512

ECONOMIC PROSPECTS AND POLICIES

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ECONOMIC PROSPECTS AND POLICIES

WEDNESDAY, JANUARY 27, 1971

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

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

Present: Senators Proxmire and Javits.

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 hearings on "Economic Prospects and Policies." Our witnesses this morning are Representative Michael J. Harrington, a Democrat from Massachusetts; Joseph B. Danzansky, president of Giant Food, Inc.; Sol M. Linowitz, chairman of the National Urban Coalition; and Esther Peterson, consumer adviser to the president of Giant Food, Inc.

In our 3 previous days of hearings, we have heard compelling evidence of the costs of our present economic predicament. The inflation and recession experienced in 1970, a combination more severe than any we have previously experienced in the history of this committee, has wrought havoc on State and local budgets; it has led to labor disputes and strikes; it has caused a sharp decline in profits. These costs are in addition to the enormous direct costs being borne by the 5 million now unemployed and the additional 2½ million who can find only part-time work.

Today we are going to continue to explore these many costs of inflation and recession. As consumers, everyone is hit by rising prices. Those consumers who are also experiencing shorter working hours, or unemployment, or who live on small fixed incomes, are, of course, hit particularly hard. We have invited Mr. Joseph Danzansky and Mrs. Esther Peterson to discuss the effect of inflation and recession on consumers, which means, of course, on all of us.

Mr. Danzansky is president of the Giant Food Co. and a member of the board of directors of the National Association of Food Chains. He is also well known for his participation in civic affairs in Washington, D.C. For the past 3 years he has served as chairman of the Mayor's Economic Development Committee, and he has just recently been elected president of the Metropolitan Washington Board of Trade. This combination of experience has put him in a position to observe the effects of changing economic conditions from many angles. We are very pleased that he could participate in our hearing this morning.

Mr. Danzansky, I see your colleague, Mrs. Peterson, has not arrived as yet. As soon as she comes in, I will ask her to come up and introduce her.

I want to tell you how pleased we are to have you here, how grateful we are for your splendid record of participating in Washington affairs so constructively and sensitively. I think you have been an outstanding citizen.

STATEMENT OF JOSEPH B. DANZANSKY, PRESIDENT, GIANT FOOD, INC.

Mr. DANZANSKY. Thank you, sir.

Chairman PROXMIRE. We are happy to hear your testimony as an eminent lawyer, as an eminently successful businessman, and as an outstanding citizen.

Go ahead.

Mr. DANZANSKY. You are very kind, Mr. Chairman. I thank you very much for the opportunity.

When I last had the privilege of appearing before this body in October of 1969, I observed that "inflation is a fearsome problem partially because most Americans do not recognize the insidiousness of its impact." I went on to say that most of us have never lived through a real or prolonged inflation, and that small doses of inflation have given many of us a false sense of well-being.

I think we can safely say that most Americans now recognize the true nature and the very real dangers of inflation. What is more, I believe that most are not only willing, but anxious that their lawmakers find new and innovative approaches to the solution of this pressing problem.

I am here today to make a plea for such a policy. I am not an economist, and therefore do not feel competent to spin out the intracacies of a new economic theory. I will therefore deal only in broad strokes.

The businessman has not been free from responsibility for the events contributing to our current economic troubles. He has all too often been concerned with the well-being of his own company and his own stockholders, and has sometimes failed to adequately concern himself with the public interest. As a businessman, I do not ascribe all our troubles to the wage earner or the union member, who has the heavy task of providing adequately for his loved ones in very difficult and troubled times.

This is not the time to point fingers at anyone. Constructive action is long past due, and I would like to respectfully suggest what may perhaps be a new approach for your consideration. In this country and in Europe, last year, the rate of increase for 1969–70 was 6.2 percent, so we now have a worldwide inflation that is matched in Europe and in this Nation. I am not competent to judge all the consequences of this in Europe, or all the consequences in all American industries. I do feel competent, however, to judge the impact upon the American food industry and upon Giant Food in particular. In recent years, wage settlements of 15 percent or more are becoming increasingly frequent in the American food industry. This is vividly true in my own company where just last year we signed several contracts which averaged 32 percent increase in wages over a period of 2 years.

Inevitably, in an industry where the norm for net profit is 1 percent of sales, some of this increase must be passed along to the consumer. For it is also true that concurrent with soaring wage increases has come a sharp decline in relative productivity. It seems clear that this trend has also become apparent in the food industry generally. Obviously, most of the difference between productivity growth and the growth of the cost of labor will ultimately be passed on to the consumer in the form of higher prices, and that means more inflation. That in turn provokes demands for still higher wages, and the endless cycle goes on. In this situation, no one wins and everyone loses.

The one who loses most is the consumer, and ironically, he is the one interested party who is not represented at the bargaining table. I suggest that the Congress move to correct this inequity, and in doing so, bring about a halt once and for all to this vicious cycle of endless rounds of price and wage increases we know as inflation.

I do not propose another panacea. We have all seen too much of those. In my view, the main reason why we have been unable to bring inflation to heel is that we have sought panaceas which have reflected the particular political or economic dogmas of those in power. None of these dogmas, unfortunately, has presented a balanced program or a balanced view.

I think we must give adequate weight to three essential considerations.

First, a well-balanced economic program must give adequate weight to an adequate fiscal and monetary policy. In recent months, this consideration has been given a disproportionate role in the rescue of our national economy, to the exclusion, in fact, of the other necessary elements of a balanced program. Fiscal and monetary restraints must be a tool in our inflation-fighting arsenal, but if they are viewed as the pat answer to the problem, as has recently been the case, unacceptably high unemployment and reduced output are inevitable, and it appears that this in itself has accelerated the course of price inflation by working against both production and productivity.

A second part of a balanced program to fight inflation must be increased productivity coupled with increased production. Productivity is often shunned as a remedy because it sounds so impersonal, but if increased wages are not offset by increased output, the cost will inevitably be passed on to the consumer in the form of higher prices, and the spiral will continue to whirl.

I think you will be interested to know that the retail food industry is now on the threshold of a massive technological breakthrough, which will result in greatly increased productivity. For example, automated warehouses are on the way which will increase the productive time of order pickers from the present 42 percent to 85 percent.

Chairman PROXMIRE. What does that mean?

Mr. DANZANSKY. That means that a gentleman working in a warehouse today is productive only 42 percent of his working hours, and with this automated warehouse, he will be productive 85 percent of the hours.

Another breakthrough which will be welcomed by the ladies is automated checkouts at the supermarket, which will all but eliminate those bothersome lines at peak hours.

It will have other benefits as well. By recording the sale of each item, it will provide the company with a precise inventory at all times, and will automatically reorder products when the stock becomes low. This should virtually eliminate both overstocks and out-of-stocks. The system will eliminate the need for costly and time-consuming physical inventory, and the need for price marking each individual package will also be eliminated. The consumer will still be able to see the price, however, which will be marked on the shelf molding. All these improvements will make for greatly increased productivity, which is expected to have a strong moderating influence on retail prices.

While the systems I have just described may take a few years to perfect. I confidently expect it to be in widespread use by the end of the decade.

These breakthroughs, made possible by the wonders of technology and automation, can contribute to both better service and price stability, but not if our current, outmoded wage and price policy is permitted to continue in its present form.

Before we leave the subject of productivity, a word about the average businessman's fondness for the simplistic view that productivity in itself can cure inflation, or can play the major role in reaching that goal. This is as dangerous as relying solely on monetary and fiscal policy, and the result is the same: high unemployment. Increased productivity must be accompanied by increased production. If fewer and fewer workers produce more and more goods through increased productivity, there must be more production to create jobs for those displaced by the productivity increase.

The third element—and this is my main point this morning, Mr. Chairman—in a well-rounded inflation control policy requires an adequate and realistic incomes policy, and here is where we have a chance to exercise our creative faculties and develop a new and innovative approach.

Our present version of collective bargaining was born in pain and strife in the early decades of this century. It served its purposes well in those days when ancient and ingrained attitudes of management had to be drastically changed. What evolved was a state of industrial belligerency, with two adversaries gearing up periodically for total war. Labor, on the one hand, had the ultimate weapon of the strike, which threatened management with a cessation of production and a loss of profit. Management, on the other hand, had the lockout, and the ability to deprive the worker and his family of their livelihood. Frankly, it was a brutal trial by force. It was necessary in those desperate days, perhaps, but today we live in a very different world. Management is no longer necessarily a dinosaur, and the American worker is the envy of his counterparts in every part of the world.

I sincerely believe that we may be moving into an age where wars of every variety are becoming obsolete, and that includes trials by force across the bargaining table. The time has come to find a better way, a way in which no one loses and everyone gains—including the forgotten party in labor-management negotiations, the American consumer.

I observed a few minutes ago that the consumer, who has just as much to lose or to gain in labor negotiations as management or labor, is nevertheless the only one with no representation at the bargaining table. I submit that this is a major reason why the consumer's major concerns—price stability and continued availability of supply—are often given such short shrift during the collective-bargaining proceedings. It is time to remedy this economic injustice by providing the consumer with such a role.

That means giving an impartial third party, who represents the public, the decisive voice at the bargaining table, with proper safeguards written into the arrangement for both labor and management.

The present system of collective bargaining is a sham in many ways. The union invariably submits demands that are far in excess of the settlement they expect to get, and management on its part often puts up a proper show of intransigence until the 11th hour before a strike. at which time both parties get down to bargaining in earnest. During this process, the true merits of the situation are rarely made known to either the members of the union, the stockholders of the company, or the public at large. The company's actual ability to pay, the question of productivity, the degree to which the wage settlement will prove to be inflationary through increased prices or deflationary for other reasons—these great and important questions get little attention at the bargaining table and are rarely explained to consumers, stockholders, or union members. Thus, the settlement arrived at may well be different in many ways. And even when such a settlement is reached, and is presented to members of the union for ratification, this lack of understanding of the issues has foreseeable results. Very often—and this has been the rule rather than the exception lately—the agreed-upon settlement package, inflationary though it often is, is voted down by the membership and a much more inflationary settlement is demanded. Or stockholders or investors, with or without merit, may be dissatisfied, which is not good for the economy in the long run.

At one time, in the early days of unionism when workers were economically downtrodden, management held most of the cards. The union could not afford a costly strike, for its members' families would suffer great deprivation. Today, the situation is very different, if not reversed. Workers can, with some belt tightening, ride out a strike. But, at least in any industry like the food industry, which I know so well, management sometimes finds the cessation of cash flow and the halt in production to be catastrophic.

And so, increasingly in our industry, the pattern has been for management to capitulate at the threat of strike action, or shortly after a strike is called, no matter how inflationary the settlement might be. For, after all, management can pass on its increased costs to the consumer, and that is precisely what happens. So, labor has its increase, management recoups its endangered profits by passing the costs along, and the consumer bears the burden in the form of increased prices.

To bring this unfortunate scenario more into line with today's economic realities and requirements, I propose the adoption of the formula suggested by former Labor Secretary Shultz, as amended by another former Labor Secretary, W. Willard Wirtz.

Briefly, the Shultz formula would provide for compulsory arbitration through an impartial arbitrator who, in effect, would represent the consumer and the public and who would be agreeable to both labor and management.

The classic form of arbitration provides for the compromising of the demands of labor and the proposals of management—in reality, a sham, since both sides have already formulated their proposals with this down-the-middle approach in view. The union tends to enter this proceeding with a pie-in-the-sky approach and mangement tends to stand pat.

The Shultz formula is designed to encourage both sides to be more realistic, more reasonable, and more responsible. Instead of dividing the two proposals down the middle, the arbitrator would not have that right. He would have to select the one which he deemed to be the most reasonable and most responsible proposal in its entirety.

The Wirtz amendment proposes that this process be softened somewhat by giving each side an opportunity to reconsider its proposal after the other side's package has been put on the table, and I endorse that. It would be sort of a bidding contest before the arbitrator.

But once the arbitrator had made his decision, it would be binding on both labor and management.

I also favor the establishment of proper safeguards to insure that management does not take advantage of labor and of the public by unjustly raising prices during the period following the wage settlement.

This formula is not perfect, and there is not enough time here to go into the details of specific legislation. I would like to observe, however, that adequate protection must be built in for the wage earner who is not now participating fully in the American way of life. Workers who are earning less than what the Federal Government has designated as a "moderate" standard of living ought to retain in full their right to strike until such time as their wages have reached a more satisfactory level so that they can support their families and live in dignity.

In summary, my plea is brief. It is a plea for the separation of economic policy from the political and philosophical dogmas that have strangled our economic life in the past and are strangling it today. This is still a great and young country, and if properly harnessed, the energies of our people can mobilize our resources to provide a decent life for all without ruinous inflation or stagnation. In my respectful opinion, we can accomplish this if we develop all three elements which are necessary to the attainment of sound economic growth: an adequate fiscal policy, steady growth in productivity always balanced by comparable growth in production, and finally, an adequate and realistic incomes policy which includes a modernization of our archaic method of resolving labor disputes.

Thank you for giving me the privilege of appearing before you today.

Chairman PROXMIRE. Thank you, Mr. Danzansky, for a very fine statement.

Mrs. Esther Peterson is presently consumer adviser for the Giant Food Co. and has worn many hats during a distinguished public service career. She has served as Assistant Secretary of Labor, Director of the Woman's Bureau, chairman of an interdepartmental committee on the status of women; Chairman of the President's Commission on Consumer Interests; and from 1964 to 1967, Special Assistant to the President for Consumer Affairs.

Mrs. Peterson, I believe that during most of the sixties, you were holding down two or three of these jobs simultaneously. It is difficult to imagine a background which would better qualify anyone to speak on how changing economic conditions affect individuals and families, especially in their role as consumers. We appreciate your meeting with us this morning.

In deference to our shared belief in the full equality of women, we think it is proper that Mr. Danzansky went first. We did not want you to feel you were going first because you were a lady.

STATEMENT OF ESTHER PETERSON, CONSUMER ADVISER TO THE PRESIDENT, GIANT FOOD, INC.

Mrs. PETERSON. I am all for it. I was afraid he might fire me for being late.

Chairman PROXMIRE. We didn't do much about that equality between employer and employee. Mr. Danzansky has a proposal for that.

Mrs. PETERSON. I am honored to appear before you. I am especially pleased to have a chance to appear before you, Senator Proxmire. You have given leadership to consumer interests and have contributed markedly to the consumers' well-being. I am happy to give my observations and to discuss them with you.

I want to say right off that I am not an economist. The facts and figures are available and if you want them supplied on those areas of my interest, I will be glad to get them for you.

Chairman PROXMIRE. May I say, Mrs. Peterson, if you want to abbreviate the prepared statement, the entire prepared statement will be printed in the full in the record.

Mrs. PETERSON. Fine, but I would like to speak from it, if I may.

I would like to say I speak not only from my experience in government, but also from the experience of a consumer who has spent my whole life in a range of consumer experience—having grown up on a farm, where we grew everything, we made everything, even the flour from our wheat to be made into bread. I came from that background to this day, from the era of the corner grocery store with a hundred or so items, to a big chain with 8,000 or 9,000 items; from the time when we prepared everything at home to now, when grandma's pies are made by the thousands. In this span, I have personally experienced the changes affecting the food industry.

Thus, I know inflation. When I talk about the impact of inflation on people, I know what this is. It is real, it is a serious thing. It is agony to the low-income people. It is despair to the elderly and it is a cause of dissention in young families and very often leads to a lot of breakups. It is awful misery for the unemployed.

The retail grocer knows long before other people how inflation is felt. That cash register is a very sensitive instrument. We women shop at least once a week, and we are aware of the prices that go up. We register our feelings at the cash register. We are very, very aware.

The poor have to spend proportionately more of their income than the more affluent. Higher costs are certainly an inconvenience to the affluent, but an intolerable burden for the lower income people. A 10-percent hike in food costs can cause a middle-income family to shift 1 percent in spending preferences. The poor, however, must transfer maybe 4 percent or more, probably, and lower the nutritional quality of their diet.

The retail level hears of these problems very, very early. I notice the reactions of the people in Giant who buy—who do the purchasing—are just the same as the housewives. These men come in and say, "look at these increases," and they show me the letters from suppliers. Here is one of them, for example.

"By this time," one supplier writes, "I am sure you have received numerous letters advising of price increases effective January 1, 1971. Regretfully, we must add ours to the list."

There are piles of these letters. Interestingly the reaction of our purchasers is the same as I hear in the store aisles from the housewife: "What do they think they are doing to us, do they think we can absorb this? Do they think we can pass it on?"

These letters from suppliers are filled with sad laments of higher labor costs, rising transportation charges, increasing packaging costs.

What it does mean is that the people who must ultimately bell the cat—that is, the retailer who must pass the rising costs to the American consumers—are disturbed. It is clear the leaders of this industry are not going to be content merely to pass increases along. They are going to be searching for other ways than merely passing along the costs. They are going to seek changes in a Government and in a system which now produces, processes, and moves the food that we eat.

I believe there is some evidence that those who largely make food policy for the Nation, the Agricultural Committees, the Congress and the administration, are out of step with the American people. Americans are concerned over food policy. We measure our health by its abundance and our sense of brotherhood by its use. To observe the action of the Congress and the administration last session, one who was not close to the debate would be led to believe that the two great food policy issues are that the farmer, who represents fewer than 5 percent of the American people, isn't getting what he deserves—and this, for the small farmer, I believe is true—and that some people, like the poor, are getting more than they deserve—and this I believe is not true. But these are not the great issues.

Anyone who has spent any time talking with consumers, however, would know they are more concerned that food prices over the past 4 years are up, and that the typical family believes it needs to spend at least 26 percent more to maintain the same food preferences as in 1966.

The problem today is not lack of abundance, but improper use of that abundance. People are concerned that large segments of our population are denied access to that abundance for a variety of social, political, and economic reasons.

They are concerned because much of the nutritive value of the foods we buy has been removed during manufacture and packaging.

They are concerned because our food supply is being poisoned by additives which have not been thoroughly tested for safety, by thought-less use of pesticides and fertilizers, and by industrial runoff into our waterways.

They are concerned that the average citizen is given so little information about these things.

And finally, they are concerned about the impact of inflation on the quality of their diet, for as the number of available dollars in the family income decreases, one of the first expenditures to be cut is that for food. Unfortunately, the cuts are usually at the expense of the more nutritious foods.

Much of our outmoded food policy is a major factor in increasing food prices for the consumer. For example, both dairy products and meat are protected from foreign competition by rigid quota systems.

The USDA sets prices for fluid milk through a veritable monopoly procedure which effectively denies any consumer participation. Fruits and vegetables are now produced under Federal marketing orders which in the guise of quality control, limit supply and thus keep prices high. Government-sponsored monopolies are more deplorable than private monopolies, since there is at least some check on the latter.

The real policy intent of these practices is to raise prices, which is unfortunate enough, but even worse, the impact falls most heavily on low-income families who can bear it least. For example, the meat imports which are frequently barred are those which are processed into meat products, such as ground beef and lunch meats. These are staples of poor families, providing nutritious protein at a much lower cost than steaks, chops, and roasts.

Another immediate consequence of our present food policy will be that the cost of food will continue to go up under pressure of manufacturing and marketing practices of producers that are not related to our food needs.

The packaging of many food products is designed to enhance appearance, not to give you essential facts which a shopper should have in order to make a reasonable buying decision. As long as food policy in Government appears concerned only with the economic health of producers, the health of consumers will take a back seat to marketing problems in the food industry.

Just one of those marketing problems which does little except add to the cost of food is the introduction, promotion, and advertising of new products—or what is described as new.

There is very little really new—frozen orange juice, instant mashed potatos, and now a new milk curd product, are the main really new products. But hundreds come out as new and 80 percent of them never sell. The cost of all this wheel-spinning, of course, is passed on to the consumer and to the taxpayer.

There is nothing wrong with research or with new products, but again, we need to readjust our thinking. Why can't we have research and development aimed at finding ways to use our agricultural abundance to nutritionally fortify those existing foods? The fried milk curd was developed by the Agriculture Department to find new markets for milk and dairy products. Something is wrong when we have to find new markets for milk with a substantial part of our whole population either ill-fed through the consumption of empty calory foods, or too poor to purchase a balanced diet. Why can't that excess milk be processed into the foods people want to eat, and why can't we see to it that the poor have an opportunity to get the milk they need for their families?

The health of the citizen and the impact of food policy on his pocketbook also are entwined in the failure of his Government to develop food standards which relate to the nutritional value of the food we eat, and the failure of the industry to promote such standards. It is ironic that one can find on the label the nutritional content of food for one's dogs and cats, but similar information is not available on food for our children.

Until recently, the American people thought that a hotdog was a form of meat, a source of protein. Only when proposals were made, and eventually adopted, to limit the amount of fat to 30 percent, did the consumer learn that over the years animal fat had been substituted for meat. The consumer was not only receiving less protein for her food dollar than she believed, but more fat in a diet already too rich in fat. Without standards, there is too frequently steadily diminishing quality. Expensive ingredients are lessened, and inexpensive fillers put in their place.

This same problem with processed foods will occur again and again, with increasing frequency as the American family spends less time in the kitchen and more time purchasing fully processed food dishes and meals. The old definition of food quality, which is simply that "food must be pleasing to the eye and taste," is hardly adequate any longer to protect the health or the pocketbook of the American citizen.

The recently announced efforts of the Food and Drug Administration to begin developing nutritional standards for food, and labeling requirements to go along with them, is a step in the right direction. However, if these standards are just guidelines, and not required minimum levels, the consumer will be no better off than before.

It is, or should be, clear that the food problems which concern the Nation today are those which involve the processing and distribution of food and not only the production. If the Nation's food policy continues to emphasize the latter while ignoring the former, the citizens will continue to be subject to the same abuses they now suffer.

There must be a better and more equitable way to set food policy. It is not necessary that we battle one another as adversaries, but it is necessary that all parties be able to influence policy. Policy formulation must not be one-sided.

This obviously will require a new definition of priorities within Congress and the administration. It also will require a specific commitment that people will be involved continuously and directly in decisions which are now made without them.

Stability in food prices will be easier to achieve once more enlightened and more progressive practices become the accepted framework within which the food industry competes, replacing the gimmicks, games, and gadgets which did little else than raise the cost without adding to the nutrition of what we buy.

We have begun these reforms at Giant. Unit pricing, open dating, and informative labeling will compensate for many of the failures of the truth-in-packaging bill. And best of all, the consumer won't have to pay for them, for they help management to run a tighter ship.

Some sections of the food industry have begun these reforms, and now changes in public policy must also begin. In effect, inflation in food is as deep seated as poverty in our society, and we have done no better in trying to cope with it.

Food prices, like all prices, reflect the health or sickness of the total economy. Sound fiscal polices are the underpinning of a healthy economy, but the impact of inflation on the American diet, both qualitatively and quantitatively, will not be solved by juggling interest rates, income policy, or by using other economic remedies. Those things obviously will help, but the real problem lies in the willingness of the Congress and the President to make food policy relevant to food problems and the concerns being felt by the American people.

Thank you.

Chairman PROXMIRE. Thank you very much, Mrs. Peterson.

I would like to ask you, Mr. Danzansky, your statement came down very hard on the problem of sharp increases in wage costs in the distribution phase of the food industry. This is most helpful, because we have not had testimony in this area. As you and Mrs. Peterson both pointed out, food, of course, is an enormous item in the consumer's budget and often a decisive item in the cost of living. You seem to feel that a large part of the problem was this question of strikes and settlements which do not seem to work out very well for anybody. Yesterday, we had Leonard Woodcock, the head of UAW; and I think a wise and capable union leader. It was brought out in the process of the discussion then that in the last 2 years, the wages of people in manufacturing have declined in real terms, that is allowing for inflation, increased taxes—local taxes especially—real wages have declined about 6 percent, in spite of the fact that there have been strikes. It is hard to see how the workers themselves have been able to benefit from the present system of determining wages.

But you come to a solution here which would be very hard, it seems to me, for the Congress to accept if I follow your recommendation. You suggest arbitration along the lines suggested, you say, by two Secretaries of Labor. Would this be compulsory arbitration?

Mr. DANZANSKY. Yes, sir.

Chairman PROXMIRE. Compulsory, binding arbitration?

Mr. DANZANSKY. Yes, sir; it would be written into every contract.

Chairman PROXMIRE. What happens to the right to strike?

Mr. DANZANSKY. There wouldn't be a right to strike.

Chairman PROXMIRE. When you do this in the food distribution industry—food is a very vital commodity, but strikes have not kept people from getting food. What happens at the present time, as you know far better than I do, is that it is devastating for the firm that has its employees go out on strike, but there are other food outlets where people can buy their food.

Mr. DANZANSKY. This is becoming increasingly less true, Mr. Chairman, in that industry is now bargaining together. Unions prefer it together that way, too. So when one is shut down, they are all shut down.

Chairman PROXMIRE. Do you know of any city in the country, any place where a strike has prevented people from getting food?

Mr. DANZANSKY. Oh, yes, sir; not too long ago in Baltimore that was true.

Chairman PROXMIRE. They did not have any food at all?

Mr. DANZANSKY. Well, you have your mom and pop stores. No. 1, they could not possibly take care of the consumer during the work stoppage and during the closing of the stores.

No. 2, if they did take care of them, it would have to be at a greatly increased price to the consumer, because their costs are higher, the mom and pop store costs are higher.

Chairman PROXMIRE. It would seem to me that you could make a strong case for compulsory arbitration in areas that affect the public health and safety, like police, firemen, possibly medical technicians, hospital employees. But if you are going to get into the area of supermarkets, it seems to me that you are just going to abolish what many people consider to be a pretty vital and almost a sacred right.

Mr. DANZANSKY. Well, now, this right need not continue beyond the current inflationary problem. This is a manner in which we can attack inflation. Because what we do, what our little company does affects the entire economy. Now, I am not crying wolf—we are not that small—we do about $450 million worth of business in this region. But we cannot afford to close our doors. We would lose a $9-million-a-week cash flow. Now, we pay our bills with this cash flow. If that is cut off——

Chairman PROXMIRE. What you are saying is that your employees, your union, can threaten to strike?

Mr. DANZANSKY. That is right.

Chairman PROXMIRE. But you just have to settle because you are in a position where you have no alternative. You just could not permit a strike?

Mr. DANZANSKY. That is right.

Chairman PROXMIRE. So they can hold you up for whatever they wish?

Mr. DANZANSKY. That is right. And the union people know this. What we do in this city—we call this Giant country—the other chains must do. And what they do in this city, they must do everything in the Nation, and this thing just grows.

Now if, during this emergency, during this terrible inflationary period that we are going through, if we were to say, OK, anyone who is not making $9,000 a year, $8,000 or $10,000—I don't care what the number is, because everyone should have the right to strike up to the point where he has a living wage for himself and his family and is able to educate his children. I do not wish to deny anyone in substandard industries that kind of a right. But in those industries where they already are making a living wage—I am not saying do not give them an increase, but give them the kind of an increase that an impartial arbitrator says is fair in view of the total economic picture of the city or the county or the Nation.

Chairman PROXMIRE. Today, in Wisconsin, we have a law which flatly prohibits a policeman from going out on strike. Well, the Milwaukee policemen are calling in sick. They are not working. The Governor is considering calling out the National Guard in order to provide law enforcement protection in Milwaukee.

Now, this is what happens. As you know, they had compulsory arbitration in Australia. We discussed that with Mr. Woodcock yesterday. In the view of many people, that did not work out very satisfactorily.

I am just not sure, even if we did pass a law, that we would prevent strikes or the equivalent of strikes—slowdowns, sickdowns, whatever you want to call them.

Mr. DANZANSKY. All that is possible. One can't possibly legislate against anarchy, I guess. You can have it on the books and if people choose to be anarchists or lawbreakers, that is their choice.

Chairman PROXMIRE. You see, these policemen are asking—I do not suppose they expect to get that—that patrolmen have an annual salary of $20,000 a year. That is far from the $8,000 or $10,000 you are talking about. They already get more than that.

Mr. DANZANSKY. And maybe the $8,000 or $10,000 should be $12,000. I am not arguing that point. I think everyone should make a living wage. But I do not think anyone should have the right to distress and disturb our total economic picture, as is happening today. I do not blame the worker. I do not blame him because he is in the midst of this spiral. All I want to do is to be sure that the consumer is represented, knows what is going on, that in fact the worker himself knows what goes on, that the stockholders of these companies know what is going on, and that something fair is imposed if the parties can't get together on it.

Chairman PROXMIRE. I just wonder how important this is going to be a few years from now. You just told us about a facinating technological revolution. You told us you expect to have your stores automated to such an extent that you will have, in effect, fewer workers. You are even going to have automated checkout counters, a situation where the number of people working is going to be far less.

Mr. DANZANSKY. Yes.

Chairman PROXMIRE. I take it, No. 1, one of the reasons you are taking this position is because of the increase in pay. I think this has been one of the great forces of efficiency in American industry, the fact that the unions have negotiated big increases and as a result, there is a clear incentive for management to put in labor-saving equipment. When you do that, you are doing it partly because wages have gone up, No. 1, and No. 2, when you move in the direction you say you expect to move in very rapidly—you are all ready to move in with automated checkout counters—when you move in that direction, you are going to have a smaller impact from wage increases on prices, are you not?

Mr. DANZANSKY. Yes.

Chairman PROXMIRE. Since you will have a capital-intensive, far less labor-intensive operation.

Mr. DANZANSKY. Yes, that is possible per unit, but hopefully, we will all have more stores and give better service.

Chairman PROXMIRE. I am not saying there is anything wrong with it. I am saying does that not solve your problem in part, rather than pass legislation which might be considered to destroy the right to strike?

Mr. DANZANSKY. It is also destroying the right to lock you out.

Chairman PROXMIRE. You are going in the direction where you won't need that in a few years, anyway.

Mr. DANZANSKY. It also destroys the right to lock out. It is a two-way street. At that point, management is forced to give the increase that the arbitrator says is fair in view of all the circumstances. He is forced to give it, whereas otherwise, he might not give it. So it is really a two-way street. Labor could be gaining just as much from this as management.

Too often we are finding today that even after a collective-bargaining agreement has been arrived at in good faith between the elected leaders of a labor union and the management, the workers have refuted what the leader has done. In our town, this was done because the fellow was up for reelection and the people working against him were not going to allow any settlement to go through. That quirk of having that election come up at a time when these contracts expired I think has had an inflationary effect on food throughout this entire Nation.

Chairman PROXMIRE. I think you earlier put your finger on the critical factor. After all, if your union knows you are not going to fight, if they threaten to strike to get what they want—after all, they are human, they want more money. Everybody wants more money. You would do it if you wanted more money.

Mr. DANZANSKY. I certainly would.

Chairman PROXMIRE. The reason for the slight improvement in the Consumer Price Index has been very largely because of the slowdown in the food price index. Other items in the consumer index are rising as rapidly as ever. Thus the food price outlook has great importance in what is going to happen in inflation. As one of the top men in the country in food distribution, what is your view on the food price outlook?

Mr. DANZANSKY. First, I would like to say, Mr. Chairman, that I am extremely proud of the food industry, the retail take-home food industry of this Nation. The information that I have is that immediately after World War II, 26 percent of the disposable income of the American consumer went for retail food. Now, that was good in those days, because that compared with something like 50 percent in Europe. Today, the retail take-home food industry, which is basically the chain stores of the Nation, take only 16 percent of the disposable income of the American consumer. So if there is inflation in the country, it is not because of the retail food industry and its great system of distribution.

Now, I have gotten the pitch in. Now, just specifically to answer your question about the future, yes, I think price rises are inevitable—inevitable.

Chairman PROXMIRE. What do you mean by—I know price rises are inevitable. They are going to go up in everything. The question is, how fast? Do you anticipate they will go up faster in the next year than they have in the past year or so?

Mr. DANZANSKY. Let me give you an example. In our company, we went through a quarter—3 months ago—our first loss in history, in the history of our company. That was a combination of a lot of circumstances, primarily wage increases and the fact that we went into a discount program, which is a great competitive thing in this Nation.

Now, we gradually are pulling out of this dilemma and while we are not earning as much as we did last year, we are earning dollars today.

Now wages are roughly 10 percent of our total income. If we are to give a 30 percent, and we just gave a 32 percent wage increase for a 2-year contract to our employees.

Chairman PROXMIRE. An average of 16 percent per year?

Mr. DANZANSKY. Yes, sir. For our little company, that is $7.5 million a year.

Chairman PROXMIRE. I can see why you were able to hire Esther Peterson, with wages like that.

Mr. DANZANSKY. At any rate, we are delighted to have her. She is just great and she has brought a lot of wonderful, new, innovative ideas to our board. But when we have this increase, when you have the 30 percent increase—just to make the arithmetic easy—on top of 10 percent of your total cost going for labor, that makes 3 percent. You need a 3 percent price increase in retail prices in order just to take care of those labor increases.

Chairman PROXMIRE. Unless you have what you have just been describing, an increase in your efficiency.

Mr. DANZANSKY. An increased productivity, which we do not have.

Chairman PROXMIRE. But which you expect to get shortly?

Mr. DANZANSKY. We hope so. But we are going to pay for that, too. There is going to be a tremendous capital investment.

Chairman PROXMIRE. But overall, allowing for the increased capital costs, you will have a reduction in your costs and be able to pass that on to the consumer.

Mr. DANZANSKY. I want to make one point clear: I am not opposed to labor getting increased wages. I am all for it. I think they must keep pace and I am not sad about the 30 percent which they got. All I am saying is that the American consumer must recognize the job that has been done by the retail food industry and not condemn them for increasing prices on top of these increased wages. Plus the fact that in order to prevent these freaks—and they occur throughout the Nation, and whatever happens in Washington will happen in Baltimore or Philadelphia or New York—if we do write into our contracts during this period of emergency—and it would only be emergency legislation—an absolute compulsory arbitration for all those industries where the worker is getting more than *x* dollars a year, which is considered to be a living wage, I think it would go a long way toward producing price stabiltiy for the consumer. The consumer would sit at the bargaining table with us. We are not trying to pull the wool over labor's eyes, we are not trying to get anything that we do not deserve. And by the very same token, we have to pay more than we otherwise would pay as a result of this.

Chairman PROXMIRE. As you know, there has been strong opposition, not only on the part of labor but on the part of management, to compulsory arbitration. It is good and refreshing to get an industrial leader who comes before us and makes this kind of proposal. But it does have a rocky road to go.

Mr. DANZANSKY. It does. In talking to Secretary Wirtz about it, he said "Don't call it compulsory arbitration, call it mediation to finality, because compulsory arbitration is anathema to legislators."

Chairman PROXMIRE. I must say, Mrs. Peterson, your statement was a remarkable statement for one who is now employed in the food distribution industry. You stressed the failures honestly and realistically of the food industry with respect to nutrition and of course, when you were a national public official you did a great job to help rectify that. You are still working on it. I do not mean that you indicated any derogation of Giant. Evidently they are doing well. But you indicated there is still a long way to go in this industry.

There is some difference, of course, in the testimony between you and Mr. Danzansky. You put great emphasis on the very serious effect of higher food prices on inflation, and Mr. Danzansky pointed out to us that only 16 percent of the consumer's dollar is going into food. This is not only the best bargain in the world by far—about half of what they pay in Europe, about a third of what they pay in Russia—but it is infinitely better than what it was 10 or 15 years ago. So food is now much cheaper. And I think that is not just because of the excellent job and the retailing revolution and distribution, but the remarkable job the farmers have done and the American farm program has done.

Mr. DANZANSKY. Amen. You are right.

Chairman PROXMIRE. People have been criticizing this farm program and the handout to the farmer. Actually, the big beneficiary has been the American consumer.

Would you acknowledge, Mrs. Peterson?

Mrs. PETERSON. I have no problem with that general concept. As I have said, I think that is true. I think we have to look at it also in terms of the percentage of the disposable income that is being spent by the consumer. For the person who is in the low-income bracket, the cost of food is still a lot of money. What I am trying to point out is that we can pass efficiencies to consumers by seeing we do not have a lot of wheel spinning, of unnecessary kinds of expenditures, and can still better improve the conditions in stores for consumers.

I would like to add, and I think this is partly because of the progressive attitude of a lot of our Washington food retailers, but the price index for food in Washington has not increased over the last year to the same extent that it has over the country; in fact, it has decreased. I would like to insert in the record some statistics on that when I review the transcript.

(The following statistics were subsequently supplied for the record:)

TABLE 1.—FOOD AT HOME CONSUMER PRICE INDEX (PERCENT CHANGE FROM 3 MONTHS AGO)

	United States	Washington, D.C.
November 1969	0.2	−1.6
February 1970	2.9	4.2
May 1970	.3	−1.1
August 1970	.6	−.7
November 1970	−1.3	−2.6

Source: U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C., January 1971.

TABLE 2.—PERCENT CHANGES IN THE CONSUMER PRICE INDEX FOR FOOD AT HOME FOR THE UNITED STATES AND WASHINGTON, D.C., NOVEMBER 1969 TO NOVEMBER 1970

Group	November 1969 to February 1970		February 1970 to May 1970		May 1970 to August 1970		August 1970 to November 1970		November 1969 to November 1970	
	United States	District of Columbia	United States	District of Columbia	United States	District of Columbia	United States	District of Columbia	United States	District of Columbia
Food at home	2.9	4.2	0.3	−1.1	0.6	−0.7	−1.3	−2.6	2.5	−0.3
Cereals and bakery products	1.8	7.1	1.3	2.0	1.6	1.0	1.3	−1.4	6.2	8.8
Meats, poultry, and fish	2.0	2.6	0.6	−3.4	0.4	−1.3	−3.0	−2.2	−0.1	−4.4
Dairy products	2.0	1.8	0.9	1.2	0.7	−0.4	1.2	−0.2	4.8	2.5
Fruits and vegetables	4.3	6.0	3.3	3.7	−1.3	−2.8	−4.8	−6.5	1.2	−0.2
Other foods at home	4.6	5.4	−3.7	−3.6	2.1	0.4	0.7	−2.2	3.5	−0.2

Source: U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C., January 1971.

Chairman PROXMIRE. To the extent that there has been a rise in food prices over the country in the past few years, what would you say is the reason for that? Over the last 2 or 3 years.

Mrs. PETERSON. I think it is part of all the inflationary problem.

Chairman PROXMIRE. Then you go back, so either the farmer is getting more—the parity ratio we have here indicates he is not—after all, he only gets about 35 cents of the housewife's dollar—or the wholesaler is getting more, or you have other costs in distribution in addition to wages and the food that you buy, which are increasing. Is this all along the line?

Mrs. PETERSON. The distribution process——

Mr. DANZANSKY. Our industry is delighted with a 1-percent net profit after taxes. If you take this whole industry and boil it down, we are operating at less than that today. You take this whole industry and boil it down and we wind up with less than 1 percent. Even in the best times, it was never more than 1.3 or 1.4 percent.

Chairman PROXMIRE. Let me ask you, Mrs. Peterson, you said something which I would like to either challenge or have you corroborate. What evidence do you have that food is one of the first items to be cut as income drops? I think this contradicts most views. People have to eat.

Mrs. PETERSON. I talked about the nutritional quality of the food that is dropped.

For example, I have been meeting with some of the people here in the District.

Chairman PROXMIRE. You may well be right.

Mrs. PETERSON. Yes. For example, they will buy the cheaper starchier foods rather than the nutritious protein foods.

Chairman PROXMIRE. What kind of studies have been made on that? I have also heard testimony that the cheap foods that you buy, the less expensive foods, are often more nutritious.

Mrs. PETERSON. Some of them are. It is a matter of nutritional quality.

Chairman PROXMIRE. Do you find, for example, as people's incomes drop, they buy less milk, fewer fruits and vegetables?

Mrs. PETERSON. And fewer meats and the protein; yes. This has been true.

I met last week with some of the home economists working with the poverty groups——

Chairman PROXMIRE. Is this done on the basis of a careful, objective, so-called scientific inquiry, or is it a guess?

Mrs. PETERSON. There are some and it would be helpful to look at them. I know from my own observations and from talking with people that this is the story.

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

So far as I know, there are no published studies to indicate that the food budget is the first expenditure item to suffer when family income drops. However, there are several unpublished studies made in connection with the Federal food stamp program which demonstrate this fact; and there are other studies made to test the reason why families do not participate in the food stamp program which show the same result.

The USDA studies were made to determine what the families in specific income categories should be expected to pay in order to receive bonus food coupons from the Federal government. While each income category spent an average amount for food, lower income levels spent proportionately more for food—for example, over 40 percent, on the average, for the very low income groups; individual families varied greatly as to the percentage being spent at the time the survey was being made. This indicates that while taste and skill in menu planning may vary, other forces than the demand for food were at work. On subsequent interviews, it was found that poor families will vary the level of food expenditure depending on the demands being felt from other elements of the life style. When rent is due, it has to be paid. Medical care is available, but it often has to be paid in advance. Utilities must be paid, or they will be cut off. Thus, in a week when fixed costs must be met, a family that cannot quite meet all its bills will go short on the food budget and hope to make it up next week.

Other studies of food stamp participants, or those eligible to participate, confirm the essential character of these observations. Families complain they cannot afford the stamps because other fixed expenses take too great a part of the available cash for living expenses at certain times. The only alternative is to drop out of the program, or not to enter it.

Chairman PROXMIRE. One of the shocking developments we have had is the nutritional deterioration of the diet of people with good incomes. You find that so many young people, especially girls, but girls and boys both in schools, even though their parents have good incomes, they are just eating very badly.

Mrs. PETERSON. This goes equally for rich and poor.

Chairman PROXMIRE. It is not a matter of income, it is a matter of taste and advertising.

Mrs. PETERSON. Exactly, and from not knowing. One of the interesting things now is the development of nutritional snacks and fortified foods, especially the cheaper foods, the macaronies and other grain and cereal products, to put in more protein. But a lot of nutrition education needs to take place at the same time.

Mr. DANZANSKY. I might say, Mr. Chairman, the Department of Agriculture and the food industry are cooperating on a nutrition awareness program and hopefully, this will bear some good fruit.

Chairman PROXMIRE. Very good.

I want to thank you both, Mr. Danzansky and Mrs. Peterson, for excellent testimony, most useful to us.

Mr. DANZANSKY. We thank you, sir, for your courtesy.

Mrs. PETERSON. We appreciate that.

Chairman PROXMIRE. Mrs. Peterson, would you come up here, please? I saw Mr. Danzansky grasp that briefcase and knowing he is the head of Giant Food and also active in the Board of Trade, I figured there must be something else he has to rush for.

