow Governors face financial crises in the current fiscal year that are even more desperate. While my short run situation could be worse, the longer run prospects are dismal.

Primarily because Ohio does not tax either personal or corporate income, and has a sales tax base that excludes the rapidly growing areas of personal services, our revenues simply do not respond to inflation as fast as our expenditures. A recent study has suggested that Ohio's tax structure is the least responsive to inflation of any state in the United States. On the other hand our expenditures in such fields as welfare, education, and the management of our correctional and mental hygiene institutions respond automatically to inflation.

These disparities between our revenue response and our expenditure response to inflation would be serious enough if I began my administration on a par with other states. I do not. By practically all measures available, Ohio has lagged behind other states in practically all areas of state and local services. While spending comparisons are not always an accurate measure of accomplishment, they do indicate something about effort. Ohio ranks 49th among the 50 states in state tax revenue per capita (Attachment 1). As a result we rank last among the states in full-time non-educational employees per thousand population (Attachment 2). Our payroll costs for state non-educational employees put us 48th among the states (Attachment 3). These situations exist despite the fact that our personal income per capita is 15th highest in the nation (Attachment 4). Our combined state and local payroll in relation to personal income in the state makes us next to last among the states (Attachment 5).

Ohio has gotten into this situation, in part, because of eight years of state leadership that was unresponsive to the needs of Ohio citizens. That leadership endorsed the slogan that "profit is not a dirty word in Ohio". That appealing slogan was used as a rationale for making state services, decent medical care, good mental and correctional institutions and a good educational system dirty words in Ohio. Ohio voters in November signaled that this situation should change, and change it will, if I have anything to do with it, even if the solutions cost money, and they will.

My predecessor left me with a budget for the next biennium which vividly shows what would happen if the state were to try to live within the revenues that would be raised by existing taxes. That budget shows that the consequences of living within those revenues would be:

(1) Using up opportunities for one-time savings by manipulating various special funds and accounting procedures.

(2) Refusing to match the increase in costs of living by pay increases to our 50,000 state employees during the next two years.

(3) Reducing the already low standard of living of welfare recipients by refusing to meet cost of living increases.

(4) Continuing very limited participation in Medicaid.

(5) Avoiding new programs of any kind.

(6) Reducing our support of elementary and secondary education despite the virtual bankruptcy of public education in Ohio.

Even excluding all of these possible sources of increased expenditures, the budget left by my predecessors balances only with very optimistic assumptions about a quick upturn in the national economic climate. Obviously, there are some things to be done at the state level, but solutions to these problems are not completely within state control.

I view with concern the fact that Ohio ranked 48th among the states in revenues received from the federal government on a per capita basis in 1969 (Attachment 6). In the most recent available statistics Ohio also ranks 48th in federal government expenditures per capita (Attachment 7). These figures reveal that Ohio has a long way to go in co-operating with the Federal government. Some of the disparaties in federal aid are caused by Ohio's failure to take full advantage of available Federal programs, but another part of the problem arises from the distribution formulas associated with Federal grants-in-aid programs.

Unfortunately, this same factor reduces the value of revenue sharing proposals in our State, since the pending proposals would tend to take more from Ohio's taxpayers than would be returned to state and local governments in shared revenues.

Both in the allocation of grants-in-aid and in the allocation of federal procurement, Ohio does not do as well as it would if it received shares of federal activities proportionate to its population.

Like other States, Ohio has also been hurt by higher interest rates. This is reflected in the fact that my new budget must show substantial increases for debt service costs. These higher interest rates have also affected our political subdivisions, particularly school districts seeking to finance their building programs.

Unemployment has also taken its toll in Ohio, even though our total state unemployment rates are running well below those of the recession in 1961. Our inner city and rural areas have been particularly hard hit. Cleveland. Toledo, Columbus all have inner city unemployment in excess of 13%. Many of our Ohio Appalachia areas have more than 10% of the work force unemployed. Decreasing employment opportunities have, in Ohio, been disproportionately concentrated in durable goods manufacturers and in fabricated metals, machinery and transportation equipment. Construction employment has also dropped significantly. Even fully employed persons are feeling the pinch as the average work week in nongovernment employment has dropped by one hour in the past year, reflecting reductions in overtime.

We all recognize the severity of our current situation. The critical question is what, on our separate levels of government, can we do.

Obviously as Governor of a single state I am not in a position to control national economic forces, even though my success as Governor depends in part upon those forces. We must rely upon you, as Members of Congress, and upon the President, for successful management of the nation's economy to produce growths in productivity and real standards of living, reduced unemployment and underemployment, and reasonable interest rates.

One of my disappointments in the President's State of the Union Message was that no proposals were made for new economic development legislation, much of which expires this year. To accomplish many of the goals the President has outlined we will need new measures to encourage economic development in our currently depressed inner city and rural areas. Hopefully, the proposed creation of a Department of Economic Development will consolidate many of the programs that are currently scattered throughout the federal government. However, legislation will be required, and I hope the Congress will act swiftly and decisively in this field.

Beyond overall management of the nation's economy, we need to be concerned with the proper management of public services. This will require acceptance of responsibility at all levels of government. Many of our most pressing public problems can be traced to the failure of a level of government to accept its full responsibility as envisioned in our federal system. In Ohio, this is most apparent in elementary and secondary education where the state has not fully mobilized its taxing powers for adequate support of schools. We will soon be recommending action to correct this situation. In doing this, however, we will recognize that there are inherent limits on just how far states can or should be involved in the management of education.

Likewise, the Members of Congress should recognize that, while federal action on many fronts is welcome, needed and indeed demanded by the States, there are limits to what the Federal government can achieve. The Federal government does not have the administrative apparatus in individual states and communities to do the job of state and local government. More important, Federal actions cannot readily be tailored to the many different situations of the several states and communities.

Terms like "new federalism", "creative federalism" and similar phrases have been bandied about in this country for decades, as government officials at all levels look for the perfect way to have local, state and federal governments relate to each other. While there may be no perfect way to develop these relationships, there are some steps that can and should be adopted immediately.

The first of these is the reform of the welfare system. The current system is detested by the welfare recipients, by those who administer the system and by those who ultimately pay the bill. The escalation of welfare costs has been a major contributor to the state fiscal crisis throughout the nation. Despite these rising costs, the welfare system does not approach providing the kind of income security-with-dignity that has always been part of Social Security disability and old age insurance. As President Nixon said, "Let us place a floor under the income of every family with children in America." I would add: let us end the administration of welfare through 50 different states with different payment levels and eligibility conditions which created a kind of competition in human misery, that is inexcusable. There is no reason why a citizen of the United States should find that his social insurance benefits vary radically from state to state.

The initiative for welfare reform must come from the federal level. States are bound by the straitjacket of existing categorical programs and a long tradition of administrative rigidity. The vehicle for reform is the Family Assistance Program, offered by President Nixon, or something closely akin to it, which recognizes the basic national responsibilities involved. Congress should act rapidly to nationalize standards for welfare, and to assume the full cost of the program. Thus we could treat all Americans in need equally, vastly streamline the welfare bureaucracy, *and* lift a burden of more than $4 billion from the backs of state and local government.

Action to improve the unemployment compensation system is also long overdue, particularly in light of our current unemployment problems, and the need to keep purchasing power high. I have received a communication from the Secretary of Labor on behalf of the President urging the improvement of state laws governing benefit levels and coverage. We expect to recommend action to our Legislature along these lines.

In its review of state and local financial problems, this Committee will be hearing much about revenue sharing and alternatives to it. My own view, as a former Member of the House of Representatives, is that it would be difficult for Congress to approve the allocation of billions of tax dollars which you take the responsibility for raising, but someone else gets the glory for spending.

President Nixon returned to the subject of Federal revenue sharing last Friday night in his State of the Nation Address, and referred to a plan which he described as being "historic in scope and bold in concept." Upon closer examination of the proposal however, it is revealed that he proposes "a $16 Billion investment in renewing state and local government—with $5 Billion of this in new and unrestricted funds, to be used as the states and localities see fit, and with the other $11 Billion of new funds and converting one third of the money going to the present narrow purpose aid programs into Federal revenue sharing. . . ."

In other words, the total of new, additional funds made available to states and local governments would be $5 Billion. Compared to current, and rapidly escalating, levels of spending for state and local government purposes of more than $140 Billion, that represents less than a 3% increase, while the inflationary spiral of the cost of goods and services continues to rise at more than 5% a year. Thus, even if the bold new program of the President were to be adopted by the Congress, state and local government would continue to fall farther and farther behind, still tied to archaic and hopelessly inadequate tax structures.

An altogether different approach must be used, one that I believe will be acceptable to Congress, because it assigns the responsibility for both raising revenues and spending those revenues to the same level of government; and it is an approach that reasonably can be expected to yield in the years ahead the amounts of new money which state and local government must have to keep abreast of the demand for public services which only they can provide with reasonable efficiency and effectiveness.

This alternative approach has been suggested by the Advisory Council on Intergovernmental Relations, and endorsed by the Committee on Economic Development. They have suggested that some level of state income taxes be allowed as a credit against federal income tax liability. Such an approach would provide an incentive for states to use income tax more extensively and rely less on property taxes than they have in the past. Because it is in the "tax expenditure" form, the credit proposal would appear to be politically more feasible to enact. The Congress would not have to worry about taking responsibility for what every unit of state and local government might do with the shared Federal dollars. The individual states would have to take the responsibility for raising the new money and spending it.

If the Congress were to amend the present Internal Revenue Code to allow full credit of up to 10% of federal corporate and personal income tax liability for taxes paid at the state and local level, and if Ohio were to enact appropriate tax reform legislation, we could have available over $700 Million in additional resources available to our state and local government without increasing by one penny the present tax burden borne by our citizens. That compares with less than $300 Million that we might receive under the President's proposal, if it were to somehow win Congressional approval.

The new Administration of the State of Ohio asks for nothing more than the opportunity to meet its responsibilities, to bear its full share of the problems, to do the job that only state government can do, in cooperation with government at the local and federal levels. We don't want to come to you as mendicants, but as full partners in a new and vigorous Federal-state relationship.

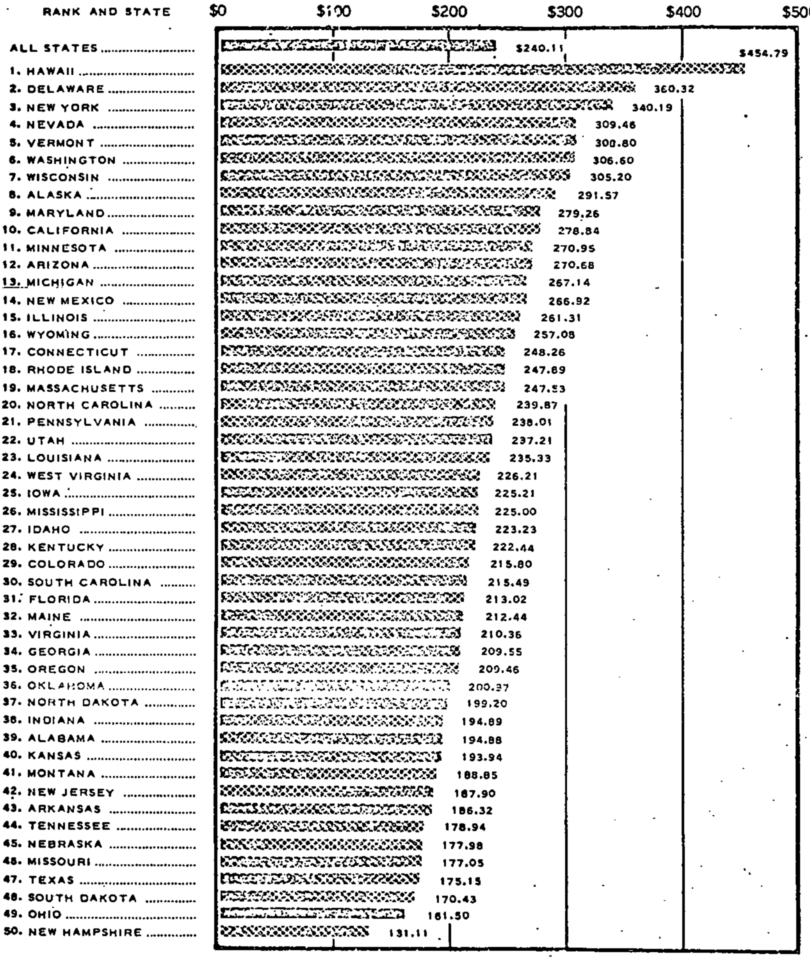
In Ohio, as well, we can seek to solve some of our structural unemployment problems through good management of available manpower training programs, and through targeting our education system toward work areas offering prospects of secure employment. We can also use government employment itself as one vehicle for opportunity and training for those who otherwise would be unemployed, and I am presently developing appropriate budget and legislative proposals for the consideration of our General Assembly. In those proposals, I hope to take many steps toward dealing with economic problems in Ohio.

One step we will be seeking to take is the reorganization of state government in order to more effectively tackle our economic problems. For example, in Ohio we have 23 Departments and 110 Commissions and Boards, which can and should be restructured into a more modern and efficient executive establishment. We are currently evaluating how we can more effectively carry out the functions of state government and reduce the duplication of effort which results from the proliferation of governmental units. I commend President Nixon on his proposal to reorganize the overlapping functions in his Cabinet positions.

We will do the best we can in Ohio, but our prospects rest in large part in national hands. As a former Member of the Congress I can sympathize with your problems in trying to get something done about the national economic situation. At the same time, I cannot stress too strongly the urgent necessity to get this country's economy moving.

ATTACHMENT 1

STATE TAX REVENUE PER CAPITA, 1970[a]



[a] Source: U.S. Bureau of the Census, State Tax Collections in 1970, November 1970 (preliminary).

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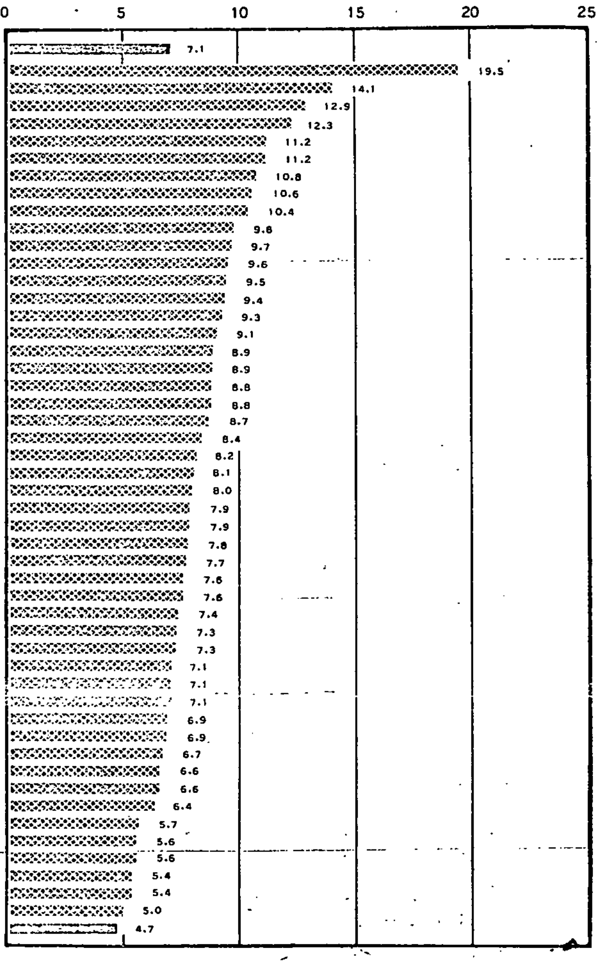
Ohio Bureau of Employment Services
Columbus 12-16-70 No. E-570

ATTACHMENT 2

FULL-TIME NONEDUCATIONAL STATE EMPLOYEES IN OCTOBER 1969 PER THOUSAND RESIDENT POPULATION, JULY 1, 1969[a]

Rank and State	Resident Population (thousands)	Employees per thousand
ALL STATES	201,123[b]	7.1
1. ALASKA	282	19.5
2. WYOMING	320	14.1
3. DELAWARE	540	12.9
4. VERMONT	439	12.3
5. MAINE	978	11.2
6. WEST VIRGINIA	1,819	11.2
7. NEW MEXICO	994	10.8
8. RHODE ISLAND	911	10.6
9. MONTANA	694	10.4
10. LOUISIANA	3,745	9.8
11. NEVADA	457	9.7
12. HAWAII	794	9.6
13. SOUTH DAKOTA	659	9.5
14. NORTH DAKOTA	615	9.4
15. CONNECTICUT	3,000	9.3
16. VIRGINIA	4,669	9.1
17. IDAHO	718	8.9
18. OREGON	2,032	8.9
19. NEW HAMPSHIRE	717	8.8
20. WASHINGTON	3,402	8.8
21. OKLAHOMA	2,568	8.7
22. MASSACHUSETTS	5,467	8.4
23. UTAH	1,045	8.2
24. KENTUCKY	3,232	8.1
25. NEBRASKA	1,449	8.0
26. KANSAS	2,321	7.9
27. PENNSYLVANIA	11,803	7.9
28. NEW YORK	18,321	7.8
29. MARYLAND	3,765	7.7
30. MISSOURI	4,651	7.6
31. SOUTH CAROLINA	2,692	7.6
32. COLORADO	2,100	7.4
33. ARKANSAS	1,995	7.3
34. NORTH CAROLINA	5,205	7.3
35. FLORIDA	6,354	7.1
35. TENNESSEE	3,985	7.1
37. MISSISSIPPI	2,360	7.1
38. IOWA	2,781	6.9
39. ARIZONA	1,693	6.9
40. MINNESOTA	3,700	6.7
41. GEORGIA	4,641	6.6
42. ALABAMA	3,531	6.6
43. CALIFORNIA	19,443	6.4
44. ILLINOIS	11,047	5.7
45. TEXAS	11,187	5.6
46. NEW JERSEY	7,148	5.6
47. WISCONSIN	4,233	5.4
48. MICHIGAN	8,766	5.4
49. INDIANA	5,118	5.0
50. OHIO	10,740	4.7



[a]Source: U.S. Bureau of the Census, "Public Employment in 1969," April 1970.
[b]Excludes District of Columbia.

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Ohio Bureau of Employment Services
Columbus 6-2-70 No. E-515

ATTACHMENT 3

PAYROLL COST OF FULL-TIME NONEDUCATIONAL STATE EMPLOYEES IN OCTOBER 1969 — PER CAPITA OF TOTAL RESIDENT POPULATION, JULY 1, 1969[a]

Rank and State	Resident Population (thousands)	Per capita payroll cost
ALL STATES[b]	201,123	$4.25
1. ALASKA	282	$18.12
2. WYOMING	320	7.93
3. VERMONT	439	7.17
4. NEVADA	457	7.05
5. HAWAII	794	6.90
6. DELAWARE	540	6.45
7. MAINE	978	6.23
8. WASHINGTON	3,402	6.09
9. RHODE ISLAND	911	6.08
10. MONTANA	694	6.02
11. CONNECTICUT	3,000	6.01
12. OREGON	2,032	5.78
13. MASSACHUSETTS	5,467	5.45
14. NEW MEXICO	994	5.26
15. NEW YORK	18,321	5.25
16. CALIFORNIA	19,443	5.21
17. IDAHO	718	5.04
18. MARYLAND	3,765	5.02
19. SOUTH DAKOTA	659	4.90
20. LOUISIANA	3,745	4.77
21. PENNSYLVANIA	11,803	4.70
22. NORTH DAKOTA	615	4.70
23. NEW HAMPSHIRE	717	4.64
24. WEST VIRGINIA	1,819	4.62
25. UTAH	1,045	4.61
26. COLORADO	2,100	4.58
27. VIRGINIA	4,669	4.40
28. MINNESOTA	3,700	4.30
29. KANSAS	2,321	4.21
30. OKLAHOMA	2,568	4.07
31. MISSOURI	4,651	4.05
32. NEBRASKA	1,449	3.97
33. MICHIGAN	8,766	3.96
34. IOWA	2,781	3.91
35. NORTH CAROLINA	5,205	3.91
36. ARIZONA	1,693	3.81
37. WISCONSIN	4,233	3.72
38. ILLINOIS	11,047	3.66
39. KENTUCKY	3,232	3.65
40. FLORIDA	6,354	3.64
41. NEW JERSEY	7,148	3.52
42. SOUTH CAROLINA	2,692	3.29
43. TENNESSEE	3,985	3.15
44. GEORGIA	4,641	3.14
45. ALABAMA	3,531	3.05
46. TEXAS	11,187	3.03
47. MISSISSIPPI	2,360	2.91
48. OHIO	10,740	2.72
49. ARKANSAS	1,995	2.70
50. INDIANA	5,118	2.59

[a] Source: Bureau of the Census, U.S. Department of Commerce, "Public Employment in 1969," April 1970.
[b] Excludes District of Columbia.

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Ohio Bureau of Employment Services
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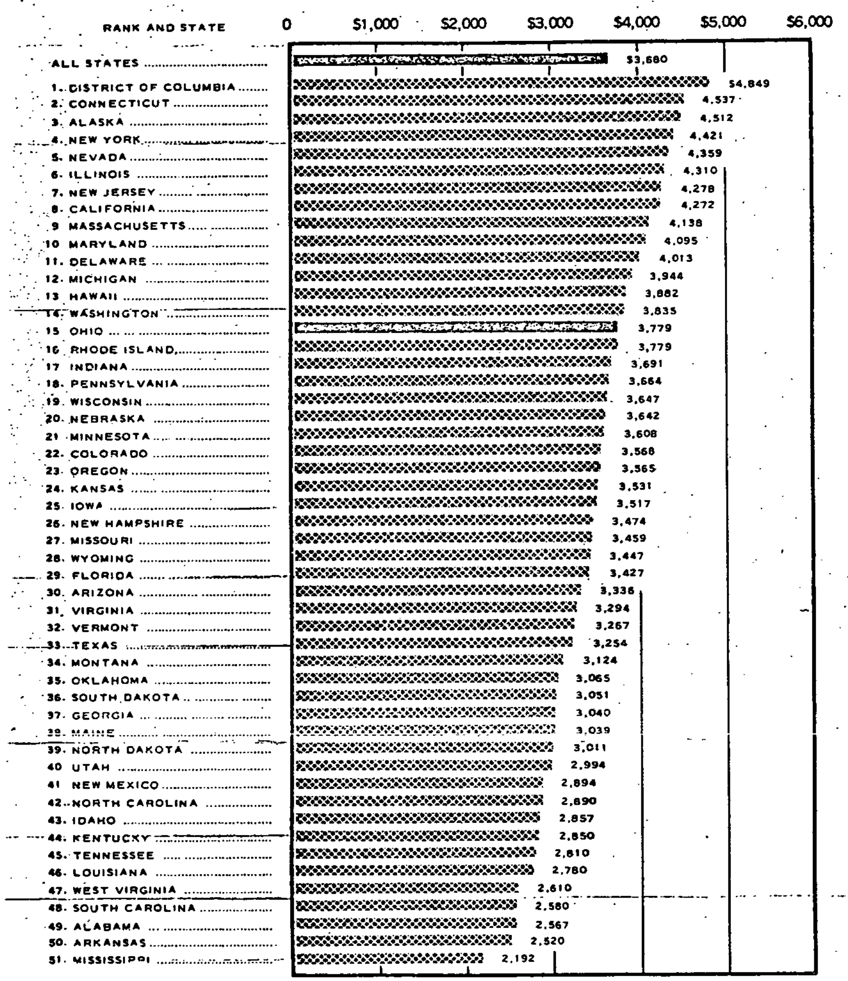
ATTACHMENT 4

PER CAPITA PERSONAL INCOME, BY STATE, 1969



Source: Office of Business Economics, U.S. Department of Commerce.

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ATTACHMENT 5

WAGE AND SALARY INCOME FROM STATE AND LOCAL GOVERNMENTS AS PERCENT OF TOTAL PERSONAL INCOME, BY STATE, 1968

Rank and State	Total Personal Income (millions)	Percent
ALL STATES	$683,702[a]	7.8
1 NEW MEXICO	2,667	12.0
2. ALASKA	1,136	12.0
3. WYOMING	1,005	11.0
4. ARIZONA	5,034	9.7
5. CALIFORNIA	76,581	9.3
6. OREGON	6,660	9.2
7. HAWAII	2,705	9.1
8 NEW YORK	75,049	9.1
9 MONTANA	2,039	9.1
10 UTAH	2,885	9.0
11 NEVADA	1,777	9.0
12. COLORADO	6,824	8.9
13. NORTH DAKOTA	1,712	8.9
14. WASHINGTON	12,081	8.8
15. SOUTH DAKOTA	1,887	8.7
16. MINNESOTA	12,185	8.7
17 WISCONSIN	14,197	8.6
18. MISSISSIPPI	4,878	8.6
19. LOUISIANA	9,814	8.6
20 VERMONT	1,306	8.5
21. MARYLAND	14,048	8.4
22. IDAHO	1,876	8.3
23. WEST VIRGINIA	4,451	8.3
24. MICHIGAN	32,119	8.2
25. NEBRASKA	4,661	8.1
26. FLORIDA	19,626	8.0
27. TENNESSEE	10,252	7.9
28. NORTH CAROLINA	13,642	7.8
29. VIRGINIA	14,100	7.8
30. KANSAS	7,574	7.7
31. MAINE	2,757	7.7
32. ALABAMA	8,316	7.7
33. IOWA	9,057	7.7
34. OKLAHOMA	7,259	7.4
35. KENTUCKY	8,516	7.3
36. MASSACHUSETTS	20,974	7.2
37. SOUTH CAROLINA	6,341	7.1
38. GEORGIA	12,705	7.1
39. TEXAS	33,254	7.1
40 INDIANA	17,270	7.1
41. DELAWARE	2,026	6.8
42. RHODE ISLAND	3,244	6.8
43 ARKANSAS	4,611	6.7
44. ILLINOIS	43,760	6.7
45. MISSOURI	15,065	6.6
46. NEW HAMPSHIRE	2,288	6.6
47 CONNECTICUT	12,611	6.5
48. PENNSYLVANIA	40,102	6.4
49. OHIO	37,151	6.3
50. NEW JERSEY	28,047	6.3

Source: Survey of Current Business, August 1969. U.S. Department of Commerce.

[a]Includes District of Columbia. May not add due to rounding.

Division of Research and Statistics
Ohio Bureau of Employment Services
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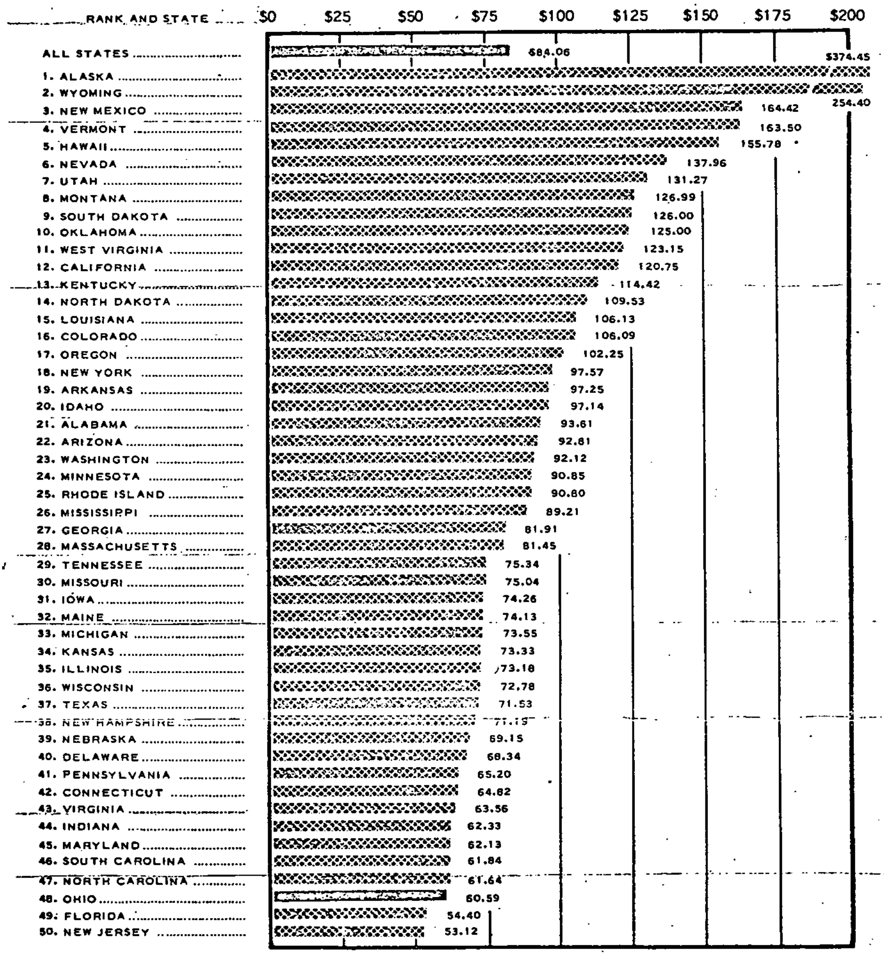
ATTACHMENT 6

PER CAPITA INTERGOVERNMENTAL REVENUE FROM FEDERAL GOVERNMENT
RANKED BY STATE, 1969[a]



[a]Source: U.S. Department of Commerce, Bureau of the Census. Fiscal year ended June 30, 1969, except: Alabama, September 30; New York, March 31; and Texas, August 31.

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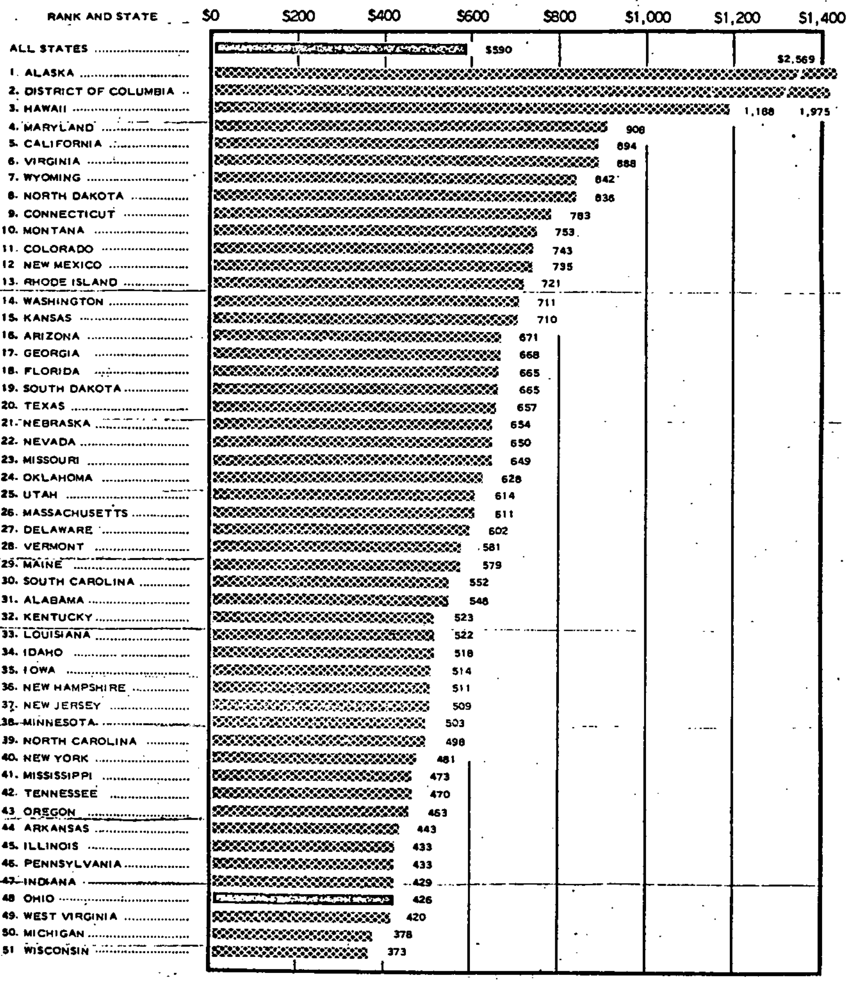
Columbus 7-13-70 No. E-566

ATTACHMENT 7

FEDERAL GOVERNMENT EXPENDITURES PER CAPITA BY STATE, FISCAL YEARS 1964-65 THROUGH 1966-67[a]



[a]Estimates by Legislative Reference Service, Library of Congress. House Committee on Government Operations, October 1968. Allocated expenditures represent 7/8 of total.

Division of Research and Statistics
Ohio Bureau of Employment Services
Columbus Rev. 5-5-69 No. E-565

Chairman PROXMIRE. I would like to suggest to the members of the committee that we on the first round at least confine this to 5 minutes apiece, because we do have Mayor Gribbs coming up and I know Senator Bentsen has to leave in a little while, and we will, of course, permit any member to question at any length he wishes but it might be more convenient if we can do that.

Governor Gilligan, I found your proposal for a tax credit instead of revenue sharing most interesting and effective. I think many members of the Congress would prefer some kind of a tax credit to revenue sharing. But I wonder if you have a 100 percent full tax credit—whether this imposes any responsibility on the State.

After all, wouldn't it simply be a matter of taking 10 percent of the Federal personal income and corporation income tax and giving that to Ohio and Mississippi and New York and Illinois and the other States? How about a system in which you had a 50-percent credit? There you would have a real incentive and a sharp incentive for imposing a progressive income tax, but you at least would have some responsibility imposed on the State so that there be some discipline for holding that tax within reason, and a continuing discipline for expending the money economically.

Governor GILLIGAN. Well, Mr. Chairman, at the present time if we are speaking of corporate income tax, we have for all practical purposes a 50-percent credit at the Federal level. In other words, State and local taxes are deducted by businesses from the income upon which their Federal tax liability is based. Because they are in the 50-percent bracket, if they pay taxes to the State of Ohio, they are paying them in 50 cent dollars because the other half of that is coming, in effect, out of the Federal Treasury.

If we hadn't charged them the tax, the total amount would go into the Federal Treasury. And in personal income tax those brackets, of course, vary anywhere from 20 to nearly 70 percent.

What I am saying is that instead of sending the money in to Washington and then having us, the mayors and Governors, come in and try to get it back again, through the pipelines of categorical programs and otherwise, if the Federal Government were to simply say that up to a certain level, say 10 percent, a dollar paid to State government or to local government in the form of income taxes would be directly charged off on a full 100-percent basis against the Federal tax liability, it would give us the elbow room we need to raise the kind of revenues which we need.

Now, as I say, my own experience as a Member of Congress was that the Congressman naturally is haunted by the fear that the money he raises through the taxes he supports is going to be misspent or spent foolishly, perhaps not in his own district or his own State but in some of the far reaches of the country, but he is held responsible for it.

That fear is going to make it enormously difficult for the Congress to raise revenues and to distribute them to the States with no strings attached. I am simply urging that, instead of doing that, the Congress make it possible for local and State government to raise those revenues at the local and State level and spend them at those levels and take the responsibility for both actions.

Chairman PROXMIRE. Well, I agree with you and I think it is a great improvement from my own standpoint over revenue sharing. I only question whether it should be 100 percent. I think you make a good point on the 50 percent being inadequate, although certainly for the average proportion of the personal income taxes paid to the Federal Government, it is less than 50 percent as you know.

Governor GILLIGAN. That is right.

Chairman PROXMIRE. Twenty or twenty-five percent. At any rate, I think maybe we can have some kind of a contribution. Of course, it is obviously advantageous to a rich State like Ohio or Connecticut as compared to a poorer State. You obviously would do a lot better sharing the income tax and that is one of the difficulties with this. It would go back to the State that needs it least in the sense that they have the most income anyway. They have the most prosperous people with the highest incomes, most prosperous corporations. Those States that have relatively lower income and relatively less corporate income would, of course, receive less because there share of 10 percent of the income taxes would be less for them.

At any rate, let me ask you about this. We have been—I have been very impressed by the limitation that almost everybody now seems to agree that we are going to have on the Federal expenditures. The President, I think, is right in accepting a full employment budget. That means $230 billion this year. We are not going to go higher than that, maybe a little lower. At any rate, this means we can't do everything we would like to do. We have to make a choice of tough priorities.

What form of assistance to the States would you put at the top of your priority list, federalization of welfare, manpower and public service employment programs, aid to education, revenue sharing? How would you list them?

Governor GILLIGAN. Mr. Chairman, in my prepared statement I spoke directly on the point of welfare reform. That is the item that I would put at the head of the list, for several reasons.

Chairman PROXMIRE. Welfare reform No. 1.

Governor GILLIGAN. That would be No. 1.

Chairman PROXMIRE. By that you mean the Federal Government taking the largest share of the welfare?

Governor GILLIGAN. In my judgment the Federal Government should take over welfare totally as they took over social security, one form of income maintenance, 35 years ago. I see no reason at all that this particular part of the income maintenance program for the people of this country should be on a competitive basis between the States, with the State competing to cut their welfare benefits.

Chairman PROXMIRE. The Federal Government to administer the welfare program from Washington?

Governor GILLIGAN. Yes; I would think so. I look to the day when we would have a full income maintenance program in this country, applying not just to those over 65 but to people of every age and in every section of the country. In my opinion by getting rid of the categorical programs—these archaic, burdensome, cumbersome, unfair, maddeningly expensive programs that we are presently burdened with—and replacing all of that with a simple nationalized income maintenance system operated as social security is operated today, we would do a lot better. We would also get rid of what is now a competition between the States in human misery—where States are, in order to attract industry, as is generally the excuse given, competing with one another to cut down welfare benefits.

We in Ohio today, for instance, under the slogan that profit is not a dirty word in Ohio, pay to people who are unable to help themselves—who are unemployed, disabled, whatever else—73 percent of what we say it takes to keep them alive. In other words, we fix the standards of what is required to sustain a family. Then we give them 73 percent of that. It is a punishment-of-the-poor program. It is inhuman, it is disgusting, it is self-defeating, enormously expensive and absolutely ruinous to the people of this country, both those who are receiving it and those who are paying for it, as well as those who are administering the program.

So in my judgment that is the No. 1 reform that the Federal Government can take over, and it can only be done by the Federal Government.

Chairman PROXMIRE. My time is up. I will be back.

Senator Javits.

Senator JAVITS. Governor, I notice with great interest that Ohio has no income tax.

Governor GILLIGAN. Not yet, sir.

Senator JAVITS. Not yet. I notice with great interest also that a number of its great cities come way down on the list of revenue efforts. For example, Cleveland is 39th among the 65 largest cities in the standard metropolitan areas in terms of its revenue efforts.

Now, do you think that whatever scheme we have for State or local aid ought to have built into it some provision respecting a comparable effort with what others are making?

Governor GILLIGAN. Yes; I think so, Senator; even though I must admit that if the pattern were adopted or the law were adopted that has been proposed by President Nixon with built-in recognition of State's efforts to help themselves, Ohio would rank 49th among the 50 States. We are, in terms of income and industrial power, one of the wealthiest States in the Nation. Yet in terms of our efforts to use our own resources, we rank 48th or 49th in virtually every category that one wants to mention. That is our job, and it is our responsibility to bring Ohio into the 20th century in that regard; and as a matter of fact, I spent all of last year campaigning on that most unlikely of campaign issues, promising the people of Ohio that if I were elected, they would be undertaking a substantial increase in taxation and in State effort.

My predecessor, in his farewell remarks to our general assembly 10 days ago, commented that Ohio, on a per capita basis measured against income, has the lowest taxes in the Nation and has less public employees per thousand population than any State in the Nation. That to me is like one of the wealthiest men in the city boasting that he spends less on his wife and his children than anybody, bar none. [Laughter.]

I think the Federal Government should build in a formula that would recognize the efforts made by local communities and States to help themselves.

Senator JAVITS. Now, there is one other element of revenue sharing. We have a recommendation in New York for endeavoring to lay aside certain functions, which will be underwritten by the Federal Government, like welfare, and I thoroughly agree with you on that, and other functions which will be strictly States' concerns which are now the subject of categoric grants, as we call them. But would you build in a needs formula? I am the ranking member of the Labor and Public Welfare Committee, and there are bills in which we have built in a needs formula. Our chairman, I think, properly says that in any of these schemes, revenue sharing, tax deduction, which you recommend, that the richer the State, which generally speaking goes with big industrial size, the more it can get out of revenue sharing. So, would you also build in a needs factor?

Governor GILLIGAN. I am not sure that I would, Senator; I would like to see the formula worked out.

It is my belief that the Federal Government will continue to operate and fund certain categorical programs. The principal effort of those programs is to take from those who have—the wealthier States, wealthier communities, and wealthier individuals—and distribute to those who do not. The needs formula is pretty carefully worked into every one of those categorical programs and I think that is quite right, and I would hope to see that continued.

But in the new manner of revenue sharing I don't, at least at the present time, see a need for the needs formula to be worked into it.

Senator JAVITS. One other question and then I am through, I think. My time is up. That is, would you agree with me that above anything else we have to guard against the States and the cities getting the money and then not performing. We must bear in mind that centralization in all these areas will result from the dissatisfaction with nonperformance by the States and cities of their responsibilities; when they didn't perform, the citizens demanded that there be performance, and they didn't care who did it. We took it over and though our performance may be poor, it certainly is some effort, and now would you agree, therefore, that we would have a right to set criteria to monitor what is to be done and to insist that if they don't do it, we will do it and charge them for it?

Governor GILLIGAN. A few years ago, Senator, when I was a Member of Congress, I would have said yes. As a Governor, I would say no.

Seriously, I think that this is one of the very natural desires of the Congress, when they are funding certain programs, to see that those programs are properly used, to see that the subordinate levels of government are performing as the Congress wants them to perform. This has led to endless difficulty and to enormous bureaucracy: when the State or local community wants to do something, it has to be checked out with the regional operator and then with the district and then sent up to the Washington level and then back down again. There are 15 or 16 checkpoints on every program. And it is simply a fact that the bureaucratic administrators in Washington, however dedicated and hard working they are, simply cannot know the local problems. They can't really judge the efficacy of the program.

That is why I am saying that, instead of doing that, let the money be kept at the local level and spent at the local level, and let the local officials and State officials bear the full responsibility for it.

It is an old temptation of the reformer to do the job that the fellow down the line won't do for himself, but it doesn't really work too successfully in many cases.

I think certainly the Congress has to see—must see—that the funds are spent with due regard to the constitutional rights of citizens. I do believe very strongly that no State or local government should be permitted to use Federal money or even their own money in an unconstitutional manner, discriminating against certain citizens, and so forth. But, beyond that I look for less Federal control rather than more.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman PROXMIRE. Congresswoman Griffiths.

Representative GRIFFITHS. Thank you, Mr. Chairman.

Welcome home, Governor. We are happy to have you here. If you keep on making courageous statements like that I hope you will come back again.

Governor GILLIGAN. Thank you.

Representative GRIFFITHS. I held the only hearings here, I think, that were ever held on revenue sharing in this committee. One of the problems that bothered me was the distribution formula.

How do you send it back so that the people who need it really get it? I read the other day that even on the money that is going back into communities for police officers, $1,200 went back for communications equipment into a town of about 1,000 people, and I happen to know that town well. They have one officer on duty in the daytime and one at night. With whom is he going to communicate? You know—what did he need the $1,200 for, for communications?

This, too, would be a problem with revenue sharing.

Governor GILLIGAN. I quite agree with you.

Representative GRIFFITHS. It will never be done any other way because you have a State legislature and each one of those men is going to want some money for his district, whether it needs it or doesn't, and for each little town in his district. So it will be forgotten that it could be a good formula.

I applaud also your suggestions, because I came to that conclusion, too, that the sensible thing to do would be for the Federal Government to take over welfare completely, and that is why I voted for the President's program, because I think it was a good idea.

The second thing would be to take over education completely, pay the whole bill. Why should an American child on the east coast be better educated than an American child in Mississippi? That is ridiculous.

But I would like to ask you on welfare, since I sit on the committee that deals with it—I am personally convinced that money is not the answer, the single and sole answer. I don't agree with Mr. Moynihan that the only thing wrong with being poor is that you don't have any money. I think there are a lot of other things wrong with welfare.

I have a bill in here that would feed every American schoolchild three meals a day in school and every child from birth up to the age of 18 as long as he was in school. Would you with the experience, for example, that Cleveland has had with the breakfast program, would you assume that this would be of some value or not?

Governor GILLIGAN. No question about it, Mrs. Griffiths. It would be of very great value. There is a school in the Cleveland system that I visited a year ago where they have made an effort to use intensively every device and every program made available by the Federal Government, concentrating all of them in that school, all of the funds and programs available under the Elementary and Secondary Education Act, all of the school lunch programs, and so forth. It is a marvelous school at the present time. They are just seeing how far they can take it and how rapidly kids can learn using all of the new techniques and all of the new equipment, and so forth.

But a teacher in one of the rooms told me that the most important thing—far more effective, far more helpful than all of the new electronic equipment and audiovisual aids and all the rest of the things—was the fact that they fed the children breakfast and lunch. She said for the first time we have children now who race to get to school to come in and get their breakfast and then are healthy enough and alert enough and well fed enough that they can begin to deal with their lessons during the day rather than worrying about whether they were going to get a jelly doughnut for lunch.

So I agree totally with you. I think America cannot do less than see that every child is at least adequately fed. If we have to feed them in the schools, so be it. Feed them in the schools and feed them in day nurseries before they are of school age.

Representative GRIFFITHS. It would be a far better program than the school lunch program is ever going to be.

Governor GILLIGAN. I agree.

Representative GRIFFITHS. There is no comparison. You actually feed the children. You are not guessing that they got it or something happened to it, the stuff was stolen. The child is fed.

I understand that one of the biggest problems in Cleveland was to keep the child at home until the school opened.

In the State of Texas there is a county that floated a bond issue and fed children on their own. I called the superintendent of schools there and he told me that the biggest problem they had was to keep the kids from lining up at daybreak to get on the buses to come to school because, of course, food is what they need.

The total cost of the whole program that I put in for three meals a day, 5 days a week, the whole year is only $4.5 billion. Now, that is about the estimated amount of the President's FAP program. Of course, I think that is underestimated but the program that I estimate I think would work, the Federal Government would pay it all, it seems to me would have some merit.

I would like to thank you.

Chairman PROXMIRE. Senator Miller.

Senator MILLER. Thank you, Mr. Chairman.

Good morning, Governor.

Governor GILLIGAN. Good morning, Senator.

Senator MILLER. You are recommending the tax credit approach.

Governor GILLIGAN. Yes, sir.

Senator MILLER. But no matter what you do, whether you use the tax credit approach as a result of which a certain chunk of revenue does not get into the Federal Treasury, or whether you take it out of the Federal Treasury directly, the important thing I would think from the standpoint of your office is that the State get some money. That is the all-important thing, isn't it?

Governor GILLIGAN. Yes, sir.

Senator MILLER. Now, it seems to me that whether you use the tax credit approach and just don't get the revenue into the Federal Treasury or whether you take it out of the Federal Treasury, the fact remains that the Federal Treasury doesn't have that much revenue.

Governor GILLIGAN. That is right.

Senator MILLER. And you indicated some displeasure over the $5 billion of new revenue outlined in the President's state of the union message, and I know that there are some who advocate upward of $10 billion.

Where would you think the Congress ought to go to get the additional revenue needed to make it more than $5 billion?

Do you think we ought to just run up a further deficit in that account or do you think we ought to increase the income tax rates or restore the tax surcharge? What would be your thinking on that point?

Governor GILLIGAN. Senator, I know full well that the Congress is engaged in year-round debate on the proper ordering of priorities for the American people. Wealthy as we are—a Nation that produces and consumes about 40 percent of all the goods and services on the face of the earth while having 6 percent of the world's population—we can't do everything. Therefore, we argue about priorities, which things must come first, what things must take precedence over others.

I felt when I was in the Congress, and since that time, and the feeling grows stronger with me every day, that this Nation has to reorder its priorities. We must begin very rapidly, decisively, and aggressively to cut back our overseas military commitments of all kinds, and to pull in our horns all over the world and begin redirecting our resources to our own domestic needs.

Now, I think we can tinker with the tax rates. I think we can raise additional money if we want, but what we have really been doing is we have been running a major war without putting this Nation on a wartime economy basis. We have been attempting to have it both ways, have a peacetime economy while running a major war. It won't work. Trying it has torn this economy to shreds. Everyone in the Nation is beginning to pay the price.

There is only one way to deal with it. Stop the war, pull in our horns, put our own house in order, rebuild our own economy on a peacetime setting, directing the financial and human resources of this Nation to the needs of people rather than to destructive warfare.

Senator MILLER. Well, what you have really said is that you would not look toward an increase in any tax revenue. You would look for reduction in expenditures.

Governor GILLIGAN. Yes; I would, but if we are going to continue to run a war like this, then let's have the taxes. I believe quite firmly that if President Johnson—in January of 1965 when I was in the Congress had come to that 89th Congress saying, "I am going to escalate the war and I want wage and price controls and I want the tax structures that are going to be necessary to undertake a major military effort of this kind, he would have gotten them and we would not have had the inflation, and the war would have been over a long time ago because everybody would have been paying for it and they would have been fed up with it and they would have stopped it."

Senator MILLER. I appreciate that frank statement and I share that view, as you probably know. However—in all this talk about priorities—I must tell you because you were not in the last session of Congress as I recall.

Governor GILLIGAN. That is right.

Senator MILLER. I must tell you that there was a No. 1 priority that was established in December a year ago. Now, we can talk about the environment and roads and education and health and all of these other things, and they are Nos. 2, 3, 4, 5, 6, 7, and on down the line, but there was a No. 1 priority that those in control of this Congress established a year ago last December and that was simply this: After picking up literally billions of dollars of revenue through tax reform, closing loopholes and the like, then they proceeded to give it away in the form of tax relief, and I don't believe they had to give as much of it away as they did.

If they had given half of it away, then we would have some of this additional money necessary.

My time is up. I would just comment that I agree with our Chairman and Senator Javits in their recognition of the fact that this tax credit approach overlooks the fact of need, and when I look at the attachments in your prepared statement I see that my own State of Iowa ranks 25th in per capita income in the country and we rank 25th in State revenue per capita. So I think we are about where we ought to be. But Ohio ranks 12th in per capita income and 49th in tax per capita. And so I would suggest to you that the opportunity for an income tax revenue in Ohio with the Federal Treasury helping out is much greater than it is in other States and I don't think the need for it is there.