Mr. DANZANSKY. You are very kind, but I have to listen to what Esther says. That is part of our contract.

Mrs. PETERSON. I must say this experience—which I never thought I would have—of being inside a corporation has been instructive and rewarding. I am very honored and pleased to be associated with this firm. It has this great feeling of social responsibility, of wanting to carry out the plans that not only benefit themselves and the stockholders, but also benefit the consumers as well. It is a great experience for me.

Chairman PROXMIRE. May I ask you this, Mrs. Peterson. As the No. 1 consumer representative in our Government for a number of years, and as one who fought very, very hard to impose some pretty tough disciplines that were vigorously resisted by industry, the food industry particularly, in truth-in-packaging and so forth, is it your feeling that that legislation that has been passed is fair and practical and effective?

Mrs. PETERSON. The truth-in-packaging legislation?

Chairman PROXMIRE. Yes.

Mrs. PETERSON. When it finally came out, it was not in the form we wanted. It was greatly weakened during the legislative process. Unit cost labeling, standard package sizes, limits on the number of sizes, all these were cut out by Congress. The act does not go far enough for the consumer. This, of course, is why I am so interested to see how the failures of the packaging bill can be overcome voluntarily. That is what is happening now at Giant, that is what we are finding.

I guess it is fair as far as it goes, but one difficulty is that it was not given appropriations, it was a stepchild, as far as——

Chairman PROXMIRE. Supposing you tell us just what additional steps we need and how much additional money we need? This is so important for the American consumer and it is so important in coping effectively with inflation. And of course, it affects not only food, it affects other industries as well.

Mrs. PETERSON. Exactly.

On the money end of it as far as appropriations go, I think certainly that the FDA or the FTC must be given sufficient funding to carry out the mandate of Congress.

Chairman PROXMIRE. You say it is not being enforced?

Mrs. PETERSON. They cannot. The agencies have not asked for the staff to operate the program. They have two people to enforce regulations on the size of type on a label and the requirement that the address of the manufacturer be included on the label. It is impossible for them to do the job.

The lack of appropriations and the lack of staff are the basic reasons. The bill was passed in 1967. We still do not have operating regulations, for example, on "cents off," promotions which have been such a nuisance to people. We still do not have regulations relative to the proliferation of package sizes. The Department of Commerce is making an effort but the changes have been only in nonfood items. All of these practices add a good deal to the cost. When you go through the warehouses and see how they have to keep track of all the different sizes of different products, then you see how all of this adds to the cost paid by consumers.

Certainly we need more staff and more appropriations. It is one thing to pass a law, but it is lip service if we do not give the tools to enforce it.

Chairman PROXMIRE. How do you envisage now an effective truth-in-packaging law? You say when you have two people for the entire country—you obviously should not have, and in my view should not have a huge bureaucracy checking everything sold by every store everyday. What do you need to do this effectively within a limited amount, but to give the housewife some reasonable protection?

Mrs. PETERSON. Each agency has said what they need. But certainly they need more than a staff of two. I know administering some laws under my jurisdiction in the Labor Department it takes over 4,000 people to handle wage and labor standards. The USDA requires over 8,000 people to inspect only meat and poultry. It is hard to say in specific numbers, but I would certainly want to begin with at least 10 to 20 people to prepare regulations, procedures and guidelines, and far more than that for the actual enforcement.

Chairman PROXMIRE. How about the labeling laws? You spoke in your testimony about how the so-called enrichment of bread is deceptive, that they take out of bread more than they put into it. Did you say that?

Mrs. PETERSON. Yes, I did.

Chairman PROXMIRE. That has been my understanding. It breaks my heart when I see my little 9-year-old boy eating white bread. No matter what they say about it, I can't believe it is going to make him grow as they show on television.

Mrs. PETERSON. This again is where I think we have to have tighter labeling regulations. There is authority to ask and to see whether producers put the ingredients on. But it has not been pressed. There are always reasons for not doing it.

Chairman PROXMIRE. Is the reason for not doing it because of lack of money?

Mrs. PETERSON. Frankly, it is not wanting—shall I put it bluntly—not wanting the consumer to really understand what is in a product, probably for competitive advantage.

Chairman PROXMIRE. This is incredible. There is a lack on the part of what department? After all, you say a law has been passed, enacted, Congress has done its job as far as putting the law on the books.

Mrs. PETERSON. Authority for fair packaging and labeling is divided between the Federal Trade Commission, the Food and Drug Administration; the Department of Agriculture also has authority over meat and meat products. The responsibility is broken up in the various phases in which each agency works. A lot could be done already with the authority that is there. The Food and Drug Administration is pressing for nutritional labeling, and I am sure we will be able to get that done, probably with some voluntary assistance from industry, as we are trying to do at Giant. Eventually there may be need for stronger regulations. But this can come later.

Chairman PROXMIRE. I would appreciate it very much if when you review your remarks for the record, you could put anything into the record that you would like, indicating what you think should be done to make this labeling effective, with respect to pulling together into one agency or providing oversight by one agency or fixing the responsibility on one person or one group.

Mrs. PETERSON. That, of course, is the big job. I will be glad to look into that. But I think also of the legislation that was before Congress last year. To set up an agency, you see, is extremely important. That kind of agency could really look and assist in carrying out the wishes of those laws.

Chairman PROXMIRE. Well, I want to thank you very, very much. You did very well the first time, you did extremely well the second time. You are a real doubleheader all by yourself.

Mrs. PETERSON. Thank you.

Chairman PROXMIRE. Our next witness is Representative Michael J. Harrington, who represents the Sixth District of Massachusetts.

I see he is not here yet.

Esther, you are just great, we appreciate it. If you would like to add something, you have 60 seconds to do so.

Mrs. PETERSON. I will be very glad to put in some supplemental material on that very complicated measure of the bill.

Chairman PROXMIRE. Truth-in-packaging and labeling.

Mrs. PETERSON. And labeling. Very definitely authority is needed. But I think it is also important for Congress to consider the need for overall consumer representation. The bill that would set up an independent agency as a place of authority to look over the shoulder of the agencies and to intervene in policy and regulatory matters did not pass. This agency should be responsible to Congress and come to Congress directly for its appropriations. That is the sort of overall authority that I think is badly needed and will not be available from the Justice Department as was proposed by the administration.

Chairman PROXMIRE. Mr. Harrington is here, but let me ask you one question before he comes up because this is something I have a special interest in. We have a health nut on the staff and I am kind of a health nut myself. Cornell University came out with a wheat-germ bread. The FDA, I understand, would not let them call it bread on grounds that it was too good. Do you know whether this is true or not?

Mrs. PETERSON. I think that is shocking, frankly. I think we really have to be honest. That is the whole thing the consumers want today, honesty. Let's tell what is in it, let's have full disclosure of ingredients; let's know. Then I think we will compete on the basis of quality, not compete on what people do not know.

Chairman PROXMIRE. Very good. Thank you very much.

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

RESPONSE OF ESTHER PETERSON TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN PROXMIRE

Question 1. You argue in your statement that the basic problem in the food industry is "that food policy in government appears concerned only with the economic health of producers." Could you elaborate on what you mean by that? Are you referring to farm policy, or to the regulatory policy of agencies such as the FDA and the FTC, or to the lack of a consumer affairs agency, or to all of these?

Answer. You ask what I mean when I say that "food policy in government appears concerned only with the economic health of producers." The answer is somewhat complex, and may be long, but I will try to be brief.

If we look at what happened in the last session of Congress there is both an immediate and direct, as well as a less direct, evaluation which can be assessed. Congress enacted a major farm bill which continued the combined direct payment and price support technique to support farm income. In addition, the bill revised the milk marketing program for dairy farmers by granting dairymen in the immediate area around a metropolitan area (a milkshed, in technical terms) the right to establish shares of that market which can be sold or passed on to their children. It creates a property right where none existed. The marketing order concept was extended to producers of other farm commodities, both to provide checkoffs for promotion activities and to allow certain types of products to be legally withheld from the market. While these legal monopolies provide for farmer representation, other individual consumers affected by these actions are given no voice in policy. Although the Secretary of Agriculture is considered under law to represent the public—or consumer—interests, the record is barren where he has taken action contrary to the wishes of the producer committees in the operation of the various marketing orders. While the Congress was enacting all these laws to benefit producers, it was holding back a bill extending the food stamp program which, in some versions, would have established the right to an adequate diet for those who could not otherwise afford one. However, by the time the Congress had rushed the food stamp legislation through its machinery in a last minute effort, the poor found that the Congress had placed a forced labor requirement on the access to the food abundance we so proudly hail.

Thus, in the one instance, Congress created a property right for one class of Americans, and created a new form of degradation for another class of citizen.

This is the immediate and direct evaluation one can make. The less direct and less obvious evaluation is in wondering what this implies in priorities. Congress enacted legislation which commits the Federal government to spend at least $3.5 billion to $4 billion a year to ensure the American people will be able to enjoy the abundance of food which an urban nation requires for both domestic health and tranquility. The only issue which arose seriously was whether a limit should be imposed on farm payments of $55,000 a crop. The limit was imposed, and will save perhaps $35 or $40 million a year; no serious discussion was given, however, to the arguments of competent economists that the farm legislation would cost substantially more—some say a half billion dollars a year—than was necessary to carry out program objectives.

I do not mean to single out the Congress in this evaluation. The actions which the Congress took were those which the Administration either had requested or had endorsed prior to final disposition by the Congress.

The sense of the Administration priorities in the food area can be more clearly seen in the rather small budget which has provided for a number of programs which are usually considered to be consumer oriented. The facts as demonstrated by agency action do not always support this view, however.

In the current fiscal year, the total Federal expenditure for meat and poultry inspection, for the food portion of Food and Drug Administration, the expenditures which the Federal Trade Commission makes on food related matters and the funding for the President's consumer advisor amount to about $178.5 million. For fiscal year 1972, the Administration is requesting $197.3 million.

This is the total amount which the Federal Government invests in consumer protection and regulation affecting a food industry that accounts for an annual gross volume in excess of $150 billion. Most of this protection and regulation money—$130 million out of the fiscal 71 total—goes for meat and poultry inspection, an agency function from which the administration this year stripped the designation of consumer protection. I do not know whether this was an act of sudden honesty, or whether some reason yet unannounced was the cause, but it is obvious that the Federal stamp of approval makes the marketing of millions of steers and hogs and chickens much easier than if the food industry alone had to convince the consumer of its good intentions.

The point which needs to be made is that everyone—consumers as well as producers, processors and retailers—have a strong interest in food protection and regulation. Only recently has FDA and the FTC begun to show an awareness of the right of the consumer to be heard in the policy and procedures they carry out. The USDA, through the Consumer and Marketing Service, has yet to demonstrate an awareness that the consumer has any rights, let alone interests. For example, I have been told that the USDA is now exploring with the State of California the withdrawal of all Federal inspection in meat and poultry plants in favor of a licensing arrangement with the State. Before such action should be contemplated, all consumers (and even the Congress) should have an opportunity to study, discuss and recommend policy.

Question 2. In particular, do you feel that the existence of a Special Assistant to the President for Consumer Affairs gives the consumer adequate representation in government? What changes in this office would you recommend?

Answer. I believe the only way, given the size and complexity of the Federal—and many State—governments, for the consumer to be adequately protected is for the consumer to be given an adequate voice before the agencies, the executive and the Congress. A Special Assistant to the President is just that, and his or her duties are to inform the President of activities and to suggest responses; a Department of Consumer Affairs with administrative responsibilities would eventually become subject to the same pressures which are now directed by the various special interests at the regulatory and protection agencies—and probably would assume much the same character. I believe that an independent agency, or a Cabinet level post, which would assume the yet undefined role of an American ombudsman with adequate staff and powers, including power to intervene, is the best means of giving the consumer an adequate voice in policy-making and policy execution. Congress has such bills before it now for consideration in this session. I hope it acts.

Chairman PROXMIRE. Now I can introduce you, Congressman Harrington. Congressman Harrington represents the Sixth District of Massachusetts. The 6-percent unemployment rate from which the country suffers at the present time is, of course, an average of different rates in different areas. The impact of recession is terribly uneven. We've already heard testimony from Mayor Gibson of Newark and Mayor Gribbs of Detroit. Both those cities have very high unemployment rates—up around 11 and 12 percent. We've heard from the Governors of Ohio and Pennsylvania, two industrial States, where the swings in economic activity are especially sharply felt.

Congressman Harrington, I believe I'm correct that you represent an area in Massachusetts, Essex County, where unemployment is also substantially above the national average, and where there are some real structural problems to be overcome in order to restore full employment. We are very pleased that you could testify this morning, and we want to know what the situation is in areas such as the one you represent and what you think ought to be done about it.

STATEMENT OF HON. MICHAEL J. HARRINGTON, A REPRESENTATIVE IN CONGRESS FROM THE SIXTH CONGRESSIONAL DISTRICT OF THE STATE OF MASSACHUSETTS

Representative HARRINGTON. Thank you, Mr. Chairman. Not having been here earlier, I trust I can be filled in by my staff.

Chairman PROXMIRE. You missed two very good witnesses.

Representative HARRINGTON. It may very well be that we should have stopped there.

If I could, I would like to read the prepared statement I have and I will be available for questions.

Chairman PROXMIRE. Fine. If you would like to abbreviate your prepared statement in any way, the entire prepared statement will be printed in the record, of course.

Representative HARRINGTON. Fine. I appreciate this opportunity to appear before the Joint Economic Committee. The fact that you are holding these hearings into the economic state of the country so early in the session is an encouraging sign that the Congress intends at this point to be responsive to a critical problem.

In years past we have talked about the fiscal plight of our cities, towns, and States. Today, however, we must often talk in terms of survival. The specter of the padlock on the city hall door is no longer confined to the distant future. Many mayors are threatened with being relegated to the position of a trustee in bankruptcy.

The general statistics are well known to this committee. The States and local governments are caught in a press between increasing demands and limited resources. Since 1950 State debt has increased 579 percent and local debt 363 percent. At the same time due to the growth factor in the Federal income tax, the debt of the National Government has increased only 35 percent.

At the present time Washington is collecting from 91 to 93 percent of all income taxes in the country, while it is estimated that 85 percent of local tax collections come from the property tax.

Unless there is some change in the fiscal situation, the cities, towns, and States will face a revenue expenditure gap of from $15 to $17 billion within the next few years. Governor Rockefeller has recently estimated that State and local governments face a deficit of $10 billion this year.

And it is not as if States have shirked their revenue raising obligations—certainly the Commonwealth of Massachusetts has attempted to meet pressing needs by increased taxes. On a per capita basis, Massachusetts ranks sixth in the Nation in the burden of its State and local taxes.

At the present time my State has not only general and specific property taxes, but a sales tax, income taxes, and excise taxes as well.

From these sources Massachusetts in 1971 will raise approximately $3 billion in State and local taxes. In the same period, however, the Federal Government will raise in this State $6.2 billion or double the revenue derived by the State.

Present estimates show that 56 percent of all State and local moneys are raised in Massachusetts by means of the property tax. And this reliance on property taxes is characteristic of State revenue raising efforts.

It is well known that the property tax is a fundamentally stagnant form of revenue raising. With this form of taxation, increases must come essentially from the raising of rates. Property values just don't rise in proportion to government needs.

Along these lines, the recent history of the property tax in Massachusetts has been a frightening one. In the last 4 years, rates have increased 67.5 percent throughout the State. The Massachusetts Taxpayers Association has already predicted another 15 percent hike in property taxes for 1971.

In some of the older Massachusetts cities the rate of property taxation has reached the point that property owners pay taxes equal to the full value of their property every 10 years.

If the property tax in Massachusetts has risen above our heads, the other forms of taxation are not far behind. We are now making heavier use of personal income taxes than any State except Oregon and your own State of Wisconsin.

Even if we double the present Massachusetts sales tax from 3 to 6 percent, and at the same time broaden its base, we could raise only $200 to $300 million less than a single year's increase in local expenditures.

The best figures now available project a need of an additional $484 million for the cities and towns of Massachusetts in the coming year. At the same time the State government is faced with an increased need of approximately $280 million.

To a great extent the spiraling demands made on State and local governments are beyond their control. The pressure for better education, for adequate welfare, for decent government salaries as well as for the services needed by a growing population must be met.

As recently as 1965 the net cost in Massachusetts for higher education was only $27 million per year. In 1970 it totaled just over $100 million. By 1975 to 1976 the costs could run close to $300 million.

The city of Boston is a good example of the effects of the monetary strangulation affecting the cities and towns.

This city depends on the property tax for nearly 70 percent of its revenue.

In the past 10 years interest costs for the city have risen 84 percent. The building cost index has gone up 47 percent. Firemen's salaries have risen 61 percent and teachers' salaries have increased 55 percent.

At the same time, the taxable valuation of Boston has increased only 9 percent.

The city of Boston now faces an increase in expenses of $51.7 million with only $8.7 million in increased revenue anticipated. Unless these figures are changed, the deficit will amount to nearly $43 million.

The cost of running Boston agencies in 1970 was almost $22 million more than the previous year. Conservative estimates show that in 1971 it will be $18 million higher than in 1970. School expense is projected at $12 million higher in 1971.

Despite a severe austerity program declared by Boston Mayor Kevin White, current estimates predict an increase in the property tax rate from $156 to $190 per thousand.

As Mayor White has stated, the present system of taxation in this country is indeed "a system that leaves us with only impossible choices."

The time has come to honestly face the fact that the State and local governments of this country are approaching the end of their revenue capability.

If the need is self-evident, the solution must be found.

Many alternatives have been suggested as a means of easing or solving the fiscal difficulties of State and local government. Some people have suggested an increase in present grant-in-aid programs or a change to block grants.

To others, the answer lies in the federalization of the welfare system through plans similar to the President's family assistance legislation.

A few have suggested a tax credit system whereby the Federal Government would encourage State income tax increases by giving a credit against the Federal income tax. Some have suggested a reorganization of local tax structures.

In my opinion, the only effective and immediate answer lies in the division of Federal income proceeds with State and local governments. Given the nature of the income tax and the extent to which it has been preempted by the Federal Government, it is clear that a sharing of this tax is necessary.

At the present time, it is estimated that the Federal Government takes in twice the tax revenue of all the State and local governments combined.

While other jurisdictions depend on taxes that lag behind, the National Government has, thanks to the income tax, revenues increasing at a rate 20 to 50 percent faster than the economy.

Federal revenue sharing with the State and local governments must be enacted by the Congress in 1971.

Under the President's plan, with a level of $5 billion, Massachusetts would receive only $136 million. As welcome as this assistance is, it would not touch a projected State and local deficit of from $600 to $800 million.

Therefore, I believe revenue sharing should provide for a minimum distribution of $10 billion in this fiscal year.

If this country can afford $100 billion to spend on the hamlets of South Vietnam and $23 billion on abandoned missile systems of various kinds, then it can afford $100 billion for the salvation of its own cities, towns, and States.

Revenue sharing alone, however, will not solve all our fiscal problems.

I do not discount the value of other methods of assistance.

Present grant-in-aid programs should be expanded, not dismantled. The pledges this country has made to solve national problems in the areas of health, housing, race, and poverty must be redeemed.

I firmly believe that the Congress should pass a family assistance program.

The welfare commissioner of Massachusetts stated this month that he will ask for an increase of $200 million for the welfare budget for fiscal 1972. The President's proposal for family assistance would add approximately $60 million to the $90 million Federal share of this increase.

In terms of tax reform, the Commonwealth of Massachusetts recently received the first report of a master tax plan that would attempt to reallocate some of the tax burden from the property tax to sales and income taxes and tighten up the tax systems. I think this should be done.

Nevertheless, the monetary palsy that is now striking State and local governments can only be cured by a massive transfusion of Federal dollars without strings.

Revenue sharing will accomplish this transfusion.

It is my hope that these hearings will lead to a recognition that Congress must act now to save the basic structure of our Federal Government.

Chairman PROXMIRE. Thank you very much, Mr. Harrington, for a most useful statement. It is good to get this kind of documentation of the needs of our cities and States.

One of the reasons for this hearing, as you can tell by the witnesses we have had, is to try to document that so we know just what the plight of our cities and States are. While I strongly disagree on the revenue sharing, I think we have to do far more than we have done in providing funds to the local and State governments.

One of the cases that indicates why I say I disagree: Although you say Massachusetts would get $136 million from the President's program, Wisconsin would get $134 million. Now, Wisconsin is far smaller in population than Massachusetts. I am sure that Massachusetts is a richer State. You must pay almost twice as much in taxes.

Representative HARRINGTON. I think we do.

Chairman PROXMIRE. It has been charged that the revenue sharing program of the President would hurt the urban States. Maybe this is an example of that.

At any rate, I think it is just extremely hard to develop a revenue sharing program which would be based on need and not go into the substantive purposes of the revenue sharing. After all, why are you sharing the Federal taxpayers' money with them? So they can do a better job in education, they can provide more law enforcement, they can provide for the other urgent and desperate needs of the localities. We have these programs in all these areas. It seems to be more logical and sensible to provide specific categorical grants.

Representative HARRINGTON. I do not think that I would quarrel with the desirability to some extent of making certain that we have a method to see that the funds are used in areas that are pressing and stated as far as their need. I really feel, though, that perhaps this could be an initiative for what we are already doing in these areas. I recognize the fact that there may be other emphases to be placed on various priorities, which are not necessarily ones that would be in general agreement on the part of all States. This may give the State officials a chance to do this.

It might also be used as a tool to encourage a degree of reformation of some antiquated and outdated forms of government structures at the State and local level which I hope might be part of any measure passed in revenue sharing.

Chairman PROXMIRE. This is a question of fact that I believe should be clarified. You say that on a per capita basis, Massachusetts ranks sixth in the Nation in the burden of the State and local taxes. We have had our staff compile a table of where the States rank. We do not come out with that at all. None of our calculations substantiate your estimate.

According to the Bureau of the Census, Massachusetts ranks 33d in tax effort when tax revenues collected are calculated relative to the high-income level in the State. This is the most widely accepted method of measuring tax effort. Taking this into account, does it not seem to you that Massachusetts ranks below average in its tax burden on its residents?

Representative HARRINGTON. I think what we can best do is attempt to verify the basis of our information. We will be very happy to provide the committee and your staff with the basis for it. Certainly if what you say is the case, obviously, our position is not as strong as we make it to be. The information that has been given to me on the basis of this is that we are very high in the category of States that impose a total burden on their citizens.

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

In regard to the variance in the tax effort status for Massachusetts, the statement of Congressman Harrington that Massachusetts ranked 6th in the nation in per capita state and local taxes was based on information from the U.S. Department of Commerce, Bureau of the Census, Governmental Finances 1967–1968, Table 24. This same source ranks Massachusetts as 22nd in state and local taxes per $1,000 of personal income.

The information compiled by your staff is based upon more recent data, namely 1970 Bureau of the Census information. According to the staff report, Massachusetts now ranks 19th in per capita tax revenue effort instead of 6th.

This rapid change in ranking order at a time when Massachusetts has increased its property tax from 40.75 dollars per thousand to 49.53 dollars per thousand shows the rapid rise in other state revenue efforts.

Chairman PROXMIRE. Is this related to your income, or is this just absolutely without relationship to income?

Representative HARRINGTON. It is absolutely without relationship to income.

Chairman PROXMIRE. That is the trouble. You can say the tax effort of Mississippi, for example, might or might not be greater than Massachusetts, even though the absolute amount per capita might be far, far less. It seems to me that is a fairer measure, because you could say that a man with a low income is making a greater contribution if a higher proportion of that income goes for taxes than a man with higher income, even allowing for progressive considerations.

You spoke in your statement about how, if we can afford $100 billion to spend in Vietnam and $23 billion on abandoned missile systems, then we can afford $10 billion for the salvation of our cities. Our next witness is a very able and distinguished man who is going to talk to us on priorities. I think you have come to the guts, the heart, of our problem here. It is just because we are spending money in those areas that it is very hard for us to give assistance to the States and localities. We have to make some very hard choices.

Everybody who has appeared before this committee has espoused a full-employment budget. The President espouses it. The conservative Republican national chairman espouses it—Bob Dole—Walter Heller, Hubert Humphry. If everybody agrees to this and they all say we shouldn't have higher taxes—nobody has come forward and said we need a big new tax bill—that means we are going to spend about $230 billion. It seems to me you have to come down just as hard on saying where we are not going to spend money as saying where we are going to spend it. Almost all the witnesses have said we need money for helping education, for helping welfare, these other very important areas, but very few of them have said, cut it out in these other areas and specify how much and indicate any kind of responsible analysis of how you can do that without enfeebling our national defense or without abolishing the space effort, something of that kind. Can you help us in that respect?

Representative HARRINGTON. I wish frankly, Senator, that I could, but I feel, frankly, that I would be prepared to have this country take a much harder look at the concept of the line of defense policy than it has. Perhaps I can do that by adding a discordant note on our side of the Congress that has been uniformly uncritical of the assessment of defense military needs. I speak now of the House Armed Services Committee in particular. But I do think that the same degree of scrutiny and care and attention that we place on evaluating the programs and effectiveness of education and housing ought to be what we do in our defense area. I think there are encouraging signs, particularly in your branch, that this is occurring. I wish I could see the same signs in my own branch.

Chairman PROXMIRE. I think that is a very encouraging statement. I might say your Appropriations Committee did a very good job in cutting the defense budget in 1969 and 1970. In 1969, they cut it on the Senate side $6 billion and the House and Senate together in 1970 did it another $2 billion. I think we can do this without enfeebling our military force. We are the supreme military force in the world, but I would agree with you that we can still cut out some of the fat from our military and still have a full adequate force. I am talking of taking a realistic look at miliary spending as you indicate we have at these other domestic programs.

Representative HARRINGTON. We are frankly, when it comes to giving ourselves the tools that I am talking of now, Congress has failed. I think we handicap ourselves very definitely in this way. I speak as one of the newer Members of the Congress when it comes to having accurate information available and the proper staffing to be effective on the specifics of what must be done. Whether this is deliberate or acknowledged or an end result of the hardening of the arteries of a system that needs a change, I think more must be done to make this an effective branch. I think we do handicap ourselves in coming to the point where we would like to handle this as expressed in your view that I certainly share with you.

Chairman PROXMIRE. I want to congratulate you on your smashing victory when you won your special election up there.

Your little folder was so effective that someone in our State took it and thought it was the greatest thing he had ever seen, to the extent that he used it in his campaign. All he changed was the name. He changed the pictures, but he just changed the name and left everything else. It did a good job. He didn't win the election, he lost it in a recount, but——

Representative HARRINGTON. We are very familiar with that campaign. We feel we hold a mortgage or two in your State.

Chairman PROXMIRE. Thank you.

Our final witness this morning is Mr. Sol Linowitz, chairman of the National Urban Coalition. Mr. Linowitz is well-known as a businessman, lawyer, and public servant. Mr. Linowitz, I understand that like so many other distinguished citizens, you got your start in Government by working for the Office of Price Administration during World War II. Since then, you've held many other positions, including that of Ambassador to the Organization of American States. Now, as chairman of the National Urban Coalition, you are taking on a whole new endeavor, perhaps the most exciting and worthwhile of all. I have read your prepared statement, and I find it a masterful presentation of our problems, of the possible solutions, and very importantly, of what those solutions are going to cost. So please proceed. If you wish to abbreviate your prepared statement in any way, we will have the entire prepared statement printed in full in the record.

STATEMENT OF SOL M. LINOWITZ, CHAIRMAN, NATIONAL URBAN COALITION

Mr. LINOWITZ. Thank you, Mr. Chairman.

I welcome the opportunity to appear before your committee and to participate in the committee's continuing efforts to discover more democratic and rational procedures for making public choices. Your hearings have helped stimulate a long overdue reexamination of the ways in which we govern ourselves.

In recent American critical self-analysis, one fact has been emerging, one dominant theme; that is that we have to have a formulation of national priorities, as you just said, Mr. Chairman. Increasingly, it has been recognized that rational government decisionmaking is impossible without clearly stated goals and priorities to guide resource allocation.

From its inception in the riot-torn summer of 1967, the National Urban Coalition emphasized this need for explicit consideration of where we wish to go as a nation. The coalition's original statement of purpose expressed the conviction that reordered national priorities were a prerequisite to the achievement of the coalition's principal objectives: The restoration of America's deteriorating cities and the reunification of our divided society.

More than 3 years have elapsed since that declaration. Both the Johnson and Nixon administrations have endorsed the call for an open and systematic review of the Nation's priorities. And the great majority of public interest organizations in this country have reaffirmed those endorsements.

But, as we all know, very little has happened. Since the Coalition's original statement, there has been a lot of talk and this has produced more talk, and we have been quick to brandish the phrase, "reorder national priorities." But very little has changed.

The main reason for this is that we have stated national goals in the abstract rather than in terms of public resources necessary. But choices must be made and priorities must be established. I know this hearing is precisely designed to focus on this aspect.

So we are at the point where we all, I think, have come to recognize that if future talk of new priorities is to serve as more than balm for social conscience, we must apply it to our single most important instrument for relating goals to scarce resources: the national budget.

To escape a rhetorical dead end, the National Urban Coalition embarked on a project never before attempted by a nongovernmental organization—the effort to construct a comprehensive alternative Federal budget matching revenue and expenditures for each of the next 5 years.

Our main purpose was to demonstrate how resources would have to be reallocated both within the Federal budget and between the private and public sectors to accomplish our goal of making the cities better places in which to live. Indeed, to make our society a better place in which to live.

But that was not our sole purpose for undertaking this ambitious project. We also wanted to focus attention on two fundamental flaws in the present budget-making process which interfere with the reordering of national priorities.

The first is what might best be called the let's-see-what-we-gave-them-last-year-and-give-them-a-little-more-this-year approach. As you know, far better than I, Mr. Chairman, this is encrusted in the fragmented committee system of Congress. This approach to marking up each successive Federal budget makes major resource reallocations by the legislative branch virtually impossible. Congress today can do little more than tinker with bits and pieces of the budget handed to it by the administration.

The second flaw is the lack of public participation in the budget process.

As we well know, both the executive branch's Federal budget proposal and the Congress' appropriations response are written behind closed doors. America's most important public decisions are reached in secret—implying that the public is either not sufficiently competent or trustworthy to have a say in such critical national choices.

Recent opinion polls published by Louis Harris reveal that the American public, in fact, does hold views which ought to play a prominent part in setting public priorities.

For example, 61 percent of all Americans would like to see less Federal money spent for national defense and the space program;

only 14 percent want more resources devoted to these areas. Yet spending for both is expected to increase in the President's forthcoming budget.

Twice as many Americans, according to these polls, oppose cutting funds for antipoverty programs as favor cuts. Yet there are indications that there may and probably will be sizable cutbacks in the war on poverty.

Why then should public officials be surprised at the fact that a growing number of citizens feel alienated from their government?

In composing its alternative Federal budget, the Urban Coalition sought to demonstrate on a microcosmic level how the budget process could be opened to broad public participation in the formulation of the budget itself. What we did was prepare a number of drafts and consult at length with leaders of American life—business, labor, local government, blacks, Mexican Americans, American Indians, white ethnic groups, religion, education, youth, women, local urban coalitions, and social-welfare organizations. On January 11, the National Urban Coalition Steering Committee culminated these months of deliberation by approving a statement of national priorities setting forth six major goals to pursue between now and 1976. Let me modestly point out, Mr. Chairman, this was 2 weeks before the President's own six major goals. Ours were:

To achieve full employment with a high level of economic growth and reasonable price stability—all of our other policy goals depend upon it.

To provide all citizens with an equal opportunity to participate in American society and in the shaping of governmental decisions affecting their lives.

To guarantee that no American will go without the basic necessities: food, shelter, health care, a healthy environment, personal safety, and an adequate income.

To rectify the imbalance in revenues between the Federal Government and State and local government.

To assure adequate national security against military threats from abroad.

To meet our obligations to assist in the economic development of the world's lesser developed nations.

Within the next 2 weeks the complete version of this alternative budget will be ready for release. I want to say, Mr. Chairman, we will be pleased to provide a copy to the chairman at that time for inclusion in the record if you think it will be helpful.

I want to stress one central fact which has emerged in all we have been doing about this project. That is that the proposals for solving the whole national problem are going to be useless in the future as they have been in the past unless they are advanced in the context of the realities of the American economy and the Federal budget.

For example, everyone concedes that the financial plight of our States and cities—about which Congressman Harrington just testified and about which other witnesses have testified here—is a critical national problem; projections of the 1975 gap between State and local expenditure needs for providing high quality services and expected revenues range as high as $100 billion. And nearly everyone is prepared to place the provision of additional revenue to eliminate that gap high on the list of national priorities.

But unless this commendable wish to rescue our States and cities is followed by concrete proposals for reallocating public resources, nothing will be accomplished.

There are a number of possible strategies for filling this revenue gap expected by 1975. President Nixon suggested the broad outlines of one approach in his state of the Union message last Friday. He proposed a 25-percent increase in present Federal aid to States and localities, with $5 billion of the total $7 billion in the form of no-strings-attached shared revenue distributed to States primarily on the basis of population.

Final judgment on the proposal will have to await the announcement of more details. The President's suggestions, properly structured, I think, could provide an important element in a Federal effort to fill the present revenue gap. I would like to outline briefly a more comprehensive strategy for the next 5 years based on the Coalition's alternative Federal budget. I am quite sure that in order to deal with the fiscal problems of the States and cities on more than a piecemeal basis, a multiyear approach is necessary.

First, we must recognize that economic growth is the first prerequisite of our strategy. If the economy returns to a full employment level by 1973 and stays there, State and local tax revenue under existing laws will increase by $6 billion a year as a result of increased corporate and personal income. As you know, State and local tax revenue registered no growth in 1970 as a result of the stagnating national economy.

Second, shifting certain present State and local expenditure responsibilities to the Federal level would reduce the gap substantially. State and local spending for welfare and medicaid will reach approximately $30 billion by 1975. Our alternative Federal budget proposes a cash assistance program and a national health insurance program to replace the present welfare system and medicaid respectively. Both of these programs would be financed entirely by the Federal Government.

The shifting of responsibilities would cut the revenue gap by $30 billion, we estimate, by 1975.

Third, we believe the Federal Government can and should expand its grant-in-aid programs to the States and localities. Subtracting current Federal expenditures for welfare and medicaid—programs whose costs would be absorbed in the future by the cash assistance and national health insurance proposals we are making—Federal grants-in-aid now total $19 billion.

Our budget calls for increasing that total to $34 billion by 1975, a proposal which would reduce the projected 1975 revenue gap another $15 billion.

Fourth, a public service employment program such as the one recently vetoed by President Nixon represents another important form of fiscal relief. It would provide States and cities with funds to train and hire employees needed to staff essential services State and local budgets cannot now support in areas of real demand such as health, education, police protection, and pollution control.

We recommend a public service employment program by 1975 of 875,000 jobs at a cost to the Federal Government of $4 billion.

Implementing all of the above proposals would still leave a sizable disparity between State and local expenditure needs and revenues in 1975 should the States and localities succeed in substantially increasing the quality of their services. What is happening these days makes it clearly unrealistic to expect Congress will want to appropriate huge sums of tax dollars without being sure that they contribute to achieving nationally defined objectives.

Therefore, it is highly probable that restoring fiscal health to State and local governments will require increased revenue-raising efforts by these jurisdictions themselves. The Federal Government can help and encourage. But it cannot and should not do the job alone.

Accordingly, we are recommending two modest revenue-sharing programs which will contribute to bridging the expenditure-revenue gap while providing incentives for States and cities to increase the yields from their own tax base:

The first is a revenue-sharing plan to divide $5 billion in Federal revenue among those States with graduated State income taxes. States without such a tax would be ineligible to receive any of these funds. Pass through provisions to insure the cities a fair share of the funds also would be mandatory.

The second program is one of general aid to education. It would provide the States and localities with an adidtional $4 billion by 1975. Like our general revenue-sharing plan, this education assistance would be tied to changes in State and local tax practices: under our proposal, States would have to assume at least 55 percent of combined State and local education costs to be eligible. This would have the dual effect of reducing the pressure on overburdened local property taxes while providing public education a tax base with greater growth potential.

Specifying the forms Federal relief could take, however, is only half the task. Any responsible proposal for rescuing our States and cities from their financial duress must include a plan for raising the additional resources required for this fiscal relief as well as for the other expenditure increases we recommend in our alternative budget.

To summarize, this additional revenue could be collected from the following four sources:

First, vigorous national economic growth which would produce additional Federal tax revenues according to our estimates of nearly $75 billion between now and 1975.

Second, cuts in existing Federal programs such as our recommendations to reduce the military budget $20 billion by 1975 and the agricultural subsidy program by $1 billion.

Third, elimination of inequities in the Federal tax system, which are spelled out in our alternative budget.

And fourth, a Federal 10-percent tax surcharge on personal and corporate income beginning in 1974 which, given our assumptions about economic growth and tax reform, would yield about $17 billion in additional Federal revenues by 1975. Let me stress that imposition of this surcharge would only make sense after we had returned to a full-employment economy, and after reform had rendered the Federal income tax graduated in reality as well as in theory.

Mr. Chairman, the content of this strategy is subject to debate and I hope it will be strongly debated. But the process for devising it is not.

Public problems cannot be attacked rationally except in terms of conflicting needs competing for limited resources. At the national level this means defining problems in the context of the entire Federal budget; calculating expenditure decisions both in terms of available resources and spending alternatives.

Yet, as this committee is well aware, Congress lacks a vantage point for such a comprehensive view. For at no time is the Federal budget considered in its entirety on Capitol Hill.

Therefore, it is clear that a necessary condition for reordering national priorities must be the creation of appropriate structures in Congess for examining the budget as a whole.

Toward this end, the National Urban Coalition will welcome the opportunity to present our alternative budget in public sessions before the full Appropriations Committee of each House. If the members of this committee believe it would be helpful to establish this precedent we would be pleased to have your assistance.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Mr. Linowitz, thank you for a superlative statement. This is exactly the response we have needed in this area and precisely what we are trying to get at. I am so grateful to you for spelling out what has been so lacking; that is, where the money is coming from. How do we do this? I think the whole vision you have of a national budget to be considered at one time by the Congress, both the expenditures, which we never consider together, and the expenditures and taxations we never put together, and then of course, economic impact, which is considered by this committee separately, usually much less so by other committees. I think that this is a masterful presentation. I would agree that some of the specific suggestions you make are subject to debate. I disagree with some of them, as I am going to indicate in my questioning. But I think the overall thrust of what you are presenting is one of the most valuable documents I have seen in a long, long time.

Mr. LINOWITZ. Thank you very much.

Chairman PROXMIRE. It is going to help us greatly in arriving at a rational position on this.

As I indicated to Congressman Harrington, I think we are going to be driven to this whether we like it or not in a few years, because of the acceptance by everybody of the full-employment concept. This committee pioneered in that respect. Paul Douglas, who was chairman of this committee some years ago, proposed this concept about 22 years ago, in 1949.

Mr. LINOWITZ. I remember. He was a prophet crying in the wilderness.

Chairman PROXMIRE. And the Committee on Economic Development has been way out front on this, but now it seems to be accepted by everybody. What this means is we have to recognize that there is so much a federal government can do without moving into an inflationary position.

Will you work out the budget that you are going to present to the Congress on a full employment basis, and if so, what level of employment would you consider full employment—level of unemployment, I should say—4 percent?

Mr. LINOWITZ. We are talking about roughly 3.8 or 4 percent.

Chairman PROXMIRE. And that was the basis on which you worked it out?

Mr. LINOWITZ. It is; we of course took into account the need for a public service program, Mr. Chairman, in order to get us to that level. We thought it is not going to be easy to do that unless we institute such a public service program and do it rather soon.

Chairman PROXMIRE. You indicated a gap of about $100 billion developing between State and local services if they are going to do anything like the job they should do and the revenues. This is in direct conspicuous conflict with the estimate of one of the ablest economists who has specialized in this area. Richard Musgrave. Let me point out what he said in a paper a short time ago:

> At the state and local level, whereas the estimates of a few years ago projected a rapidly rising level of deficits, more recent approaches give a less alarming picture. . . . In 1975 state and local expenditures will be at $191 billion after allowing for increased workload due to rising population and for quality improvement at past rates. Revenue, including federal aid expanding at normal rates, is estimated at $174 billion, leaving a deficit of $17 billion. Of this, $11 billion will be covered by normal borrowing, leaving a gap of $6 billion. This is only slightly above what the Administration's revenue-sharing program would add annually by 1975. Alternatively, it could be met by a 5 percent increase in tax rates at the state-local level, an increase which seems well within the reach of state-local governments, given their past records of rate increases.[1]

It is my understanding that the demographic experts tell us that because of a shift in population, with fewer young people in school in relation to the total population, fewer old people in relation to the total population, the fantastic burden that the States have had to cope with and the local governments have had to cope with in the 1950's and 1960's will diminish. No longer will they have proportionately as heavy an educational burden or welfare burden.

Mr. LINOWITZ. Mr. Chairman, let me just say on that point, as will be made clear on our submission of the full budget: We recognize that the estimates of this anticipated revenue gap vary across the board. We get anything from nothing, at all, to a surplus, to a tremendous gap. Even Mr. Robinson of the Office of Management and Budget indicates a difference in what the gap will be, that it won't be massive if we continue what we are doing now and project that forward for 5 years as against doing what he calls an "aspiration" kind of job, doing the things that ought to be done and paying for them. It is the latter that we have focused on. We think there are many things that ought to be done that are not being done, that there are many jobs for the State and local governments which they are not undertaking, and we think we ought to plan in terms of what this country ought to do.

Chairman PROXMIRE. You are assuming then what the States ought to do in the area of welfare, education, and so on?

Mr. LINOWITZ. Yes, sir.

Chairman PROXMIRE. Therefore, an alternative approach would be one that has been proposed by some of the witnesses, and some of the people think that is the simplest way to handle it, that the Federal Government should move in and take over the whole welfare program, funding the whole welfare program.

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[1] Richard A. Musgrave and A. Mitchell Polinsky. "Revenue Sharing—A Critical View." Financing State and Local Governments, Monetary Conference, June 1970, the Federal Reserve Bank of Boston, p. 22.

Mr. LINOWITZ. We are suggesting that.

Chairman PROXMIRE. Then there would still be a gap of $100 billion in the State and local revenues?

Mr. LINOWITZ. We think that is part of the $100 billion gap. If the cost of the welfare system is absorbed by the Federal Government, that would, of course, diminish the gap.