That is one of the virtues of taking it out of the Treasury and allocating it back to the States through direct revenue sharing. Then Congress does have an opportunity to put some factor of need into some of these areas.

I appreciated your answers very much.

Governor GILLIGAN. Thank you.

Chairman PROXMIRE. Senator Bentsen.

Senator BENTSEN. Thank you, Mr. Chairman.

Mr. Chairman, I have to agree with you that the problem of the tax credit is that it favors that State that has the highest income and doesn't really get to the needs problem.

I am concerned too, with the political feasibility of federalizing the welfare system, trying to find out how it is done when you have a variance, for example, in cost of living among the States. Can we bring this about in trying to answer the needs problems on a varying basis amongst the States under a Federal welfare system?

Governor GILLIGAN. I think we can, Senator. What we are talking about generally when we are talking about helping the poor with direct payments is helping them just to get to the minimum standard. That seems to be an abiding concern in many areas of the Nation.

But my theory is that when you get down to rockbottom subsistence levels, the variations aren't that great in the cost of living and that they are variations that could be handled on a formula basis.

Again I say that this Nation has run an income maintenance program for a great many years involving millions and millions of clients and done it very successfully, very well, with a minimum of bureaucratic red tape in the social security system. We have demonstrated to ourselves what we can do. There is, as you know, the consuming fear that people are going to cheat and get on welfare when they didn't deserve it. There is probably less cheating in welfare than in the income taxes. The people who are really cheated are those who are entitled to welfare today but don't get it because they don't know about it or don't know how to handle the bureaucratic tangle to get the assistance they need.

So I think simplifying welfare, nationalizing the standards, and nationalizing the administration would eliminate a great deal of this and would lead to a much healthier attitude on the part of all Americans toward what we are doing for poor people.

Senator BENTSEN. Let me congratulate you, Governor, on your desire to get the tax burdens of the State of Ohio and their income more in balance because I couldn't help but notice, too, what Senator Miller had said.

Let me ask you one more. Was it your thought that we need the tax credits on the income tax and in addition to that, a federalizing of the welfare system?

Governor GILLIGAN. Yes. I am talking about both. After reviewing the President's state of the Nation address, it seemed to me that those were the two that had the greatest possibility for relieving the States of what now seems to be a terrible financial crisis. I am the first to admit—and have said on every platform in the State—a lot of Ohio's problems are Ohio's fault, because they are the fault of the government of Ohio. We can do a lot for ourselves that we haven't been doing. But I say at the same time that, unless the States and the cities—especially the major cities, get early assistance from the Federal Government, we are going to be confronted with the virtual collapse of local and State government in this country. And that is really not overstating the case.

For instance, today in Cleveland, our largest city in Ohio, they need more in the way of public services than they have ever needed before. Yet they are in the process of dismissing 850 people from the Cleveland municipal payroll because they can no longer afford to pay them. That is the policeman, fireman, sanitation worker, public health worker, recreation supervisor and everything else.

They are cutting the service levels in Cleveland by about 30 percent. Cleveland very soon will be uninhabitable if that trend continues.

Senator BENTSEN. I have nothing further, Mr. Chairman.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Governor Gilligan, we all very much appreciate the candor of your comments about your own State. Illinois would be in a similar situation except for the fact that we now have for the first time a State income tax. Although politically difficult it was the right thing to do and we have been able to dramatically increase our State contribution to education and other areas.

I particularly want to commend you for your cutting down expenses by cutting out the duplication or the dissemination of pictures of the new Governor. This is a very tough decision to make. [Laughter.]

More State Governors and politicans ought to follow that example.

Governor GILLIGAN. It is not so painful, Senator, if you look like I do. [Laughter.]

Senator PERCY. A favorite subject of the chairman's and mine and other members of the committee has been the SST. In looking at national priorities, we have felt that this is a dramatic way to say let's not do something now. It has been called a west coast WPA project, yet the engines will be built in Ohio.

Governor GILLIGAN. That is right.

Senator PERCY. I understand that you do not support the SST. This is a courageous position on your part. Would you tell us why you do oppose it?

Governor GILLIGAN. Senator, I would simply say that in the order of national priorities, we cannot do everything. The SST seems to me one program that we could put on the back burner or pigeonhole entirely. The engines will be built at the General Electric plant in my home community of Cincinnati. But, of course, every change that we would attempt to make in our war efforts or anything else relates immediately back to a defense contract that hits in some community. If we are not willing to forgo the benefits, direct and indirect, in terms of employment, and so forth, in those areas, then we are never going to give up any of the things that we are presently doing.

Beyond that reordering our priorities that is involved in setting aside the SST program, there is a further question of course, the whole question of the environment and the threat represented by supersonic planes to it. I think again the Congress might have a two-fold impact on the Nation's consciousness by setting the program aside for both reasons, dramatically underlining our concern about reordering priorities on the one hand and, secondly, the preservation of our environment.

Somewhere, sometime, someone has to say that we are going to give up something to preserve our environment. Maybe action on the SST isn't going to do it, but it would be a step at least.

Senator PERCY. Thank you. You have said that you need to reorganize State government, simplify it, and make its organization more logical in the light of current needs. Have you had a chance to study the President's reorganization of the Federal Government? Do you have a favorable or unfavorable reaction to that as it might affect your responsibilities as a Governor working with the Federal Government?

Governor GILLIGAN. Senator, I have not had the opportunity to look at the program in any detail. Strangely enough we had a task force of young people, academicians and those with some business experience, who began studying the Ohio State government early last spring and with an eye toward reorganization and restructuring of its executive departments. They came up with a proposal which we have not yet presented to the general assembly, and may not in its present form. They came up with a proposal very similar to the President's as a matter of fact, in relating some departments in the field of human resources, some others in the field of economic development and preservation of the environment and others in what are called administrative departments.

So the grouping of the agencies and the departments seems logical enough. Industry, it seems to me, has learned on a very practical level over a great many years the necessity of constant restructuring and reformation—reforming of its processes and procedures with group vice presidencies set up, and when a new process or product is developed, being able to assemble the necessary structural machinery around it.

We have not yet learned that well enough in government. I think we must.

Senator PERCY. You, as the chief executive officer of the State want to cut down the number of departments and commissions that report to the chief executive. You have got 23 departments and 110 commissions—but you can imagine what the President has. The principle is a universal principle that we ought to cut down.

Governor GILLIGAN. Right.

Senator PERCY. May I ask you about national welfare. If it were taken over by the Federal Government, how would you take into account the differences in cost of living between high cost areas such as urban areas in Ohio and low cost rural areas in, say, some of our Southern and Western States.

Governor GILLIGAN. Well, we at the present time, under existing welfare programs, recognize these variations within the States. For instance, an individual case worker will figure out for a family what is needed in terms of rent, food, and clothing and educational expenses, and so forth and so on, and then make up the family's budget based on that.

Now, it could be done on a case-by-case basis or it might be done on a regional basis. There are ways of doing it mechanically if we wanted to do it. I don't think it really is a very great problem.

Senator PERCY. You feel it should be done, though——

Governor GILLIGAN. Yes.

Senator PERCY (continuing). And that it ought to be taken into account?

Governor GILLIGAN. Yes. I think the living costs in some urban areas are obviously much greater, but, you see, what has begun to happen all too frequently is that people are coming in from the rural areas—where the economy has changed dramatically and where there is no longer any employment available to them—into the cities in hopes of finding work. They come into areas where living costs are much higher than the areas that they left and where they had no income at all.

Now, if we nationalized the program so that people would stop moving, migrating across the country looking for both work and welfare, we might stabilize this flow of people a little bit and stabilize some of them in the rural areas rather than having them come into the cities.

Senator PERCY. Thank you, Governor.

Chairman PROXMIRE. Governor, I want to thank you very much. I would like to ask you, if you would, if you would do so, to stay at the table. We are asking Mayor Gribbs to come forward and before he does, I want to tell you this, that you have been a most unusual and helpful witness. It is remarkable that a man should campaign on a program of providing an income tax for the people of his State and then come before us and say he is not going to disappoint those people, that they are going to get that nice present.

Governor GILLIGAN. With the concurrence of a Republican legislature, we will.

Chairman PROXMIRE. Well, you are going to do your best. And then you indicated that your priority was for welfare reform over revenue sharing which is mighty welcome as far as I am concerned, and you are also opposed to the SST although the engines are built in your home town of Cincinnati, and you come out for reorganization one way or another of your State government which is always an onerous political problem and express sympathy for the President's proposal although you say you haven't examined the details.

This has been most unusual and as I say, very welcome.

Senator PERCY. Don't forget the no pictures of a Governor and that comes from a former photographic company. That cuts deep.

Chairman PROXMIRE. I think Governor Gilligan is a very handsome fellow but he said there was no sacrifice on his part because he feels he would do a little better if people don't know how he looks.

I would like to ask Mayor Gribbs if he would come forward and if you could remain at the table, Governor Gilligan. I think that would be very helpful so we can question both you and the mayor together, from two neighboring States.

Mayor, will you sit over here at the other mike. I want to say a word about Mayor Gribbs and after that I am going to ask Congresswoman Griffiths from Michigan to introduce the mayor.

Let me simply say that Mayor Gribbs has been a vigorous and aggressive mayor of the city of Detroit.

All of our cities have very serious problems and we consider that Detroit is no exception to that. but we are delighted to have you here.

I have had a chance to read your prepared statement. I am going to ask Congresswoman Griffiths, an esteemed member of this committee, to introduce you.

STATEMENT OF HON. MARTHA W. GRIFFITHS, A REPRESENTATIVE IN CONGRESS FROM THE 17TH CONGRESSIONAL DISTRICT OF THE STATE OF MICHIGAN

Representative GRIFFITHS. I am very happy to introduce the mayor. He is a constituent of mine and he lives in the next voting precinct. It is only purely accidental that the most competent people in Michigan all happen to live in the 17th district.

What I would like to say about the mayor, the thing I admire most about him is that he has not spent his time in an office building an image. He has spent it working.

Mayor GRIBBS. Thank you.

Representative GRIFFITHS. And I think that is really a very wonderful thing to say about him. I daresay he knows more about Detroit now and its problems than any other man who was ever mayor of Detroit.

I am delighted to see that you are here today, Mayor.

Mayor GRIBBS. Thank you.

Chairman PROXMIRE. You may go ahead. You have two statements, one to read and the other to be put in the record. Both will be printed in the record in full. You can handle your statement and read it any way you wish, abbreviate it if you wish.

STATEMENT OF HON. ROMAN S. GRIBBS, MAYOR OF DETROIT, MICH., ACCOMPANIED BY ROBERT ROSELLE, CONTROLLER; AND NORMAN MILLER, SPECIAL ASSISTANT TO THE MAYOR

Mayor GRIBBS. Thank you, Mr. Chairman, and my Congresswoman, for those very kind words.

Mr. Chairman and members of the committee, it is truly a great honor for me to be here today. I am here joined on my left by two distinguished public servants in the city of Detroit, Mr. Robert Roselle, controller of the city of Detroit, a lifelong public servant of great esteem and ability, and Mr. Norman Miller, special assistant in my office, an attorney, and a man of distinguished although young years in his career already.

I will attempt to state briefly a few points and the nature of my remarks will be somewhat different than I had originally intended, and perhaps you may have anticipated. When I received the invitation to address the Joint Economic Committee on the problems facing the economy, I determined at that time to present a comprehensive statement on that subject, particularly as it relates to the city of Detroit.

I met with several of the members of my staff and outlined to them the general content of what I wanted to say. I instructed them to perform a thorough job of researching this subject and to meet with me frequently for the purpose of developing the best possible prepared statement.

They have prepared a lengthy prepared statement replete with statistics which I will leave with you and have left with your staff to be entered in the record. But that prepared statement has one fatal flaw. It does not properly express the very strong sense of urgency which I personally feel.

If I may put it this way, I simply cannot bring myself to discuss economic problems in Detroit in these abstract terms at this late date.

Unemployment is not simply a statistic. It is tens of thousands of people who are hungry and poorly clothed and housed.

Production cutbacks are not simply a list of figures expressed in percentages. They are tens of thousands of people who are angry and embittered to the point of violent reaction.

The effects of inflation, the decrease in housing starts, the higher interest rates: to me, they represent conditions of such tremendous urgency—of such imminent danger—that I am convinced that the time for mere discussion is long past.

It is at the local government level that the effects of unemployment and inflation and other economic problems are most sorely felt. It is there that the desperate lack of funds is preventing the alleviation of these problems.

I want to utilize this brief opportunity to implore you—individually and collectively—to join with us in city government in taking remedial action before it is too late.

Just to put the situation in perspective, let me make a brief comparison of city government with our Nation's commercial and industrial giants. On the list of sales of major U.S. corporations, Detroit, with its annual budget of $583 million, ranks 186th—just ahead of the Pillsbury Corp.

Our budget is larger than the annual sales of Kellogg, Lever Bros., Liggett & Myers, Kaiser Steel, and Polaroid.

By any comparison, the management of this city of Detroit is as complex and difficult an undertaking as the operation of any private corporation.

But there is, of course, a major difference. I and other big-city mayors don't have the luxury of being able to go out of business if our problems get too great—nor can we cut out costly activities merely because they fail to produce enough revenue to support themselves.

We must continue to supply services as best we can—even though the services are grossly inadequate.

When I assumed office, just a little more than a year ago, we in Detroit were facing a cash deficit of some $22 million in our city budget. We also knew that we would have to have an additional $49 million for the coming fiscal year just to continue the then existing level of services. What, then, could we be expected to do to create jobs or provide for basic human needs or minimize frustration and alienation?

We are getting through the current fiscal year by means of a series of last-ditch emergency measures.

We have laid off 539 city employees.

We have not filled some 2,000 positions which have become vacant.

We have passed an excise tax on utility bills.

We are selling off land which is owned by the city and which has a far greater intrinsic value to the city than the price we are going to get for it.

We have curtailed services to the taxpayers.

We have increased the real property tax to the legal limit.

We have postponed essential programs which might have reduced crime or might have diminished the use of narcotics or might have provided better service in our municipal hospital.

Obviously, these are precisely the wrong things to do in a period of economic decline.

And having done all these things during the current fiscal year, what could we do the following year to find funds with which to improve the lot of our citizens?

There are no further tax resources available to us.

We cannot make further cuts in city personnel or municipal services.

We cannot count on sufficient help from a State government which is itself over $100 million in the red today.

We have nothing else of value to sell.

We cannot hold back the effects of inflation or the demands of city employees for a higher rate of pay.

We are facing the fiscal year once again with a cash deficit in the amount of some $15 million and a further revenue gap in excess of $43 million.

Certainly, we cannot even hope to resolve the problems which beset our disadvantaged and our deprived under these conditions.

I do not exaggerate when I say to you that I simply do not know where the necessary money to deal with these difficulties is going to come from if it does not come from the Federal Government.

In his state of the Union message last Friday, President Nixon sketched an idea for revenue sharing that could be the long-awaited response to our pleas for direct aid to local governments.

The people of our cities have endured high taxes, insufficient public services and a deteriorating environment while awaiting national recognition of the gravity of local fiscal problems.

The rallying cry for this new Federal awareness has been that we must "reorder our national priorities."

The people of our cities agree—wholeheartedly. But if this first flicker of response remains promise rather than performance, the future of our cities and our Nation will be threatened as never before in our history.

I am deeply concerned that two-thirds of the funds mentioned by the President would merely be a redistribution of existing funds.

Many of our people may not realize the critical distinction between the allocation of new dollars and the juggling of money from many existing programs into a central fund.

Actually, the formula should be just the reverse. Two-thirds of the money should be new money, not presently allocated to categorical programs.

Under the President's formula, the cities can, at best, expect a modest increase in the return of their tax dollars.

At worst—and this is a very real possibility—the President's plan could lead to an actual decrease in Federal funds returned to their source.

We at the local level have never faltered in seeking this just allocation of tax moneys.

Now, the President has indicated his willingness to make a beginning—however questionable the allocation.

The people of the Nation's cities will wait—and watch—to see how the President's detailed plans affect them—to see how he utilizes the power of his office to obtain the needed legislation—and to see how the Congress reacts to this vital need.

I have spoken of revenue sharing as a critical element in the survival of our urban areas. But I do not believe that it is the panacea for all of our ills.

Our country needs to achieve the existing commitment to full employment so that those capable of employment will not be relegated to seeking public assistance.

For most persons, job opportunities could result from a Federal policy of economic growth. For others, there is a need for job training. For still others, there must be a public employment program.

The unemployment rate for the entire city of Detroit is now 12.5 percent. A year ago, it was 6.6 percent.

For the disadvantaged in the inner city, the rate is 24 percent; this means out of a work force of 40,000 people, almost 10,000 are unemployed today in that inner city area. The human suffering and hardship reflected by such a rate very obviously cannot be measured statistically.

I urge the passage of a manpower bill with a substantial public service employment provision.

I also strongly support the passage of a welfare reform bill.

This is all I can say to you today. In the short time allotted to me to speak, I chose not to engage in extensive rhetoric on economic conditions or to present elaborate charts and tables because this is not a time for me to speak of failures and omissions of the past. And I doubt very much that this is a time when I should discuss the role of business or banking theory or the multitude of elements which comprise the the matrix of recession and depression.

It is the time, I think, to say very clearly and unequivocally that the power and responsibility of saving America's cities rests squarely on the shoulders of the President and the U.S. Congress.

Whatever else you may or may not do, you must give us your attention and your support.

To the extent that I have not responded to your specific questions, I apologize.

I have prepared a much more detailed prepared statement which I am leaving for your perusal; and, of course, I will be pleased to answer your questions.

But I say to you that you cannot reasonably expect to invite the mayor of a large American city to address you in these times and to hear anything but a desperate call for help.

You have heard mine.

Thank you.

(The prepared statement of Mayor Gribbs follows:)

Prepared Statement of Hon. Roman S. Gribbs

INTRODUCTION

This supplementary report on Detroit's current economic situation has three parts.

Part one describes the somber reality of the financial problem facing the City of Detroit.

Part two describes three broader dimensions of our deteriorating economic health: the rising cost of living, the rising level of unemployment, and rising interest rates.

Part three describes the actions that we in Detroit have taken in order to postpone financial collapse.

PART ONE: THE REALITY OF DETROIT'S FINANCIAL PROBLEM

A vivid sense of the intransigence of Detroit's financial situation is contained in the recently completed five year financial forecast for the City. A copy of the full report has been submitted to your staff. The report indicates that, in less than six months, the City budget for 1971–72 will be hopelessly out of balance unless sizable new sources of revenue are found. It is presently estimated that this budget imbalance will be at least \$43 million—11% of our present revenues. Worse yet, our projections for the future indicate that this deficiency will grow to an annual amount of \$92 million in the next five years. Detroit's tax revenues are already levied at the maximum rates permitted by State law. There is no way for the City, acting on its own, to raise significant amounts of new revenue.

Let me use next year's expenditure-revenue projections as an illustration. In 1971–72 the City of Detroit expects to appropriate approximately \$490 million to run tax-supported departments of the City. \$322 million will go toward the cost of personnel, including wages and salaries, pensions and fringe benefits. Debt service will require \$35 million. Capital expenditures will require \$34 million. Materials, supplies and other expenses will require \$55 million.

Our 1970–71 deficit will require \$15 million. Subsidies to the bus system and other miscellaneous expenses will total \$29 million.

For 1971–72, we expect to collect approximately \$447 million in revenues. The property tax will provide the City with \$144 million. The City income tax will provide another \$96 million. The utility-users excise tax will provide \$18 million.

State-shared revenues will provide another $46 million. We will receive $39 million from traffic fines and the sale of bonds for capital projects. Other departmental revenues will account for $104 million.

As you can see by comparing our revenues with our expenditures, we anticipate a revenue shortage for the year 1971–72 of $43 million. This means that the City will be spending $120,000 more per day, and $3.6 million more per month than it is taking in, in order to provide a skeletal level of city services for its residents.

These projections are made with the realization that everything that could be done to support the City in the past year has already been done. All taxes imposed on Detroiters are at the legal limit allowed under present laws. Property taxes are at the maximum rate, income taxes are at the limit of 2% and ½% for residents and non-residents, respectively, and a new utility excise tax has been instituted at the maximum rate of 5%. It is truly a grim picture.

PART TWO: BROADER SOCIAL ECONOMIC INDICATORS

The seriousness of the City's broad social economic problems also can be seen by reviewing some of the standard economic indicators for Detroit.

Interest rates

Changes in the national economy have also affected the City of Detroit by forcing higher interest rates. While our bond rating has not changed over the last five years, our interest rates have increased significantly. In 1966, for example, we marketed an issue of General Obligation Bonds at an interest rate of 3.747%. Last November, our most recent General Obligation issue was marketed at 6.708%. In other words, for each $1 million of outstanding bonded indebtedness, the City of Detroit had to pay almost $30,000 per year more than was necessary five short years ago. Since we issue an average of about $25 million of bonds a year, the increased debt service cost is about $740,000 per year, or $8,800,000 over the full life of the issue.

Perhaps of more direct concern to individuals is the rise in the price of home mortgages. In 1965, mortgages could be obtained at interest rates in the range of 5 to 5½%. Since the State of Michigan had a 7% usury limit on home loans, it became virtually impossible to obtain a conventional mortgage when the market rate for loans exceeded this figure. However, government insured mortgages were exempted and the volume of mortgage activity shifted to this sector.

Mortgage rates have recently declined somewhat from their recent record high levels. The high point for conventional mortgages of 8½% represented an increase of some 35% over the same payment at 5½%, available five years earlier. This has had the effect of limiting the number of families able to purchase housing. As noted in another part of this report, the Federal interest subsidy program has been one of the mainstays of the housing market in the Detroit area.

These are dramatic increases, and they are the direct result of the high interest rates and the tight money policy of the last several years.

Cost of living

The rising cost of living has placed a significant burden on the citizens of Detroit. Although the median income of Detroiters rose from $6,350 to $7,440 between 1965 and 1969, real buying power—the amount of goods and services that can be bought with this money—dropped 2%.

The Consumer Price Index for the Detroit metropolitan area currently stands at 137.8. Since 1965, the national price index rose 25.2% while the Detroit index rose 29.5%. Inflation has therefore effected Detroiters more than most Americans.

All segments of our population have been hurt. The best statistics available indicate that between 1969 and 1970 prices rose 6% while weekly take-home pay rose only 1.1%. Thus the Detroit bread-winner is less able to provide for his family.

The burden of rising prices has fallen especially hard on Detroit's retired persons and others with fixed incomes. Twenty-two per cent of the population receive Social Security payments, which lag greatly behind cost of living increases. Many of the services which they especially require, such as medical care and public transportation, have undergone extreme price increases. As usual, inflation is severely effecting the segment of the population which can least afford it.

Unemployment

The average rate of unemployment for the City of Detroit for 1970 was 11.7%, a drastic increase from the 1969 figure of 6.6%, the 1968 rate of 6.8%, and the 1967 rate of 7.0.% In December, 1970 alone, the unemployment rate was 12.5%, the highest figure for the month of December since 1961.

The nation-wide economic slow-down and the recent General Motors strike are generally acknowledged to be the principal causes of this situation. The automotive industry—and, consequently, related industries—are heavily dependent on the state of the national economy and the Detroit economy is, in turn, heavily dependent upon car manufacturing.

As of 1969, 15.5% of the total wage and salary employees in the Detroit area were engaged in the auto industry. The preponderance of other manufacturing employment was directly or indirectly related to it in the role of suppliers, sub-contractors, and supporting services. Slower growth or actual decline in automotive production, therefore, affects a sizeable proportion of the city's economy.

Employment in the auto industry in the Detroit area in 1969 was below the actual figure for 1966. Growth in that sector has been substantially below growth in the labor force as a whole: registering only an 18.1% increase between 1960 and 1969 as compared to a 27.8% rise in the total labor force.

Other areas of Detroit's economy have also suffered. The construction industry is lagging with across-the-board 30%–50% unemployment rates in the building trades. This is up considerably from the usual seasonal layoff figure of between 10%–30%. In addition, manpower training programs have been curtailed, both for lack of initial funds and available positions. Some 4,500 training positions were discontinued by Chrysler last year, while the veto of the manpower training bill precluded 1,500 definite and 3,500 potential jobs for unemployed persons.

Housing construction

Current economic conditions have seriously affected the housing market throughout Detroit and its suburbs. Because of high interest rates and spiraling costs, housing starts in the tri-county metropolitan area have steadily declined. Although final figures for 1970 are not yet available, it is expected that total starts will be the lowest since 1963. Of significance is the fact that single family home starts have dropped to their lowest level in twenty years. This is in part attributable to the high cost of financing. Table 1 illustrates activity in the housing industry over the past decade for the Detroit Metropolitan Area.

These trends have also been evident within the City of Detroit. Permits were issued for fewer new units in 1970 than in any year since the credit crunch of 1966. Some recovery did occur in 1970 in the construction of new single family homes. However, this was a result of two factors—the introduction on a fairly large scale of modular or factory built homes and the availability of financing for single family homes at lower interest rates under the Section 235 program. Virtually all of the single family homes built in the city during 1970 were either factory built or financed under the interest subsidy program, or both. This phenomenon is reflected in the fact that of the 828 single family homes for which permits were issued in 1970, only 33 were valued in excess of $25,000.

The construction of multiple unit dwellings in the city also continued a decline in 1970. From a total of more than 1,800 in 1968, multiple units authorized dropped to 1,170 in 1969 and 801 in 1970. What is even more significant is the heavy dependence of the multiple construction market in Detroit on subsidies from the Federal government. More than 78% of the new multiple units were built on land that had been made available through urban renewal. Another 13% of the units were financed under a Federal aid program for low and moderate income families. Only 9% of the units—only two buildings—did not involve some type of assistance. It is clear that, without the assistance of the Federal government, there would be almost no new housing activity within the City of Detroit.

Although the suburbs around Detroit have felt the pinch of inflation, tight money and declining demand, the effects have not been as severe as in the city.

The following table indicates that, while it is becoming more and more difficult to find new housing in the city, the cost of existing housing is skyrocketing. Although no 1970 figures are yet available, the average sales price of an existing single family home in Detroit rose by 66% in the previous six years. Although sales volume has remained at high levels, this sector of the market is also dependent upon aid from the Federal government in the form of mortgage insurance and housing subsidies for low and moderate income families. If this trend, the cost of existing homes rising faster than the increase in incomes continues, the purchase of any home will be beyond the means of more than half of the city's residents.

TABLE 1.—NEW CONSTRUCTION—DETROIT METROPOLITAN AREA

Year	Single-family	family	Multi-family	Gross total	Less demolitions	Net total
1955	41,253	436	1,037	42,726	(3,424)	39,304
1960	15,229	138	1,062	16,429	(2,235)	14,194
1961	14,403	88	1,308	15,799	(3,540)	12,259
1962	14,401	74	4,439	18,914	(5,169)	13,745
1963	15,612	176	6,061	21,849	(3,728)	18,121
1964	17,280	98	8,221	25,599	(4,049)	21,550
1965	18,470	114	13,315	32,025	(5,409)	26,616
1966	14,330	114	9,942	24,386	(5,101)	19,285
1967	16,887	98	12,926	29,911	(5,258)	24,658
1968	13,494	138	14,020	27,652	(5,112)	22,540
1969	10,222	162	13,582	23,966	(4,062)	19,904

Source: Southeastern Michigan Council of Governments (SEMCOG), Planning Division, 1969 residential construction in the Detroit region.

TABLE 2.—AVERAGE SALES PRICE OF EXISTING SINGLE FAMILY HOMES IN DETROIT

Year:	Number sold	Average sales price
1960	5,387	$13,800
1961	5,536	13,300
1962	4,676	13,500
1963	10,325	13,500
1964	7,482	14,500
1965	10,102	15,500
1966	9,559	17,300
1967	11,045	18,900
1968	13,734	20,200
1969	13,185	22,400

Source: Figures compiled by Schiefman and Associates for the Advance Mortgage Corp.'s "U.S. Housing Market Reports (1970)."

TABLE 3.—HOUSING STOCK CHANGES IN DETROIT

Year	Units authorized	Demolished	Net change
1960	2,071	1,719	352
1961	1,601	2,704	−1103
1962	3,128	3,831	−703
1963	2,197	2,498	−301
1964	2,321	3,060	−739
1965	1,751	4,176	−2425
1966	1,478	3,645	−2167
1967	1,710	4,294	−2584
1968	2,163	4,228	−2065
1969	1,708	3,009	−1301
Total	20,128	33,164	−13,036

Education

The Detroit Board of Education anticipates a $25.5 million deficit this year which will be compounded if there is a massive closing of Detroit area parochial schools. Should this occur, space will also be a major problem unless the public schools can lease or buy parochial school buildings.

Enrollment in the Detroit schools is down by 8,000 to 284,000 this year but costs continue to rise. Teachers' and administrators' salaries make up 75% of the school's budget. Rising construction costs make replacement of obsolete facilities extremely expensive. The school system is limited to long-term bonding equivalent to 3% of the city's assessed valuation and it has already reached that ceiling. As a result of rising costs, fewer classroom units can be built within this limitation.

Welfare

The caseload and total payments for public assistance and categorical aid have risen spectacularly in recent years. While the State of Michigan is responsible for all public welfare activities, the rise in the number of persons receiving aid is a rough indicator of reductions in consumption capacity with consequences for retail trade, in taxable income, and in capacity to maintain real property, contributing to its depreciation. Furthermore, the increased payments which must be made by the State (especially as provided by law in categories where the federal government participates) competes for State monies with such city services as education, police training subsidies, recreation projects, and discretionary grants.

The following table provides a summary of welfare trends in recent years:

WELFARE CASELOAD [1]

MONEY GRANT CASELOADS

Program	July 1969		October 1970		Percent increase case	Percent increase pay
	Cases	Payments to recipients	Cases	Payments to recipients		
OAA	12,687	$908,131	13,873	$1,088,591	9.3	19.8
AB	618	63,672	637	70,169	3.1	10.2
AD	10,446	1,007,198	12,414	1,343,173	18.8	33.4
ADC	25,723	5,366,525	37,270	8,738,990	44.9	62.8
GA	10,890	1,528,389	21,923	3,638,833	101.3	138.1
Total	60,364	8,873,915	86,117	14,879,756	42.6	67.7

[1] This data is for Wayne County, including the city of Detroit. The county is the lowest level of reporting. The State department of social services estimates 80 percent of the caseload lives within the city limits of Detroit.

FOOD STAMPS

Type [1]	July 1969 cases	October 1970 cases	Percent increase
Nonassistance	2,616	[2] 23,277	789.7
Assistance	11,539	28,229	144.6

[1] Nonassistance cases do not receive OAA, AB, AD, ADC, or G.A. Assistance cases receive OAA, AB, AD, ADC, or G.A.
[2] Inflated figure by approximately 17,000 GM strike cases.

MEDICAL ASSISTANCE [1]

	July 1969	October 1970	Percent increase
Persons certified	13,024	22,691	74.2

[1] Persons receiving OAA, AB, AD, ADC, are automatically certified for medical assistance.

Note: These figures represent those persons not receiving assistance. They are certified to receive medical assistance.

Retail sales

Detroit's retail trade has undergone a serious decline in recent years. While the total dollar value of national retail sales was pushed higher by affluence and rising prices, sales volume within the City of Detroit dropped in both absolute and relative terms. Between 1965 and 1969, retail sales within the City of Detroit dropped from $2.8 billion to $2.5 billion. Thus, while the national figure rose 23%, City of Detroit retail sales dropped 10%. This directly translates into fewer retail jobs, greater commercial blight, lower tax revenues and poorer services.

Crime

The overall crime rate in the City of Detroit increased by 15.7% in 1970 alone. Since 1950, there has been a 240% increase in crime in the city. While a direct cause and effect relationship between sluggish economic conditions and crime rates is difficult to prove, one can speculate that widespread unemployment which often results in individual demoralization, contributes to the commission of criminal acts.

At the same time, increasing crime adds to the burden on municipal government by necessitating increased manpower in the Police Department and more crime deterrent measures such as better street lighting. Not only are more units required in each case (the total police force increased 19% from 1950 to 1970), but more at a higher price per unit as wages, fringe benefits, and material costs continue to increase. In the past 20 years, Detroit's population has fallen some 15%, leaving a decreased tax base to support the additional services.

PART THREE: DETROIT'S EFFORTS TO SOLVE ITS FINANCIAL PROBLEMS

Detroit's financial crisis is typical of urban areas in our country today. As inflation has strained our tax resources, we have tightened our belts to the point that we are choking the life of our cities with falling levels of municipal services. This year the general economic downturn and the General Motors strike have accelerated the growth of our fiscal crisis.

In order to meet the crises which I have faced since taking office last January, I have been forced to take stringent economy measures, including the first layoffs of over 500 City employees. This included cutbacks in the areas of recreation programs, health services, library services, street maintenance, tree trimming and others. By the close of the 1970–71 fiscal year, we expect to have 2,500 vacant payroll positions.

In addition to these measures, my administration has passed an excise tax on utility bills, has increased the real estate property tax to the local limit, and has curtailed services to the taxpayers. The City is selling land which it owns, and which has a far greater intrinsic value to the City than the price we are going to get for it. I have postponed essential programs which might have reduced crime or might have diminished the use of drugs or might have provided better service in our hospitals.

Obviously, these are precisely the wrong things to do in a period of economic decline.

In summary, what I have actually succeeded in accomplishing by these actions during the past year is to buy a margin of time—not only for us in the cities, but for each of you, for your fellow Congressmen and for the President of the United States . . . Time to face the reality of central city decline, and to act decisively to reverse it.

Chairman PROXMIRE. Mayor, this is a very powerful statement. You certainly have to make no apologies at all. You make your points and with great emphasis.

I think most of us think of Detroit as peculiarly subject to the business cycle and to recession, depression, and so on. And your statistics that you gave us on unemployment seem to reflect that.

To what extent is this primarily a problem of recession, slowdown, problems in not selling automobiles, and to what extent is it a long run, more or less permanent problem for Detroit? Do you think that if we were able to get the economy moving in a substantial way, reducing unemployment, having a bigger year for the sale of cars, that your problems would be largely solved or not?

Mayor GRIBBS. Well, there would be a substantial improvement, of course, but these problems would not be solved entirely. Detroit is like other core cities. We have a disproportionate share of the old, of the poor, of the welfare problems, and those will be there, I expect, even if the unemployment rate goes down substantially.

So we have to do both, really. We have to urge you to do what you can and must do for national economic growth, to help from that standpoint—and also for the city as such. Even with full employment if that is achievable, and I think it is—the core cities need special attention because of the unique problems that they face.

Chairman PROXMIRE. This is the Joint Economic Committee. Of course, we have a broad charter from Congress to do our job in helping other committees and Members of the House and Senate to decide on Federal economic policies that affect many committees. I take it that a large part of your problem these days could be solved if we could help make recommendations that would stimulate our economy, improve it, expand it, and so forth.

Mayor Gribbs. Yes.

Chairman Proxmire. Let me ask you this: All of our witnesses so far seem to agree very strongly that federalization of welfare programs is one form of aid the States and localities want and need more than any other. I want to know, first, if you agree with this, and I also want to know this: In your prepared statement that welfare costs in Detroit have increased 68 percent over a 15-month period; now, that is an astonishing increase. How much of the total welfare cost is actually paid from city funds and how much help would it be to your budget if the Federal Government took this over? First, you agree it should be federalized; and second, how much help would it be if the Federal Government took it over?

Mayor Gribbs. I agree it should be federalized but I quickly point out that welfare is a State burden in Michigan. The city of Detroit has been contributing to the welfare budget on a declining basis, with just under $300,000 paid out this year as a direct cost to our operating budget. Nevertheless, federalization of welfare programs would have a direct impact on the State's total budget which would in turn affect Detroit's revenues.

That is one of the reasons that the State budget—and Governor Milliken has spoken to this on several occasions—is now in the red by $110 million. State officials are trying to resolve that crisis in the next 6 months before the end of their fiscal year.

The ability of the State to help us financially is an important factor in our general economy. This is why I point out the burden that welfare costs place on State resources. Federalization of welfare costs would alleviate this strain.

In the welfare program——

Chairman Proxmire. There was an increase of 68 percent in 15 months, 1 year and 3 months.

Mayor Gribbs. That is right.

Chairman Proxmire. I think you make a devastating point in arguing that you are in a position where there is nothing you can do. You sold valuable assets. You have laid off employees at a time when there is heavy unemployment anyway, and you say you contributed to worsening the economic conditions because you have no alternative. You have increased taxes, cut spending. You are in a very, very difficult position.

I think one of the principal purposes of these hearings is to try to bring home to the Congress how very serious your plight is, because I think it is a double message, one, that we have to help you and, two, that we have to do our best to get this economy moving.

How could the President's revenue-sharing plan lead, as you say in your oral remarks you have just given us, how could that lead to a decrease in the Federal funds which Detroit would receive? You said it might lead to an actual decrease.

Mayor Gribbs. Well, it depends on what they do with the existing categorical programs and——

Chairman Proxmire. It could, in your view, lead——

Mayor Gribbs. It could, and this is why I am waiting anxiously to see the specifics of the total program. Fifteen mayors of the larger cities met last week in Washington and we were briefed on some of the possibilities. Certainly, we don't have the complete plan.

Chairman PROXMIRE. That is very interesting.

Mayor GRIBBS. But there was a great feeling then among the mayors that the revenue-sharing program would come from existing programs being cut back rather than from new money being put into the effort. I was pleased to find that the President indicated there would be $5 billion or $6 billion in new money. However, I think it is still insufficient. Looking at it from the fiscal point of view of the city of Detroit, we are, Mr. Chairman, literally in a cage. We have nowhere we can go legally. The city of Detroit, as I indicated, has taxed itself as far as we can on income tax, utility tax, and real estate taxes.

To increase our city income tax requires enabling legislation by our State legislature. We asked for that authority last year. We did not receive it.

I was grateful for two items to which the State legislature responded positively, thereby allowing us to survive this fiscal year. For the first time in the history of the State legislature, and with the Governor's help, they gave us a direct grant, gave the city of Detroit a direct grant of $5 million which we could add to our budget.

In addition to that, they gave us enabling legislation which allowed us to pass a utilities tax. It is a flat rate and it only raises $18 million yearly but it did help. We immediately enacted the city legislation, required to put the tax into effect at the maximum rate allowed by State law: 5 percent.

This year we have no place else to go. And if we don't receive Federal aid and if the State legislature does not allow us to raise city taxes, we will somehow have to cut back services in order to balance our budget.

At this point it is estimated, as I indicated, that we need $43 million in new revenue.

Now, where do we go?

Chairman PROXMIRE. It occurs to me on the basis of your oral statement this morning and your reference to the conference of 15 mayors, it would be helpful after we get the details of the budget, which will be in a few days, if as chairman of this committee I should write to you and to mayors of other principal cities in the country and find out just what effect the President's proposed revenue-sharing program will have on your situation.[1]

Mayor GRIBBS. Yes.

Chairman PROXMIRE. If it will benefit you, how much will it benefit you? Of course, if there is any evidence that any of the cities will lose from it, we would certainly want to know that. I think that would be most valuable and useful.

Mayor GRIBBS. I would again like to indicate for the record that this is a possibility and we hope it will not happen.

Chairman PROXMIRE. I am sure we can't get a complete and precise answer because I imagine some of the revenues that will be shared with

[1] Letters and questionnaires were subsequently sent by the Joint Economic Committee to all 50 Governors and a representative sample of mayors requesting their evaluation of the need for additional Federal aid and of the impact of the administration's proposals. The results of this survey are being published in a separate volume.

the States, we don't know what they are going to do about it. But we at least ought to make some assumptions and get a general idea of what could happen.

Senator Miller.

Senator MILLER. Thank you, Mr. Chairman.

Mayor Gribbs, in your oral statement you say, "We have increased the real property tax to the legal limit."

What is the legal limit?

Mayor GRIBBS. Twenty mills.

Senator MILLER. How long ago was that established?

Mayor GRIBBS. 1932. We are the only city in Michigan that has raised it to the legal limit.

Senator MILLER. I am just wondering why couldn't the legislature authorize an increase in that if that was established clear back in 1932? There have been a lot of changes in the meantime. I know out in my own State there have been changes made by the State legislature in bonding limits, for example, and other authorities to local governments to keep pace with changes in the economic conditions over the years.

Mayor GRIBBS. There have been, Senator, other changes made. We have since received the authority to levy a city income tax up to set limits. Michigan has also authorized a State income tax. So there have been changes.

Senator MILLER. Have you asked the legislature to increase that 20-mill limitation?

Mayor GRIBBS. No, we have not. It is in the constitution. The constitution was revised last in 1963.

Senator MILLER. So you have a——

Mayor GRIBBS. It is a constitutional limitation.

Senator MILLER. You would have to get a constitutional amendment to change that maximum millage.

Mayor GRIBBS. Yes, sir.

Senator MILLER. What about the valuation of properties? What has been done to update valuations?

Mayor GRIBBS. Historically, there has been some updating of that. Real properties are assessed at a rate of 50 percent of their market value. And there is a statewide mechanism to assure that the assessments are equal throughout the State.

Senator MILLER. Well, if the State legislature so dictated, they could make it 60 percent instead of 50 percent and then, of course, your 20-mill levy would bring in more revenue.

Mayor GRIBBS. Yes.

Senator MILLER. We have been going through the throes of reevaluations out in my State and I know it is not easy, but that is another possible source of State action.

Mayor GRIBBS. Oh, indeed it is. But our preference is to have the authority and ability to tax income: a progressive form of taxation as opposed to straight regressive property taxes, which fall heavily on the poor.

Senator MILLER. What do you have in the way of an income tax in Detroit?

Mayor GRIBBS. Two percent.

Senator MILLER. A flat rate?

Mayor GRIBBS. A flat rate. That is right. It is a flat rate city income rate and a flat rate State income tax.

Senator MILLER. And you cannot change that without authority of the legislature.

Mayor GRIBBS. That is correct.

Senator MILLER. What about a city sales tax?

Mayor GRIBBS. We have none. The State has a 4-percent sales tax and, again, it is a constitutional limitation. That is the maximum that they can levy, and——

Senator MILLER. You mean in the State.

Mayor GRIBBS. In the State.

Senator MILLER. But could the State legislature authorize the city to have, for example, a 1-percent sales tax?

Mayor GRIBBS. Not without a constitutional amendment again.

Senator MILLER. You have got some constitutional amending, perhaps, that might help you.

I note in your oral statement that you suggest that you can't go to the State because the State is $100 million in the red. Here you are down here in Washington and where do you think the Federal Government is? We are much worse off than your State on a proportional basis.

Mayor GRIBBS. Well, let me indicate, first of all, that we are going to the State—we are working with the Governor at this moment in hopes of increasing the State aid formulas of various sorts that bring some money back to the city.

For example, we participate in the State collections of gas tax and sales tax and income tax. There is a rebate process, a percentage. We are hoping to use that vehicle to obtain more funds.

I want to call your attention to a matter that all States and cities face in this regard. If they increase their taxing ability or authority or rate, then they face the question that I face about having a favorable economic climate to attract industry, business. In my own instance, the city, with each increase that I make, we become less competitive with communities around the city in point of attracting new business to the city. Likewise, the State faces the same problem by risking becoming less competitive with other industrial States in attracting new business and new industry.

Thus we reach the conclusion that it would be better from the point of view of encouraging more equitable economic conditions to collect on a national basis via the income tax and turn the moneys back to the cities.

Senator MILLER. And then you sit in our committee hearings and the Finance Committee, for example, and you find that we are competitive in the world and we are concerned about jobs going overseas and about the balance of payments and about imports increasing and exports decreasing relatively. So you see we have the same problem on this level.

All I can say to you, if you premise your request to the Federal Government on the fact that your State is $100 million in the red, I think most of us would say that you are in far better shape in Michigan than we are at the national level. I thought I should make that point.

Now, in your oral statement, you stated you are going to see how the President's detailed plans work out, see how he utilizes the power of his Office to obtain the needed legislation.

I am reminded of Governor Gilligan's statement just a few moments ago that with the consent of the Republican legislature in Ohio, they will have an income tax. And, of course, with the consent of the democratically controlled Congress, the President may have revenue sharing.

But I must tell you that the power of the Presidency on this point is very limited. He can exhort, he can make speeches, but the control and the determining, decisive elements are right here in Congress.

Mayor GRIBBS. Well, I am encouraged that he has placed this at the top or near the top priority items. It is one of the six goals he spoke of.

I think the time has come when the Federal Government, through the Congress and through the President, must realize that historically we have a problem that we did not face 20 and 40 years ago. That much like the farmer has needed special attention in the thirties, and we had special problems in the forties and the fifties and the sixties, the special problem of the Nation has got to be the cities in this decade.

We are starting with a fiscal bind. If that isn't solved, we can't even begin to touch the other great human needs that exist in the core cities, primarily the core cities.

Senator MILLER. I have long been for revenue sharing. May I say it is going to be people like you who take the time along with your staff to come down here and present the picture you have presented that will be necessary to get Congress to act, and I commend you for coming before us.

Mayor GRIBBS. Thank you, sir, and I appreciate the opportunity and we will be here every time I am invited.

Chairman PROXMIRE. Congresswoman Griffiths.

Representative GRIFFITHS. Thank you very much.

May I ask you, Mr. Mayor, supposing we sent you $5 million, where would it first go?

Mayor GRIBBS. I would place it in the general operational budget because it is necessary to balance the budget.

Now, if you asked what I would spend it for, it would go to all of the ordinary, if that is the correct word, services provided by the city.

Representative GRIFFITHS. What percentage of the budget is salaries and wages?

Mayor GRIBBS. Seventy percent.

Representative GRIFFITHS. And what percentage is pensions?

Mayor GRIBBS. Fifteen percent.

Representative GRIFFITHS. About 15 percent.

Mayor GRIBBS. It is in the seventies. When we consider salaries, that is part of the package.

Representative GRIFFITHS. Is that 85 percent?

Mayor GRIBBS. No.

Representative GRIFFITHS. The 15 percent is within the 70 percent?

Mayor GRIBBS. Yes.

Representative GRIFFITHS. The 15 percent is within the 70 percent. So that in reality, what you need to pay is for running the city?

Mayor GRIBBS. Yes.

Representatives GRIFFITHS. And for those who have in the past run the city.

Mayor GRIBBS. Yes.

Representatives GRIFFITHS. That is, to retirees.

What percentage of the wage of Detroit employees is the pension?

Mayor GRIBBS. About 25 percent of the wages—about 25 percent of the total wage cost—pensions are about 25 percent of the total wage cost.

Representative GRIFFITHS. But don't retired employees, at least in some departments, receive as pensions one-half of the income of the present holder of the office?

Mayor GRIBBS. Yes. Police and fire.

Representative GRIFFITHS. And didn't you just face a situation where an arbitrator gave firemen, I believe, a 13-percent increase.

Mayor GRIBBS. An 11.1 percent increase. Firemen and police. They both went into arbitration under a new law. We offered them, as we did offer the general employees, 6-percent increase last year, a rise of income of 6.8. So we resolved 144 different bargaining units and there was an agreement of something a little above 6-percent increase last year among the general employees.

The police and fire rejected that offer and under our State law went into arbitration and they—the arbitrators in both instances, different groups—awarded the police in the fifth year an 11.1 percent increase and the firemen got the same thing with the exception that it would take effect just in the last 6 months of the fiscal year instead of the entire year.

Representative GRIFFITHS. May I ask, what is really going to happen? How can they enforce pensions against the city of Detroit? If there came a time when you just couldn't pay them, do they have the right to levy against the tax income?

Mayor GRIBBS. Yes.

Representative GRIFFITHS. Would they be paid before all present employees?

Mayor GRIBBS. Yes. We have had court decisions on the fact that we must not only pay but it must be actuarily soundly funded.

Representative GRIFFITHS. Have there been funds withheld under model cities and manpower programs from the city of Detroit other than those that have been authorized by the Congress?

Mayor GRIBBS. Well, we have to advance our own money. Either we borrow and pay the interest or do without. When funds that are granted, planned for, people are hired, action is taken based upon the income, and if it does not come to us in the time that it should be scheduled, then we have to advance it from the general city coffers.

Representative GRIFFITHS. How badly has this hurt you?

Mayor GRIBBS. Well, in model cities, it has not been a serious problem but you call to my attention, Congresswoman, the fact that it did happen to a serious extent in our pollution fight. The city of Detroit water department has committed itself to a program of sewage treatment to eliminate pollution.

We are presently involved in a $166 million treatment facility construction program. In order to have it continue and in order to complete the facility in the time that we promised to do it with the joint agreement among the State and Federal Governments and the city of

Detroit, we in the city have had to sell bonds to the extent of $40 million and we are paying the interest on those bonds because Federal funds were not provided.

We expect that the Federal Government's credit is good. We expect the money to arrive, and in order to not deter or stop that building program to clean the water, and to go below the minimal standards that have been agreed upon, we borrowed the money.

Construction is on-going and we are waiting for the funds from the Federal Government.

Representative GRIFFITHS. What would be the effect upon your budget, if any, if the Federal Government paid more of the education costs? None of the money comes out of your budget, does it, for education?

Mayor GRIBBS. It does not.

Representative GRIFFITHS. But it would make some tax room available?

Mayor GRIBBS. Yes. The board of education in Detroit is a separate entity, elected separate operational entity, as you remind me. So it would not affect us directly. But it would relieve the tax burden that the local citizens now shoulder in addition to the city taxes, thus giving us elbow room, if you will.

Representative GRIFFITHS. My time is up but I would like to remark that during the time I spent in the Michigan State Legislature, I observed that in every formula that reallocated money to the city of Detroit at that time, it paid more than 50 percent of all of Michigan's taxes. In every formula sending money back, we were at the low end of the totem pole. We never got back in proportion to what other of our State communities received.

So that if we had a better distribution formula, we might be helped a little, too. Isn't that a fact? Out of State funds.

Mayor GRIBBS. Yes. And there is some encouragement this year that that might happen. At least our staff and the Governor's staff are discussing it. There are programs and committees on this work that will be presented and, hopefully, we will be able to effect something, at least, of an improvement in the formula.

Representative GRIFFITHS. Thank you.

Chairman PROXMIRE. Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mayor Gribbs, Governor Gilligan, I, too, want to welcome you before the committee. I know your testimony is important and it represents the plight of a major State and certainly a very major city.