What I am trying to say is that if things remain today without changes in the structural pattern that is one thing; but anticipating that more is done in each of the areas than is now being done in the way that we think ought to be done, then we have a total package of $90 to $100 billion gap that has to be filled one way or another.

Let me say, Mr. Chairman, we are not trying to kid ourselves or anybody else; it is reaching for a problem as soon as you say let's face up to the possibility of a $100 billion, $90 billion, $75 billion gap. Yet, unless we do this, we are going to try to get by on the bargain basement approach. We are going to try to do it in bits and pieces of a billion dollars here, a billion dollars there and not face the fact that if, as the President said, these State and local governments are indeed on the brink of financial disaster, we had better look down the road 5 years and see what they may be encountering and what they ought to be doing as far as services are concerned.

Chairman PROXMIRE. With regard to where the money is coming from, your first indication of where the money is coming from is a mighty rosy outlook. You are suggesting vigorous national economic growth which would produce additional Federal tax revenue. What kind of real growth does this assume?

Mr. LINOWITZ. In the next 3 years of about 5 percent and a couple of years thereafter, about 4½ percent.

Chairman PROXMIRE. How do you happen to estimate this, on the basis of our past experience?

Mr. LINOWITZ. It can be done.

Chairman PROXMIRE. Of course, unemployment is high, but by historical standards, it is not.

Mr. LINOWITZ. Let me say we didn't pull these figures out of the air. In making this budget, we consulted with some 200 experts.

Otto Eckstein for instance, Charles Schultze. What we tried to do is take into account realistically what we can do in this country, not precisely in accordance with the programs we now have, but the programs we want to have.

For example, let me say in other words to achieve this kind of economic growth with the right kind of restraint on inflation, I believe we have to do a lot more than has been done. Today we are not doing enough to be effective.

Chairman PROXMIRE. It is very important that the mechanism be effective. And if it is going to grow that rapidly, in view of our recent experience, we are likely to have a very serious inflation unless we have some pretty dramatic institutional changes.

Mr. LINOWITZ. Right. And as one who served both in OPACS and OPA a hundred years ago, I know the range of possibilities is very extensive. I know you have had testimony before this committee about the stabilization board and so forth. I don't care at this precise moment what precise mechanism is used.

Chairman PROXMIRE. You have had experience with this that is very valuable to us. Would you favor moving into a standby OPA?

Mr. LINOWITZ. I would not favor compulsory price and wage controls at this point. But I do believe that the country is ready for the encouragement of voluntary restraints and not enough has been done to work within the range of voluntary holding back, both in industry and labor. Even the President's commenting in the state of the Union message that he hoped that industry and labor together would work to keep down prices and wages is hortatory rather than indicating that the Government is directly involved in what is happening.

Chairman PROXMIRE. Would you favor a wage-price review board?

Mr. LINOWITZ. I would. I would like to see a board.

Chairman PROXMIRE. Would they require that before industry increase prices, the industry appear before the board to announce what the increase is going to be in advance and that the labor unions indicate what their demands are going to be in advance?

Mr. LINOWITZ. I have not clearly worked out the details. I think the best way would be to work this out in advance, come up and talk it over and make sure it makes sense, and work within a framework that is mutually acceptable. Again I wouldn't stick within that framework if there is something else. I would move step by step in that more moderate approach and then as necessary move further and further along the line until you have a hold on it.

Chairman PROXMIRE. You have proposed $20 billion cuts in the Federal defense budget?

Mr. LINOWITZ. Yes, sir.

Chairman PROXMIRE. When you consider the fact that we are likely to have inflation during this period and you consider the fact that the President has proposed an increase in the defense budget in the coming year, and the increase would be more if they were not anticipating a further diminution in expenditures in Vietnam, how realistic is this proposal? Is it based on a competent analysis by defense experts?

Mr. LINOWITZ. Extraordinarily competent analysis by the defense experts.

Chairman PROXMIRE. Who?

Mr. LINOWITZ. Adam Yarmolinsky, Paul Warnke, Townsend Hoopes, et cetera. We had also Robert Anthony, former Defense Department Controller.

Chairman PROXMIRE. It would be very helpful to this Senator and this committee if we could get that analysis. What is your proposal for the coming year?

Mr. LINOWITZ. $12 billion cut in defense expenditures.

Chairman PROXMIRE. Below what the President is requesting?

Mr. LINOWITZ. No; below the $70 billion of the present budget.

Chairman PROXMIRE. That would be about $58 billion——

Mr. LINOWITZ. Exactly.

Chairman PROXMIRE. That is based on analysis by former Defense Department officials?

Mr. LINOWITZ. Yes, and a number of other experts around the country and taking into account the President's own estimates of what he anticipates it should be possible to do in this country if we withdraw from Vietnam, even in accordance with his own schedule.

Chairman PROXMIRE. Do you break this down?

Mr. LINOWITZ. We break it down.

Chairman PROXMIRE. How you cut personnel, what you do about troops in Europe, what you do about the Navy and Air Force?

Mr. LINOWITZ. I can give you the outlines now, for next year.

The four areas: First, Vietnam. We talk about $12 or $13 billion being cut by 1975–76, the next 2 or 3 years. Second, having the allies, both in Asia and Europe, take over most of the responsibility for ground forces. We are talking about several billions of dollars there.

The elimination of systems duplication, doing away with such things as the Safeguard and MIRV'ing some of the missiles that are in prospect.

Fourth, eliminating both obsolescent equipment and inefficiencies according to the recommendations that the Fitzhugh Commission made. We think if we put that whole package together, we get an effective——

Chairman PROXMIRE. Would this permit a volunteer army by then?

Mr. LINOWITZ. It is moving into the possibility of a volunteer army.

Chairman PROXMIRE. Your economies would be sufficient so that even though you were increasing pay enough so that you could get a volunteer army, you would still be maintaining other reductions in personnel and so forth that would give you the funds to do that?

Mr. LINOWITZ. We are hoping to.

Chairman PROXMIRE. I would like to get that in any detail you could get it.

You say elimination of inequities in the Federal tax system.

Mr. LINOWITZ. Yes, sir.

Chairman PROXMIRE. Members of Congress thought they did that, as you know, last year, or the year before last. Anyway, it was very recently. And it is unlikely that we'll get a tax bill that will provide additional funds. I see you do not provide any specific sum for that.

Mr. LINOWITZ. We do, sir.

Chairman PROXMIRE. How much?

Mr. LINOWITZ. Several billion dollars. I can't give you the exact figure.

What we are talking about, obviously, is what can be done in such areas, in particular as subsidies, windfalls, and allowances, that now accrue, places where they can be tightened up. I recognize some of these proposals sound like fantasies in the real political world in which we live. But what we are dealing with is not so much what seems politically feasible at the moment but what this country ought to be facing up to and ought to do. I would say if we are really serious about the possibility of a tax increase in 1974, and I know you have some misgivings about that, we first have to keep faith with the American people about correcting some of the present problems in the tax structure.

Chairman PROXMIRE. You feel that would be essential if you are going to impose a 10-percent surtax?

Mr. LINOWITZ. I don't see how we can with good conscience go to the country and say we want to put on a 10-percent tax increase unless we have cleaned house.

Chairman PROXMIRE. In view of the statement of President Nixon that people are fed up with government at all levels—meaning that taxes are too high, and other things, too—what kind of public support do you think you can get in peacetime—the war is over—for a 10-percent surtax?

Mr. LINOWITZ. I have a great deal of confidence in the basic good sense and desire of the American people to do things that ought to be done.

Chairman PROXMIRE. Why wouldn't they argue that if the Federal Government has so much money it can share it with the States, why would they not cut their taxes and——

Mr. LINOWITZ. I think the story is the local and State governments have said they can't raise the taxes and they have come to the Federal Government. We have come full circle now. Forty-one States now have a State income tax and the others say it would be political suicide to try to introduce it.

As I recall, $7 billion is the total amount raised by income taxes today in all the States in the country, which is about 20 percent of their total tax revenue.

In short, I do not think it is an answer that they not have the Federal Government do it, but have the States and local governments do it, because the State and local governments do not do it, they say they cannot do it. So we are back to the question will the American people go for a tax increase?

Before you can answer it, we have to say in all decency, two things. One, we have no right to ask unless we have truly reordered our priorities. We have some idea what we would like this country to be and in order to do that, we have to have some resources.

Two, we have taken care of the inequities in our present tax structure so we have these things coming out of the present tax system. Then we have the right to say, we have to ask you to do it now.

Chairman PROXMIRE. You are absolutely right talking about the morality and the justification. But I wonder about the realism if we are going to have a family assistance program which by 1974 or 1975 is at a $3,000 or $4,000 level. And most people agree that would be the goal, perhaps, that maybe we cannot possibly get it that high, the realism of expecting to have the great bulk of American peoples whose incomes aren't much above that agree to a tax increase when they can look across the street or across the road or into another section of the town and see where their tax money is going, to people they feel are getting it without working—although I agree that most of these people can't work. I am talking about the realism, not, again, about the morality.

Mr. LINOWITZ. I know. I have forgotten the name of the French economist who once defined taxation as the art of plucking a goose so that you get the greatest amount of feathers with the least amount of hissing. I think if the art is properly applied to be made effective, it ought to do the job.

It is not going to be easy. I come back again. I do not mean to sound unduly idealistic. But it seems to me if the American people believe the money is going to do a job that is right—for example, if we were to reinstitute the tax rate we had in this country between 1954 and 1961, we would get $24 billion more than we are getting.

We are not asking for impossible things. Other countries in Europe have much higher tax rates and people live comfortably. It is a matter of how it is presented.

Chairman PROXMIRE. Those other countries in Europe, do they pay their taxes as conscientiously as we do?

Mr. LINOWITZ. Yes; many do. You know, I used to be in Latin America a lot. I think it is not quite as bad as it is rumored. I think they are doing a better job.

Chairman PROXMIRE. I am especially impressed by your point about the lack of public participation in the budget process. This committee has long been concerned with that problem. Our hearings, of course, are all public. We continually find ourselves requesting the Office of Management and Budget to make their information publicly available. I think this committee has made a contribution over the years to a greater understanding of the budget process. However, as you rightly point out, we obviously do not have adequate public participation in the formulation of the budget.

Indeed, many of the items, such as the SST fly in the face of public opinion. What are your ideas about increasing public participation?

Mr. LINOWITZ. In the first place, it would be a fine thing if there could be hearings on the total budget under the aegis of the Congress. Perhaps this has been proposed—a standing committee on national priorities ought to be established which would begin to get public opinion on this. But certainly, there ought to be some mechanism, whether it is to start with no more than having the full Appropriation's Committee come together and look at the budget in each House and then form a composite judgment. But, I think somehow the effort has to be made, both by the administration and the Congress, to interest the people, make them aware that the one single fact that all the talk about priorities and all the talk about what we ought to do with our money really gets down to one document that nobody reads, called the Federal Budget, where the choices are really made.

I have often wondered if it isn't just the word "budget" that turns them off.

Chairman PROXMIRE. I wish you would make just as explicit and concrete as you can how we do this, because many of us have felt this for a long time, but none of us have arrived at any specific way that we can focus attention on a good budget debate and budget discussion on the overall impact of the budget. We just have not done that.

We have had a little bit of that in restricting the amount the Federal Government would spend. We did it on a tax increase a couple of years ago, but we didn't discuss the details of the budget.

Mr. LINOWITZ. Maybe somebody ought to write a book, "Everything You Have Always Wanted To Know About the Budget But Were Afraid To Ask."

Chairman PROXMIRE. You have suggested that your budget be submitted to the Appropriation's Committee. I think that is an excellent idea.

Several years ago, we began hearing talk about the peace dividend. Now you are talking about a tax increase even in our peacetime economy. Whatever happened to that illusory fiscal dividend?

Mr. LINOWITZ. We have included that. We have assumed that the dividends, fiscal and peace, would give us a certain amount of money to include in meeting these needs.

Chairman PROXMIRE. I remember Walter Heller and everybody else used to talk about all this money we were sure to get with a growing economy and a fading war. As soon as we get to full employment, we were going to have it. We got to full employment and then some. Instead of having a fiscal dividend, we had a $26 billion deficit.

Mr. LINOWITZ. Yes. Well, we have been through some developments since then, including passing through the "Valley of the Moynihan Dissent." I think to the extent that we are going to have a dividend, we have taken it into account.

Chairman PROXMIRE. Would you consider a desirable feature of that consideration by the Appropriations Committee of the Federal budget establishing a ceiling and then working within the ceiling? As I say, we did that after the budget had come over and while it was being considered. Then we did not relate it to the specific parts. But an overall ceiling was established by an amendment proposed by Senator Williams of Delaware. Do you think that would be a desirable feature of these hearings? They should focus on something. If you just have hearings, you are not going to have people attend. If the purpose should be to establish a specific ceiling and perhaps then consider the possibility of imposing that ceiling on particular subcommittees, then let them work within that ceiling, you might have a pretty good overall discipline. Would that be your objective, so that you could get from a generalization of discussion to a point of real action?

Mr. LINOWITZ. Mr. Chairman, I think you have put your finger on exactly why we feel this is a useful thing to do.

What people really need is not just an argument about a budget that is presented, saying that is too high or we cannot have all that for defense or we ought to be able to do something better than something else, but an alternative to consider. We think they have never had that. They have never had side by side two ways of using their money. If out of this comes the first effort of presenting even in fragmentary form an alternative budget, so people can look and say, should we be putting $75 billion into defense or can we save $15 billion and put it into something else, then I think we have precipitated a national discussion and put it in realistic terms. So if you will put it in terms of a ceiling and see then what is the best way to use the money that you are going to have——

Chairman PROXMIRE. Let me get to this. You mentioned in your statement a need for a greater tax effort on the part of the States. I would like to underline that. We did hear earlier from the mayor of Newark, Mayor Gibson, some of the most heartbreaking statistics—highest crime rate in the country, highest venereal disease rate in the country, nearly one-third—over 30 percent of all their people in the city on welfare, now, this year. Yet it was brought out that at the same time, New Jersey is one of the richest States in the Nation. I think it ranks sixth from the top. They have no State income tax and they will not authorize the city of Newark to impose a commuter tax. The problem is not really a shortage of Federal aid, it is a maldistribution of wealth within the State.

We had testimony from Governor Gilligan of Ohio, the same story. By his own calculation, Ohio ranks 49th out of 50 States in relative tax effort, even though it is one of the wealthy States.

Bearing this in mind, I wonder if even a limited revenue-sharing plan is really the best answer. How do you feel about a tax credit plan as an alternative?

Mr. LINOWITZ. It is worth considering. I noticed that Governor Gilligan had made the proposal.

The problem with it, as I think about it, is twofold. One, if you do allow the credit, let's say 50 percent of the State tax is allowed on the Federal tax, your total take is actually diminished. You get less in the composite than if you do not have the credit. That means that the individual has the money and not the State. It goes back to the individual.

Now, I assume the States would say, then we are in a better position to come in with a tax increase to do the job that has to be done. But it seems to me we ought to recognize that it is taking two steps—allowing the individual to keep part of the tax that is payable and then hitting him with a higher State tax in order to get the additional revenue.

Chairman PROXMIRE. Let's consider we have several States that have no income tax at all. You give them an incentive in that 50 percent of the State tax that they pay is deductible from their Federal income tax as a credit.

Mr. LINOWITZ. I like our incentive better, the one we are proposing, which is tough. It says only States with an income tax are going to be eligible to get this revenue-sharing fund we propose, $4 or $5 billion, whatever it is.

Now, this, we think is not being unfair to the States but permits them to do——

Chairman PROXMIRE. Is their revenue sharing related to the severity of their tax?

Mr. LINOWITZ. We have proposed this: One, this revenue-sharing fund be distributed not only on population but also on the basis of need; two, that only those States which have a State income tax be eligible to receive——

Chairman PROXMIRE. Suppose they just have a nominal tax of one-half of 1 percent? If you do not have a corporation income tax or permanent income tax, or vice versa.

We have a 10-percent tax in Wisconsin, very limited exceptions. Illinois is much lower, 2 or 3 percent. It varies all over the place. So unless you relate it to how high the tax is, it seems to me you do not have the kind of incentive to move to a progressive tax system and raise funds to where you should be able to raise them.

Mr. LINOWITZ. I think that is a relevant point. Maybe it was a little too cavalier to say, as we have here, only a State which has an income tax. It has to be a credible income tax. Maybe it ought to be refined more than that. But we, in the first instance, talked about trying to get those States that do not have an income tax that say they need an income tax but say politically it is suicide, to be able to go to the people and say, look, we need an income tax in order to be able to get it from the Federal Government. Much as we dislike it, we are not going to be able to share in this revenue-sharing program. That helps them put an income tax in effect.

Chairman PROXMIRE. In the statement on national priorities which the Urban Coalition put out recently, you have a statement that economic growth alone accounted for over 55 percent of increased State revenues between 1966 and 1968.

Mr. LINOWITZ. Yes, sir.

Chairman PROXMIRE. Our committee is very interested in measuring the response of State and local revenues to economic growth, to inflation, and to recession. I do not believe this subject has been studied nearly as much as it needs to be.

Thank you very much. I think you have made historic testimony. What you have given us this morning is so important, so vital. You have not only talked about priorities, you have given us a framework on which we can build a program. You have even come up with a budget, which, of course, is the first document you have to have on priorities. You have indicated where we can cut spending, given us alternatives. I think this is very, very helpful testimony that goes a long way toward moving us in the direction of a far more rational expenditure policy on the part of the Federal Government. It is a fine job.

The committee will stand in recess until 9:30 Friday morning, when our first witness will be Governor Rockefeller, of New York, who will be followed by Governor Lucey, of Wisconsin, and former chairman of United States Steel, Mr. Roger Blough.

(Whereupon, at 12:20 p.m., the committee adjourned, to reconvene at 9:30 a.m., Friday, January 29, 1971.)

ECONOMIC PROSPECTS AND POLICIES

FRIDAY, JANUARY 29, 1971

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

The committee met, pursuant to recess, at 9:30 a.m., in room G-308, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Fulbright, and Percy; and Representatives Reuss and Conable.

Also present: John R. Stark, executive director; 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.

This morning we resume our special hearings on economic prospects and policies.

Our witnesses this morning are Nelson A. Rockefeller, Governor of the State of New York, Patrick J. Lucey, the Governor of the State of Wisconsin, and Roger Blough, who is now chairman of the Construction Users Anti-Inflationary Roundtable and former chairman of the United States Steel Corp.

Already in these hearings we have identified many of what might be called the hidden costs of the inflation-recession combination.

Of course, these costs are not hidden from those who are paying. The worker on part-time hours knows about it. The manufacturing worker knows that his real earnings have declined significantly, especially in the last 2 or 3 years. The State or city budget officer is very conscious of his financial problems. But to some extent, these costs have been hidden from the rest of us; partly because they are not immediately apparent in the aggregate statistics of output, prices, and employment on which most economic analysis tends to focus.

The budget problem faced by State and local governments has suddenly ceased to be hidden. The problem has now become a crisis which can no longer be ignored. It has suddenly become a central question of Federal economic policy.

Like many other problems, this one has a variety of possible solutions.

The administration has proposed revenue sharing as a solution to existing fiscal imbalances.

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I look forward to seeing the details of the administration's proposal, some of which will presumably be revealed in the President's budget message this noon. However, I hope we will not become so absorbed in arguing the pros and cons of the administration's proposal that we will neglect other promising alternative ways of aiding States and localities.

As I have pointed out previously, a major avenue of assistance, and the one to which we should give highest priority, is the restoration of full employment and reasonable price stability, and, of course, that is the function of this committee, to recommend policies to achieve that.

Inflation and recession together may well have cost our States and localities $10 billion or more in 1970. This certainly has been a major cause of their immediate financial problems. Beyond this, there are additional policies to be examined; tax credits, federalization of welfare, more aid to education, expanded urban programs; public service employment; and others.

Our first witness this morning is Governor Nelson Rockefeller of New York.

Governor, may I extend my sympathy for your great personal loss which prevented your appearance here on Monday as originally scheduled. We very much appreciate your willingness to appear this morning. I know you are on a tight schedule. I know, too, that you have given much study to the fiscal problems of States and cities; that, indeed, you have continuous daily experience with these problems; that you have some solutions to propose, and I might say, Governor, that I think that of all of the men in this country, in view of your experience over many years as Governor of a great State with a tremendous population, and a great variety of varying problems, and also your experience in the Federal Government, that you have probably more expertise and more experience than almost any other man in the country, so you are very welcome and we are very delighted you are here.

I am not sure I will agree with your proposals, but I certainly want to hear you present them and study them and, I might say, Senator Javits was called away by a heart attack that his brother Ben suffered and asked to have me convey to you his sorrow at not being here.

Barber Conable, who is one of your very able Congressmen from New York, a member of this committee, will present his statement.

Governor ROCKEFELLER. Hear, hear.

Representative CONABLE. Thank you, Mr. Chairman, very much.

Senator Javits was most upset that he was not able to be here to greet you personally this morning, Governor Rockefeller. And he asked that I read the following statement:

OPENING STATEMENT OF SENATOR JAVITS

I take great pride, on behalf of the State of New York, in introducing to the Joint Economic Committee, Governor Nelson A. Rockefeller, who has shown a unique awareness of the critical issues facing our country in respect of our economic prospects and policies and especially in directing public attention to the financial plight of local government at the State and city level.

It is well recognized that we face a crisis in the American cities in which over 70 percent of Americans live. It is becoming clear that if there is to be a solution which will preserve the Federal system and local responsibility, it will call for a far more enlightened system in sharing the tax resources which are made available to the Federal Government, which has most of the taxing power, with the States and cities.

Governor Rockefeller has perceived that while we are unlikely to be able to reform the political boundaries established almost 200 years ago, we can reform the economic and social boundaries in order to serve the peoples' welfare. He has also perceived that effective performance at the State and local level must be commensurate with the sharing of the available resources.

In the consideration of revenue sharing and similar programs already brought forward so prominently by the President, by Governor Rockefeller, and others on the national scene, I know we shall be helped immeasurably by Governor Rockefeller's testimony.

It is a matter of great regret that I must be absent from the hearing today due to illness in my family. But I know the Governor will enjoy every courtesy from our chairman, Senator Proxmire.

Mr. Chairman, I would like to add at the outset of this meeting, from his unprecedented fourth term as chief officer of a badly polarized and fragmented State, it is obvious that Governor Rockefeller has considerably more than his great personal attractiveness to commend himself to the voters of New York. Such a political durability has to be built on great service, on great dedication, and I would say the exercise of remarkable judgment in finding out what the people want, and in finding ways to help them achieve their goals. We in New York are all very proud of Governor Rockefeller. We think in the area of States rights that through his perception of the need for responsibility on the State level, he has done more to advance wise decentralism than the demagogs can ever damage.

Thank you, Governor Rockefeller.

Chairman PROXMIRE. I might say, Governor Rockefeller, before you begin, that Senator Percy also has a statement.

OPENING STATEMENT OF SENATOR PERCY

Senator PERCY. My words are very brief, Governor Rockefeller. Those of us who in 1967 supported the first revenue-sharing bill and tried to pioneer in this field—and even before that I came to Washington to testify on behalf of the Patman plan—are immensely grateful for the leadership you have provided. I can report that as of yesterday morning, having breakfast at the White House, I have never seen the President more determined to bring something about than he is revenue sharing. His entire staff is electrified about the effect that this can have in really rejuvenating local and State governments. So we are grateful for your leadership among all the Governors as the dean of the Governors, and the story this morning that you have for us will be most interesting indeed.

Chairman PROXMIRE. Governor, proceed; and if you would like to abbreviate or skip over any part of your prepared statement, the entire prepared statement will be printed in full in the record.

STATEMENT OF HON. NELSON A. ROCKEFELLER, GOVERNOR OF THE STATE OF NEW YORK

Governor ROCKEFELLER. Mr. Chairman, thank you very much indeed. I am greatly honored by the opportunity to appear before this committee, one of the most distinguished and sophisticated committees in the Congress, on a subject of unique importance at this moment in the history of our country. I thank you very much.

I appreciate your graciousness in allowing me to postpone the appearance, and I think that you have already made a summary which really puts the whole subject in perspective.

I have a prepared statement; I would like to read a few passages from it; but I would first like to outline the problem as I see it, and then answer whatever questions may be before you.

May I just express my appreciation, first, to Barber Conable, whom all of us in New York State consider as one of the bright stars of the political scene, both for our State and Washington; and to thank my good friend, Chuck Percy, with whom I have a very close personal friendship and sort of a family tie.

Mr. Chairman and gentlemen, I know that the basic subjects for consideration by your committee are those problems of inflation, wage-price squeeze, cost of money, economic slowdown, lower profits, growing unemployment, and Federal deficits. However, I am not going to try to get into those problems in detail but rather the indications of those and the exacerbation which they have as far as the financing and the conduct of the affairs of State and local governments are concerned.

However, I would like to just say that, in my opinion, serious and important as these temporary—we hope—problems are in our economy, a more fundamental and more lasting and more serious problem underlying the strength of this Nation and the strength of the federal system—is the financial crisis which affects State and local government nationwide at the present time; and I would like to discuss briefly why I think we have this problem, and what can be done to deal with the problem.

If one looks at the increase in expenditures by the different levels of government over the past 20 years—that is, from 1950 to 1969—you will see that Federal domestic expenditures are up a little over 200 percent. Those are expenditures which include Federal aid to State and local governments, but also all of your other activity—the Post Office, social security, and so forth.

Local expenditures during this period are up about 350 percent, and State expenditures are up over 400 percent.

Now, we see a situation here where there is a growing demand at the local level for services to meet people's needs; a rising price level which has exacerbated the problem which you mentioned; and the State governments increasingly trying to help their local governments meet those problems to a point where, in our own State, 63 cents of every tax dollar we collect goes back to local government.

Now in this situation, where we have these sharply increased expenditures at the local level, we have to look at the sources of revenue to meet them. If you look at the total tax picture, you will see that 65 percent of all taxes are collected by the Federal Government, and 35 percent by State and local government. But then, when one analyzes what taxes are collected by what level of government, one finds that the Federal Government collects 91 percent of the income tax, and State and local government 9 percent; and that most of the State and local governments revenues come from real property taxes, sales taxes, and various other nuisance taxes or general taxes.

So we see a situation here where the big growth is in the Federal tax, and the big growth in problems is at the local level.

Now, this situation is further complicated by the fact that inflation or rising costs in the last 10 years for all sectors of the economy are up about 30 percent, Federal Government expenditures are up about 43 percent, but State and local costs are up about 54 percent.

The reason for this is that Government wages, which are the big factor in State and local expenditures, had lagged behind the wages in industry and have been catching up, so we now have an accelerated cost increase at the State and local level.

If you take the actual figures of increases and expenditures over the past 20 years:

In 1950, State and local governments together were spending about $20 billion.

In 1968–69, the last year that we have the actual figures issued by the Federal Government, it was $97 million.

During that period, State and local expenditures have been rising at the rate of about 10 to 12 percent a year, but State and local revenue from this existing tax structure have been going up at the rate of 4 to 6 percent a year, leaving a gap.

This gap has been filled in two ways: Partly by increased State and local taxes, and partly by increased Federal aid through almost 500 categorical grants of one kind or another by now.

However, this situation is becoming more aggravated by the fact that State and local expenditures now, instead of increasing at the rate of 10 to 12 percent, have moved up and are now between 16 and 17 percent a year. So we have a situation in which—this coming fiscal year—we estimate the increased demand will be between $20 and $22 billion.

We estimate that about $5 billion of that will come from growth in revenues, and that leaves $15 billion.

It has been the pattern of the past 20 years that about one-third of the cost increase has been met by growth of normal revenue, one-third by increase of taxes and one-third by aid from the Federal Government and borrowing. This pattern will no longer work because revenue increases are not rapid enough—to keep up with their one-third, and State and local tax growths are not rapid enough to keep up with their one-third. We now have a situation where, if we are to prevent a serious breakdown of services nationwide, particularly in metropolitan areas, we can only hope for about 25 percent of that increase coming from growth of State and local revenue, about 25 percent coming from increased State and local tax rates, and 50 percent will have to come from the Federal Government.

This leads us to the question of the present structure of grant-in-aid programs of the Federal Government, which is a categorical grant structure.

This goes back, of course, to the period of the great depression, and the Second World War. We could go back further than that and say that the basic problem we face today, in terms of the imbalance of where the money goes and where the problems are, comes out of the 16th amendment when the Congress was authorized to collect a Federal income tax without reference to where the money came from; in other words, they did not have to return it on the basis of which they collected it.

That was under Woodrow Wilson, just before World War I. Federal income taxes went up very sharply to meet the needs of the people during the depression and during World War II, and at that same time this categorical grant system grew greatly, with a distribution on the basis of an inverse ratio between population and income.

The situation really is different today from what it was then. The situation of the so-called poor States and wealthy States no longer really pertains, because we now have in the wealthy States the poor areas in the metropolitan areas and much of the population from the poor rural States has moved into the so-called rich States, and to their urban areas, and now we have a new form of poverty and deprivation which is very serious.

These categorical grants were stepped up even further—and combined with a fiscal problem during the Johnson administration. When the major increase in the activities in Vietnam took place, along with a war on poverty—conceptually a great concept—but without raising taxes, we ended up in fiscal 1968 with a deficit of about $26 billion coming on top of an economy which was operating almost at a full level. This pressure of additional spending, both for the military and for the poverty programs, caused two things: It caused an economic or a monetary inflation, plus an inflation of rising expectations which could not be fulfilled because there wasn't the money to do it.

Now, I would like to make one more comment about the present system of categorical grants. I think the Federal Government has in the neighborhood of 100 grants in the field of education. We have to, as a State, fill out for the Department of Health, Education, and Welfare 20 State plans on education, which are overlapping, really duplicating, often unrelated to our problems or the structure of our educational system, which is a State and local system.

Now you would think that, during all this, and carrying out all of these efforts, that we would get some money that would go with it. But of our total cost of public elementary and secondary education we get 5 percent from the Federal Government. So that here we are really in many ways spending a great deal of money to carry out paperwork and filling out programs and setting up or talking about how we have got these statewide plans, trying to match these categorical grants, and then we end up only getting 5 percent of the costs from the Federal Government. The State puts up 49 percent and local government puts up 46 percent.

What has happened, and I think this goes to the heart of the present categorical program that is carried out by the Congress, is that categorical grants are to encourage States to do new things, to meet new needs, and to catch up in terms of social progress.

Well, this is a wonderful objective, and during the period of the depression and the subsequent years, many of these things have had a most beneficial effect. But we now do not have enough money to meet the basic services for teachers' salaries, the policemen's salaries, the sanitation workers' costs. In other words, our problem is in meeting our fundamental responsibilities, and yet this flow of grant-in-aid programs is continuing, all of which are on a matching basis, all of which get tremendous publicity when they come out because they meet new needs; they arouse new hopes and then, as you gentlemen know, they require matching.

Sometimes, when the program comes out, as in the case of pure waters, there is a very important authorization and then, 6 months later, there is an appropriation which could be 20 percent or 25 percent but that does not get into the press. Back home, our people are stimulated—Washington is going to make this possible, and the goals are tremendous, and they are important—and so we then are left with trying to carry out these programs, which are fine programs, but for which we do not have the money. And the Federal appropriation has been cut, but nobody knows this, and so the people look to their local government and their State government and ask, "Why aren't you giving us the program which Congress promised us?"

Now—this is a serious situation. It is true in education, it is true in the pure waters field, in cleaning up our environment, and it is a very difficult situation.

Now, you can say, "Well, why don't you raise your own taxes? You can raise taxes and you can deduct them from the Federal tax, whether it is an income tax or another tax." That is a perfectly valid statement and I have said myself on previous occasions that the Federal Government has not completely preempted these taxes which some people like to say. They have not.

However, if you will excuse me for using New York State as an illustration, we have raised our taxes. In fact, New York State and its local governments today have the highest taxes per capita in the country, and I have a very unfortunate message for the people of New York that will come out next Monday about what is going to be necessary pending action by Congress; pending action by you to help us in this financial crisis, we are going to have to raise taxes substantially again.

But here is the difficulty: We have a 14-percent progressive income tax. None of our neighbors has any income tax and we live in a large metropolitan area so there is a very real temptation, which is succumbed to by some, for an individual to move across the line and live in one of our neighboring States and avoid our income tax and then come in and take advantage of all of the services which we provide.

We have another problem: Business, which is more mobile today than ever before in our history, can move, and they are constantly coming up with new products so they have to develop new plants so they say, "Well, let's look around and see where we can get the best deal in terms of operations, the most profits," and they may say, "Well, we can locate in some other part of the country."

So as we raise our taxes to meet our people's needs, and provide better services, we have a tendency to cause the loss of the income producers and the job producers, but as our services improve, we are attracting those who are less fortunate in other areas of the country in terms of educational opportunities, training, et cetera, who cannot find jobs so they come to New York or they come to Chicago, and there they find that they get certain benefits because of our social programs, and so we find ourselves in New York State today with a percentage of our population on welfare double that of the Nation.

We have 10 percent of the State's population on welfare. It is rising at the rate of about 15,000 a month. The rest of the Nation has about 5 percent of its population. But again you take the Federal laws, our rates are higher than anybody's, well, almost anybody else's benefits.

But under the Federal law we cannot cut those rates without losing the matching funds, even though they are higher by 5 or even 10 times those of some other States.

So I am taking the liberty of going into some of the realities of the present Federal, State, local relationship as seen from the view of the State and local governments.

Now, I was frankly very impressed and very pleased when the President gave his state of the Union message and faced up to some of the problems in a way, to me, that was extremely encouraging, and I would just like to read a few paragraphs from the opening pages of my prepared statement, here, to give you my own impression of why this position which he has taken is so encouraging to State and local governments.

The President in his state of the Union speech 1 week ago today, made historic and imaginative proposals for meaningful Federal revenue sharing and radical changes in the Federal structure and financing of essential services.

These two new conceptual approaches, if enacted by the Congress, will go a long way toward making our federal system more responsive and relevant to today's needs.

I feel, however, that the magnitude of the present fiscal crisis at State and local levels of government requires an initial $10 billion of new money through revenue sharing, to take effect on July 1, 1971, instead of the proposed $5 billion.

Only revolutionary changes in the structure of the federal system along the lines outlined in the President's message can help us meet the challenge facing America today—and the President is to be congratulated for his courage in proposing them.

His bold proposals afford the Congress a unique challenge and opportunity for statesmanship:

An opportunity to help reverse the centralization of power in Washington;

To help return to the people the opportunity of achieving responsive and responsible government at State and local levels which has been the historic strength of America;

And to help save our federal system and restore the greatness of our free society.

I would just like to say, gentlemen, that we are facing growths, and I will give you the figures here. the estimated total through 1973:

Expenditures, 1968–69, $97 billion.

The next year, which is the past year, 1969–70, $112 billion for State and local government.

In 1970–71, $130 billion, a growth of $18 billion.

Next year, which is the year we are coming to, 1971–72, a growth of $21 billion to a total of $151 billion; 1972–73, a 17-percent growth rate. $26 billion increase, $178 billion. And 1973–74, another 17 percent growth, total additional needs of $30 billion coming to $208 billion, and that is only 4 years away.

Now, and I can say that this is almost equal to the Federal budget this year, and yet you have the fastest growing revenues coming into Washington. In the past 5 years, you have cut these three times, and we at the State level in the past 10 years have had over 300 tax increases, and our neighbors in Connecticut created a tax committee to make recommendations on a bipartisan basis and they just came up with a recommendation 2 days ago that Connecticut should impose a 20-percent surcharge on Federal income tax, which, if imposed in our State, would produce some $4 billion, so a desperate situation exists. Of course, from our point of view, if our neighbors start doing something like this, it is going to be very helpful to us and maybe some of the "lost sheep" will return.

But I think that gives, Mr. Chairman, the picture that State and local taxes on real estate and on sales, and on all of the other fees cannot meet these growths. Income taxes are not impossible on an equal base throughout the States, and, therefore, we are seeing this increased distortion, and so I support revenue sharing and a simplification of categorical grants in the block grants by areas, and I think the President has made a major contribution.

I know there are other important recommendations in the same field which, I think, are very valuable contributions, and all I can say is that if we do not meet this problem we are going to see a breakdown of services this year in our cities and metropolitan areas spreading throughout the country which can create an uprising in a form which would be hard to predict but which can be the most serious our Nation has ever seen.

So I appreciate your kindness in letting me be with you.

Thank you.

(The prepared statement of Governor Rockefeller follows:)

PREPARED STATEMENT OF HON. NELSON A. ROCKEFELLER

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REVENUE SHARING

The President's revenue sharing proposal for $5 billion of new money for the first year, divided evenly between state and local governments. is undoubtedly a major breakthrough in this moment of fiscal crisis at the state and local levels of government.

I will continue to work with all interested groups in support of the President's concept—but will also continue to urge an initial $10 billion level.

CONSOLIDATION OF CATEGORICAL GRANTS

President Nixon has also proposed radical changes, consolidating a multiplicity of Federal categorical grant-in-aid programs into six blockgrants, tied into a restructuring of the Federal government itself.

Consolidation of categorical grants, together with revenue sharing, both long supported by tthe National Governors' Conference, would make possible a renewal of the vitality and effectiveness of state and local governments.

THE FISCAL PLIGHT OF STATE AND LOCAL GOVERNMENTS

Current economic conditions—inflation, the wage-price squeeze, the cost of money, the economic slow-down, lower profits and rising unemployment—all exacerbate the present problems of state and local governments. Today, I want to talk to you about an even more fundamental, long-range problem that effects all of us and the future of our Country. It is this fiscal crisis facing the state and local governments in America.

I would like to discuss first, how we got to the point of fiscal crisis, and, secondly, why $10 billion of new Federal aid from Revenue Sharing is absolutely essential to end the crisis.

Let us begin with some statistical background. In 1950, state and local governments, nationwide, were spending $20 billion. By 1969, they were spending $97 billion, almost five times more. At the present accelerated pace, it is estimated that state and local governments, nationally, will be spending about $200 billion by 1975.

Now let us look at where the money is coming from to pay for state and local services to people. Federal domestic spending in the last 20 years has gone up 219 per cent, local government spending 354 per cent and state government expenditures by 413 per cent. During this period, state and local expenditures increased by an average of 10 to 12 per cent annually. But, their revenues from existing taxes grew by only 4 to 6 per cent a year. Consequently, state and local governments had to increase taxes constantly to meet new demands on them and higher costs.

We have now reached a point where state and local expenditures are rising between 15 and 17 per cent. But their revenue sources are still producing only an average increase of 4 to 6 per cent under the present tax structure. These figures give a statistical picture of the financial vise crushing state and local governments.

Now, let us look at who collects what taxes. The Federal Government collects 65 per cent of all the taxes paid in the United States. Local governments collect 16 per cent and state governments about 19 per cent.

Not only does the Federal government collect the bulk of all taxes, it also collects 91 per cent of the fastest growing tax, the income tax. State and local governments have to depend heavily on the less progressive taxes such as real property taxes, sales taxes as well as fees and nuisance taxes for most of their money.

The Federal government has collected the lion's share of the fast-growing taxes—particularly in the recent period of substantial economic growth, before the GNP slowed down.

In fact, we have seen three Federal tax cuts in the past 6 years, while state and local governments across the Country have had to increase taxes almost 300 times.

Here we have a situation where the severest problems are growing at the local level; but tax revenues are growing fastest at the Federal level.

HISTORICAL ROOTS OF THE PROBLEM

Let's take a brief look at history to see how this situation came about. Our society was originally agrarian, and the focus of government originally was at the state and local level. Then came the Wilson Administration. The Sixteenth Amendment—the income tax—which was enacted in 1913. The critical point here is that the Federal income tax did not have to go back to the states in the proportion in which it was collected. That's an important factor.

Later, under President Roosevelt, there was a period of tremendous increase in Federal power as a result of the Depression, World War II and the withholding tax system.

These events eventually led to a tremendous increase in Federal tax collections. The growth in Federal power and revenues was understandable, given the tragic problems and drastic needs of the times.

As you know, it was during the mid-Thirties, in order to relieve the terrible consequencies of the Depression, that the concept of categorical grants was started. These categorical grants were based on population and were calculated in an inverse ratio to income in order to help what were considered the poor states most—to give them a higher ratio of return.

Today, between 400 and 500 of these Federal categorical grants are available to the states and local governments.

They were and are intended to spur innovative and new programs at the state and local levels. This is fine, except that categorical grants do not help us meet the cost of basic, day-to-day ongoing services. And this is where the crunch is today in state and local governments.

In fact, through their matching requirements, categorical grants take money away from basic services and add to state and local taxes to pay the matching costs of new programs. Consequently, categorical grants can aggravate, rather than alleviate, state and local, fiscal problems.

More recently, two additional factors have aggravated the plight of state and local governments further—the expansion of the Vietnam war and the declaration of the war on poverty during the Johnson years.

These developments required major increases in expenditures at a time when the Nation's economy was reaching full capacity. Taxes were not raised to pay for either war, until at one point the Federal government had a $26 billion deficit. The result, of course, was the inflation which is still plaguing the Nation.

But, in addition to the inflation of prices, an inflation of hopes and expectations also grew out of this period. The war on Poverty raised the hopes of the least fortunate members of our society. But the funding of the poverty programs never was enough to fulfill their promise. The low appropriations level never seemed to match the high publicity level. These unfulfilled hopes led to frustration, bitterness and diminished confidence in government.

Television played a part, too, in inflating expectations. Television helped create the "Now" generation, and not just among the young, but among people of all ages. Television showed many people what they didn't have. And what people saw, they wanted—now. They want it yesterday, not tomorrow, and they won't take no for an answer. They do not want to be told it is not possible now, because, in this great Country of ours, everything seems possible.

All these forces together, the tremendous growth of Federal revenue from the income tax;

The smaller share of revenues going to state and local governments;

The steeply rising expectations of people for things they expect state and local governments to provide;

The failure of the Federal government to fully fund programs—after whetting the public's appetite;

The reluctance of individual states to raise taxes for political reasons, or out of fear that higher taxes will drive out industry;

Are the historical roots of the financial disaster facing state and local governments today.

NEW YORK STATE ILLUSTRATES THE FISCAL CRISIS

Let me typify the situation confronting state governments using the State of New York for illustration.

New York traditionally has been a progressive state. Some may think it's too progressive. But, we have tried to meet our responsibilities to the people, and on a sound basis.

We have a 14 per cent progressive income tax. None of our neighbors has an income tax. Our difficulty is that if we increase our taxes too much, we are going to affect our position relative to other states in the competition for jobs and industry.

Also, because we are a progressive state, and because there are no national standards for welfare and medicaid, many needy people have been drawn to New York from other states. Initially, they came looking for opportunity, but often they wound up on public dependency. This migration has added problems to New York which originated elsewhere.

In brief, here are the hard fiscal realities we are up against in New York. As I pointed out in my recent State of the State message, just for the State to carry out the programs it is already committed to, will require an overall budget increase of over $1.5 billion.

This is the increase figure before any new major State programs or any State increase to local governments to help them meet their needs. New York City, for example, projects a $1 billion deficit for the coming fiscal year.

THE PATTERN IS NATIONWIDE

New York's situation is typical. It's part of the pattern of crisis afflicting State and local governments throughout the Country.

In New Jersey, Governor Cahill said that the financial collapse of New Jersey cities is "an issue of life and death."

Governor Meskill of Connecticut says his state, with one-sixth the population of New York State, is "wallowing in debt" and will need $800 million in new taxes over the next two years—proportionately a worse situation than in New York.

Florida, with just over a third of New York's population, needs $200,000,000 more to continue programs at present levels.

Michigan, with about half of New York's population faces a $344,000,000 gap between state spending and revenues.

In Oregon, Governor McCall had to take funds from schools to pay welfare costs.

And Governor Shapp has told this committee that Pennsylvania will be out of money and unable to meet its obligations within 30 days, unless new revenues are forthcoming.

REVENUE SHARING, AND SIMPLIFICATION OF FEDERAL GRANTS-IN-AID ARE THE ANSWERS

When present rates of growth in state and local expenditures are projected nationwide, it amounts to a need for increased expenditure of over $20 billion for the coming fiscal year alone.

By themselves, state and local governments can not possibly raise more than half that sum—$10 billion, $5 billion from revenue growth and perhaps $5 billion more from increased taxes—without crippling effects on local real property taxpayers and serious further distortion of the tax structure between all levels of state and local governments.

We have simply got to get more of this Nation's resources—more of the two-thirds of all taxes and nine-tenths of all income taxes now paid to Washington—back to your constituencies where local government services are virtually falling to pieces.

That is why I support the President's splendid and courageous initiative in proposing revenue sharing providing $5 billion in new money for the first year. But, because of the magnitude of the problems we face, that is why I will continue to urge the enactment of revenue sharing at the $10 billion level to be effective July 1, of this year. To put this recommendation in better perspective, let us bear in mind that in talking about revenue sharing of $10 billion we are talking only about 5 per cent of the Federal budget.

I also strongly support the President's excellent proposals for replacing many of the rigid, narrow categorical grants with grants for the broad purposes of urban development, rural development, education, transportation, job training and law enforcement.

These less restrictive grants will give state and local governments the opportunity to exercise greater initiative and to put Federal aid where they know their greatest needs are. As the President himself has said, the idea that a bureaucratic elite in Washington knows best what is best for people everywhere and that you can not trust local government, is really a contention "that you cannot trust people to govern themselves." And when we are talking about opposition to revenue sharing, and to more flexible Federal grants, it is a contention that people do not even know how to spend their own money wisely.

The fact is that the 200 million Americans that Congress represents are the same 200 million Americans that leaders in state and local governments represent. And here, it seems appropriate to mention that, according to a recent Gallup Poll, 77 per cent of all Americans support revenue sharing.

CONCLUSION

There has been a profound psychological transformation in the mood of the Country in the past decade. At the beginning of the 1960's Americans were filled with hope. They could talk about the opportunities and challenges of the future. Today, so many of the problems confronting our society seem so huge and unmanageable, that the public mood tends toward feelings of frustration and helplessness, if not hopelessness.

A crisis of confidence in our governmental institutions has developed. Many of our citizens are beginning to question whether those institutions are, in fact, capable of coping with some of the urgent problems that confront us. Indeed, many doubt whether our governmental systems are, or can be made responsive to the needs, aspirations and concerns of individual citizens.

Charisma and exhortation alone are no longer enough. A sense of progress is needed based on demonstrable evidence that we are beginning to pull ourselves out of the current morass. I believe that the President's proposals can help restore people's confidence in government by helping to restore government that really serves people—at every level in the Federal system.

As the President said, in his State of the Union address, this can be an historic Congress in turning power back to people and reversing the overcentralization of power in Congress. Revenue sharing on a meaningful scale and the simplification of categorical grants are the keys.

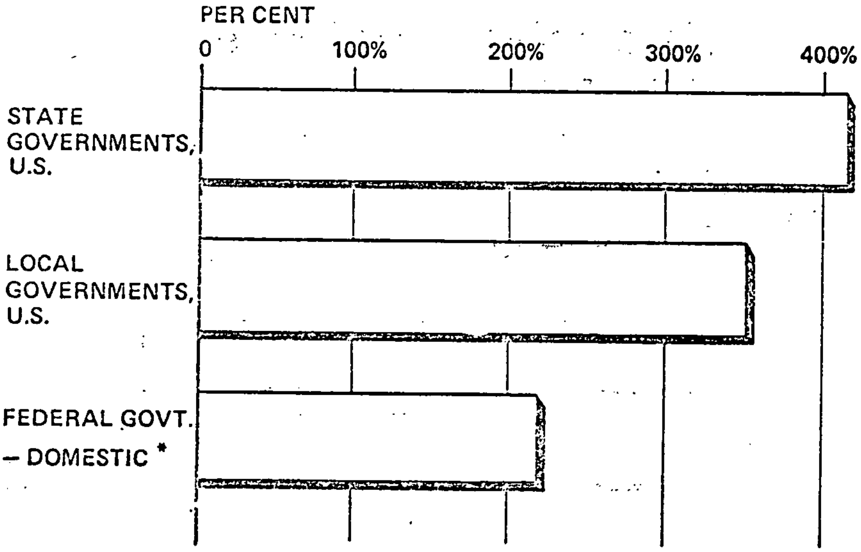
Given the breakdown in local services, the Federal government must either provide the needed money or take over these vital services. But the prospect of the Interior Department cleaning the streets of our cities, for example—is inconceivable. Revenue sharing and less rigid Federal grants are the right answers.

What those of us promoting these objectives are calling for is nothing less than the preservation of the greatest system of government ever devised by man to serve the needs of mankind.

I am confident the Congress will answer that call.

*Increase in all government expenditures**

UNITED STATES 1950-1969

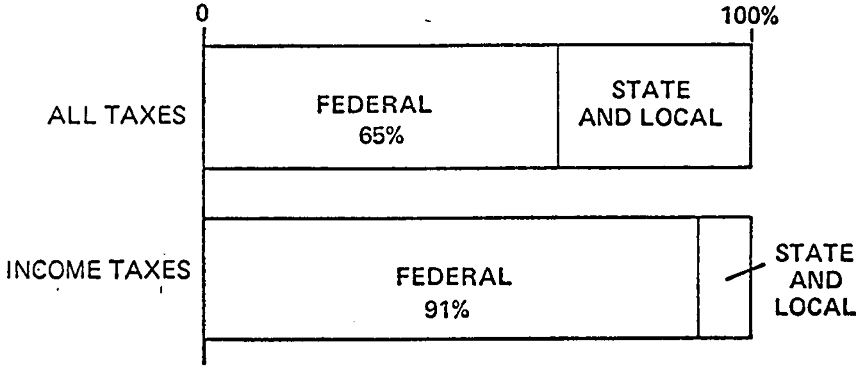


* Excludes defense, international and space expenditures.

SOURCE: U.S. Bureau of the Census.

Tax collections, all governments

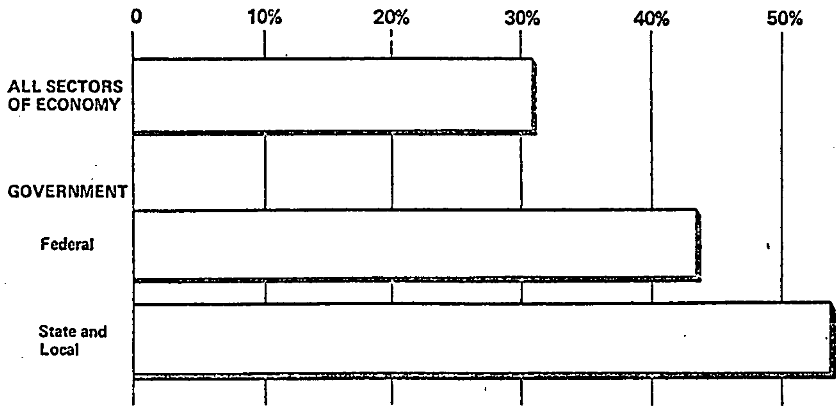
TOTAL FOR U.S., FISCAL 1969



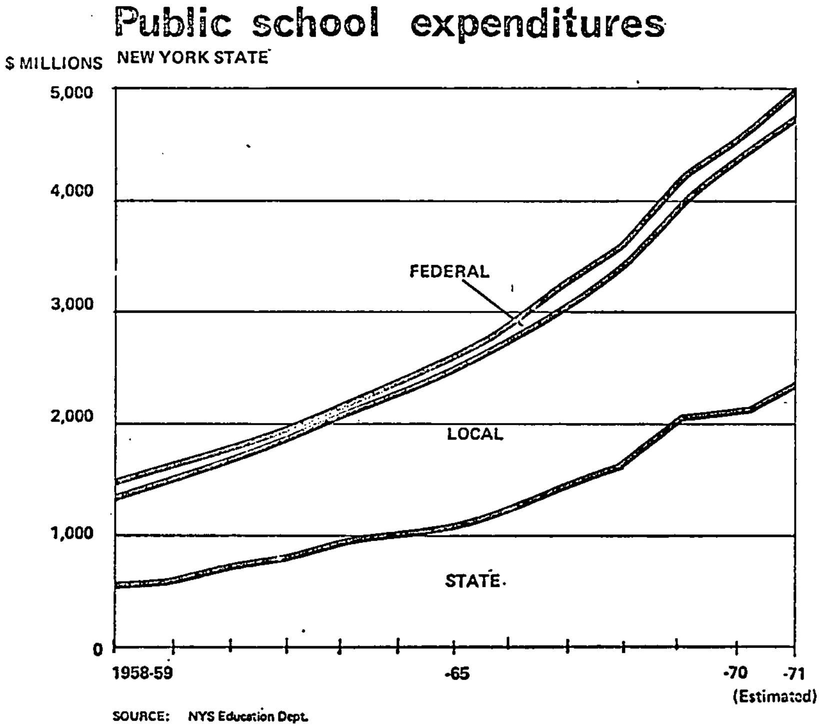
SOURCE: US Bureau of the Census.

The costs of materials and services

PERCENTAGE INCREASE, 1960-1970



SOURCE: U.S. Dept. of Commerce



Chairman PROXMIRE. Thank you, Governor Rockefeller. I have listened to a number of appeals for revenue sharing, and I think you presented yours as the most convincing I have heard by far.

You answered many of the arguments against it and, of course, you speak on the basis of great experience and, as you indicate, you have made an effort yourself just in the last few days, and the paper this morning reported you are asking for a tremendous tax increase.

Governor ROCKEFELLER. Over a billion dollars.

Chairman PROXMIRE. Over a billion dollars.

Governor ROCKEFELLER. One State, and it just puts us out of line with everybody else. I have no alternative.

Chairman PROXMIRE. By the same token, New York was already the 19th in the country and this would move this up unless the other States would increase their tax rates, and I am sure they will, but still you are not in the position of other States who testified.

We had the Governor of Ohio, the Governor of Pennsylvania——

Governor ROCKEFELLER. Yes.

Chairman PROXMIRE (continuing). And they agreed that they have to increase their taxes very greatly. Ohio was 49th in tax effort. Pennsylvania is way down in tax effort. New Jersey is, I think, 46th or 47th.

What I am getting at, however, Governor, is that I wonder if this is the sensible overall way to do it.

You have a rich State; you have made a very strong case that you simply cannot ask for much more in tax revenues because of the competitive problem. At the same time, supposing we had a law passed by the Federal Government that would permit States to have a tax credit in Federal income tax, that would help New York taxpayers greatly. It would certainly provide a sharp and immediate incentive for other States to impose income taxes. It would greatly reduce the competitive obstacle that you have for increasing taxes, and it would do the most important of all—it would provide that the agency of Government responsible for spending the money raises the money, and has some discipline in connection with its expenditures. What is wrong with that kind of an approach?

Governor ROCKEFELLER. Well, may I make two comments: First, about what you said a little earlier, and then come to that?

Chairman PROXMIRE. Yes, sir.

Governor ROCKEFELLER. You said we were 19th in State tax effort. That is correct. However, our local governments are way out ahead. So when you combine State and local taxes in New York we have a tax, combined tax, per capita of over $500, and we are the highest.

So that you really cannot consider——

Chairman PROXMIRE. You are the highest overall. What I am talking about is the relationship between your taxes and your income.

Governor ROCKEFELLER. Oh, I see, the tax on the income. That is correct. But that is not something that a man or a company thinks about when they are trying to figure—and one of the serious problems we have are companies trying to get middle management to come to New York to work, and they are the future growth in the private enterprise system, and they have to pick up not only their increased costs but they may have a problem getting people to come.

Now, Mr. Roger Blough is here, one of the distinguished industrialists of our State, and he can testify to this kind of problem.

The other thing is we are a State with the highest per capita income or right up at the top and we do send down here $23,600 million, and we get back for State and local services $2,500 million. That is 11 cents on the dollar, and my contention is that we cannot meet these rising costs and demands of teachers, firemen, and policemen. You have had the distinguished mayor of New York City here, and I am sure he gave a closer view of the problem, but we have got in our budget for next year $950 million of increased aid to local governments and school districts, and that is all mandated by legislation that was passed last year, and the years before. But none of that goes toward helping the city of New York, meeting additional needs, for instance, where they estimate their needs up to a billion-dollar gain next year.

Chairman PROXMIRE. I would agree you definitely need more revenues.

Governor ROCKEFELLER. What are you suggesting?

Chairman PROXMIRE. Of course, my question is: Why shouldn't we create a situation in which you can raise the revenues yourself?

Governor ROCKEFELLER. All right. If you had a deduction, an income tax deduction, from the Federal tax, which I suppose would be, whatever we raised we could deduct in total amount from the Federal funds.

Chairman PROXMIRE. Perhaps not in total amount. We would like to provide some incentive; otherwise there would not be the kind of discipline we are talking about. Maybe you could deduct 50 percent.

Governor ROCKEFELLER. Well, you see what we have got to get at is something all the States will do because we cannot have a plan which will further distort the relationship between the States. That is our biggest problem. I have asked for tax increases and have been successful six times in the past, and this is the seventh time.

Now, the Secretary of the Navy, who is here, John Chafee, tried this in Rhode Island and he won by 72 percent of the vote at the time before he went all out for an income tax, and he was defeated by a man who said they did not need it. That man still happens to be Governor and now he finds himself that Rhode Island's deficit is the size of his entire budget. So that this situation is a very difficult one.

I have no concern personally as to what method we use to get a larger share of the total tax revenue back to the States. All I want to be sure is that it is not just New York that uses it, because we are going to lose our business and our industry and the people who are paying the taxes and create the employment, and we are going to get continually more and more people coming from other areas where these standards are not so high.

Now, as I have gone, and the Governors have gone, because we have been dealing with this for years, all different routes, and we have recommended all kinds of things, different methods, including the one which you proposed.

I remember discussing this at a meeting at which Mel Laird was present and he had been one of the proposers of this and I said, "All right, Mel, what would your reaction be if 20 of the largest industrial States' Governors got together and said, 'Fine, we can take this credit.'" Now we are going to get together and we will impose a 10 percent tax or 20. If we did 10, we can pick up about $15 billion; if we did 20, we will pick up $30 billion. We will face you with a revenue loss of $30 billion. I know what Congress will do; they will immediately do what they did when they passed the Medicaid program. We studied the law very carefully and figured we could get $270 million by improving the laws. We improved and we went to Washington with a basket and got the $270 million.

Your distinguished colleague, Jack Javits called a meeting of our delegation of Congressmen and said: "What are you doing, you are taking all the money we planned for the entire nation." I said, "Look, Senator, I did not write the law; you fellows wrote the law; this is what it said. We followed the law and we got it."

So what did they do? They changed the law and cut back, and we had to take about 1 million people who had become eligible for medical care off the rolls because you cut back, we had to cut back so we did not have the money to go it alone.

Now my concern very frankly is if you went this route, and we really acted, and picked up the money, Congress would be horrified and say, "Well, we did not have that in mind." So that you change the laws and we then would lose the money.

Now, I am only trying to be pragmatic about this, because we have tried everything to get a larger share of our own taxpayer's money back to New York.

Chairman PROXMIRE. My time is up. I will be back.

Governor ROCKEFELLER. Thank you.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. I would first like to say to the chairman that unlike other hearings that I have heard announced on this subject we are having open hearings here with open minds rather than announcing open hearings and then having a closed mind on the contents of the testimony.

I hope that the chairman, who has been somewhat cool to this concept, will be warmed up by it this morning, because he will be one of the strongest advocates we can have, if he does support it.

I turned around on the SST, and someone who gets religion, I believe, becomes an even stronger convert. I hope he will be a strong advocate of this principle when the hearings are concluded.

Chairman PROXMIRE. May I just interrupt to say there is no stronger opponent to the SST than Senator Percy. He has done a fine job in the progress we made against it last year.

Senator PERCY. I hope I can give all this credit back to our chairman for getting revenue sharing through this Congress. [Laughter.]

Chairman PROXMIRE. No chance.

Senator PERCY. There is no more tenacious fighter for a cause when he believes in it.

I would like to ask, first of all, the question that comes up in many States—how much States pay in taxes and how much they get back? How much would New York's proportionate share of the cost of revenue sharing be and what would it get back if there were a $5 billion bill passed under present formulas?

Governor ROCKEFELLER. We would get about 10 percent or $500 million, and if the sharing is as it is planned, 50 percent to local government, 50 percent to the State, we would get $250 million. That represents $250 million as against an increase in State expenditures this year of $1.5 billion.

And $250 million for local government is against, for instance, New York City's estimated increased needs of a billion. So that we are, frankly, I hate to say it, I do not want to seem ungrateful, but it is pitching pennies against a wall unless we really face the realities of what is happening in America.

Now, if we did slow this thing down, which maybe just by the fact that the services are going to break down is what is going to happen, I think unless we really look at this not in a form of—well, the concept is great, I do not want to seem unappreciative, but still we have got to face the realities and you gentlemen are tremendously knowledgeable and sophisticated, and with these programs of growth, $5 billion is the best that has been suggested, but I really think that $10 billion is going to be required to prevent a real breakdown.

Senator PERCY. The initial administration revenue-sharing bill was half a billion. We have now come up to $5 billion so it is a tenfold increase. At least we are moving in the right direction so far as you are concerned.

Governor ROCKEFELLER. That is right. But the problem is not going to wait. That is the only message I want to try to get out.

Senator PERCY. I won't inquire as to whether you are a long-term Keynesian or an instant Keynesian but do you support the concept of a full employment budget taking into account the state of the economy today?

Governor ROCKEFELLER. Yes, I do but I figure that you men are more sophisticated in this area than I am.

I do support it, and I think it is going to be very helpful, and just a perfect illustration is our revenues this year dropped $275 million—a little under $200 million. Excuse me, from the last estimate, $200 million.

Now these are serious swings which come out of the economic retardation. So I am for that.

Senator PERCY. To help meet this fiscal crisis which the States are going to face and are facing, will the President's welfare reform program, family assistance program, help materially if more welfare costs are taken over by the Federal Government?

Governor ROCKEFELLER. Yes. I think it is an excellent program. I have supported it fully. The Governors have supported not only that but the full takeover of welfare, but the President's program does two things which I think are essential: One, it creates incentives for the father to stay with the family. This is fundamentally necessary. We have over a million mothers and children without fathers on welfare in New York State, and so I think that is No. 1.

No. 2 is work incentives, which are excellent. These I think are very important. And he takes in 11 million people under his plan who are now not receiving benefits, even up to $1,600 for a family of four, and gives them assistance. This will slow down the movement of population from some areas of this country to the big industrial cities which, I think, can be very helpful, too.

But it does not from a money point of view; it does give about $100 million of help on a $2 billion welfare budget which we and the localities are handling.

Senator PERCY. Other Governors have testified before us indicating that revenue sharing will be necessary just to maintain certain current programs and keep their heads above water.

Would the $5 billion level enable you to have any new programs at all in New York or would it just be a matter of maintaining current programs?

Governor ROCKEFELLER. No, it won't even in New York maintain the current programs.

Senator PERCY. Could you comment on the effect of local property taxes on landowners? This is where I hear from a great many of our people.

We have raised a lot of our revenue in Illinois from property taxes and we are under a crushing burden. Do you think that revenue sharing may eventually, if it is generous enough, alleviate the pressure and the burden on property holders?

Governor ROCKEFELLER. Certainly this is a necessary objective. If education keeps on growing the way it is in costs, educational costs are doubling every 6 years, so that education falls—the local share—on the real property taxpayer, along with the local government.

I do not think that it would be reasonable to assume that at the $5 billion figure there would be any relief for real property taxpayers. Even at a $10 billion figure what it would do would be to slow down the increase on the real property taxpayers.

If you take $20 billion as a conservative estimate of increased State and local costs, and you take $5 billion as about a fair estimate of growth in revenue, you have got $15 billion to go, and if you take the State and local tax base which is real estate as you point out, and the sales tax and the fees, and 9 percent of the income tax, how do you raise anywhere nearly enough? All you have to do is look at our tax package on Monday and you will see how we have got to raise the money we have got to raise and it is a crushing blow to the taxpayers and the economy.

Senator PERCY. Governor Rockefeller, thank you very much for the very compelling argument you have provided to us. It is exceptionally good.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Excellent statement, Governor Rockefeller. I am a believer in revenue sharing if done right, and you have made a strong case for it.

Governor ROCKEFELLER. Thank you.

Representative REUSS. You have pointed out two of the great fundamental problems in your State of New York when you say, on the one hand, you have a terrific welfare burden much of which did not originate as your problem at all, but is really a national problem, and then, on the other hand, you try to be progressive in your tax system, having a progressive income tax but your neighbors do not have it and so you see your industry going over the hill, which if continued could be ruinous.

On the welfare point, would it not be sensible, if in addition to revenue sharing, from which I do not back off at all, the Federal Government would pick up all or substantially all of the basic cost of welfare leaving administration to the States and localities? Would that not be a great additional help to the new federalism?

Governor ROCKEFELLER. It would be tremendous. It would be tremendous, both in terms of social implications, because then there would be national standards, and financially to our State.

Our concern, although the Governors have announced and endorsed this concept for a number of years, our concern in New York State is that Congress is going to be reluctant to help New York to the tune of $2 billion, because it is New York, and a lot of other States are spending very little so they get very little out of it.

And if you use a minimum standard and put people on welfare who really need the help, of course that does not help the States themselves in other parts of the country.

So that, politically speaking, I worry that it could be done. But were it to be done it should be done to the greatest possible extent.

Representative REUSS. And in combination with revenue sharing——

Governor ROCKEFELLER. Fabulous.

Representative REUSS (continuing). You think it would make our system work better?

Governor ROCKEFELLER. Oh, yes.

Then you really are talking substantive, major substantive changes in the system which can preserve what our country has always felt was the Government closest to the people.

Representative REUSS. I agree with you.

Now, turning to the other side of your problem, to the fact that you have an income tax and your neighbors do not, you have in answer to the Chairman's question shown unease, which I happen to share, about the use of tax credits to induce other States to pass income taxes. Tax credits, of course, go at least in the first instance to the taxpayer, not to the State, and they also go to wealthy taxpayers more than they go to less wealthy taxpayers. So there is considerable to be said against them.

Let me get your idea, your reaction, to an idea designed to get States to pass progressive income taxes and thus relieve the competitive disadvantage under which your State labors. This idea is incorporated in a revenue sharing bill that Senator Humphrey and I have just introduced.

We would give in our allocation to the 50 States, which allocation in almost all revenue proposals is based on population weighted by revenue efforts——

Governor ROCKEFELLER. Right.

Representative REUSS. We would give double weighting to the revenue that a State obtained from its income tax, thus making it very advantageous for a State to pass an income tax, and once having passed one for the 50 States to attain about the same level of progressiveness. What would be your reaction to incorporating such a weighting proposal in revenue sharing?

Governor ROCKEFELLER. Well, anything that will encourage States to even out their tax structures so that we do not develop an artificial climate within this country between States so that it is more attractive to go to one place and less to another, and so forth, I think is constructive particularly from a tax point of view.

If that incentive would work, it is fine.

Representative REUSS. Do you see any reason why it won't? It seems to me that it is a real incentive, and that it does not distort the structure, the income tax structure.

Governor ROCKEFELLER. Well, the problem is, it is the individual Congressman, pardon me, not Congressman, but legislator, who has to vote for the tax and who has constituents who are opposed to it, and the attractiveness of it would help but if he is under enough pressure he just won't vote for it and depends perhaps on a limited group of constituents who are supporting him.

Representative REUSS. Of course, even in the States like some of your neighbors, where they do not have an income tax there are a great many people, including a great many Congressmen, who think that their State ought to have an income tax, not to be nice to you, the neighbor that does have one, but because they are not fulfilling their function as a State without one.

Governor ROCKEFELLER. Let me put it then very simply, I think it could have—it could be made to work and it could have—a very positive effect.

Representative REUSS. Thank you very much.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Governor Rockefeller, those of us who support revenue sharing appreciate your appearance here because it is very helpful, and I am somewhat amused by your statements about the sophistication of the congressional group on this issue. We live in an ivory tower compared to you who are out in the trenches. If sophistication is born of experience, I think you are the ultimate in sophistication.

Representative REUSS. Will the gentleman yield at that point? I appreciated the fact that Governor Rockefeller wanted to be flattering to us when he used the word "sophisticated." However, in Wisconsin, it is not all that good a word, and I am not sure I want to accept it. [Laughter.]

Governor ROCKEFELLER. Thank you. I withdraw the use of the word under those circumstances.

I will talk to you afterward to find out the meaning.

Chairman PROXMIRE. We are smart but unsophisticated.

Representative CONABLE. Governor Rockefeller, is this a political issue with the Governors as a group? We have had quite a sharp change in the makeup of the Nation's Governors as the result of the last election. Have you noticed any change in attitude toward revenue sharing as a result of this change in personnel?

Governor ROCKEFELLER. Well, I have not had enough contact with the incoming group of Governors to be able to answer clearly your question.

I think the situation is so desperate—for instance, the speaker of the assembly, the newly elected speaker in Pennsylvania, was here last weekend. I do not know whether he was before your committee, but the legislative leaders had a meeting in Washington, and our speaker was down there talking to him, and he said that they were going to run out of money and would stop a lot of State functions in 33 days and, of course, what they made a mistake in, I think where they made a mistake, the legislature in Pennsylvania authorized a budget for three-quarters of the year because that is all the money they had, and then they left, so that now the new legislature is back, and they are coming to that last quarter when there is no money raised to meet it.

So, we have got major crises, and I think that Governors, regardless of their philosophy, are going to reach for whatever methods of assistance they can get financially, and this certainly is the simplest and the clearest.

Representative CONABLE. In the past this issue has crossed party lines, certainly.

Governor ROCKEFELLER. That is true.

Representative CONABLE. And there is not any reason, in light of the pressure on our Governors, to assume that there is going to be a change in that respect, is there?

Governor ROCKEFELLER. No; I talked to the chairman of the Governors' conference, Governor Hearnes, and he said that he was supporting revenue sharing wholeheartedly, 100 percent, because it had been voted by the Governors consistently over a period of the last 5 years, and that he, as a leader, was supporting it. He had been previously an opponent philosophically but not from the money point of view.

Representative CONABLE. I raise this issue with you because I understand there is an effort to get cosponsorship of the President's bill, and there has been reluctance on the part of the major party here. I wonder if the Governors' conference itself is going to take an active role for the purpose of supporting this concept in Congress.

Governor ROCKEFELLER. The Governors' conference is, the mayors are, the county officers, the legislative, national legislative leaders association, all of the bodies, national bodies, of local governments, are united for the first time on this subject, and we have set aside differences in relation to how the money is distributed. We will just take it in any form.

Representative CONABLE. Now, I understand the point you made about categorical grants, and I think the very great drain on the decisionmaking powers on the local level is a very serious problem about categorical grants.

Are there any types of categorical grants that you would rather not see folded into this special revenue sharing proposed by the President, but because of their nature continued specifically as categorical grants?

Governor ROCKEFELLER. Well, the President's program called for $10 billion out of $28 billion.

Representative CONABLE. About 30 percent.

Governor ROCKEFELLER. Yes, about 30 percent. I am sure there must be some—they do not come to my mind immediately—but I would assume that that could be worked out without any problem, particularly if there were only 30 percent going to be put into block grants.

Representative CONABLE. Generally speaking, any relaxation in the matching figure with respect to these categorical grants or any folding into the block-grant category where previously there has been a comparative rigid categorical grant will be an improvement from the State's point of view, won't it?

Governor ROCKEFELLER. Very definitely. More and more, the more categorical grants you have, and the smaller your revenue base in relation to the Federal revenue base, and the more categorical grants, then that come and you have to match, the more difficult it becomes because you have to take money from other things or you have to let the grant go by, and that politically locally is very, very difficult because these are well advertised, and so constituents say, "Why aren't you getting that money from Washington which is just lying there to be picked up?"

They do not realize you have got to change your program, readjust your structure, and then find the matching money, and then get local government funds in matching money, and this is getting to be impossible.

Representative CONABLE. One last question, sir: It has been alleged here that the President's program discriminates against the urban States. As the leader of one of the major urban States, I guess the major urban State, I wonder if you have any comments about that? You would like a little of that kind of discrimination, wouldn't you?

Governor ROCKEFELLER. I am not aware of the basis for such a comment. I have studied the program carefully.

Representative CONABLE. Are you aware it had been made?

Governor ROCKEFELLER. I was not aware it had been made, but I can just say categorically this is the best program that has been presented, and that I think in the light of the realities, political realities, that this is excellent. I see no basis for accusation of discrimination.

Representative CONABLE. You are aware of the fact that the President's program does include some effort element in determining the amount of money that goes to States, and for that reason that the urban States will have some benefit if they are involved in major tax efforts themselves.

Governor ROCKEFELLER. Well, I admire the Congress for putting the effort concept in, and I thought Mr. Reuss' idea of some carrot that would, along with the stick, encourage them to make more effort, I think, is essential. But the effort has to be done on a more balanced basis nationwide or we distort the whole social and economic structure artificially.

Representative CONABLE. Then you have no specific feeling that the President's proposal discriminates against urban States?

Governor ROCKEFELLER. No; quite the contrary, I think it is very sensitively worked out to balance out all of the forces and the demands, and so forth. I think it is excellent.

Representative CONABLE. Thank you.

Chairman PROXMIRE. Senator Fulbright?

Senator FULBRIGHT. Well, Mr. Chairman, I was very pleased to see the Governor here this morning, but having come in late I am afraid that I will probably be subject to criticism for plowing old ground if I ask questions.

There is one point generally I would like to explore that you have not dealt with, and I would like the Governor's views about the adequacy of the tax payments, by our people for our purposes at all levels, State and Federal. Have you discussed this?

Governor ROCKEFELLER. No; we have not discussed this, Senator, and I would just like to repeat what I said to Senator Proxmire—how grateful I am for this opportunity to appear before you gentlemen, and to discuss this subject.

I have felt, and I know the position is not a popular one, I have opposed the tax cut a year ago in December, tried to get all the Governors to get their Senators to vote against it, and to get the President to veto it. It is taking $10 billion of growth, as I saw it, out of the future revenues of the Federal Government which could have amounted to maybe $100 billion or $125 billion more by 1975 or shortly thereafter.

Now, I hoped we could get an allocation of a percentage of that to the States.

I supported maintaining the 10-percent surcharge, I supported maintaining the 5-percent surcharge, and I just feel that this country has the capacity, if the taxes are raised on an equitable basis nationwide, to meet the needs of our people and our responsibilities at the same time.

Now, I recognize that today there are certain economic problems which make certain types of taxes depressing in terms of the restoring of kinds of employment and economic activity, but I still think that we have got to meet our problems in the long run, and we have the capacity to do it.

Senator FULBRIGHT. Well, then, the answer is that the burden is not heavy enough. In other words, we ought to pay more taxes at all levels to meet the public needs of the public institutions if we spend much more on private consumption relative to public services, transportation, all the things that are involved here. Would you agree with that? I take it you would.

Governor ROCKEFELLER. Senator, you are looking at a man who is making his seventh tax increase recommendation to the legislature, and that is about as tough a proposition——

Senator FULBRIGHT. I know that. I am just trying to make a record so that everybody will know it and not only the people of New York.

Governor ROCKEFELLER. I do not like to be cast in this role because I have to plead guilty, but it is done to meet the needs of the people.

Senator FULBRIGHT. That is right.

Governor ROCKEFELLER. And what worries me is that while the State and local governments are raising these taxes, that the national level has been cutting them. This, if you will excuse me, is the thing that concerns me.

Senator FULBRIGHT. I do not see anything wrong with that.

The one criticism that Congressman Mills had in his speech which seemed to appeal to me is, why don't the local governments, why doesn't the State of Arkansas, raise its taxes for its needs. After all, our income tax in Arkansas is a deductible item when you come to pay the Federal tax, and why bring it up here and send it back. That rather appeals to me.

I would hope that our State governments raise their own taxes to meet their own needs.

Governor ROCKEFELLER. Senator, if you will excuse me for making a family reference, but I had a brother who used to be a Governor of your State.

Senator FULBRIGHT. I know it very well.

Governor ROCKEFELLER. He made a mistake of getting on the wrong side.

Senator FULBRIGHT. That does not mean he was wrong as far as the merits are concerned.

Governor ROCKEFELLER. No. But on taxes he did ask for $90 million of new taxes.

Senator FULBRIGHT. That is correct.

Governor ROCKEFELLER. He got $6 million from the legislature. He called them back in a special session and got nothing more. Now, this is the problem we face. So many other Governors have done this. They have given the leadership.

Senator FULBRIGHT. We have to educate our constituents. We all run into that kind of problem. We have run into that problem on the war for a long time.

Governor ROCKEFELLER. But if I can ask you, sir, how does Congress educate the constituents to accept the taxes?

Senator FULBRIGHT. You are doing it this morning. This is why we have you here. Your opinion that the tax burden should be increased to pay for the services is part of the education. It would mean some sacrifice in the private sector.

I think you are correct in it. I agree with you. I would help shoulder the burden.

One other question: Is it not a fact that compared to other industrialized nations with somewhat comparable standards of living, according to the indices that we use, that the tax burden on the people of the United States is less than, for example, Sweden?

Governor ROCKEFELLER. That is right.

Senator FULBRIGHT. That is not known. Most Americans think we pay more taxes than anybody; isn't that true?

Governor ROCKEFELLER. You are correct.

Senator FULBRIGHT. This is what I am talking about—education. They simply do not know this. I think if you asked the average man he will say, "Oh, yes, Americans pay more taxes. We are the only honest people and we pay our taxes, and we pay more than anybody."

But it just happens not to be true.

If this is so, there is a great opportunity for education.

Governor ROCKEFELLER. Now, Senator, I share completely your point of view. I have only got one problem here. We can sit here and discuss, philosophically, this question, and you can deplore the fact that your legislature in Arkansas did not vote the taxes, and then we leave it and we drop it. But industry from my State is going to Arkansas because they do not have the taxes, and that loses revenue for us.

Senator FULBRIGHT. There is another reason—a better climate. [Laughter.]

Governor ROCKEFELLER. The only point I would like to make is if we cannot get legislators and Governors, but primarily legislators or constituents, to raise the money, then I do not think we can just say, "Well, we can't get them to do it so it is too bad."

I think we have then got to say there has to be money raised nationally on a basis that is level and even for all, and returned to the States.

Senator FULBRIGHT. My time is up, but I must say I am impressed with the argument that those who are going to spend it ought to have to raise it. It is the psychological problem that bothers me very much.

Governor ROCKEFELLER. But when you—I do not want to sepak too much—but if we can be realistic, the people who raise the tax that you, the Congress, is getting, those who voted for the 16th amendment, and you have not had to do too much since then after World War II when President Roosevelt and the Congress at that time raised the taxes—as a matter of fact, since then most of the actions in Washington have been to cut taxes. And that is very popular, and I am taking the unpopular end of this argument which, although you and I are together on the basic argument, in actually doing this at the local level, we are reaching a point where we cannot do it any more and, therefore, if it is not done the services are going to break down.

There is going to be a disillusionment of the people or greater disillusionment than they have now because of the conditions under which they live, the filth in the streets, the crime in the homes and on the streets, the lack of housing, and you see what happened in our welfare cases in New York City, one of them even being in the Waldorf. That is because we are losing 50,000 apartments a year because there is no incentive for the owners to keep them up because they lose money on them, and there are only 16,000 being built this year.

So that we are going to a situation where we are seeing a deterioration of the life of our metropolitan areas, and while we can be philosophical about it and say this ought to be done or that ought to be done, this is going on, and it can be the destruction of the federal system in America, and we are going to end up like so many countries in the Old World where the Federal Government runs it, and it will be Federal police, and the Department of Interior will be picking up the garbage, and that is OK with me, but I do not think that is America.

Senator FULBRIGHT. Thank you.

Chairman PROXMIRE. Governor, you have been very, very responsive and helpful to us. I would like to ask one or two more questions. Governor Lucey has arrived, he is waiting to appear. He is the No. 1 citizen of my State, so I am anxious to have him come up, too.

But let me ask you this, Governor: You were allied with Senator Fulbright. Both of you are very courageous men, and you deserve your great eminence, both of you. But I must say I do not think it is simply a matter of raising taxes being the right way now.

Furthermore, I do not think it is realistic to expect Congress to do that this year and under present circumstances.

Furthermore, we have, as Congressmen Reuss has indicated, a $230 billion ceiling on the amount the Federal Government can spend within the full employment budget, and I do not know any liberal economist who advocates that we go higher than that. So we have a $230 billion level. No taxes are going to come in, we are not going to go into any further deficit spending.

My question is, Where is the money coming from? You have advocated an additional $5 billion for revenue sharing. You accepted with great enthusiasm Congressman Reuss' proposal that the Federal Government take over all welfare costs, that will be an additional $7 or $8 billion.

Now, if you are going to have this $13 billion of additional expenditures by the Federal Government, you have to cut somewhere. My target is the Department of Defense expenditures, and I think we can do it.

You are one of the most knowledgeable men in this area. You always have been a strong advocate of a strong military force, strong security. I would like to ask you if we can cut from the defense budget and, if so, how much?

Governor ROCKEFELLER. Well, I would like to give you an opinion, but I just do not feel I have enough information to speak with the kind of authority, in this sensitive area, that would be required. And, I suppose, it depends importantly on how rapidly the war in Vietnam is terminated and the fighting men come home, which we are all praying will be very rapidly.

I would like to suggest that there are other methods that Congress could use to finance some of the capital expenditures. For instance, in the pure waters field, cleaning up our environment, where major authorizations of money have been enacted by Congress, and where very small appropriations of money have been made, and where we are financing Congress, we are advancing the money in order not to hold up our projects, and to get the job done, so we have been getting about 7 percent of what has been authorized by the Congress in appropriations.

Would it not be possible for Congress to consider creating some authorities, as we have done at the State level and as Congress and the President used to do during the Roosevelt administration, create authorities and authorize those authorities to sell bonds and to guarantee local bonds?

Chairman PROXMIRE. What you are advocating, Governor, is we provide institutions to enable the State and local governments then to go into debt, but on the basis of revenue bonds, and so forth, instead of providing—going into debt further.

Governor ROCKEFELLER. We do not provide for going into debt. But, for instance, we have a rule in the Federal interstate highway program which prevents us from putting any toll on any road that is aided by the Federal Government. Now, I think, we are reaching a point where we cannot keep providing so many services without some user fees.

Chairman PROXMIRE. You see what I would like for you to come back with here, Governor, because you are an able man, you have an excellent staff, is if you could give us your opinion of where the Federal Government can get this money. You have suggested that possibly more funds could be raised by an authority to permit more borrowing but we have a tough priority problem down here——

Governor ROCKEFELLER. Sure.

Chairman PROXMIRE (continuing). As you know. We want to provide more funds for the cities one way or another, and for the States, but we have to cut defense or space or cut out the SST, we have to cut down in some of these areas, and it seems to me it is just as important to concentrate in those areas where we have to make reductions as to make a strong plea, which you have made this morning, for providing our resources in other areas.

It is a priority problem, and here is where, I think, you can make a most useful contribution for us.

Governor ROCKEFELLER. I appreciate it, and we will take a look at this, although I would be presumptive to take the total Federal picture and, as a Governor, to try and presume as to how this should be handled.

Chairman PROXMIRE. Well, we are nothing if not presumptuous down here. We have to move into these areas. None of us are military experts, of course, and they remind us of that all the time, but we have to do this because we have to bite the bullet, we have to make the decision on where the money will have to be spent. You are at least as expert as we are, and if you would give us your recommendation it would be most helpful to us.

Governor ROCKEFELLER. May I make one recommendation. You said there was a limit of $230 billion of expenditures. Where did that limit come from?

Chairman PROXMIRE. That limit comes from the assumption we are calculating our expenditures on a basis of where the budget would come into balance if we had full employment at that level of 4 percent unemployment. If we had more people employed, more corporate taxes, the yield would be up. The tax yield would be $230 billion.

Economists say if you spend much more than that, then you are really getting into an inflationary situation, and that would undermine confidence.

Senator FULBRIGHT. It is really a fancy way of saying deficit spending.

Chairman PROXMIRE. Deficit spending, but it is something widely accepted now. President Nixon accepted it, his party seems to accept it warmly. This committee has advocated it for 23 years. Senator

Douglas, who was chairman of the committee, proposed this in 1949; the Council of Economic Development, a business group, proposed it for at least 10 years.

I know you are familiar with it.

Governor ROCKEFELLER. I would like to support the concept and say we have been spending for self-liquidating projects money in the State through authorities on bonds which, I think, have been importantly responsible for keeping our unemployment rate from dropping as low as the national average during this last year because we did have these expenditures which we could use to keep this economy from going down.

I sympathize very much with what you are saying, sir, and I shall be glad to give further thought to this. I am not sure I will presume to try to tell you even my own thoughts on the subject.