Part three of your prepared statement, Mayor, describes the actions you say have been taken to postpone Detroit's financial collapse. Do you see this collapse as an inevitability?

Mayor GRIBBS. No. I feel that if the Congress and the President, and there are indications of this, are absolutely aware of our condition, that they will respond much as our legislature did respond to our plea for help last year during an election year.

When I started the effort to urge legislation that would increase taxes, and when I started the effort to have the legislature—and this was originally the Governor's proposal but I joined in seeking to have the legislature grant us—give us an outright grant for the first time in history of $5 million to put into our general budget, the predictions were that it will never happen. The practicalities of politics, the legislature being up for election last fall, it just won't happen.

We then proceeded to point out the desperate need for this action and others, and they did respond. A little late, a few months later than we had hoped, but they did respond, because when they evaluated our condition, and that was brought home by every means that we could conjure up, they realized the condition we were in.

This year it will be a little more difficult to get more money because they are restricted by the same problem that the Governor mentioned here that Ohio has. Nonetheless, I expect that they will respond in some fashion because of the need.

So I am here today and the big city mayors are hoping that the President and the Congress would realize that at this point in history the cities must have special attention, and apparently some States—and the Governor speaks for some States if not all—but we must have some attention in getting more dollars into our areas of responsibility to survive or at least continue the kind of services that we are presenting now, and we must continue to provide for the citizens.

Representative WIDNALL. To what extent have the recent automobile strikes impaired the financial ability of Detroit to go on and meet its obligations? How did it affect tax collections? How did it affect income for the city as a whole and the business of the city?

Mayor GRIBBS. Well, at this point our best estimate is that it cost us at least $4 million. That is part of the $15 million deficit that we see coming this year. It was an unexpected drop in anticipated revenue. At least that amount.

The strike is over, of course. The difficulty is calculating how long it takes for suppliers in the city to rehire based upon the return to operations of GM.

But at least to answer your question directly, it cost us at least $4 million.

Representative WIDNALL. Well, actually that cost is not just measured in unemployed who are with the automobile company, but many who worked in the service industries that went with automobiles were let go. This is usually reflected precisely in the figures in connection with a strike.

Mayor GRIBBS. That is very correct. That is why I indicated it is an estimate, that we feel it is a good sound estimate but it takes a while for our city income tax to be collected and to be able to assess, because we have just finished the year, the reduction accurately, precisely, especially the effect on those supplier firms and their employees that were laid off because of the strike, and we don't know when, precisely, they will be geared up completely.

Representative WIDNALL. The tragic thing about all these strikes, in spite of what is won or realized by reason of a final settlement that appears advantageous to the striker, is an economic impact that is never regained and everybody has to come to the Federal Government to seek a bailout as a result of the strike. That certainly is a most unsatisfactory means of settling things for the entire economy.

It adds to the fuels of inflation. It seriously adds to the problems of the municipalities. And we certainly have to find a better way of doing it than we have in the past.

Last Friday, Mayor Gibson, of Newark, testified before this committee and he painted a very bleak picture similar to yours. Do you agree with him that there is nothing that can be done on the local level to deal with problems of unemployment, that a Federal manpower program is the only means of relief at this time, and will you endorse a federally supported public sectors jobs program?

Mayor GRIBBS. Yes; I would support and do support it, sir. Let me indicate that a public service provision in the manpower bill was one that I was pleased with before it was vetoed by the President, and we looked forward to having it—we were very pleased that Congress passed the bill. It meant to us somewhere from 1,500 to 3,500 jobs as best we could estimate the effect of that bill.

It is not the law now. I would urge the review and return to that bill with, as I indicated, substantial provision to provide for a public service sector.

We could accomplish two things. You would provide jobs, of course, eliminate the unemployment, and at the same time you would allow the city to provide services that it is not now providing, and that citizens should have and should expect, and do expect.

I would like to quickly indicate, if I may, that I would be here regardless of the strike. That was a small portion. That is a very small portion, relatively speaking, of our total fiscal problem that has occurred this year but if there were no strike, I would be here saying the same things except the figure would be $4 million less.

Representative WIDNALL. I didn't mean to infer that by my question. I was just trying to point up a couple of things.

My time is up. I appreciate your testimony.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Mr. Chairman, I would appreciate it as a followup question on the public service area if both the Governor and the mayor would comment on what type of public service jobs would be created.

The President regretfully vetoed the manpower bill that the Congress had passed. He said that he wanted to prevent the creation of dead end WPA-type jobs. I thought WPA was a pretty useful thing. It put people to work rather than keeping them on welfare.

But what type of jobs would you have available that would not fall in the category of dead-end jobs, Governor?

Governor GILLIGAN. Senator, I think such jobs are available in almost any type of employment that you want to mention. The anomaly is that in all our great cities and in our great industrial States that one has to just ride through the cities to see undone work on every hand. The cities need cleaning up. We need building of all kinds. We need repair work. Our parks and recreation areas are a disgrace, nor are they used as they should be because we lack attendants.

We could use virtually any type of human endeavor. It is not enough to dismiss such occupations as dead-end jobs. They are better than no-end jobs. At least we would be putting people to work. We would be making our cities and communities more livable, more attractive. We would be spending the resources of the Nation as it seems to me they should be spent.

We are not going to be able, in my judgment, to get the revenues at the State and local levels to man such programs. If it is going to be done, that additional money has to come out of the Federal Treasury It will be money well spent.

Senator PERCY. Mayor Gribbs.

Mayor GRIBBS. I would second everything the Governor has stated just now. We have some 2,500 positions that are approximately allocated and budgeted that are not filled and they run the spectrum from top to bottom. There are laborers, there are some semiskilled, there are skilled vacancies that the city needs and has programed that have been cut back. Jobs that would provide not only a work record if we could hire those that are unemployed now, but it would give them some training and exposure to services that run the gamut that are needed across the Nation. The police. There isn't an area where we couldn't use additional help and fruitfully use at various levels of skills and experience.

Senator PERCY. I would like to take the position that I think everyone in this country who is able to work and wants to work should have a job and the Government must be an employer of last resort if the private sector cannot provide that employment. There is a great deal that has to be done and I think the majority, the overwhelming majority of the people of this country, would support that kind of policy. I hope this Congress will enact appropriate legislation.

I would like to go into the area of housing. Your prepared statement which I found very interesting gives the emotional impact of how deeply you feel as well as the statistics. To think that in the city of Detroit, in the last decade, 20,000 new housing units were authorized but 33,000 were demolished, so you lost in a decade 13,000 housing units. That means every housing unit that remains is 10 years older than it was in 1960.

So they are crumbling and getting older.

You also indicate that only two buildings last year were put up without the assistance of the Federal Government, for housing, in the city of Detroit.

Mayor GRIBBS. Yes.

Senator PERCY. A few of us have this responsibility to provide the stimulus from the Federal Government. I am glad we provided that stimulus. You say there are 828 single-family homes erected, largely under 235 programs. Could both of you comment on the way we go about this? There has been some criticism of home ownership because of flagrant abuses by profiteers and housing developers. We haven't had a watch dog operation over it.

The 235 is the principle of homeownership where people have subsidized interest and buy their own homes. Does this make a more stable, better citizen in your city or in your State than if they just are put in rental units in public housing?

Mayor GRIBBS. Yes; homeownership is a great moving force for care of the facility. We talk to a landlord and he is having constant tenant problems because it is not their property. You talk to perhaps others where they have a program of joint ownership, same type of facility, and there you will see that one neighbor causes the other to take care of his property a little better because they each have a stake in the property. And that applies to multiple housing as well as individual housing.

I think that homeownership should be supported and I commend the Congress for allowing these homes to be built. Without the 235 program, as you pointed out carefully, it just wouldn't have happened.

I would like to also mention that more than 78 percent of the new multiple units that were built were built on land made available through urban renewal, another program that is helping the cities and must be continued under the categorical grant classifications, if you will.

That is why I state and restate that these programs should not be cut back, or put into another disbursement process, and that we must have continued support of both areas.

I believe that the present criticism of 235 housing is an administrative matter, that the allegations, if proven, can be corrected or the procedures can be changed. We have offered our assistance to the local office of HUD. We have a building and inspection department that has been working with HUD on a good number of HUD programs inspecting the homes and determining that they are livable and that they are up to the code by technical inspection.

Thus, when the mortgage is approved, they know that there are no violations. It doesn't need a new roof because the roof is adequate. The furnace not just looks good, but it is a solid furnace—that kind of thing.

We have expanded that program just recently to the citizens in an effort to upgrade the kind of homes we have and to eliminate the condition where there are those that, because of their lack of sophistication, buy a home that appears sound but it is not sound.

Senator PERCY. Thank you very much.

Governor GILLIGAN. Senator, we have in Ohio, according to the latest statistics available, well in excess of 500,000 substandard housing units presently being occupied by people.

We are building today less than half of the units needed to keep up with the present rate of deterioration, never mind cutting into that backlog of a half million. With every month that goes by we are falling farther and farther behind.

I do believe that home ownership is an element in good citizenship and in helping to maintain a good neighborhood. I served 12 years in the city council of the city of Cincinnati before I came to the Congress. We wrestled on a day-to-day basis with these problems in council.

I think I learned one thing during my service in the council. Mrs. Griffiths was raising the question about feeding children before. There have been questions about our other public facilities, and now about housing. All of them really relate back to income. If we could have a meaningful program of income maintenance in this country, the people would do pretty well feeding their own children and living in pretty decent homes.

Let me point out one thing. There are hundreds of millions of dollars of building going on in our central cities today, but not in housing. The most luxurious office space ever constructed on the face of the earth is being built because there are businessmen waiting to rent it at a profit to the entrepreneur who is putting it up without Federal subsidy or Federal backing.

When medicaid and medicare were adopted by the Congress, suddenly funds were made available to people who didn't have, some years before, funds for nursing home care.

Immediately nursing homes, quite attractive places in many instances, were built all over the country, hundreds and hundreds of units, because now there was a market for them.

So part of the problem in housing is to provide the people with the wherewithal to afford decent housing, and then the private builders and the others and the lenders will come forward to meet that need. But today I don't think we are really hitting the problem head-on.

Senator PERCY. Thank you very much.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Mayor Gribbs, I apologize for my tardiness in coming today. This is a busy place. I want to welcome you before the committee, and also Governor Gilligan, who we remember as a fine member of the House of Representatives. We are proud of his exalted new role.

I would like to ask you first to define this word "collapse" a little further. We have heard a good deal about the imminence of the collapse of the cities. I wonder if it is meant generally that the services provided traditionally by the cities are going to collapse or if there is such inflexibility in the typical city's budget that there simply will not be any way of reducing the demands on the city and we will have to have a repudiation of obligations already accrued.

What are we talking about in "collapse"? Are we talking about bankruptcy or simply a collapse of services?

Mayor GRIBBS. Well, I suppose ultimately both, potentially both, but let me indicate what it means to Detroit now.

We are curtailing museum hours. We are cutting back and have cut back on tree trimming, which is necessary for safety. Instead of cleaning the streets six times a year, it is four or five times a year. This kind of cutback has already taken place.

The next question is, where do you go from there? I did not lay off any policemen or firemen last year because the obvious No. 1 concern of the cities is the crime problem. We need professionals to fight crime. Because statistics continue to climb in a frightening fashion, we must maintain that work force.

We may have to cut back even in those critical services such as police, fire and hospital, in the next fiscal year.

So far we have reduced those kinds of services important to the quality of life—cultural facilities and activities that a city should provide to make life fuller.

We are reaching the point where we are going to have to cut back on essentials like police protection if we don't get some help.

We reduced service at a recreation center on Belle Isle, one of our large parks. It was losing money. Initially I proposed that it be closed down completely, but there was such a reaction because it was a very popular place, used by the senior citizens where they could gather and talk and have a snack and enjoy their later years, so we backed off somewhat and provided one floor instead of several.

The point is that in one area, recreation services, we have already taken action. We will have to continue along these lines and we are now reaching the stage that without additional revenue we will not be able to maintain the existing reduced level of services. We will have to cut back still more.

Representative CONABLE. Isn't this part of a normal process of running a city, however, to have changing priorities, to discontinue some types of services? I take it your point is that, rather, you are now cutting back on what you consider to be high-priority items and that you are already fairly far advanced in the process so that it will not be too long before you find a place where the collapse is not just of services but of structures. Is that correct?

Mayor GRIBBS. Reach that level, yes.

I might indicate that part of the total picture is the strike experiences that the cities have had, and I wanted to mention this before. The level of pay the city employees receive is not higher than what Federal employees receive, or State employees. They are generally a little behind and the demands by the employees in the city of Detroit are not unreasonable.

The State of Michigan this year will raise their employees' wages by 8 percent over last fiscal year because of the rise in the cost of living. Our employees will be asking for almost the same thing. They will ask for more. Where do we settle? What is the equitable basis? What are the limitations of our capacity to pay, our ability to pay for a raise without new revenue?

Representative CONABLE. I notice in your remarks a few minutes ago you talked about desiring not to see categorical grants cut back. You are familiar, I am sure, with the President's proposal made the other night, that we have $5 billion of new money, that roughly $10 billion be folded into a less categorical type of grant under some sort of consolidation program which, however, has been in the categorical grant area previously.

And that $1 billion be added to this, also, in new money to be a reassurance that there was planned no cutback in the total amount of categorical grant funds that were coming out.

Do you find that the temptation to accept categorical grants has been so strong that it has cut in somewhat to your decisionmaking power on the local level? Would you prefer to have categorical grants expressed more in block form so that you wouldn't have the restrictions on their use?

And a third question—will you, if you receive your share of the $5 billion of new money going into comparatively unrestricted grants such as general revenue sharing—will it result in some reduction of your own tax efforts or will it simply permit you to do more things?

Mayor GRIBBS. Let me answer the last question first. It will not result in any reduction in our own tax efforts. Taking again a very wide "guesstimate" that if the program is passed by Congress that the President proposes, with the new money, it will nowhere near provide the funds for the city of Detroit to meet our anticipated revenue gap for this fiscal year. Something like $13 million was calculated as the most we can expect, depending on when the money was available.

It will be difficult to be precise at this point. We will not cut back any of our taxing efforts.

I do favor block grants, less restrictions.

Going to the question of the President's efforts to consolidate departments and the funding processes, if it helps administer the programs more effectively—fine. I take it that is the reason for it, to improve the delivery of the services by categories to the cities. I have no objection to that.

We would prefer more flexibility under these categorical programs. I generally favor block grants. But they are doing a job in Detroit. There are problems of administration and delays and frustrations, but they are doing a job.

In urban renewal, for example, we wouldn't want the new effort to be made at the cost of existing programs. This is the thrust of what I am saying. And I would rather see new money. We need new money in addition to the help that is coming to us now.

Representative CONABLE. But if you had the same amount of money in a block grant or in a categorical grant and had the choice, you would choose the block grant.

Mayor GRIBBS. Yes; and we could be more flexible and adjust it to our needs. There is some commonality of need, but even States of a given size will have differing needs.

Representative CONABLE. Thank you, Mr. Chairman.

Chairman PROXMIRE. I would also like to say that when I said I thought the committee should write to the various mayors after we find out more about the President's revenue-sharing program, I had in mind that we would write to the Governors, too, and to you, Governor, and get your view of what it might mean to Ohio.[1]

Governor, I would like to ask you, and perhaps Mayor Gribbs might comment on this, too, what would you think of this kind of a quid pro quo possibility, that the Federal Government would take over all welfare costs and in return for that the States would take over all education costs?

Governor GILLIGAN. At the present time, Mr. Chairman, my memory is that the Federal Government's contribution to education is about 5 percent of the total effort. So we would be picking up that much additional responsibility.

Chairman PROXMIRE. You would be way ahead on that. If the Federal Government moved into welfare, they wouldn't be giving up much if the Federal Government didn't continue the smaller amount, whatever it is, that we contribute to education.

Governor GILLIGAN. You are right.

Chairman PROXMIRE. I take it that the welfare burden on the localities varies but it amounts to something and, of course, the education is a very largely local burden. Isn't that correct?

Governor GILLIGAN. It is. I would say, however, as one who had the pleasure of voting for some of those great Federal programs in education, that I would hate to see them abandoned because through them we were able to do things in the Nation which the local communities and States might never have undertaken on their own.

But if I had to make the decision today, if the offer were made, I would make the swap.

Chairman PROXMIRE. Well, there is a sound basis. After all, we do have a national interest, a very real national interest even from a strictly military standpoint in education. Of course, that was, as I understand it, one of the reasons for the beginning of the Federal interest in the educational program. And a stimulus in 1957 was sputnik.

Governor GILLIGAN. Oh, yes, that is true. And, of course, the Federal Government's involvement in education goes all the way back to the ordinance of the Northwest Territory, so it is an interest which I think is legitimately recognized at the Federal level and will continue to be.

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[1] See footnote on p. 119.

Chairman PROXMIRE. Mayor Gribbs, I take it you wouldn't object to that kind of an arrangement.

Mayor GRIBBS. It would help us generally but it would not solve our fiscal problem today because I must remind you the board of education is a separate entity, separately taxed.

Chairman PROXMIRE. You responded to Senator Miller or someone in his questioning saying this would give you more elbow room.

Mayor GRIBBS. Yes.

Chairman PROXMIRE. More leeway. It would mean your local taxpayers' property tax burden would be separately listed and you would be in a position to raise more money.

Mayor GRIBBS. And hopefully, the State would be in a position to assist by either changing the rebate formula or some basis, direct grant, aid to the cities, something like $5 million last year.

Chairman PROXMIRE. Governor Gilligan, Governor Shapp was here the other day and he made a very interesting suggestion. There appears to be a need to go out right now to shore up State and local finances temporarily until we get out of this recession and make decisions about longer range programs.

Governor Shapp proposed a program of special drawing rights, as he put it, under which States could obtain in advance from the Treasury or the Federal Reserve moneys due under Federal grant programs during the fiscal year.

Do you have any comment on that?

Governor GILLIGAN. I think, Mr. Chairman, that the suggestion has real merit. I understand Governor Shapp's present fiscal predicament to be somewhat more painful and immediate than ours in Ohio. Our problem in Ohio really is at the level of the local school district. We have had school districts closing their doors in Ohio, one of the wealthiest States in the Nation, and even if our general assembly acts with a good deal of vigor in the coming months and adopts new revenue proposals which will be offered to them, it is going to be sometime before we can get the money in the pipeline and get it into the local school districts. Quite frankly we have no reserves on which to draw, with which to bail out those local school districts, and we don't know what we are going to do to keep those schools in operation until the new legislation can go into effect.

But so far as State operations are concerned, we have now before us a budget put together by my predecessor which will continue the State's current operations for the next 2 years, no diminution of service but no new services or no increase in quality. The cost per year is an additional $267 million, in addition, but it reflects no additions, no improvement in the service level.

We can get by with that. We are not in Pennsylvania's position at the present time. But sooner or later we will be.

Chairman PROXMIRE. What Governor Shapp is referring to is perhaps this. Some economists don't even define it as a recession, although I think the unemployed would disagree with those economists, but it has been a slowdown. We have actually produced a little less in 1970 in real terms than in 1969.

It wasn't anything like some of the recessions we had in the fifties or certainly anything like what we had in previous times. We could have a deeper economic slowdown, a more profound and more disturbing situation, and we should be prepared for that kind of a situation perhaps under those circumstances, possibly some kind of right for the States to be able to borrow money from the Federal Government on a temporary basis, which might be desirable.

Governor GILLIGAN. I quite agree.

Chairman PROXMIRE. Would you like to comment?

Mayor GRIBBS. Please allow us to borrow it, too, under those circumstances.

Chairman PROXMIRE. I don't know how the Federal Reserve might feel about some of the cities, but they certainly should be allowed to do so.

Well, gentlemen, any further questions? [No response.]

Gentlemen, I want to thank you very, very much. It has been a most helpful and useful morning and enhanced our understanding and awareness of the very serious problems of our States and cities.

Thank you very much.

The committee will stand in recess until tomorrow, when we have as our witnesses Leonard Woodcock, the president of the UAW, and Mr. Howard C. Petersen, chairman of the board of the Fidelity Bank of Philadelphia.

(Whereupon, at 12:30 p.m., the committee adjourned, to reconvene at 10 a.m., Tuesday, January 26, 1971.)

ECONOMIC PROSPECTS AND POLICIES

TUESDAY, JANUARY 26, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room G-308, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Javits, Jordan, and Percy; and Representative Brown.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Courtenay M. Slater, economist; and George D. Krumbhaar, Walter B. Laessig, and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

This morning, we continue our special hearings on the problems of the economy. As I indicated at the outset, our basic purpose is to gain a more direct understanding of the impact of the inflationary recession on the individuals and institutions of our society; an understanding that would take us beyond the naked statistics of declining output, 6-percent unemployment, and a 5.7-percent rate of inflation; an understanding that would assist us in the development of new economic policies leading to better economic performance.

In the first 2 days of these hearings, we heard from some of the key State and city officials in this country. Their story of the effects of the present economic situation on State and local governments proved highly disturbing because it was so uniformly bleak. Inflation is putting the cost of essential government services out of reach. The effect of the recession is to drastically reduce State and local revenues and increase unemployment. In fact, some of the city officials who testified, the mayors who testified, said that they have had to lay off people in this recession because their revenues have declined so. Combined, these byproducts of the inflationary recession have caused a serious financial crisis in our State and local governments.

The serious, adverse impact of this inflationary recession is not limited to State and local governments, but is unfortunately more widespread. Let's look at what we already know about some of the other sectors of the economy:

There are 5 million people unemployed; and the real weekly earnings of those who are employed in manufacturing have declined by 6 percent in the last 2 years.

In farming, net income per farm fell by almost $200 from 1969 to 1970.

In business, corporate profits have been reduced $7 billion since 1969—the largest decline in the sixties—and the failure rate of businesses is rising.

We look forward to obtaining additional and firsthand information from today's witnesses on how these other sectors have been affected by the stagnation of our economy.

What is almost as distressing as the sad state of our economy is the realization that it did not all have to happen, nor does it have to continue. There are real alternative economic policies available to the Nation. One, an expansionary Federal budget together with a change in national priorities that transfers resources from defense and space to domestic programs that deal with the urgent problems of our cities, the environment, health care, manpower training, and lower taxes. Two, a critical reevaluation of restraints on the market mechanism that are inflationary, and do not appear to serve a broad public purpose, such as the oil import quota, some artificial price supports, and non-competitive Government procurement. Three, the vigorous pursuit of a wage-price guidelines policy that focuses public attention and pressure on the offenders. Four, we should endorse the antitrust laws in order to instill greater competition which would help reduce prices. Some have proposed that we should break up General Motors into more competitive economic units.

I believe it is time we took forceful public actions in the public interest.

Our first witness is Mr. Leonard Woodcock, president of the United Auto Workers. He will be followed by Mr. Howard C. Petersen, chairman of the board, the Fidelity Bank of Philadelphia. Both of these men have direct experience in how the inflationary recession is affecting the many sectors of the economy. I am also anxious to hear them speak on alternative economic policies, for they are well qualified on these matters too.

Mr. Woodcock has had a long and distinguished career with one of the great labor unions in this country, the United Auto Workers. As president of that union, he carries forward a great tradition of informed, progressive concern about the economic problems of our society. He knows the problems of labor and business especially well. He has testified here before, and we have come to expect extremely thorough presentations from him. Welcome again, Mr. Woodcock.

We welcome you, Mr. Woodcock. I notice that you have a very detailed prepared statement. You implied, at least, although you didn't state it, that you might abbreviate the prepared statement. It is over 90 pages long. The full prepared statement will be printed in the record and you handle it any way you wish.

You are being followed, as you know, by Mr. Petersen whom we would like to have time to question. I would appreciate it if you would abbreviate it.

Senator Javits.

Opening Statement of Senator Javits

Senator Javits. Just a word. I would like very much to welcome the President of the UAW and also compliment him on the fact that he is one trade unionist who is willing to mix it up, engage in a debate, which is what we are really having. I think it is a most creditable idea and shows the kind of public responsiveness which I think is desirable.

I would like to say the same thing for a very old friend and very dear friend of mine, Howard Petersen. He, too, is a businessman, a bank president, who is ready to mix it up, too, which I think can only help the country. He is a man who believes in business in the public interest, just like Mr. Woodcock believes in trade unionism in the public interest.

Mr. Petersen is also the chairman of the board of the ADELA, which is a very critical interest of mine, a great multinational, multilateral company to help develop private enterprise in the underdeveloped nations of Latin America.

Finally, Mr. Chairman, I would like to say I believe that one of the major touchstones of a reform of the business community in the terms we are talking about may be the very antitrust laws the Chair referred to—tough enforcement and lax enforcement have both not seemed to deliver the goods in terms of the American economy. If any of the witnesses have any suggestions on that score, I would certainly be very deeply interested. The time is rapidly coming when we will find the antitrust laws to be completely archaic in their application to the real facts of the American economic community and we may find that that is the handle we need in order to really reform the system and make capitalism address itself to the time.

Chairman Proxmire. Mr. Woodcock, pleased proceed.

STATEMENT OF LEONARD WOODCOCK, PRESIDENT, UNITED AUTOMOBILE, AEROSPACE, AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW), ACCOMPANIED BY CARROL COBURN, RESEARCH DIRECTOR, UAW

Mr. Woodcock. Thank you, Mr. Chairman, Senator Javits. I am accompanied by Mr. Carrol Coburn, research director of the United Auto Workers.

Again our country faces problems which are more serious than at any time since the Korean war. It is true we have had problems before, but this time we have a vast and very fastgrowing log of unmet domestic needs. These unmet domestic needs are creating smoldering fires of estrangement among the blacks, among Chicanos, the poor, the young, the aged, because our rhetoric outstrips our reforms among these age groups. The blue-color worker finds himself estranged because he is beset by unemployment, underemployment and inflation; has the false belief that others in some cases are being taken care of while he is being neglected.

In continuance of the war in Indochina, which thankfully does have a lessening of combat casualties and a reduction of ground combat troops, it is my belief the stepping up and widening of the air combat portrays the Nation at its worst, exercising a monstrous mechanical power, with a complete disdain for human life, that this is making a psychological corruption of our national life, which is showing itself in so many fearful ways.

There is also a lack of planning and coordination. It is a curious correlation that we have a military budget proposed of, I believe, $74.5 billion, yet there is a 27 percent unemployment rate in the aerospace industry. That would lead us to believe that there must be tremendous wastage hidden in that figure of $74.5 billion. Of course, the unemployment rate, the huge unemployment rate in the aerospace industry includes massive numbers of technicians, engineers, and scientists for the first time in 20 years.

The returning troops from Vietnam and all across the world who are released singly and unsung, and often to unemployment is creating additional strains and stresses in our social pattern.

Now, we have had a most erratic economic policy over the last few years on the part of our National Government and we look to this committee and to the Congress for leadership and effective action. The diagnosis that apparently was made by this administration of the problem being excessive demand and the measures taken to restrain that are, of course, we believe, not sustained by fact. Two years before this administration took office, capacity utilization rates had been trending downward and they have been ever since, accompanied, of course, by ever-rising prices.

I would like to make it emphatically clear that the first period of this inflation was accompanied by reduction in unit labor costs. Inflation had its genesis in the escalation of the Vietnam war in the second quarter of 1965 and the prices began to spiral shortly thereafter. For 12 to 15 months, unit labor costs in fact were going down. It was not until workers began to struggle, No. 1, to catch up, and No. 2, to try to protect themselves against the obvious prospect of ever-rising prices that we began to have a wage-cost push in the inflationary situation.

I would like to say that our endeavor and settlement that we made with the General Motors Corp. in the recent strike was to put emphasis on the fact that we wanted to restore the cost-of-living factor on an escalated basis to wage determinations so that we would be in a position to have a moderate and restrained increase in the second and third years of that agreement. And that, of course, we did. The wage increase is 3 percent in the second year, 3 percent in the third year, which is below the level of national productivity and substantially below the level of General Motors productivity. The first year wage increase was 3 percent plus 39 cents, of which 33 cents was catchup money as measured by the cost-of-living escalator principle.

In this regard, Mr. Chairman, I would like to draw the attention of the committee to a very strange performance on the part of the Ford Motor Co. and its chairman, Mr. Ford. The General Motors settlement was announced to the world on the 12th of November. On the 13th of November, Mr. Ford in Chicago said he thought—and I am quoting now from the Wall Street Journal of November 16—said he thought the GM settlement was inflationary, but he said he doubted that it would force Ford to raise the prices of its 1971 models again. "Ford already has posted two rounds of increases on the 1971 models, averaging a total of $170 a car, or 5.1 percent."

Now, in fact, on the 6th of December, I think it was, Ford had a third price increase. But on the 13th of November, Mr. Ford said that the GM settlement was inflationary.

General Motors then, a few days after this point, made similar increases in the salaries of its nonunionized personnel, made applicable to them the same 3 percent plus 39 cents which had been the product of the settlement with the UAW. But on the 15th of December, the Ford Motor Co., for its salaried, nonunionized personnel, increased them by 13 percent. Now, that 13 percent by itself has no great significance, because in fact, including the catchup money, our first year increase was more than 13 percent. But they put under that a guarantee of 49 cents. Whereas 13 percent applied to the production and maintenance group itself, it was only about 49 cents. So that the settlement or the proposal that was put into effect by the Ford Motor Co. for the nonunionized salaried personnel was substantially in excess of what General Motors had done for its nonunionized salaried personnel. The General Motors Corp., a few days after that, was forced to follow suit because of dissatisfaction among their salaried, unorganized people.

Now, this incredibly irresponsible performance of the Ford Motor Co. on the 15th of December did not prevent Mr. Ford going to Paris on the 22d of December, a week later, and saying "The recent new wage contracts signed by U.S. auto firms show that labor holds the upper hand in the United States. Now the power is on labor's side and not on the side of management," he said. Ford told a news conference that wage settlements the automobile manufacturers signed with unions were very inflationary ones. Yet we had made a settlement which provided for a tool and die maker 54 cents an hour. There are comparable classifications in the Dearborn engineering unit of Ford Motor Co. and under the thing which Ford unilaterally determined, that individual with a comparable skill and comparable work assignment, got 65 cents an hour.

Now, I think this completely irresponsible behavior supports the proposition that we make in our statement that Congress should legislate, and I hope the President will accept, the setting up of a price-wage review board so we will begin to tackle this question of administered prices. Because during a recessionary period as we are having now or had in 1958, the competitive prices tend to go down in correspondence to classical expectations. The administered prices, because they are set by formula, set on the basis of the cost of doing business, in fact increase because in a recessionary period, the costs of doing business tend to rise per unit. We believe that if a board was set up with statutory authority that required any company having a dominant position in any industry, such as GM in auto, Ford in auto, United States Steel in steel, proposing to increase the price, it will be required to come forward after having given notice and be required under subpena to produce all of the facts upon which they were making such a determination. And if they were saying that the respective action of the union was forcing them to that, then the union also would be required to come forward under that same power of subpena to make its case. We do not propose that the board would have the power of order or the power of recommendation, but simply to publish the facts so that public opinion could begin to play upon this hidden, cloistered sector of our economy.

I am not at all impressed by the recent behavior in the steel industry, when one company came forward with a 12-percent increase which was denounced as monstrous and the second company comes forward with 6.8 percent and that rather gigantic increase is hailed as a victory. I would suggest a few more victories like that and we are indeed undone.

If the Congress is to seriously again consider the question of wage and price control, it seems to me that it has to be on the basis of a total incomes policy, although in this regard, I think we can't close our eyes to the fact that other countries that have tried this have not been very successful in doing it.

With regard to the very sharp levels of unemployment in the aerospace industry, we would hope that the Congress would sympathetically consider the National Economic Conversion Act that has been introduced into the Senate. Possibly, as a separate approach, there could be the creation of a NASA-type agency through which the Nation could commit itself to find solutions to urban problems, to mass transit problems, traffic control, the whole matter of urban congestion and sprawl, crime control, pollution of our air and water, a NASA-type agency that could make the same commitment as we did in the moon program. Because the aerospace industry does have unique capabilities. It is the one industry which we have which proceeds on the basis of systems analysis and total programing. It has been geared to do exactly that. And our social problems, we believe, can yield to that same approach.

Those unemployed people in this industry, many of them concentrated in certain areas of our country, in the New England States, in Connecticut, southern California, the Northwest, need immediate help. In those places where we have contracts, we have supplemental unemployment benefit plans. There is not one single company in which those plans have not long since gone bankrupt because of the drawing down of their resources.

We say that those who are unemployed or underemployed by virtue of defense and unrelated cutbacks are entitled to up to 2 years maintenance of their normal weekly straight time earnings, the protection of their pension credits, insurance coverage, and retraining if necessary. This is similar to the assistance provisions of the Trade Expansion Act and are really based on the same principle. We have said where the national interest required the unfortunate dislocation of people, then the Nation had a responsibility to those people. If it is in the national interest to reduce military spending and people are directly affected by that, then the Nation has a similar responsibility to those who are so displaced.

Now, we do need a stimulus to our economy. That cannot be by a deficit budget which is brought about by sheer weight of circumstances but where Government spending is directed to investment spending, which is for the social good and inherently not inflationary as against, for example, military spending, to which the chairman referred in his opening remarks, where the spending is essentially, by its nature, inflationary.

Now, the question of social security, the statement does not deal at any length with this problem, but it is a fact that the benefits of our social security system are far below those of other nations when you measure the benefits as a percentage of the normal wage while working. We have been trying to get the attention of the Congress to the problem of pension reinsurance. Some persons call it terminal insurance, where the workers have been for years employed by a company that goes out of business or, in this day of conglomerates, where they are simply abandoned and where the pension fund does not contain sufficient money to answer all of the claims against it. Then you go down a scale by order of age until the funds are exhausted and then cut it out.

Some 25,000 people annually are caught up in these abandonments. It could be handled by a very small amount of tax through a system comparable to the Federal Deposit Insurance Corporation.

In these recent negotiations, and this goes to the question of social security, we negotiated what had been a somewhat controversial item which came under the slogan of "30 and out." Now, our contract with the General Motors Corp. and then Ford and now Chrysler provides that a man who is 58 years old who has 30 years of service can retire, providing he gets entirely out of the labor force. One year later, in 1972, it will drop to the age of 56.

Now, under our present social security rules, you take your earnings from 1950 until you are 65, dropping the lowest 5 years from that calculation. Now, if a man is 58 and he gets out of the labor force, and that is a requirement for getting this benefit, then he has 7 blank years, can drop only 5, reduces his average and reduces then his social security amount by $57. At the point it drops to the age of 56, that figure becomes 9 years and not 7; dropping 5, leaving 4 blank years; also forces him to take the years in the beginning of the period when wages were substantially lower and thereby reducing even more his social security entitlement.

Now, we prosecuted the demand for "30 and out" because of two reasons. The onerous work in much of the automobile industry, where a man who has been doing it for 30 years is literally worn out and wants to get out, can't be compared to a profession or anything comparable, and also because of the growing displacement by virtue of the onward push of technology, which we do not oppose, which we welcome, providing its benefits are generally shared. We would hope that in this kind of situation, we can get sympathetic attention of the Congress to allow a greater freeze period, where it is tied to affect the individual by virtue of the private benefit being removed from the labor force and in that fashion, helping the problem of unemployment.

On the matter of revenue sharing, which is now getting such great attention, there isn't any question that States and localities are bearing a great burden of taxes, and there is an enormous need. As a citizen of the city of Detroit, I am well aware of the enormous need my city has. I am a little confused by the phrase, "power to the people." I have become accustomed to that phrase being one thing and now from the President of the United States, I hear it means something else. I am troubled by the fact that the tax systems in the cities and the States are much more regressive than the Federal system. Certainly, if there was any thought of giving tax credits, it seems to me it would have to be on the premise that the State or local tax system would match the Federal system in its progressivity and not simply be a funneling back of funds in return for taxes which were raised in a very regressive atmosphere.

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I am troubled by cutbacks in Federal aid programs to provide revenue sharing. I do not think we would have made the progress that we have made in civil rights; I think that our educational system would be, as bad as it is, would be even worse if it had not been for Federal aid. I am, however, for revenue sharing through specific acts. I would hope the Congress would adopt the family assistance program. We have quarrels with the arithmetic of the family assistance program, but very frankly, I am more interested in the principle and would be willing to fight about the question of the arithmetic at some future date. Through this, we can begin to modernize and civilize our welfare system, which would do more than anything now proposed, as I see it, in helping the States and the localities out of the morass in which they find themselves.

Also, if the Congress can move toward enactment of the health security program that has been introduced now in both the House and the Senate to provide for a system of universal coverage, the States and the localities would not have a direct tax upon them. They would in that regard produce $2 to $3 billion of revenue sharing which would be tied to a specific act. And the resource development program provided by the health security program, which would bring greater assistance to the medical schools, many of which are State supported, throughout our country, would add billions of dollars also to that kind of specific revenue sharing rather than the granting of funds without any restrictions.

This, in general, covers the highlights of our very lengthy prepared statement. I might say, Mr. Chairman, that I have been told that one of the best ways to keep a secret is to put it in a UAW statement.

(The prepared statement and statement on the President's state of the Union message of Mr. Woodcock follow:)

Prepared Statement of Leonard Woodcock

Mr. Chairman, I appear before this Committee at a time when the nation faces problems sterner and more serious than at any time since the Korean War, and possibly than at any time since World War II.

It is true that there have been times when unemployment, for example, has been even more widespread and more difficult to overcome than it is today. There have also been times when inflation has spread more rapidly and seemingly irresistibly than is the case today. But there has never been a time in the history of our nation since records of these matters were kept when we faced such an ineluctable combination of severe and growing unemployment and severe and rising inflation at one and the same time.

These economic problems come at a time when we are also faced with other difficulties of the gravest nature, both at home and abroad.

At home, we have a backlog of unmet domestic needs which grows ever higher, and our failure to meet them, or even to have plans to meet them, has created a smoldering fire of estrangement among large minorities of our people, especially among the blacks and among the poor and the young of all races, which periodically breaks out into an open blaze of local riot and threatens to spread from center to center of our distress. As against this, we have also a smaller, less conspicuous, but probably better organized and potentially more dangerous group of extremists of the far right, who welcome every opportunity to use the protests of the afflicted as excuses for undermining the confidence of our people in the democratic processes and protections upon which the whole fabric of our nation stands.

Abroad, we seem unable to disengage ourselves from the troubles of our own creation in Southeast Asia, for even as we do succeed in bringing back some of our own troops, we find ourselves faced with demands to keep pouring out more and still more of our precious wealth to maintain in power shaky and corrupt dictatorships which rely on us for support, as do dictatorships in so many other parts of the world. And even as we do crank down some portions of our defense industry, we do so with such an utter lack of advance planning that instead of using the resources so set free for programs to meet our domestic needs, we merely add to the problem of unemployment. And if the SALT talks on disarmament with the Soviet Union should ever bear fruit, we are no better prepared to meet the further problems of peacetime conversion which that world-preserving success would create.

Finally, we have a government headed by an Administration which follows a most erratic economic policy.

Mr. Chairman, it is a gloomy prospect which lies before us, but we should never forget that the Administration is not the sole arm of government. There are wiser heads and stouter hearts in Congress, many of them on this Committee, and it is to you and to your decisions that we look for the leadership and the effective action which our country needs today more than it has done at any time in the past quarter-century.

CAPACITY UTILIZATION AND UNEMPLOYMENT

When the Nixon Administration took office two years ago its immediate diagnosis of the nation's ailment was "excessive demand." The cure for excessive demand was to be monetary and fiscal restraint. The economy was "overheated" and needed "cooling off."

While American society and the American economy are afflicted with many ills, "excessive demand" is not numbered among them. "Effective demand," that is, demand supported by purchasing power and so translated into production and jobs, has not in any recent year come close to touching the dimensions of our needs or our capabilities. There has been no *general* excess of demand nor was there when the Administration took office.

True, demand has pushed against the limits of capacity in some sectors of the economy, most notably the capital goods sector where demand in recent years has soared to unsustainable highs. And there have been troublesome supply bottlenecks in other sectors, a notorious example being our shameful performance in failing to supply adequate health care to our people. We probably pay more per capita and get less value per dollar in the health care field than any other nation. These special situations and others have indeed put pressure on some prices.

But overall monetary and fiscal restraint are hardly appropriate measures for relieving these kinds of strain, and in fact are more likely to aggravate than to alleviate them.

The general case for "excessive demand" can be made only if the economy as a whole is straining the bounds of the human and physical resources that are available to produce goods and provide services. By these yardsticks—employment and capacity utilization—we have been afflicted with too little rather than too much demand.

There have at times been shortages of labor in certain occupations and certain areas, but there has been no general shortage of labor. The lowest unemployment rates we have achieved in recent years would seem shockingly high, for example, in any of the industrial democracies of Western Europe.

Our record in reducing unemployment has been a disgrace compared to the accomplishments of other modern industrial societies. The table which follows compares U.S. unemployment rates of the 1960s with those of five European countries and Japan. In each case the rates have been adjusted to U.S. definitions:

UNEMPLOYMENT RATES ADJUSTED TO U.S. DEFINITIONS

Year	United States	France	Great Britain	Italy	Japan	Sweden	West Germany
1960	5.5	2.5	2.0	4.3	1.7	(1)	0.8
1961	6.7	1.9	1.9	3.7	1.5	1.5	.5
1962	5.5	1.8	2.8	3.2	1.3	1.5	.4
1963	5.7	2.1	3.5	2.7	1.3	1.7	.5
1964	5.2	1.6	2.5	3.0	1.2	1.5	.3
1965	4.5	(2) 2.0	2.2	4.0	1.2	1.2	.3
1966	3.8	(2) 2.1	2.4	4.3	1.4	1.6	.3
1967	3.8	(2) 2.7	3.8	3.8	1.3	2.1	1.0
1968	3.6	(2) 3.2	3.7	3.8	1.2	2.2	1.2
1969	3.5	(2) 2.8	3.7	3.7	1.1	1.9	(2) .7

[1] Not available.
[2] Preliminary.
Source: Bureau of Labor Statistics.

Of the six countries, only Italy had unemployment rates even remotely as high as ours during the 1960s. Rates in France were held below three percent in nine of the ten years. Great Britian's worst unemployment experience was about equal to our best. Unemployment rates in Japan never reached two percent at any time during the decade and in the latter half were reduced almost to one percent. Rates in Sweden were generally below two percent. Rates in West Germany were held below one percent in eight of the ten years.

By no stretch of the imagination could it be said either that there have been excessive demands on our physical capacity to produce. Capacity utilization rates in manufacturing had, in fact, been trending downward for more than two years at the time the Nixon Administration took office, from about 90.5 percent in 1966 to 85.3 percent in 1967 and 84.6 percent in 1968.

The real pressure on prices came first from the "administered price" sector of the economy—more specifically, from the hundred or so major corporations which so dominate the industries in which they are established, and are so well equipped with internally generated sources of funds for continued growth, that within relatively wide limits they are independent either of the competitive forces of the market place or of governmental attempts to influence their decisions through the operation of fiscal or monetary constraints. This pressure has, admittedly, been reinforced more recently by the perfectly justifiable efforts of working people to gain wage increases which would at least enable them to maintain a stable standard of living in the face of a growing inflation which they had not initiated and did not desire. To this theme we shall return.

THE PAST TWO YEARS

But first let us turn to the events of the past two years.

We ended 1968 with the economy still showing strength, although there were already warnings of trouble ahead. The unemployment rate fell to 3.3 percent in the final month of the year—still inordinately high in comparison with the rates of two percent or less achieved in many of the countries of Western Europe, but still the lowest rate which the United States had enjoyed since October 1953.

There were warning signals, however, in the slowing down of growth of real GNP, which increased by only 0.7 percent in the fourth quarter of 1968 as compared with 1.4 percent in the fiscal quarter, and also in weaknesses in the growth of real personal income and retail trade. Investment in housing was still rising, although the increase in new housing starts had begun to slow down. Other new investment commitments had risen sharply from the third to the fourth quarter of 1968, although in the face of growing weakness in consumer demand this could not be considered an unmixed blessing, since it heralded the danger of productive capacity still further outrunning demand with, as end results, the threat of a continued increase in idle capacity and a return to increasing rates of unemployment.

With respect to money and financial developments, December 1968 saw a spectacular rise in interest rates which brought the prime rate up to a record 7½ percent. The source of this should be attributed mainly to very strong credit demands associated with inflationary expectations rather than to a policy of economic restraint by the Federal Reserve System, because at the same time bank reserves and money were being pumped into the economy at a very rapid rate.

This increase in interest rates was to seriously disrupt the housing industry, making it virtually impossible for even a moderate-income family to purchase a new home except by undertaking extortionate payments on a long-term mortgage, and was also to make it impossible for state and local governments to meet the growing needs of their citizens.

The thorough-going tax reform demanded by many voices in Congress and throughout the nation, which should have required the many wealthy tax evaders to bear their full share of the burden of meeting the country's needs, eventuated in the Tax Reform Act of 1969. This measure did make the tax system somewhat fairer, but it closed only about one-third of the loopholes open to wealthy individuals, families and many major corporations, while not enough relief was made available to provide real tax equity for those with moderate incomes, and the tax burden carried by those living in actual poverty was only lightened, not eliminated, as it should have been and must eventually be.

Even the moderate improvements made by the Tax Reform Act have begun to be watered down. In the past year, for example, at least one additional $100 million tax loophole has been opened up through relaxation of the provision which was supposed to ensure that every wealthy person paid a minimum tax of at least ten percent each year.

HOW NOT TO DE-ESCALATE A WAR

In response to overwhelming pressure from the Congress and the people, a policy of decreasing commitment in Vietnam was initiated—interrupted, unfortunately, by an adventuristic incursion into Cambodia which drew that unfortunate country also into the theatre of war—and military expenses generally were reduced. These cutbacks in defense spending should have provided the means for a long step toward the establishment of an economy which would produce more goods and services to meet private and public social needs. Instead, these cutbacks helped to create an economic and social catastrophe for scores of communities and hundreds of thousands of workers when nothing was done to encourage or assist the conversion of defense plants to meeting civilian needs, and the savings on military spending, instead of being used for socially necessary purposes, were diverted instead to a vain attempt to balance the federal budget. There was no increase in federal nondefense purchases to offset the decline in military spending. Consequently, total federal expenditures for goods and services during the first year of the current recession dropped by close to four percent. This is in sharp contrast even to the policies of the Eisenhower Administration in 1958, when in the first year of the recession federal government purchases increased by close to ten percent.

The savings in military expenditures did not even help to produce a budget surplus. Instead, the imbalance in the economy resulting from the cut in federal purchases caused a drop in revenues and eventually led to a budget deficit.

In the meantime, as we have indicated, the reduction in defense spending, in itself laudable, played a major role in the worsening of the economic and social situation in defense-oriented communities. Defense production had been growing steadily during the three-year period ending with fiscal 1968 as a result of our involvement in the Vietnam war. Defense purchases from the private sector of the economy rose about 80 percent; it is estimated that defense-generated employment in the private economy rose from 2.1 million in 1965 to almost 3.6 million in 1968. As a proportion of total private employment, defense jobs increased from 3.9 percent in 1965 to 6.1 percent in 1968. In the aircraft industry, for example, defense employment rose from 55 percent in 1965 to about 72 percent in 1968, or from 331,300 to 615,900. At the same time, public employment generated by the Department of Defense increased from 3.6 million to 4.6 million.

The aerospace industry has been the worst hit by the cutbacks in defense spending. The index of industrial production of the aircraft industry, for example (on the base 1957–59=100) was at 138.0 in November 1970, down 24.8 percent from a figure of 183.4 in July 1969. Government aerospace expenditures have fallen from $21.6 billion in fiscal 1968 to an estimated $17.7 billion in fiscal 1971, a decrease of 17.9 percent. Total employment in the industry has declined from 1.4 million in 1968 to 1.1 million in October 1970, a decline of 23.1 percent in aerospace jobs.

The picture is even grimmer for production workers. By October 1970, 30.7 percent had been dropped from the payrolls since December 1967. Aerospace industry sources estimate that this figure will climb to 35.0 percent by March 1971. For those who have been retained, average weekly overtime hours worked have been drastically cut, from 5.2 in December 1967 to 2.3 in October 1970.

Technicians, scientists and engineers have fared much worse than in any previous slump. Aerospace industry sources estimate that the decrease in employment from September 1969 (already a year away from the peak) to March 1971 will be 18.3 percent for technicians and 12.9 percent for scientists and engineers.

This has been responsible for an almost unprecedented decline in white-collar employment generally. Between February and November 1970 white-collar worker employment in manufacturing dropped by 222,000. This is nearly three times as much as in the 1957–58 recession when the corresponding decline amounted to 81,000. During the 1960–61 recession, white-collar employment in manufacturing continued to increase.

In December 1970 the unemployment rate of all white-collar workers amounted to 3.7 percent and the unemployment rate of professional workers amounted to 3.0 percent. Both these rates represent all-time peaks for the 13-year period for which the data are available.

A Pentagon source estimates that 560,000 civilian and military jobs have been dropped by the Department of Defense from the peak of the war effort through last June 30, and that some 200,000 additional personnel will be cut from the payroll by June 30, 1971.

Due to the fact that plants of the aerospace industry have tended to cluster in a few regions of the country, the impact of the cutbacks has been especially catastrophic in those regions. It is expected that in the period between March 1970 and March 1971, 41,000 additional workers will be laid off in the Northeast-Mid-Atlantic region and 51,000 in the Pacific area. Some areas where plants of the aerospace industry are located have experienced a spectacular rise in their unemployment rates in the last year, as the following table shows.

Area	Unemployment rate (percent)	
	October 1969	October 1970
California:		
Anaheim-Santa Ana-Garden Grove	3.6	6.5
Los Angeles-Long Beach	3.7	6.2
Kansas: Wichita	3.5	9.3
Washington: Seattle	4.5	10.6

Source: U.S. Department of Labor, Manpower Administration.

Consistent with the Administration's effort to "dampen" the economy, nothing has been done to encourage and assist the conversion of defense plants into activities conducive to meeting our civilian needs. Instead the major aerospace manufacturers have been encouraged to hope that a number of big new weapons programs will be funded by Congress in fiscal 1972. The industry as a whole is not used to working within the framework of cost minimization or the vagaries of the consumer market. Thus it finds itself most at ease with the kind of federal contracts it has been handling so far. The army, navy, and air force are certainly eager to fill needs they contend were neglected during the war, and are calling for an array of expensive new weapons and equipment. Their proposals threaten to push Pentagon requests upward once more and bring on fresh conflicts with much-needed federal expenditures in the area of human resources.

CONVERSION NEEDED—PLUS IMMEDIATE RELIEF

The UAW has for many years contended that the aerospace industry and the government should prepare plans for conversion of defense plants to peacetime production, ready to be put into effect when needed. Our voice has largely gone unheeded. We still support vigorously such measures as the National Economic Conversion Act, first proposed by Senator McGovern in the 91st Congress. But right now plans for conversion, essential as they are in the long run, are not enough to meet the short-time need. Already many tens of thousands of former defense workers have exhausted their unemployment compensation benefits, or are about to do so. What they need is immediate financial help.

Such help is proposed in Senator McGovern's measure and I propose that it be given immediate, emergency consideration, if necessary, in order to speed its passage, as an independent measure separated from the long-term provisions of the bill.

This part of the McGovern bill provides that any workers certified as having become unemployed, underemployed or downgraded as a result of defense cutbacks would be entitled for a period of up to two years to maintenance of his normal weekly straight-time income, including supplementation of income on a lower-paying job, to maintenance and continued accumulation of vested pension credits, to maintenance of health and life insurance coverage, to retraining, if necessary, for civilian work, and for reimbursement of any reasonable relocation expenses for the worker and his family if that should be necessary for him to find a suitable job.

This proposal is similar, though somewhat broader in scope, to the assistance provisions of the Trade Expansion Act, and is based on the same principle—that when a worker and his family suffer unemployment or other financial loss as a result of policy decisions made by the government for the benefit of the country as a whole, then the financial cost incurred should be borne by the country as a whole.

The need for such a measure is immediate. It is urgent. The needs of tens or even hundreds of thousands of defense workers are dependent on it. I urge that it be given first priority attention by this Congress.

While areas in which the defense industry is concentrated have been especially hard hit, heavy unemployment has not been confined to those areas but has become widespread throughout the economy. The nation has 150 major labor market areas with 50,000 or more population. As of December 1970, only 17 of these areas had unemployment rates of less than 3 percent. A year earlier there were 59 such areas. Areas of substantial unemployment (6 percent or greater) totaled 37 in December, up from only 5 a year ago. Eight major labor market areas had unemployment rates of 9 percent or more compared with two such areas a year earlier. In total, 654 major and smaller labor market areas were classified by the Department of Labor as having "substantial or persistent" unemployment in December 1970.

The rise in general unemployment is greater in this recession—2.4 million in the current recession as compared with 1.7 million in 1961. In terms of the percentage of the civilian labor force the increase was 2.7 percentage points in the current recession as compared with 2.1 percentage points in 1961. Unemployment has already nearly doubled during the last two years, rising from 2.6 million in December 1968 to 5.0 million in December 1970.

But the official unemployment figure tells only part of the story. There were approximately another million workers who wanted work, but because of their age, or the lack of any work they could do in their communities, or for other similar reasons, had given up the search for work and were therefore not included in the official count of the unemployed. And there were still another two and one-half million workers who wanted full-time work, but for economic reasons were forced to accept part-time jobs or short workweeks.

Hardest hit by unemployment have been the adult male workers who are as a rule the main breadwinners of their families. Thus, between November 1969 and November 1970, unemployment among white male workers between the ages of 20 and 24 increased by 118 percent, and among white male workers between ages 25 and 54 increased by 112 percent. The corresponding increases among nonwhite workers were 106 percent for those aged 20 to 24 and 45 percent for those aged 25 to 54.

This does not mean, incidentally, as the Administration has claimed, that in this recession blacks and other nonwhite people have been hit less than whites. On the contrary, to a large extent the reason why the nonwhite official unemployment figures show less of an increase than for whites is because blacks, especially young blacks, constitute an increasing proportion of those who have simply given up the search for jobs they have discovered that they cannot find. Between November 1969 and November 1970 the labor force participation rate (those either employed or seeking work) for nonwhites aged 16 to 17 dropped from 34.8 percent to 28.9 percent, and for those aged 18 to 19 dropped from 68.4 percent to 58.0 percent.

MORE IDLE CAPACITY

As the result of the Administration's policies, our present level of capacity utilization compares with the worst experience of the entire post World War II period. It is necessary to go back to the recessions of 1961 and 1958 to find a comparable wastage of productive potential.

By industry, from January 1969 to November 1970 (latest data) idle capacity increased as follows:

UNUSED MANUFACTURING CAPACITY

[In percent]

	January 1969	November 1970 (preliminary)
Durables	18.0	38.0
Nondurables	14.5	20.0
Machinery except electrical	17.5	34.0
Electrical machinery	19.0	35.5
Autos, trucks and parts	16.5	60.0
Other transportation equipment	18.0	42.5
Fabricated metals	17.0	33.5
Instruments	15.5	36.5
Chemicals	17.5	29.5
Paper	7.0	10.5
Rubber	6.0	17.5
Stone, clay and glass	17.5	33.5
Petroleum refining	13.5	8.0
Nonferrous metals	8.5	22.5
Food and beverages	18.0	16.5
Textiles	10.5	20.0
Total manufacturing	16.5	29.5

Note: Based on McGraw-Hill data on capacity utilization.

The November 1970 utilization rate in manufacturing was only 70.5 percent. While the strike at General Motors was a contributing factor to the extremely low figure, it is significant that McGraw-Hill did not forecast an increase in utilization as a result of the settlement, but predicted only that "Since the strike at GM has been settled and production is now rolling again, the December operating rate will probably see a leveling off."

Overall output declined in the fourth quarter as real GNP dropped at an annual rate of 3.3 percent. According to the *Wall Street Journal*, an Administration spokesman estimated that the GM strike caused a $14–15 billion loss of GNP, without which there "probably would have been a fairly substantial gain" in real output. But the *Journal* also referred to other analysts who noted that accepting the government estimate of the amount of GNP loss would mean that, without the strike, real GNP in the fourth quarter would still have risen at an annual rate of only 2.5 percent, "far narrower than the 7% to 8% pace the Nixon administration is hoping for in some quarters of this year. And some Government and private analysts figure the GM strike only took about $10 billion from the economy, and on this basis real output would have advanced at less than a 1% pace."

There are preliminary December 1970 figures available for industrial production, nonagricultural payroll employment and overtime hours. These figures show an improvement as compared to November. But it is too early to draw any conclusions. We cannot say that a definite trough has been reached in November, particularly since the available data for December are only preliminary. Furthermore, it is quite possible that these data represent only a temporary "wiggle," or rebound due to take place at the end of the GM strike, after which the downward movement might continue. In fact, most of the developments associated with a strong recovery are not with us. Overall economic activity has not begun to expand, although the above-mentioned indexes (industrial production, nonagricultural payroll employment and overtime hours) and the figure for housing starts have shown a comeback in December.

PRICES

As I said in my introductory remarks, the recession was brought on deliberately, in blind adherence to an economic dogma which says that plentiful jobs and price stability are incompatible. According to this brand of economics, to slow down the rate of price increase, the pace of the economy must be slowed. In plain English this means that people have to be thrown out of work to stop inflation.

The trade-off of unemployment for price stability would be morally reprehensible even if it were economically sound. Inflation is not the cruelest tax of all. Joblessness is a far crueler tax.

However, the trade-off is not even sound economics, and predictably has been a dismal failure. While more than two million jobs have been wiped out in the name of "what is best for all of the American people," the claimed deceleration of the inflationary spiral has not yet been established. And those same Administration economists to whom so many Americans owe their joblessness would be sorely pressed if they were required to demonstrate that the game plan was at all a factor in any price relief which may have occurred.

Fifteen months ago President Nixon said:

"Let me be careful not to mislead anyone: Prices are still going up. They may continue to do so for a while—a 5 year momentum is not easy to stop. But now prices are no longer increasing faster and faster. The increases not only have slackened but the rates of increase are actually down. Without shock treatment, we are curing the causes of the rising cost of living."

If the game plan had any validity, surely those who were advising the President would have had some grasp of the outlook for prices. But they obviously did not and, consequently, the President's words *were* misleading. The pace of inflation was not slowing down when he made the speech, but continued to accelerate for many, many months.

Recently, we have again been hearing that inflation is finally on the wane. In his recent televised press conference the President flatly claimed: "We are beginning to make real progress in fighting inflation."

While I would like to hope that he has been correctly advised this time, the evidence seems less than convincing. It has just been revealed that the GNP deflator, which is the most comprehensive price index available, rose at a 5.7 percent annual rate in the final quarter of 1970, up sharply from the third quarter rate of 4.6 percent and from the fourth quarter 1969 rate of 4.9 percent.

Recent month-to-month changes in the Consumer Price Index have been erratic and not indicative of any general trend. Quarter-to-quarter changes in the CPI suggest, if anything, a re-acceleration of consumer prices late in 1970 following a slowdown in the summer months.

Over the longer term, measuring by half-year periods, there does appear to have been some improvement in the CPI. However, these data do not reflect a broad slowdown of the price spiral, but only very sharp fluctuations in food prices, which are far more influenced by short-run supply conditions than by the state of the economy generally.

In the past four half-year periods the trend in the CPI, including and excluding the food component, has been as follows:

ANNUAL RATE OF CHANGE IN THE CONSUMER PRICE INDEX

[In percent]

	All items	Food component	Services and nonfood commodities
1969:			
1st half	+6.30	+7.08	+5.93
2d half	+5.80	+7.01	+5.45
1970:			
1st half	+5.94	+4.31	+6.37
2d half [1]	+4.62	-.54	+6.35

[1] Through November.

Throughout 1969, food prices, which have a weight of about 23 percent in the index, exerted an important upward pull on the CPI. In 1970, they exerted a sharp downward pull. As a result, while the increase in the All Items CPI was lower in the 1970 second half than in any of the three preceding half-year periods; the second half increases in the nonfood components of the CPI was almost identical to that of the first half, and was significantly higher than the increases of either half of 1969.

Thus, any progress on the consumer price front seems to be dependent in large measure on developments in food prices, developments, I might add, which are almost certain to be reversed in the coming months. With no abatement of the rising trends in the prices of services and nonfood commodities, any claim that we are making real progress in fighting inflation rests on extremely shaky ground.

For the year 1970 as a whole, the GNP deflator increased by 5.3 percent and real GNP dropped by 0.4 percent. This is the first yearly decline in real GNP since 1958 and the steepest price increase since 1951.

The following is the *Wall Street Journal* (1–19–71) comment:

"While the full-year drop in real output was the first since 1958 and the price rise the steepest since 1951. on balance 1970 was worse than either of those earlier two years, some Government analysis noted. In 1958, though production fell, prices rose only 2.6%, while in 1951 the sharp rise was paired with a strong 7.9% increase in real output."

WORKERS ARE THE VICTIMS, NOT THE CAUSE OF INFLATION

It is fashionable to date the beginnings of the present inflation in the year 1966. However, its roots are to be found in the years 1960–1965. It is equally fashionable to attribute the inflation to wage increases but again its real roots are elsewhere. In an illuminating analysis of the causes of inflation the *Wall Street Journal* of August 5, 1968 stated:

"Any attempt to fix the blame for today's inflation, however, shouldn't be limited simply to a consideration of labor costs. The blame, it can be argued, belongs in many places.

"A major culprit may be corporate profits. A glance at the economic history of the post-World War II era certainly suggests that inflation often has been just as much 'profit-push' inflation as 'wage-push.' Consider a few facts of the postwar era:

> "In the past 20 years. there have been three distinct periods in which factory prices climbed substantially over a prolonged interval.
>
> "In each instance, labor costs per unit of factory output were *declining* when the price climb began and these costs continued to decline for a considerable period after the price rise was under way.

"In each case, corporate profits began to increase sharply well *before* the price climb started.

"Such facts, at least to some economists, bear an obvious message. 'The pattern is clear enough,' says Peter L. Bernstein, president of Bernstein-Macaulay Inc., a New York investment counseling service. 'Instead of labor costs pushing prices up, what we see instead is a sort of profit-push. Profits are already well on their way up before prices begin to rise, and prices are well on their way up before wages begin to rise faster than output.'

"Indeed, some analysts say that the postwar economic record suggests a chain of events that runs something like this: Profits begin to climb, first through the impact of better machinery and work methods on unit labor costs, and then through higher prices; the rising profits finally prompt labor to attempt to 'catch up' by seeking sharply higher pay; ultimately, unit labor costs begin to rise, too, giving inflation a further push." (Emphasis in original.)

As the *Wall Street Journal* points out, and as I documented in great detail before the House Banking and Currency committee last June, labor costs were falling when wholesale prices began to rise sharply at the end of 1964. There were no pressures of labor costs to justify the price increases which started the upward spiral on its way. Moreover, unit profits were rising even before prices were increased; there were no nonlabor cost pressures either which would justify any increase in prices. On the contrary, with unit labor costs falling and unit profits rising, clearly it was a period when price *decreases* were in order.

Nor was there an excess of demand relative to supply to cause a "bidding up" (the economist's euphemism for price-gouging in a rapidly rising market) of prices by consumers during this period when the inflationary spiral started. Unemployment, while declining, remained excessively high throughout the period. Capacity utilization, while on the increase throughout much of the period, remained far below optimum rates. The most obvious explanation for the price increases which launched the inflationary spiral is that the business community saw an opportunity to increase profit still further and seized it—with no concern for the inflationary consequences of its actions.

As a result, the economy had gotten badly out of joint by the end of 1965, with income imbalances that sorely needed correcting. Boosted by unwarranted and excessive price increases, corporate profits had increased by 56.5 percent during the preceding 5 years. Dividend payments to stockholders had increased by 47.8 percent. Personal interest income had increased by 65.3 percent. Wages and salaries, on the other hand, had increased by only 32.5 percent.

The upward pull of prices on unit labor costs has been apparent since 1966 as workers have been forced to seek increases in money wages at rates in excess of productivity gains to protect their living standards against further erosion by inflation and to attempt to correct the distortion in the distribution of national income that was made at their expense. They have met with indifferent success. As of November 1970, the gross weekly earning of production workers in manufacturing averaged $134.25, an increase of 21.0 percent since December 1965. During the same period, however, the Consumer Price Index advanced by 24.1 percent. The *real* earnings of manufacturing production workers declined by 2.5 percent during this period. The decline in real spendable earnings (after social security and federal income taxes) for the head of an average family of four was even greater, amounting to 6.0 percent. Thus, for the past five years production workers in manufacturing have been fighting a losing battle. Not only have they failed to achieve gains commensurate with increased productivity since 1965, but the buying power of their earnings is less than it was five years ago.

Earnings of other occupational groups, especially professionals and managerial employees, have increased much more rapidly. The median earnings of male civilian, year-round, full-time workers by occupation were as follows in 1964 and 1968:

MEDIAN EARNINGS OF MALE CIVILIAN YEAR-ROUND FULL-TIME WORKERS, 1964 AND 1968

Occupation of longest job	1964	1968	Increase: Amount	Increase: Percent
Professional, technical, and kindred workers:				
Self-employed	$14,167	$17,358	$3,191	22.5
Salaried	8,311	10,243	1,932	23.2
Managers and officials (salaried)	8,828	10,661	1,833	20.8
Craftsmen, foremen, etc	6,613	7,958	1,345	20.3
Clerical and kindred workers	6,225	7,324	1,099	17.8
Operatives and kindred workers	5,738	6,773	1,035	18.0
Service workers (except private household)	4,861	5,898	1,037	21.3
Laborers (except farm and mine)	4,487	5,606	1,119	24.9

Note: The Census Bureau also publishes data on self-employed proprietors and farmers and on salesworkers, but since these groups encompass such a broad range of earnings levels, comparisons of median earnings over time are not apt to be meaningful as a measure of income changes. 1964 is used as the starting point of the table because 1965 data are reported to be unreliable due to processing errors.

Source: U.S. Census Bureau, "Population Characteristics."

As the table above shows, operatives and kindred workers, the group most likely to be associated with strong labor unions, experienced nearly the smallest percentage increase in income of any occupational group shown. The biggest percentages went to the highest-paid and the lowest-paid occupations.

The significant gains achieved from 1964 to 1968 by low-paid service workers and laborers, who tend to have the least bargaining strength of any groups in the employed work force, illustrate the tremendous force of a prosperous and rapidly expanding economy in improving the lot of the working poor. Because a strong and increasing demand for workers is essential in enabling them to make meaningful progress, the restrictive economic policies undertaken in 1969 had the greatest impact on these groups. Changes in median income by occupation between 1968 and 1969 compared as follows:

MEDIAN EARNINGS OF MALE CIVILIAN YEAR-ROUND FULL-TIME WORKERS 1968–69

Occupation of longest job	1968	1969	Increase: Amount	Increase: Percent
Professional, technical, and kindred workers:				
Self-employed	$17,358	$20,279	$2,921	16.8
Salaried	10,243	11,427	1,184	11.6
Managers and officials (salaried)	10,661	11,849	1,188	11.1
Craftsmen, foremen, etc	7,958	8,741	783	9.8
Clerical and kindred workers	7,324	7,942	618	8.4
Operatives and kindred workers	6,773	7,324	551	8.1
Service workers (except private household)	5,898	6,333	435	7.4
Laborers (except farm and mine)	5,606	6,024	418	7.5

There can be no question of the meaning of these figures. In year one of the game plan, those who had the most got the most, not just in absolute dollars but in percentage terms as well. Data for 1970 will not be available for some time, but there is no reason to believe that the 1969 results were not repeated, except possibly to an even greater degree.

The snail's pace of real progress among lower-paid occupational groups in 1969 can be seen even more clearly when the data are adjusted for increases in the cost of living. The figures which follow are in dollars of constant (1969) buying power:

MEDIAN EARNINGS (IN 1969 DOLLARS) OF MALE CIVILIAN YEAR-ROUND FULL-TIME WORKERS 1968-69

Occupation of longest job	1968	1969	Increase Amount	Increase Percent
Professional, technical and kindred workers:				
Self-employed	$18,295	$20,279	$1,984	10.8
Salaried	10,796	11,427	631	5.8
Managers and officials (salaried)	11,237	11,849	612	5.4
Craftsmen, foremen, etc	8,388	8,741	353	4.2
Clerical and kindred wrokers	7,719	7,942	223	2.9
Operatives and kindred workers	7,139	7,324	185	2.6
Service wrokers (except private household)	6,216	6,333	117	1.9
Laborers (except farm and mine)	5,909	6,024	115	1.9

The real progress of clerical workers, operatives, service workers and laborers in 1969 was well below the long-term trend of productivity growth. Real earnings of professionals, managers, and other high-paid occupations were, on the other hand, well above the long-term rate of growth in productivity. Again, the conclusion is inescapable. Those who direct their fire at blue-collar and non-supervisory white-collar workers in the fight against inflation are aiming at the wrong targets.

GM SETTLEMENT

Few have been hurt more than auto workers and their families by the inflation and by the restrictive policies which the Administration has used in its ineffectual effort to fight it. The auto worker suffers even more severely than most other workers because a new car is an expensive and often a postponable purchase. Auto sales are apt to drop sharply when the economic climate is threatening. Even people who are safely employed, if they begin to worry about their economic prospects, often translate that worry into action by "letting the old car do for another year."

For auto workers, 1970 was a difficult year in which to conduct collective bargaining. In the first half of the year, production worker employment averaged 25,000 persons less than in the corresponding period of 1969. For those who were still employed, average weekly hours of work declined by nearly 4 percent. Straight-time hourly earnings were somewhat higher, but gross weekly earnings were slightly lower due to the reduction in the workweek.

The after-tax pay (spendable weekly earnings) of the average employed auto worker with three dependents, expressed in current dollars, was less than one percent higher in the first half of 1970 than in the first half of 1969, even though half of the surtax was removed at the beginning of January 1970. And the buying power of his paycheck was down 5 percent because of the inroads made by rising prices on things which he and his family had to buy.

Caught between uncertainty of employment, shrinking income and rising living costs on the one hand, and a restrictive political and economic climate on the other, the task of collective bargaining was most difficult. Not until after a strike of more than eight weeks' duration were the UAW and GM able to reach an honorable settlement: one which by any objective analysis was fair to the auto worker, fair to the corporation and fair to consumers.

Almost before the ink was dry on the new agreement, however, the Council of Economic Advisors issued its second "Inflation Alert." singling out the agreement as one which "if generalized throughout the economy, would crowd further upward costs per unit of output and, therefore, the price level."

I resent and reject this charge.

Instead of being a target for criticism, the UAW-GM agreement should be welcomed by the Administration as counter-inflationary.

The Council makes much of the average 51 cents per hour increase provided in the first year of the agreement. However, the Council well knows that the first year wage increase would not have been nearly as large had the Administration kept its promise to stabilize prices. A major part of the first year increase is cost of living "catch-up" money which merely makes the auto worker whole for past inflation. The only wage increases General Motors workers are guaranteed in the second and third years of the contract are the 3 percent "annual improvement factor" increases which are extremely conservative in relation to the actual average long-term rate of increase in national productivity, and greatly understate the country's national productivity potential. And as the Council well knows, the increases are far below the long-term trend of auto industry productivity increase. By no stretch of the imagination can such wage increases be called inflationary.

There is no anticipation of further inflation built into the General Motors agreement, only protection against inflation if and to the extent it does occur. Auto workers will not get a single penny more than the 3 percent annual improvement factor increases unless prices continue to rise, and then only after they have risen. Under our cost-of-living wage escalator clause the chain of events is "price-wage," not "wage-price."

The Alert takes the position that any increases in money wages in excess of long-term productivity trends are excessive. However, common sense dictates that in the absence of price stability this claim loses any validity it might ever have had.

Realistically, the choices confronting the parties to a long-term agreement during an inflationary period are essentially two. One, they can speculate as to the further progress of inflation and anticipate that inflation by adopting greater wage increases now or at stated times during the life of the agreement. This builds into the cost structure of the industry the consequences of an inflation which may or may not occur. In doing so it can put pressure on prices.

The alternative is to employ a cost-of-living escalator clause which, as I have said, comes into play only if prices should increase, and then only after such increases do in fact occur. Such an arrangement exerts no pressure on prices. No inflationary expectations are built into industry costs.

For the CEA to label an escalator clause as inflationary is to claim that those who have been disadvantaged by an inflation to which they did not contribute have no right to make themselves whole. To claim that escalator clauses cause price increases "down the road" and thus contribute to the continuation of an inflation once it has begun is to infer that those who have been advantaged by the inflation (and as we have shown, workers are not included in that privileged group) have the right (and the market power) to protect their inflated gains by pushing up prices still further.

The Council's reference in the Alert to competition from imported cars is directed to the wrong address. There would be no significant import problem today if the auto corporations had heeded more promptly the repeated urgings of the UAW over a period of many years to compete head-on with imports by producing small cars in their U.S. facilities. As the era of the compact car proved a decade ago, the industry can compete most effectively with foreign producers when it chooses to.

While complaining about the terms of the settlement, the Council barely mentions GM's two rounds of price increases on its 1971 model cars. Those increases, as the Council could easily have calculated, were far in excess of the first-year cost of the settlement, even if no allowance is made for normal increases in productivity. While the Council is certainly aware of the enormous profitability of the automobile industry, it makes no comment whatever on the ability of General Motors to absorb the cost of the settlement without raising prices.

I take strong exception to the official CEA line that achievement of price stability depends on saddling workers with permanent losses of real income. The pressure on prices that is exerted by any given wage increase can be measured only in terms of productivity and profitability. It is unfortunate that the Council did not direct its efforts to examining the ability of General Motors to absorb the negotiated wage increases out of its productivity and excessive profits.

MORE PROMISES—NOT MORE PERFORMANCE

The Administration suggests that a new phase of expansion is just ahead of us. In his televised conversation with a small group of reporters on January 4 last, President Nixon said:

"This the prediction: 1971 is going to be a year of an expanding economy in which inflation, the rise in inflation, is going to continue to go down; in which unemployment, which is presently too high, will finally come under control and begin to recede. Nineteen seventy-one in essence, will be a good year, and 1972 will be a very good year.

"Having made that prediction, I will say that the purpose of this administration will be to have an activist economic policy designed to control inflation but at the same time to expand the economy so that we can reduce unemployment, and to have what this country has not had for 20 years, and that is a situation where we can have full employment in peace time without the cost of war and without the cost of excessive inflation."

Such promises would be more impressive if we had not heard them all before. As some members of this Committee may recall, when I appeared before your Subcommittee on Economy in Government on June 16 of last year, I quoted then some promises made by the President in his State of the Union Message the previous January. In that message he said particularly:

"As I look down the new road which I have tried to map out today, I see a new America as we celebrate our two hundredth anniversary six years from now.

"I see an America in which we have abolished hunger, provided the means for every family in the nation to obtain a minimum income, made enormous progress in providing better housing, faster transportation, improved health and superior education.

"I see an America in which we have checked inflation, and waged a winning war against crime.

"I see an America in which we have made great strides in stopping the pollution of our air, cleaning up our water, opening up our parks, continuing to explore in space.

"And, most important, I see an America at peace with all the nations of the world."

To which I found mystelf called upon to add:

"These are fine words, but they need to be transformed into action . . . That action has not yet been forthcoming."

ACTION NOT FORTHCOMING

The action has still not been forthcoming.. Between January 1970, when the President delivered his State of the Union Message, and the latest dates for which figures are presently available, almost a year has passed. In that period, unemployment, seasonally adjusted, has gone up from 3.4 million to almost five million, or by 46 percent, and the rate of unemployment has risen from 3.9 percent of the civilian labor force to 0.6 percent, the highest rate in nine years—and, as I have already pointed out, these official figures exclude large numbers of people who are actually unemployed or underemployed, but who for technical reasons are not included in the unemployment count.

The Consumer Price Index has risen from 131.8 to 137.8, or by 4.6 percent in 10 months, equivalent to an annual rate of 5.5 percent.

Far from hunger having been abolished, the buying power represented by the weekly after-tax paycheck of the average factory worker has dropped by 2.8 percent. And, according to the *New York Times*, the budget of the Office of Economic Opportunity for the upcoming fiscal year is to be cut by 10 percent—after the agency had successfully resisted attempts by the Administration to slash its budget by 22 percent.

The *Washington Post*, in a more detailed report on January 7, indicated a cut of about 9 percent. It reported:

"The budget summary, dated Jan. 3 and still in galley form hasn't yet received final White House approval. It was smuggled out by poverty corps officials determined to block the crippling and dismantling of antipoverty projects.

"VISTA, the domestic Peace Corps which sends volunteers into impoverished ghetto neighborhoods and rural districts, at first was phased out entirely in the backrooms.

"In the final struggle, however, $33 million was allotted to keep VISTA alive—down $3 million.

"The Rural Economic Loan Program, a multimillion dollar project to help dirt-poor farmers would be wiped out.

"The heart of the antipoverty effort is the community action programs whose enemies at first slashed them by $40 million. In the Jan. 3 draft, however, the programs have actually been increased by $1 million to a $368 million level.

"Special impact funds also will be cut from $36 million in Fiscal 1971 to $25.5 million in Fiscal 1972. These funds are used to meet sudden and special economic problems in ghetto areas.

'The controversial legal aid services, which provide eager young attorneys to help the poor with their legal battles, have been cut back from $65 million to $61 million."

Among other contributions made by the President toward the creation of "a new American experience" have been vetoes of a number of bills—two education measures, extension of the Hill-Burton program of aid for hospital construction, added funds for urban development, a raise in pay for federal blue-collar workers, and an expanded manpower training program which would have included adoption of the principle of the government as an employer of last resort, recommended by the Automation Commission in 1966.

By contrast with his vetoes of these constructive measures, the President just a few weeks ago signed a bill increasing his own retirement pay—and that of other Presidents—from $25,000 to $60,000 a year, with provision for further automatic increases whenever the pay of Cabinet members is increased.

These are not the ways to meet America's needs today.

And if the President has such supreme confidence in the success of his policies, some of his chief advisers do not.

Just last November, Mr. Herbert Stein, a member of the President's Council of Economic Advisers, spoke to a group of the California Bankers Association. After explaining the difficulties of reducing unemployment while at the same time restraining inflation through the use of the orthodox measures recommended by the Council and strongly endorsed by the President, Mr. Stein put the problem facing the Administration in these words:

"The general problem we face may be briefly summarized. We seek a rate of increase of total demand which will meet our goals for progress on the inflation and unemployment fronts. We cannot be certain what the required rate of increase is. Moreover, we seek to achieve the required rate of increase by the use of fiscal and monetary policies, although we cannot be sure what dosage of these policies is required."

One cannot help but admire Mr. Stein's frankness. But such a statement, and the attitude toward our present economic difficulties that it reveals, cannot give us too much confidence in the economic policies of the Administration to which he is an adviser—especially when that Administration is headed by a President who is convinced that there is a simple solution to all our problems—even after two years of continuous failure to find it.

STIMULATION OF THE ECONOMY IS ESSENTIAL

One fact, however, is perfectly clear. Even the President has now admitted first, that there is a need for stimulation of our stagnant economy to take us out of our present recession and back into a period of continuing growth, and second, that such stimulus must come from expansionary policies on the part of the government.

Certainly, in a period of rising unemployment and declines in the real purchasing power of those still employed, we cannot expect any spontaneous stimulus from increased consumer spending. Rather, these factors have led inevitably to more pessimistic consumer attitudes, which will affect particularly purchases of durable consumer goods such as automobiles and major appliances, which must be paid for over time.

The Census Bureau conducts periodically a survey of consumer attitudes and consumer buying intentions. In these surveys the Census found that the changes in consumers' actual incomes and the change in consumers' expected future incomes are two factors which influence significantly consumer buying intentions. Thus it is most significant that the most recent survey showed that both these factors have greatly deteriorated. The percentage of families whose income was lower or substantially lower than a year ago increased from 10.1 percent in October 1968 to 11.1 percent in October 1969 and 13.6 percent in October 1970. At the same time, the percentage of families who expect next year's income to decline increased from 5.5 percent in October 1968 to 6.0 percent in October 1969 and 7.3 percent in October 1970. The Census Bureau in the summary of the survey considers these two trends as its most significant findings.

The complete collapse of car sales in recent months was blamed by the Administration on the GM strike. But now that the GM strike has been settled the situation has not improved as much as had been expected. The *Wall Street Journal*, correctly, blames for the customer reluctance the "inflation backlash", i.e., the cumulative effect of the annual price rises since 1965. This is what the *Wall Street Journal* has to say about the situation:

"They aren't trading this year—and dealers from coast to coast are in trouble. Dealers interviewed here at the convention of the National Automobile Dealers Association—which ended yesterday—say many of their regular customers are hanging on to their late-model cars for another year. Special efforts to get them into the showroom don't seem to be working. And when they do come in, many are harder to sell, than in the past.

"The postponed purchased pattern is helping dealers' service business, but it is cooling the optimism of many dealers about how sharply car sales are going to rebound from last year's dismal pace."

It is true that Mr. Stein, in his address to the California bankers, did see a ray of hope in "a sharp rise in the number of new houses started and an expansion in financing for State and local government expenditures." But for the six months ending in December 1970 the average rate of housing starts was not only a million units per year below the level of 2.6 million which Congress has decided we must maintain for at least ten years in order to make up our deficiencies in housing, but was actually below the level achieved as far back as 1963.

In order to put our current performance in the housing field into the right perspective, we ought also to look at the expenditures for residential construction, expressed in dollars of constant buying power. These data reflect not only the quantity of housing built but also its quality. Expressed in dollars of 1958 buying power, residential construction expenditures in the fourth quarter of 1970 at an annual rate amounted to $21.7 billion, or 3.0 percent of GNP. In 1963 and even in 1959 these expenditures were higher by approximately 15 percent, amounting to $24.8 billion and $24.7 billion respectively. Expressed as a percentage of GNP these expenditures amounted to 4.5 percent in 1963 and 5.2 percent in 1959. These data indicate very clearly that the current "achievements" in residential construction are extremely poor if measured either against our goals or against what had been achieved in the recent past.

As for expansion in State and local government expenditures, no continuing increase can be anticipated there on the basis of present sources of revenue, which have totally failed to keep up with needs. The possibility of increasing these expenditures through large federal grants or "revenue sharing" will be discussed below.

NO SURGE IN BUSINESS SPENDING EXPECTED

Nor can we expect any expansionary impetus from business fixed investment expenditures. In this respect we agree completely with Professor Heller and with the econometricians of the University of Michigan who expect a decline in 1971 in real investment spending.

Such expectations seem justified in view of the fact that interest rates, although somewhat below their peak, are still abnormally high, and that the relative increase in the net corporate debt has sharply accelerated in recent years and between 1968 and 1969 was three times larger than the average for the postwar period.

While it is true that the Administration has announced liberalization of depreciation rules which will permit already-accelerated depreciation on business equipment to be accelerated still more, it is questionable whether this will have a significant effect on business spending when approximately 28 percent of our industrial capacity is still idle.

This conclusion is supported by a survey conducted by the *Wall Street Journal*, which reported bluntly on January 12 last:

"President Nixon's new liberalized depreciation rules aren't likely to unleash a flood of corporate capital spending in the immediate future."

The report went on to describe "the lethargic reaction of a score of businessmen across the country to the new depreciation rules." The gist of the survey's findings was that the new rules simply wouldn't provide enough stimulus to initiate new investment in the face of low levels of consumer spending and the present extent of idle capacity.

Another most important point made by the report, however, was that even if the new depreciation rules did not stimulate investment, they would provide a substantial cash windfall for many companies even without increased investment. The report said:

"Even if they don't spur capital spending in the immediate future, the new depreciation rules could mean handsome tax savings and additional cash for companies. Generally, the amount deducted for depreciation, lumped together with after-tax earnings, make up a company's cash flow.

"Charles R. Allen, vice president and chief financial officer of TRW Inc., estimates a 20% reduction in depreciation lives will boost the cash flow of the Cleveland-based aerospace company $400,000 to $500,000 in the first year. For the second year, the gain could jump to 'a little over $1 million,' he said.

"Not that TRW plans to increase its spending because of the windfall. 'I doubt seriously that a change in depreciation guidelines would affect our spending rate,' he said."

If the only effect of the new depreciation rules is to increase the cash in the treasuries of corporations which are already unwilling to increase their investments, it is clear that the amount of revenue thus lost to the government could be far more effectively used in direct spending to meet such social needs as a stepped-up housing program.

In some ways, in fact, to the extent that it does stimulate investment, this form of assistance to business may conceivably do more harm than good under present economic conditions. Almost certainly it will be of relatively greater value to large corporations than to the smaller business firms; the larger companies are more likely to have available to them both internally generated sources of funds and opportunities for borrowing. Thus the new depreciation rules will tend to assist larger firms to grow at the expense of smaller ones, so increasing the degree of concentration of economic power in fewer hands, lessening competition and increasing the area of the economy which is subject to administered price (profit-push) inflation.

It is argued that encouragement of investment in new capital equipment, which presumably incorporates the most advanced technology, also tends to increase productivity. I would be the first to defend the principle that it is sound and desirable policy to use technological advance for the purpose of producing more goods with the same amount of labor, or the same amount of goods with increased *voluntary* leisure—and I would emphasize as strongly as possible the importance of that word "voluntary"—or any combination of increased production and increased leisure which is found to be technically feasible and deemed socially desirable. But our appreciation of the potential values of increased productivity tends to lose much of its savor in a period of high unemployment and falling buying power, when in practice the application of improved technology may *not* mean the production of more goods with the same amount of labor, or an increase in voluntary leisure, but rather the production of the same volume of goods with less labor, and in consequence an increase in unemployment.

On the other hand, direct action by the government either to place more buying power in the hands of those who have too litle, or to meet our pressing and long unmet needs in such areas as housing, health, education, mass transport, antipollution and the conservation and development of our natural resources, to name only a few, will create an increase in demand which in turn will lead to lower unemployment, higher production and more encouragement for the investment needed to increase both the volume and the efficiency of production.

A NEW VIEW OF PRODUCTIVITY

I regret that the public, misled by some professional economists and some politicians, tends automatically to identify technological progress with higher living standards. This is the result of a failure to distinguish "production" and "productivity." It is assumed that technological progress will always have the result of providing more goods and a higher standard of living. But the thrust of my argument—and unfortunately it is fully borne out by the experience of the past two years—is that this simply is not necessarily so.

In order to give us a broader and more realistic overview in terms of the broad social and economic goals of our nation, I would like to see the statistical agencies of government faced with the challenge of determining, in addition to the present productivity indexes, an index of efficiency of manpower utilization which would compare for the total economy the volume of goods and services with the number of man-hours available rather than with the man-hours actually worked. This would mean, in effect, that if a new machine were introduced which could and did replace a dozen or perhaps a hundred men and women at the same level of production, there would be indicated no increase in our national economic efficiency *until those displaced men and women had been found alternative productive work.*

I believe that the creation of such an index of national economic efficiency is by no means beyond the capacity of the government's statistical agencies, and even if only a rough measure of our true economic efficiency were available by this means, it would at least give us some practical indication as to how closely we were approaching what should be the major material goal of every society—that of most efficiently making productive use of the efforts of all of its citizens who are able and willing to work.

CIVILIAN NEEDS MUST TAKE PRIORITY OVER MILITARY GOALS

Nor is it enough to say that government must adopt more expansionary fiscal and monetary policies. It must choose also those policies and programs which will best meet the most pressing needs of the people. In particular, that means that more emphasis must be placed on meeting civilian needs, and less emphasis on meeting goals, some of them totally unrealistic even by defense standards, set by the Pentagon.

There are several good reasons for this shift in emphasis from military to civilian spending. First, we have huge civilian needs which not only are unmet on a current basis, but which are building up a growing backlog of unmet needs, particularly the needs of the poor, the disadvantaged and the racial minorities. Our neglect of these needs is creating perfectly justifiable feelings of frustration, of estrangement and of real desperation both among the sufferers and among many others, especially the young people, who feel that we simply are not doing the job which must be accomplished in a just society.

Alleviating these feelings of frustration and desperation must be our top priority.

We urge this shift from military to civilian expenditures primarily because we are concerned about the welfare of those whom our society today is cheating of their birthright. But in addition we must recognize that many types of civilian expenditures by government will benefit not only the direct recipients, but society at large.

Military spending is essentially inflationary because it involves the spending of money in wages, salaries and profit which increase buying power, while it produces no goods on which this buying power may be spent; on the contrary the military program uses up resources which might otherwise be available for civilian purposes. Many types of civilian spending, on the other hand, provide programs and facilities which improve the health, the skills and the general capability of the labor force and thereby, in the long run, contribute to higher productivity and the reduction of inflationary pressures. Examples which come to mind are programs like Head Start, which try to compensate for early childhood deprivation, programs which aim at decreasing the size of overcrowded school classes by providing more schoolrooms and training more teachers, or programs to improve certain school facilities, such as libraries, laboratories, etc. Other examples would be expenditures to provide more hospital beds, more funds for research into the cause of various physical and mental diseases and more scholarship funds to educate and train more physicians and nurses. A complete list of such programs would be virtually endless, but one factor that they have in common is that they all tend to improve the quality of the labor force and thereby to raise the overall productive potential of the society.

And in addition, of course, there are those programs, such as the provision of a genuinely adequate minimum income for those unable to work, and a genuinely adequate minimum wage for those who do work, which are essential not primarily for their economic value to the nation, but because without them we cannot build a society in which we who have been more fortunate need feel no shame.

In the last two years the pressures of a determined Congress, for which members of the Committee are entitled to no little credit, resulted in declines in the military budget, a relatively small decline in fiscal 1970, but in '71 a decline of almost six billion dollars, or 7.3 percent in current money terms—the first decline of such magnitude since the end of the Korean War. Although it is still too early, barely half-way through the fiscal year, for this decline in military spending to have had any significantly measurable effect on the rate of inflation, it certainly does contain the possibility, if accompanied by other appropriate measures, to make an appreciable contribution toward reduction of inflation in future years.

One of the appropriate measures which is required, however, is that the reduction in military spending be continued, and that equivalent amounts or more be diverted to meeting our social needs. Although the official Budget figures for fiscal 1972 have not yet been released, is is well understood that the Administration intends to ask for an increase in military spending, probably of the order of two billion dollars. This must again be resisted by Congress.

No one—least of all the Pentagon, I suspect—knows exactly how much pure waste and fat there is in our military spending, but I think the evidence which has been given to Congress has made it clear that it amounts to considerably more than the cut in military spending to date. In addition, as Senator Proxmire pointed out last year, there has been substantial escalation in some areas of military spending, so much so that although savings were being made through procurement cutbacks and other methods totalling some $25 billion, and even after allowing $10 billion for uncontrollable increases such as those due to inflation, higher pay and allowances for military personnel and so on, we should have enjoyed a "peace dividend" of $15 billion to spend for domestic needs, but that this amount had been reduced to less than $6 billion due to increased spending on other projects—some of them to "defend" us against military weapons which did not even exist.

WHAT'S A FEW BILLION

Not only does the Pentagon not know how much waste there is in its operations, but in some areas it doesn't even know how much it is spending, while in others it appears to be doing its best, as it has for many years, to keep the true facts from Congress. The most succinct report of what has been uncovered that I have seen appeared in *Newsweek* of January 18 last although much of it has also been reported elsewhere. The facts are known to members of this Committee, since they were uncovered in hearings before one of its subcommittees, but I should like to put the *Newsweek* story in the record as an example of the difficulties that this Committee and the Congress face in trying to get at the facts which should, as the elected representatives of the people, be freely available to them at all times.

Newsweek reported:

"The question seemed so predictable as to be almost perfunctory. During his hearings last week on the scope of U.S. military assistance to foreign nations, Sen. William Proxmire simply wanted to know if anyone could tell him exactly what was the total annual cost of the government's military-aid program. Behind a table strewn with documents a Pentagon team had carried into Proxmire's Joint Economic Subcommittee hearing room, a Defense Department aide began some quick scribbling. Several suspenseful minutes crept by before he announced, 'Seven billion, three hundred and thirty-nine million . . .' A voice interrupted him. 'That's not right,' boomed the aide's Pentagon boss, former Alabama Congressman Armistead I. Selden Jr. 'That's not correct.'

"Now Selden snatched a pencil and began doing some hasty calculations of his own. More minutes passed. 'Four billion' proclaimed Selden at last, 'eight hundred and ninety-six million, two hundred thousand.' Since that figure was still eight times the amount officially listed in the President's Budget, Proxmire kept probing. And as it soon came out Selden had neglected to include at least one whopping item—the $224 million the Pentagon had handed out from its 'excess' weapons stockpile. Nor could he estimate how much in U.S. equipment and installations had been handed over to South Vietnam and Thailand."

Apparently, I might interject, the attitude of the Pentagon is a casual "What's a few billion dollars here or there?"

The *Newsweek* report continues:

"By this time the look of incredulity on Proxmire's face had soured to a scowl. 'This is the first time,' he said of the U.S.'s military-aid dole, 'that the Defense Department has added it up.' And in a blistering indictment of the whole affair, the senator concluded: 'Most of us in Washington have seen a lot of mismanagement in government programs. But military assistance is the first program I have come across that appears to be characterized by unmanagement. The problem here seems to be that no one is in charge.'

"Some in attendance might have considered even that harsh verdict rather lenient, for the facts that Proxmire's investigations unearthed last week pointed considerably beyond a woeful dearth of comprehensive record-keeping. The hearings uncovered what appeared to be a governmental practice of spinning off certain military aid programs so as to obscure their true parameters from Congressional and public scrutiny. Among the disclosures:

"One of the less publicized purposes of the American Food for Peace program appears to have been the military development of some of the recipient foreign nations. Under the program's provisions, a country receiving American fold commodities must set aside a corresponding amount of funds for internal development. But as U.S. Comptroller General Elmer B. Staats testified, over the past six years nearly $700 million of those funds has been used to buy arms—all under the aegis of Food for Peace.

"Allegedly to meet the exigencies of the Vietnam buildup, armament grants to South Vietnam, Laos and Thailand were transferred from the official Military Assistance Program (MAP) budget to the regular Defense Department budget.

The net effect was to remove these appropriations from the watchful eye of the Senate Foreign Relations Committee, which has scrutiny over MAP, and place them under the jurisdiction of the far more friendly Armed Services committees.

"Under what Proxmire called 'hidden' programs, the U.S. has lent or leased $24 million worth of ships to seventeen countries. Proxmire was particularly incensed that Spain got a made-in-U.S.A. armada including five destroyers, a submarine and a helicopter carrier. 'Why in the world do they need these ships?' he asked. 'Are they going to be attacked by Corsica?'

"Originally, the U.S.'s military assistance policy was governed by a relatively straightforward rationale: aid given to 'forward defense' countries on the Communist periphery saved the U.S. the expense of installing its own military outposts. Consequently, the bulk of MAP funds has been pumped into South Korea, Taiwan, Greece, Turkey and now Cambodia. Eventually, however, military aid was dangled before other nations as a lure to win permission to set up American bases (e.g., Spain, Thailand, the Philippines) or simply to seal their friendship. Today MAP aid flows to 47 countries.

"As former Pentagon official Townsend Hoopes testified, much of the decision-making authority over this enormous sum has flowed from the Secretary of State to the Secretary of Defense. That shift, charged Hoopes, has produced what he termed such 'ludicrous extremes' of military logic as an annual JCS operating plan that attempts to establish the desirable size and budget of the military force of every non-Communist nation in the world.

"Pentagon witnesses denied trying to hide anything and insisted that all the facts on all the programs are available to Congress. But Proxmire vowed he would press for a fuller public accounting—and clearer accountability—in military aid. 'In some respects,' he said, 'the U.S. has been transformed . . . [into] a gigantic discount supermarket with no checkout counters, no cash registers, no store managers—only clerks who blithely deliver to foreign governments of practically any persuasion whatever.

I would strongly urge this Committee and the Congress to stand firm on the necessity for continuing to dig for the facts and track down and eliminate waste wherever it occurs in the military program. Congress should insist on full and rigid justification before any expenditures are approved for new military programs, with a view to still further substantial reductions in military spending as a whole. The need to use a considerable proportion of these savings for the conversion of defense industries to civilian production and to create new jobs for displaced defense workers and for members released from the armed forces, as well as for workers already unemployed, I have discussed earlier.

In connection with the need to expand civilian programs, I feel it necessary to warn this Committee and the Congress against a rather peculiar form of "numbers game" now being played by the Administration and some of its advisers, which in fact bears a certain relationship to the familiar "shell game" which has long been so popular as a means of duping the gullible at county fairs and similar attractions.

The essence of the game, if you are an Administration spokesman, is to spell out "commitments which already have been made" for the use of our resources in future years, compare them with the resources which will actually be available at so-called "full employment"—usually meaning about 4 percent unemployment—and so "prove" that there will simply not be the resources available for additional commitments, such as adequate health, education or welfare programs.

One of the most flagrant examples of this type of numbers game was that engaged in by Paul W. McCracken, Chairman of the Council of Economic Advisers, in a lecture at the University of Michigan last September 18. Comparing the "total GNP and currently visible claims for the uses of output" in 1969 with projected figures for 1975, he "proved" that even at "full employment," the claims now currently visible would take up all but $6 billion dollars (in 1969 prices) or one-half of one percent of total GNP in 1975, and even this depended on a relative decline in federal, state and local government purchases from 12 percent of GNP in 1969 to 11 percent in 1975.

The trick used in this particular numbers game—or at least the major one; there may be others—is the assumption, in contradiction to all the visible evidence, that the economy is going to achieve the goal, set by Congress in the Housing and Urban Development Act of 1968, of building 26 million dwelling units in the ensuing decade, that is, 2.6 million units per year by 1978.

I do not for one moment question the desirability of that goal. But the possibility of our reaching it is receding with every month and every year that passes, especially under an Administration which is as frankly uninterested in public effort in this field as the one now in office. For the whole of 1969 and 1970, all housing starts, including farm, totalled only 2.9 million, falling short by 2.3 million of the 5.2 million housing units we ought to have had during the past two years. As I have already pointed out, our current record in residential construction is extremely poor, whether measured against the goal of 2.6 million units per year or against even the achievements (much below the goal) of prior years. To say, therefore, as Mr. McCracken does, that our housing goal "is, of course, an obvious case of a social commitment with a substantial degree of specificity," and that "We are, in short, already at the point where further actions giving rise to the commitment of future resources may result in an aggregate of relatively explicit commitments that will over-run the aggregate of probable economic resources available"—is, in fact, to say that we mustn't make any plans for future new programs, because if we do all the things we have said on paper that we intend to do, but just haven't gotten around to doing them yet, there won't be any additional resources available.

I have to admit that I do not possess a crystal ball in which I can place anything like the confidence that Mr. McCracken appears to have in his. But I would suggest that in these difficult times in our nation's history we are, all of us, looking into a particularly clouded future. And I must admit that I would feel much happier about that future if the Administration and its advisers would spend less time in trying to explain to us why we can't do all the things that need doing, either today or four or five years from now, and would instead devote more time and thought and effort to getting ahead with the job of putting our economy back on an even keel, avoiding the irrecoverable losses of intolerably high unemployment and wastefully low use of our present capacity, and then, with full production and full employment restored, planning how best to use our present resources to meet our most pressing present needs.

THE NEED FOR PENSION REINSURANCE

The 91st Congress can claim to its credit many useful measures adopted which will help to advance the welfare of the American people—or would have done so if they had not been killed by the President's veto. But one action of which the Congress cannot be proud is its defeat of the measure proposed by Senator Hartke to provide a system of national reinsurance for private pension plans.

It is particularly shameful that while Congress acted to protect private speculators against losses up to $50,000 in the event of bankruptcy of a broker to whom they had entrusted securities, it defeated Senator Hartke's amendment to the bill which would have afforded similar protection to workers and others whose lifetime security is taken from them through the bankruptcy of a company with which they have negotiated a private pension plan which promises security but cannot provide it because the pension fund has not yet been fully funded.

Congress has provided through legislation strong incentives for the establishment of private pension plans. Although the response has been gratifying in terms of the number of such plans which have been instituted, the very fact that most pension programs have been in existence for so few years has created a serious problem. Since most pension plans are newly created, they are still far from being fully funded even where a program of funding has been undertaken. In fact, present tax regulations preclude the funding of past service liabilities in less than about 12 years; they do not require that they be funded at all.