Chairman PROXMIRE. Governor, let me ask you one other thing. I have asked other Governors, and I would like to ask you, as well as the mayors of our principal cities, to take a hard look at this budget and to tell us, not only in correcting your remarks but over the next 2 or 3 weeks, if you can, what effect the details by the President, as spelled out in his budget, will have on our major programs, what effect will it have on housing and welfare, and so forth.[1]

If we can have that kind of information, it would be most useful to us, so we understand what the revenue-sharing impact really is pro and con.

Governor ROCKEFELLER. You are talking about revenue sharing and the revision of categorical grants?

Chairman PROXMIRE. Yes.

Governor ROCKEFELLER. Has the President announced which grants would be included in the six categories?

Chairman PROXMIRE. Well, the budget—I have not read the detailed budget—I have read the document called the budget, and it is spelled out to some extent, and I believe it is spelled out.

Governor ROCKEFELLER. We will need that in order to be intelligent——

Chairman PROXMIRE. I understand.

Governor ROCKEFELLER (continuing). And do an appropriate job, and I would be delighted to do it and get it to you as rapidly as we can.

Chairman PROXMIRE. Fine.

Governor ROCKEFELLER. I appreciate tremendously, Mr. Chairman and gentlemen, this opportunity. I thank you for what you are doing for all of us.

Chairman PROXMIRE. Thank you for an excellent statement and your most responsive answers.

Our next witness is going to be Governor Lucey, of Wisconsin.

Pat, it is good to have you here this morning, and it is good to have you as Governor of Wisconsin. In my judgment, Pat Lucey is one of the ablest men in State government or Federal Government, for that matter. He served as chairman of our party, and I have often said

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[1] Subsequently, all the Governors and a representative sample of mayors were asked to respond to a committee questionnaire concerning the need for additional Federal aid and the impact of the administrations' proposals. The results of this survey are being published in a separate volume.

he was the best State chairman in the country, and while people may be skeptical or cynical about political capacity, I think it is the most important single element in the effectiveness of a Governor, and Pat Lucey has that as well as a great degree of integrity and understanding of State problems.

Furthermore, it is good to be hearing testimony from the Governor of a State that ranks well in terms of its own tax effort. We heard testimony earlier in these hearings about States such as Ohio, Pennsylvania, and New Jersey, which don't yet have State income taxes.

We've just heard about New York which, of course, does have a progressive tax system, but it's also a very rich State. Wisconsin ranks slightly below the national average in terms of per capita income, but above the national average in terms of relative tax burden. So I think even someone more objective than I on the subject of Wisconsin might feel more sympathetic to Wisconsin's fiscal plight than to that of some other States.

So we are very happy to have you here. As I say, I am sure you will contribute greatly to our understanding, and I want to call on Congressman Reuss, also from Wisconsin.

Representative REUSS. Thank you, Mr. Chairman.

I want to join with the chairman in the deservedly good things he said about you, Governor Lucey, and I am intensely interested in what you are going to say. I am not going to intrude upon your time.

Chairman PROXMIRE. Thank you.

Incidentally, if you want to abbreviate any part of your prepared statement, your full prepared statement will be included in full in the record.

STATEMENT OF HON. PATRICK J. LUCEY, GOVERNOR OF THE STATE OF WISCONSIN

Governor LUCEY. Thank you, Mr. Chairman and distinguished members of the committee.

I am certainly grateful for the opportunity to appear before this meeting of the Joint Economic Committee.

I address you today both as a newly elected Governor and as a concerned citizen of the State of Wisconsin. I deeply sense the urgency for my State's fiscal well-being, and this is what has brought me here today.

I think the time is rapidly approaching when no State in this Union will be able to avoid economic disaster without drastic alterations in our Federal system of revenue disbursements.

I think that our national priorities are badly misplaced, and that the result is fiscal chaos. In light of this, I feel compelled to lay before you the bleak economic prospects of my State government and my perceptions of the numerous Federal stumbling blocks which now bar the road to recovery.

In Wisconsin alone, State agency budget requests for the 1971–73 biennium total $2.2 billion—a figure which exceeds the yield from our present tax structure by some $500 million. Even if we were to disapprove all proposed new programs, and simply allow for the cost of continuing existing programs, we would fall short some $292 million during the next 2 years.

Sources of revenue in the State of Wisconsin have been tapped to near capacity. We have, according to the latest census, some 4,300,000 citizens. They are paying the highest individual income tax in the Nation per $1,000 of income, the ninth highest corporate income.

Furthermore, Wisconsin's 4-percent general sales tax takes an additional bite. Overall, Wisconsin ranks seventh among the States in total per capita taxes collected.

The city of Milwaukee, our largest city, has the highest per capita tax of any of the top 25 large cities in the country.

By way of example, a family of four living in Milwaukee, with an income of $10,000 in 1970 paid $385 of State income taxes, $1,070 in real estate taxes, and $131 in sales taxes. Thus, the State and local tax payments of that family came to $1,586. This sum, when coupled with the $1,100 in Federal taxes, resulted in over one-quarter of the family's income being devoted to taxes.

What should be of particular concern to this congressional committee, it seems to me, is the fact that this serious tax dilemma is occurring in a State which is an active and contributing partner of local governments, and which maintains a very elaborate system of shared taxes and aids to our counties and our villages and our towns and our school districts to the extent that 66 cents out of every dollar collected for general revenue purposes in Wisconsin is actually distributed to the local communities for expenditure.

In spite of these tax-sharing relationships, Wisconsin is still forced to rely very heavily upon the property tax. As a matter of fact, in the last 10 years the property tax has more than doubled. Today, property taxes in Wisconsin amount to over $1 billion a year. This is in spite of the fact that the property tax, as we know, is the least flexible tax base; it severely limits the capacity of the State to finance services in a period when the costs of the services are escalating rapidly.

Property tax valuations lag far behind the economy. This means that municipalities relying on the property tax are not able to share in the prosperity of an economic boom without a costly timelag.

When all of these various taxes are added together, the burden placed on the citizens of Wisconsin is awesome, and I think that we are very near the breakingpoint.

The one time people have a chance to vote on a tax is when we have a referendum on a school bond issue. In 1970, we had 29 school bond issues approved and 44 rejected.

Now, from World War II on, it was almost axiomatic in Wisconsin that any school bond issue would be approved. But to give you an idea of how progressively worse it is becoming, in the last 3 months of last year, October, November, and December, only one school bond issue was approved, while 24 failed.

Senator FULBRIGHT. What was that period?

Governor LUCEY. Just October, November, and December of last year we had 24 rejected, one approved for the construction of schools, for elementary and secondary education.

Down in Beloit, we have a Wisconsin property owners league which is now advocating the withholding of property taxes because they feel that the tax is being used excessively. In short, Wisconsin and her sister States are approaching an economic climate that may eventually force municipalities to refuse to make expenditures which are vital to its self-interest.

My testimony today before your committee is tempered by my belief that the real antagonist in this tax dilemma is the Federal Government. It is the Federal Government which has preempted the major sources of tax revenues available to States. It is the Federal Government which has utilized economic policies that have had a negative impact on State Governments, and which has left the States the victims of the vagaries of economic business cycles.

The income tax is the most responsive source of revenue, and the one best able to finance a government in the face of an inflationary economy. And yet, the Federal income tax is so burdensome that the States have only limited access to revenue generated by a State income tax.

Wisconsin citizens last year paid $5,300 million in total taxes; $3,300 million or 63 percent went to the Federal Government. This left $2 billion to operate all of the services of both our State and local government.

The States are further crippled in their attempt to tap effective and equitable tax sources by the interstate competition for tax dollars and for taxpayers, something certainly that Governor Rockefeller elaborated on here this morning. The competition between the States and localities to attract corporations and citizens to their boundaries has made it impossible for most taxing authorities to develop fair and rational systems.

Wisconsin is the highest taxed State of the six northern Midwestern States. Milwaukee, as I pointed out, is the highest taxed large city of the top 25 cities in the country.

There is an exodus from Milwaukee, there is an exodus from Wisconsin, and the more mobile and higher income citizens who leave, the more intensive our problem becomes.

The national economic policies which have failed to check inflation or avoid recession, have had a disastrous fiscal impact on the States. The increase in the cost of services has not been matched by an increase in State revenues. For example, payments on the State's debt obligation will increase from $63 million at present to $138 million during the next 2 years. That is a 120-percent increase, and you might say, "Well, you are going into debt at a very rapid rate."

The fact is, because of the tight money market in the last year, it has been necessary to shorten the term of our bonds; it has also been necessary to increase the principal payments on the bonds and, as a result, the cost of debt service for the new biennium will be $138 million.

Under the Full Employment Act of 1946, the power to regulate the national economy is appropriately vested in the Federal Government. The ability to rely on deficit financing has made it possible for our Nation to survive periods of economic recession. But, State and local governments cannot rely on deficit financing. The only thing we can go into debt for is for capital expenditures.

At the same time, State and local governments, with their inadequate fiscal tools, are asked to be responsible for most of today's pressing problems. Public safety, education, health and welfare, the environment—all high-priority problems with rapidly increasing price tags—are all traditionally judged to be primarily in the bailiwick of State and local governments.

In order to better cope with these problems, local and State governments must be given access to funds now traditionally retained in the federal system. After reviewing some of the testimony presented to this committee, I realize it would be difficult to propose any new solutions for the transfer of these funds. However, it is imperative that the Federal Government start to implement proposals for increased access to tax dollars at the local level.

I support the concept of tax sharing, but I recognize that it is no panacea. Congress should also consider implementing a system of Federal tax credits for taxes paid at the State and local level. This would promote uniformity and help eliminate the existing and counterproductive interstate competition for tax base.

Congress should continue grants-in-aid, but on a more rational basis.

At the present time—Mr. Don Hall here with me from State government, whose concern is to make sure that we get our share on the various categorical aids, tells me that there are a little less than 1,000 categorical aids about which he has to be informed in order to be sure that we are not shortchanged.

Also, all too often expensive programs have been instituted by the Federal Government which require State and local participation and then there has been a cutback, and we are left committed to these programs, and have to fund them entirely out of our own resources.

If we are to encourage responsive and effective government, revenue should be made available to jurisdictions whose boundaries match the scope of each problem. Only then will there be sufficient political accountability to cause an effective response.

When a problem is a legitimate State concern, Congress should use the revenue-sharing procedures to assure that sufficient moneys are available to cope with them. When it is a regional matter, such as transportation or pollution, funds should be granted to a regional commission.

When problems are national in scope, welfare and education, for example, then I think the grant-in-aid program with which we are all familiar is the proper tool.

I strongly support revenue sharing in addition to—rather than instead of—a modified system of Federal categorical aids. Any system of revenue sharing should incorporate a procedure which enables the States to make use of the Federal Government's deficit financing capabilitis. If a revenue-sharing trust fund is adopted, the funds should be distributed in a countercyclical manner. Whatever the delivery system eventually adopted, the fiscal case for increased Federal assistance to States is too compelling to ignore.

A plan for revenue sharing, which also incorporates incentives for the States to standardize their taxing procedures, and which enables the States to avail themselves of deficit financing, must be pursued.

The Federal tax structure, except for modest changes in the 1960's, is the same system which was in existence near the end of World War II. It is hard to believe that new Federal priorities have not yet been realized. Our present tax system was built to provide Federal revenues first to combat a depression, and then to fight a war. After cessation of hostilities, however, the wartime taxes were never significantly reduced.

The money thus collected has been used to support cold-war arms races, the Korea conflict, and most recently the Indochina war and elaborate defense systems. The taxes originally raised to meet real crises have now been used two decades later to combat what seems to me contrived crises.

Consider the financial burden placed on individual State economies by America's inflated defense budget. In Wisconsin at the present time, taxpayers are obligated to support a biennial Federal military budget with approximately $3 billion in tax moneys, an amount that exceeds our entire executive budget by $1 billion.

Now, I think if the people of the State of Wisconsin were given their choice they would not elect to provide Mel Laird with $3 billion of their tax money during the same period that they allot to me $2 billion to meet all of the services of the State government.

Considering the financial situation, I call upon Congress to reorder not only the procedures for disbursing funds, but also the ways in which these funds are used. Until the national administration faces up to one of the very real sources of the current revenue shortage—the irrational expenditures being made for the machinery to make war—proposals for revenue sharing will have little meaning.

As long as this Nation spends over $75 billion a year for defense, there will never be enough money to cope with local and State problems.

As the United States enters the decade of the 1970's, it is clear that our federal system is not working. In the main, State and local governments must still look after our great domestic needs, but they have not been given the revenues necessary to do so competently. City dwellers demand more police protection and facilities for the elderly. Suburbanites want clean air and waters, and more efficient transportation. Residents of small towns see their schools deteriorating, even as the taxes on their homes increase, and they, too, beg for help from someone, somewhere.

Gentlemen, as Governor of a State which is proud of the efforts it has made for the social and environmental betterment of its citizens, I am not here today pleading for a share of some Federal pot of gold, nor am I apologizing for the forthright fiscal effort we have made or will continue to make in Wisconsin.

Rather, I am asking you this question: How well have we achieved the solution of national problems using the vast, complicated, bureaucratic, redtape system of categorical grants now being employed? If your response is negative, I suggest with urgency that other routes are available to us.

The States and our local governments stand ready to take an aggressive role in the accomplishment of nationally determined goals, but presently we do not have the fiscal capacity to do so.

The time has come for the Federal Government to realize fully its obligation to its State and local units of government. It must support taxpayers by providing new and adequate financing for urgent domestic needs. Such a reordering of economic priorities is essential for the preservation of our entire system of government.

I thank you.

Chairman PROXMIRE. Governor Lucey, thank you for a very hard-hitting and most effective statement. It is certainly in character. It is the kind of fighting statement that I would expect from you.

The main purpose of these hearings is to dramatize the impact of the recession and inflation we have suffered in the last year or so on State governments, State and local governments, and we are interested, of course, in long-term improvements and changes.

But it seems to us that if we can adopt policies that will move the economy ahead, hold down prices at the same time that we can make a very substantial contribution to Wisconsin's plight, especially as Wisconsin's tax revenues are more sensitive than most to the business cycle.

I am sure that tax revenues would increase disproportionately in Wisconsin as compared with other States if we had economic recovery, for example.

Wouldn't you agree that one of the most significant contributions the Federal Government can make is to start the economy moving again in an effective way, and also adopt policies that would help hold down inflation?

Governor LUCEY. There is no question about it.

A few years ago we could anticipate a 10 to 12 percent increase in the yield of our present tax structure each year. At the present time the growth of revenue from our existing tax structure is below 6 percent.

Chairman PROXMIRE. Now, because we have a progressive tax system, and because we have relied so heavily in Wisconsin on the income tax, and some other States do. New York does to a certain extent, you would agree with Governor Rockefeller and others that this ought to be encouraged?

Governor LUCEY. I cannot think of anything that would encourage it more than to provide a tax credit. No. 1, it would help Wisconsin's citizens immediately because the income taxes that they pay to Wisconsin could be deducted from the Federal income taxes.

No. 2, it would provide a sharp incentive for Illinois and other other States to increase their income taxes, so the competitive factor would be lessened, and I would think that that particular kind of approach might be most useful, especially in view of the fact that it would then put Wisconsin in a position where it could consider the possibility of raising the taxes itself without pricing itself out of the industrial market.

I think the tax-sharing, or the tax credit, is a desirable device, and in my statement I have proposed a three-pronged approach, really.

I think that certainly tax sharing would do the things you suggest; that is, tax credits. It would encourage other States to adopt a more progressive system. It would encourage States that do not presently have an income tax to adopt one. It would encourage States that have a flat income tax to go to a more progressive income tax. It would do all those things.

But it would have a regressive factor in it, in that it would not equalize the relationship between the wealthy and the less wealthy States. It would reward the wealthier States more handsomely.

But I think the tax sharing would tend to crank in, particularly to the extent that it was on a per capita basis, would tend to crank in an equalization factor.

I think the third prong of the approach has to be categorical aids; but I would suggest that certainly some rationality could be brought into the whole program of categorical aids, so that we would not have to keep ourselves informed on a thousand different categorical aids that are available to us.

Chairman PROXMIRE. One of the things I admire most about your statement—it is a very fine statement—is your detailing of priorities and your hitting hard at the fact that the Federal Government, in your view, is expending money unwisely with respect to some areas where you think expenditures can be cut.

So it is a practical kind of an approach, more practical than some of the testimony we have had where they want money but they won't tell us where we are going to get the money, which is a serious problem for us.

How about your own priorities? I do not think we will be able to give everything. I do not think we are going to be able to provide a generous, more generous revenue-sharing program, plus sharing of welfare, plus public service employment keyed to job training that President Nixon vetoed, and so forth. Which would you prefer, how would you rate these priorities: federalization of welfare, where would that come, or revenue-sharing, where would that come, or Federal employment, where would it come?

Governor LUCEY. I would rate federalization of welfare very high. I think in actual dollars it would not help us as much as it might. I think it would amount to something like $11 million a year. But it has other things to recommend it. The fact that it would put even an inadequate floor, but at least a floor, under welfare payments across the country, the fact that it would do away with this sort of apologetic attitude the Government takes, both at the State and National level, in terms of subsidization of the working poor.

I think that a welfare program that encourages families to break apart is not a desirable public policy, and I think the administration's program does provide subsidization for the working poor, which I think is important.

I think after the welfare family assistance program, that I would rate a per capita tax-sharing program—revenue sharing.

Chairman PROXMIRE. My time is up.

Senator Percy.

Senator PERCY. Governor, I am happy to welcome the Governor of our sister State, and also the home of my own sister who lives in Appleton, Wis.

I will be very brief because we are running late this morning. You have suggested a system of credits for Federal taxes; that is, credits for State and local taxes against the Federal tax.

Do you contemplate a 100-percent credit or 50 percent? We have had various formulas proposed. Do you have anything in mind?

Governor LUCEY. I have not devised a formula, and I suppose it would have to be something less than 100 percent.

Senator PERCY. You mentioned that we cannot really support and sustain a $75 billion defense budget. Do you have any specific suggestions for areas where we can cut the Defense budget? Do you support what the Federal Government is trying to do in consolidating military bases, cutting some of them out of the States? We have had some cut out of Illinois. Would you support that even if it did cut the bases in Wisconsin that were duplicated?

Governor LUCEY. I certainly would not maintain any military base because it is good for local business. If a military base is not justified in military terms it ought not to be allowed to exist, and I think, I really think, that our present attitude in terms of Indochina is a despicable attitude. I think it is less defensible than the attitude we had a couple of years ago.

It seems to me we have reached a point where, as long as we have sort of salved the sensitivities of Americans by cutting back on our own casualties, that we apparently are embarking upon a policy that would permit us to finance indefinitely the economies that continue there, and even extend it from one small nation to another, and as long as we hold down our own casualties, apparently the American people are willing to do this, and I think it is outrageous.

Senator PERCY. Do you support the concept that there should be a reward for those States that tax heavily? Should they get greater revenue sharing to compensate them for the extra load they are carrying at the State and local level?

Governor LUCEY. Yes; I think if it is accurately measured, you know if the tax effort is accurately measured, then I think that it should.

Senator PERCY. You say in your testimony that revenue should be made available to jurisdictions whose boundaries match the scope of each problem. Do you feel that we should take into account much more the larger areas because of declining income in the cities, increasing income in the suburbs, and to work toward a program where we take, say, the complete standard metropolitan statistical areas as units for taxation?

Governor LUCEY. What I am talking about, when I talk about regional approaches, I was even going beyond that. I was suggesting that in some areas the Federal Government ought to contribute on a regional basis involving several States. I suppose examples of the regional approach would be the Appalachia program or the program for the Upper Great Lakes.

But also if we are concerning ourselves about the program of pollution, air and water pollution, in the Lake Michigan area, a regional approach would be appropriate, and I think the same regional concept could very well apply to problems intrastate.

Senator PERCY. Thank you, by the way, for the preciseness of your comments and the crispness of them.

I have only one more question. This would involve the assumption by the Federal Government of all welfare costs. Many witnesses have proposed this to us. What is your position on that?

Governor LUCEY. I think eventually we are going to have to come to that because otherwise you have forced migration of people from one area of the country to the other. You have, as Governor Rockefeller pointed out, the city of New York becoming a mecca for people simply because they have a more humane program or can afford a more humane program than some other section of the country.

I think it is a national problem and eventually it is going to have to be nationally financed.

Senator PERCY. May I ask the corollary to that, then? You say eventually, why not now? Is there any reason to put it off or should we be biting the bullet on it now?

Governor LUCEY. I think the sooner the better. In our State, increased welfare costs are just unbelievable because of the difficulty in meeting these demands. Our last legislature confessed they were only providing 83 percent of absolute need and, very frankly, in my budget which I will be submitting to the legislature next month, I think to get back to 100 percent of need I will have to do it on a staged basis. I cannot do it in the first year of the biennium.

Senator PERCY. Thank you.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Many of us who support revenue-sharing perceive in simplistic revenue-sharing a danger. If you give absolutely without strings and without question to a State large sums of money, aren't you going to encourage that State to perpetuate its nonconcern for the problems of localities which, in many States, has been too true?

If we are going to get the States to fulfill what really has to be their function of modernizing State and local government, of making it more efficient and effective, of reordering its tax systems, of encouraging greater democratization at the local level, some say we should give in revenue sharing an incentive to States that want to do that.

Senator Humphrey and I have introduced legislation with which, I think, you are familiar, which would condition eligibility to a State for revenue sharing on the State Governor's preparing a plan, perhaps a 10- or a 20-year plan, for reforming, modernizing both the State Government and, particularly, its relationship to its localities.

There would be no strings once this plan had been filed by the Governor. Nobody would be in a position to say that this plan was not good enough, and it means you would not get the money, nor would anyone be in a position to say you are not conforming to the plan and you would not get the money. But there would be in our bill a requirement that the reform process start in the States.

Would you have a judgment as to the need for and the desirability of such an initial requirement and whether, if it were imposed upon you in the State of Wisconsin, you would be prepared to go ahead with such legislation?

Governor LUCEY. I think it is a very desirable adjunct to a revenue-sharing program, and I can say categorically that Wisconsin would be prepared to go ahead with such a plan. And, I think, perhaps, maybe not in the initial enactment, but some place down the road you would want to establish some sort of criteria, and once some sort of criteria were established to require a degree of compliance as you progress.

I think just adopting a 20-year plan and then putting it in mothballs would not achieve the purpose that you seek, and I realize it would be hard to establish criteria that would be applicable to different situations because we are certainly not starting off from the same absolute point, but I would think some way of measuring progress ought to be determined and that, at least, part of the aid ought to be conditioned upon meeting these standards.

Representative REUSS. On this question of States like Wisconsin which have a progressive income tax and feel some jeopardy at losing industries to States that do not, you mentioned the tax credits. However, I thought, you gave rather a trenchant critique of some of the difficulties of an income tax credit as an equalizer.

You pointed out quite correctly that an income tax credit would induce States that do not have an income tax to pass such a tax, since if their taxpayers are going to be exempted from it anyway, it really is not very much of a burden on them.

However, you also pointed out quite accurately, I think, tax credits do nothing——

Governor LUCEY. To poor States.

Representative REUSS (continuing). To equalize the situation in wealthier and less wealthy States. For example, tax credits would not help the State of Arkansas very much because the State of Arkansas is a State of relatively lower per capita income.

Would not, therefore, in light of this view of yours, which I share, wouldn't a better way of getting at this be to do what I described to Governor Rockefeller that has been done by the Humphrey-Reuss bill; namely, don't fool around with income tax credit but in the revenue-sharing legislation provide for additional weighting, perhaps double weighting, for States that do have an income tax, so that the State with a progressive income tax would get more than a State which did not have one.

How does that idea appeal to you on increasing utilization?

Governor LUCEY. I think that would be a step in the right direction. My own position would be that we ought to have both, we ought to have a tax credit program as well as a revenue-sharing program. But I do think that in the revenue-sharing program you could certainly have it weighted in favor of those States that make the tax effort and make a progressive tax effort.

Representative REUSS. Just one final short question. It is sometimes argued against revenue sharing that that unit of government which spends the money ought to raise the taxes. In fact, as you have testified, in Wisconsin, and the same is true of other States, the State government raises, I think you said, 66 percent goes to the localities.

Governaor LUCEY. Moves to the localities; yes, that is right.

Representative REUSS. And you have not found the skies falling in on Wisconsin because the State raises the revenues and the localities spend them.

Governor LUCEY. No; because you take in the case of education, about 38 percent of the cost of elementary and secondary education is raised at the State level, 4 percent comes from the Federal Government; with all of the to-do we have had about Federal aid to education, that is the extent of Federal aid to education.

The balance, which is almost 60 percent, is raised locally. I think in terms of frugality there is still plenty of incentive for the local school board to hold down its budget.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Fulbright.

Senator FULBRIGHT. Well, Mr. Chairman, I want to join you and Congressman Reuss in complimenting this witness for his very enlightened attitude. I am particularly impressed about what he said incidentally about the war in Indochina. I think that is the culprit which has contributed more than any other single thing to the distressful conditions we have all over the country.

We have spent, I would say today—because the last estimate I had from the Library of Congress was over a year ago—nearly $1,500 billion on military activities in the last 25 years. It is so big that no one can comprehend it. But the taking out of our resources of this kind of money leaves a pretty serious gap in the capacity to service the needs of the people, it seems to me, and until we stop it, I think we are going to largely spin our wheels about these plans. I know you cannot stop it, although your representatives in Congress have certainly done a good job helping us. I may say your three-pronged approach here is very impressive to me. I approve of the tax credit approach. It seems to me that is good.

But what you are saying is, don't rely on that altogether. That is part of the picture, and you also want the tax-sharing.

About the tax-sharing, you do not wish it to be categorical. You wish it to be just a block grant, so to speak.

Governor LUCEY. Well, I think, the categorical aids we already have ought to be cleaned up a bit. I cannot believe really there are a thousand different national priorities that ought to require the Congress to enact 1,000 different categorical aids.

Senator FULBRIGHT. Yes.

Governor LUCEY. So I think that there are some things that are of such national importance that the Congress appropriately should express its concern through a categorical aid program. I think if we could bring some rationality into that whole area that it would be helpful.

It would certainly simplify the problems of the States in wading through it.

Senator FULBRIGHT. Yes.

Governor LUCEY. But I think, in addition to that, that the block grant, on a per capita basis, is desirable. It certainly would provide the kind of flexibility that I need as the chief executive of a State in getting through the budget and figuring out how we can match our expenditures to available revenue.

Senator FULBRIGHT. For example, I was very impressed by what you said about school bonds. I have not seen the figures, but my impression is that the entire country is having the same experience now of voting down school bonds.

What is going to happen to us if we have this tremendous neglect of educational facilities for another 5 years? This war can go on another 5 years. They have refused to make any estimate of how long it will go on, as you well know. It could keep going on unless there is some kind of a rising up of the people of this country. So you had in mind that we are faced with a pretty difficult situation in education.

You would like to use this money for education?

Governor LUCEY. That is right. We still rely on the local communities to provide the capital expenditures. That is where the bond issues come in. But the State ought to increase its contribution to the operating expenses of elementary and secondary education, and presently we are just unable to do it.

Senator FULBRIGHT. Well, I think, of course, that welfare, drug addiction, crime, and so on have increased—much of it attributable to the war.

Just a few days ago, there was a dramatic NBC program. There were two deaths a month last summer from overdoses of heroin in the Army, and now there are about two deaths a day, according to NBC. So these rapidly growing problems are going to come back to you in Wisconsin and every other State, are they not?

Governor LUCEY. That is true; there is no question about it. I wish, somehow, somebody could really itemize the true social cost of our involvement in Southeast Asia and, perhaps, then people would take another look at it.

Senator FULBRIGHT. I wish we could, too. I do not know quite how to go about it. We can get these sums of what it costs overall—the amounts spent on military expenditures. But you would be amazed on how difficult it is to get information of this kind out of the Defense Department, for instance. They are very reluctant to be forthcoming.

Governor LUCEY. Of course, there are costs they do not even tally in the Defense Department.

Senator FULBRIGHT. Right.

Governor LUCEY. I thought once the war became bad for business it would end, but it did not work that way.

Senator FULBRIGHT. I did, too. I used to think that it would gradually be impressed upon the business community. But, of course, in the famous words of one of the former Governors, a very courageous man, Mr. Romney, I think the American people have been brainwashed about the war. They believe it, and they have been told that it is on the way toward being liquidated and that they can forget about it. But it is not being liquidated, but is rather being made more tolerable.

Well, I saw in the last few days we are dropping more bombs on Laos and Cambodia than at any time in the war in volume. We are completely devastating large areas there in an effort to try to prevent the buildup of their forces.

Well, I think you have made a great contribution, and it is a very good thing for Governors who have plenty to do at home to come down here and help us educate the public and our colleagues in Washington.

Governor LUCEY. Thank you, Senator.

Senator FULBRIGHT. Thank you very much.

Chairman PROXMIRE. Governor Lucey, before you depart, I just want to say you are the last of the series of Governors and mayors we have had before us.

The reason why I decided that we should have Governors and mayors as witnesses in this series of preliminary hearings before the Economic Report comes out is because we sensed on this committee that your financial plight was extraordinary, far worse than could normally be expected because of the slowdown in the economy and the inflation, and I think that you and your fellow Governors have dramatized this most eloquently.

We do not agree on solutions, of course. We agree we have to have a far more intelligent and thoughtful and effective provision of assistance by the Federal Government.

Governor LUCEY. I hope at least we can stress the urgency of finding a solution now.

Chairman PROXMIRE. That is the first step in any problem, to understand what the problem is, and I think you have played a very helpful part in dramatizing that. Thank you. Thank you very much.

Governor LUCEY. Thank you, Mr. Chairman.

Chairman PROXMIRE. Our final witness this morning is Mr. Roger Blough. Mr. Blough is well known as a true business statesman. He became, of course, famous as the chairman of the United States Steel Corp. and, Mr. Blough, our minds are so full of steel price increases just now we may have trouble remembering we invited you to come here and to discuss primarily another troublesome subject.

For over a year now you have served as chairman and prime mover in an organization called the Construction Users Anti-Inflationary Roundtable. Construction cost increases are one of the most difficult economic problems we face at the present time. In a sense, it is comforting to know that businessmen as well as home buyers and other individual consumers are affected by and concerned about construction costs. We are all in the same boat on this one. I understand you have some slides to show us; is that correct?

Mr. BLOUGH. That is right.

Chairman PROXMIRE. Before I yield to Senator Percy, who has a statement, I want to say I appreciate the fact that you prepared a very fine and detailed and comprehensive prepared statement which, I understand you will place in the record.

Mr. BLOUGH. Yes, please.

Chairman PROXMIRE. I want to yield to Senator Percy.

Senator PERCY. Mr. Chairman, I would like to only comment on one aspect of Roger Blough's life. I think he typifies the fact that many businessmen in America serve in many different capacities. They serve in business and industry in order to directly run the operation for which they are responsible, but Roger Blough has also contributed his thoughts to the insurance industry, the commercial banking field—he was a director with me of the Chase Manhattan Bank—and has also served on the Advertising Council.

He has been chairman of the National Industrial Conference Board, a little known public activity, but one that is very important within the business community in time of crisis. He was chairman of the Business Council. I have served in that group for almost two decades with my friend, Roger Blough, and his perception of a problem, his tact in working it out, and his courage in facing up to it has preserved for the U.S. Government the most influential and powerful and dedicated group of businessmen serving their Government.

Democratic and Republican administrations have called upon the Business Council for help, counsel, advice, for service and for manpower. It is available to the Federal Government at any time at no cost, and I have never seen a group of men serve more selflessly, and very seldom have I ever heard anyone say "No" when he was asked by the President to serve.

Just typical of the kind of service Roger Blough has performed is as general adviser on arms control in the Disarmament Agency to find a way to stop the arms race and to do it on a mutual basis by mutually deescalating our expenditures for needless defense if we can get both sides to recognize this makes good, sound sense.

So I am proud indeed to have a dear friend, but also a man for whom I have developed a profound admiration through the years, here this morning.

His subject is highly controversial. Never has Roger Blough feared to bite the bullet and face up to the problem. We do not have to agree with everything he says, but it is going to be very interesting.

Thank you.

Chairman PROXMIRE. Mr. Blough, go ahead.

STATEMENT OF ROGER BLOUGH, CHAIRMAN, CONSTRUCTION USERS ANTI-INFLATION ROUNDTABLE

Mr. BLOUGH. Thank you very much.

I appreciate the opportunity of being here today. It is a very important subject about which we converse.

I would like to say at the beginning that inflation has had in the past many causes and combinations of causes. These include overspending by Government for war or peace reasons, errors or miscalculations in monetary and fiscal policies, and disruptive wage and price movements sometimes occasioned by unusual demands in the economy.

My purpose today is to concentrate on inflation 1971 style and attempt to single out the most blameworthy cause of today's serious inflation breakthrough. This cause I believe to be overly large wage increases.

My further purpose is to discuss the wage patterns in the construction industry including its worsening productivity problems. After a quick review of some background material I will have some suggestions of a remedial nature, legislative and otherwise.

Accelerating employment costs in construction are of mounting concern to unions, management, and Government, as well as consumers. Although wages and other benefits have recently been rising rapidly in the economy generally, the inflationary impact of skyrocketing settlements in the construction industry has been almost unbelievable in magnitude.

The magnetlike upward influence of construction increases on other industry negotiations is daily becoming more serious. This effect on other wages involves many more economic consequences for the Nation and many more dollars for the construction user than the increased direct cost in construction itself.

Chairman PROXMIRE. Could I just interrupt for a minute, Mr. Blough? I was given to understand you were going to——

Mr. BLOUGH. I am going to give you just a few of the charts and then I am going to complete.

Chairman PROXMIRE. I was going to say proceed any way you want. I wanted to be sure we understood each other.

Mr. BLOUGH. Yes; we do.

Mr. PROXMIRE. Very fine. Your entire prepared statement will be placed in the record.

Mr. BLOUGH. Very fine.

Homeowners are feeling the cost pressures of building trades increases. Taxpayers are reacting to the impact of spiraling construction costs in schools, hospitals, and public building generally. It is high time for action by construction users who pay the bills, by contractors, by construction unions, and by Government which in addition to being the largest construction user also has an entire economy at stake.

First, some background.

In order to conserve time, I have selected just a few charts [1] which we will show at this time, and I believe you will find them quite——

Chairman PROXMIRE. Mr. Blough, I do not know whether to turn my back on you or turn my back on the charts.

Mr. BLOUGH. I would rather have you turn your back on me.

Chairman PROXMIRE. All right, sir.

Mr. BLOUGH. First, as to the size of the industry, very hurriedly I want to state it is the largest industry, larger than steel and automobiles put together, and equal to almost 10 percent of the Nation's gross national product.

Next chart, please. You can see from the number of employees that are involved, there is not any industry that approaches it. You can also see the number of employers that are involved.

The next chart, please—and there are a great many of those employers. Who does the construction of this country?

The next chart, please. You can see, first of all, the importance of government in this whole picture, and I call that to your attention particularly. About a third is government, about a third is residential, and the balance, you might say, is industrial.

Now, the next chart, please, and this is the one that I call to your attention particularly. You can see by quick observation that there was a fairly constant relationship between wage increases in the construction industry and wage increases in other industries for a long period prior to 1965. Then you can see that in 1969 the median increase for all industries was 22.1 cents per hour, but for construction it soared to 70.2 cents per hour; and in the first 9 months of this year, this trend has been accelerated.

Now, anyone who is involved in industrial relations or in the welfare of the country or in the economic future of the country must be dismayed when he looks at that chart.

The next chart, please. Here you see what has happened to the increases for other industries, other segments of the economy, and for construction.

The next chart, please. Now, this chart, I think, requires just a moment of observation. First of all, you see the craft, you see the location, you see the current rate, you see the increase, and you will notice that the contract term of many of them, most of them, is 3 years, and you see the final rates.

Now those, ladies and gentlemen, are not rates per day. These are rates per hour, and you multiply that by eight, and you get an idea of a day's wages, unless you have 2 hours' overtime, for which you usually pay 12 hours of pay, and you can readily understand what is happening to construction wages.

One of the things you might do is just to compare that with the wage rates that are being paid in areas of which you have personal knowledge.

The final column, however, indicates the percent increases. I know many of you recall the days when we had great struggles over whether

[1] The charts referred to may be found in the prepared statement.

we were going to increase employment costs by 4 percent or 5 percent a year. Look at those, 26, 25, 15, 25, 18, 20 percent. Multiply that by three and you get a little idea of what is happening in the construction field.

The next chart, please.

I am going to—the next chart, please. I am going to run through these charts pretty fast.

This simply shows you how a bad settlement in one area travels to other areas in the same city and to other cities.

The next chart, please. I call your attention to the BLS wage data for the third quarter of 1970, 22.1 percent. Now, that is the first year on an annual basis.

I call your attention also to the fact that if you multiply that by three you have a very, very difficult period ahead, not only for the construction industry but for the country because of the effect that construction wages have on the balance of the country.

The next chart, please. This shows you the trend in construction. I would like to just read one thing. Many electricians in New York City are paid, according to some contractors, more than $35,000 a year.

William J. Hunkin, who is a contractor in Cleveland, says, "Last year, I paid one operating engineer $34,928. I paid one common laborer $27,844, and another one $23,983."

Now, in addition—the next chart, please—to the enormous wage increases, I would have to tell you that we have special problems in productivity. I am going to pass this chart.

The next one, please. Many people say, "Well, productivity will be so much improved that that will offset any increase in wages." I would like to point out that while it is difficult to arrive at a proper measure of productivity in the construction industry, this chart will give you a faint idea of what is happening in construction. Productivity moving in a downward trend; compensation per manhour going through the roof.

The next chart, please. The cost of living is no justification. Bad as it is, it is no justification for what is happening in construction.

The next chart, please. Some people say what about corporate profits? If you follow the profit as a percent of gross national product, which is what you should, I think, look at, you can see that since 1966 there has been a trend in reduction of profits.

Chairman PROXMIRE. Could I just ask at this point, Mr. Blough, your emphasis on wages has been consistently in the construction industry. Now, you are shifting to corporate profits overall.

Why don't you give us the increase in profits or drop in profits, rate of increase, in the construction industry?

Mr. BLOUGH. I have no adequate data for profits in the construction industry. Many of the firms are privately owned and the data is not published.

Chairman PROXMIRE. Thank you.

Mr. BLOUGH. I have a short space of allotted time and as you suggest, I am going to include the balance of the material in the record, until we come to part II of my prepared statement. This part I would like to go over with some care. I commend the earlier part of the entire prepared statement. I think you will find it very interesting if you are as concerned about the economy as I am and I am sure you are.

Now, may we have the lights, please.

I have reviewed much too hurriedly the extent of wage inflation in construction and pointed to the deplorable productivity situation.

Now, where do we stand as a Nation with respect to inflation? To this observer it appears this way.

During the past 12 or more months the economic policy pursued was based on the gamble that fiscal and monetary restraints would slow not only demand-pull inflation but wage-push inflation as well. So far as wage-push inflation is concerned, this has been a losing gamble in the leadership wage sections of the economy—especially construction.

The economic policy pursued also assumed that the domestic economy had more to gain than to lose by underemphasizing the impact of wage-push inflation. This has been an equally unrewarding gamble.

Reliance during the past 12 months upon expected improvements in productivity to bail out the economy was simply not a feasible solution. Whatever improvement now exists is a fraction only of the employment cost increases, and the rate of improvement in productivity where it exists is not sustainable because, in the main, it represents the temporary effects of reductions in the working forces and in overtime.

For these reasons it appears to this observer that unless we wish to contend with the effects of mounting inflation, our national remedies require a complete overhauling; specifically:

Serious wage inflation will not go away of its own accord. The unions and union leadership are themeselves, to a large extent unwillingly, caught in an upward ratcheting race. They are forced by internal political pressures to chase after enormous increases in construction and a number of other settlements. Realism does not support the thinking that employment increases are being dampened when bargaining agreements in manufacturing for the third quarter of 1970— the latest data available when this is being prepared—provided for first-year increases of 9 percent or more and when construction settlements reached 22.1 percent.

Now, recall that for the economy as a whole total costs consist of 75 percent to 80 percent wage costs. With the trend to 3-year contracts, as a nation we face wage increases in manufacturing of 30 percent or more in 3 years—30 percent or more in 3 years—and at least 50 percent to 60 percent in construction in the same period. As an example of the problem, only a few weeks ago a Presidential board recommended an increase for certain railroad employees of 37 percent over 3 years.

Recall also that, at its most optimistic long-range best, improvement in productivity or output per man-hour will rise at no more than 3 to 4 percent.

Thus, one can observe the widening gap between the wage-push inflation and improvement in productivity. It spells out in unmistakable terms one economic phenomenon—galloping inflation.

Now, the longer adequate action is deferred, the more difficult any remedy for the wage-push type of inflation will become.

Certainly the cure administered by a colossal economic bust is the least desirable of all possible solutions but not necessarily a remote one if current inflationary conditions continue to worsen.

There are available some measures which, if courageously tried, have promise. If a program of wage restraint can be devised and successfully carried out, these measures will provide greater freedom of action to stimulate the economy and relieve unemployment by relaxing stringent monetary restraints.

AVAILABLE MEASURES

First, among these measures let us set aside general wage and price controls as unmanageable and undesirable under current conditions where the Nation is rapidly moving to a peacetime economy. Regardless of the current atmosphere in wage increases, there is little reason to encompass in a national incomes policy the unmanageable reactions of millions of service employees—now numbering more than all other employees—the thousands of small, medium-sized, and large businesses, plus untold complexities, by any venture into peacetime wage and price controls.

Second, if the main source of the wage flood can be checked, the subsidiary floods will, hopefully, gradually subside without overt controls.

Third, the source of wage-push inflation lies primarily, although not entirely, in the field of construction. Being much the largest industry with about 3.4 million employees and being so widespread over the country with many employee skills much the same as those in other industries, construction is a most telling influence. Because of the inherent weaknesses in the bargaining structure of the industry, since 1966, in the face of increased demands, out-of-line wage increases and poor productivity have burgeoned. The third quarter construction settlements of 22.1 percent a year are ample evidence of the fountainhead of the wage problem.