As a result, termination of a pension plan may mean that the funds accumulated are inadequate even to pay full pensions to those nearing retirement age, let alone to protect the benefit expectations of other workers who may find that the security they thought they had established for their older years, through the accumulation of pension credits, has disappeared overnight.

A proper pension reinsurance plan would insure to the worker at least some measure of the security which he has rightly come to expect; and because of its self-financing feature it would not result in the expenditure of one cent of public funds. It would protect a worker's investment in a pension fund, just as his savings are insured if deposited in a savings bank or a savings and loan association which are protected by insurance through a government corporation. It would also insure the obligation of the fund to make future payments to him, just as a mortgagee's right to receive future mortgage payments is insured by FHA. And, most important, it would recognize proper priorities by protecting wage workers no less than those fortunate enough to have money to invest in stocks.

PENSION RIGHTS PROTECTED

Based on a conservative actuarial study of the limited data available, a maximum premium rate if one-half of one percent of unfunded obligations should be amply sufficient to protect all credits earned under private pension plans against the risk of termination. Those who are concerned about the adequacy of the premium should be further reassured by the fact that it is higher than that set out in some of the other proposed legislation on this subject. If the premium proves to be excessive, provisions can be made to reduce it. If, by some chance, the premium should prove to be insufficient, a series of priorities for protection can be established.

The highest priority would go to those who have already retired and who are receiving a pension and to those who are eligible to retire under the terms of their plan and who have attained normal retirement age. Next in line for consideration would be those who are eligible to retire by virtue of having attained the age specified in the plan for early retirement. If early retirement is not provided, age 60, the usual age for early retirement, would be used.

Finally, reinsurance would be provided for all other pension credits in ar order to be determined, if necessary, by the Secretary of Labor on the basis oi expert advice.

This last classification could, of course, provide the extensive coverage of early earned pension credit which should be the ultimate goal of such a measure. The desirability of such extensive coverage need not be restated.

It should be understood that insurance of credits for those not yet at retirement age would not mean immediate payments under the pension reinsurance system. Payments would be made only when the individual reaches retirement age. This delay also represents an additional guarantee that the premium can be set at a proper and adequate level and can even out the effect of short-term fluctuations in plan terminations.

PENSION PLANS ELIGIBLE FOR INSURANCE

Our proposal contemplates insurance for all private pension plans which qualify under the Internal Revenue Code and which have been in operation and have paid premiums for a specified number of years before the insurance became effective. This protective clause is designed to prevent the establishment of a plan with the knowledge that the plan will be terminated for one of several reasons. The program would exclude "pay as you go" plans, but would include all funded plans whether the funding payments are deposited with an insurance company or in a trust fund. The program would cover those plans which provide for terminal funding, those which provide for the funding of all future service liabilities but only pay interest on unfunded liability, and those which provide for the funding of both past and future service liabilities. It is recognized, of course, that since these different types of plans have significantly different levels of funding, the unfunded liabilities will vary from plan to plan. Since it is this unfunded liability that will be insured, the amount of the individual plan's premium will be computed on the basis of the amount of unfunded liability.

We do not propose any funding requirements beyond those already imposed by the Internal Revenue Code. However, it will lead to the accumulation of experience which will allow an informed judgment on whether any additional funding legislation is necessary. Such legislation might be desirable if it is determined that the reinsurance scheme would progressively become more expensive because of the large unfunded liabilities of aging firms.

The only limitation which I believe should be placed on this all-inclusive aspect of the insurance is one related to the amount of benefit which any particular plan promises to its members. This would be similar to the limitation on the amount of bank deposits and savings which are eligible for insurance under existing programs. Such limitations were set forth in Senator Hartke's bill.

RISKS AGAINST WHICH THE SYSTEM SHOULD INSURE

A persion reinsurance system must take into account all risks to earned pension credits if it is to provide a meaningful sense of security to the employee. These risks fall into two categories: (1) risks to the plan which depend on the degree to which it is funded, and (2) risks to the plan which depend on forces outside of it and which operate irrespective of the extent to which it is funded.

A clear example of a risk in the first category would be the situation of a partially-funded plan terminated because of the business failure of the employer. In such a case the risk insured against would be its unfunded liability which is attributable to the rights which are insured. As previously pointed out, the premium for insurance of this risk would be determined by the amount of unfunded liabilities.

Since the reinsurance plan is basically underwriting the benefit levels set forth in the plan, the amount of the unfunded liability, for the purpose of determining both the liability insured and the premium charged, would be determined on the basis of a set of standard actuarial assumptions and procedures. These actuarial assumptions and procedures would be determined by the Secretary on the basis of consultation with an expert Advisory Council established specifically for the purpose of consultation on the proposed program. The procedures could be designed to be largely self-policing by recognizing varying degrees of conservatism in different actuarial methods and assumptions, and particularly by their treatment of unfunded liabilities based on assumptions which have proved their inadequacy by leading to actuarial losses in the past.

When the employer has not gone out of business, but has closed a plant or reduced the work force, continued funding of the past service liability may become such a burden as to jeopardize the existence of the remaining operation. To protect the rights of both terminating and continuing employees, the measure should provide sufficient flexibility so that where there is a partial termination determined in accordance with Internal Revenue Service Regulations (code sec. 401(a)(7)), an appropriate portion of the assets could be allocated to the terminating employees. The reinsurance would then pick up any additional liability on behalf of those employees. The employer would continue operation of his plan, with the remaining assets, on behalf of the continuing employees.

Where there is no termination, the program would not normally be applicable, but if there is a severe reduction in the work force due to cessation of some operations, the program could perhaps include regulatory provisions permitting assumption of a part of the liabilities. The severity of a reduction in work force could be measured by whether the per capita past service amortization payment on a plan exceeds some specified percentage (e.g., 200 percent) of the initial per capita past service amortization payment. The reinsurance would assume any past service liability financing required which is in excess of the specified percentage.

A second type of risk different from those discussed above, and which should be indirectly insured against, is the risk of depreciation of the funded assets. The overall degree of risk involved in such situations is probably very slight. However, provision should be made for the establishment of formulas and standards concerning the assets which can be deducted from gross liabilities to establish the unfunded liabilities. Assets of dubious value or held without adequate guarantees of fiduciary responsibility could be wholly or partially excluded from calculations with the result that the insurance premium would increase. Such a measure would therefore do its part in promoting high standards of administration and investment.

ESTABLISHMENT AND ADMINISTRATION OF REINSURANCE SYSTEM

After consultation with various legislators and others supporting this proposal, it was concluded that the program should be placed under the direction of the Secretary of Labor since his department is responsible for the protection of workers and already collects detailed annual information on assets, costs and actuarial liabilities under the Pension and Welfare Plans Disclosure Act and duplication of reporting can thus be avoided. Close cooperation will be required with the Internal Revenue Service, which would impose the sanction of disqualification on plans which do not participate in the program, and which could make a plan ineligible for the program if it failed to satisfy its minimum funding standards. Cooperation would also be desirable with the Social Security Administration, which has the machinery to notify beneficiaries of rights. Further, these two agencies also have useful technical expertise.

The legislation would authorize the Secretary to borrow moneys from the Treasury for the establishment of a reinsurance fund. This money would be repaid by the premiums which the fund would receive and the legislation would thereby achieve a self-financing status at no cost to the public.

The proposal which I have just outlined follows very closely the provisions of the Bill which was introduced in the last session. I hope it will be reintroduced in this session, if that has not already been done, and that this time it will receive the favorable support it deserves.

SOCIAL SECURITY ACT NEEDS IMPROVEMENT

The Social Security Act could also stand considerable improvement, to an extent that I do not propose to go into at this time. Suffice it to say that our present arrangements for the security in retirement of workers and their dependents are far inferior to those of other countries with much less resources than we have, and that the income available to a couple who have no other source of income than Social Security is far below any acceptable standard.

There is one specific need, however, which I wish to bring to the attention of this Committee because it flows from a new situation which has been created in the auto industry and which will undoubtedly spread to other industries.

As you probably know, under the new agreements which we have signed with the major auto companies, a worker with 30 years of service can now take early retirement at age 58—in fact, he can take it at an even earlier age if he is prepared to accept a reduction in the negotiated pension—and by October of 1972 this age will have been reduced to 56. This improvement in our pension plan was negotiated primarily for two reasons. First, because of the onerous nature of many jobs in the auto plants, many workers are "burnt out" before they reach normal retirement age, especially if they have been holding down such jobs for thirty years or more. The demand for "Thirty and Out" which came directly from the rank and file of our union was a cry from the heart, a protest of the soul against any man's having to spend more than thirty years in the atmosphere of constant pressure for production, often also in an atmosphere of noise, smoke, fumes and other inhumane conditions which are all too frequent even in today's modern plants.

The second reason for negotiating early retirement was a social purpose—that of providing more jobs for younger workers. In a time of intolerably high and still growing unemployment, this was one method by which we could help to ease the problem.

We now find ourselves in the position, however, that workers who take advantage of the early retirement provisions of our negotiated pension plans have to accept a reduction in their Social Security pension when it comes due. This is because the method of calculating the Social Security pension is based on the averaging out of a worker's covered earnings after 1950 and before he reaches the age of 65, with the five years of lowest earnings dropped out. Normally, those will be the first five years of the period, since both wage rates generally and covered earnings have increased.

This provision means, however, that if a worker retires at age 58, he has seven years with no earnings before he reaches age 65, and when he becomes able to retire at age 56, he will have nine such years of no earnings. He can drop five of those years in calculating his Social Security benefit, but he must still include two of them, and will later have to include four, as well as including the years from 1951 through 1955 when his covered earnings were lower than in later years.

Our actuaries have computed that for a man and wife, this could mean a reduction in the Social Security benefit of as much as $57 per month for the man who chooses early retirement at age 58, as against the man who chooses to work to age 65. This is a substantial proportion of the couple's income, and will have a significant deterrent effect on the worker who might otherwise choose to retire early and create a job for a younger man.

It seems to me that if a man chooses to retire before age 65 for any reason, he should not be penalized under the Social Security system for having made that choice. I would therefore urge that among the many other needed improvements to the system that should be made, we should include a provision that after a person has retired from the work force, none of the succeeding years before he reaches the age of eligibility for Social Security benefits should be taken into account in the computation of the basis for determining those benefits.

THE MYTH OF THE "FULL EMPLOYMENT BUDGET"

The latest economic gimmick being used by the Nixon Administration is the so-called "Full Employment Budget" which is to be presented to Congress for fiscal 1972. This has a good, solid sound to it, as though it were a Budget which had been carefully worked out to ensure a return to full employment. In fact, it is nothing of the sort. It is simply a mildly expansionary Budget, in which the Administration will plan to spend the same amount as it would receive in revenues if we had what it considers "full employment." Since the Administration's concept of full employment is the 4 percent rate which was originally set by the Kennedy Administration as a purely interim goal as the economy was being pulled out of the 1960–61 recession—and is actually the equivalent of what a 4.5 percent rate would have been under Kennedy, due to technical changes made since that time in the manner in which the Labor Department counts the unemployed—even this would be a totally unsatisfactory goal. But I have inquired of the economists on the staff of our union. and they tell me that nowhere have they been able to find any economic study or model which indicates that this so-called "Full Employment Budget" would provide the necessary stimulus to the economy to reach even this very modest goal. There simply is no relationship between a "Full Employment Budget" and the size of the deficit needed to restore full employment. The whole thing is merely a public relations gimmick rather than a soundly based economic policy.

If we are really going to achieve full employment, we must first redefine the term to represent what we *could* do, not merely what we have achieved in the recent past. As I have already pointed out, many other countries have over long periods of time achieved unemployment rates far below the 4 percent which the Nixon Administration considers acceptable, and even appears to consider the minimum which can be safely aimed at. At genuine full employment, not only would both overall production and the rates of productivity advance be far superior to the levels implied by the goals of the Nixon Administration, but government revenues—at all levels of government—would also be substantially higher, permitting far greater spending for our domestic needs even while remaining within the limits of a balanced budget.

REVENUE SHARING

President Nixon has indicated that he intends during this Session to present the Congress with a state-federal revenue sharing program "going far beyond anything that we have suggested to date." It is, of course, impossible to comment in any but the most general terms on such a program until we see it laid out before us in detail, but there are one or two aspects of the program on which I think we can make some assumptions on the basis of the available evidence. In his press conversation of January 4, he tied in the concept of revenue sharing with that of bringing the decision-making process closer to the people. From that I assume that the greater part, if not all, of the revenue sharing program will be of the "no strings attached" form—that is, that the federal government will simply hand over to state and/or local governments large amounts of revenue and leave it to these governments to decide how it is to be allocated, both as among programs and as among regions within the state. This would be in line with the President's message to Congress on August 13, 1969, when he proposed sharing federal revenues with the state and local governments with no strings attached, as a supplement to existing grants in aid which are given for specific purposes.

According to the *New York Times*, in a report dated January 4 last, however, it is intended that the new revenue sharing program will be accompanied by cutbacks in existing federal programs, although no final decision had at that time been made. According to the *Times*:

"The source for such revenue has been a subject of intense debate within the Administration. Administration sources said today that the White House had made an initial decision to cut back some existing domestic programs and divert the funds to revenue sharing, but that this was being appealed and no final decision had been made."

Farther on in its report the *Times* became more specific. It said:

"For example, one proposal would cut deeply into some of the programs designed for deteriorated areas of the cities, arousing considerable opposition in the agencies involved. It was reported today to be under review."

As I have said, it is difficult to comment on such proposals in any but the most general terms while they are before us only in such nebulous terms, but I can say that to the extent that revenues to be shared with the states are obtained by cutting down on essential federal programs, or on grants in aid of existing state and local programs, and to the extent that the grants are made with no designation as to how they are to be used, I believe that revenue sharing in this form would constitute a backward rather than a forward step.

In the first place, to the extent that revenue sharing is financed by cutbacks in federal programs, it produces no expansionary effect on the economy whatsoever. It is simply a matter of taking money out of one pocket and putting it into another.

In the second place, there are some programs which I believe are better administered under some degree of federal control, whether as direct federal programs or as state-administered programs financed in whole or in part by the federal government, but financed for a specific purpose.

One such program which comes immediately to mind is federal aid to education. While we still have a very long way to go before we achieve true integration in many of our schools, I am quite sure that we would not have progressed nearly as far as we have if the federal government had not had both the courage and the legal authority to cut off educational aid funds to states or to school areas which, if left to their own wishes, would have retained complete and total segregation in their school systems.

I am also concerned by the conflict which may be generated within states as to the allocation of funds between urban and rural areas. I am not suggesting that in many states there are not both rural and urban areas with pressing social needs which should be met. I am suggesting that in many states there is a natural political division between urban and rural voters and the representatives they send to state legislatures—whether or not that division tends to follow or to cross party lines—and there is a real danger that the section of the state which holds the greater political power may not be the portion which has the greater need.

Finally, I am very much afraid that a system of straight cash grants will constitute a huge political grab-bag in which, again, the allocation of funds among the states may tend to be based on political considerations rather than on the needs of the people. I am sure that every member of this Committee can recall occasions when, in his opinion at least, the location of federal projects was unduly influenced by considerations of political expediency. When it comes to the consideration not merely of federal spending but of the distribution of several billions of dollars of federal cash, which seems to be in the Administration's mind at present, I am afraid it would require the wisdom of Solomon to determine a fair distribution—and I am not sure that even Solomon could have succeeded.

SHOULD WE ADOPT AN "INCOMES POLICY"?

The question has been raised as to whether or not we should have an "incomes policy" for the United States. The only answers I can give to that question are that no one has yet provided what I could consider a satisfactory definition or description of an incomes policy, and that, to the best of my knowledge, wherever anything called an "incomes policy" has been attempted, it has failed.

In the first place, what *is* an "incomes policy"? Is it a policy by which the government attempts to regulate the income of every individual in the nation? If we agree to that definition, then we have to admit that such a policy would be universally unacceptable, and impossible to carry out except in the most totalitarian of societies.

Unfortunately, most of those who say they believe in an "incomes policy," but who would certainly repudiate one such as I have just described, turn out to have defined "incomes policy" in their own minds as a policy of regulation of the incomes of wage-earners, and particularly of wage increases negotiated by organized labor.

The gross inequity and total impracticality of such a policy should be immediately obvious. Are workers alone to be asked to bear the entire cost and burden of stabilizing the economy and maintaining its stability, while others are permitted to make unlimited profits at their expense? In Great Britain, even a Labor government which attempted an "income policy" which turned out to be primarily one of restrictions on wage increases quickly lost the support of its own followers, and was ignominiously turned out of office at the first opportunity.

That was also essentially the nature of the "guideposts" policy adoptd in the early 1960s by the Council of Economic Advisers, which also turned out to be a failure. Again, the main reason was that the "guideposts" covering price policy were nebulous in the extreme, and even then were departed from whenever any individual business chose to do so, and the Council lacked the necessary powers to get at the facts which would enable it in most cases to determine whether or not firms were adhering to the guideposts.

The "guideposts" for labor, on the other hand, were expressed in terms of a single figure for percentage wage increases, and although a number of exceptions were formally admitted, they never made any impression on the public mind, and the wage guideposts revolved around the "magic figure" of 3.2 percent which was used to hit labor over the head with in every round of negotiations until it became obvious that an annual 3.2 percent increase in money wages would not even be sufficient to maintain the standard of living of workers and their families in a period of inflation initiated primarily by the refusal of business to follow the price guideposts.

So far did business stray from the guideposts, that the Council found it necessary to say in its 1964 Report:

"It is appropriate to focus special attention this year on price *reductions*. The guideposts call for reductions in those industries whose trend productivity gains exceed the national trend. IT IS FAIR TO SAY THAT LARGE INDUSTRIAL ENTERPRISES THUS FAR HAVE NOT WIDELY HEEDED THIS ADVICE. AND YET, AS NOTED EARLIER, THERE WILL BE AMPLE ROOM FOR SUCH REDUCTIONS IN 1964. IF THEY ARE NOT FORTHCOMING, OVER-ALL PRICE STABILITY WILL BE RENDERED MORE DIFFICULT." (Underlined emphasis in the original; capitalized emphasis added.)

There, in a nutshell, you have the reason why the guideposts failed, and why the present spiral of inflation started later in 1964.

Another question to be considered is whether business and labor could be expected to cooperate in a voluntary incomes policy. Again, I am afraid the answer is no, and my opinion is based on my own immediate experience and that of my Union, the UAW. Time after time, in negotiations going back at least to 1958, the UAW has proposed to the major automobile producers, and in particular to General Motors which acts as their leader, that if the companies would announce a reasonable reduction in car prices, we would be prepared to negotiate within the framework of the financial situation in which they found themselves as a result of that price cut.

That was a genuine effort on our part to establish a cooperative, voluntary incomes policy. But every time the answer we received was a blunt, unshakable "No."

The inability of government to bring about a voluntary incomes policy has also been illustrated by the experience of our neighbors to the North. Late in 1969 the government of Canada established a Prices and Incomes Commission with the express purpose of bringing about a program of voluntary restraints on the part of business and labor. Early in 1970 the Commission called a meeting of about 200 business leaders, and asked them to agree to restricting price increases in that year to something less than might be justified by cost increases. All but a handful of the businessmen who replied stated that they agreed with the proposal in principle, but of course they could speak only for their own firms—and the handful replied that they couldn't even speak for their own firms!

Faced with this unwillingness on the part of business to make a firm commitment even for a single year, labor's response to the proposal that it accept voluntary restraints on wage increases in the face of rising inflation was, of course, also in the negative.

The Prices and Income Commission finally reached the nadir of its influence a few months later, when it declared that an identical price increase in identical forms if tinplate, imposed by two companies which had previously been selling at identical prices, was inflationary in the one case and noninflationary in the other because one of the firms was still trying to recover from the effect of losses suffered from a strike of its employees in the previous year!

The Canadian Prices and Incomes Commission has since relapsed into a condition of innocuous desuetude.

A further possibility is that of mandatory controls. One of the most interesting comments on that subject recently was that of Stewart S. Cort, chairman and chief executive of Bethlehem Steel Corporation, who was reported in the *Wall Street Journal* of January 11 last as having "remarked aprovingly" on a suggestion that Congress ban for two years any wage and fringe-benefit increases exceeding three percent per year. (Incidentally, if such a ban had been in effect during the past two years, the result for every full-time worker and his family would have been a reduction in living standards of five percent.)

According to the *Journal* Mr. Cort went on to say, however, that no form of price control was necessary, because prices would "follow unit costs" and thus would be restrained by any limit on wage increases as well as by competition.

The very next day, Bethlehem Steel Corporation announced price increases of as much as 12.5 percent on plates, structural shapes and other of its products—with no indication of a wage increase for its workers.

The corporation at the same time revoked its former guarantees that it would impose no more than one price increase in any year.

If I were asked my opinion about the respective merits of mandatory price and wage controls respectively, my opinion would be the exact opposite of Mr. Cort's. I am confident that mandatory price controls would effectively control wages also, because after many years in the front line of collective bargaining I know only too well that you just can't get the wage increase you might like if the money isn't there.

In fact, however, I am opposed to either mandatory price or wage controls, because I believe they would require a monstrous bureaucracy to administer, and I am sure that except in a time of large-scale war that threatened our country's existence they would be totally unacceptable to the public and for that reason just as impossible to administer as Prohibition was in the 1920s.

In short, if by an "incomes policy" we mean any program, either voluntary or mandatory, which would attempt to regulate the incomes of one group in the population only, I would consider it grossly inequitable; and if we mean a program that would attempt to regulate all incomes, or even to regulate all prices and wages, I believe it would be totally unworkable.

The best we can do in the direct area of incomes, I believe, is first to put a genuine and adequate floor under all incomes, so that no person and no family shall be forced to live in poverty; and second, to proceed with the tax reforms which have already been started, so as to share the burden of taxation more fairly, lessening it upon those with relatively low or modernate incomes, and closing the loopholes which still permit wealthy individals, families and some corporations to escape paying their fair share.

AN ALTERNATIVE COURSE

In the area of prices and wages, however, I believe there is a course to be followed which would require no great bureaucracy to administer, would be both welcomed by and informative to the public, and could have the effect not only of restraining unjustifiable price and/or wage increases, but also of rolling back present unjustifiably high prices. I refer, of course, to the adoption of a Price-Wage Review Board, which has long been endorsed by me and my colleagues in the UAW, but has recently received support also from some of the country's leading economists, including some in the Administration itself. Thus, for example, on November 19 last, the Hon. Murray L. Weidenbaum, assistant secretary of the Treasury for economic policy, called for:

"* * * the conscious effort to create a new climate in which more reasonable and sensible wage-cost-price decisions are made and particularly in those areas of the economy where substantial concentrations of private power exist. Until this climate is achieved, or unless these substantial concentrations of private economic power are reduced, I find it hard to see how we can soon arrive at those two highly desirable and interrelated objectives—the return of full employment and the substantial and sustained reduction in inflation. That is the challenge of economic policy that now faces us all."

A short time later, on December 7, Chairman Arthur F. Burns of the Federal Reserve Board, in an address on "The Basis for Lasting Prosperity" was still more specific. He said:

"*We might bring under an incomes policy, also, the establishment of a high-level Price and Wage Review Board* which, while lacking enforcement power, would have broad authority to investigate, advise, and recommend on price and wage changes." (Emphasis in original.)

Finally, on December 16 last the *Washington Post* reviewed a book soon to be published by John M. Blair, who was chief economist for the Kefauver Committee, which made many studies of economic concentration and its effect on prices. The review, written by Hobart Rowen, is worth quoting at length. It says:

"The seeming paradox of persistent inflation at a time of rising unemployment troubles many thoughtful people; somehow, the idea of rising prices seems inconsistent with recession. This is the specter of 'the worst of both worlds' that the Nixon administration had desperately hoped to avoid.

"Yet, in this community and in others throughout the nation, scientists and teachers are driving taxis or working behind sales counters—and others aren't that lucky. The unemployment rate is a matter of serious concern at 5.8 percent nationally; 10.6 percent in Seattle; 6.4 percent in Detroit; and 6.2 percent in Los Angeles.

"If the price thus paid had at least cut down the high cost of living, Mr. Nixon's policy could be said to be working, in part. But the record on prices has been a shocking disappointment; the rate of the increase had diminished, but only slightly. As Paul Samuelson had said the improvement is only in the eye of the expert.

"But why do prices continue to rise while more people struggle for jobs? There is a relatively simple answer: many prices and wages do not respond to changes in supply and demand.

"There is an important area of our industrial economy, which is unresponsive to slack or recession. Big industry and big labor can tell and have told Mr. Nixon and his "game plan" to go hang.

"The distinguished economist, Gardiner C. Means, has pointed out over the years that some industries (where a monopoly or near-monopoly exists) can 'administer' prices regardless of so-called 'free' market factors.

"In a forth coming book, 'Economic Concentration' to be published early next year by Harcourt Brace & Javanovitch, John M. Blair goes far to explain the 'paradox' of economic slack and rising prices.

"Blair, chief economist for the landmark Kefauver Committee studies of price-fixing in the steel, drug oil and other industries, makes a strong case that during a recession—even a mild one—prices in concentrated industries not only fail to come down—they actually tend to rise. Thus, efforts to stop inflation 'by contracting the economy will not merely be ineffective; they will have an opposite effect to that intended.'

"Blair's explanation rests on the manner in which the price leaders in key industries set their prices. The price for, say, a Chevrolet is not determined by supply and demand factors, but by General Motors' 'target return pricing.' The company makes a judgment on the likely sales volume; then it calculates its cost per unit, and sets a price that will yield a percentage or 'target' on the net worth (stockholders' investment).

"General Motors seeks to price its cars in relation to costs (including taxes, which means they are passed on to the consumer) in such a way as to yield a fat 20 percent annually on net worth.

"What Blair shows in his new book is that General Motors and other price leaders, in a demonstration of brilliant corporate management, have been able to make the target consistently. This is great for the stockholders, but it doesn't do much to combat inflation. It's the key to the recession-inflation paradox: in years when the volume falls off, prices are pushed up to cover higher per-unit costs.

"Most of the leaders made their targets most years. When they missed, there usually was an explanation. Thus, in 1958, voluntary import quotas on oil broke down and Jersey Standard missed its target. But when mandatory quotas were slapped on the next year, Jersey Standard's profits again were on the beam.

"To show how successful the 'administered' price industries are in keeping prices high enough in leaner years to make their 'targets,' here is a table derived from Blair's study comparing pricing goals with actual results over an extended period:

TARGET RETURN PRICING

	Percent rate of return on net worth after taxes	Percent actually averaged 1953–68
General Motors	20.0	20.2
United States Steel	8.0	8.4
Alcoa	10.0	9.5
Standard Oil (New Jersey)	12.0	12.6
DuPont	20.0	22.2
Average of all 5	14.6	15.1

"The record thus shows that whether or not people are out of work, or times are 'poor', prices can be managed by key industries to maintain an established target. U.S. Steel compensated for a production loss of about 20 per cent in each of the 1953–54 and 1957–58 recessions by substantial prices increases (4.7 per cent and 3.5 per cent respectively). That produced the established return (and since other companies in the industry are more efficient than Big Steel, they did even better when they followed Steel's price leadership)."

PRICES ARE THE MAIN ISSUE

As all of the above comments indicate, and as we in the UAW have made clear many times, it is necessary to provide a mechanism that would, when required, expose attempts at wage-gouging by big trade unions as well as proposed Board a Price-*Wage* Review Board. We believe that when any union tries to abuse its economic power it should be subject to public scrutiny in just the same way as any big corporation.

We also believe, however, that the major activity of such a Board will of necessity be directed toward the area of prices, primarily for the following reason.

Wage decisions are not made unilaterally by unions. Except in unorganized shops, where wage decisions are made primarily by the employer, they are the result of collective bargaining between the two parties concerned. And major bargaining, between large corporations and large unions, normally takes place under the close scrutiny of all the media—television, radio, newspapers and magazines, all are at hand to listen, to observe, to report and to comment. Even when the parties, at a crucial stage of bargaining, may agree to a news blackout, it will have been preceded by weeks of bargaining in which both parties explain and justify the decisions that have been made.

Those major price decisions which most seriously affect the whole economy, on the contrary, are made in the privacy of executive boardrooms, and the data as to costs, productivity and profit goals on which they are based are among the most closely guarded of corporate secrets. Repeatedly in the past such data have been refused even to Congressional investigating committees. Yet such information is vital to the public, especially in an inflationary period such as we are now experiencing, because without it there is no way in which the people can decide whether price increases are justified, or, if they are not, where the responsibility for them lies. Informed decisions on those matters could be made if the necessary information were made available through a Price-Wage Review Board.

On June 18, 1970, I appeared before the Committee on Banking and Currency of the House of Representatives and explained in considerable detail the exact nature and functions of the Board as we envisaged them. With the permission of this Committee, I should like to submit as an exhibit to this statement that portions of my testimony before the House Committee which explained the structure and operations of the proposed Board. In consequence, I will only outline those matters very briefly at this point.

Basically, any corporation holding a dominant position in a key industry—for example, controlling 25 percent or more of sales—would have to give 60 to 90 days' notice to the Board of any intended price increase—with allowable exceptions in case of emergency situations. The Board would then have power to call public hearings if it deemed them necessary, to subpoena and examine witnesses under oath, and to demand all pertinent information from the company.

The Board would report only on the facts it discovered. It would make no binding determinations, but would simply make sure that the public had the information on which to make its own judgment.

There would also be a Consumer Counsel, who would represent the public interest at hearings and would also have authority to ask the Board to initiate hearings if there was good evidence that existing prices were already too high.

As I have indicated, if a corporation claimed that a price increase was necessary because of the demands made on it by a union, both the corporation and the union would be required to attend the hearings and justify their respective positions.

The number of corporations affected would probably not be greatly in excess of 100, since they would be restricted to the dominant company in each industry. As the recent partial roll-back of Bethlehem Steel's intended price increase illustrates, if the industry price leader doesn't raise prices, the smaller companies have to fall in line.

This may seem like a very loose form of control. But the fact is, as I have said, that the internal financial affairs of a major corporation today are among its most closely-guarded secrets, and if it is aware that an intended price increase will open them up to public scrutiny, I am sure that even the most powerful corporation will not propose such a price increase unless it is absolutely necessary.

CONCLUSION

In conclusion, Mr. Chairman, may I say that there are many subjects on which I have barely touched which are deserving of the most serious attention. To have dealt adequately with all of them would have made this statement unduly long, and in any case both the relatively short notice on which these hearings were called—although I think the Committee was very wise in calling them as promptly as it did—and the protracted and pressing nature of the collective bargaining problems which have faced our union in the past few months, would have made it impossible for us to prepare a statement covering all those problems with which you, and the Committee, and the Congress will have to deal.

I have not dealt at any length, for example, with the war on poverty, which is still to be won, or with the need for a national manpower policy which ought to be one of our most potent weapons against unemployment. I have no more than mentioned the unforgivable gaps and failures in our entire system—or, rather, nonsystem—of delivering health services, or the equally serious gaps and failures in our educational system, in both of which areas our failures of today will inhibit the well-being and progress of our children for a lifetime.

I have not dealt with the problems of pollution, which are making our cities and even many parts of our countryside virtually unfit for healthy human existence. Above all, I have not dealt with the necessity for us to progress toward more adequate and more democratic advance planning of our economic and social affairs, without which we can never make the best ultimate use of our resources to meet the needs of all our people.

However, these are all matters upon which, on other occasions, the UAW has placed itself well on the record. I think you know where we stand on these matters, and I want to assure you that our stand has not essentially changed. I hope that there may be more occasions in the future when we may have the opportunity of discussing them with you again.

EXHIBIT

Proposal for establishment of a national Price-Wage Review Board, as presented by Mr. Woodcock before the Committee on Banking and Currency, U.S. House of Representatives, June 18, 1970.

SUMMARY OF PROPOSAL

The proposal would require the price-leading corporation in each major administered price industry to give advance notice of proposed price increases. Other firms could be brought under the procedure by the President if he thought it necessary in the interests of price stability. A Price-Wage Review Board would hold hearings on the proposed increases with a Consumer Counsel representing the public interest. The subpoena power would be used to assure the presence of needed witnesses and the availability of all pertinent books and records.

The Consumer Counsel would be empowered to initiate hearings aimed at bringing about reductions of prices he considered excessive. Unions would be required to participate in the hearings if the corporation proposing the price increase alleged that granting union demands would necessitate the increase. At the conclusion of the hearings, the Board would not pass on the merits of the proposed price increases (or union demands) but would issue findings of fact designed to enable the public to make its own judgment of the merits. After the notice period expired, the corporations would be free to raise its prices and the union, if any were involved, would be free to press its demands. Both would act, however, in the knowledge that the public had the facts required to pass informed judgment on their actions.

EXPLANATION

The above summary of the proposal (which is presented in greater detail in Appendix B) is largely self-explanatory. It may be desirable, however, to elaborate on certain of its features and to emphasize the signifiance of certain others.

To begin with, the proposal differs from the guidepost approach in a number of highly important respects:

1. Focus on prices.—The UAW's proposal recognizes the obvious fact that the goal of stabilization policy is to achieve reasonable stability of the *price* level. It therefore parts company with those who shift the conversation from prices to wages whenever inflation is discussed.

As shown in Appendix A, the last three periods of inflation (including the present one) began at times when unit labor costs were actually declining. Thus, it is clear that wage restraint will not prevent prices from rising. On the other hand, price restraint will make unnecessary the augmented wage increases that are necessary to compensate workers for the erosion of their buying power by inflation. Wage increases are relevant to price stability only when they would necessitate price increases or would prevent price reductions that otherwise would be put into effect.

For these reasons, wages would be involved in the proposed procedure only when a corporation alleges that its proposed price increase (or refusal to reduce excessive prices) is attributable to the cost of meeting union demands that have been presented to it. Under those circumstances, the union involved would have to justify its demands in public hearings side by side with the corporation employing its members.

The focus on prices also recognizes that it is both perfectly proper and entirely compatible with price stability for labor and management to bargain over their relative shares in the income generated by an industry or enterprise. This principle was recognized under the guideposts. In fact, in the Council of Economic Advisers 1962 *Report* which presented the initial statement of the guideposts in 1962, it was stated and restated three times, as follows:

On page 186:

"* * * There is nothing immutable in fact or in justice about the distribution of the total product between labor and non-labor incomes."

On page 188:

"The proportions in which labor and nonlabor incomes share the product of industry have not been immutable throughout American history, nor can they be expected to stand forever where they are today. *It is desirable that labor and management should bargain explicitly about the distirbution of the income of particular firms or industries.* It is, however, undesirable that they should bargain implicitly about the general price level." [Emphasis added]

On page 190:

"Finally, it must be reiterated that collective bargaining within an industry over the division of the proceeds between labor and nonlabor income is not necessarily disruptive of overall price stability. The relative shares can change within the bounds of noninflationary price behavior."

The same thought was reiterated in subsequent Council reports.

2. Availability of facts.—The Council's lament that it did not have the data required to evaluate the propriety of price changes has been quoted above. The UAW proposal would meet that problem by equipping the Consumer Counsel with subpoena power to assure that all necessary witnesses and all pertinent data are available for examination in the public hearings.

3. Price reductions.—The UAW proposal would empower the Consumer Council to initiate hearings designed to mobilize public opinion in support of price reductions where the facts show existing prices to be excessive. The guideposts, as the Council confessed, were a complete failure in this respect. Yet, a major factor causing recent inflation has been the refusal of industries with rapidly advancing productivity or abnormally high profits to reduce their prices. The general price level obviously cannot be stabilized if industries with rising costs raise prices while those with low or falling costs maintain or even increase their prices.

4. Keeping the task manageable.—The guideposts represented a scatter-gun approach. In theory they applied to every firm and every union in the entire country. In practice, the price guideposts was used to mobilize public opinion in only a handful of cases while the wage guidepost became a shibboleth for employers generally both in the public forum and across the bargaining table.

Application of the UAW proposal would be confined to the potential sources of serious inflationary abuses—the price-leading corporation in major administered price industries and to such other firms or industries as the President might from time to time find it necessary to bring under the legislation.

The "price leader" could be defined as a firm that accounted for 25 percent or more of the sales of an industry or product. Any field in which one firm controls that large a part of the total market is obviously one in which price administration or oligopoly prevails. A major industry could be defined as one with sales in excess of a specified dollar amount. If public opinion is to be effectively mobilized, it would be unwise to apply the procedure to industries or products having only negligible effect on the general price level.

It would be enough to confine the notification and hearings procedure to the price leader (i.e., the dominant corporation) in each industry because its decisions necessarily determine the prices of other firms in the same industry. The auto industry provides numerous examples of situations in which Ford and Chrysler adjusted their prices—up or down—to approximately the levels set by General Motors for comparable cars or optional equipment.

An analysis made by UAW economists some years ago indicated that *coverage of only about 100 corporations in all would be sufficient to exert significant leverage on over-all price level changes.*

At the same time the proposal would enable the President to bring other firms or industries under the procedure when necessary to safeguard price stability. This would make it possible to cover the construction industry, for example.

5. *Advance notice.*—The UAW proposal would assure that the public had advance notice of impending price increases in important industries. The facts would be brought out and public opinion would be able to exert its influence before the price increase became a *fait accompli*. Under the guideposts the Council often could do little more than wring its hands after an inexcusable price increase had been put into effect. *Post-mortems* on price increases conducted by Congressional committees have been revealing but have come too late to have any practical effect.

Unions are now required by law to give advance notice of intention to modify or terminate their contracts which, among other things, generally means to seek wage increases. This part of the UAW proposal would do nothing more than to put a small number of corporations under a similar obligation with respect to price increases.

6. *Case-by-case approach.*—As previously noted, the President's Labor-Management Committee found it "impractical if not impossible" to translate the guidepost goals "into formulae for application to every particular price or wage decision." That conclusion, as also noted above, applies with ever greater force to the current situation because of the extremely uneven distribution among workers and firms of the gains from and sacrifices imposed by years of inflation. Attempts, under these circumstances, to hold wage and price changes within the confines of uniform formulae would be doomed to failure for no system of voluntary restraint will work if its end product is flagrant inequity.

Implicit in the qualifications and exceptions noted in the Council's original 1962 statement of the guideposts was the necessity to look carefully into the facts of each case. Today's circumstances emphasize that need. The UAW proposal provides for the required case-by-case approach and would establish machinery to assure that all pertinent facts of each situation are elicited and brought to the public's attention.

OTHER FEATURES OF PROPOSAL

I believe it will be useful to call to the Committee's attention certain other features, aspects or probable effects of the UAW proposal which lead us to believe that it would be a workable mechanism contributing in important degree to price stability.

1. *Deterrent.*—We believe it would create an effective deterrent to unjustifiable price increases. With the proposed procedure in operation, we doubt that any major corporation would even formally propose to make any price increase for which it could not make at least a presentable case. It is almost inconceivable, for example, that U.S. Steel would have proposed the 1962 price increase which President Kennedy succeeded in rolling back if it had had to contemplate the prospect that its officers would have been required to submit to cross-examination in public hearings, with all pertinent data available, concerning the necessity and justification for the price decision.

The proposal contemplates that every reasonable effort would be made to give the hearings the widest possible publicity. Televising the hearings (or selected segments of them chosen by the Board to assure balanced presentation of all viewpoints) would be useful both in informing the public and for strengthening the deterrent effect of the procedure.

2. *Relatively few hearings.*—The deterrent effect would have the further value of limiting the number of hearings which would have to be held. Public attention could therefore be focused sharply on relatively few cases. Toward this same end, the proposal (as stated in Appendix B) would permit the Board, with the consent of the Consumer Counsel, to waive hearings where, for example, preliminary examination of the data indicated that the proposed price increase was clearly justified or where it would have negligible effect on the general price level or where it would be offset by price decreases for other products of the same company. With only about 100 corporations in all normally covered by the procedure, the scope of the procedure would be sufficiently narrow to permit public opinion to zero in effectively on clear-cut cases of abusive price increases. Consumer groups and business or government customers having an important interest in the particular prices involved could be counted upon to help bring the pertinent facts of significant cases to public attention. It would be more difficult to do so effectively if the number of covered corporations were too large.

3. *Permanent machinery.*—The Price-Wage Review Board and the Consumer Counsel are intended as permanent agencies. This would enable them and their staffs to develop a high level of expertise in dealing with price issues and in presenting their findings in a manner readily understandable by the public. The existence of the machinery on a permanent basis would also help to avoid the initiation of inflationary spirals. As is clear from Appendix A, such spirals start with prices. Once some important prices rise, they work their way into the costs of other businesses or into consumer prices, inducing or compelling increases in other prices or in wages, which then, in turn, lead to further increases in prices and wages, etc. If public opinion is mobilized effectively to halt the initial price increases, there will be no spiral.

4. *Emergency price increases.*—The proposal recognizes that on occasion firms may be confronted with sharp increases in costs which necessitate immediate price increases in order to avoid serious impairment of profits. It would therefore permit such price increases to be put into effect prior to the expiration of the period of advance notice which would otherwise apply. As is made clear in Appendix B, however, severe penalties would be imposed for price increases improperly made under false claim, or exaggeration of the extent of an emergency. The amount of the penalty could be objectively determined on the basis of the size of the price increase measured against the actual cost increase, if any. The Board, in consultation with the Consumer Counsel could develop standards and regulations concerning, for example, the extent of impairment of profits that could be considered to create an emergency and methods of measuring such impairment.

5. *No recommendations.*—Under the proposal the Board would not pass on the merits of the proposed price (or wage) increase or make any recommendations as to whether or not it should be put into effect. The reason is that there is at present no generally accepted basis for determining the propriety of any level of prices, wages or profits nor, as previously noted, are there any general formulae that can properly be applied to the enormous variety of individual situations. Given the facts of particular cases, the public will begin to form, and to express, its own judgments as to what is or is not proper conduct under certain sets of conditions. Out of these judgments there should, in time, evolve generally accepted standards of proper conduct. When that occurs—but not before then—it may be possible to formulate criteria that could be used as the basis for recommendations and to write such criteria into law.

6. *Findings of fact.*—Although the proposal would prohibit recommendations or judgements on the merits, it does call for the Board to issue findings of fact. The facts to be made public should include such matters as changes in production costs, the source of such changes (e.g., wage costs, materials prices, overhead costs, changes in volume of production, etc.), the degree to which cost increases are offset by cost savings (such as those flowing from advances in productivity), the profit position of the corporation, the effect of the proposed price increase upon per unit and total profits, the effect upon those profits if the ascertained

net cost increases were to be absorbed by the corporation, and all similar matters which would enable the individual citizen to make an informed judgment as to the propriety or justification for the proposed price increase.

In order to insure that every area of pertinent fact is covered, the proposal contemplates that all parties to the hearings (which may include, besides the corporation proposing the price increase and the Consumer Counsel, unions, consumer organizations, customer corporations, government agencies, etc.) would be invited, at the conclusion of the hearing, to submit lists of their contentions based on the evidence presented at the hearing. The Board would issue its findings with respect to each such contention. For, example, if a union contends that, after granting a proposed wage increase, the corporation would still have, at a given volume of output, a profit equal to X percent of its investment, the Board would make a finding of fact on that claim. If the corporation should contend that it requires a profit of Y percent in order to attract needed capital, the Board might issue a finding concerning profits earned by other corporations operating under similar risk factors and their experience in raising capital.

7. *Flagrant cases.*— Despite the absence of provision for recommendations, the proposal definitely does not contemplate that responsible government authorities would do nothing in flagrant situations of abuse of pricing power. Although, as noted, there are no generally accepted standards of proper price behavior, it is possible to recognize clearly outrageous behavior totally unjustified by the facts of the situation. Where hearings had elicited evidence that effectuation of a proposed price (or wage) increase would be of that nature, it would be entirely appropriate for the President (or others high in government) to direct the fire of public opinion against the threatened abuse. With the hearings having uncovered the facts, effective mobilization of public opinion would be greatly facilitated.

OTHER MEASURES NEEDED

In concluding, I should make it clear that we do not advance our proposal as a panacea which, in and of itself, would eliminate the inflationary problem and all its damaging consequences. Administered price abuses are a major, perhaps *the* major, factor causing inflation in our economy. But there are other sources of inflation which have to be dealt with also. For example, there are serious supply bottlenecks in certain sectors of the economy, of which medical is an outstanding example. There are situations in which disproportionate increases in certain forms of demand put inflationary pressures upon capacity. For example, rapid increases in profit following the end of a recession encourage and provide the means for speculative investment in new plant and equipment and in inventories. We need to be alert, always, to problems of these kinds and to develop a battery of selective measures designed to open up supply bottlenecks which interfere with the achievement of national priority goals, to suppress inflationary non-essential demand and, to the extent consistent with national needs and purposes, to route demand toward underutilized capacity and away from the supply bottlenecks.

Wise use of selective measures could help to prevent the onset of inflation. Such measures also could be helpful in ending inflations when they do occur and in minimizing the social damage and economic losses that flow from use of the blunderbuss of restrictive over-all fiscal and monetary policies to halt inflation. For example, selective credit policies could protect the flow of urgently needed funds for housing and the projects of state and local governments while choking off credit for excessive investment in new plant and equipment at a time when more than one-fifth of existing capacity lies idle. Selective manpower measures, such as a public service employment program, for example, could provide useful jobs, maintain family incomes, supply valuable training, and serve important public purposes even as demand was curtailed in certain areas of the economy to damp down the inflationary fires.

We regard our proposal for a Price-Wage Review Board and a Consumer Counsel as merely one element—although an important element—in the arsenal of selective economic weapons needed to maintain price stability simultaneously with full employment.

We urge this Committee to give that proposal serious and favorable consideration.

APPENDIX A

INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE
& AGRICULTURAL IMPLEMENT WORKERS OF AMERICA–UAW
Detroit, Mich., December 18, 1969,

DEAR ECONOMIST: Traditionally, it has been regarded as the duty of scientists in every field to disseminate truth and combat falsehood as their research enabled them to distinguish one from the other. Great scientists, Galileo and Bruno are two examples, have suffered persecution and even death for carrying out that duty. The same zeal to make truth prevail, unfortunately, has not been manifested by most of today's economists.

I regret to say that it seems to me that the members of the economics profession, with few exceptions, have been negligent of their responsibilities with respect to a matter in which they have a particular obligation. They have stood by idly while large numbers of their fellow citizens have suffered abuse and seen their welfare seriously jeopardized by distortion of facts that are, or at least should be, well known to economists.

For roughly two decades, most economists have remained silent in the face of the brainwashing of the American public into acceptance of the notion of the so-called "wage-price" spiral—the myth that wage or unit labor cost increases trigger inflation.

Surely, professional economists, all of whom presumably have read *The Wealth of Nations*, should have been alerted to skeptical examination of that allegation by Adam Smith's observation nearly 200 years earlier that:

"Our merchants and master-manufacturers complain much of the bad effects of high wages in raising the price, and thereby lessening the sale of their goods both at home and aboard. They say noting concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains. They complain only of those of other people."

Data are not lacking to test the allegation. I am enclosing six charts and a *Wall Street Journal* article that reflect and discuss the government-compiled statistical data that bear directly on the issue. The charts are based upon two separate sets of statistics, one relating to all manufacturing industry and the other relating to the entire nonfinancial corporate sector of the economy which accounts for more than 61 percent of the total gross product of the private economy.

These data reveal beyond all possibility of doubt that in each of the last three inflationary periods (including the current one), price increases preceded increases in labor costs. Moreover, the price increases were not necessitated by increases in other costs as indicated by the fact that, in each case, profits per unit of output were rising even before prices began to rise. The rises in unit labor costs began much later than the increases in prices—in the case of the current inflation, roughly 18 months later for manufacturing and later still for nonfinancial corporations.

The increases in unit labor costs occurred primarily because of the workers' need to protect themselves and their families against erosion, resulting from *prior* price increases, of both their living standards and their share of the fruits of technological progress.

In other words, the indisputable evidence makes it clear that inflation was triggered, in each case, by corporations and not by workers. In each case, the thesis expressed by the late General Motors President, C. E. Wilson, as long ago as 1952, was borne out. Mr. Wilson wrote:

"I contend that we should not say 'the *wage*-price spiral.' We should say 'the *price*-wage spiral.' For it is not primarily wages that push up prices. It is primarily prices that *pull* up wages." [emphasis in original]

Yet most economists continue either to remain silent on this subject or themselves to parrot the phrase "wage-price spiral." Moreover, many of them today call upon workers, who clearly were not responsible for the present inflation, to bear the sacrifices of arresting it. Workers are asked to accept unemployment to stop the price rise and they are asked to forego the wage increases they require to correct the distortions in the income distribution from which they have suffered as a result of industry's price increases. As you doubtless know, real weekly after-tax wages of production and nonsupervisory employees on private nonagricultural payrolls, for example, are today lower than they were four years ago even though real per capita disposable income has risen significantly during that period.

Do not these facts impose upon economists a responsibility to combat the falsehood implicit in the phrase "wage-price spiral"? You can doubtless find means and occasions to meet that responsibility. I would like, however, to suggest two ways in which you and your fellow economists can help to right a serious wrong that has been done to the millions who work for wages and salaries in American industry.

The first involves group action. Economists meet regularly in groups of one kind or another—in departmental meetings on university campuses, and in conferences of various kinds, local, regional and national. Is it too much to ask that such meetings adopt statements bringing to the attention of the public that compelling evidence shows the "wage-price spiral" to be a myth and that, in fact, the nation has been afflicted by repeated "price-wage spirals"?

The second suggestion involves individual action. It would be helpful in the cause of economic truth, and most appreciated, if you and other economists would state your own conclusions from the enclosed evidence in letters to the UAW which we could use publicly.

If you are among those few economists who have taken up the cudgels in behalf of workers who have been blamed falsely for inflation that has been triggered by their employers, you have our deepest gratitude. If you are not, I hope you will recognize that after approximately 20 years as targets of economic falsehood wage earners feel entitled to call upon you for help in a matter in which you have special competence and a special duty to speak.

At this time of testing for America and its free institutions—a time when we face difficult and challenging social problems—the people, in whose hands rest the ultimate power and responsibility for democratic decisions, must be equipped with the facts to deal soundly with those problems. They have a right and a need to know the truth about such critical economic matters as the role of prices, profits and wages in relation to the serious problem of inflation. I hope you will help dispel the cloud of economic falsehood that surrounds this issue so that the American people may know the truth and may help shape America's policies in the light of that truth.

Very truly yours,

WALTER P. REUTHER, *President, International Union, U.A.W.*

Enclosure.