Earlier I have portrayed some measures construction users and contractors might take—and that is part of the prepared statement that is filed—such as increasing the supply of trained workmen with special emphasis on minorities, doing more maintenance construction work with internal forces, exploring the pros and cons of the growing quantities of merit and open shop construction, using contractual relations to increase apprentices, reducing scheduled overtime, backing up contractors in local negotiations, and developing manpower resource pools using government or privately operated manpower banks.

Contractors in turn can improve negotiating techniques, develop measures for terminating jurisdictional disputes, do more in the training of work forces, and find means of restoring at least some measure of on-the-job management now largely lost.

But I am aware this Joint Economic Committee is primarily interested in what Government can and should do. A word about that.

THE ROLE OF THE FEDERAL GOVERNMENT

The need for more training for more people, especially minorities, is constantly reiterated. The executive branch has taken a number of steps in this area but much more effective action is needed.

Training is one thing but the admission to union membership after training or during training is quite another. Ironclad barriers have been interposed to prevent trainees and skilled workmen from getting work as union members. These barriers should be removed. With the massive amounts of construction ahead in this decade, the construction industry will need all the skilled employees it can get.

A second measure is this. More and more knowledgeable people in and out of industry and government, as well as among contractors, have concluded that the absence of the right on the part of the contractor to manage work on a project is one of the most important and devastating developments in the construction field. To restore at least some improvement in productivity it will be necessary to restore the right to engage qualified people, including minorities, to permit adequate management on the job, and to achieve some flexibility in work assignments.

The source of this difficulty appears to be the institution of the union-controlled hiring hall. As an institution, the hiring hall provides the contractor access to a particular labor pool but it likewise provides the union with the means of controlling the size of the labor pool and the jobs of its members.

The use of the U.S. Employment Service or some other type of manpower pool outside of union control is needed. This would remove much of the power local unions have to make or break contractors by granting or denying the contractor's request for competent employees. A change in the hiring practice would insure the employment in construction of more members of minorities.

With control of the manpower supply, the local union agent has the last word on the very existence of the contractor or of new contractors who wish to enter the competitive field. It is an unhealthy condition for unions and union members, as well as for contractors.

The Government, as the largest construction user, has the right to contract for work on a basis that will loosen up sources of manpower. This would not interfere with membership in unions or the union shop. This action will be opposed as antiunion. Quite the contrary, it is not antiunion. It is only anti-unhealthy manpower control.

Also, as the largest consumer of construction, the Federal Government can adopt and, on federally supported projects, induce the adoption by States of improved contracting measures. Among these are the:

1. Requirement of full complements of apprentices.
2. Scheduling of construction during off-seasons of demand wherever possible.
3. Requiring bids on a 40-hour-a-week basis in contrast to a scheduled overtime basis.
4. In areas of excessive wage rates, the Government can stipulate what it will and will not contract for in wage costs and in escalation. This, of course, involves the Davis-Bacon Act and the so-called prevailing wage concept.
5. The Federal Government can also deal with the Davis-Bacon Act problem to which Mr. Arthur Burns referred in his Pepperdine College talk of December 7, 1970.

Enacted in the deep depression period of the early 1930's, the Davis-Bacon Act has long since outlived whatever usefulness it might have had and in recent years has acted as an engine of inflation. It ties the hands of Government in securing competitive bids. It assures unions and contractors that however high the wage rate they negotiate may be, the Government will pay those rates because it is required by law to do so. By its example, it forces higher rates on nongovernment work. It spreads high city rates to rural communities.

Naturally construction unions will oppose the repeal or suspension of this act. Fortunately, the act provides:

> In the event of a national emergency the President is authorized to suspend the provisions of the Act.

If there has ever been an economic national emergency surely one of an inflationary nature exists today, especially in construction.

Suspension of the act by the President or its repeal by Congress would have the salutary effect of signaling to everyone that the Government means business in its campaign to restore stability to our economy.

If the question is raised as to why single out construction, there are adequate reasons. It is the source of much of what is wrong. If the trend of wage inflation in construction cannot be changed, the game is up for changing the trend in all wages. Even if only partially successful in changing the trend in construction, it would still be a big help.

In golf, a particularly difficult shot to be made under stress is frequently referred to as a character-building opportunity. Action such as is proposed here against opposition of the politically strong craft unions is likewise very likely to be a character-building experience.

PUBLIC AWARENESS

Members of Congress and the administration can do another thing to stem the tidal wave of wage-push inflation now engulfing the country.

A. Move from the public position that monetary and fiscal measures are sufficient to stem inflation—especially wage-push inflation constantly rising in a noncompetitive union world.

B. Publicly note that savings and pensions are being eroded; that the cost of housing is going sky high and will go higher in spite of reduced interest rates; that recent wage increases provide an endless treadmill leading to an inflationary period of harmful stagnation, one especially harmful to workers; that inflation itself accelerates more inflation; that inflations in the past have ended in reduced investments in new plant and equipment, reduced production, and reduced jobs; that if continued long enough, the saving habits of a nation will be adversely affected, which in turn will affect the entire economy; that the national interest demands an end to an expectation of more and more inflation.

C. Publicly it can be noted that our international position is worsening competitively and that this signifies action is needed on the domestic front to halt round after round of wage and price increases; that jobs in America are very much at stake; that economic stability may be an old problem and a continuous one but, in terms of the current situation, wage-push inflation must be dealt with now and forceably.

It is said that the American people have lived through depressions and fear them mightily, but that they do not fear inflation because, unlike the people of Germany and some other countries, they have never had to contend with it. Personally, I fear both conditions. My views have much in common with the recent OECD report which contained a dire prediction of the social and political consequences of continued inflation.

Because resentment against inflation is incoherent and diffused through the community, it provides favorable terrain for extremists at both ends of the political spectrum. It gives ammunition to those who favor more authoritarian forms of government relying on extensive wage, price, and production controls, and to those who hark back to earlier times before governments had accepted their present responsibilities for growth, high employment, and social justice.

Unemployment is undeniably of current serious import, but the immediate problem is to recognize that the road to fuller employment lies in finding a path to a more stable economy, to confidence in the value of the dollar, and to recognize that serious inflation is a job-destroying virus of first magnitude. Employment is the natural beneficiary of stable wages and prices.

The big problem today is to grasp the nettle: to be willing to fight inflation at the definite risk of temporarily losing favor with certain elements of unionism.

In substance, and in effect, it is a political decision. It will, necessarily, be made one way or the other—for, unhappily, it cannot be avoided.

Thank you.

(The prepared statement of Mr. Blough follows:)

PREPARED STATEMENT OF ROGER BLOUGH

Inflation has had in the past many causes and combinations of causes. These include over-spending by government for war or peace reasons, errors or miscalculations in monetary and fiscal policies, and disruptive wage and price movements sometimes occasioned by unusual demands in the economy. My purpose today is to concentrate on inflation 1971 style and attempt to single out the most blameworthy cause of today's serious inflation breakthrough. This cause I believe to be overly large wage increases.

My further purpose is to discuss the wage patterns in the construction industry including its worsening productivity problems. After a quick review of some background material I will have some suggestions of a remedial nature, legislative and otherwise.

PART I

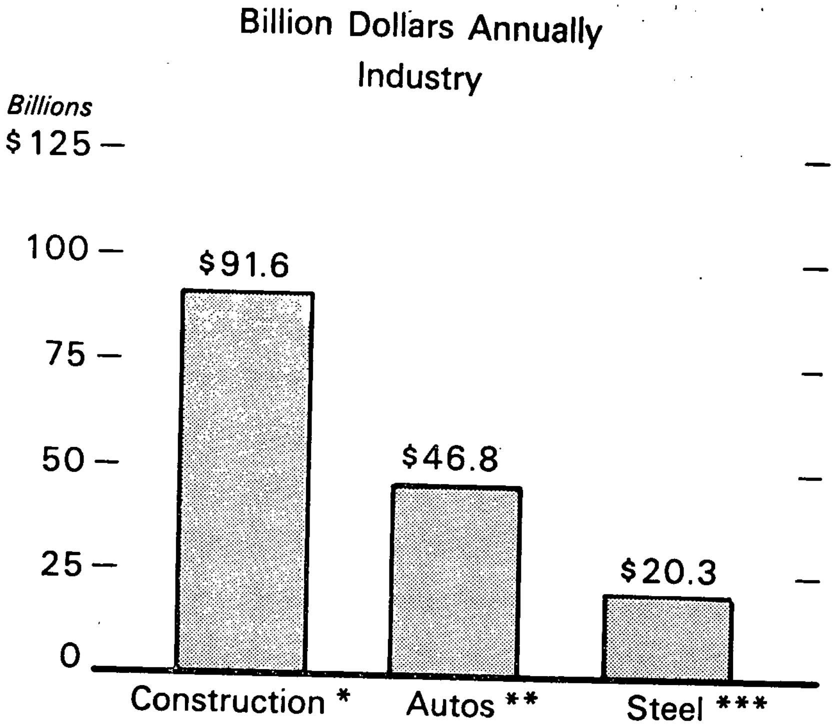
Accelerating employment costs in construction are of mounting concern to unions, management, and government, as well as consumers. Although wages and other benefits have recently been rising rapidly in the economy generaly, the inflationary impact of skyrocketing settlements in the construction industry has been almost unbelievable in magnitude. The magnet-like upward influence of construction increases on other industry negotiations is daily becoming more serious. This effect on other wages involves many more economic consequences for the nation and many more dollars for the construction user than the increased direct cost in construction itself.

Homeowners are feeling the cost pressures of building trades increases. Taxpayers are reacting to the impact of spiraling construction costs in schools, hospitals, and public building generally.

It is high time for action by construction users who pay the bills, by contractors, by construction unions, and by government which in addition to being the largest construction user also has an entire economy at stake.

First some background.

Industry size - 1969 . . .



Among Industries, Construction is the largest

- equal to almost 10% of GNP
- more than autos and steel combined

Sources:

* Commerce Department

** Consolidated revenues - four automobile companies

*** American Iron and Steel Institute

The Largest Industry

Construction is a large industry—much the largest—and covers every segment of the economy, government and private alike. New construction is equal to almost 10% of the nation's gross national product. If maintenance construction is included, the total is close to 13%.

For comparison purposes, two other large industries are automobile manufacture and steel production. But construction is more than autos and steel put together.

Employees . . .

1969

	Number
Total industry	3,400,000*
Local unions	10,000
Building trade councils	535
National unions	17

* Source – Bureau of Labor Statistics

Employees

About 3.4 million people work in construction. Most of these employees are represented by 17 national unions, such as the Carpenters, Bricklayers, and the Plumbers.

There are 535 employee building trade councils, and over 10,000 local unions and local labor agreements.

Growth in union membership has not kept pace with construction needs. Local union structures are rigid with endless inter-union jurisdictional claims and political rivalries. Apprentice regulations are outmoded. The periods for training are overly long. Ratios of apprentices to journeymen are dictated by union politics rather than industry needs.

Employers . . .

	Number
Contractors — Total	870,000*
Contractors — 100 or more employees	1,200*
Local contractor associations	1,000's*
National contractor associations	12

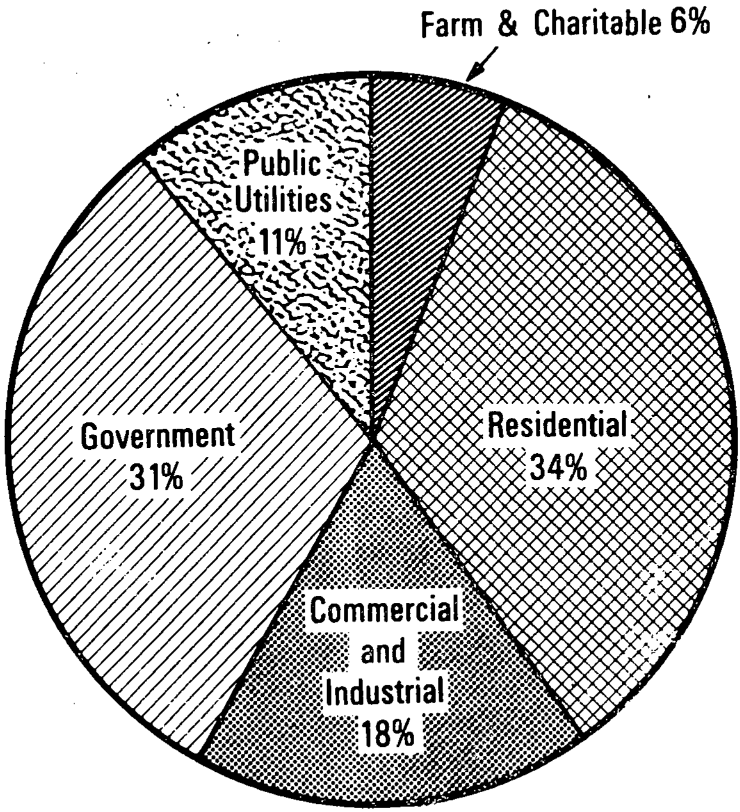
* Estimated

Employers

On the employer side, there are about 870,000 construction contractors throughout the nation, most of whom are quite small. There are 12 national contractor associations and literally thousands of local contractor associations.

Only about one-tenth of 1% of contractors employ one hundred or more people. No one contractor does even 1% of the total industry volume. Undercapitalization and inability to withstand the economic pressure of the large trade unions is common in the industry. Moreover, many contractors become beholden to unions through the hiring hall and through arrangements under which unions virtually police contractor work jurisdiction.

Total construction - 1969 . . .



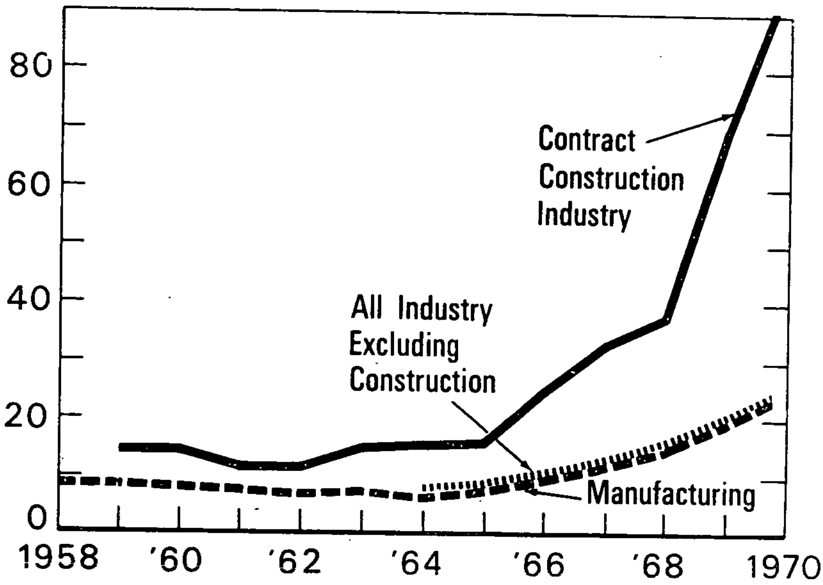
Source: Commerce Department

Total Construction—1969

About one-third of all construction is authorized and financed by federal, state, and local governments. This involves construction of highways, schools, post offices, military installations, government buildings, dams, harbors, housing and the like.

Two-thirds of construction is private. This includes manufacturing plants, railroads, stores, office buildings, public utilities, dwellings, and thousands of other types of construction.

Median wage increase in cents per hour . . .



Source: - Bureau of National Affairs

The Widening Gap

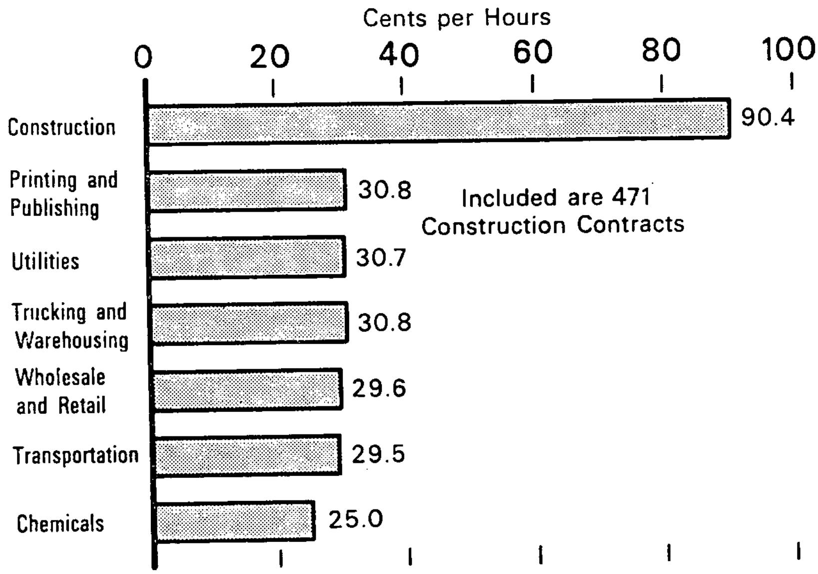
There was a fairly constant relationship between wage increases in the construction industry and wage increases for other industries for a long period prior to 1965. Since 1965 the differential has widened dramatically. By 1969 when the median wage increase for all industries was 22.1¢ per hour, the median wage increase for construction had soared to 70.2¢ per hour.

In the first nine months of 1970, this trend has continued with construction settlements escalating sharply moving first year increases to 90.4¢ per hour. This compares with the all-industry median excluding construction in the first nine months of 1970 of 24.3¢ per hour.

A comparison of these rates with wage increases in other industries imparts a feeling of dismay. The widening space between the curves is creating a vacuum which is certain to suck up all wages. The effect construction has had on other settlements such as trucking and automotive is notable.

Median increase first 9 months of 1970 . . .

2,146 Contracts Covering 50 or More Employees



Source: Bureau of National Affairs

Construction vs. Other Industries

In this chart you see some comparisons with other industries. While the median construction increase during the first nine months of 1970 was 90.4¢ per hour, first year median increases in other industries in the same period were 30.8¢ in printing and publication, 30.7¢ in utilities, 30.8¢ in trucking and warehousing, 29.6¢ in wholesale and retail, 29.5¢ in transportation, and 25.0¢ in chemicals. The outsize settlement in trucking came in July so the full effect is not shown in these nine months' comparisons.

1970 wage settlements . . .

Craft	Location	Current Rate	Increase	Contract Term	Final Rate	Annual % Increase
Electricians	Phoenix	$6.75	$2.77	2 years	9.52	20.5
Sheet Metal Workers	Los Angeles	7.06	5.00	3 years	12.06	23.7
Ironworkers (Reinforcing)	No. & Central California	7.295	2.06	1 year	9.355	28.2
Electricians	Hartford, Conn.	6.75	5.75	3 years	12.50	28.2
Plumbers	New Britain	6.31	4.06	2 years	10.37	32.1
Laborers (Building)	Connecticut	4.60	4.275	3 years	8.875	30.9
Pipefitters	Miami	6.76	3.50	27 months	10.26	22.8
Carpenters	Vero Beach	4.50	3.70	27 months	8.20	36.4
Operating Engineers	Chicago	6.55	4.50	41 months	11.05	28.8
Sheet Metal Workers	Evansville, Ind.	5.50	3.10	3 years	8.60	24.2
Plasterers	Council Bluffs, Iowa	6.15	1.80	1 year	7.95	29.2
Carpenters	Joliet, Ill.	7.05	3.15	2 years	10.20	22.3
Laborers	Topeka, Kansas	4.575	3.425	3 years	8.00	24.9
Operating Engineers	Wichita	5.40	5.10	3 years	10.50	31.4

1970 wage settlements . . .

Craft	Location	Current Rate	Increase	Contract Term	Final Rate	Annual % Increase
Carpenters	Baltimore	5.43	4.25	3 years	9.68	26.1
Plumbers	Baltimore	5.68	4.38	3 years	10.06	25.7
Plumbers	Detroit	8.095	2.50	2 years	10.595	15.5
Sheet Metal Workers	Albany	5.85	4.43	3 years	10.28	25.3
Plumbers	Buffalo	7.07	3.90	3 years	10.97	18.3
Bricklayers	Cincinnati	6.66	2.775	2 years	9.435	20.8
Plasterers	Cincinnati	6.235	3.01	2 years	9.245	24.1
Laborers	Rhode Island	4.60	3.55	3 years	8.15	25.7
Cement Masons	Memphis	4.63	2.38	2 years	7.01	25.7
Plumbers	Washington-Outstate	6.90	2.00	18 months	8.90	19.3
Ironworkers	Madison, Wisconsin	5.95	3.50	3 years	9.45	19.5

1970 Settlements

Here are examples of the higher 1970 construction wage settlements. Unquestionably these settlements were influenced by high settlements in 1969 and in turn will influence others later.

The magnitude of these settlements is shown by the pipefitters in Baltimore who will receive an annual increase of $8,760 over the next three years based on a 2,000-hour year at straight time. The electricians in Waterbury, Connecticut, will receive an annual $12,000 increase over the same period.

The Kansas City settlement . . .

September 1969

- $5.30 per hour over 3 years . . .
- Average employment cost per hour in the 3rd year

– Operating engineers	10.05
– Teamsters	9.39
– Cement finishers	10.10½
– Laborers	$ 9.18

Beginning August 1, 1971 a laborer, at straight time, would receive 19,094.40 for a full year

The Kansas City Settlement

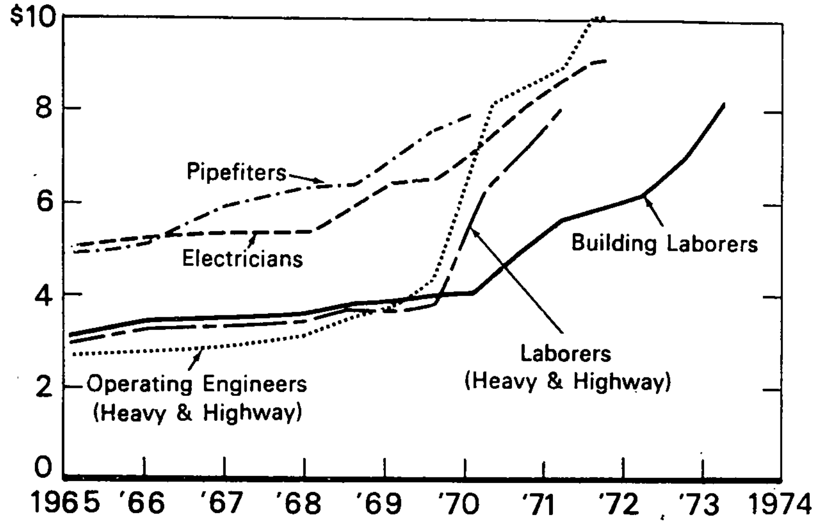
In September 1969, the Heavy and Highway Industry in Kansas City announced a three-craft settlement of approximately $5.30 per hour. Agreements were for a three-year term, but all of the wage increases were effective after the first two years.

The percentage increase for Operating Engineers was approximately 110%, for the Cement Finishers 109%, and 137% for the Laborers. In addition to these wage and fringe benefits, the Operating Engineers' agreement calls for upgrading wage job classifications involving additional costs.

Following the lead established by the Heavy and Highway settlement in Kansas City, the Building Laborers, who are engaged primarily in private construction, went on strike on April 1, 1970, demanding an immediate wage increase of $4.00 per hour with an additional $1.00 each year for the succeeding two years. After a five-month strike, settlement was reached giving the Laborers a wage increase of $4.15 over four years. Although about half their demand, this will more than double their hourly rate in four years.

Pattern of Kansas City wage rates . . .

(Including Fringe Benefits)



One High Settlement Creates Another

The precedent setting effect of one craft on another is shown by this chart. In 1966, the Pipefitters, a craft which is engaged principally in industrial work and which has been in short supply in most cities, received a substantial wage increase which put pressure on the other crafts to catch up and maintain historical differentials. This pattern has been evident in many other cities—settlements in one craft triggering a number of strikes and inflationary wage increases by other crafts in an attempt to maintain historical wage differentials within the building trades.

The Heavy and Highway settlement of $5.30 per hour has been effectively underwritten by the out-moded Davis-Bacon Act. This law establishes wage rates on government work at the so-called "prevailing rate" and has the effect of placing a tremendous burden on construction in the private sector as well as on the government.

B.L.S. wage data . . .

Annual Rate Increase – First Year of Contract

	Employees	Median	Mean
1969 (year)	404,000	14 %	13.1%
1970 (nine months)	504,000	15.7%	17.5%
1970 (3rd quarter)			22.1%

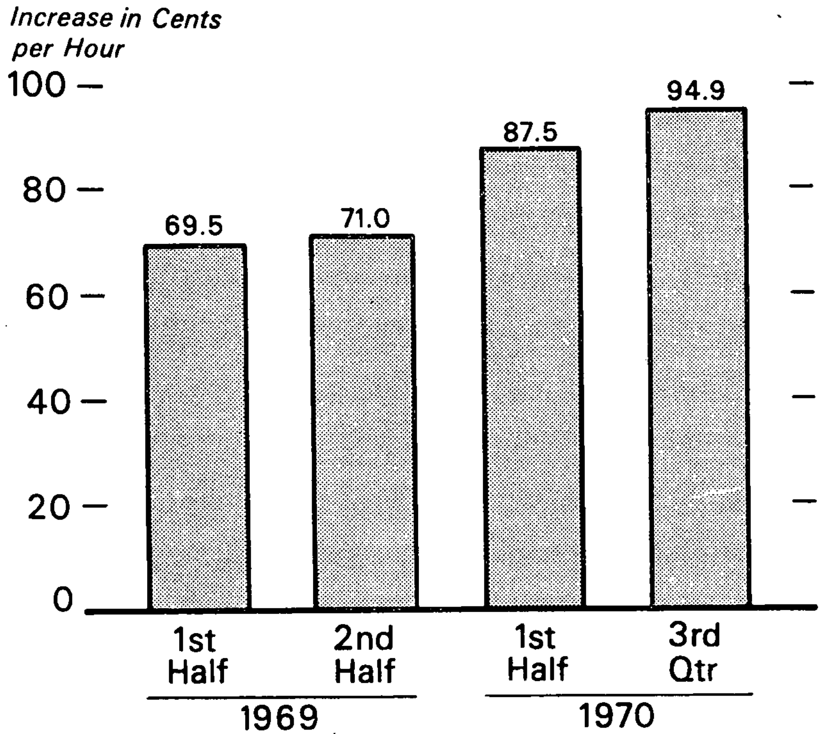
B.L.S. Data

Bureau of Labor Statistics data for 1969 show a mean wage increase of 13.1% covering 404,000 construction employees.

B. L. S. data for the first nine months of 1970 indicate a mean wage increase of 17.5% for 504,000 construction employees. The third quarter 1970 figure is 22.1%.

The agreements analyzed by the Bureau of Labor Statistics are those covering 1,000 or more employees, the exception rather than the rule in construction.

1969 & 1970 trends . . .



Source: Bureau of National Affairs

1969 and 1970 Trends

A better illustration of what has been happening is an analysis by the Bureau of National Affairs of 412 construction labor agreements negotiated in 1969. This shows a median increase of 69.5¢ per hour in the first half, advancing to 71.0¢ per hour in the second half. The trend continues in the first half of 1970 with an increase of 87.5¢ per hour. In the third quarter of 1970 the increase was 94.9¢ per hour.

In addition to these wage increases added costs of fringe benefits and work restrictions are adding materially to construction costs.

In an editorial on July 1, 1969, *The New York Times* complained that construction costs were already so high that unsubsidized apartments could be built only for the rich, but that present costs would appear modest when the public had to start paying for the new agreements in the construction industry. Characterizing the settlements of 35% to 40% over three-year term as "extortionate", the *Times* concluded that the war against inflation has been ". . . put in the deep freeze and the dollar suffers another blow." True as this is, the facts indicate a three-year increase of upwards of 50%, a sad but forceful commentary on current cost-push inflation.

Effect of construction wage increases on industrial and other union negotiations . . .

- Industrial and other unions must compete with construction settlements
- Special premiums for industrial crafts
- Fragmentation of industrial unions
- Early retirement
- High turnover

Construction Settlements Affect Other Industries

The direct and obvious effect of recent construction wage raises upon in-plant crafts and upon wages generally in industrial and other areas can readily be demonstrated. It is common for industrial bricklayers to receive hourly rates approximately one-half of the hourly rates called for in some of the new construction agreements. Industrial craftsmen in the rubber, oil, and auto industries have already demanded and received special premiums over and above the percentage increases given to their associated employees in the same plants, primarily to offset differences between their rates and those of similar skills outside.

The reference in 1970 trucking, printing, and other industrial negotiations to the construction settlements is further evidence, if any is needed, of the beacon effect of construction settlements.

Members of industrial unions are widely aware of the magnitude of construction settlements. When a State Building Trades President recently said, "There is no reason why a union man should not be earning $30,000 a year," his publicized words carry weight with unions and other workmen everywhere. When many electricians in New York City are paid, according to some contractors, more than $35,000 a year, it must be clear the effect will be felt on wages generally.

William J. Hunkin II, President of Hunkin-Conkey Construction Co., Cleveland, said (July 30, 1970 E N R 9), "Last year, I paid one operating engineer $34,928. I paid one common laborer $27,844 and another one $23,983. Seven of my other common laborers earned $19,500 to $22,500."

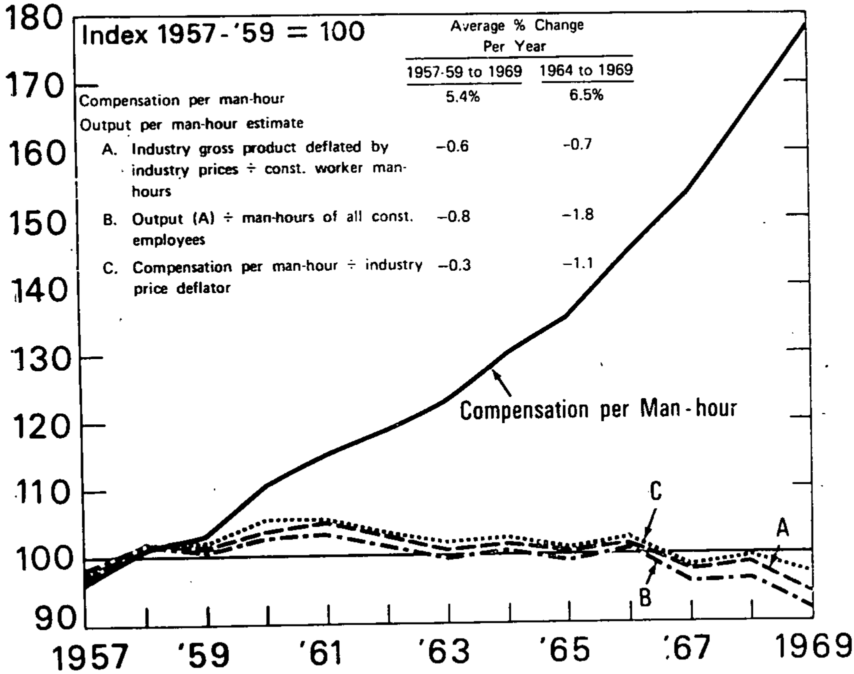
In a recent conversation the head of a key civil service New York City union complained to a building trades union leader that construction pay scales had been pushed so high his civil service members were unconcerned by the city's financial plight. "Do you think I like making these screwball demands?" the building unionist asked. "The trouble is you ask for the moon and you wind up getting it."

Productivity Trouble

But wages are only part of this burgeoning problem. It becomes increasingly apparent that in the construction industry, productivity has declined. The National Constructors Association in a recent presentation to the Building Trades Executive Council cited an alarming increase in jurisdictional work stoppages, severe skilled labor shortages, and decreases in labor productivity of as much as 34%. In other words, the construction user gets much less per dollar than he did.

Among the major causes of this decreasing productivity is the introduction, over many years, of notorious work preservation and featherbedding practices. It would be easy to recite examples like the plumbers who cut off threads and rethread the pipe on the job; the carpenters who will not install pre-hung doors or sash; the painters who limit the size of the brush or roller or will not permit the use of spray; the bricklayers who will lay only 400 bricks a day compared with a normal 800 bricks a day on open shop work; or the electricians who require a skilled craftsman to install a new light bulb. All these exist on a widespread scale. They contribute to inflationary building costs. That they exist is indisputable. Why they exist and what can be done about them is a matter of national concern. But first some attempt at measurement.

Output per manhour estimates - contract construction . . .



Source: Output - U.S. Dept. of Commerce (OBE)
Man hours - U.S. Dept. of Labor (BLS)

Output Per Man-hour Estimates in Contract Construction

Contractors are constantly referring to deterioration in performance on the job. This experience seems to be so universal that the complaint of loss in man-hour production appears to have validity. Nevertheless, demonstrating this deterioration in performance is not easy since no official estimates of change in construction output per man-hour are published by the government.

The Department of Commerce publishes output estimates in terms of dollars. The Department of Labor publishes input estimates in terms of man-hours. But both involve recognized data deficiencies.

In this chart an effort is made to portray in Curve A industry gross product deflated by industry prices, and this result is divided by the number of construction worker man-hours. In Curve B the output is the same as in A, but it is divided by all man-hours of construction employees including the growing number of salaried workers. In C the compensation per man-hour is divided by the industry price deflater with the result shown.

There is an alternative approach in which the gross product is deflated by the over-all national rate of inflation instead of specific price indices for the construction industry. This produces a small positive rather than a negative trend, but since it is common experience that construction prices are rising faster than general inflation, the result obtained this way has doubtful validity.

The general downward trend of these estimates is in spite of the fact that some segments of construction such as highway work, where there has been large expenditures for new labor-saving types of equipment, should be able to show some output per man-hour improvement.

It is also recognized that to date there is no unqualified measure of output per man-hour in construction, and that the curves have deficiencies. Nevertheless, they tend to confirm the experience of many contractors. Moreover, if those results are compared with the compensation per man-hour increase, also shown on the chart, the wide divergence of movement is evident.

The chart demonstrates the sources of the problem in construction—little or negative growth in output per man-hour and an enormous rise in wage rates.

Artificial Labor Shortages

Limiting membership in the crafts is a practice long in the forefront of the methods by which construction unions create artificial labor shortages. Among the results has been a large-scale exclusion from membership of qualified craftsmen and apprentices.

Limiting membership also fortifies the refusal by business agents and craftsmen to man a job that does not schedule overtime on a regular basis. Studies have demonstrated the unproductivity of overtime on construction types of work. Refusing to man work not using scheduled overtime is most often purely a device to raise wages under the guise of manpower shortages.

Little wonder Secretary of Labor Hodgson referred to current wage gains and other conditions in construction as "Bad news for the economy and for construction."

Cost of Living No Justification

There has been a marked rise in the cost of living in 1969 and 1970. This rise, however, does not justify the wage increases the construction industry has experienced.

During 1969 the Consumer Price Index rose 6.1%. This compares with median first year construction cost settlements of 14%, with many settlements much higher.

In the first nine months of 1970 the annualized cost of living increase was 5.4% compared with means first year wage increases of at least 17.5.%

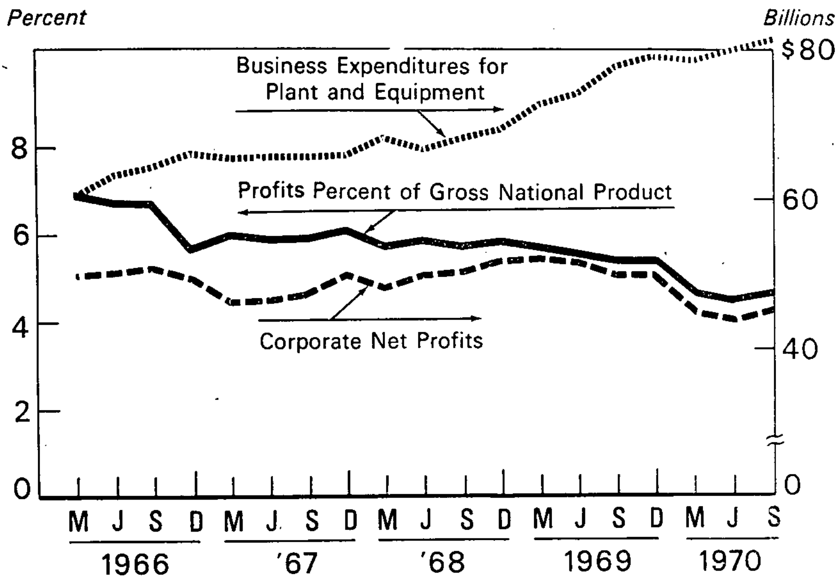
Seasonality No Justification

Wages, including benefits such as pensions and insurance, in the construction industry have been traditionally higher than industrial wages for work generally involving comparable skills. Part of the justification for this was related to what was thought to be the seasonal nature of construction work or its physical working conditions. But today building goes on in winter as well as in summer and north as well as south with relatively few interruptions and working conditions are no more onerous than in many non-construction activities. The crutch of seasonality and working conditions cannot justifiably support these higher and rapidly advancing rates.

Cost of living no justification . . .

6.1%	Increase in CPI in 1969
14.0%	Median for construction settlements in 1969
5.4%	Increase in CPI annual rate first 9 months, 1970
15.7%	Median increase in construction settlements, first nine months 1970
17.5%	Mean increase in construction settlements, first nine months 1970

Declining corporate profits . . .



Source - Department of Commerce

Corporate Profits No Justification

Unions occasionally try to justify higher wages by reference to corporate profits. This chart shows, on a quarterly basis, what has happened to business expenditures for plant and equipment and to corporate net profits since 1966. Note that profits, after a dip in 1967 and a rise into 1969, have in recent months been at lower levels. In 1970 the first, second, and third quarter profits were lower than the declining fourth quarter of 1969. Note, also, the declining percent of profits to Gross National Product. That was also lower in 1970. There is nothing in these profit data to warrant higher and higher wage increases.

It may be observed, moreover, that currently there are a number of bankruptcies among construction contractors and a number of contractors reporting substantial losses on construction operations.

In the construction industry the UNION not the Employer . . .

- Decides who gets which job
- Supplies foreman as well as craftsmen
- Has decisive voice in management of
  - Pensions,
  - Insurance,
  - Vacations
  - and
  - Fringe benefits
- Largely controls manpower and production

Unequal Bargaining Strength and the Hiring Hall

Building trades unions have been traditionally strong. Contrary to this, contractors have been in a notoriously weak bargaining position. Recent settlements have reflected the disparity in bargaining strength.

Many of the contractors are small and of less than average financial stability. Moreover, because of the nature of the industry, very few contractors, except the large ones, have adequate industrial relations bargaining personnel.

It must also be recognized that the employer-employee relationship, such as it is, in the construction industry is quite unusual and this also affects bargaining results. While the skilled worker appears on the payroll of a given contractor for the duration of a construction project, when the job is finished he generally moves to the payroll of another contractor. The union actually arranges this. That is, the union finds the work, determines who shall be hired, and is in complete control of job security. This control or operation of the construction labor pool is commonly referred to as the "hiring hall".

Moreover, unions have in most instances a controlling influence over pension and welfare plans. Frequently even the discipline of the erring employee is left up to the union.

Under these circumstances, the union acts in a role much like an employer with the union-employer so-called "negotiation" being in effect one employer contracting with another. But in construction this contracting is on a most unequal bargaining basis.

In the past few years of construction boom contractors have almost always been able to pass along higher than normal cost increases to their customers—that is, to the construction users. This has also probably been a contributing factor leading to larger-than-normal wage increases.

Some remedies - for construction users . . .

- Avoid unrealistic completion dates
- Scheduled overtime only for genuine emergencies
- Organize and support local negotiations
- Guarded use of national agreement option to work while local contractors are on strike
- Increase manpower by internal training
- Do more of own construction work especially maintenance.
- Use contract provisions to better advantage

Some Remedies for Construction Users

When it comes to remedies, it is doubtful if there is a single one which alone can effect the changes necessary. But it is clear that a combination of changes can be of some help in easing the situation.

Those who are authorizing construction can help, recognizing that each solution involves fortitude, and frequently self-sacrifice on the part of the construction user. The following suggestions are not listed in the order of their importance. They are all important and their priority varies in a given area or negotiation.

First, consider the construction user's normal pressure for early completion by resorting to overtime. Scheduled overtime has more than one detrimental effect. It increases the overtime costs on the job itself. In turn, it frequently creates an area overtime problem. When a contractor goes to scheduled overtime, he naturally draws employees from other jobs and the pressure is soon on in the entire area to go to an overtime basis. In theory, each construction job could end up with the same number of employees but on an overtime basis.

The point might be made, however, that more hours are being worked and, therefore, more construction accomplished. To the contrary, there is much evidence to indicate that frequently a 10-hour day accomplishes little, if any, more actual work than an 8-hour day. Likewise, a 6- or 7-day week frequently reaches the point of diminishing returns from a productivity point of view.

Absenteeism during a 6-day week even at overtime rates is often as much as 20%, severely restricting the results which the extra day was supposed to achieve.

As a measure of the cost of overtime a recent case study is of interest. During the week of June 9, 1969, a public utility in the midwest authorized a 45-hour week in order to obtain skilled men to complete a new installation costing about $500 million. This single step is estimated to have cost the utility and later the public $18 million. If a 50-hour week had been authorized, $40 million of cost increase would have been added.

Regardless, therefore, of competitive situations and regardless of it being "just a little baby" of a building which must be rushed to completion, unrealistic completion dates, scheduled overtime, and undue pressure on completion are a direct cause of aggravated industrial employment costs. So one thing the construction user can do is to be realistic in making his agreement with the contractor and, second, to avoid scheduled overtime in carrying it out.

Third, construction users have at their command the power to increase pressure on local negotiations when they choose to require their contractor to exercise rights under a so-called "national agreement" to keep on working during a local strike. This often subsidizes the union by providing local employment for strikers, thus undercutting the negotiating position of the local contractors.

Very simply, a national agreement is an arrangement between a contractor and an international craft union which provides, among other things, that in the event of a strike in a local area where that contractor is working, the contractor has the option to continue or not to continue to work during the strike. This means that local contractors who have taken a strike to try to hold wage rates or resist restrictive work practices, may find that their striking employees are actually at work on another "national agreement" job. Under such circumstances the local contractor has only two choices: he can either give in to the union demands or he can sit by until he is economically exhausted.

Construction users, therefore, can support local negotiations, and strengthen the bargaining contractors by publicly stating well before local negotiations commence that they will refuse, difficult as it may be at times, to employ this particular benefit of "national agreements."