PRICES, LABOR COSTS AND PROFITS

(Six Charts and a <u>Wall Street Journal</u> Article)

International Union
United Automobile, Aerospace &
Agricultural Implement Workers of America - UAW

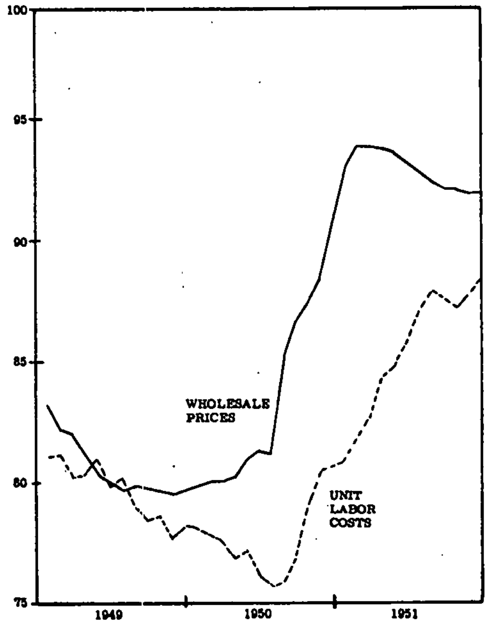
December 15, 1969

Prices, Labor Costs and Profits in Manufacturing[a/]

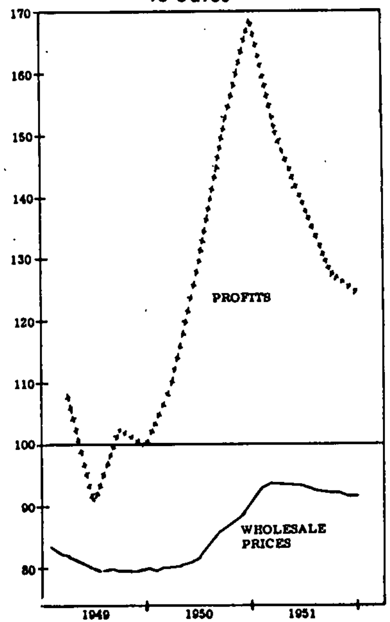
January 1949 - December 1951

(Indexes 1957 - 59 = 100)

Wholesale Prices and Unit Labor Costs



Wholesale Prices and Ratio of Profits to Sales



a/ Monthly data for prices and unit labor costs; quarterly for profits before taxes; seasonally adjusted except for prices.

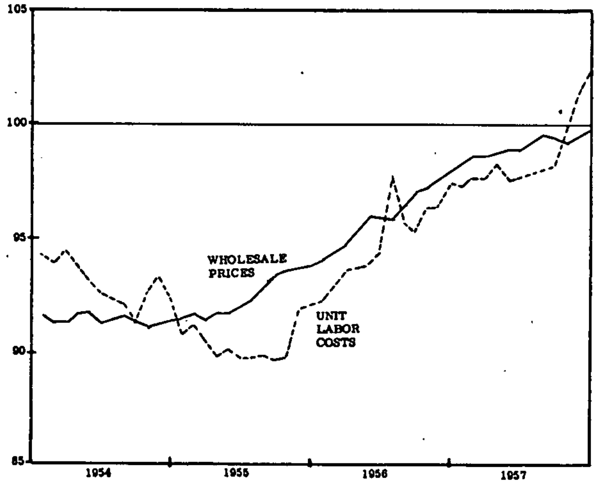
Data: Bureau of the Census, Business Cycle Developments.

Prices, Labor Costs and Profits in Manufacturing [a/]

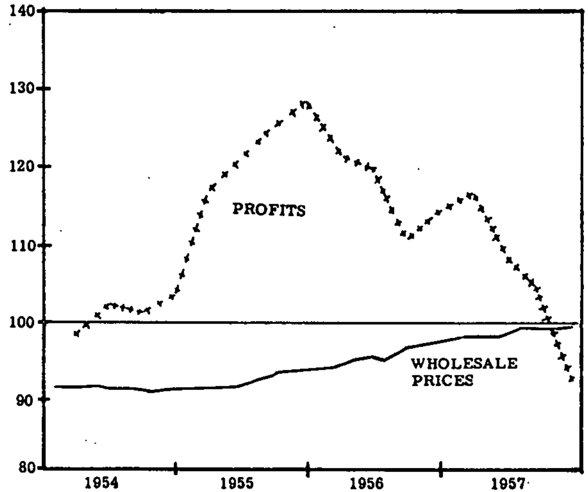
January 1954 - December 1957

(Indexes 1957 - 59 = 100)

Wholesale Prices and Unit Labor Costs



Wholesale Prices and Ratio of Profits to Sales



a/ Monthly data for prices and unit labor costs; quarterly for profits before taxes; seasonally adjusted except for prices.

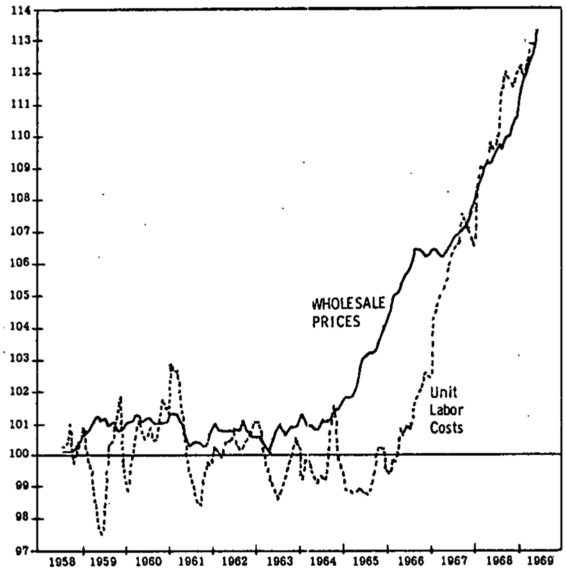
Data: Bureau of the Census, Business Cycle Developments.

Prices, Labor Costs and Profits in Manufacturing

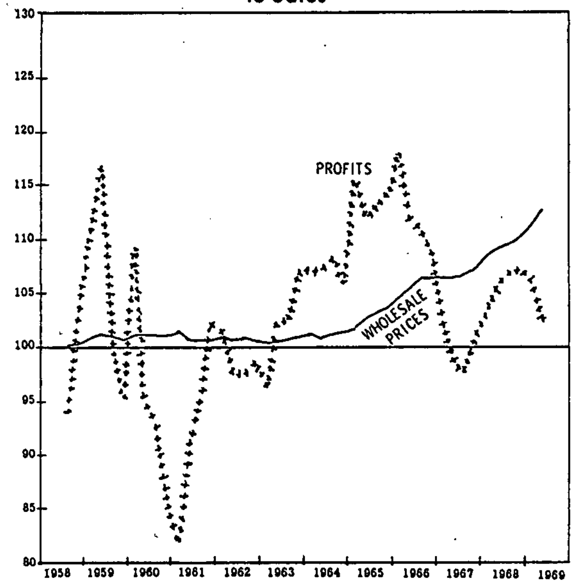
July 1958 — June 1969

(Indexes 1957 - 59 = 100)

Wholesale Prices a/ and Unit Labor Costs a/



Wholesale Prices b/ and Ratio of Profits b/ to Sales



a/ Monthly data for prices and unit labor costs (unit labor costs seasonally adjusted).

b/ Quarterly data for prices and profits before taxes (profit data seasonally adjusted).

Data: Bureau of the Census, Business Cycle Developments; except that profits for fourth quarter 1968 and first half 1969 are from Quarterly Financial Reports for Manufacturing Corporations, seasonally adjusted by UAW.

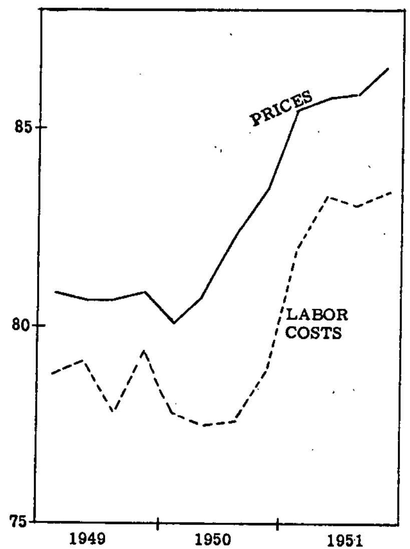
Prices, Labor Costs and Profits, Nonfinancial Corporations[a/]

(Current Dollar Cost per Unit of 1958 Dollar Gross Product Originating in Nonfinancial Corporations)

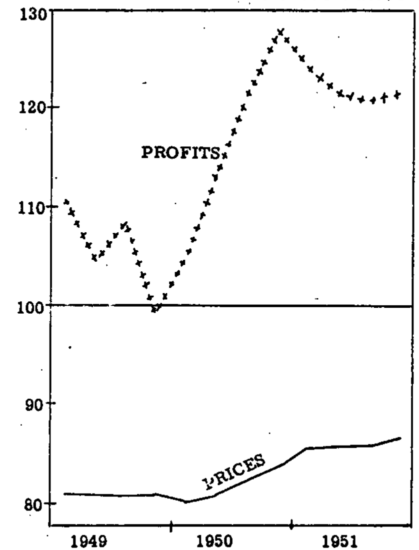
January 1949 — December 1951

(Indexes 1957-59 = 100)

Prices[b/] and Labor Costs[c/]



Prices[b/] and Profits Before Taxes[d/]



a/ Quarterly indexes, seasonally adjusted data.

b/ Total current dollar cost per unit (i.e., deflator for gross product of nonfinancial corporations).

c/ Compensation of employees per unit.

d/ Corporate profits and inventory valuation adjustment per unit (does not include inventory profits resulting from rising prices).

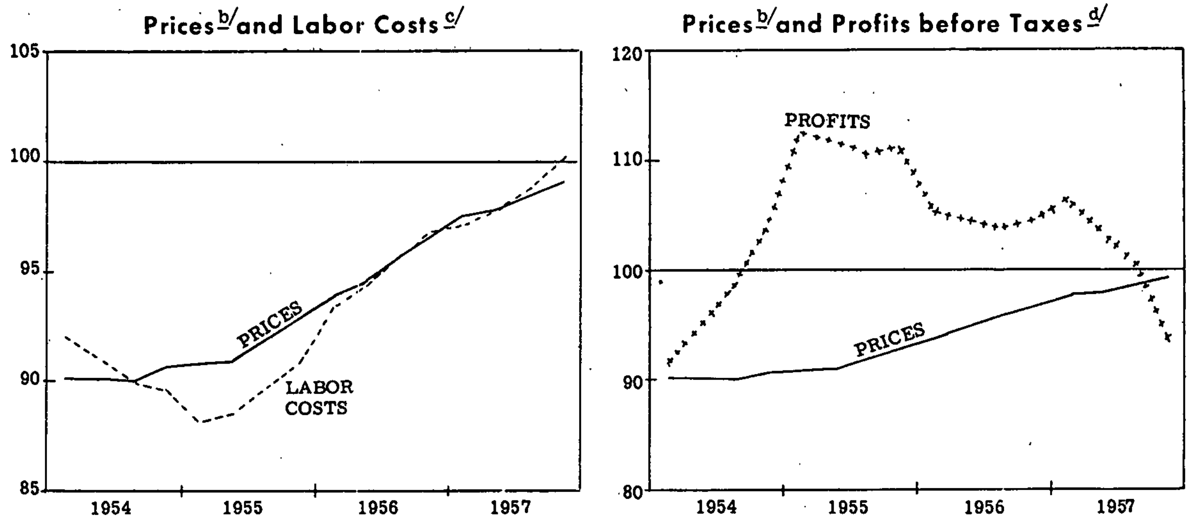
Data: Survey of Current Business, U.S. Department of Commerce.

Prices, Labor Costs and Profits, Nonfinancial Corporations[a/]

(Current Dollar Cost per Unit of 1958 Dollar Gross Product Originating in Nonfinancial Corporations)

January 1954 — December 1957

(Indexes 1957 - 59 = 100)



a/ Quarterly indexes, seasonally adjusted data.

b/ Total current dollar cost per unit (i.e., deflator for gross product of nonfinancial corporations).

c/ Compensation of employees per unit.

d/ Corporate profits and inventory valuation adjustment per unit (does not include inventory profits resulting from rising prices).

Data: Survey of Current Business, U.S. Department of Commerce.

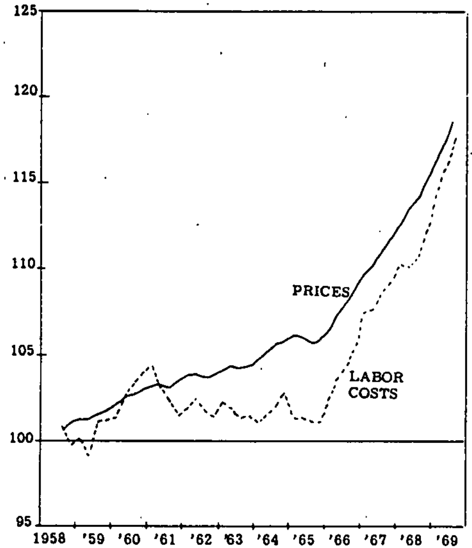
Prices, Labor Costs and Profits, Nonfinancial Corporations[a/]

(Current Dollar Cost per Unit of 1958 Dollar Gross Product Originating in Nonfinancial Corporations)

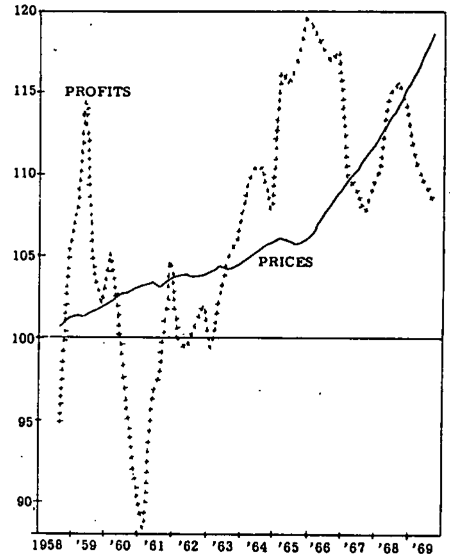
January 1958 — September 1969

(Indexes 1957 - 59 = 100)

Prices[b/] and Labor Costs[c/]



Prices[b/] and Profits before Taxes[d/]



a/ Quarterly indexes, seasonally adjusted data. Third quarter 1969 data are preliminary.

b/ Total current dollar cost per unit (i.e., deflator for gross product of nonfinancial corporations).

c/ Compensation of employees per unit.

d/ Corporate profits and inventory valuation adjustment per unit (does not include inventory profits resulting from rising prices).

Data: Survey of Current Business, U.S. Department of Commerce.

The Outlook

Appraisal of Current Trends In Business and Finance

Even the staunchest union leader would probably concede that rapidly rising labor costs have a great deal to do with the country's dreary price record in recent years—a record made still more dreary by last week's news of steel price boosts and sharply climbing consumer prices. The consumer price index rose at an alarming annual rate of 6% in June, the latest month available. In the early 1960s, in contrast, the index increased only about 1.2% yearly. At the same time, labor costs per unit of factory output are about 10% higher now than in mid-1966. In the early 1960s, such costs remained approximately flat from year to year.

Any attempt to fix the blame for today's inflation, however, shouldn't be limited simply to a consideration of labor costs. The blame, it can be argued, belongs in many places.

A major culprit may be corporate profits. A glance at the economic history of the post-World War II era certainly suggests that inflation often has been just as much "profit-push" inflation as "wage-push." Consider a few facts of the postwar era:

—In the past 20 years, there have been three distinct periods in which factory prices climbed substantially over a prolonged interval.

—In each instance, labor costs per unit of factory output were *declining* when the price climb began—and these costs continued to decline for a considerable period after the price rise was under way.

—In each case, corporate profits began to increase sharply well *before* the price climb started.

Such facts, at least to some economists, bear an obvious message. "The pattern is clear enough," says Peter L. Bernstein, president of Bernstein-Macaulay Inc., a New York investment counseling service. "Instead of labor costs pushing prices up, what we see instead is a sort of profit-push. Profits are already well on their way up before prices begin to rise, and prices are well on their way up before wages begin to rise faster than output."

Indeed, some analysts say that the postwar economic record suggests a chain of events that runs something like this: Profits begin to climb, first through the impact of better machinery and work methods on unit labor costs, and then through higher prices; the rising profits finally prompt labor to attempt to "catch up" by seeking sharply higher pay; ultimately, unit labor costs begin to rise, too, giving inflation a further push.

"There's no question that excessive labor costs add fuel to inflation," declares James Tobin, a professor of economics at Yale University and a member of President Kennedy's Council of Economic Advisers. "But if you want to put first things first, have a look at the role of profits."

In the postwar era, the first sharp, sustained rise in factory prices occurred in the early part of the Korean war. The Government's wholesale price index for manufactured goods was actually lower in the early months of 1950 than a year earlier. But in July 1950, the index climbed almost 2 points to 83.2 (1957-59 equals 100) and by the end of the year it stood at 90.7. By the following March, it was at 93.8, almost 14 points higher than in March 1950.

Corporate profits also climbed sharply in most of those months, but the rise began in the second half of 1949, rather than in mid-1950. Unit labor costs, moreover, declined through most of 1950, and did not begin to move clearly upward until the year's final three months. Between March and August of 1950, when the factory price index rose from 80 to 85.1, unit labor costs fell from 77.6 to 75.9 (1957-59 equals 100).

The second big rise in factory prices in the postwar period took place in 1955-57. In July 1955, the Government's price index for factory goods, at 92.3, was actually slightly lower than in July 1951. But by July 1956, the index stood at 95.7 and by July 1957 it hit 99.3. Corporate profits began climbing sharply much earlier; records show that the rise began in the first quarter of 1954. By the time the price index turned up in late 1955, profits had risen more than 70%. The statistics further show that unit labor costs were dropping in mid-1955. They did not begin to rise until late 1955.

The third substantial upturn in factory prices began in 1965 and is still going on. Again, the record shows, profits began rising long before prices. And unit labor costs actually were declining slightly at the time the price rise got under way.

One question that the postwar record raises is: If rising profits bring on an initial inflationary push, must profits also stop rising before relatively stable prices can be achieved? The record book suggests so. Profits have been approximately flat or have declined during the postwar periods of prolonged stability in factory prices. In this regard, it is interesting to note that occasionally there have been substantial increases in unit labor costs—with no corresponding rise in factory prices.

Do such facts mean that the country must always face a Hobson's choice of flat profits or painful inflation? Some analysts believe that the choice is something of that sort, though not so drastic. "A rise in profits that relates to basic growth in the economy—for example, through a larger, more efficient labor force—would not seem to condemn us to any inflationary spiral," says Geoffrey H. Moore, director of research for the National Bureau of Economic Research, New York. "The trouble is, the big profit increases usually reflect a good deal more than just basic economic growth."

Theoretically, of course, competition for customers is supposed to deter willy-nilly price increases that feed sharp inflation. Some economists, however, contend that competitive considerations often are insufficient to deter excessive price boosts. "There is very little price competition in some industries," claims Nat Goldfinger, an AFL-CIO economist.

Recently, the economist adds, "nearly everybody has been raising prices, so that customers have almost nowhere to turn" if they want to take their business elsewhere, unless they wish to turn to foreign suppliers. Many have done just that, of course; U.S. imports of manufactured goods have approximately tripled since 1961.

—ALFRED L. MALABRE JR.

The Wall Street Journal - August 5, 1968

Appendix B

Outline of Provisions of Bill To Require Hearings on Administered Price Increases in Order To Make Private Economic Decisions More Responsive to Public Needs

1. PURPOSE

To bring an informed public opinion to bear upon price policy in administered price (and certain other) industries as a substitute for the price-restraining influence of competition which is lacking in such industries.

2. ADMINISTRATIVE MACHINERY

(*a*) A Price-Wage Review Board to conduct hearings on price increases proposed by certain corporations.

(*b*) A Consumer Counsel to represent the consumer and public interest in such hearings.

The relationship between the Board and the Consumer Counsel might be similar to that between the National Labor Relations Board and the General Counsel of the NLRB.

3. COVERAGE

The legislation should apply permanently to corporations in a position to act as "price leaders" in their respective industries. Specific and objective criteria should be devised to determine the corporations that fall into the "price leader" category. Total coverage should be limited to the minimum number of corporations required to accomplish the basic purposes of the bill. One possible criterion for coverage could be: all corporations accounting for 25 percent or more of total sales in a major industry. (Such corporations could be identified from data in the files of the Census Bureau, the SEC and the FTC.) Under this criterion, only a limited number of giant corporations in major industries would be covered on a permanent basis. In addition, the President should be authorized to extend application of the legislation temporarily to other firms if he believes that a price action taken or about to be taken by such firms threatens overall price stability.

4. ADVANCE NOTIFICATION OF PROPOSED PRICE INCREASES

Covered corporations should be required to notify the Price-Wage Review Board of intention to increase a price and should be prohibited from putting such a price increase into effect for a specified minimum period (perhaps 60 or 90 days) sufficiently long to permit the Board to hold hearings on the proposed price increase and to issue its findings concerning such increase. The corporations should be required to supply to the Board, simultaneously with their filing of the notice, all data which they consider pertinent to the proposed price increase. The Board should publish the fact that notice has been received and make available for examination by groups listed below under "Other Appearances" the data filed with such notice.

5. WAIVER OF HEARINGS

Upon analysis of the data submitted with the notice, and after a reasonable time has been allowed for examination of the data by all interested parties, the Board, with the consent of the Consumer Counsel, should be empowered to waive hearings and permit the proposed price increase to go into effect immediately. In such cases, however, the Board should be required to publish promptly a report setting forth the reasons for so doing.

6. EMERGENCY PRICE INCREASE

Upon a claim that an increase in production costs creates an emergency requiring the corporation to raise its prices prior to expiration of the notice period, the corporation should be permitted to raise its prices within that period. In such case, however, the Board, in addition to its other findings, would be required to make a finding as to whether or not such an emergency in fact existed and whether or not the price increase exceeded the amount required to meet increased production costs. If it found that the claim of emegency was not supported by the facts, the corporation would be required to rebate to every customer who paid the price increase damages equal to three times the amount of such price increase for products shipped during the notice period. In the event the ultimate purchaser of the products in question could not be ascertained, the corporation would be subject to a fine equal to the triple damages specified above. If an emergency were found to exist but it was also found that the price increase exceeded the cost increase, the triple damages rebate of fine would apply to the excess.

7. PRICE REDUCTION HEARINGS

The Consumer Councel should be empowered to initiate hearings when, in his judgment, there is reason to believe that a corporation permanently or temporarily subject to the legislation should reduce the price of its products. (This power is essential to promote stability of the general price level because it would help to bring about price reductions in industries with above-average rates of productivity growth to offset unavoidable price increases in industries with below-average productivity gains.) If a corporation responded to the notice of a hearing with an acceptable price reduction, the hearing could, of course, be cancelled by the Consumer Counsel.

8. SUBPOENA POWER

The Consumer Councel would have power to subpoena witnesses, to examine them fully, and to require production of all pertinent books and records.

9. INVOLVEMENT OF UNIONS

If a corporation claims that its proposed price increase would be required as a result of granting union demands, the Consumer Councel would be empowered to subpoena and examine representatives of the union. Union and corporation representatives would be permited to cross-examine each other.

10. OTHER APPEARANCES

Representatives of unions, of consumer organizations, of corporations purchasing products affected by the proposed price increase, and of interested government agencies (federal, state, local) should be allowed to participate in the hearings voluntarily, subject to permission granted by the Board. Such voluntary witnesses would be required to submit to cross-examination and would be permitted to cross-examine corporation witnesses. All testimony taken at the hearings would be under oath.

11. OPEN HEARINGS

All hearings should be open to the public, the press, and radio and television. (The matter of possible "confidentiality" of certain types of data should be considered in drafting the proposed legislation. It should be kept in mind in this connection, however, that the legislation is premised on the absence of price competition in the industries affected; that, therefore, there are not apt to be genuine "competitive secrets" related to costs and prices; and that the public interest is as deeply involved as in public utility rate hearings in which all pertinent facts are publicly available. If, nevertheless, it should be decided that certain types of information required for purposes of the hearings should be treated as "confidential," the Board might be empowered to go into executive session while such information was being presented and considered with the participants in such executive sessions subject to penalties for public disclosure of such information.)

12. FINDINGS

The Board should make findings of fact only, and should not pass on the merits of or justification for proposed price increases (or union demands). Each party to the hearings—the corporation, the Consumer Counsel, and the union, customer corporations, consumer organizations and government agencies, if any are involved—should submit to the Board at the conclusion of the hearings a list of its contentions, and the Board should state its findings of fact with respect to each of such contentions. The findings should be published before the expiration of the notice period.

13. PENALTIES

Penalties should be provided for failure to give the required notice of a proposed price increase, for failure to respond to subpoenas, for taking reprisals against any person who testifies, and for perjury. The penalties should be severe enough (particularly in the case of failure to give notice) to deter violations. In the event of failure to respond promptly to subpoenas or to requests for production of books, records, etc., or if the corporation is found to be engaging in other dilatory tactics, the Board should be empowered to extend the period during which no change in prices would be permitted.

14. NO PRICE OR WAGE CONTROL

Regardless of any finding of fact that the Board may make, upon expiration of the notice period (or any extension of it), the corporation would be free to determine its own prices (to the extent specified in its original notice or to any lesser extent), and the union would be free to pursue its demands. The only restraint on the corporation and the union would be the restraint of enlightened public opinion.

(This procedure, of course, would not rule out the possibility of Presidential intervention in a case where a corporation insisted on imposing a price increase which the hearings had shown to be clearly unjustifiable. In that case, the President would then be in the position of having a fully informed public opinion from which to mobilize support.

In the great majority of cases, however, it can be anticipated that no company would be prepared to face the unfavorable publicity bound to rise from such an action. In most cases, a price increase would not even be proposed, when the company knew a public hearing was likely to result, unless it was sure that the economic facts did justify an increase.)

STATEMENT OF LEONARD WOODCOCK ON THE PRESIDENT'S STATE OF THE UNION MESSAGE

I am sorry that the President's Message on the State of the Union was delivered so close in time to these hearings that it was not feasible to leave the completion of my statement until after the Message had been delivered. However, there are some comments I wou'd like to make in the form of a supplementary statement.

Some of his suggestions, such as that of revenue sharing, I have dealt with in my statement. As we suspected, the greater part of the funds for revenue sharing would come from cutting back of existing federal programs. What is most serious is that the largest cutbacks, apparently, would be in federal aid to education. In many states, this would mean that the leverage now available to the federal government to fight segregation in the school system would simply disappear.

According to the *New York Times*, among the federal programs to be dismantled would be all those established under the Secondary and Elementary Education Act, most of the Model Cities Program, urban renewal and water and sewer grants, most of the federal manpower training programs, the anti-crime funds appropriated under the Safe Streets Act of 1968, rural development programs and mass transit programs. All of these are essential prorgams, and there is no assurance that they would be carried on by the various states and communities. Indeed, the pressures for reduction in state and local taxes would almost ensure that a substantial proportion of the revenues would be used for this purpose rather than for continuing under state auspices present federal programs.

I am completely in favor of federal government assistance in cutting the present overwhelming burden of state and local taxation, but this should be accomplished by a federal program directed specifically to that purpose, and not by cutting down existing essential programs.

As to the argument that revenue sharing will restore "power to the people," that is complete nonsense. After all, members of the Senate and the House of Representatives have to be elected by the people just as do members of state and local governments, and they presumably feel just as great a need to keep close to the people who have power to elect or unseat them.

As a matter of fact, there is every evidence that state and local governments are less concerned with meeting the needs of all the people, and more subject to the influence of special interests, than is the federal government. Why, for example, is state and local taxation so much more regressive than federal taxation? A major reason is that state and local governments are engaged in a competition to maintain a so-called "favorable climate" for business, which is actively fostered by large corporations in the form of demands for special tax and other concessions—all at the expense of the small taxpayer.

If the President really wanted to restore "power to the people," he might better have done so by recommending the direct election by popular vote of future Presidents and Vice Presidents.

Neither is there any evidence that municipally directed welfare programs, for example, are any less bureaucratic or dictatorial in their approach than federally controlled programs. On the contrary, for many minorities, especially the black people in the South, there is every reason to believe that those who administer federal programs will be much more responsive to their needs than the administrators of locally controlled programs.

In his welfare program, in fact, the President has completely misjudged the needs of the people. His frequently proposed floor of $1,600 a year for a family of four would represent only 42 percent of the $3,800 a year recently announced by the Department of Labor as the poverty line for an urban family of that size.

Mr. Nixon proposes to "stop helping those who are able to help themselves but refuse to do so." Actually, this is not the problem. The problem is rather that too many of those who "help themselves" nevertheless remain in poverty.

In 1969, there were more than a million families which received an income below the poverty level, even though the family head worked full-time, the year around.

Among black families, more than one-fifth received an income below the poverty level even though the family head had been working full-time all year-round.

All told, there were more than 5 million workers and dependents in 1969 who lived in poverty although the family head held a year-round full-time job.

With reference to inflation and unemployment, I think that the President is both too optimistic and too vague. He talks about the "tide of inflation having turned;" earlier in this testimony I have expressed my doubts that this is so. Moreover, I would have liked to see much more concrete policies geared to bring the unemployed back into the economic mainstream. In particular, I would have welcomed a firm commitment towards linking further cutbacks in military spending with efforts to provide adequate housing, restore the environment, and improve our transportation system.

As to health care, we will have to delay full comment until the details of the President's program are set forth. It may be significant, however, that his Message promised only to bring "basic medical care" within the reach of every family. This could mean a severely stripped-down program that would leave many major medical needs unmet.

As to the President's proposal for reorganization of government departments, again we will have to wait for details. But I fail to see how eight "monster departments" can be more efficient and less bureaucratic than twelve smaller departments. And one thing is sure, that if the Congress allows itself to become involved in the vigorous clashes of opinion and the prolonged debates that must precede any such far-reaching reorganization of the government, it will have little time left indeed to enact either the President's programs or any other of the urgently needed measures to halt inflation, to reduce unemployment, to provide for conversion of defense industries to the needs and purposes of peace, or to enact any other of the measures so vital to the welfare of this country's people.

Chairman Proxmire. Thank you, Mr. Woodcock. I think your statement was excellent. I did have a chance to read your prepared statement. I am glad I took a course in rapid reading some years ago. It helped. You certainly did a fine job of summarizing it, as you always do.

In view of the powers to which you referred of Ford, particularly, General Motors, also, to increase prices in a soft market, and in view of the reported proposals by a recent Assistant Attorney General in charge of antitrust to take action to try to break up the big automobile combines, would you favor that kind of action as a long-term way of getting at this administered inflation?

Mr. WOODCOCK. Well, I am reminded of what Winston Churchill said back, I think, in 1945, that he didn't become Prime Minister to preside over the breaking up of the British Empire. I am not too quick to advocate this as president of the UAW. I would have to know much more about what the consequences would be.

I think, for example, if there were, in the case of General Motors, a spinning off of Chevrolet, which would seem to be a quite obvious device, unless restrictions were put either upon the operation of the new Chevrolet, which would be a major entity by itself, or upon the remaining General Motors, I think we would quickly find ourselves back in the condition from which we had begun.

The antitrust laws act in a very peculiar way—the Ford Motor Co. being ordered to divest itself of the electrical group that they had bought from the Autolite Co., yet the General Motors Corp. can keep AC Sparkplug simply because it had it longer. So I would think the whole antitrust thing needs to be surveyed.

Chairman PROXMIRE. The problem is, both you and Mr. Petersen advocate some kind of wage-price review on a systematic basis and presume it should be pretty much of a permanent institution, capable of doing this, with the ability to have some influence in holding down prices. We have relied over the years or thought we have to a considerable extent on the discipline of competition to keep prices down and to prevent this kind of administered inflation at times when companies are operating far below capacity. But it just does not seem to be working now and I think one reason, of course, is because you have these big concentrations of power in the hands of two or three very large automobile companies.

Also, I am a little biased because I come from Wisconsin, and American Motors—I would like to see them all about that size.

Mr. WOODWOCK. I would like to see them in better shape, though.

Chairman PROXMIRE. I am sure Roy Chapin would, too.

Mr. Woodcock, we sometimes get the feeling that everything that is wrong with the economy is the result of the General Motors strike. That is what we have gotten, that kind of impression has been given to people, I think, in the last couple of months. I think it is important to guard against this kind of exaggeration. I think we would have had very serious economic problems in the last quarter even without that strike. Nevertheless, this strike is damaging the economy. I understand you say in your statement that some estimates have run as high as a $10 billion cost. And the possibility of a steel strike breeds distortions in the patterns of economic activity as business builds up steel inventory against a possible strike.

Right now, in Milwaukee, we have something close to a policeman's strike. They had something like that, a slowdown, at least, in New York, as you know. We have had sanitation strikes and teachers strikes and, of course, construction strikes. Many people feel we have been pushed to an extreme.

My question is, Are these strikes, in your view, necessary? Could we not arrive at equitable settlements by some method which would not lead to strikes and without compulsory arbitration? Is there some way that the Congress and the President can contribute to an atmosphere or to the creation of institutions which would prevent this kind of situation in which we have, No. 1, an adverse effect on the economy and, No. 2, an inflationary effect, and No. 3, apparently not much benefit to the people who go out on strike?

As I point out, after the past 2 years, the incomes of people in manufacturing have dropped 6 percent. Isn't there a better way for us to handle this?

Mr. Woodcock. Well, making the statement, obviously one has to say, yes, there is a better way. But it is like democracy; obviously there has to be a better way until one considers all the other ways. In the relationship between an employer and the union, there has to be a pressure point to bring the thing into focus where a settlement can be made. That pressure point in the system that we have developed is the threat of a strike or an actual strike. It is not too rational a system, but the only real alternative to it would be some form of imposed arbitration which, in the case of Australia, has not worked very well and certainly has not eliminated strikes, except that they tend to become antigovernmental strikes by virtue of the existence of the compulsory governmental system.

I do not—the General Motors strike, obviously, had an adverse impact on the economy. On the other hand, General Motors is now operating under forced draft to catch up on its loss during those weeks. It will have a favorable impact on the economy, which will not, possibly, entirely wipe out the negative factors but will largely diminish them.

When you get into the area of those who directly serve the public, whether it be sanitation or police or whatever, I would hope that there could be some way found which would have to be on a voluntary, acceptable basis, to find some other way than the imposition of that immediate and drastic impact upon the people generally that the strike brings forward.

Chairman Proxmire. My time is up.

Senator Javits?

Senator Javits. Thank you.

Mr. Woodcock, I found your proposal for a wage-price board very interesting. I feel very strongly about a wage-price board myself. But I did notice the difference in treatment between the price leader in the industry and the union. Now, why would it not be more auspicious for your own proposal to put them on a complete parity? That is, to require notice by the price leader and notice by the wage leader? If anything, the trade union is much more pervasive in the industry than General Motors; for example, your union covers every corporation. Would you not be better off and the whole thing make a better showing if you put both on a parity, especially as I can hardly conceive of a company giving notice of a price increase that did not try to shift some of the responsibility to labor right away? So you get all the disadvantage. Would you explain that?

Mr. Woodcock. Well, Senator, not only do I think we would not object to that, I think we would agree with it.

Senator Javits. I think that is very good and very helpful.

Now, one other thing. I was very interested in Senator Proxmire's question as to the problem of dealing with strikes, especially strikes having an impact on the national health and safety. Has your union come forward or would you be able to come forward with any ideas? You know, the President has made a proposal to give him a certain range of authority. I have a proposal in of long standing of a partial seizure. We just ran head on into it in the railroad situation. I know it might not necessarily apply to all of the UAW, but rather only to programs in the defense aspect of the business. But it would certainly set the climate and character for what to do about strikes. Would you or your union have any ability to help us on that score with a concrete suggestion or idea?

Mr. WOODCOCK. Of course, speaking to our own experience, after the long and bitter strike with General Motors in 1945 and 1946, we had over 20 years of essentially peaceful relations in the automobile industry. The strike in the Ford Motor Co. in 1967 was the first one in that company in 26 years. The strike in General Motors just concluded was really pushed on both of us by circumstances over which neither of us had any control, meaning the whole problem of inflation. We were fighting to get back to a method of wage setting which had been the underpinning of the 20 years of stability in the industry. The fact that we got back to that could well lay the basis for peaceful relations in the future.

Our people do not gain by strikes. They are painful, they require sacrifices. But I just know of no alternative in our kind of free economic society.

Now again I repeat, when you get into the area where it has a direct impact on the public, you are in a dfferent sphere. I would think that the people directly involved should be brought together to see if they could not evolve a system which would avoid placing that burden on the public, because the public just is not going to stand for it.

Senator JAVITS. Thank you, Mr. Woodcock. One other question if I have time. I have a little time.

That is on pension reinsurance. Now, I was opposed to the effort to attach pension reinsurance to the broker-dealer insurance bill for many reasons, but also for the following reasons, on which I would greatly appreciate your comment, as I suppose I have the principal pension and welfare fund bill in. In the absence of funding and vesting requirements or other equivalent regulatory controls, would we not, by reinsurance, simply paper over a very inadequate structure and should we not restructure it altogether—that is, require at least prospectively, funding and expressing by some fundamental criteria so we know what we are doing with insurance, so we have that planned.

Mr. WOODCOCK. You have me at a disadvantage because our union has always fought for funding, always fought for vesting. We would welcome it, but there are others who do not see it in that light, which is why we always try to detach it.

Chairman PROXMIRE. Congressman Brown.

Representative Brown. Mr. Woodcock, I want to follow through on Senator Proxmire's question regarding strikes affecting the national economy. In one of my other capacities on the House side, I sit on the House Committee on Interstate and Foreign Commerce. This is the second time we have had to face a strike in the railroad industry. The previous experience was when Secretary Wirtz was Secretary of Labor. At that time, he testified before our committee that he did not feel the economy could tolerate strikes in a number of industries. He listed public services, transportation, communications, and steel as industries having a generalized impact on the national economy; and autos, and even newspapers in certain areas where they dominated the means of advertising in those areas. The Federal response to the General Motors strike was to take that strike. What I am really asking is, in your experience, do you prefer the Nixon approach to that strike, or did you prefer the Wirtz approach, which called for some method of making such strikes illegal or providing for compulsory arbitration over them?

Mr. WOODCOCK. I think the proposal to make strikes—in autos, just taking that piece of it—illegal would be absolutely unacceptable and unworkable. I think the approach of the Nixon administration to the automobile negotiations was no different than any administration at any time we have had negotiations. There has been no Federal intervention in that sense. There has been inquiry, there has been expression of solicitude, and this happened with this administration. But there has never been, since 1946, any direct Federal intervention .

Representative BROWN. Apparently there is now a different kind of environment in the auto industry with regard to strikes which, I would assume, well, I was going to say puts more pressure on the industry. It may in fact put more pressure on both the industry and the representatives of the employees to come to a settlement that has within it a relationship to productivity. That is the amount of foreign imports that impact this industry. It appears obvious to me that if the price of automobiles per unit for sale gets so high, the industry, which means the stockholders and the employees and managers and everybody, will suffer. They will be selling less units if you can go out and buy a Toyota a lot cheaper than you can buy a Chevrolet or an American Motors car. Now, can you give me some indication of the impact of the strike in that area?

Mr. WOODCOCK. Well, if it has an undue influence on cost, it would worsen that problem. But the problem of imports, I think, is not too well understood. Way back in 1949, we urged upon this industry the development of a small car. At that time, in the immediate postwar period, the United States dominated the world auto market, just as today, it dominates the air transport market. Had we developed in this country at that time a small car and marketed it internationally, we well could still have that preeminent place. General Motors, in fact, began to develop such a small car. They were going to build a plant for it in the Cleveland area. Then for some strange reason, they changed their mind and that small car, which was designed and tooled up in the United States, became the General Motors Holden in Australia. The steel which was ordered for the building in Cleveland was shipped and added to an expansion of the Vauxhall General Motors plant in England. So they got out of that area. It was not until the early 1960's that they began to compete at the compact level.

Representative BROWN. Some companies are competing at the compact level by building their cars abroad. Does the size of the automobile relate to the costs involved in the automobile? In other words, the fact that these cars can be made cheaper abroad seems, whether they are made by a U.S. company abroad or whether they are made by a foreign company abroad, seems to be having some impact upon the automobile market. Are you suggesting that the real impact is the size of the car and that they have gone to a marketable small car?

Mr. WOODCOCK. In 1960, imports were up to 11.2 percent. That is when the compacts were introduced—the Chrysler Valiant and other comparable cars. They began to compete and the import shares went from 11.2 percent down to 6 percent and stayed in the 5 or 6 percent range for 5 years. But then the industry took those cars, stretched them out, put bigger engines in them, put what had been options in as standard equipment because they made more profit per unit, and they quit competing. Then it went back up again. Now they are back competing with the Pinto.

Now, it is true the engine in the Pinto is made abroad, but if the volume develops sufficiently, and I believe it will, I think they will begin to make that engine here, although with the new multinational setup, that may not be true. The Vega has not yet been tested because of the GM strike.

Representative BROWN. You mean in the market?

Mr. WOODCOCK. Tested in the marketplace. But it is my understanding that in one-third of the Pinto sales, an import is the trade-in. If the same thing happens in the Vega, the Vega is a little bigger price, but it is a much better car than the import cars—I hope General Motors will give me credit for this commercial—it can meet the competition.

We have a situation that's a little different overseas. But it bothers me when a Chevrolet costs $10,000 in Japan and they can do all of those things on their end of it and we have to be a recipient. It has to be a two-way street if we are going to continue this kind of posture.

Representative BROWN. My time is up, but did you make reference to the aerospace industry and the air transport industry? Are you talking about the aerospace industry developing the small plane or the SST?

Mr. WOODCOCK. I wish your time really were up. On the question of the SST, our union has no position. We have thousands of members who look to that program for jobs and I understand their anxiety. I am troubled by the position of our airlines today. One generation of planes is crowding so fast on another, I think it is the main element in the bad economic situation of our airlines. The 747 is not doing well. The fact that National is giving up the two 747's that it bought, that would say we should look very carefully before we go any further down that road. The fact that the Concorde or the Russians will take over the market—we have control of that if upon ecological grounds we say they can't come to the United States, because that cuts off the profit factor completely.

Representative BROWN. I am sorry my time is up.

Chairman PROXMIRE. Senator Jordan.

Senator JORDAN. Mr. Woodcock, I have found several constructive ideas in your very able presentation. We have already discussed a price-wage review board. I was intrigued by your reference to the fact that we probably will have a $74.5 billion defense budget, yet there will be a 27-percent unemployment rate in the aerospace industry. You suggest that just as we did under the Trade Expansion Act—the Federal Government accepted some responsibility for relocating technicians or people who were displaced—so should we in this instance direct the energies of the Federal Government in relocating this highly skilled group to work in traffic control, crime control, pollution control, urban problems, et cetra. I think that is a very good suggestion. Would you elaborate on it a little bit? Do you think it is possible to do that? Do you think these people who are highly skilled in the aerospace industry could be induced or persuaded by some kind of government inducement to direct their energies into these other areas where there is a great shortage of technical skills now?

Mr. WOODCOCK. I have reason to believe the aerospace industry would welcome the approach of a NASA-type agency to get into this area.

Senator JORDAN. Where we could define the goals, would we invite them to move in and direct their substantial abilities toward the solution of these urgent problems?

Mr. WOODCOCK. I believe that is true; yes, sir.

Senator JORDAN. I was impressed by your statement about "30 and out" and the program you espouse there. A man works 30 years in industry and even though he is not of the age of 65 or anywhere close to it, you would recommend—and I was not quite clear what you did recommend—that he should not suffer in social security by reason of his early retirement? Is that what you are getting at?

Mr. WOODCOCK. Yes; I am not proposing, Senator, that he gets his social security at any age earlier than now. That is a separate question. But now he takes his years from 1950 up to the time he becomes 65 and he can drop out the lowest 5 years of earnings to determine the wage average which determines his social security. If he gets out at 58 and gets out of the labor force, he then has 7 blank years.

Senator JORDAN. That is right.

Mr. WOODCOCK. We are trying to devise some means whereby there could be a continued relationship so that on the pension which he gets, which is private completely at this point, there would be a social security tax paid. We found no legal way of doing that. So that is not being done.

So having 7 blank years, being able to drop only 5 out, he has two absolute zeros and he has to go back to the 1950's, where his wage was much lower, to determine his overall average, the result being, he loses on average $57 from his social security income entitlement at age 65. We are suggesting that in this special kind of circumstance, the years beyond 5 be also dropped where in fact the person has gone out of the labor force.

Senator JORDAN. So he is not disadvantaged to the extent of having to go back to those low paid years?

Mr. WOODCOCK. That is correct; yes, sir; in this case no-paying years.

Senator JORDAN. Yes. In your prepared statement, you express some doubts about the President's revenue-sharing proposal. You had several suggestions. There have been a number of witnesses before this Committee and others—Mayors, Governors, and others—who were very much in favor of revenue sharing of one kind or another. You mentioned something about using the device of a tax credit, but you did not expand upon it. Will you explain it now? What do you propose in lieu of revenue sharing as proposed by the President in his message?

Mr. WOODCOCK. I propose it through specific acts like the acceptance by the Federal Government of responsibility for our welfare system.

Senator JORDAN. You would federalize the welfare system?

Mr. WOODCOCK. Yes, I would, sir.

Senator JORDAN. Totally?

Mr. WOODCOCK. Totally.

Senator JORDAN. Up to the poverty level or beyond?

Mr. WOODCOCK. It would depend upon what the definition of the poverty level were. I think it would be good for the country if we had one standard across the whole country. I have said specifically regarding this that we are supportive of the family assistance program. We question the arithmetic, but I am more concerned with the principle at this point in time than the arithmetic.

Senator JORDAN. It lacks a lot of being a total program?

Mr. WOODCOCK. Yes, but it would be a step along the way.

With regard to the tax credits, I said if Congress were to consider this—I understand Governor Gilligan again advocated this—certainly it would have to be tied to reform of a regressive tax system in a locality or a State before the Federal Government should rebate back Federal money. Also, we would have to make some allowance in poorer States, which would be disadvantaged under such a straight tax credit scheme.

Senator JORDAN. Thank you. My time is up.

Chairman PROXMIRE. As you know, Mr. Woodcock, the administration has accepted the concept of the full employment budget, meaning that expenditures would be calculated to be in balance with revenues which we would have if we had unemployment at 4 percent and an increase in profits commensurate with that level of unemployment. Now, that would mean that we are going to have a deficit this year of $10 billion at least, probably $15 billion, maybe more. Now, you are adding some additional expenditures that are pretty substantial to what the President seems to be proposing. You propose that the Federal Government assume all welfare costs. The best estimate for the year 1971 would be that these would cost almost $17 billion, of which the Federal share was $9.7 billion and the State and local share, $7.3 billion. That means adding $7.3 billion to the Federal budget. Other proposals impose a minimum of $10 billion to the budget. What the President wanted would be only $5 billion.

We will have a national health proposal backed by your organization which will cost $40 billion, of which half is out of general revenue. That will add another $20 billion.

You and I favor a public service employment bill, last year's vetoed bill. This year's emergency bill is only about $700 million.

All of this adds up to about $33 billion, not counting the increase you suggested here in social security or the higher family assistance plan figure which you strongly favor.

Now, to add that or even half that to the budget would either mean that we would have what almost everybody would consider a highly inflationary level, or you would have to have a much deeper reduction in defense spending than most people have advocated. How would you handle this serious problem?

Mr. WOODCOCK. Under the reordering of priorities. We have asserted that up to $20 billion can be taken out of the military budget. I am certainly no expert on that. I do not know whether it would leave us open to our enemies. I seriously doubt it. It seems to me quite obvious in a budget as huge as the military budget, there is enormous wastage. There are programs in being which simply keep being done because they have been done, even though their effectiveness is long since gone.

Chairman PROXMIRE. So you would cut up to $20 billion from the military budget? You have already indicated you are concerned about the SST without taking a position. I can understand that.

I take it that you might take another look at the space program? With some reductions there?

Mr. WOODCOCK. That is already substantially reduced.

Chariman PROXMIRE. At least to hold it down?

Mr. WOODCOCK. I would; it certainly could stand sharper evaluation, yes.

Chairman PROXMIRE. Well, I think that this is most interesting, because we have always had——

Mr. WOODCOCK. I might add, Senator, that the Congress can further pursue the question of tax reform. There are continued glaring loopholes that could be closed.

Chairman PROXMIRE. Yes; but you see, we are in an arithmetic situation where even if you increase taxes or increase tax revenue substantially, you would still be—well, I suppose you could do that, that in true. You could take more out of the private sector and work in the public sector. You could do that. But very few people now advocate an increase in taxes, including liberal economists. But you say you would increase taxes in the sense that you could get greater revenue out of our present tax system by plugging loopholes?

That is very hard to achieve now. We just passed a tax reform bill, as you know, last year, which had great weaknesses in it. I would have liked to see it much more productive. But it is unlikely for the next 3 or 4 years that we can get anything more substantial.

Mr. WOODCOCK. I think that is true, unfortunately.

Chairman PROXMIRE. So we are really in, I think for the first time, an economic and budget situation in which we can get some agreement between liberal people and conservative people. We have the President, Bob Dole, who said he supports the full employment surplus—he is a conservative Senator; you have people on the liberal side, some of us have been identified as big spenders in the past—all pretty much in agreement at what the level should be. But the real argument is where you spend the money. The real argument is where you cut it and where you spend it. That is the real difference. You feel the cut can be made primarily in the military area?

Mr. WOODCOCK. Yes.

Chairman PROXMIRE. Let me ask you this. I just want to clear up to my satisfaction what Mr. Brown was talking about. What is the UAW's attitude toward the voluntary import quotas in effect for steel and the increases in sheet steel prices that are expected for later in 1971? You talk about import quotas affecting primarily autos. I want to get into steel here.

Mr. WOODCOCK. With regard to autos, I simply express the concern that the relationship with Japan is not a fair and proper one and there should be some negotiations to that effect. I am not, I don't have enough knowledge of all the facts to express an opinion relative to the steel quotas.