Fourth, the supply of trained workmen has repeatedly been pointed out as a most vital part of any remedy. Construction users can help increase the supply by more intensive internal training of craftsmen: This internally created supply of skilled workmen will supplement the external supply making more skills and more people available inside and outside to do the needed work. The main obstacle to success in the past has been the inability to insure admission to union membership at the end of the training. It is here that government measures can be of help.

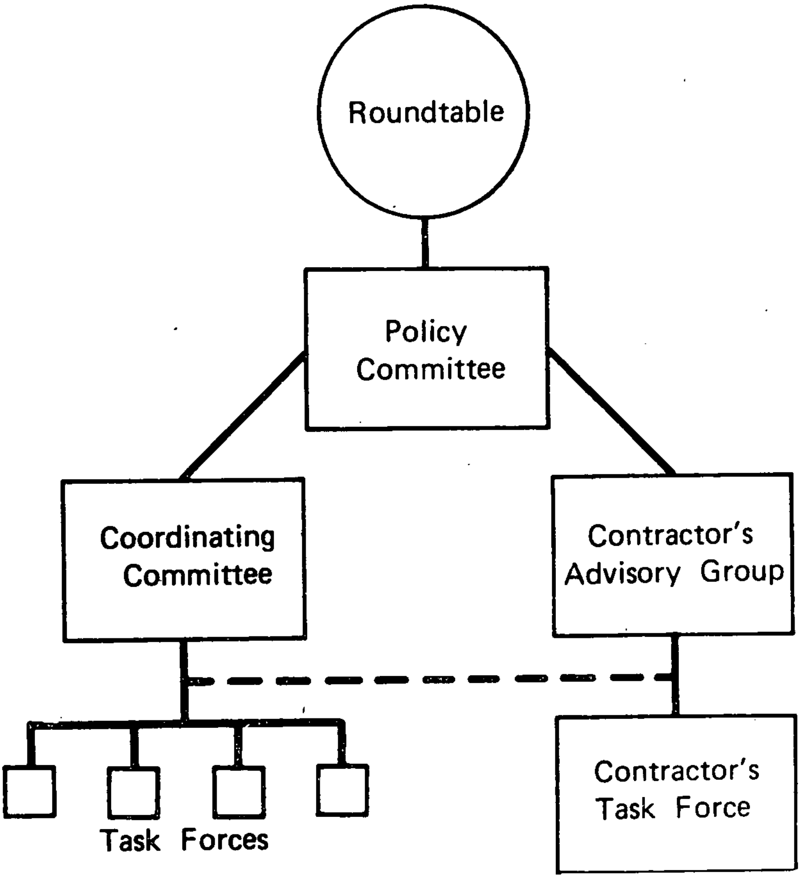
Fifth, construction users can do more of their own construction work, especially maintenance. Doing this will relieve the strain on the supply of workmen. It will probably be accomplished more economically and with less ripple effect on internal wage rates from higher outside wages.

Sixth, construction users can increasingly give open shop operators a fairer chance to contract new projects. Open shop operators claim more ability to manage, more flexibility in work assignments, no jurisdictional strikes or stoppages which are the bane of effective construction work, as well as more continuity of employment and an ability to bid lower prices. Competitively, open shop contractors claim they provide about the same pay and benefits as those afforded by union shop operators. At the same time they seem to offer lower contract prices in many instances.

Seventh, construction users can use their contractual ability to insure outside contractors will use sufficient apprentices, especially from minority groups.

Eighth, construction users can use contract provisions which will strengthen the contractor's labor relations with the local union. One way of doing this is to require contractually more adequate and consistent development of a local well-trained labor pool as well as its utilization.

Roundtable organization . . .



The Construction Users Anti-Inflation Roundtable

This organization is precisely what the name suggests—an informal group of construction users trying to combat excessive and inflationary construction costs and the permeating effects of those costs on other negotiations. It is not a union-busting effort. Many intelligent union leaders are equally concerned.

Affiliation with Roundtable efforts at the national level or at the local level does not impair the freedom of action of any company. Each company is able at all times to make its own decisions, to decide its own construction policies and tactics and to make its own contractual arrangements. The Roundtable does not exist for the purpose of substituting its decisions for the individual decisions of its members. As a construction user, however, it is in every company's own best interest to coordinate with others in the battle against inflationary construction settlements.

To keep the internal operations of the Roundtable at a manageable level, a few of those who participated in the early discussions are members of a Policy Committee. They, in turn, seek advice from some of the leading executives in the construction industry who form a Constractors' Advisory Committee.

Eighteen of the principal members of the Roundtable have assigned competent men of stature in their organization to a Roundtable Coordinating Committee. This working committee is supervising various smaller task forces who direct their attention to appropriate individual problems.

Some of the things these task forces are involved with are:

(1) The available skilled labor supply, of course, is critical. There are simply not enough craftsmen to go around, partly due to current demand but largely due to union policies relating to apprentices, training and admission of new members. The key to unlock the restrictions on entry into the building trades must be found. Currently a strong ally in this vital matter is growing public as well as legal support for the hiring of minorities. "Manpower Supply in the Construction Industry" is the subject of one report.

(2) Restrictive work practices have long been a thorn in the side of the construction industry. The recent Supreme Court ruling which permits secondary boycotts directed at work preservation has aggravated the situation. Now unions demand either total abstinence from the use of labor-saving products or premium rates for their installation. This is another problem crying for solution. "Restrictive Work Practices in the Construction Industry" is the subject of another report.

(3) Overtime practices and economic results of scheduled overtime is another subject of a task force study. Briefly, this study demonstrates the uneconomic results and virtual futility of most scheduled overtime. The report is entitled "Effect of Scheduled Overtime on Construction Projects".

(4) The claim of seasonality of employment as a justification for higher-than-industry wage scales is still another field for fruitful inquiry in wage negotiations.

(5) "Restoration of the Management Role in the Construction Industry" is the subject of another report.

As the need arises, and as the availability of time and personnel permit, other projects will be initiated.

Areas with local construction-user activities . . .

1. Albuquerque
2. Baton Rouge
3. Birmingham
4. Chicago
5. Cincinnati-Dayton
6. Cleveland
7. Corpus Christi
8. Dallas-Fort Worth
9. Detroit
10. East St. Louis
11. Erie
12. Evansville
13. Houston
14. Kansas City
15. Lake Charles
16. Los Angeles
17. Mobile
18. Marietta-Parkersburg

Areas with local construction-user activities . . .

19. Milwaukee
20. Minneapolis/St. Paul
21. New Orleans
22. New Jersey (North)
23. New Jersey (South) - Philadelphia - Wilmington
24. Outstate Michigan
25. Phoenix
26. Pittsburgh
27. Quad Cities (Eastern Iowa & Western Illinois)
28. Rochester *
29. Richmond
30. Sabine Area
31. Saint Louis
32. San Francisco - Oakland (Bay Area)
33. Shreveport (Northern Louisiana & Southern Arkansas)
34. Tampa
35. Tulsa
36. Wheeling

* Formation of other groups throughout Upstate New York is now underway.

Activity is currently underway toward establishing groups in . . .

Baltimore
Denver
Hartford, Connecticut
Oklahoma City
Portland, Oregon
Salt Lake City
Seattle

Work of Construction Roundtable and Local Construction User Groups

One of the first tasks of the Construction Roundtable was to try to acquaint top executives of major companies especially concerned with construction expenditures with the alarming situation in the construction industry. One objective of the Roundtable is to obtain the understanding and support of major construction users.

A second step is to assist in organizing construction user groups in local areas and perhaps within regions. Discovering workable arrangements in order to assist the formation and evolution of such groups is part of the work of the Roundtable.

Currently there is local user group activity in approximately thirty-six locations throughout the country with a possible ten more underway.

Government involvement . . .

- Overtime practices
- Training of disadvantaged persons
- Adequate number of apprentices
- Legislative reform
- Responsible user practices
- Reason with responsible union leadership

Government Involvement

The part to be played by government in moderating the highly inflationary wage demands in construction is necessarily an important one.

The government, itself, is the largest construction user. It has a vital interest in removing roadblocks from new housing. It has an important stake in overtime practices, the training of disadvantaged persons, legislative reform, and responsible user practices. It is also in the best position to reason effectively with responsible union leadership.

It is clear that the present Administration is concerned about the inflationary impact of the construction industry. In the Fall of 1969 President Nixon ordered a very substantial cut-back in new government construction. On March 17, 1970, he restored a substantial part of the cut-back and the balance July 1. The restoration, with other measures, was made in view of changes in the economy and in construction, especially housing. The President, in the same directive, also took steps to increase training and manpower in construction.

A Cabinet Committee on Construction has been formed and is constantly working on the construction industry and seeking to recommend solutions for its problems. A tripartite Construction Industry Collective Bargaining Commission was also created by Presidential order in September 1969.

Supporting Roundtable efforts helps everyone - including construction users . . .

1. Use overtime in emergencies only.
2. Support local negotiations at your construction projects
3. Weigh labor supply & demand when scheduling construction
4. Promote craft membership expansion including jobs for minorities
5. Help remove work restrictions and other impediments to productivity increases
6. Facilitate stronger contractor bargaining groups
7. Explore legislative needs
8. Supply key people for special projects
9. Give construction your personal attention

Program for Action

To top executives and to all who recognize the vital nature of construction problems, the Roundtable recommends the following:

1. Use overtime only in the course of genuine emergencies. Avoid contractually scheduled overtime.
2. If local contractors are jointly engaged in a negotiation strike, authorize work on a project in the same area only if consonant with the local negotiations.
3. Schedule significant construction with a view toward the labor demand and supply in a given area.
4. Support efforts to expand the available supply of workers in skilled crafts, including minorities.
5. Assist in removing work restrictions and impediments to increased productivity—short-term and long-term.
6. Cooperate with like-minded construction users and contractors in organizing and supporting stronger contractor negotiating groups in specific areas or geographical regions.
7. Foster efforts directed at exploring legislative needs in construction.
8. Make key people available for special projects often involving significant time demands.
9. As a top executive, give this matter high priority and provide direct access for decision making.

PART II

I have reviewed much too hurriedly the extent of wage inflation in construction and pointed to the deplorable productivity situation.

Now where do we stand as a nation with respect to inflation? To this observer it appears this way.

During the past twelve or more months the economic policy pursued was based on the gamble that fiscal and monetary restraints would slow not only demand-pull inflation but wage-push inflation as well. So far as wage-push inflation is concerned, this has been a losing gamble in the leadership wage sections of the economy—especially construction.

The economic policy pursued also assumed that the domestic economy had more to gain than to lose by underemphasizing the impact of wage-push inflation. This has been an equally unrewarding gamble.

Reliance during the past twelve months upon expected improvements in productivity to bail out the economy was simply not a feasible solution. Whatever improvement now exists is a fraction only of the employment cost increases, and the rate of improvement in productivity where it exists is not sustainable because, in the main, it represents the temporary effects of reductions in the working forces and in overtime.

For these reasons it appears to this observer that unless we wish to contend with the effects of mounting inflation, our national remedies require a complete overhauling. Specifically:

Serious wage inflation will not go away of its own accord. The unions and union leadership are themselves, to a large extent unwillingly, caught in an upward ratcheting race. They are forced by internal political pressures to chase after enormous increases in construction and a number of other settlements. Realism does not support the thinking that employment increases are being dampened when bargaining agreements in manufacturing for the third quarter of 1970 (the latest data available when this is being prepared) provided for first year increases of 9% or more and when construction settlements reached 22.1%.

Now recall that for the economy as a whole total costs consist of 75% to 80% wage costs. With the trend to three-year contracts, as a nation we face wage increases in manufacturing of 30% or more in three years and at least 50% to 60% in construction in the same period. As an example of the problem, only a few weeks ago a Presidential Board recommended an increase for certain railroad employees of 37% over three years.

Recall also that, at its most optimistic long range best, improvement in productivity or output per man hour will rise at no more than 3% to 4%.

Thus one can observe the widening gap between the wage-push inflation and improvement in productivity. It spells out in unmistakable terms one economic phenomenon—galloping inflation.

Now the longer adequate action is deferred, the more difficult any remedy for the wage-push type of inflation will become.

Certainly the cure administered by a colossal economic bust is the least desirable of all possible solutions but not necessarily a remote one if current inflationary conditions continue to worsen.

There are available some measures which if courageously tried have promise. If a program of wage restraint can be devised and successfully carried out, these measures will provide greater freedom of action to stimulate the economy and relieve unemployment by relaxing stringent monetary restraints.

Available Measures

First, among these measures let us set aside general wage and price controls as unmanageable and undesirable under current conditions where the nation is rapidly moving to a peace-time economy. Regardless of the current atmosphere in wage increases, there is little reason to encompass in a national incomes policy the unmanageable reactions of millions of service employees—now numbering more than all other employees—the thousands of small, medium sized, and large businesses, plus untold complexities, by any venture into peace-time wage and price controls.

Second, if the main source of the wage flood can be checked, the subsidiary floods will, hopefully, gradually subside without overt controls.

Third, the source of wage-push inflation lies primarily, although not entirely, in the field of construction. Being much the largest industry with about 3.4 million employees and being so widespread over the country with many employee skills much the same as those in other industries, construction is a most telling influence. Because of the inherent weaknesses in the bargaining structure of the industry, since 1966, in the face of increased demands, out-of-line wage increases and poor productivity have burgeoned. The third quarter construction settlement of 22.1% a year are ample evidence of the fountain-head of the wage problem.

Earlier I have portrayed some measures construction users and contractors might take, such as increasing the supply of trained workmen with special emphasis on minorities, doing more maintenance construction work with internal forces exploring the pros and cons of the growing quantities of merit and open shop construction, using contractual relations to increase apprentices, reducing scheduled overtime, backing up contractors in local negotiations, and developing manpower resource pools using government or privately operated manpower banks.

Contractors in turn can improve negotiating techniques, develop measures for terminating jurisdictional disputes, do more in the training of work forces, and find means of restoring at least some measure of on-the-job management now largely lost.

But I am aware this Joint Economic Committee is primarily interested in what government can and should do. A word about that.

The Role of the Federal Government

The need for more training for more people, especially minorities, is constantly reiterated. The Executive branch has taken a number of steps in this area but much more effective action is needed.

Training is one thing but the admission to union membership after training or during training is quite another. Ironclad barriers have been interposed to prevent trainees and skilled workmen from getting work as union members. These barriers should be removed. With the massive amounts of construction ahead in this decade, the construction industry will need all the skilled employees it can get.

A second measure is this. More and more knowledgeable people in and out of industry and government as well as among contractors have concluded that the absence of the right on the part of the contractor to manage work on a project is one of the most important and devastating developments in the construction field. To restore at least some improvement in productivity it will be necessary to restore the right to engage qualified people, including minorities, to permit adequate management on the job, and to achieve some flexibility in work assignments.

The source of this difficulty appears to be the institution of the union-controlled hiring hall. As an institution, the hiring hall provides the contractor access to a particular labor pool but it likewise provides the union with the means of controlling the size of the labor pool and the jobs of its members. The use of the United States Employment Service or some other type of manpower pool outside of union control is needed. This would remove much of the power local unions have to make or break contractors by granting or denying the contractor's request for competent employees. A change in the hiring practice would insure the employment in construction of more members of minorities.

With control of the manpower supply, the local union agent has the last word on the very existence of the contractor or of new contractors who wish to enter the competitive field. It is an unhealthy condition for unions and union members as well as for contractors.

The government, as the largest construction user, has the right to contract for work on a basis that will loosen up sources of manpower. This would not interfere with membership in unions or in the union shop. This action will be opposed as anti-union. Quite the contrary, it is not anti-union. It is only anti-unhealthy manpower control.

Also, as the largest consumer of construction, the federal government can adopt and, on federally-supported projects, induce the adoption by states of improved contracting measures. Among these are the—

(1) Requirement of full complements of apprentices.

(2) Scheduling of construction during off-seasons of demand wherever possible.

(3) Requiring bids on a 40-hour a week basis in contrast to a scheduled overtime basis.

(4) In areas of excessive wage rates, the government can stipulate what it will and will not contract for in wage costs and in escalation. This, of course involves the Davis-Bacon Act and the so-called "prevailing wage" concept.

(5) The federal government can also deal with the Davis-Bacon Act problem to which Dr. Arthur Burns referred in his Pepperdine College talk of December 7, 1970.

Enacted in the deep depression period of the early 1930's, the Davis-Bacon years has acted as an engine of inflation. It ties the hands of government in securing competitive bids. It assurès unions and constractors that however high the wage rate they negotiate may be, the government will pay those rates because it is required by law to do so. By its example, it forces higher rates on non-government work. It spreads high city rates to rural communities.

Naturally construction unions will oppose the repeal or suspension of this Act. Fortunately, the Act provides:

"In the event of a national emergency the President is authorized to suspend the provisions of the Act."

If there has ever been an economic national emergency surely one of an inflationary nature exists today, especially in construction.

Suspension of the Act by the President or its repeal by Congress would have the salutary effect of signaling to everyone that the government "means business" in its campaign to restore stability to our economy.

If the question is raised as to why single out construction, there are adequate reasons. It is the source of much of what is wrong. If the trend of wage inflation in construction cannot be changed, the game is up for changing the trend in all wages. Even if only partially successful in changing the trend in construction, it would still be a big help.

In golf, a particularly difficult shot to be made under stress is frequently referred to as a "character-building opportunity". Action such as is proposed here against opposition of the politically strong craft unions is likewise very likely to be a "character-building" experience.

Public Awareness

Members of Congress and the Administration can do another thing to stem the tidal wave of wage-push inflation now engulfing the country.

A. Move from the public position that monetary and fiscal measures are sufficient to stem inflation—especially wage-push inflation constantly rising in a noncompetitive union world.

B. Publicly note that savings and pensions are being eroded; that the cost of housing is going sky-high and will go higher in spite of reduced interest rates; that recent wage increases provide an endless treadmill leading to an inflationary period of harmful stagnation, one especially harmful to workers; that inflation itself accelerates more inflation; that inflations in the past have ended in reduced investments in new plant and equipment, reduced production, and reduced jobs; that if continued long enough, the saving habits of a nation will be adversely affected which in turn will affect the entire economy; that the national interest demands an end to an expectation of more and more inflation.

C. Publicly it can be noted that our international position is worsening competitively and that this signifies action is needed on the domestic front to halt round after round of wage and price increases; that jobs in America are very much at stake; that economic stability may be an old problem and a continuous one but, in terms of the current situation, wage-push inflation must be dealt with now and forceably.

It is said that the American people have lived through depressions and fear them mightly, but that they do not fear inflation because, unlike Germany and some other countries, they have never had to contend with it. Personally, I fear both conditions. My views have much in common with the recent OECD report which contained a dire prediction of the social and political consequences of continued inflation.

"Because resentment against inflation is incoherent and diffused through the community, it provides favorable terrain for extremists at both ends of the political spectrum. It gives ammunition to those who favor more authoritarian forms of government relying on extensive wage, price, and production controls, and to those who hark back to earlier times before governments had accepted their present responsibilities for growth, high employment, and social justice."

Unemployment is undeniably of current serious import, but the immediate problem is to recognize that the road to fuller employment lies in finding a path to a more stable economy, to confidence in the value of the dollar, and to recognize that serious inflation is a job-destroying virus of the first magnitude. Employment is the natural beneficiary of stable wages and prices.

The big problem today is to grasp the nettle: to be willing to fight inflation at the definite risk of temporarily losing favor with certain elements of unionism. In substance, and in effect, it is a political decision. It will, necessarily, be made one way or the other—for, unhappily, it cannot be avoided.

Chairman PROXMIRE. Well, thank you, Mr. Blough, for a most comprehensive and very interesting statement. You have done a superb job in pulling all this together and making a very strong case for your point of view and, I might say, your point of view is most timely.

Just a few minutes ago the Consumer Price Index was disclosed to us as having risen by one-half of 1 percent. That is on an unadjusted and seasonally adjusted basis. At any rate, it is an indication—that during the past month—that inflation is continuing apace; that although we have had fiscal and monetary policy that is designed to restrain the economy, indeed the economy has been restrained, we have had growing unemployment, we have had reduced profits—and in spite of that, inflation is going right ahead.

So I think your statement is most helpful.

I would agree wholeheartedly with you that we need an incomes policy of some kind. We need to move in on these wage increases which are inflationary, and I think on price increases that are inflationary.

At this point I must say I differ very sharply with much of your analysis. Here is why. I think you have made a strong case, but I think you have overstated your case very heavily. It is just as if somebody would point to the salary of the president of United States Steel and say this is typical of the income that every businessman gets, ignoring the fact that the president of United States Steel, of course, is almost unique, and because it takes enormous ability, and he has great responsibility.

Let me just point out what has really happened to all wages in this country over the past year or so. The Wall Street Journal in an article entitled "The Outlook—Appraisal of Current Trends in Business and Finance" of December 21, 1970, and I point out this is the source of my information, came to this conclusion on the basis of a Federal Reserve Board study.

Without objection, I ask unanimous consent that the entire article be printed in the record at this point.

(The article referred to follows:)

[From the Wall Street Journal, Dec. 21, 1970]

THE OUTLOOK—APPRAISAL OF CURRENT TRENDS IN BUSINESS AND FINANCE

'Tis the season to be jolly, to be sure. Still, you may be forgiven if you occasionally secretly wonder what in the world the country is coming to. Strikes on top of strikes. Featherbedding. Shoddy workmanship. Service with a frown. More pay for less work.

It all seems pretty awful to anyone who believes that hard, honest effort is the ingredient that most determines this country's progress, economic and otherwise. Before concluding that the Land of Opportunity has been hopelessly transformed into the Land of Importunity, however, you should consider a few seldom-noted facts.

To the extent that misery welcomes company, some comfort can be obtained from what has been happening on the labor front abroad. Take, for starters, the matter of wages. The table below, condensed from a recent Federal Reserve Board study, pinpoints the annual rates at which hourly wages rose during the first halves of 1970, last year and 1968.

	Increase in wages		
	Percent 1968	Percent 1969	Percent 1970
Belgium	4.2	7.8	10.8
France	5.9	7.0	10.6
Germany	6.0	8.0	16.7
Italy	3.9	8.0	30.6
Netherlands	7.8	12.8	10.1
Japan	16.3	14.1	11.1
Britain	7.9	7.2	6.1
United States	7.4	5.6	4.3

The U.S. increase in the 1970 period is the smallest. Moreover, the *trend* of the U.S. increases over the three years is downward, while in most of the other countries it is upward.

The U.S. wage level continues to be much higher than elsewhere in absolute terms. Labor Department statistics show that the gap has actually widened in recent years. However, if anything like the patterns noted above persists for very long, the U.S. position would begin to improve even in absolute terms.

Regarding the matter of less work, other Labor Department statistics show that the U.S. workweek has indeed shortened in recent years. But even sharper workweek declines have occurred in Belgium, Japan, the Netherlands, Britain and Canada. In absolute terms, the U.S. workweek is longer now than in Belgium, Italy, Sweden or Canada. A decade ago, only Swedish workers, among the above, worked a shorter week than those in the U.S.

The workweek for Italian production workers averaged about 36 hours last year, more than four hours shorter than the U.S. average.

Not surprisingly, in light of such statistics, unit labor costs have climbed more slowly in the U.S. recently than in other industrial lands.

The comparisons provide an interesting footnote for the current debate over how heavily the U.S. should rely on some sort of "incomes policy" to curb wage-price increases. Such policies have been applied—with obviously little success—in many of the aforementioned foreign lands in recent years.

Argus Research Corp., an investment advisory concern, recently reported that Western Europe and Japan are "beset by even stronger inflationary pressures than the United States." The report cited "spiraling wages" as the chief culprit.

Evidence that the wage spiral is worse abroad, of course, does not alter the fact that labor costs are exerting a highly inflationary "push" on prices in the the U.S. Even without foreign comparisons, however, the U.S. situation seems not quite as difficult as headlines may indicate.

Perhaps the most significant, though not the most publicized, development on the U.S. labor front has been a sharp pickup in the worker productivity, or output per man-hour. Productivity in the private, nonfarm labor force rose at an annual rate of 4.6% in the third quarter, and many economists look for even sharper increase in coming months. Between the fourth quarter of 1968 and the second quarter of this year, in contrast, productivity did not increase at all.

At the same time, as the table above shows, hourly wage increases in the U.S. have been getting smaller. This is hardly the picture one gets from headline news of record pay packages in such big-union industries as autos and railroads. However, only about a quarter of the country's labor force is unionized, and nonunion wage boosts have shrunk in the past year or so.

A Commerce Department study pinpoints what has happened. In mid-1969, wage boosts for both union and nonunion workers averaged slightly above 5% per year. In mid-1970, the average wage increase for union workers climbed above the 6% mark. But the average increase for the much more numerous nonunion personnel dropped to 4%.

The prompt responsiveness of nonunion wage trends to general economic activity, it should be noted parenthetically, suggests that the U.S. economy remains considerably more flexible than most advocates of wage-price controls contend. Admittedly, the picture could change if unionism were to spread rapidly. But so far it hasn't.

Historically, wage trends for union workers tend to follow the nonunion pattern. Accordingly, if history repeats, union wage boosts will get smaller in the months ahead.

To assess the true inflationary pressure of labor costs, of course, one must view wage increases and productivity gains together. A moderate wage increase offset by no productivity gain is more inflationary than a big wage increase offset by a still bigger productivity gain.

The Government's index of labor costs per unit of output takes both factors into account. In October, this index was 2.2% higher than at the year's start, a worrisome increase. But in the same period a year ago, the index rose 3.3%. (A virtually unnoticed development: *Nonlabor* costs per unit of output have recently been rising much more rapidly than labor costs.)

None of these considerations means that the country's labor problem can be taken lightly. But neither do they justify deep pessimism, especially at Christmastime.

ALFRED L. MALABRE, JR.

Chairman PROXMIRE. The most recent period for which they could get figures was the first half of 1970. They compared wage increases here with wage increases in other countries.

What they found were these: that in Italy wage increases last year, the first half of this past year, were 30 percent; in Germany, 16 percent; and so it goes.

No. 1, the U.S. increases were the lowest of any country, any industrialized country. The study consisted of the following countries: Belgium, France, Germany, Italy, the Netherlands, Japan, Britain, and the United States, which was the lowest.

No. 2, wage increases have been declining, and quite sharply, in this country over the past 3 years. They increased from 7.4 percent in 1968, 5.6 in 1969, and 4.3 percent in 1970.

No. 3, they found virtually an unnoticed development which is that nonlabor costs per unit of output have been rising much more rapidly than the labor costs.

Furthermore, that while the wage increases have been moderating, productivity increases have increased, productivity improvement has increased overall. I am not talking about this particular union. So the actual increase in wage costs has been even more moderate in the past year or so.

Now, under these circumstances I wonder if it is quite fair to apply the extraordinarily unique analysis that you have given of our wage-price picture to the whole problem of wages and prices?

Mr. BLOUGH. Mr. Chairman, I would like to comment on that. First of all, taking up the so-called worldwide inflation, when in Germany, for example, where the wages are under $2 an hour, they increased wages by 10 percent. They increased it 20 cents an hour.

In this country, where the wages are roughly $6 an hour in the same industry, you increase it by 10 percent and you increase it by 60 cents an hour.

Now, the point I make to you, and it is a very obvious point, is that employment costs result in what? The costs that go into the product, and the products that are manufactured in Germany that compete with the products manufactured in the United States are sold in terms of dollars.

Chairman PROXMIRE. Let us take that precise point that you have made with respect to Germany and the United States. The increase in Germany was at an annual rate of 16.7 percent; the United States 4.3 percent, almost four times as great in Germany.

It is true that our absolute level is much higher than in Germany. Even still in absolute terms the wage increase in Germany was greater and, of course, in percentage terms it was infinitely, it was four times as great.

Mr. BLOUGH. Oh, no—let me be clear about that. When you are talking in your overall averages for the United States you are including all the service employees and you are including a lot of others. You are not including manufacturing. Mr. Burns said just recently——

Chairman PROXMIRE. I am including manufacturing.

Mr. BLOUGH. You are including it but you are not separating it.

Chairman PROXMIRE. I want to come to that in a minute, yes.

Mr. BLOUGH. Mr. Burns said recently that the manufacturing wages in this country had gone up at a rate of over 9 percent, between 9 and 10 percent.

Now, that was the reason I chose the 10 percent.

I would like to comment a little bit also upon what is happening in this country. What you have seen in this country, and this is the reason you are referring to the averages as you have there, is a reduction in the wage increases in certain segments of the economy, but you have not seen that in other segments of the economy which are the lead segments of the economy.

I am referring to manufacturing, I am referring, for example, to the railroad industry. I am talking about the highly unionized segments, I am especially talking about construction.

Now, in spite of all the other increases that are appearing, construction is so far out, it is creating such a vacuum, it is dragging up all the other wages. You may not think that we are in the middle of the most devastating wage increase inflation that this country has had, but I think we are.

Chairman PROXMIRE. My time is up, but I would like to just point out the actual real increase or the real effect on wage increases in the past 3 years in manufacturing exclusively has been a decline of 6 percent in real terms, allowing for inflation, allowing for increased taxes.

Mr. BLOUGH. You are relying on the past, sir. We are now at a place in 1971 where you are facing the worst wage inflation that this country has had in recent years. I know the contracts that are up for negotiation, I know what is happening. I know what the wage rate increases have been in industry, and what is going on, and unless something very drastic takes place we are going to have one of the worst wage-push inflations that the country has seen.

Chairman PROXMIRE. Yes; we are talking about different things. I am talking about real wages and I will come to these statistics when I come back.

Senator Percy.

Senator PERCY. I trust that we will have the unions here later. I am sorry the unions are not here today. We could have had a lively exchange, I am sure.

Chairman PROXMIRE. May I say, Senator Percy, that I intend to invite the unions to come up, construction unions, and reply to Mr. Blough. I think he has made a very helpful and interesting statement.

Senator PERCY. I think that would be very helpful indeed, Mr. Chairman, and I fully support the invitation to the unions because they should have a chance themselves to study this and make an answer.

Mr. Blough. I think so, too, and I think you will find if you discuss the problem with some of the real leadership in the construction unions that they are as concerned, as much concerned, about this problem as we are.

Senator Percy. I think that is true. They are good citizens and they have a direct responsibility to their members. But I think they also have an overall picture of what is important. I am very hopeful that the President can pull together both labor and management in the same room and charge both with the responsibility to do something about it. I think the creation of the roundtable is a healthy step in this direction. I only wish labor members were on that roundtable, frankly.

I would like to comment on the question the chairman raised about profit in the construction industry.

McGraw-Hill shows contractors' profits are on the decline. They are now at a 1.2-percent level against gross.

Common stocks of construction companies, which also is an indicator of these sophisticated analysts' appraisal of the profit opportunities in the construction industry, taking such companies that are traded in the market, Morrison-Knudsen, Perini, and Del Webb, these stocks have taken a real beating, so that the outlook for their profits is not very good, considering the trends. I think we all have cause for concern.

Mr. Blough, I wonder if you could tell us—and you have been exceptionally helpful in providing recommendations not only for the industry to follow but also those of us in Government, and character-building recommendations are particularly appreciated—I wonder if you could tell us what would happen, what would have happened to wages in the construction industry if the construction industry were subjected to foreign competition as so many industries are in this country? Would that have changed the picture?

Mr. Blough. Well, it is an interesting thing as to just what is developing. First of all, when you manufacture a pair of shoes, in, let us say, Austria, and you build a plant to manufacture the shoes, the contruction cost goes into the manufacturing plant cost. Every time you sell a pair of shoes, you are selling a piece of that plant. So, whether it is recognized by the construction unions or others in this country, the construction costs abroad are definitely involved in every product that is shipped in from abroad. It cannot be otherwise.

There is, therefore, competition. It is not the direct kind of competition that you normally are looking at, but there is definitely indirect competition between construction costs abroad and construction costs in this country.

Now, another thing is happening, and this is relatively new. The construction unions have done a great deal of fabrication in this country, and the fabrication is starting to come into the country in, shall I say, prefabricated form. In other words, we are starting to import into this country the fabricated product, partially fabricated usually, and this is more direct competition between the two.

So I would have to answer your question by saying there is a lot of competition between all kinds of construction abroad and all kinds of construction in this country.

Senator Percy. Thank you very much.

I have gone through the testimony as carefully as I could in the time we had. In your recommendations I do not find—maybe it is buried in there some place—but I would seriously hope that the roundtable would take into account the possibility offered by offering stockownership in construction companies to workers.

This industry faces a crisis. We face that crisis in the railroad industry, and the Chicago, Northwestern Railroad is now facing up to it and offering the whole railroad to the workers if they will buy it.

I wonder then whether the featherbedding would be such a serious problem or whether there would not be some self-policing among the employees if the unprofitable nature of the operation was taken out of their pockets?

Is there any significant profit sharing or ownership involved in construction companies?

Mr. BLOUGH. Two comments on that. I do not know anything about the railroad business, but some of the railroads are, well, let us say, hard to support. I will let it go at that.

The other thing that I would like to say is that in the construction industry there are many companies that now have some kind of a profit-sharing arrangement for at least the supervision and for others, and I see no reason at all why something cannot be done in that, except for one reason. In construction the nature of the work is such that an individual changes jobs many times and works for many different companies, and I think you would have to work out a very unusual arrangement to have any kind of a profit sharing.

Again, I would like to take exception to what I just said. Some of these companies are working out a better stability arrangement for longer employment with the same employees, and in those cases I do not think it is too difficult to offer incentives. If you are talking about incentives, I would say that there are at the present time a number of incentive plans in construction, and there is no reason why there cannot be more.

Senator PERCY. Thank you, Mr. Chairman.

Chairman PROXMIRE. Let me get back to the figures here. I have got the Economic Indicators, and this is put out by this committee so the figures must be accurate. [Laughter.]

The Council of Economic Advisors vouches for them, too.

Mr. BLOUGH. The presumption is in your favor.

Chairman PROXMIRE. We have a bipartisan agreement. Total nonagricultural private sector, wages seem to have increased 5 percent overall, not allowing for inflation, 5 percent in dollar terms between 1969 and 1970.

In manufacturing they increased about 5 percent in dollar terms, and there was no perceptible increase toward the end of the year, so I am not living in the past.

As far as contract construction is concerned, you have a good point there, there was an increase of about 10 percent, twice as great as in manufacturing and twice as great as in the rest of the private sector. However, even here, it seems to me, you are looking at the hourly wages of the most highly skilled workers, and only a small portion of the industry, and only in the central cities of the country.

Mr. BLOUGH. May I point out what is wrong with those figures?

Chairman PROXMIRE. Yes, sir.

Mr. BLOUGH. And I do not mean to be difficult about living in the past, but it is awfully important to understand trends.

Now, what is being cranked into the figures that you are reading are all the wage increases of the old contracts, and then one other thing they do is to take all the wages that are being paid and just add up the increases. The thing which they are not observing in those figures are the trends.

What I am trying to say is the important thing from the standpoint of the future of this country is the new contracts and what is happening in the new contracts; and my data portray what is happening in the new negotiations. It is the new negotiations that are important. The new negotiations are the ones that are setting the trend not only in construction but in other areas of the country.

Now, you know, of course, Mr. Chairman, that when the trucking industry has a 44 percent settlement in 3 years that it has no relation whatsoever to 5 percent a year.

Chairman PROXMIRE. I would agree wholeheartedly that there are great differences in the wage increases in some industries as compared to others, just as there are great differences in profit increases in some industries as compared to others; and I would furthermore agree whereas you may justify the profit increases, at least in part, on the differences in efficiency and in performance on the basis of management, that many of the wage increases cannot be justified on any basis. But I just wanted to get at the overall picture.

Now, isn't it true that about 80 percent of the housing built in this country is done without a union contract?

Mr. BLOUGH. Well, it is some high percentage, and I do not know, but let me point out the two things before we leave this question of the overall. It is not a useful thing to look at overall data and expect to understand what is happening to wage-push inflation.

Chairman PROXMIRE. I come right back and say it is not a useful thing to look at just the extraordinarily bad examples alone. I think you have to look at all of them.

Mr. BLOUGH. Right.

Chairman PROXMIRE. That is why I am trying to look at this in perspective. Let us look at what Mr. Blough has pointed out as the abuses, but let us look at what is the overall picture in construction and in manufacturing.

Mr. BLOUGH. Let me add another thing. You have to look at the leadership areas, you have to look at the General Motors settlement, you need to look at the construction settlement, the railroad settlement, the trucking settlement. You need to look at the printing settlement, and I hesitate to suggest it, but you need to look at some of the impending settlements that are coming up this year that are very important.

Chairman PROXMIRE. I am hesitant to suggest it, but I say we also need to look at the kind of steel price increases recently imposed by Bethlehem Steel and by United States Steel at a more moderate rate, and we have to look at those and consider whether they were justified or inflationary. I may say part of that was in anticipation of a union settlement to come in compliance with the General Motors settlement. But if you are going to anticipate a big wage increase by a price increase, it seems to me you are going to encourage it, and that is going to push inflation.

Mr. BLOUGH. I am not here to talk about steel. I am no longer connected with United States Steel except as a director. But let me say this, that you heard this morning from the several Governors who were here, and I also heard, what was happening in the country. They did not talk about it, but a great part of their problem, Mr. Chairman, is just what I have been talking about, and that is the wage-push that is affecting all of the costs in the individual States.

Now, this is happening in New York City, it is happening in other places in New York State.

Part of the problem that you are observing here is the effect of wage-push inflation all over the country, and you have just seen the beginning of it.

Chairman PROXMIRE. I think that is right. But I think we can cope with it better if we can understand what does lie behind it, whether or not there is any equity in it, and for that reason I would like to call your attention to the fact that the Economic Indicators say that in contract construction hourly earnings are now $5.40. I am told in this industry workers work only about 1,500 to 1,600 hours a year, not 2,000 a year as is typical for the economy as a whole.

You do not, they do not, engage in construction at the same pace. When it is very cold or when it rains or when—and very often there are periods in which they simply do not work because the jobs are not there.

At any rate, the yearly income for a highly skilled workman on the average is about $8,000. Now, on that income, the workmen building a $25,000 house could not afford to buy that $25,000 house.

Mr. BLOUGH. Let me say this, that the averages you are referring to there are not for those who are spending their full time in construction under present-day employment cost increases. I have read you some of the averages that are occurring. I realize that in construction the data are very, very insufficient. I understand that the Bureau of Labor Statistics has underway some additional data collection procedures that are being prepared with respect to construction data.

If I were examining this, I would find out what was going on in the industry as distinguished from some very, very outmoded data.

Chairman PROXMIRE. Well, I think it is most useful to call our attention to, as I said, and there is no question that, contract construction wages have increased twice as rapidly as in manufacturing or as in the rest of the private sector.

But let me ask you this: Are you aware of the practice in construction of pyramiding costs; that is, the builder is given a percentage of the cost of building as his fee? The architect gets a percentage of the cost, so there is no incentive really for the builder to hold down costs. He makes his big settlement with the union which gives him a big price increase, and that helps him because that means he gets a percentage of the cost as a fee, and he has reason to have a weak resistance to unreasonable demands. The architect is in the same position to the extent that he has any influence over settlements.

Mr. BLOUGH. Well, I am not here to defend every practice in the construction industry. I think it is time the construction industry looked at all of their practices. But I would say this: that the basic problem in construction is the one I pointed to, along with the lack of management and the loss of productivity. Anyone who is connected with it, including, I am sure, some of the general presidents of some of the construction unions will agree with that.

Chairman PROXMIRE. I just wondered if this is true that labor costs are the principal problem, and you know the increases have been great, and the cost of housing and construction, land, must be 15 to 25 percent, and in housing the money costs are as much as the house itself; the rest are materials, closing costs, bank fees, et cetera. The cost of the labor on the site, which is construction labor, is a small fraction, very small fraction, of the cost of that house.

You buy today a $20,000 home, and if the interest rate is 8 percent, the cost of the money is around $30,000, $32,000; the cost of the house is $20,000, including the land, the labor costs, the materials, everything that goes into it, so that the labor itself in this relationship to the total $52,000, that is $20,000 for the house and $32,000 for the money, so it just has to be a relatively lesser cost than these other elements.

Mr. BLOUGH. Mr. Chairman, I come back to two things which it may be difficult for someone who is not connected with this to accept. But, first of all, the construction industry is the leadership wage industry at the moment and is pushing up all wages.

Second, in that house, while you were talking about wages on the site, and those are going out of sight, all of the wages that go into all the products that go into that house are involved in what I call wage-push inflation at the present time.

Now, my premise is that the construction unions are now pushing up their wages so high, and other wages are creeping up to catch up to them, that all wages and all products and all costs are too rapidly rising.

Now, therefore, it is an insufficient picture to talk about construction costs, but I will talk about it for just a moment.

There is a very large housebuilder in the Philadelphia area who said:

> Yes, I hear what some of the labor economists are saying about the land costs and how little the employment costs are on site.
>
> I want to tell you, however, that I am using land which I have owned for 5 years. Two years ago a three-bedroom house was being sold, that is, erected and sold, for something like $23,000. Today that house is $31,000, and this gentleman said. "The entire difference is in labor costs on the site."

Now, let me go on a little bit further. What you do not understand, because I have not made it sufficiently clear, is that it is not only the wage rate. It is the lack of productivity that is happening. The contractors are no longer in control of what is going on on the job site. The problem is that the control of the people on the job, that actually do the erection, has been lost to the local unions. The employees really do not work for the contractor in the ordinary sense. They have not any way of getting a job—I'm not talking universally now because there are some contractors where this is not true—they haven't any way of getting a job without going through the union hall, and under those circumstances the loss of management on the job is one of the worst factors in cost increases.

Chairman PROXMIRE. Well, you have been most patient. I want to yield again to Senator Percy, but I just wanted to say that my administrative assistant, Howard Shuman, a very able man, was administrative assistant to Paul Douglas for many years, and he went with Paul Douglas on the commission that went into housing costs in great detail. They studied it for 2 years. They tried very hard to document the charge about restrictive practices in the construction industry.

They talked to hundreds of people all over the country. Every time they would hear a complaint such as the one you have given me about some man, an anonymous fellow, who says the costs have increased from $23,000 to $31,000, they would go out and find out whether they could document, and whether they would show this was strictly a labor cost, and they were not able to document this.

Mr. BLOUGH. How long ago was this?

Chairman PROXMIRE. This was 2 years ago.

Mr. BLOUGH. Two years ago? Lots has happened.

Chairman PROXMIRE. You make a very powerful case. It would be most helpful, although you have given us a lot of documentation this morning, if in these horror stories we hear, we could get as much documentation, No. 1, that they can show exactly where the cost increase was.