Chairman PROXMIRE. Let me ask, what is your opinion of unrestricted auto imports, and for example, the manufacture of engines abroad for installation in American compact cars as anti-inflationary and competition-strengthening devices? Would you favor that? Because you are a free trader and you have taken a very courageous position on it. At the same time, I see it could have impact on the jobs of UAW members.

Mr. WOODCOCK. No question about it. As you drive out to the Metropolitan Airport in Detroit, you pass the headquarters of the Ford Motor Co., which proudly says, "Ford Motor Company World Headquarters." I presume they make their decisions so they develop an engine which they are going to use across all the nations in which they make cars. It may make sense to them in an economic sense, to just build it in one place. They do not think in terms of being American entities anymore, they think in terms of being international entities. I would hope it does not get to the point where that will require government-imposed controls to protect the well-being of Americans.

Chairman PROXMIRE. You have not taken a position in favor of imposing quotas on the imports of engines made in foreign countries for use in American cars.

Mr. WOODCOCK. We protested to the Ford Motor Co. about the fact that they were going to put foreign engines——

Chairman PROXMIRE. But you have not appealed to any legislation or the Federal Government that it be restricted?

Mr. WOODCOCK. No; we have not.

Chairman PROXMIRE. Thank you.

Senator Javits.

Senator JAVITS. I was interested in the quota business, too. I think you heartened me considerably by the fact that one union, one great union, at least, has kept its balance in this regard and realized that the thing to do was to knock down the trade barriers of the other fellows, not add the stones ourselves and build them up. I thoroughly agree with you, the Japanese have been most ill advised, one, in not coming to an agreement on a voluntary textile agreement; and two, in maintaining the structure of protectionism from which they are bound to suffer the most, ultimately. We have to really do our utmost to knock that down if there is any hope for liberal trade in the world. I thoroughly agree and compliment you and the union upon that position.

I had just one question in addition to those already asked; that is, on the relationship of productivity to compensation for the work. You remember that the guideposts or guidelines, the 3.2 guidelines, expressed that relationship and in an administration that was considered favorable to trade unionism. I just wondered, what is your feeling about relating wage increases to productivity?

Mr. WOODCOCK. Well, the other wage formula which first came from General Motors in 1948 was based upon the proposition of tieing any increases to the social or national productivity, but protecting that by cost-of-living escalation, which is both plus and minus. If in fact prices go down, then wage rates go down in like degree.

Now, corollary with that, if that system is to work, and it would become relatively universal, it would require reduction of price in those enterprises operating above the national productivity level to allow those operating below the national productivity level to increase their price in order to pass on those economic benefits to their employees. That part of the system has not worked too well. But it has to be a component factor for the whole system to operate.

Senator JAVITS. So that you feel that there is, however, a direct relation between productivity and wages, provided that the whole system operates on that basis?

Mr. WOODCOCK. That has to be.

Senator JAVITS. The accusation is often made that in the trade union field itself there are inequities bringing about the very condition you described. For example, there is often cited the bulge of wage increases in the construction industry. Of course, the construction unions contest it on the ground that construction workers do not work the year round. But I think even taking that into account, there is a considerable bulge. What do you think can be done in the trade union field to encourage a better relationship between what the public has to pay for a house—where that bulge does exist in wage rates—and what he has to pay for an automobile where it does not exist?

Mr. WOODCOCK. I am informed—again I am no expert—that in fact the wage component of house construction costs has gone down, despite the escalation of hourly rates. It is land costs, other costs which have added to the price.

Senator JAVITS. So you would challenge the finding?

Mr. WOODCOCK. Plus the fact that in most of the United States, housing construction labor is nonunion.

Senator JAVITS. Thank you very much.

Chairman PROXMIRE. I apologize to Congressman Brown and Senator Percy. I understand that Mr. Woodcock has to leave at 11:15 this morning. We are going to permit questioning until then.

If you would permit, Mr. Woodcock, would you be able to stay a little longer than that and still catch a plane?

Mr. WOODCOCK. My international executive board is meeting at 1 o'clock and I am too young a president to leave them on their own.

Chairman PROXMIRE. Senator Percy has not questioned at all.

Senator PERCY. I will yield to Mr. Brown.

Representative BROWN. In your colloquy with Senator Proxmire, you said that certainly $20 billion could be cut out of a $75 billion defense budget. That leaves $124, $130, or $135 billion in the budget otherwise. Does it follow that we can cut 26½ percent—which is 70/75 ratio—out of the rest of that budget? I am not sure I follow the logic in that. On that basis, we can cut maybe $35 billion out of the rest of the budget and we can really have a windfall here for the taxpayer. Is that what you are suggesting?

Mr. WOODCOCK. No; I am proceeding from the premise that here we have a substantial reduction in hardware purchases as far as defense is concerned with a resulting 27 percent unemployment rate in aerospace, which is also, of course, reflective of the drop in the space program. Yet a budget as high as it is, that says to me that there is great wastage there in that big an amount.

Representative BROWN. Does it follow there is as much wastage in the balance of the budget, $125, to $135 billion?

Mr. WOODCOCK. I don't believe so, because they have never been on such a long leash as the Department of Defense.

Representative BROWN. But we could not cut anything out of the remaining?

Mr. WOODCOCK. They have had to fight harder and justify better what they have got than DOD ever had to.

Representative BROWN. With regard to inflation, are you a subscriber to the principle of the full employment budget, or do you see something wrong with that?

Mr. WOODCOCK. We find deficiencies in it. We certainly quarrel with the assumption that 4 percent means full employment.

Representative BROWN. Using that figure, if I may, based on the full employment budget at 4 percent, during the years of 1960 to 1965, which you said laid the groundwork for inflation, we actually——

Mr. WOODCOCK. I did not say that, sir.

Representative BROWN. I beg your pardon. I was under the impression that you said it.

Mr. WOODCOCK. I did not intend to. I said the escalation of the Vietnam war in the second quarter of 1965 was the genesis of our present inflation and—I did not say this—the failure of the Johnson administration to grasp the nettle and impose the necessary additional taxes.

Representative BROWN. We are closer to balance, then. I misunderstood that. I misread your statement. I was going to point out that a surplus was run on the basis of a full employment budget in 1960–65 and we had substantial unemployment. And a deficit was run from 1966 to 1968, including a very substantial deficit in 1968, when we had unemployment less than the full employment 4 percent. And both of these would be in direct opposition to the concept of getting us on balance with the full employment budget approach. I would assume that you find some fault with that if you were subscribing to a full employment budget.

Mr. WOODCOCK. I would have been for the imposition of additional taxes in 1966 and I think the elimination of the surtax was in error.

Representative BROWN. Thank you.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Mr. Woodcock, I am delighted to welcome you this morning for three reasons: First, the chance to commend you on the forthright position you have taken on Vietnam, calling for a standstill cease-fire to end this dreadful war, because nothing could do more to combat inflation and get our priorities right than ending the war. Your influence has helped the Congress, and as you know, the President has taken the proposal very seriously, and we are unanimous in support of the position he took on that. Your taking leadership on this very important issue is helpful to us.

Second, the outstanding leadership that you and Walter Reuther have taken on this question has been immensely helpful in that it has led to interest around the country.

Third, I would like to say you have a great many constituents in Illinois, virtually all of whom voted for Paul Douglas, whom I ran against. He was the distinguished former chairman of this committee. Very few men in American public life have done more to help the working man than my predecessor, Paul Douglas.

Mr. WOODCOCK. If I may so, sir, he was a great man who has a great successor.

Senator PERCY. So I am delighted to have you here.

I would like to know what your position is on welfare reform, whether you feel this is a matter of high priority and that we must find a better way to handle our welfare programs? As a corollary to that, where do you stand on creating public service jobs so that a man, if he is able and willing to work, can have a job, even if the Government has to be an employer of last resort? This would require large-scale appropriations, but I think it is the type of thing we can do.

Mr. WOODCOCK. We are completely supportive of welfare reform. I put forward today what might almost be characterized as a collective bargaining demand of full federalization of the welfare program. Obviously, a step in that direction would be welcome to us.

The notion of the Government as an employer of last resort, I think, is essential to that whole concept. There is nothing more demeaning and damaging to an individual's character than to want to work and not be able to work.

Senator PERCY. You do then support public service jobs?

Mr. WOODCOCK. Yes, we do.

Senator PERCY. I would hope that these jobs are not going to be WPA dead-end roads, but jobs that can usefully employ people, giving them the skill and education and giving them the dignity of working for their money rather than just being the recipients of welfare.

Mr. WOODCOCK. We have not said so, but that would be a very creative way of revenue sharing.

Senator PERCY. Thank you.

In your prepared statement, you indicate that you support the concept of providing continuity of pay for 2 years for anyone who is adversely affected in his employment because of defense cutbacks. I am puzzled by how we would do this. Wouldn't we be discriminating against some employees in the same company, because most of our companies have both defense and commercial contracts? If the Defense Department cuts back, the employee might get 2 years continuity pay. If he loses his job through no fault of his own—if he had been assigned by the company just to certain work in the commercial area—he would have no more than he now gets in such benefits. Would it not be hazardous to discriminate as to the cause of the unemployment? Unemployment is unemployment and the worker has very little discretion in the matter if he is assigned by the company to a particular type of work.

Mr. WOODCOCK. We had the same difficulties and problems, and they are real, in the Trade Expansion Act dislocations. This has not happened on a very massive scale, but where it has happened, it has proved to be manageable.

Senator PERCY. I think that suggestion needs a good deal more probing and I would like to talk with your people more about it.

You have addressed yourself to the problem of inflation. It is the toughest problem any of us are dealing with down here, I think. Do you have any alternative solutions to price push inflation instead of, or as a supplement to, the price-wage review board that you recommended? Certainly that is a commendable recommendation.

Mr. WOODCOCK. Well, we believe that through a more effective taxing policy, through a more generalized approach to wage setting, through moderate increases protected by cost of living which do not come into play until after the event, it would be an additional contribution. But I must confess I do not know of any magical solution.

Chairman PROXMIRE. Unfortunately, I think I am going to have to interrupt. I apologize, Senator Percy. Mr. Woodcock has to catch a plane, I understand. We understand what it must mean to be a new president, although I must say you are mighty secure.

You have done a good job, Mr. Woodcock. We thank you very much. You represent one of the really great unions in America. Your union and you have been a fine influence on our society as well as our economy. I want to thank you very much.

Mr. WOODCOCK. Thank you.

Chairman PROXMIRE. Our next witness is Mr. Howard C. Petersen, chairman of the board of the Fidelity Bank of Philadelphia.

Mr. Petersen has an exceptionally strong background for understanding the economic problems of this Nation; he is president of one of our major banks; he has served in many government posts on domestic and international economic matters; and he was one of the chairmen for the Committee for Economic Development responsible for the important new statement on national policy entitled "Further Weapons Against Inflation."

Mr. Petersen, we are very happy to have you here today to talk about the problems of our economy and the development of new, alternative instruments to deal with them. You may proceed in any way you wish. We'll have your full statement printed in the record if you want to skip over parts of it.

Senator Javits.

Senator JAVITS. Mr. Chairman, may I say I have already introduced Mr. Petersen and paid my respects to him as a really great business leader in America and the banking world. I would like to point out that I am due on the floor in 10 or 15 minutes, so if I leave, I hope you will forgive me. I shall be back if I can, before you adjourn.

Chairman PROXMIRE. Mr. Petersen, you may proceed.

STATEMENT OF HOWARD C. PETERSEN, CHAIRMAN OF THE BOARD, THE FIDELITY BANK, PHILADELPHIA, PA., ACCOMPANIED BY FRANK W. SCHIFF, VICE PRESIDENT AND CHIEF ECONOMIST, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. PETERSEN. Thank you, Mr. Chairman. I am appearing here today as a vice chairman of the Research and Policy Committee of the Committee for Economic Development (CED), but I cannot help but remember that I am also a banker. I know I feel a great deal more comfortable appearing here with the prime rate at 6 percent than I would if I were here when it was 8½ percent.

The dramatic decrease in this price, which is the price of our principal commodity in the banking business, a 30-percent decrease over a very short period of time, ought to be great evidence that the American commercial banking system is highly competitive.

I appreciate the invitation to appear. The basic subject which you are considering here today—the policies which are required to achieve steady economic growth and high employment without inflation—has been at the core of the Committee on Economic Development's interest since its formation nearly 30 years ago, and I have been a member of the committee for a large number of those 30 years. It seems to me that we have learned more about how to raise employment than we have learned to keep prices down. We tried to fill this gap in our knowledge in our statement, that the chairman referred to, entitled "Further Weapons Against Inflation: Measures to Supplement"—and I stress the word "supplement"; they are not substitutes for—"Measures To Supplement General Fiscal and Monetary Policies."

Each of you has received a summary on this larger document. This was prepared under the very able leadership of Phil Sporn, who chaired the Wage-Price Subcommittee. The project director for this study was Mr. Frank W. Schiff, vice president and chief economist of CED, who accompanied me here today.

My remarks this morning will be based on the key elements of our recent policy statement. The principal conclusion reached was that the task of achieving both high employment and price stability is exceedingly complex and difficult and is not likely to be solved by any one policy instrument alone. Rather it requires a continuing multipronged approach and a much more determined and better integrated effort by both the Government and the private sector to attain this goal.

There is no question that sound fiscal and monetary policies are the fundamental prerequisites for the achievement of a steady growth without inflation. Whenever total demand is excessive, these policies should be used promptly and vigorously to bring demand under control. CED's Research and Policy Committee has not hesitated to call for needed action along this line in the past, including the use of income tax surcharges which we advocated long before they were adopted. We have also urged, and continue to urge, that the President be granted discretion—subject to congressional veto—to raise or lower income tax payments by up to 10 percent in order to allow more flexible fiscal responses to rapid changes in demand conditions.

We were pleased, indeed, to see the President and the administration embrace the principle of the full employment budget. We like to think of this as a CED creation. It was first espoused by the CED in 1947. We have consistently urged this as an important tool of monetary and fiscal policy.

But in the circumstances confronting us today, aggregate demand management policies alone cannot be counted on to produce both high employment and reasonable price stability. The current problem for demand management is to cure deficient rather than excessive overall demand; and the most serious inflationary pressures that face us in the nearer-term future stem more from cost-push—or from what used to be called the wage-price spiral—and to a large extent structural factors than from demand pull.

Our committee, therefore, fully agreed, first, that the basic aim of fiscal and monetary policies should now be to restore an orderly resumption of economic growth that will bring the economy back to high employment within a reasonable period of time; and, second, that a series of supplementary measures should be used to help contain the pace of price increases as the economy resumes its general forward thrust.

In my view, it was somewhat regrettable that press reports on the supplementary measures recommended in the recent policy statement by CED focused almost exclusively on the committee's endorsement of voluntary wage-price policies. Certainly, this was a very significant feature of our statement, and I personally feel that recent events have reinforced the case for the kind of approach to wage-price policies that we have advocated and that I shall discuss more fully later on.

I want to emphasize, however, that our statement placed great stress on the importance of using a range of supplementary approaches in an integrated fashion. In particular, we attached major significance to the use of basic structural measures designed to strengthen the forces of active competition, overcome bottlenecks, and raise productivity.

We also endorsed a substantially more active use of manpower policies to render labor markets more efficient and to minimize the human costs of unemployment and underemployment resulting from vigorous anti-inflationary demand measures. Thus, our November policy statement comes out strongly for substantially stepped up training programs and for added funding of public service employment at times of excessive unemployment.

I should like to cite here a few of our key recommendations for structural improvements—an area to which I personally attach the greatest importance:

1. In addition to various other measures to increase competitiveness, efficiency, and productivity of both labor and product markets, we recommended a comprehensive review of existing statutes, regulations, and policies to eliminate features with an inherent inflationary bias. These features often date back to the great depression of the 1930's and are no longer appropriate in today's conditions of strong government commitment to high employment. In this connection, we particularly stressed the need for a basic restructuring of our labor laws and regulations to bring about a better balance in the relative powers of union and management.

I have myself seen in the banking industry that many of the statutes and restrictions governing banks grew out of the great depression, and the laws became quite archaic with the change of circumstance from 1930 to the 1970's.

2. We placed special emphasis on the need for reform of labor-management relations in the construction industry, where median first-year wage increases negotiated by unions came to a shocking 15.7 percent in the first 9 months of 1970. The cost of construction index has risen about 10 percent a year over the last 10 years. This means that the cost of construction has doubled every 7 years. In the last 2 years, the construction index has risen at an even higher rate.

Among other things, we recommended that the National Labor Relations Board require that the size of collective bargaining units be substantially enlarged and that contracts with different craft unions expire at about the same time. We also called for repeal of the Davis-Bacon Act and urged that, pending congressional action in this area, every effort be made to administer the act in a less inflationary way and that consideration be given to suspension of the act on an emergency basis. We are, of course, pleased that the President's speech in early December included a number of recommendations along the lines we have advocated.

3. With respect to trade policy, we stressed that it is highly important for overall price stability and economic efficiency that this country continue to adhere to its basic commitment to liberal international trade policies. As one who has for many years been deeply involved in

the battle for such policies—I was Special Assistant to President Kennedy for Trade Policy when the Trade Expansion Act of 1961 was enacted—I feel particularly strongly that it would be utter folly for the United States to move toward increased protectionism at the very time when the need for finding additional means of dealing with domestic inflationary pressures is daily becoming more apparent.

Indeed, there needs to be an active effort to reduce unnecessary restrictions on imports and other barriers to international trade. Our Committee for Economic Development—I was chairman of the subcommittee—did what I think is a very excellent piece of trade distortions, the nontariff barriers to trade. This was done in conjunction with seven like business organization in other parts of the world.

It will also be of interest to you that our committee specifically recommended that the Tariff Commission be required by statute to consider general price stability as one of the objectives to be taken into account in rendering its decisions.

4. A recommendation that I believe has an especially large potential for a high near-term payoff is to introduce more vigorous and much better coordinated procedures for reducing upward cost and price pressures that the Government tends to exert through its own operations. The direct and indirect effects that governments at all levels have on prices through their procurement and construction policies, specific budgetary decisions, stockpiling practices, subsidies, et cetera, are formidable.

Public construction, for example, has in recent years accounted for over one-half of all nonresidential construction. We have, therefore, recommended that a central governmental unit or agency be entrusted with the task of serving as a "public defender" of the price stability objective within the Government. Part of the task we have in mind is now being carried out by the newly established Regulations and Purchasing Review Board in the Office of Management and Budget. We believe, however, that the magnitude and scope of the Board's operations should be greatly expanded.

Among other things, we recommend that a "public defender of price stability" agency be required to calculate and highlight the likely impact on consumer prices of significant new proposals for governmental action—including new spending programs, subsidies, trade restrictions, and many others. In effect, this is a recommendation for "inflation alerts" regarding current and prospective actions of the Government itself. In my view, use of such a new procedure could have a major educational effect and would be of great assistance in mobilizing public support for anti-inflationary policies. It would give both, Government policymakers and the consumer, a readily understandable demonstration, in dollars and cents, of what various existing and proposed Government policies might cost in terms of higher prices.

We believe it is vitally important that there be early progress toward instituting the kinds of structural reforms we have recommended. Some of these measures can have important near-term effects. Nevertheless, it seems clear that the majority of the needed structural measures are difficult to put in place and will in any case take a long time to become effective. This is why we see a need for additional action that will exert more direct restraints on the wage and price decisions of labor groups and business firms that have some degree of discretion in making such decisions. A substantial majority of our Research and Policy Committee reached the conclusion that such additional action should take the form of voluntary wage-price—or incomes—policies. I should add that a substantial majority of 59 voted in favor of publishing the policy statement and six voted against publication, and that those favoring the proposed incomes policy outnumbered the opponents by about 5 to 1.

We considered this issue with great care among our trustees. Trustees do debate and do participate very heavily in the formulation of policy statements. There was a full awareness that use of wage-price policies carries the risk of creating various inequities and that their effectiveness is by no means guaranteed. But the committee was impressed by the consideration that, in the absence of additional measures to deal with the cost-plus problem, the United States will, for some time, almost certainly be confronted with two unpalatable alternatives: excessive price increases if policies to expand demand are used to move the economy rapidly back toward high employment; or alternatively, an excessive prolongation of unemployment and economic slack if these policies are mainly geared to holding prices in check.

In either event, the resultant inequities and economic losses and hardships—people out of work—are likely to outweigh those that might result from the use of voluntary wage-price policies.

In our view, any uncertainties regarding the results of wage-price policies should not keep us from trying such policies. We may learn something. If they should not prove to be very effective, adverse effects are likely to be small. If they do help in reconciling high employment with reasonable price stability, the payoff from adopting them could be significant.

Let me now spell out briefly the main elements of the type of wage-price policies that our committee advocates and that we believe would have the greatest chance for success. I want to make clear that we are not asking for a precise replica of policies formerly employed or currently in use in other countries.

First, as already noted, wage-price policies must clearly be supplements to appropriate fiscal and monetary policies and to basic structural measures.

Second, we believe that the wage-price policies currently needed should be based on voluntary cooperation rather than compulsion. Mandatory wage and price controls would require a far greater degree of interference with individual decisions and a much more elaborate bureaucracy than the voluntary system we envisage; they might also prove unenforceable under present conditions. Voluntary wage-price policies. on the other hand, would act as a continuing educational force which would make clear to all the groups concerned that it is against their own longer term interests to engage in a leap-frogging competition of wage and price increases.

Third, if wage-price policies are to be meaningful, they must go beyond purely general appeals for restraint, or beyond just general exhortation. They should spell out in some reasonably precise fashion what kind of behavior by labor and business can be regarded as broadly consistent with the public interest in a return to overall price stability. Moreover, the applicability of these "rules of the road" in specific situations should be capable of being readily understood in advance, particularly when it comes to major scheduled labor-management negotiations.

Incidentally, Mr. Woodcock spoke about notification of price or wage increases. We do not think there should be a requirement for prior notification of such increases.

Fourth, the norms evolved need to be basically equitable and must be regarded as such by the major groups concerned. There have been various recent proposals for incomes policies that would tend to place the entire burden of restraint on either labor or management alone. In my view, a one-sided policy simply does not stand a chance of gaining public acceptance.

Fifth, we believe that once the rules of the game are spelled out with reasonable clarity, every effort should be made to mobilize public opinion in support of the wage-price policy. This means that an appropriate public body should, after careful study of the facts, place the spotlight of public attention on particular instances where either unions or business firms push up costs and prices in a clearly excessive manner. Anyone who underestimates the power of public opinion in such matters might recall its influence in the recent strike of electric power workers in the United Kingdom. After the brownouts and the blackouts were experienced all over the United Kingdom, the force of public opinion was such that the electrical workers went back to their jobs.

Sixth, we believe that adequate formulation as well as implementation of wage-price policies requires a concentrated and continous effort by a small but able independent body within the Government. These functions might be assigned to the National Commission on Productivity, or alternatively—and in my view, preferably—to a special three-man board on prices and incomes, appointed by the President and subject to Senate confirmation.

A major advantage of such a board would be that it could operate on a full-time basis and that its members would represent the public at large rather than particular interest groups. The board would, of course, need to consult as fully as possible with all the interest groups and Government agencies concerned.

Let me stress one other point which I feel argues strongly in favor of the general approach we are recommending. It seems to me that if significant cost-push pressures persist during the period of economic upturn—as will in all likelihood be the case—the Federal Government will almost inevitably be driven to undertake various ad hoc efforts to hold such pressures in check. Recent events suggest that this is, in fact, already occuring—the steel case, the oil case, and so forth. Our recommendations are based on the view that it would be more equitable as well as more effective if the needed efforts were undertaken as part of a systematic wage-price policy based on publicly stated rules and carefully worked-out administrative procedures.

How much effect would the kind of wage-price policy that I have outlined be likely to have? Certainly no one can give any precise answer to this question. However, I do not agree with the frequently heard statements that "incomes policies have never worked anywhere." Such statements, it seems to me, generally result from applying much stricter yardsticks of success to these policies than tend to be applied to other types of economic policies. It seems significant to me that reviews of foreign experiences have recently led leading officials of key international agencies to call for the active use of wage-price policies whenever appropriate.

The last Annual Report of the International Monetary Fund and the recent report on inflation by the Secretary General of the OECD are particularly noteworthy in this connection.

My own belief is that in the present U.S. setting, a carefully worked out wage-price policy could make a significant though not spectacular contribution toward reconciling high employment with price stability. To achieve this effect, however, such a policy must involve a massive and continuing educational effort that will bring the dangers of inflation much more broadly into the consciousness of the American public and will cause individual decisionmakers to take a broader view of their own long-run self-interest than would otherwise be the case.

In closing, let me stress that it would be a major mistake if near-term signs of some easing in inflationary pressures should lead to a premature relaxation in our determination to tackle the basic problems. In the immediate months ahead, the statistics on price increases could well show an improvement. But a lessening in the rate of price increases during—or just after—a period of weak demand and excessive unemployment should not lull us into false security and keep us from using the full range of possible weapons at our command.

The greatest danger of renewed inflationary excesses is likely to come when the forward movement of the economy begins to accelerate and we move closer to the range of higher employment. It is the need to hold back excessive increases on the cost side under such conditions which makes it especially important that early steps be taken to institute and to maintain the kind of program the CED has advocated and which I am pleased to present to you today.

(The policy statement of CED, referred to in Mr. Petersen's statement, follows:)

Further Weapons against Inflation

Measures to Supplement General Fiscal and Monetary Policies

A Statement on National Policy
by the Research and Policy Committee
of the Committee for Economic Development
November 1970

CED

The Responsibility for CED Statements on National Policy

This publication is a reprint of Chapter One of the Statement on National Policy, "Further Weapons Against Inflation: Measures to Supplement General Fiscal and Monetary Policies," and includes a specially edited synopsis of subsequent chapters of the complete statement. The statement has been approved for publication by the members of the Research and Policy Committee and its drafting subcommittee, subject to individual dissents or reservations as noted. The individuals who are responsible for the complete statement are listed on page 35 of this reprint. Company or institutional associations are included for identification only; the companies or institutions do not share in the responsibility borne by the individual members of the two committees.

The Research and Policy Committee is directed by CED's bylaws to:

"Initiate studies into the principles of business policy and of public policy which will foster the full contribution by industry and commerce to the attainment and maintenance of high and secure standards of living for people in all walks of life through maximum employment and high productivity in the domestic economy."

The bylaws emphasize that:

"All research is to be thoroughly objective in character, and the approach in each instance is to be from the standpoint of the general welfare and not from that of any special political or economic group."

The Research and Policy Committee is composed of 50 Trustees from among the 200 businessmen and educators who comprise the Committee for Economic Development. It is aided by a Research Advisory Board of leading economists, a small permanent Research Staff, and by advisers chosen for their competence in the field being considered.

Each Statement on National Policy is preceded by discussions, meetings, and exchanges of memoranda, often stretching over many months. The research is undertaken by a subcommittee, with its advisers, and the full Research and Policy Committee participates in the drafting of findings and recommendations.

Except for the members of the Research and Policy Committee and the responsible subcommittee, the recommendations presented herein are not necessarily endorsed by other Trustees or by the advisers, contributors, staff members, or others associated with CED.

The Research and Policy Committee offers this Statement on National Policy as an aid to clearer understanding of steps to be taken in achieving improvement in the operations of the American economy. The Committee is not attempting to pass on any pending specific legislative proposals; its purpose is to urge careful consideration of the objectives set forth in the statement and of the best means of accomplishing those objectives.

Further Weapons against Inflation: Measures to Supplement General Fiscal and Monetary Policies

A Reprint of Chapter One

and a synopsis of subsequent chapters of the complete policy statement

Explores to what extent fiscal and monetary policies can be relied upon to bring about the simultaneous achievement of reasonable price stability and steady economic growth at high levels of employment. Criticizes the thesis that there is an inevitable conflict between these goals. Stresses that stabilizing fiscal and monetary policies must continue to be the most important weapon in the battle against inflation and recommends guidelines for the next year and beyond.

Points out that despite their vital roles fiscal and monetary policies alone probably cannot succeed in reconciling price stability and high employment. Notes that an important share of the continuing high upward pressure on prices stems from long-term structural factors, for example in service and construction activities, that are not readily influenced by changes in aggregate demand. Recommends measures to alter the structural and institutional environment in which demand policies operate, with special emphasis on manpower and other supply bottlenecks, restrictive labor union practices, and lagging productivity growth. Emphasizes the need for a central government unit that will serve as a "public defender" of price stability where inflationary pressures arise from government operations.

FOUR: THE ROLE OF VOLUNTARY WAGE-PRICE POLICIES

Past Experience with Wage-Price Policies
Should the United States
Employ Wage-Price Policies?
What Kind of Wage-Price Policies?

Deals with the "cost-push" inflationary force that labor unions and business firms with some market discretion can exert even when the economy is operating significantly below full capacity. Reviews the nation's experience with wage-price policies and finds that they made a modest contribution to price stability before excess demand developed early in 1966. Proposes that the U.S. use *voluntary* wage-price (or "incomes") policies to supplement general fiscal and monetary policies and structural reform measures in an integrated effort to reconcile price stability and high employement.

FIVE: CUSHIONING ADVERSE IMPACTS OF GENERAL DEMAND POLICIES

The Human Costs of Fighting Inflation
Selective Credit Control Measures

Recommends wide-ranging programs to minimize the human costs of vigorous anti-inflation policies and provide economic "safety nets" for persons near or below the poverty line who suffer heavily because of the resulting economic slowdown. Differentiates between structural unemployment and unemployment that results specifically from demand restraint and suggests policies to provide special job opportunities in the latter situation. Points out that selective credit controls may be needed at times, in order to permit a more effective application of general monetary restraint.

APPENDIX

I. Introduction and Summary of Recommendations

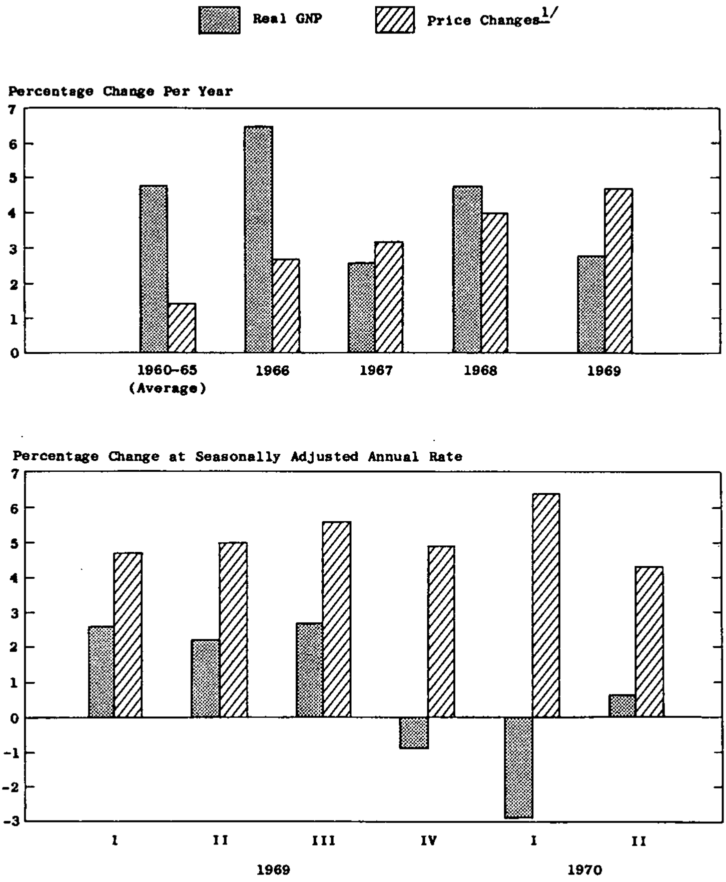
Recent economic developments have brought into sharp new focus the difficulty and complexity of the task of reconciling price stability and high employment.

Our economy, it now appears, has just passed the peak of a continuous acceleration of inflation that began in the mid-1960's. The major impetus to this upsurge in prices came from the excessive increase in total demand that accompanied the 1965 escalation of the Vietnam conflict. Prior to that event, prices had for some years been unusually stable. From 1960 to 1965, they increased at an annual average rate of only 1.4 per cent. Thereafter, however, the rate of price increase mounted rapidly; by 3 per cent in 1966-67; 4 per cent in 1968; and 4.7 per cent in 1969. In the first quarter of 1970, as shown in Chart I on page 10, the rate of inflation exceeded 6 per cent, the highest level since the Korean War.

Statistics alone by no means convey a full picture of the seriousness of the inflationary problem. As the pace of price increases mounted during recent years, inflationary psychology became increasingly widespread. More and more people became convinced that there might simply be no practical way to stop inflation – or at least to stop it for any extended period. Anticipations of sharply rising future costs led many business firms to step up their capital outlays beyond initial plans. In the financial area, suppliers of funds have insisted with growing frequency on arrangements that protect them against inflationary risks. Wage and other income demands, while in part oriented to allowing real incomes to catch up with past price advances, have increasingly tended to reflect expectations of continuing inflation.

Chart I

GROWTH IN REAL GNP AND RATE OF PRICE INCREASES



1/ Measured by the GNP deflator, which covers the over-all price levels of goods and services included in the GNP and is the most comprehensive index of price changes. It includes price changes in the goods and services bought by consumers, as the Consumer Price Index does, and in addition business spending on structures and equipment, as well as the cost of government services.

Source: U.S. Department of Commerce, Office of Business Economics, Survey of Current Business.

Since early 1970, signs of a gradual reduction in upward price pressures have begun to appear. This reduction primarily has resulted from the marked dampening in over-all demand produced by the application of more restrictive fiscal and monetary policies during the past several years, beginning with the imposition of the 10 per cent surtax in 1968. As Table I in the Appendix indicates, further moderation in inflationary pressures is now apparently being aided by a renewed growth of productivity, following a period of very little increase and then actual declines.

While these recent developments are indeed welcome, they do not by themselves provide adequate assurance that the battle against inflation is being won, or will be won soon enough. By most calculations, the rate of price increase by the end of this year will still be uncomfortably high. The response of the price level to reduced demand has actually been substantially slower than at first anticipated. A peak in the rate of increase in over-all price levels was reached only after almost a year of significantly slower growth in real GNP than in potential output and after two quarters during which total real output actually declined.[1]

At present, the economy is still operating significantly below "high employment" levels. The unemployment rate, as shown in Chart II, has increased to over 5 per cent of the labor force since the spring of 1970. For some segments of the labor force, notably teenagers and minority groups, the percentage of unemployment is much higher. The rate of capacity utilization in manufacturing has stood at less than 80 per cent since the beginning of the year – the lowest level since 1961.

A lessening of inflationary pressures at times of substantial economic slack and relatively high unemployment has been a typical experience in the past. As discussed more fully in the next chapter, however, there is considerable agreement that it would not be satisfactory to rely on long-continuing demand compression or stagnation to deal with the inflationary problem. The cost of such a course – in terms of lost output, reduction in profits and other earnings, and rising unemployment – is likely to be substantially greater than the American people would or should tolerate.

The basic challenge for economic policy now is not just to end the upward course of prices in the present setting, but to achieve relative price stability as the economy moves back to and remains at high employment. What we want is steady economic growth with stable prices.

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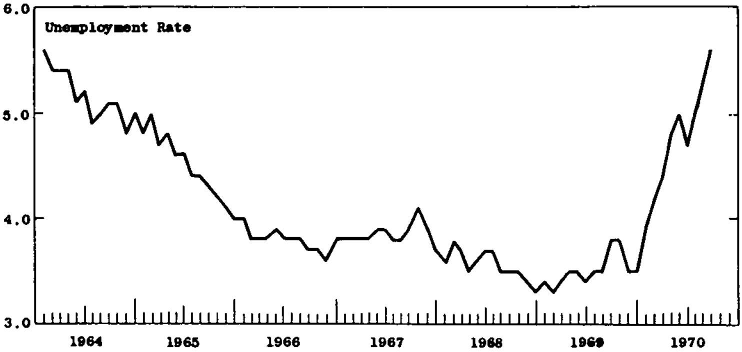
1 See Table II for detailed figures 1960–1970-II for growth in real GNP and the rate of price changes (measured by the GNP deflator); Table III for changes in the Consumer Price Index, 1960 to August 1970; and Table IV for changes in the Wholesale Price Index, 1960 to August 1970.

Chart II

CHANGES IN THE UNEMPLOYMENT RATE

Per cent of Civilian Labor Force



Source: U.S. Department of Labor, Bureau of Labor Statistics, Employment and Earnings.

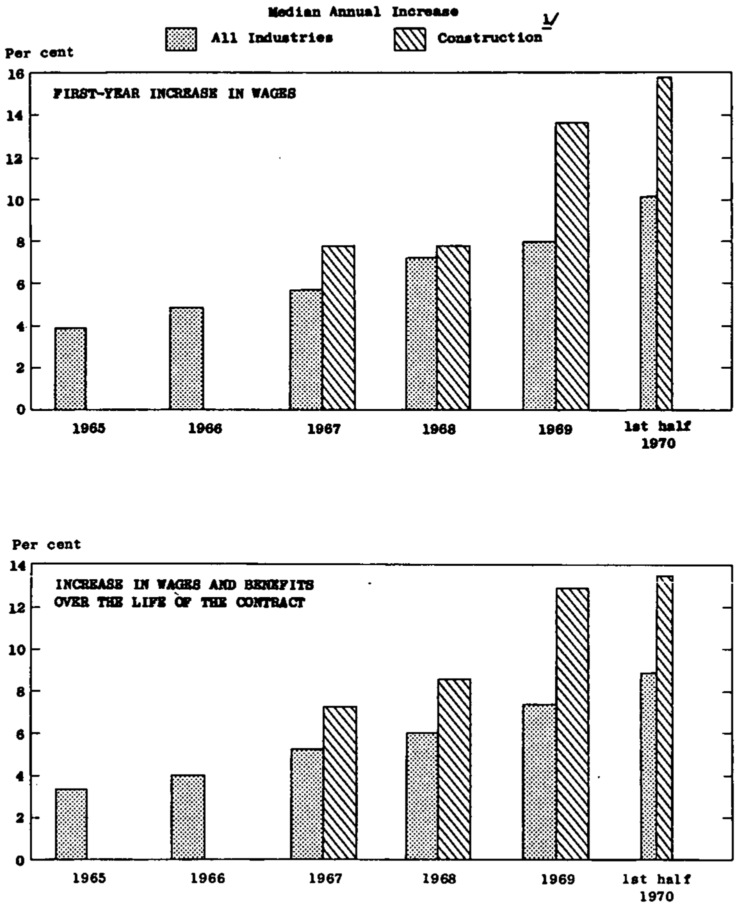
There are some who believe that the degree of restraint on total spending which the economy has already experienced is by now placing a sufficient damper on inflationary expectations to make feasible by itself a gradual resumption of the growth of demand and of real GNP without excessive price increases. In this view, much of the remaining inflationary momentum in the economy merely represents temporary "hangover" effects of the previous splurge in over-all spending, making it unnecessary to place significant reliance on economic policies other than those concerned with the management of total demand.

However, while appropriately stabilizing fiscal and monetary policies are clearly essential for the containment of inflation, it seems doubtful that these policies *alone* can fully succeed in reconciling price stability and high employment. There are strong indications that an important share of the continuing upward pressure on prices stems from cost-push elements and longer-term structural factors that are not readily influenced by changes in aggregate demand. It is noteworthy, in this connection, that major labor settlements negotiated in the first half of 1970 resulted in average first-year wage increases of 10.2 per cent, in contrast to 8.0 per cent in 1969 and 3.2 per cent in 1964. While these over-all averages reflect a range of diverse influences, severe cost-push pressures in various important sectors of the economy have clearly played a major role, as has been most dramatically demonstrated recently by the sharp rise in construction wages (see Chart III).

The force of such upward cost pressures could well intensify as economic activity returns closer to capacity. Indeed, there are good reasons to believe that, unless means can be found to deal directly with structural imperfections and cost-push elements, our economy will continue to have a built-in inflationary bias that will lead to excessive price increases on the road to and at high employment.

Chart III

MAJOR LABOR CONTRACT SETTLEMENTS



1/ Data for the years before 1967 not available.

Source: U.S. Department of Labor, Bureau of Labor Statistics, Current Wage Developments.

ALTERNATIVES FOR ECONOMIC POLICY

What, then, are the alternatives for economic policy? One course would simply be to accept continuous inflation as inevitable. As this Committee has emphatically stated many times in the past, we reject the advice of those who would have us follow such a course. The damage that unchecked inflation is likely to inflict on our economy and society would be extremely serious. Inflation constitutes a highly discriminatory tax that redistributes income unfairly among our citizens. It hits hardest at many of the weaker groups in our society – those who depend on pensions or other fixed incomes or who have inadequate bargaining strength to improve earnings from current work. It arbitrarily tends to reduce the flow of people into many occupations that society values highly and also places a premium on speculative activities. It tends to undermine savings incentives, reduces the flow of savings into thrift institutions and home mortgages, and hampers the effective functioning of financial institutions and markets. Internationally, it can inflict severe damage on our competitive trade position and on our balance of payments. Finally, by distorting normal incentives for efficiency and productivity as well as for rational resource allocation, inflation is increasingly likely to impair the over-all growth of the economy.

We are convinced that the goal of sustained economic growth at high levels of employment*can be achieved without continuing or accelerating inflation; in fact, control of inflation is in our view an essential prerequisite for attainment of this goal. But we also believe that simultaneous achievement of these multiple objectives – within the foreseeable future and without excessive costs – requires a much more determined effort and a wider and better use of policy instruments than has been witnessed to date.

Of course, considerable controversy in academic and other circles is likely to continue as to whether demand restraint alone might not succeed in producing price stability at high employment. Whatever the eventual outcome of this debate may be, we do not believe that there is time to wait. Inflation is too serious a problem to permit us the luxury of ignoring potential weapons for curbing it that are at our disposal.

General fiscal and monetary policies must continue to constitute the most important weapon in the battle against inflation. We strongly believe, however, that a clear need exists for adopting a series of measures to supplement these general policies. Such measures should be designed to change the structural and institutional environment in which demand policies operate so that a given restraint of demand will be accompanied by a

*See Memorandum by Mr. H.C. Turner, Jr., page 27.

greater diminution of price pressures and by a smaller – or at least less burdensome – rise in unemployment than is presently the case.

In this connection, we welcome the fact that the President's speech on the economy of June 17, 1970 placed major emphasis on the need for such supplementary measures. The speech announced a number of new steps to intensify the battle against inflation. Three of these steps are especially important.* First, the President appointed the National Commission on Productivity, which is composed of representatives of business, labor, the public, and government and has the task of exploring means of improving productivity in the economy and achieving "a balance between costs and productivity that will lead to more stable prices." Second, the Council of Economic Advisers was instructed to prepare periodic "Inflation Alerts" (to be published by the Commission) calling attention to outstanding cases of price and wage increases and analyzing their impact on the general price level. Third, a federal Regulations and Purchasing Review Board was established to examine all government actions "to determine where federal purchasing and regulations drive up costs and prices."

The Committee believes the President's program contains significant steps toward the development of a coordinated and vigorous approach for dealing with the problem of inflation in all its facets. Our statement points to the major elements that should be included in a comprehensive anti-inflationary program and makes a number of specific recommendations – in part reinforcing the President's proposals and in part going beyond them – in areas where we believe priority action is needed. More particularly, the statement examines:

- The appropriate course for general demand management policies when these are employed in conjunction with supplementary measures.
- The urgent need for active and wide-ranging policies to remove structural and institutional impediments to efficiency, mobility, and greater competitiveness in both labor and product markets, and to increase productivity and supply.**
- The potential further contribution to reconciling price stability and high employment that may be made by voluntary wage-price (or "incomes") policies.
- The importance of using manpower and related policies to

*See Memorandum by Mr. H.C. Turner, Jr., page 27.
**See Memorandum by Mr. H.C. Turner, Jr., page 27.

minimize the human costs of anti-inflationary demand policies in terms of unemployment and poverty.

- The extent to which use of selective credit restraints may under some circumstances serve to reduce uneven impacts of general monetary policy and improve the scope for more vigorous use of general demand measures.

SUMMARY OF RECOMMENDATIONS*

A STABILIZING FISCAL-MONETARY POLICY FOR NEXT YEAR AND BEYOND

In its January 1969 statement on *Fiscal and Monetary Policies for Steady Economic Growth* the Committee set forth in detail the basic principles for applying sound aggregate demand management policies. On the basis of these principles, more specific guidelines for action during the current year were outlined in the December 1969 statement of our Program Committee, entitled *A Stabilizing Fiscal and Monetary Policy for 1970.* The latter statement indicated that, in the interest of containing inflation, demand restraints that slowed down the growth of total output to less than the long-term optimum rate would be appropriate for a temporary period.

Since such a slowdown has been in effect for some time, we believe that the basic aim of fiscal and monetary policies should now be to restore an orderly resumption of real economic growth to levels at which aggregate demand and supply will be generally in balance. It is our view that fiscal and monetary policies should not be so restrictive as to create extended recession or stagnation, and therefore that these policies must be supplemented by other measures if inflation is to be brought under control without excessive costs in terms of unemployment and lost output.

In line with these broad policy objectives, budgetary policy over the next year should seek to achieve a "high employment" budget surplus[1] in the neighborhood of $6-10 billion. No attempt should be made, however, to resist deficits in the actual budget to the extent that they are needed to counter the current weakness in the economy. This is particularly true of

1 This concept refers to an estimate, for any point in time, of what the budget position *would* be if – given actual federal expenditure programs and tax rates – the economy were operating at high employment. This makes it possible to distinguish between the budget's effects on the economy and the economy's effect on the budget. To the extent that at a particular time, the economy in fact operates below the high

(Continued)

*See Memorandum by Mr. Theodore O. Yntema, page 27.

portions of the deficit that reflect the effects of the economic slowdown on tax receipts, and thus serve as automatic stabilizers for the economy. **A principal share of the stimulus that the economy currently requires to resume its forward movement should be provided by monetary policy.**

For the longer run, we believe it is vitally important that fiscal policy be designed to (a) permit a definite shift in the fiscal-monetary mix that will lead to a significant easing in the pressure on financial markets and to lower interest rates; and (b) allow adequate room for critically needed federal expenditures in support of domestic programs to deal with the urgent problems of our cities, education, poverty and welfare, health care, and the environment.

To achieve these ends, every effort will have to be made to secure the needed additional fiscal resources through prudent budgetary management and reduction or elimination of programs of lesser essentiality. We welcome current endeavors to achieve further significant savings in the defense budget. We also commend the reductions the Administration has made in the space program but believe this program, too, should be cut further. In addition, we reiterate our previous recommendations for sizable cuts in the present large-scale agricultural subsidies, and urge that proposals for new subsidy programs – such as those for the supersonic transport and the maritime fleet – be subjected to the closest possible scrutiny. **If budgetary savings do not, however, prove adequate over the longer run to provide the added fiscal resources needed, we believe it is essential that taxes be increased sufficiently to produce the required extra revenue.***

To assure that flexible tax adjustments can be made promptly in case of need, we again urge[1] that the Congress grant the President discretion to raise or lower personal and corporate income tax payments by up to 10 per

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(Continued)

employment level, tax revenues will fall short of potential and the actual budget position will show a lower surplus than the high employment budget, or even a deficit. Preferably, the estimated high employment budget figure should also assume stable prices at high employment, thereby eliminating from the estimated budget surplus the swelling of revenues attributable to inflation. An adjustment along this line is difficult to work out in practice, however, and has not been applied to the figures cited in the text. It should also be noted that the high employment figures used here refer to the budget surplus on a National Income and Product Account (NIA) basis, which excludes government lending. If the $10 billion high employment surplus figure were adjusted to take account of inflation effects and placed on a unified budget basis, it would probably be reduced by about one-half.

1 See: *Fiscal and Monetary Policies for Steady Economic Growth*, a Statement on National Policy by the Research and Policy Committee, Committee for Economic Development (New York, January 1969), p. 21.

*See Memorandum by Mr. C. Wrede Petersmeyer, page 28.

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cent in a form to be decided by Congress and subject to its veto.*

OVERCOMING STRUCTURAL OBSTACLES TO PRICE STABILITY AND EXPANDING SUPPLY

The most important among the supplementary steps needed to reconcile high employment and relatively stable prices are measures to overcome structural impediments to price stability; to raise productivity; and to expand supply. In the markets for labor as well as for products, a much more intensive effort needs to be made to strengthen the forces of active competition and to remove the restraints on free market mechanisms that interfere with efficient resource allocation and impede innovations. While most of the required measures are of a long-range nature, a substantial number of actions with a nearer-term impact can also be taken.

There is an urgent need to deal with the exceptionally strong inflationary pressures that characterize many service activities (among which medical care is an outstanding example) as well as the construction sector. Manpower or other supply bottlenecks, restrictive labor union practices, and lagging productivity growth have been major contributors to the inflationary push in many of these areas.

Chapter III lists in more detail the specific areas for further action that in our view should be given priority attention by the new National Commission on Productivity and by government, business, and labor generally. Our principal findings from an examination of the priority areas are the following:

1. A comprehensive review of existing statutes, regulations, and policies should be undertaken to eliminate features that have an inherent inflationary bias and work counter to efficiency and mobility. Many of these features had their origin in the experience of the Great Depression and reflect fears, that are no longer appropriate under high employment conditions, of excessive price declines and of dynamic change and innovation.

2. High on the agenda of such a review should be a reexamination of existing labor legislation.** **We believe a basic restructuring of our labor laws and regulations is required to bring about a better balance in the relative powers of unions and management.** Unions should be able to give adequate expression to the legitimate interests of their members. At the same time, steps must be taken to assure that they do not have excessive powers to restrict the supply of labor through such means as outdated apprenticeship requirements or racial discrimination, nor the power to place undue

*See Memorandum by Mr. Alexander L. Stott, page 28.
**See Memorandum by Mr. H.C. Turner, Jr., page 28.

restrictions on productivity improvements.

3. **To bring about a reform in labor-management relations in the construction industry and thus help deal with the exceptionally sharp rise in construction labor costs, we recommend that the National Labor Relations Board require that the size of collective bargaining units in construction be substantially enlarged and that contracts with different craft unions expire at or about the same time.*** These measures should aid in correcting the unbalanced and fragmented nature of collective bargaining in an industry that has tended to put employers at a severe disadvantage vis-a-vis the unions. If existing authority for taking such initiatives is considered inadequate, action should be initiated to secure the needed legal powers.**

We also recommend that the Davis-Bacon Act, which serves as a continuing engine of inflation, be repealed. This Act has a built-in inflationary bias by requiring that the federal government (and federally-supported programs) pay higher wage scales on construction projects than may be warranted by basic supply and demand conditions in labor markets. Moreover, the Act has tended to be administered in a way that maximizes its inflationary potential. **Pending Congressional action in this area, we urge that every effort be made to administer the Act in a manner that will hold inflationary effects to a minimum.** In addition, the possibility should be explored of having the President suspend the Act on an emergency basis.

Various other measures to cope with the severe inflation in the construction industry are discussed in Chapter III, including steps to overcome the many existing barriers to entry into the construction labor force, to develop more efficient production methods, and to render construction work less seasonal.[1] We regard as a particularly promising recent development the initiative being taken by a sizable number of the large national business firms on whose behalf much of the ongoing private commercial construction is undertaken (i.e.,the major construction "buyers" or "users"). These firms are for the first time engaged in a concerted effort to help contain the rise in construction costs by agreeing not to insist on unrealistic deadlines for project completion; by instructing their local managers to discourage unnecessary overtime; by seeking to exert an active influence on the outcome of local bargaining between construction

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1 The special stress which this statement places on construction partly reflects the fact that the Committee devoted particularly close attention to the problems of this industry, as an example of an industry affected by unusual structural and "bottleneck" factors. While the rise of construction costs and prices has indeed been exceptionally serious, inflationary pressures generated by structural and cost-push factors are of course of major importance in various other industries whose problems are not taken up in detail in this statement.

*See Memorandum by Mr. Robert R. Nathan, page 28.

**See Memorandum by Mr. Herman L. Weiss, page 29.

contractors and unions; and by numerous other means. Such efforts deserve the strong support of the business community as a whole.*

4. A wide range of other steps are required to help adapt the structure of labor supply to major changes in the structure of the demand for labor, and to enhance the mobility and productivity of our manpower resources generally. These include expanded training in skills that are in short supply; upgrading the education and training of the unskilled and disadvantaged; eliminating racial and other inappropriate restrictions on entry into particular crafts and skills; and greatly improving the mechanisms for matching job opportunities with job seekers at all skill levels. **To help cope with existing or emerging manpower supply bottlenecks, we specifically recommend (a) expanded governmental and private assistance to apprenticeship training programs in construction;** ** **(b) special governmental measures to assure that returning veterans of the Vietnam War will have adequate opportunities to use skills acquired in the service; and (c) increases in the very low current ceilings on earnings that now apply to persons receiving social security and railroad retirement benefits.** Since the budgetary costs of raising the ceilings on permissible extra earnings by social security recipients might prove very sizable if the ceilings were raised across the board, consideration might be given to limiting increases in such ceilings to cases where earnings are derived from work in which labor shortages can be certified to exist.

5. To assure more vigorous competition and efficient functioning of product markets, there should be a reexamination of various laws and regulations that place floors under prices or call for excessively detailed rate and other regulation in industries where greater reliance on competitive forces would often be preferable. The present cumbersome regulatory mechanisms in many areas of transportation constitute a case in point.

6. Emphasis needs to be placed on fostering productivity and efficiency, particularly in many areas of the service sector. Measures to encourage productive long-term private investment, such as the investment tax credit that this Committee has long favored, should be given renewed attention.

7. Much more intensive efforts should also be made to curtail uneconomic subsidies and output restrictions and to reduce (or avert) unnecessary restrictions on imports and other barriers to international trade. We believe, too, that the Tariff Commission should be required by statute to consider general price stability as one of the objectives to be taken into account in rendering its decisions.

*See Memorandum by Mr. Philip Sporn, page 29.
**See Memorandum by Mr. Charles Keller, Jr., page 29.

8. Far greater attention needs to be given to reducing the upward pressures on costs and prices that governments at all levels tend to exert through their own operations, and to enhancing governmental productivity and efficiency. The direct effect that governments have on prices through their procurement policies, detailed budget decisions, stockpile management, subsidy provisions, international trade measures, labor relations practices, etc. is indeed formidable. In recent years, public construction has amounted to over one-half of all nonresidential construction, which is the segment of the industry in which inflationary pressures and excessive wage settlements have been by far the most serious. **We believe there is a vital need for a central governmental unit or agency that will concentrate continuously and exclusively on reducing or avoiding inflationary pressures associated with the government's own operations, either directly or indirectly. The proposed agency should, in effect, serve as a "public defender" of the price stability objective within the government.**

The President's recent action in creating a federal Regulations and Purchasing Review Board within the Office of Management and Budget should go a long way toward filling this need. The Board should encourage the adoption of more cost-conscious and "abrasive" buying policies in all areas of the public sector. **If the Regulations and Purchasing Review Board is to become a true "public defender" of price stability, however, its functions should in our view be substantially broadened.** The Board should not only concentrate on the price effects of the federal government's own current operations and regulations, but should also concern itself with relevant actions of state and local governments that are subject to federal influence. In addition, it should be required to highlight the price implications of significant new proposals for governmental actions with a potential inflationary impact. It should, in effect, indicate the likely impact on consumer prices of proposed new spending programs, subsidy provisions, trade restrictions, and other government actions. It should also have special responsibility for early identification of emerging manpower and other supply bottlenecks and for assuring the development of appropriate policies to cope with such bottlenecks.*

VOLUNTARY WAGE-PRICE POLICIES**

The removal of structural impediments to price stability is in time likely to make it possible for the economy to maintain both high employment and price stability, assuming proper general fiscal and monetary

*See Memorandum by Mr. Robert R. Nathan, page 29.
**See Memoranda by Mr. Joseph L. Block, page 30, and Mr. Frazar B. Wilde, and Mr. Theodore O. Yntema, page 31.

policies are followed. But these structural reforms are difficult and cannot be achieved overnight. Unless additional measures are adopted, therefore, policy-makers may for some time still be forced to choose between two unpalatable alternatives – high employment with unacceptably high rates of price increases on the one hand, or relative price stability with excessive unemployment and economic slack, on the other hand. Whatever the choice, major inequities and economic losses are likely to result.

Voluntary wage-price policies (or "incomes" policies, as they are often called) constitute measures intended to help avoid that choice and its attendant inequities.* Such policies seek to induce restraint in wage and price decisions on the part of business firms and labor groups that have some degree of discretion in making such decisions. The evidence from past U.S. and foreign experience regarding the effectiveness of these policies is mixed. On balance, it seems to indicate that wage-price policies cannot prevent the inflation generated by a badly over-heated economy, but can help lessen upward price pressures that may be present even when aggregate demand is not excessive.**

Viewed in perspective, voluntary wage-price policies thus are not a panacea but a possibly useful adjunct to appropriate monetary and fiscal policies and to basic structural measures. Their function is to help reduce the costs of using demand restraint to bring inflation under control – with costs being measured in terms of unemployment, lost output and profits, and retardation of economic growth. Although use of such policies is likely to produce some inequities, these must be weighed against the potentially greater inequities that may result from increased unemployment or inflation if no action is taken.

We do not believe that failing to develop and employ such policies would be warranted simply because their effectiveness cannot be predicted with certainty. If they should not prove to be very effective, any adverse effects are also likely to be small. But if they do help in reconciling high employment with reasonable price stability, the payoff from adopting them could be significant. **On balance of considerations, therefore, we believe that the United States should include voluntary wage-price policies among its tools for reconciling price stability and high employment.**

It should be clearly understood that what we are advocating are voluntary wage-price policies. **We are opposed to mandatory controls on wages and prices, except in the event of a major war.*****

*See Memorandum by Mr. Allan Sproul, page 32.

**See Memorandum by Mr. E. Sherman Adams, page 32.

***See Memoranda by Mr. Rafael Carrion, Jr., page 32, and Mr. Melvin J. Roberts, page 33.

a. **PRINCIPLES**

We believe that such wage-price policies as may be evolved should adhere to the following broad principles:

- To the maximum extent possible, they should be based on full and continuous consultation among government, business, and labor, and should represent as wide a consensus among these groups as feasible.

- To be meaningful, voluntary wage-price policies should go beyond purely general appeals for wage and price restraint. They should include some ground rules or norms which define wage-price behavior that is consistent with the public interest in over-all price stability and that can be regarded as basically fair to all groups involved.

- Such ground rules should be designed to assist rather than impede efficient resource allocation. Thus, any general rules should provide adequate exceptions for special price or wage adjustments that may in some instances be needed to correct significant imbalances between demand and supply.

- Since the policies would be based on voluntary cooperation, they should basically rely for their effectiveness on the fact that the public would be kept fully informed about significant instances of excessively inflationary behavior and the factors involved.

- The formulation as well as implementation of wage-price policies should be entrusted to an independent body within the government rather than, as in the past, be considered a function of the President himself or of his Council of Economic Advisers. The development of appropriate standards should, however, be carried out in close consultation with the Council of Economic Advisers and other relevant agencies in the government, as well as with the Congress, representatives of state and local governments, and the private sector.

b. **PROCEDURES**

We believe the appointment by the President of the National Commission on Productivity and the establishment of an Inflation Alert system represent major forward steps that should facilitate the development of the kind of approach to fostering wage-price restraint which we are advocating. We recommend, however, that the announced new procedures be given added strength in a number of respects.

1. The fact-finding functions of the new "Inflation Alert" system should in appropriate cases be utilized to highlight important prospective

wage and price developments rather than being solely directed at decisions that have already been taken. In particular, it would be helpful to alert public opinion to potential inflationary threats in advance of major scheduled labor management wage negotiations. We do not imply, however, that advance notification of price changes should be required.

2. The National Commission on Productivity, or a new body, should be assigned the task of developing broad norms of appropriate noninflationary wage and price behavior that would give some guidance to business and labor groups which may be affected by Inflation Alerts.

3. There should be authorization for such a group to publish, after careful scrutiny of the facts, reports and relevant background analyses regarding instances of wage and price behavior by individual unions or companies that deviate substantially from such broad norms as may have been established and that represent special threats to over-all price stability. This procedure would vary sharply from detailed involvement of regular government agencies in particular wage and price decisions, since it would be carried out by a wholly independent group within the federal government and would predominantly rely on presentation of the facts to the public.

4. Effective implementation of these functions may over time constitute a greater burden than should be imposed on the Council of Economic Advisers or on the new National Commission on Productivity. We recommend, therefore, that consideration be given to the creation of a three-man Board on Prices and Incomes, appointed by the President and subject to Senate confirmation, that would have principal responsibility for developing norms of noninflationary behavior covering private wage and price decisions that are subject to some discretion and changes in government wages and salaries. The Board also would be responsible for detailed examination of important instances of deviations from such norms. The members of this three-man body should be distinguished citizens, working on a full-time basis. They should represent the public at large, though drawing on the advice of the National Commission on Productivity and other appropriate groups with key representation of management, labor, and government.

While the direct concern of the proposed Board would mainly be with shorter-term issues of wage-price policy, it would be expected to make reports to the Executive Branch and the Congress regarding more basic longer-range remedies for inflationary wage and price pressures which, in the light of its experience, it believes deserve particular attention and should be further explored. The remedies to be considered would presumably encompass various structural steps to strengthen competitive forces in particular industries and labor markets, and in some exceptional instances might also include the possibility of compulsory arbitration.* It would be highly important that suggestions generated through this process or other appropriate channels be followed up by thoroughgoing basic studies and by strong efforts to carry out needed reforms.

MINIMIZING HUMAN COSTS OF VIGOROUS ANTI-INFLATION MEASURES

Vigorous pursuit of anti-inflationary demand policies will at times call for temporary reductions in over-all economic activity to levels considerably short of full capacity and high employment. To make pursuit of such policies feasible without excessive human costs and inequities, economic "safety nets" should be provided for persons who become unemployed or whose incomes might otherwise be plunged below poverty levels as a result of the added demand restraint. Further action is particularly needed along four major lines:

1. **To cushion the impact of demand restraint on persons who are thrown out of work, the coverage of the present system of unemployment compensation should be as inclusive as possible and the period during which compensation is paid should be materially lengthened at times when the national level of unemployment rises significantly above the rate which would exist at "high employment."** The federal unemployment compensation legislation enacted in August of this year is a major step forward in this direction. Its early implementation, however, is dependent on passage of complementary legislation by the individual states. We therefore urge that all states take prompt action to render their unemployed eligible for the benefits available under the new law. We also believe that additional improvements in the unemployment compensation system are desirable, including a further broadening of coverage, and some lowering of the unemployment levels that will trigger an extension of benefit periods.

2. **As spelled out in our April 1970 policy statement on *Improving the Public Welfare System*, we favor a basic reform of the welfare system to provide for a national minimum income, with eligibility based solely on need and with positive work incentives for those able to work.** Such a reform would serve as a defense against poverty, whether caused by long-term structural factors or by temporary reductions in over-all demand.

3. **The scope of governmentally-sponsored or assisted training programs should be substantially enlarged at times when total demand falls substantially short of high employment levels.** This would call for intensified federal financial support of existing private and public training programs. A possible further vehicle for expanding training opportunities might be the "Jobs Corporations" proposed, on an experimental basis, in our recent

*See Memoranda by Mr. Robinson F. Barker and Mr. Herman L. Weiss, page 33.

policy statement on *Training and Jobs for the Urban Poor.*[1] However, as that statement makes clear, major government support for programs to provide training for the structurally unemployed will be needed even when the economy is operating at high employment levels.

4. **During periods of markedly lagging total demand, the federal government should also significantly increase its efforts to provide subsidized private employment or useful public service employment to persons who are able and willing to work but who cannot obtain regular jobs in the private sector.** As part of these efforts, the government might well enlarge the operations of the proposed Jobs Corporations that relate to employment opportunities (assuming experiments with this device are successful) and increase its support of the Job Opportunities in the Business Sector (JOBS) program wherever feasible. More direct federal assistance for temporary increases in public service employment would also be desirable. While a large portion of these public service jobs would be at the state and local levels, the federal government should provide strong direction and adequate funding for this job-creation effort.*

The enlargement of such programs of federally-assisted training and employment should be limited to periods of markedly lagging total demand. Additional funding should automatically begin when the unemployment rate exceeds a certain level and might be stepped up further as the rate rises above still higher "trigger" levels.** The geographical distribution of the added funds should also take account of differences in local labor market conditions. Such added funding should be phased out when a sufficient number of suitable private employment opportunities reappears.

SELECTIVE CREDIT CONTROL MEASURES

To permit a more effective application of general monetary restraint and help avoid excessive upward pressures on the general level of interest rates, we believe that it may from time to time also be desirable to utilize some selective credit controls. Use of such devices should mainly be designed to help reduce the often uneven impact of monetary policy. Whether or not such selective restraints should be applied at any one moment needs to be decided in the light of further study and evolving circumstances. We do not advocate adoption of new measures of this type at the present time.

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1 See *Training and Jobs for the Urban Poor,* a Statement on National Policy by the Research and Policy Committee, Committee for Economic Development (New York, July 1970), pages 63-67.

*See Memorandum by Mr. Herman L. Weiss, page 33.
**See Memorandum by Mr. Robert R. Nathan, page 34.

Memoranda of Comment, Reservation, or Dissent

Page 14—By H. C. Turner, Jr.:

A distinction should be made between a high level of employment and full employment. Evidence has shown that "full employment," generally considered to be 4 per cent or less, leads to labor shortages in various trades which in turn results in excessive wage and benefit demands, excessive overtime and lower productivity. Hopefully a "high level of employment," say 4 per cent to 5 per cent, may be maintained without accelerating inflation.

Page 15—By H. C. Turner, Jr.:

The national commission on productivity has been ineffective and requires a more aggressive policy. One of the principal goals should be proposals leading toward a resurgence of responsibility for a day's work and a pride in labor achievement.

The Council of Economic Advisers has procrastinated and been ineffective in acting on "inflation alerts."

Page 15—By H. C. Turner, Jr.:

This paragraph should also refer to the need for stepped up productivity in the service sector which now employs a larger share of the labor force than manufacturing and agriculture combined.

Page 16—By Theodore O. Yntema, with which William C. Foster has asked to be associated:

I wish that I could vote to approve this policy statement because there is much in it that I endorse. I cannot, however, subscribe to the prescription of voluntary (?) wage-price policies and a Board on Prices and Incomes.

Page 17—By C. Wrede Petersmeyer:

I do not believe that a further increase in taxes should be offered even as a fall-back alternative to achieving a "high employment" budget surplus. The surplus can and must be achieved by holding expenditures well within the estimated revenues that are provided by the existing tax system. Taxes already take one-third of total national income. At some point a further increase in the proportion of total national income channeled into the public sector reduces the incentive, productivity, and long-term growth of the economy. I suggest that this point may already have been reached. Congress must reorder the priorities of government expenditures and exercise the necessary self-discipline in budgeting to achieve such a surplus without increasing taxes.

Page 18—By Alexander L. Stott:

The disruptive effects of tax changes on business planning and performance make it essential, in my opinion, to avoid frequent changes in taxes on business. Changes in business expansion plans may be expensive or impractical, while changes in earnings may require rate action by regulated business. For these reasons I would suggest that a greater effort be made in the budgetary reviews to anticipate the expenditure effects of on-going government programs, and that short-term adjustments in the budget be made through changes in proposed federal spending, where possible. Where a change in taxes is necessary, I believe that this can be accomplished best through the President and Congress working together under present arrangements.

Page 18—By H. C. Turner, Jr.:

With respect to a re-examination of existing labor legislation, consideration should be given to a law requiring compulsory arbitration in the construction field for labor disputes which represent major threats to the general economy in a particular area or region and to price stability.

Page 19—By Robert R. Nathan:

It certainly would be desirable to achieve improved labor-management relations in the construction industry toward the end that productivity and cost factors would be more fully taken into consideration by both parties at the bargaining table. However, the proposal with respect to the size of the bargaining unit and the timing of contract expirations will not likely prove fruitful. Certainly a careful review of these problems by the National Labor Relations Board would be helpful. Such a review should also take into account the structure and pattern of employers in the volatile industry. It would have been better to have called for open-ended studies and recommendations by the National Labor Relations Board rather than limit suggestions to two proposals of dubious effectiveness.

Page 19—By Herman L. Weiss, with which John D. Harper has asked to be associated:

Experience in other industries has demonstrated that as collective bargaining units have become larger and as the expiration dates of contracts have been brought closer together, the collective bargaining process has become more rigid and more prone to result in strikes which last longer, when they occur, and do more damage to the general public.

Page 20—By Philip Sporn:

This can take specific and, as I can testify, effective form. For example, provisions in the contract between the building contractor and the builder can be included that make the contractor a representative of the builder in wage negotiations with the construction unions: the contractor could be required to absorb a portion, say 15 per cent, of every wage increase he negotiates.

Page 20—By Charles Keller, Jr., with which Robert R. Nathan has asked to be associated:

This governmental and private assistance should also be designed to encourage innovation, modernization, and improvement in the apprentice training system in construction, to increase its effectiveness, reduce the drop-out rate, and shorten its duration.

Page 21—By Robert R. Nathan, with which E. Sherman Adams has asked to be associated:

This whole discussion of using the leverage of government procurement and regulations to lean against inflationary pressures is appropriate and desirable. Certainly the functions of the Regulations and Purchasing Review Board should be substantially broadened as proposed, but it should function especially aggressively and imaginatively at times when serious inflation threatens or prevails. There is ample justification for adjusting stockpile policies to inflationary circumstances and even to consider delays in the timing of government procurement of goods that need not be purchased regularly on a fixed schedule. Nor should the "buy American" policies be rigidly pursued when inflation exists. Until and unless imaginative and courageous policies are adopted and pursued, the very creation of the Board will be an illusion and may preclude other actions which are necessary and desirable. If the Administration is serious about fighting inflation with other weapons than unemployment and idle machines, it should be prepared to let suppliers know that the governmental procurement leverage and its policy alternatives will be used to exercise real influence. Gentle raps on wrists and empty platitudes will not prove effective. All reasonable measures will need to be pursued seriously if the power of huge government purchases is to serve the purposes of slowing inflation.

Page 21—By Joseph L. Block, with which Marvin Bower, C. Wrede Petersmeyer and Robert B. Semple have asked to be associated:

I do not favor the principal recommendations made in respect to "Voluntary Wage-Price Policies." Most believers in the supremacy of the free market system are opposed to mandatory wage and price controls except in the event of a major war, and favor reliance on fiscal and monetary measures to control inflation. This is CED's policy. But many of these people – and now CED is joining the group – seeing what they deem slow and imperfect results from fiscal and monetary actions – turn to some form of so-called "voluntary" restraint in their desperation.

The report recommends that a governmental body should take such actions as highlighting "important prospective wage and price developments," "developing broad norms of appropriate noninflationary wage and price behavior" and publishing reports of "instances of wage and price behavior by individual unions or companies that deviate substantially from such broad norms." This assumes that individuals associated with such a governmental body are so wise that they know the answers to these questions – a bold and highly improbable assumption. For instance, how would they know that a particular price increase, leading to improved profits and expanded capacity, would not be more in the long-run public interest than restraint?

In my opinion, under the general umbrella of constructive fiscal and monetary measures, we should rely on the forces of the market place – competition and supply and demand – to do the job. I would, however, favor study by an appropriate governmental body of factors, such as labor or business monopoly, which impede the effective operation of the free market, and their recommendation for corrective action. This is, of course, recommended in the report.

Page 21–By Frazar B. Wilde, with which E. Sherman Adams and Philip Sporn have asked to be associated:

This statement is an excellent presentation of our country's major problem. It does not offer an adequate remedy. Inflation cannot be contained by the conventional measures of fiscal and monetary means alone or in concert. Under the political requirement of full employment, no administration is able to use its power to apply fully either fiscal or monetary measures in a sufficient amount to get results. Only by the development over time of a fully implemented incomes policy can our system hope to reach its proper ambition of consistently high employment and reasonable price stability. The limited success of incomes policy to date in other countries should not condemn it. We can and must develop a formula which will have to include more government intervention than we presently advocate. The preservation of a private enterprise economy is at stake.

Page 21–By Theodore O. Yntema, with which William C. Foster (except for the words "will strangle the economy"), C. Wrede Petersmeyer, and Robert B. Semple have asked to be associated:

I cannot subscribe to these prescriptions of voluntary (?) wage-price policies and a Board on Prices and Incomes. These prescriptions will prove to be generally ineffective and, where they have effects, the effects are likely to be inequitable. Appropriate norms or standards for levels of wages and prices and for changes in wages and prices, that will permit the economy to function efficiently and that are equitable, have not been and cannot be established. Nor will norms and standards receive general support. Any such guideposts and guidelines will be flouted by unions with the power to defy the actions of the Board and by both business and labor where their actions are likely to go undetected or escape reprisal. Businesses with high visibility and with high vulnerability to government pressure will be abused. Instead of the rule of law, we shall have rule by men guided by opportunistic considerations. The responsibility in the government for economic policy to cope with business fluctuations will be further diffused and confused by the proliferation of bureaucracy. When the so-called voluntary measures fail, they are likely to be followed by outright wage and price controls, which, if retained beyond the limits of a temporary emergency, will strangle the economy. Finally, pretending that we are coping with inflation by these measures, we shall feel less urgency to deal with its causes.

Page 22—By Allan Sproul, with which S. Abbot Smith has asked to be associated:

The use of the terms wage-price policy and "incomes policy" interchangeably, and the emphasis which tends to be placed on labor's demands for wage and benefit increases in excess of productivity gains, gives a misleading impression of what is involved in an "incomes policy" – voluntary or mandatory – and attracts a measure of support particularly among businessmen which may be misplaced. An "incomes policy" strictly defined involves the equitable distribution of all forms of industrial income, including not only wages but also dividends and profits. Even limited authority of government in this division of rewards runs into difficulties at every point in our kind of an economy. The economic, social and political problems involved are enormous. Their solution will be a long term undertaking, not a present help.

Page 22—By E. Sherman Adams:

On the basis of experience in European countries, many observers are convinced that an incomes policy can at times help to moderate price inflation, particularly when aggregate demand is not excessive, which is the situation in the United States today. For example, at an international conference on incomes policy held in Stockholm in 1969, Sir Alec Cairncross summed up experience in the United Kingdom as follows: "The Prices and Incomes Board under its present regime has been a remarkably successful institution . . . There's not much doubt that if we look at what has happened to the course of prices, cost of living and profit margins, prices are perceptibly below what they might have been expected to be, given previous relationships as used in our forecasting model."

Page 22—By Rafael Carrion, Jr., with which William C. Foster, Charles Keller, Jr., and S. Abbot Smith have asked to be associated:

I take exception to the statement: "We are opposed to mandatory controls on wages and prices, except in the event of a major war."

To me the term "major war" is not sufficiently precise. Presumably, Viet Nam is not regarded as a major war. However, the impact it has had on our economy is certainly of major proportions. In any event, I would not limit the exception to the event of a major war.

I am basically opposed to government controls, and certainly I do not advocate their adoption. Therefore, every effort should be made to combat inflation without having to resort to a direct control of wages and prices; and I agree generally with the measures and methods recommended in this paper. However, the one major objective we are pursuing is still to protect the value of the dollar by stemming inflation.

We owe it to our citizens, as well as to the citizens of other nations whose official reserves are in dollars, to preserve the stability and value of our currency.

If *all* other measures prove ineffective in combating inflation, and controlling wages and prices seems to be the answer, I feel we should accept this as a measure of last resort.

Page 22—By Melvin J. Roberts, with which William C. Foster and Charles Keller, Jr. have asked to be associated:

If inflation cannot be contained by other measures, it may be necessary to accept wage, price, and credit controls as the only alternative to continuing inflation.

Page 25—By Robinson F. Barker, with which Marvin Bower has asked to be associated:

While I heartily agree that better means must be found for dealing with the exceptionally sharp rise in construction labor costs, I am inclined to question the desirability of imposing compulsory arbitration as a solution. Negotiations in other major industries, steel and autos for example, also could pose a threat to price stability, and once the compulsory arbitration foot was in the door it would be difficult, if not impossible, to confine its use just to construction. The impact on our concept and practice of collective bargaining would, in my judgment, be very harmful.

Page 25—By Herman L. Weiss, with which Marvin Bower has asked to be associated:

The termination of the collective bargaining process with compulsory arbitration represents an abdication of the responsibilities of the primary parties, because it turns the critical issues over to a third party who does not have to live with the results. The implications of "compulsory arbitration" have not been considered anyplace in this statement. Therefore, I think it is inappropriate to make a reference to compulsory arbitration, even as a "possibility."

Page 26—By Herman L. Weiss:

I do not believe we have sufficient evidence to conclude that such a program by the federal government would not degenerate into another WPA system.

58-512 O - 71 - 16 pt. 1

Page 26—By Robert R. Nathan:

The purposes set forth in the preceding four paragraphs are commendable. Measures should be designed to minimize the impact of recessions on workers and families. However, several of the measures proposed ought to be pursued at all times and not just when there is increased unemployment above specified "trigger" levels. Unemployment is a hardship whether it occurs during a recession or during prosperity. Unemployment benefits, properly administered, should cover longer duration irrespective of the level of unemployment. A national minimum income is needed at times of prosperity as well as recession. More effective training programs are essential if we are going to overcome structural obstacles to achieving a better balance between full employment and price stability at higher levels of total activity. The policies proposed are excellent but the repeated emphasis on undertaking these measures only when the rate of unemployment rises above certain levels is not in the best interest of the country, the economy and of those who do not share in our affluence even in periods of high prosperity.

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1. Voted to approve the policy statement but submitted memoranda of comment, reservation, or dissent, or wished to be associated with memoranda of others.
2. Voted to disapprove this statement.
3. Did not participate in the voting on this statement because of absence from the country.

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Chairman PROXMIRE. Thank you, Mr. Petersen, for what I think is a really remarkable statement and a most encouraging statement.

Mr. Petersen, do you favor the full-employment budget?

Mr. PETERSEN. Yes; I do. I do not want to get into what the numbers should be in terms of what deficit is or is not inflationary. It is obviously quite clear that a very large deficit would show a small surplus at full employment. I think the full employment budget concept is a good device for gaging what your fiscal policy should be.

Chairman PROXMIRE. You would favor a deficit now?

Mr. PETERSEN. Certainly.

Chairman PROXMIRE. A substantial deficit in order to stimulate the economy?

Mr. PETERSEN. Certainly.

Chairman PROXMIRE. Is that view shared, as far as you know, by other members of the CED?

Mr. PETERSEN. Oh, yes; the full-employment budget is a CED principle. I think we are all pretty much in agreement on it.

Chairman PROXMIRE. This is an unusually prestigious group of leaders in American business. I notice you have the chairman of the General Foods Corp., chairman of the board of the Green Giant Co., the president of Merck & Co., and so forth—many of the most successful firms in the country are represented on your particular board.

The reason I'm calling attention to this is that I think it is most remarkable that we have a business organization, at least an organization made up of leading business figures, that takes a position taken by one of our most distinguished labor leaders, who just appeared. It indicates that there are things we can do if we get a consensus of powerful support.

You also indicate in your statement that you favor manpower training and public service employment; that you favor, of course, in the main thrust of your statement, a wage-price board; that, as I understand, you would favor standby credit controls, not to be put into effect now but in the event we move into an inflationary situation, with sharply rising interest rates, presumably they might be used. Is that correct?

Mr. PETERSEN. That is correct. We said we did not think selective credit controls were needed now. We have in the past favored some credit controls, during the Korean war and its inflationary period. This is part of the arsenal of weapons you have, and you employ them when you think it is wise to do so.

Chairman PROXMIRE. In your view, is this position shared by business generally? I know it is shared, of course, by the distinguished members of the group you represent, but is it shared widely by business?

Mr. PETERSEN. I think the banking industry would probably not like any further control.

Chairman PROXMIRE. I am talking about the Wage-Price Board and the other proposals you have made. Do you think this would be accepted by business? Because an element in the success would be, of course, whether we get voluntary compliance with the principle and fact.

Mr. PETERSEN. The problem is not with the business organization, it is with the labor unions.

Chairman PROXMIRE. But it would be with both, one part of it.

Mr. PETERSEN. That is right. You would have to have both, that is correct.

Chairman PROXMIRE. It would have to be business cooperation, and you are absolutely right, there would have to be labor cooperation, too.

Mr. PETERSEN. I think there has been a shift on this matter. I think most businessmen formerly were against any kind of controls because, obviously, if you have wage controls, you must have price controls. But I think they feel the necessity of supplementary measures to try to get back on full employment and with reasonable price stability.

So if our committee is any indication, you have a kind of 5-to-1 vote in favor of this voluntary form.

There were several of our trustees who thought that perhaps these controls ought to be mandatory, but this was a very small minority. But this, again, is indicative of a shift in opinion.

Chairman PROXMIRE. I think it is very important that this board be made effective so that its recommendations work. I am a little confused about who would be in charge of the guideposts under the policy you advocate. Do you envisage that the President would enunciate the guideposts, or would the entire responsibility rest on what you call the small but able independent body which you would set up?

While I agree that an independent body is needed to administer the guideposts, it seems to me important to use the full persuasive power of the Office of the President if this is going to work, if it is going to have effect.

Mr. PETERSEN. We think that the development of these standards would obviously have to be carried out in close consultation with the President and with his Council of Economic Advisers and other relevant agencies, and the Congress as well.

Chairman PROXMIRE. The President would play a role? The President would use the power of his Office?

Mr. PETERSEN. Certainly. But I think it is important to have an independent agency of men of impeccable qualifications and integrity and ability, with a proper staff, to set up these norms. I do not think you get these out of industry committees or groups that are composed of people all having self-interests to follow.

Chairman PROXMIRE. At the present time, we seem to have kind of an impromptu, catch-as-catch-can kind of jawboning. The Bethlehem Steel incident is one that I welcomed. I thought the President acted well and wisely, and he got results. I took it that the thrust of your statement was that business might be more willing to accept this if it were systematized and applied to everybody equally, and if there were a group of acknowledged, objective experts that would make some factfinding on which action could be based. Is that right?

Mr. PETERSEN. That is correct. I think the Bethlehem Steel case was unfortunate, because we did not have a system. The reason I think it is unfortunate, it tends to stigmatize not only an industry or a company within an industry but it tends to stigmatize a person. I do not like that.

I think that if you have norms established, a system in effect, then you do not have to have these ad hoc flare-ups and you have a more equitable treatment of people, because the norms and guidelines or rules of the road, whatever you call them, would be understood by everybody.

I think we are going to have to do more of these ad hoc things unless we get them systematized.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN. Mr. Petersen, in your recommendation No. 2, you suggest that, "among other things we recommended that the National Labor Relations Board require that the size of collective bargaining units be substantially enlarged and that contracts with different craft unions expire at about the same time."

In minority views to these recommendations in the full chapter, we have this statement from Herman Weiss and John Harper,

> Experience in other industries has demonstrated that as collective bargaining units have become larger and as the expiration dates of contracts have been brought closer together, the collective bargaining process has become more rigid and more prone to result in strikes which last longer, when they occur, and do more damage to the general public.

Could you resolve those conflicting majority and minority views for me, please?

Mr. PETERSEN. Mr. Harper and Mr. Weiss are executives of very large industries, Alcoa and General Electric. In the construction industry the unions do have a very considerable monopoly because of the fragmentation of the construction industry itself. It is not like dealing with General Electric or like dealing with the Aluminum Co. of America. You are dealing with relatively small contractors who are working in a certain locality and you have a large number of craft unions.

Representative BROWN. Well, a single craft union deals with all the contractors who are organized, I would assume.

Mr. PETERSEN. Only in an area.

Representative BROWN. In an area?

Mr. PETERSEN. Normally, they do have area negotiations, such as the Philadelphia area.

Representative BROWN. I do not understand the purpose of your recommendation. Would you explain it?

Mr. PETERSEN. I think there is a very unfair advantage given to unions when there are a number of unions the employment of all of which is essential to complete a job and their contracts have different expiration dates. Then they have a strike and everyone is off the job. First the common labor people, then the steamfitters and so on. Each brings up their demands and they are given increased economic power because they have the ability, even though they may be a very small part of all those employed, to close down a whole large piece of construction.

Representative BROWN. So, really, you are talking about these——

Mr. PETERSEN. We are talking about economic power.

Representative BROWN. In one case, it is the power to whipsaw an employer. That is what you are talking about in your recommendation?

Mr. PETERSEN. Sure.

Representative BROWN. What they are talking about, apparently, in their view is the power of an industrywide union, as Senator Javits mentioned to Mr. Woodcock, that controls the flow of labor in and out and also can dominate the whole industry. Is that what you are suggesting?

Mr. PETERSEN. When you have a larger sized collective-bargaining unit, and this is the construction industry alone that we are talking about here, you bring in a lot more people into the labor pool, and the rates may be very different indeed. All I know is that a large majority of our members, most of whom know more about labor matters than I do as a banker, felt this would be very helpful in the construction industry.

One of our trustees is the head of Turner Construction Co., for example.

Representative BROWN. Yes; thank you.

Do you recommend your voluntary wage-price policies as being a permanent operation, or is this something that would be invoked only at times when inflation hits a certain rate? How would this be operated?

Mr. PETERSEN. Well, knowing government, of course, even though it were not necessary that it be permanent, it might turn out to be that way.

Representative BROWN. That occurred to me.

Mr. PETERSEN. I think it is a long haul, because as I say, we have the Full Employment Act of 1946, the commitment of government to high or full employment. This, plus the structure of our industry, the structure of our labor unions, seems to me gives a bias in our economy toward inflation. We inflate but we do not visually deflate. We do not reduce wages; bankers do reduce the price of money, but price reductions are not perhaps as commonplace as price increases.

I do not think of these measures as a temporary thing just for the next year or so. Inflation is one of the recurring problems of our times.

Representative BROWN. That is one of the problems, the tendency for governmental advisory boards set up on a temporary basis to become permanent. The other part is the tendency for a voluntary organization or an organization to supervise voluntary standards to become an enforcing agent and to set up a method by which they would force or make the decisions. Now, can you comment on that?

Mr. PETERSEN. Some of our trustees, I think, felt quite strongly that this was a foot in the door; and that you start out voluntary and you put moral suasion on and pretty soon, you get sanctions by statutes, and that is why they are against it. My associate, Mr. Schiff, has found exactly what our committee said about the permanency of this: "Our support of voluntary wage-price policies is pragmatic. We do not know whether or not they will be needed on a permanent basis. But we do feel strongly that incomes policies should be tried now and should be tried at least through the period of recovery. Indeed, it is during the period of renewed expansion that there is likely to be a particularly marked need for such policies."

So this equivocates a bit. But logically it means to me that these policies should be kept as long as necessary. There is likely to be a need for this both here and abroad—inflation, you know, is a worldwide phenomenon now in all the industrial countries.

I think that there is a bias in the economy for inflation. This is a part of our commitment to high employment, which is good. So I think the need for a wage-price policy is a fairly long-range thing.

Use of such a policy will give you a body of knowledge on which to base action if it again becomes necessary, and you never put into force or effect a system of this sort unless you are under duress. When the duress is over, you forget about it. Then when you are under duress, it is normally too late to be effective.

Representative BROWN. We both concur that the bias also is for long-range and more stringent implementation. That is one of the biases that exist in government.

Mr. PETERSEN. We very well do.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Mr. Petersen, I would like to endorse the chairman in commending you on this statement. Once again, you have demonstrated the CED is one of the most enlightened and forward-looking organizations we have in dealing with economic activity.

I was particularly pleased to have your forthright statement as to the utter folly of our looking toward a protectionist system. This is a battle we have waged together through the years, and I think that we must continually remind ourselves that the Tariff Commission and other commissions and agencies of the Government are really here to protect the consumer, not just the producer.

The producer has all sorts of protective devices; the consumer needs more protection.

Your specific suggestion of the Tariff Commission having to consider price stability when making decisions in the trade field is very important. I would like to follow up the idea that Arthur Burns had for creating a nationwide series of productivity councils. During the war, we had some 5,000 councils to focus atttention in local communities on featherbedding, on inefficiency and waste, and to really educate the public and the workers that the only way we can really earn wage increases and bring prices down, year after year, is increased productivity.

The AMA sponsored an economic conference in the midst of the recession in 1958, which was highly successful. Could organizations such as the American Management Association, or the CED, really help in the creation of productivity councils around the country, so that this idea of Arthur Burns can be given flower and brought to fruition, not by some Government agency acting in the Commerce Department, but by voluntary organizations in our economy taking it up and seeing what can be done with it?

Mr. PETERSEN. I think they can, Senator. CED's birth was really in this area. It was formed somewhat under the inspiration of Jesse Jones. He got these businessmen together, Paul Hoffman being the first chairman, to assure that when World War II was over, you would not have the massive unemployment that was predicted. CED formed committees all over the country at that time to look at the situation, what reemployment was necessary, and how it could be achieved.

As you know, there was great doom-casting in those days. Predictions were that we would have 10 million unemployed, which did not happen. It was that same process of which you now speak that made a contribution to the solution.

We have done some studies, for example, in the aerospace field as to what will happen when the war is over. The war is not over, but the aerospace industry is badly hurt. So I would, myself, say we could encourage the formation of such committees. I do not think CED, however, is the instrumentality to do it because of our nature.

Senator PERCY. I would appreciate your comments on the practice that has been brought to my attention by newspaper articles, called target pricing in various leading industries. Rather than letting the laws of supply and demand operate in declining markets by lowering your prices in order to expand volume, a leading industry will just go back and say, now, what do I have to get for my product in order to keep my rate of investment up to this target level. This means, therefore, that as demand goes down, prices go up.

This recently has happened in steel to a large extent. It seems to me that prices in leading industries do rise faster than prices as a whole. Would you comment on that as a matter of business policy? Is that good policy, and to your knowledge, does this practice exist and is it something we ought to take a look at as a committee, inquiring as to its effect on the economy and the country?

Mr. PETERSEN. I do not think I can really comment. I do not have any understanding as to these relationships. I am a director of a chemical company. I know chemical price indexes have gone down in the past 10 years and the profits have been very, very much lower. So here is an example of an industry which is highly competitive, where target pricing obviously has not worked to increase prices.

The return on investment in the chemical industry has been down very substantially.

Senator PERCY. Has that been due to the pressure of imports, though?

Mr. PETERSEN. In chemicals, no.

Senator PERCY. Has it been in response to a declining demand?

Mr. PETERSEN. No; I think some of the chemical people might tell you differently. In the coal tar end of it, the dyestuffs, which are batch processes, has been hurt from imports. But largely, as you know, Senator, the industry is a very substantial exporter.

Industry as a whole is a great deal more competitive than many people give it credit for. I know this in my own industry, the banking industry, where we work mighty hard to beat the other fellow.

Senator PERCY. I notice in a study that has been made, speaking of chemical companies, that a great corporation, Du Pont, with its management processes which I have long admired and tried to follow in my own business experience, has a target percentage rate of return on net worth after taxes of 22 percent. They exceeded that target from 1953 through 1968 with a 22.2 percent average. So they are doing pretty well in that particular end of the industry.

Mr. PETERSEN. Yes; they are.

Senator PERCY. My time is up. I would like to just elicit a very brief comment from you on the subject we are all interested in, providing useful public sector employment. In your estimation, are these dead end WPA-type jobs, as someone has described them—a member of your committee did—or is this something we really in good conscience must work toward? As long as we are going to pay the welfare costs anyway, can we not create the opportunity for people to work and earn their living and, then, by gaining education and skill, find a way to stand on their own feet in the private sector?

Mr. PETERSEN. Well, I think it is very important, as you suggest, that this be strongly coupled with training programs and educational programs so that people will not take a dead end job, but they can see the promise, through gain in skills, of an improvement in their position of employment requiring these skills. We suggested in our statement that the added funding of public service employment be triggered at a time when there was an increase in unemployment rates and lessened as unemployment decreased.

I think one of the criticisms of the WPA and the various make-work programs in the great depression was it persisted too long, and a lot of the jobs were not very useful.

It has to be useful, it seems to me. It has to give a man—or a woman—a sense of dignity, a feeling that he or she is usefully employed. I do not think a boondoggle does this.

Senator PERCY. Thank you, Mr. Petersen. I yield to my distinguished colleague, Senator Javits.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Mr. Petersen, if you have been asked this question. tell me. But what do you see as the difference between the board recommended by the CED and the board recommended by Leonard Woodcock, speaking this morning?

Mr. PETERSEN. If you read the document—I glanced at it while he was testifying—his whole orientation was toward prices. I think when Congressman Brown was questioning him, however, he agreed that both prices and wages ought to be in on the same basis. We think it is absolutely essential that they be on a parity and both be treated alike. There is no other way, no chance of its getting any acceptance without this.

He also had a price notification requirement, when you had to notify the board in advance. We thought this was not the thing to do, that this was much greater interference with private decisionmaking. Of course, under the method we suggest, any contemplated price or wage increase can be measured against the rules of the road, or guidelines, the norms which have been established by this board.

Senator JAVITS. I think there is an essential difference and it is very essential. It is what I wanted to get your opinion on. The essential difference is that he requires advance notification. I think he said in the wage thing, he would require advance notification of a wage or price increase.

Now, you say, or the CED says, that it would have principal responsibility "for developing norms of noninflationary behavior covering private wage and price decisions, both are subject to some discretion and changes in Government wages and salaries."

Is that not a very vital difference?

Mr. PETERSEN. Yes, I think it is; I do.

Senator Javits. And is it not inherent in your point, in the CED's point, that you must have norms or it really means nothing?

Mr. PETERSEN. That is right. Otherwise, you are back to the Bethelehem ad hoc business.

Senator JAVITS. Right. So your board would be based upon norms, and his board would be based upon notice, really.

Mr. PETERSEN. Really, I think that is the difference.

Senator JAVITS. What is the objection to notice?

Mr. PETERSEN. I gave one objection, which is interference with the private decisionmaking. You are in the realm of public debate before anything has happened. I think both labor and management should have the right to do these things. which are within their purview. They may be excoriated for having done them if they do not conform to norms, but I think that people will tend to act responsibly if they know what the rules of the game are.

I think having these rules acts as a restraint, whether it be on the consideration of price increases or on wage increases.

Senator JAVITS. I have another question which again relates to Mr. Woodcock's definition of the relationship between wage increases and productivity. He said he thought wage increases should bear a relation to productivity subject to a cost-of-living escalator which would be automatic, but those were the only two factors that he put into the equation.

Can you give us your views on that in terms of what would be our policy?

Mr. PETERSEN. Well. I always felt that there were not enough factors in this equation, and one of the factors, if the productivity is increased, is that you might get price reduction as one consequence rather than passing the whole benefit on to labor.

On the other hand, in the situation which we find ourselves in now, where many, many wage settlements are much, much beyond the productivity increases, we would be fortunate, indeed, if we could confine them to the amount of productivity increases.

One of the problems I see, Senator, is that most of the leaders in wage settlements are the very large industries—steel workers and auto workers—and they are dealing with very large economic units, whereas in the service industries, productivity increases are very hard to come by.

I think there is no way—you know, take the barber. We do not go to him so much nowdays, with the change in styles; and in fact, he has pretty much priced himself out of the market. But he has not learned to cut hair faster.

Take the whole field of medical care.

And we have only a small part of our total work force that is unionized.

Senator JAVITS. Sixty million to about 70 million. Do you have any suggestion for us—because this is a very big thing—as to how we can improve productivity?

Mr. PETERSEN. Well, Senator Percy talked about Arthur Burns' idea of having countrywide seminars, labor-management, to tackle the problems of increasing productivity, and so forth. I think one of the things this creature, well set up, would do would relate, obviously, increases in wages to increases in productivity.

You would know what the productivity increases were. They would be established by experts and objectively. You could measure this against what the wage increase was, and out of this you would get some sense of the impact on the total economy.

Senator JAVITS. In 1963, I offered a bill for local productivity councils. I am proposing to reintroduce it. That would take a network of such councils, it would finance them, it would give them statutory authority, it would enable them to be clued into the collective bargaining process.

Do you think well of that idea?

Mr. PETERSEN. We discussed that with Senator Percy before you came back, and I do think well of it, because these matters have to be discussed on the ground, they have to be held locally. They differ all over the United States. We always deal in aggregates of everything. People don't aggregate very well. There are some human differences.

Senator JAVITS. Well, I am very glad to hear you say that.

Thank you, Mr. Chairman.

Chairman PROXMIRE. I just have one quick question. You are a banker and a very eminent banker, Mr. Petersen. I notice you said that the bankers had endured a drop in the price of their commodity of about 30 percent over the last few months. I am kind of a dropout from banking, where Senator Hubert Humphrey is a dropout from pharmacy.

I spent 6 months with J. P. Morgan back in 1940–41.

Mr. PETERSEN. I have heard this.

Chariman PROXMIRE. I love bankers and I love banking. As you would agree, they did not do that out of the goodness of their hearts, although they have very good hearts. I am not sure they did it because it is the most highly competitive industry. It is competitive, but it is not as perfectly competitive as we would like it to be, perhaps, under some circumstances.

It seems to me it may well be that this reflects a much deeper weakness in the economy than many of us have realized. I wonder if you feel the decline may be a reflection of a weak economy, a weak demand for capital now, as compared to what it was a while ago, and something that might give us some trouble as time goes on?

Mr. PETERSEN. Well, certainly, it reflects the sluggishness in the economy, whereas the high rates were reflective of a really very restrictive monetary policy. But it is a competitive situation. The commercial paper market is 100 basis points, one percentage point, cheaper than the prime rate. We have customers going into the paper market.

There are so many alternative sources of financing. When you drop the rate in response to market forces, strangely enough, you do not heighten the demand.

I have always taken the position that the cost of money is not that important. It is the availabiltiy that is the important thing and the fact that you can use it profitably. So it is a reflection of the sluggishness of the demand. The long demand is not there. It has fallen off in a time when there was some increase of the money supply.

Chairman PROXMIRE. Most of us are hopeful, as I am sure most bankers are, that as rates continue to drop, particularly in long-term areas, mortgaging and so forth, there will be an increase in housing. I am wondering whether or not this is a realistic expectation or hope in view of the big deficit we expect and the demand by government for capital, and in view of the effect that this is likely to have on the economy in general.

Do you foresee interest rates stopping their drop?

Mr. PETERSEN. I would think the short rates would level out. You have had a susbtantial decline in long-term rates. For example, Tampa Power and Light was offered at 7.15 last week. That is an AA utility. They would have been, a year ago, about 9 percent.

After all, A.T. & T.'s financing was 8¾. The Aluminum Corporation of America issued 9 percent bonds. These are top-quality credits. So there has been some appreciable effect on the long-term rates.

Banks have reduced their mortgage rates; savings and loans have as well.

Chairman PROXMIRE. Very important for the expansion of our economy, it seems to me, is that mortgage rates continue to fall. If they do not, we are unlikely to have the 1.9 or 2 million housing starts that the administration is counting on, and I think the rest of us are counting on.

Mr. PETERSEN. I agree, and one of the really bad results of strict monetary policy is that it always hits that sector harder than any other sector. That is always the case. You can trace that.

Chairman PROXMIRE. Of course, the lags are so great here. As I recall, the Federal Reserve Board was increasing the supply of money——

Mr. PETERSEN. Starting in February.

Chairman PROXMIRE. But go back a few years, at a time when interest rates were rising. It is hard to see a very close connection without a very substantial lag. It may be even 18 months.

Mr. PETERSEN. One of the problems, of course, Senator, is that no one knows what these lags are. I have some notion that they are at different periods of time. The same policies are adopted. They are never adopted in the same economic climate.

Chairman PROXMIRE. I want to thank you very much, Mr. Petersen, for, as I said before, a superlative statement. It is so good to have so much agreement between one of the great labor unions in our country and one of the great business organizations. It seems to me you give us an area where we can do some really constructive work. You have been most helpful.

Mr. PETERSEN. Thank you. I am pleased indeed to be here and pleased to see my old friend, Senator Javits. He mentioned I was chairman of ADELA. He did not mention that he is the father of ADELA. He takes great pride in it, and rightfully so, because he started this endeavor in the private sector which is having important international consequences in spurring development in the less developed world.

Senator JAVITS. Thank you.

Chairman PROXMIRE. The committee will stand in recess until 10 o'clock tomorrow morning, at which time we shall hear Mr. Joseph Danzansky, Mrs. Esther Peterson, Congressman Harrington, and Mr. Sol Linowitz.

(Whereupon, at 12:20 p.m., the committee adjourned, to reconvene at 10 a.m., Wednesday, January 27, 1971.)

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