No. 2, where they can show this is a universal problem, where it applies. This would be most helpful to Congress and the committee in working with the union officials, and we are going to ask them to come up to give their viewpoint, so we can have the basis of a reasonable dialog and come to some conclusion.

Senator PERCY. I would like to ask Mr. Blough for his reaction, with all due deference to a former colleague and college professor, Prof. Paul Douglas, I would say if they could not find any discrimination in labor union hiring practices from the standpoint of hiring minorities, they are color blind.

Chairman PROXMIRE. I did not talk about that; no.

Senator PERCY. That is part of the labor market.

Chairman PROXMIRE. I would agree with that.

Senator PERCY. If you leave out the biggest pool available today and make it impossible for people who are black to come in—or you won't take anyone into a glazier's union unless he is the son of a present member—you are restricting very strictly the labor pool available to that union and to that industry. I think we have got to break the back of these discriminatory practices, and I have said that face to face with the unions in Illinois, who are my constituents, my voting constituents. They know it, and many of the most enlightened ones are leading the fight to stop these restrictive practices.

But that discrimination and the restrictive practices have added immensely not only to the immorality of what we might say is the hypocrisy of American life when it comes to hiring practices and discrimination, but also to real costs that in the end the poor and the unfortunate must pay because of these practices.

So I must, without filibuster, turn to Mr. Blough.

Chairman PROXMIRE. If the Senator will just yield on this point, I will say the Senator is absolutely right. He knows Paul Douglas was always in the forefront of fighting these practices.

Senator PERCY. He always spoke against them.

Chairman PROXMIRE. Of course, he spoke against them, and highlighted them and, of course, this was the case. I was not talking about that practice, because that is one we all agree on. But there were other restrictive practices charged that they just could not document.

Go right ahead.

Mr. BLOUGH. Mr. Chairman, I do not think we should lose sight of the main show in the main tent, and for me the main show in the main tent that is going on now is what I choose to call wage-push inflation rather than cost-push inflation. Anyone who examines this matter will readily see that it is happening. Anyone who comprehends the effect of that will have to agree, I believe, that unless something is done about that, we are going to change the things that happen in the United States of America. It cannot be otherwise.

You cannot increase manufacturing wages 30 percent in 3 years on the average, and construction wages 50 to 60 percent in 3 years on the average, without changing the nature of the United States.

Now, there needs to be something happen with respect to this wage-push problem; and while I can go into many details, it happens that I did not ask for the work that I now have. It was thrust upon me. But, nevertheless, I am involved in it, and I have spent a large part of my time in the last year and a half on this construction problem. It is the No. 1 problem within the No. 1 domestic problem of the country.

The No. 1 domestic problem of the country is the effect of the wage push on the total lives of everyone.

If this wage-push thing continues, you are certainly going to slow down everything that is done. It cannot continue without creating serious unemployment. I think there are many on both sides of the fence—and I am talking about the union and the employer fence—who understand it exactly as I do.

Senator PERCY. Mr. Blough, I have a couple of additional questions. You have been very patient this morning while waiting and the time we have taken with you.

Mr. BLOUGH. I appreciate the opportunity.

Senator PERCY. I feel very deeply about the exclusion of minorities from the labor pool, and the discriminatory practices in the industry.

Mr. BLOUGH. Right.

Senator PERCY. And I can understand and applaud the chairman when he says that the unions will be brought in and have an opportunity to come forward because I have no doubt they are going to show they are going to change the hiring practices and are in the process of doing it. They are putting much more emphasis on training, and they are recognizing that the labor pool available and some of the practices must be improved.

On the question of productivity let me give my own parochial experience. Before the war, the lowest price of the movie camera we sold—that is, World War II; in the 1940's and thirties—was $49.50. I was bound and determined we were going to get something lower priced and better. And we came out some 20 years later with a $39.50 camera. No one sells it at that price today, but I will bet it is not too far from that.

We were paying people on the line two and three times as much as we were paying them before.

Mr. BLOUGH. That is right.

Senator PERCY. The only difference was productivity.
Mr. BLOUGH. Exactly.
Senator PERCY. It did not matter what we paid per hour providing every time we made hourly increases we increased our productivity and reduced our unit cost of production. Wage rates do not mean a thing if we can relate it to unit increases in output and lower the unit cost of production. That is the crux of the whole matter, and I think that is what we have to get at. I hope that the unions will show us they have a full understanding and appreciation of the fact that the sky would be the limit for wages if along with it you get that productivity increase.

Mr. BLOUGH. May I say in behalf of at least two of the general presidents of these construction unions that within the last 6 months they have sent the very story that you are talking about on productivity to their members and, in effect, they said, "Boys, you have got to shape up on productivity."

So I think the general presidents understand this, and they are trying to do something about it. But the fact that they are trying to do something about it is no evidence that it does not exist. It does exist, and it is devastating.

Basically, the problem is the lack of management, and basically the problem is that the control of the work force is in the hands of the local union, and that is where the crunch comes. Now, this is becoming more and more apparent to everyone who is connected with this problem.

I would like to tell you that some unemployment in construction has had a beneficial effect on wages and on productivity. I have to tell you that that is not so.

I would like to tell you that the reason for the statements that went out from the general presidents was related to their own check on productivity. I think it was probably more related to the competition they are beginning to feel from the merit shop and the open shop operators. But, nevertheless, I think it was a very commendable thing for them to do.

Senator PERCY. I think labor, enlightened labor leadership that I know, is concerned about productivity. Their biggest threat is the fact that in Germany they are averaging now a 10-percent annual increase in productivity. Japan has been higher than that over recent years. We must match that increase in productivity. I saw a lot of condemnation of the President's revision of depreciation and amortization schedules, but this was long overdue to help productivity.
Mr. BLOUGH. I am sure it was.
Senator PERCY. And the only way that industry can afford to buy the equipment to reduce the unit costs of production is to have realistic schedules accepted by the Government and the Treasury Department.
One of the last questions I would like to ask you is on housing starts.

The chairman and I are both deeply interested in this field. We see a dramatic upsurge in housing starts which, I hope, we have had our share in helping by pumping a tremendous amount of Federal financing into the field. This surge will help our economy, but do you see if the construction industry remains unchanged, that this new surge will simply aggravate inflationary problems which we have been talking about?

Mr. BLOUGH. We certainly need more housing, and there is an upsurge in the number of housing starts, no question about that.

I am inclined to believe, and one of the reasons I am inclined to believe, was the point made earlier that a high percentage of housing is open-shop housing, open-shop work. I am inclined to believe that the upsurge in housing will not be as bad from the standpoint of pushing up wage costs as some of the other things.

Now, I again point out that where we have trouble in construction is in the leadership areas. The leadership areas are on government work and also on what we call the heavy work, the manufacturing jobs, the public utilities, the big plants, the machinery and equipment installations, the high-rise buildings; that is where you have the main thrust of union control where the hiring hall comes into effect and where you have the higher wages.

But I also point out to you that within construction itself you have the same pattern as you have between construction and the balance of the economy.

Within construction what happens in these other areas affects what happens in housing.

Now, my predicition would be that between now and 1975 unless something drastic happens, the costs, the labor costs, in housing will go up materially. I do not believe increased housing starts will have as serious an effect on inflation as though it were happening in other areas.

Countering that, I suspect that in the other segments of construction you will have less material put in place in 1971 than you had in 1970, so there may be some offset.

Senator PERCY. What is the capital outlay of the Construction Users Anti-Inflationary Roundtable per year?

Mr. BLOUGH. I really do not know, but many of the members have important expenditures. But I really do not know what it is.

Senator PERCY. It is an immense figure.

Mr. BLOUGH. It would be a very important figure and, of course, the reason they are concerned is the very reason I outlined. What happens in construction is this: They do not employ these people, they hire the contractor to do the job. But what happens in the wage rates of the contractors' men affects the wage rates the construction users have to pay.

It is this ripple effect that is important.

Senator PERCY. The emphasis today has placed the major part of the blame on the unions. I know your sense of fairness to realize that a certain burden of responsibility must be shared also by the users themselves.

Is there anything that can be done in the scheduling of labor construction projects to reduce costs and to take the pressure off inflation? Right in my own State, in Joliet, Ill., in the Union Oil Co.'s refinery there, it seems the scheduling of that project was such that it brought a tremendous inflationary pressure on wage rates simply by the way it was done.

Mr. BLOUGH. Two things on that. First of all, there is no wish on my part to be unpleasant to unions, as such.

I do, however, reserve the right to oppose a particular union policy, and that is what I have been talking about today. It is the union policies that are up for question as distinguished from the unions themselves.

With respect to scheduling, I do not know if anything can be done about that. One of the principles that we operate on is to advise the individual construction users to check the labor market in the individual areas where they are planning construction. It is difficult, however, for a public utility that has to serve, let us say, a given city of Nashville, or Tampa or Houston to put that plant in a place where it is economically unfeasible. So there is a limit to that.

The big answer to your question is to remove the union restrictions on apprentices and on more craftsmen in the union trades, and then there won't be so much a problem about building the structures and there won't be so much strain on taking an extraordinarily large building and fitting it into a total picture.

Senator PERCY. Is it your feeling that there is plenty of labor available trying to get in but it simply cannot get in because the doors are closed?

Mr. BLOUGH. Well, and as you pointed out a while ago, that applies particularly to the minorities. I do not want to leave the impression that the construction unions are unmindful of their problems. I think they are quite mindful of their problems.

I do want to say, however, that the individuals who will appear before you will be speaking from their national point of view as distinguished from what is actually happening out where the contracts are made. The contracts are not made in Washington. The local restrictions are not made in Washington. The problems are arising in the 10,000 or more locals all over the country.

Senator PERCY. Yes; we will bring them right down to the local situation.

What is your personal impression of the President's proposal for regional bargaining in the construction industry?

Mr. BLOUGH. I do not believe that I am prepared to answer that because the President spoke in very general terms, and I have not seen anything which is said to be the product of the administration.

There is a problem there in the construction industry, so many problems that it is hard to enumerate them all. One of them is the manner in which the industry is structured at the local level when it comes to negotiation.

Senator PERCY. Could you speak for the construction users in responding to the President's proposal to cooperate with his plan for the stabilization of the construction industry? He has called, as I recall, for the construction industry parties to come up with proposals in 30 days.

Mr. BLOUGH. The answer to that is that the construction users were not included in that plan. This only applied to the unions and the contractors. I am not asking to be included. All I am saying is that certainly we will try to be helpful. But the problem was properly laid out by the President to a group, as I understand it, of union heads and contractors as distinguished from the construction users.

Senator PERCY. Lastly, even though you are not now directly a head of a steel company, if you want to comment, although I would not press the point at all, would you want to comment on the President's jawboning steel prices?

Mr. BLOUGH. Well, if it is all the same to you, and in view of the hour, I would prefer not to comment.

Chairman. PROXMIRE. We should have asked you that question first. [Laughter.]

Senator PERCY. Thank you.

Chairman PROXMIRE. Well, Mr. Blough, I want to thank you so much. You have done a fine job. You organized your presentation just beautifully and dramatically, and you made a strong case. As I indicated in my questioning, there would be some points we disagree on. You have presented your points very well, and we will try to have a balance and get the union people to come in and give their views.

As you say, they may agree with you.

Mr. BLOUGH. They won't agree wholly.

Chairman PROXMIRE. Well on some things. Productivity, for example, they recognize the effect, they will recognize the effect wage costs have had on inflation.

Thank you.

The committee stands in recess until Monday morning, when we will hear from Walter Heller; Joseph Califano, former Special Assistant to President Johnson; and James Farmer, former Assistant Secretary for Administration, Department of Health, Education, and Welfare, at 10 o'clock, in this room.

(Whereupon, at 12:55 p.m., the committee adjourned, to reconvene at 10 a.m., Monday, February 1, 1971.)

ECONOMIC PROSPECTS AND POLICIES

MONDAY, FEBRUARY 1, 1971

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

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

Present: Senators Proxmire, Humphrey, and Percy; and Representatives Bolling, Reuss, and Brown.

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.

Tomorrow the Subcommittee on Economy in Government will hold another day of hearings on foreign military assistance and the State Department will be represented by Secretary Irwin.

This morning's session will conclude our special hearings on "Economic Prospects and Policies." During these hearings we have identified many different aspects of inflation and recession. We have focused a good deal on the financial crisis which has been created for State and local governments. We have looked, too, at the costs to the consumer, the worker, and the businessman. We have examined solutions as well as problems. We have heard several proposals for controlling inflation, for restoring employment, and for improving the fiscal balance among levels of government.

This morning in Walter Heller, Joseph Califano, and James Farmer we have three witnesses extraordinarily well qualified to sum up the economic situation and place in perspective all of the diverse information we have gathered at these hearings. Among them, our three witnesses have held positions of great responsibility in three different administrations. Among them they bring us a wealth of experience in assessing national problems, measuring available resources, and directing resources and efforts where they are most needed.

Walter Heller is an old friend of this committee. We have always looked forward to having him appear before us, both when he held the office of Chairman of the Council of Economic Advisers and since then as a professor of economics who has been most generous in the amount of time and energy he has devoted to assisting the work of the committee. Mr. Heller, in 1970 we experienced by far the worst combination of inflation and recession of any year since the Employment Act was passed in 1946. Price indicators which came out last week gave us no reason to hope that things are getting any better. We need your advice as badly as we ever did, and perhaps more than ever.

Mr. Heller, go right ahead. Incidentally, if you abbreviate any part of your prepared statement, it will be placed in full in the record.

STATEMENT OF WALTER W. HELLER, REGENTS' PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. Heller. Thank you very much, Mr. Chairman.

As always it is a pleasure and privilege to appear before this committee. I am testifying today at the awkward stage, too late to guess what is in the budget message and economic report, and still too early to have final judgments on the administration's brandnew economic assumptions, numbers, and policies. But given the economic punches the White House has already telegraphed, one doesn't exactly have to shoot from the hip in the search for economic law and order for 1971–72. My statement this morning draws on and addresses itself to—

The bullish—but wishful—administration forecast of $1,065 billion GNP for 1971;

The intelligent—but in major respects, mistaken—projections, predictions, and policies of the budget message released Friday and the economic report released today;

The firm—and commendable—commitment to the full-employment budget approach in the state of the Union message and the—possibly too modest— followthrough of $229 billion of spending in the budget message;

The encouraging—but highly tentative and selective—move by the White House from wishboning to jawboning in steel, oil, and construction;

The recent—and highly questionable—granting of a bountiful bonus to business of a $2½ to $4½ billion tax cut in the form of liberalized depreciation; and

The unexpected—and inexplicable—veto of the jobs and job-training bill several weeks ago in the face of 6-percent unemployment.

With this much of the newest Nixonomics already known, one cannot claim the immunity of ignorance. It is surely encouraging that the President has discarded his discredited economic game plan, that he has moved from last year's target of full-employment surplus in the teeth of a stagnating economy at least to the target of a balanced full-employment budget in a slowly recovering economy, that he is pressing the Federal Reserve to go along with his expansionary policy, and that he has begun to use the jawbone.

But all of this does not add up to $88 billion increase of GNP for 1971, to a vigorous revival of real output coupled with inflation that more quietly steals away. Nor do I find in the economic report either a sector-by-sector analysis or a persuasive policy prescription to explain—

The huge gap of $20 billion between the "standard" private GNP forecast of about $1,045 billion for 1971—my own stands at $1,048 billion—and the administration's $1,065 billion figure; and

The even more awesome gap of $30 to $35 billion in the rate of GNP for the fourth quarter of 1971—let me add, by the way, that the Council is becomingly modest about the $1,065 billion figure, speaking of it as high but feasible and consistent with the satisfactory progress toward a range of four and a half percent unemployment and 3 percent inflation by mid-1972.

Yet in the White House briefing on these numbers, it is reported that a ranking administration official responded to reporters' quizzical reactions to these far-out forecasts by noting that many forecasters overlooked "the intricacies and mysteries of the American economy."

Well, if this, as it seems to imply, means that the President has some secret formula for pulling us out of the economic morass of 6 percent unemployment coupled with 6 percent price increases—a formula for making peace with inflation and quickly thinning the ranks of the unemployed—I hope he reveals it sooner than his promised secret formula for ending war in Vietnam. It is certainly not revealed in any convincing way in either his budget or economic messages.

Nevertheless, every humanitarian concern leads us to hope that the President and his economic advisers turn out to be right. Perhaps they know something we don't know; for example, how rapidly and how far the independent Federal Reserve will ease money, or how fast Federal budget funds can be poured into the economy. Perhaps, in its forecasting model, the CEA is using more accurate and realistic parameters than the rest of us. Perhaps President Nixon feels that his bold and revolutionary programs and his unqualified optimism and enthusiasm on rising GNP coupled with falling inflation will shake consumers out of their lethargy and bring them flocking back into the market for goods and services.

But if the strategy misfires—if it fails to fire up consumers, investors, and the economy at the expected pace—let us also hope that the President and his advisers will not again lock themselves into an economic game plan that is long on promises and short on performance.

Indeed, it's far too late for playing games of any kind with our current combination of inflation with economic torpor—and I will continue to spare the administration that terrifying word, "recession," unless and until the National Bureau of Economic Research dubs it such. This time around, if the plan is clearly falling short as 1971 unfolds—and last week's cutbacks in GM's production plans are an uncomfortable portent—the President and his advisers, one fervently hopes, will come clean and say so. Presidents tend to fall prey to the syndrome of smiling assurance, to the delusion that a posture of unflinching economic optimism will find its mirror image in glowing economic confidence among consumers and business.

But economic confidence simply won't grow out of replacing a credibility gap with an incredibility gap. Owning up to honest mistakes and overpromises—as the CEA's 1971 report does with considerable candor and grace—facing the jobs and prices dilemma squarely, and telling the American people exactly what the administration plans to do to overcome its mistakes—not only those of its predecessors—will do far more to restore confidence than an overdose of dissembling discourse and rosy rhetoric.

This is not to withhold credit where credit is due. The President's full conversion to full-employment fiscal thinking and planning is highly encouraging—especially when viewed in the perspective of his misguided attempt a year ago to hold to a balanced budget in a sagging economy, an attempt he backed up with ringing vetoes, largely on the grounds of the inflationary dangers of deficit spending, in the case of badly needed welfare, education, and housing bills. Associated with this misguided budget policy was a recordbreaking $20 billion boner in budget forecasting—last January's $1.3 billion surplus for fiscal year 1971 has already turned into a deficit of $18.6 billion for this fiscal year.

Now we seem to have arrived at a truly bipartisan agreement on the modern fiscal philosophy President Kennedy introduced nearly a decade ago. Coupled with this conversion is a laudable shift in the budget target from a full-employment surplus to a full-employment balance. This gives the President at least some additional fiscal elbowroom for an expansionary policy.

Indeed, the combination of a balanced full-employment budget and short-term interest rates well below 5 percent is a reasonable set of conditions for normal expansion of the U.S. economy. But let's not forget that we're still running well below normal—the economy is running about 5 percent below its full-employment potential, a loss of over $50 billion a year in output. By the way, Mr. Chairman, I am aware that the council uses a 6½ percent figure, in other words, something like $65-plus billion below full employment potential for 1970's fourth quarter. But that gap is inflated by the GM strike, and I am trying to give the administration the benefit of the doubt in using an adjusted $50 billion figure rather than the $65 billion.

Now, given a 5 percent GNP deficit, plus a 4¼ percent growth rate in potential GNP in real terms, we would need 13½ percent real growth this year and next combined, in 1971–72, to get to full employment by the end of next year. In the face of that arithmetic, I would say two things:

First, we can't get there from here, at least not without reigniting inflation; in other words we will have to wait until 1973 for restoration of full employment under present policies.

Second, under these circumstances, with so much unused capacity, there is no reason to sanctify a balanced budget at full employment any more than there was to sanctify either the annually balanced or cyclically balanced budget.

If the President is to realize the lift of a driving demand that can achieve even his 4½-percent unemployment target in mid-1972 or by the end of 1972, he will either have to wheedle an aggressively expansionary monetary policy out of the Federal Reserve or temporarily aim at a deficit at full employment to stimulate the sagging investment sector and lagging consumer demand.

On January 11, Mr. Nixon fired the opening salvo of his new fiscal offensive in the form of liberalized depreciation giving a $2½ billion tax bonus to business this year, rising to over $4 billion by 1976. Speaking not as a lawyer—that is, not addressing myself to the possibility that this $4 billion tax cut may transcend executive authority—but as an economist, this looks to me like the wrong tax cut in the wrong way at the wrong time. This $2½ to $4½ billion tax bonus—and one should not forget that it is a permanent tax loss to the Treasury and permanent gain to business unless business suddenly stops buying machinery and equipment—is the wrong way of stimulating investment and creating jobs under present circumstances.

Let me just interpolate and say if this were the only move that was possible, and we were in a straitjacket, where nothing else could be done, one could make a case for it. But at a time when there is less than 75 percent of manufacturing capacity in use, no big rush to buy machinery and equipment will be touched off by the newly liberalized depreciation. We have the example of 1962 when it really took 2 years—it was not until after the big tax cut of 1964—that the 1962 measures began to bite. It will be a long time before the billions of additional cash flow trickle down to the creating of many new jobs.

If a really pointed investment tax stimulus was wanted, the 7-percent-investment credit would give us a much bigger bang for a buck of tax loss and also provide a sharper instrument for helping stabilize investment and hence stabilize the economy. As I argued in vain in 1969, we should have suspended, not repealed, the investment credit. In other words, I am not against the stimulation of investment, but the question is the way and the time.

Going beyond the question of private capital spending stimulus to the more basic issue of the proper priorities in the use of the country's resources: coming hard on the heels of the President's veto of job-training and public service jobs in December—the very kind of program that would have helped the truly disadvantaged, the hard-core unemployed who are the real victims of our war on inflation—this large bonus to business looks strangely out of focus. And if it's investment we want today, after a 7-year boom in private capital spending, why not direct the $2½ to $4½ billion into public investment, into the sadly neglected infrastructure of State and local governments, into antipollution projects, into public housing, into rebuilding of the ghettos? In short, when it comes to meeting today's needs—especially the needs for jobs for those at the bottom of the economic ladder and the needs for investment to improve the environment and public infrastructure—the big tax reduction to business in the form of more liberalized depreciation simply won't measure up as compared with alternative needs and uses of the money.

Let me turn now to the not-so-latent problem of inflation. The 1970 figures, as the Chairman pointed out, give very little cause for joy, and the December and fourth-quarter numbers are positively jolting:

For the year, the GNP price deflator rose 5¼ percent and the Consumer Price Index 5½ percent.

For the fourth quarter, the GNP deflator rose 5.7 percent and the CPI 5.5 percent at annual rates, dashing the happy hopes generated by the declining pattern of CPI increases—from roughly 6 percent in the first quarter to 5 percent in the second and 5 percent in the third.

The President's messages show a remarkable calm on the price front in the face of these facts. They don't ignore it, but I think they are mighty calm in light of the way prices have developed especially in the last quarter of the year. One can only explain that calm on that assumption (for which there is considerable justification) that 1971, at least, will be a year of remission on the inflation front. At last, the economic lags that wrecked the game plan are working for us, not against us. In 1969–70, we have already bought and paid dearly—in lost jobs, lost profits, and lost income—for moderating inflation in 1971.

Even rather strong initiatives on the budgetary and monetary front are not going to upset this applecart. This must be the reasoning that underlay Mr. Nixon's confidence that he can pull out the fiscal and monetary stops in 1971 without renewed inflation. In his messages, he spoke confidently of not reigniting the inflationary fires. What was strangely lacking, however, was any evidence that we are taking out the necessary insurance to keep the inflationary chickens, or rather vultures, from coming home to roost in 1972–73.

One might think that the gloomy price numbers I just cited would have jolted the Nixon administration into a new activism on the price-wage front—and perhaps it still will—into the realization that they must use this year or so of comparative relief on the price-wage front, when we will probably have, say, a 4¼-percent rise in the GNP deflator instead of the 5½-percent rise we had last year, that they would use that year to build up the Nation's defenses against the inflationary fires that will surely flare up again as the economy gets back within striking distance of its full potential. In effect, the President's messages largely sidestepped this critical question and seemed to trust to luck to avoid the resurgence of inflation.

True, the Economic Report says some hopeful things about taking steps to eliminate government interference with the competitive market system and about more pointed reports on inflationary price and wage decisions. And the administration has moved in the right direction in the oil, steel, and construction industries where it correctly feels that Government is contributing to the maintenance of high prices through import quotas and the like. But it is important to add that unwarranted wage and price increases in those industries and labor unions that wield excessive market power—that is, that control the supply of labor and of products so tightly as to thwart competition and extort excessive wage and price increases from the public (even in the face of 6 percent unemployment and a $50 to $65 billion GNP gap)—are unwarranted whether that power comes from government's price-propping, import quotas, and Davis-Bacon Acts, or simply from the oligopolistic and monopolistic positions they have carved out for themselves in the marketplace. And they should be equally fair game for the pitiless spotlight of White House publicity, indignation, and public censure of the type that cut the recent steel price gouge in half.

What I am saying is there seems to be a fair amount of agreement within the administration that where the Government is doing the mischief, let's say, by import quotas, or by other price-propping activities that they will move in. But unless the Government as such is responsible for it, there seems to be a hesitancy indeed, an unwillingness, to move in.

I do get a little encouragement that yesterday, Arthur Burns in "A Moment With . . ." said, "I expect this country will move into a vigorous price-wage policy—we have been moving in that direction, I think we need it."

Well, I hope he knows something that the rest of us don't yet know.

Now, I am not about to suggest that new wage-price ground rules, or even a Wage-Price Stabilization Board along the lines espoused by Arthur Burns, Congressman Reuss, and others will turn out to be a white knight, slaying all the inflationary dragons. But it can make some difference, perhaps a crucially important difference. The fact that Presidential persuasion and indignation do work was illustrated in the recent steel price cutback.

Even if a new confrontation between the forces of expansion and the forces of inflation is at least a year away, it is more urgent than ever for the President to step forward and serve as the Nation's ombudsman to big business and big labor, using the full persuasive power of his office to see to it that the rule of noninflationary reason prevails in their price and wage decisions. He has moved from the wishbone to the jawbone, and now I hope he will give it some backbone.

A President should keep vividly in mind that the public does not share the economist's distaste for direct controls, the economist's fears of lost economic freedom and the inequities, bureaucratic inefficiencies, economic distortions, and black markets that go along with the mandatory controls. Even those we had in wartime, in OPA, OPS had all of those failings. But poll after poll after poll today shows increasing majorities of the public favoring direct wage and price ceilings in spite of all their ills.

It still remains to be seen whether this country can strike a tolerable bargain between jobs and prices without direct controls. I am not saying that this question is resolved by any means.

In large measure, the outcome will depend on the willingness of Washington's policymakers to break loose from economic dogmas of the past, and to balance their efforts to restore jobs and profits in 1971–72 with efforts to contain inflation in 1972 and beyond. Vigorous fiscal and monetary expansion may be a good prescription for the next year or two. But without a simultaneous and determined, innovative, and meaningful program of price-wage restraint, it will surely not meet the economic policy needs of the decade of the 1970's.

Chairman PROXMIRE. Mr. Heller, thank you for a superlative statement. You have made many fine statements before the committee and this is one of the very best in every respect.

Mr. HELLER. Thank you.

Chairman PROXMIRE. Although I disagree with parts of your testimony, I am sure that all of us can agree with much of it, but I would like to ask you, first, about your reaction to the President's implication and, I think, to the express statement made by someone in the White House that this budget he has proposed is a kind of a self-fulfilling prophecy. He calls it a full-employment budget, the idea being if this budget is enacted by Congress in its present form we will move inexorably toward the relatively low level of 4-percent unemployment.

You indicated here that to do this you think we need more vigorous fiscal stimulas. Do you think even if there is more vigorous fiscal stimulus that you will have a self-fulfilling prophecy in a sense that you will have full employment within a year or two?

Mr. HELLER. Well, Senator, there is a certain self-fulfillment about a vigorous budget policy in the sense that the added stimulus that is injected into the economy helps raise the level of demand by consumers and by businesses, by government units, State and local as well as Federal, and that does help us get back toward full employment.

But when you are in a period of very weak private demand, when the surveys all show that plant and equipment investment is going to be below in real terms this year what is was last year, when you have a dispirited consumer—let's see, 73 percent of the consumers told Mr. Gallup they expected worse unemployment this year than last as against 57 percent a year ago, and something like 70 percent said they expected economic trouble as against a much smaller percentage a year ago—when you face that kind of a situation, a very flabby demand situation, even the advance to the full employment budget concept, for which I do commend the President, is not necessarily self-fulfilling.

When there is a weakness in private demand to the extent they have today and a $50 to $65 billion GNP gap, we may have to go beyond balance——

Chairman PROXMIRE. After all, didn't we have something close to a so-called full employment budget last year, something close to it?

Mr. HELLER. Something close to it.

Chairman PROXMIRE. And we had unemployment increase during the past year very greatly by, what, a million and a half?

Mr. HELLER. Right.

Chairman PROXMIRE. Something like that.

Mr. HELLER. Right.

Chairman PROXMIRE. And we had a deficit of $18 billion, we are working now on a deficit of $18 billion. I don't know what it was in calendar 1970, but it was very large, but we didn't move toward full employment, we moved away from it, and I think there is some feeling that while this undoubtedly is a favorable factor in moving in the direction of employing your resources, it is far less decisive and less effective than many thought it was in the past.

Mr. HELLER. Well, I do not believe all the returns are in. Needless to say, our first disappointment came in the surtax of 1968 which didn't have as much bite as we expected. But we should also recognize that there are very substantial lags in policy. Before either a fiscal or a monetary move that is made today really has its full impact on the economy, it is 6, 9, 12 months. Fiscal measures will move faster in this respect than monetary. So that by itself this is not a self-fulfilling budget.

Chairman PROXMIRE. Let me ask you this: You have a very pessimistic conclusion, that we cannot get to full employment even if we use other more vigorous policies by 1973, as I recall.

Mr. HELLER. Excuse me. It will take until 1973 to get back to 4 percent unemployment.

Chairman PROXMIRE. To get back to it.

What about a combination in addition to what the President has proposed, No. 1, public service employment on a large scale, No. 2, better planning for conversion from defense to civilian employment. I notice that the Economic Report says we have 1.1 million people out of work because of the cutback in defense during 1970, but they haven't made any significant plans that I know of for reconversion. No. 3, comprehensive incomes policy, mandatory controls, if necessary.

Would that get us there sooner than 1973, get us to full employment before 1973?

Mr. HELLER. Well, if I understood your question correctly, you threw in mandatory controls at the end.

Chairman PROXMIRE. Well, I threw those in at the end because if you are going to have this vigorous a program of recovery and have it sustained, and not have us back and fill, we perhaps will need something like that.

Mr. HELLER. Given the combination you have just specified, a vigorous public service jobs program which I thoroughly endorse, given very vigorous fiscal and monetary policy, given either strong enough incomes policy or a mandatory controls policy, which I regard obviously as an absolute last resort, yes, we could get to full employment by the end of 1972.

Chairman PROXMIRE. I agree with that.

Mr. HELLER. But I repeat the numbers. Last year we grew at subzero levels. In other words, we grew at minus 1 percent or so because of the GM strike.

What is being proposed is that we grow by 13½ percent or if you adjust for the additional 1½ percent we are out for the GM strike, 15 percent in real terms in 2 years. Fifteen percent in real terms in 2 years would mean we would have to have—and let's be very optimistic on inflation for a moment and say we could average 3½-percent inflation—would mean our GNP would have to grow by about $110 billion both this year and next to get to full employment in 2 years. Now that is a whopping growth, and I don't see anything in the current set of policies that has a prayer of getting us there.

The combination you set with mandatory controls to prevent inflation could perhaps get us there sooner, and what I am willing to do obviously is pay some price to maintain our economic freedom.

Chairman PROXMIRE. I say I agree with you wholeheartedly in mandatory controls only as the last resort. I do not favor them now. My time is up.

Congressman Bolling.

Representative BOLLING. Mr. Heller, I agree with the chairman that as usual this is an excellent statement, But I would like to confine myself to a subject you do not mention and for the reason——

Mr. HELLER. One that I was sure would come up.

Representative BOLLING. The question of revenue sharing—and the reason I do so is I strongly suspect that the argument over revenue sharing is going to be used as an excuse by some for not having a clearer economic policy, and by others as a deliberate method of obfuscating the situation as it developed. It lends itself to wonderful debate in the 1972 election over who shot John, and I think it is, therefore, important in this record to elict some comments from you on your attitude toward revenue sharing, particularly because the President has so generously attributed the original idea to you. I think you deserve the credit but I suspect the reason why he is so generous in giving you all the credit.

Now, I notice you were kind enough to call my attention to the fact that there is a letter from you to the editor of the Wall Street Journal printed in today's edition which clarifies one of the questions that arises. There is an argument already in Washington as to whether revenue sharing is going to have any effect on deficits, whether it is going to be only undertaken when we have surpluses, the actual surpluses, and so on and so on, and I wish you would—I would like unanimous consent to put this particular letter in the record.

Chairman PROXMIRE. Without objection, it will be placed in the record at this point.

(The letter referred to follows:)

[From the Wall Street Journal, Feb. 1, 1971]

LETTERS TO THE EDITOR

MR. HELLER'S POSITION

Your throughful editorial "Thoughts on Revenue-Sharing (Jan. 18) is in error in stating that "Mr. Heller, you'll recall, envisioned the Federal Government distributing surplus revenues to the states and cities."

The per-capita, no-strings-attached, tax-sharing plan that I developed for President Johnson in 1964 (in collaboration with Joseph Pechman's Presidential Task Force) was at no time or in any way limited to the distribution of surplus Federal tax revenues.

The basic idea was, and is, to let the state and local governments tap the superior, growth-responsive Federal individual income tax in such a way as to promote, not undermine, their independence.

Because the plan was developed and publicized at a time when there was a prospect for a Federal "fiscal dividend" (which disappeared with the Vietnam war and has not yet reappeared), some observers got the mistaken impression that the plan was somehow related to Federal surpluses.

To lay this mistaken notion to rest, I said the following in my Godkin Lectures at Harvard in early 1966:

It also goes without saying—or at least I thought it did—that the Federal commitment to share income tax revenues with the states would be a contractual one, good through thick and thin, through surplus and deficit in the Federal budget. But since privately circulated memoranda have labeled the plan "surplus grants," and pounced on its supposedly fatal flaw of being payable only when the Federal Government has a surplus, it is perhaps worth underscoring the obvious in this case. The plan would hardly have its claimed advantages of stiffening and strengthening state and local governments if they were last in the fiscal line, ever fearful that the revenue bounty might suddenly be withdrawn. The very nature of the proposal calls for them to be first in line for their modest share of the income tax, even if it means that the Federal Government has to bear the brunt of periodic deficit financing—which, indeed, it can do much more readily and appropriately than state and local governments.

WALTER W. HELLER,
Regents' Professor of Economics,
University of Minnesota.
Former Chairman, President's Council of Economic Arvisers, 1961–64.

Representative BOLLING. I would like your comments on revenue sharing as it affects deficits and general revenue problems of the Federal Government.

Mr. HELLER. Well, in general, Mr. Bolling, what revenue sharing would do, or the way it should be thought of in the Federal budget, is just like any other Federal budget expenditure. It would be funded through thick and thin, it would be financed whether you had a deficit or a surplus, it would be a first or prior claim by the States and localities on a particular chunk of the Federal individual income tax. Whether it be 1.2 percent or 2 percent of the base is a matter for discussion.

The reason that people began to identify it with the surplus was because when we first discussed it in 1964 we were hoping for a fiscal dividend in the form of a faster growth of Federal revenues than the growth of Federal expenditures. Then came Vietnam and also a greater awareness, thank heaven, of the problem of poverty and pollution, the environment, the ghettos, and it turned out that our fiscal dividend simply did not appear.

But the idea of revenue sharing was never dependent on the existence of that fiscal dividend. The Federal Government has superior revenue-raising power and if it needs to raise tax rates to finance revenue sharing, then it needs to raise tax rates to finance revenue sharing. In other words, it can do so with far better power, more efficiently and with much less pain and adverse consequences in terms of interstate competition and so forth than States and localities.

So, in brief, the idea of revenue sharing does not depend on the existence of a Federal surplus.

I would like to say just one other thing on this front. Knowing the difficulties that exist in the political path of revenue sharing, at least we in Minnesota—and let me note that the unusually distinguished junior Senator from Minnesota just came in—we in Minnesota are not counting on revenue sharing in the budgeting for the next biennium. Our young and superb Gov. Wendell Anderson is asking, believe it or not, in a State of 3,800,000 people, for some $760 million of additional revenues for the next biennium because of the new demands on government and because of the poor state of the economy. I made a rough calculation that if the economy were operating at full employment, he would only have to ask for about $470 million. In other words, underemployment, underutilization of the economy, is costing the State of Minnesota nearly $300 million in revenue in the next 2 years out of a total budget of $3 billion.

Nevertheless, this is an indication of how desperately the State of Minnesota, along with other States, does need these revenues that would come from revenue sharing.

Representative BOLLING. I think that answers the question.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN. Mr. Heller, in your statement you suggest that we have paid in 1969–70 for moderating inflation in 1971, but in fact wasn't that a payment for the inflationary spiral which began in 1968 with what was something considerably apart from the full employment budget concept in 1968 when we had the massive deficits at something less than 4-percent unemployment?

Mr. HELLER. There is no question but that the Nixon administration started with a legacy of inflation left by the preceding administration. Going back a bit, we were moving nicely, I might even say beautifully, toward full employment in mid-1965 under the gentle zephyrs of the tax cut. We were even running a surplus in the Federal budget in the first half of 1965 after a Federal tax cut of $12 billion. We were moving toward 4, we were down to 4½-percent unemployment by mid-1965. Then, of course, escalation in Vietnam struck, and added $25 to $30 billion to what was already a full employment program. That $25 to $30 billion was not matched by either expenditure cuts or more appropriate tax increases in the Federal budget and, as a result, we had a $25 billion deficit at full employment, and that was simply wrong policy. I am not about to allocate the blame for that. I think that President——

Representative BROWN. You were not involved in that policy, were you?

Mr. HELLER. I did not favor it, but I was involved in this sense: Although I was already out of Government, President Johnson has said publicly, that all his advisers, both inside and outside of the Government, advised him to go for a tax increase at the beginning of 1966—this is on the public record but that he felt he could not get it from the Congress. As I say, I don't want to enter the political jugdments in this case. There is no question that a sensible policy——

Representative BROWN. So, in effect, you said earlier something about the 1968 or the surtax increase not being sufficient. It wasn't a matter of its being insufficient, it was a matter of its being terribly tardy, wasn't it?

Mr. HELLER. It was terribly tardy as far as 95 percent of the country's economists are concerned. Of course, 95 percent can be wrong, but in this case they were right in believing we should have had a tax increase right at the beginning of 1966, and even a 5-percent surtax at that time would have been more effective than a 10-percent tax late in 1968.

So what I am saying is that one cannot deny—nor do I think my colleagues do—that the Nixon administration was presented with a very tough inflation problem before they took office. But they have had 2 years in office now, and the unemployment has gotten worse and the inflation, although showing some signs of improvement, has also gotten worse.

Representative BROWN. Let's talk about the 2 years, if we may. You talked about, in your statement, President Kennedy introducing nearly a decade ago the modern fiscal philosophy of a full employment budget. We had the Committee on Economic Development and they took some credit for introducing it in 1947.

Mr. HELLER. Excuse me.

Representative BROWN. In concept.

Mr. HELLER. Yes; that is correct.

Representative BROWN. So I guess it really never got into Government or what you are saying is that it never got into Government until President Kennedy took office; but I am not so sure, as I read the statistics from that period of time, that it got effectively into Government then.

Now, we had a 6-percent unemployment level during the first few years of the sixties, most of that under President Kennedy's leadership; and, as I recall, we had a full employment budget surplus, did we not?

Mr. HELLER. Yes; that is right.

Representative BROWN. And that is not the policy we should have pursued, if I understand the philosophy right, in order to get that 6-percent unemployment rate down to 4 percent; isn't that correct?

Mr. HELLER. Mr. Brown, first of all, it takes time to educate Presidents in economics, and that is why I said "about" a decade ago, because Mr. Kennedy did not adopt the full employment budget concept in 1961.

Representative BROWN. In fact, on the full employment budget concept what was done in the early sixties was not the right thing to do, isn't that correct, to run the surplus?

Mr. HELLER. Let's be clear on the statistical record. The full employment budget surplus in a $500 billion economy, not a trillion dollar economy, was $14 billion when Kennedy took office. It went down, not steadily, but it went down, to about $11 billion by the time the tax cut concept was introduced and the tax cut that was planned in 1962 and introduced in 1963 was aimed explicitly at removing that surplus.

Now, it also should be remembered—and I am getting reasonably tired of Mr. Nixon's constantly talking about the high levels of unemployment in the early sixties—it should be remembered that Mr. Kennedy entered office with 7-percent unemployment, and with a set of economic policies or a set of economic philosophies in this country that was very slow to be converted to the full modern economics of the full employment budget.

That unemployment rate went down steadily. It was too slow, I grant you that.

Representative BROWN. I was going to ask, my time is up——

Mr. HELLER. It was on its way down.

Representative BROWN. How long does it take normally?

You suggested we wouldn't be able to get it before 1973. How long does it take normally before it is accomplished? It apparently was not accomplished in the sixties with full employment budget policies.

Mr. HELLER. We went from 7 to 4½ percent in mid-1965. That was not fast. But at that time we were not yet committed in a bipartisan way and let's say, at both ends of Pennsylvania Avenue, to the full use of our modern economic tools. We are now. We shouldn't have to take as long today to move from 6-percent unemployment to 4-percent unemployment as we did in the early sixties. I assume there is progress in this country, and we ought to make use of our past experience and our past mistakes, both Democratic and Republican.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman. Mr. Heller, I want to commend you for a great analysis. Without having had an opportunity to read the Economic Report, you have delivered a better critique of it than a good many who have.

Do you recall that line in Keynes' "General Theory" which goes something like this:

> Practical men who believe themselves to be quite exempt from any intellectual influences are usually the slaves of some defunct economist. Madmen in authority who hear voices in the air are distilling their frenzy from some academic scribbler of a few years ago.

Mr. HELLER. A few decades sometimes.

Representative REUSS. Doesn't it do your academic scribbler's heart good to contemplate that the 8- or 9-year-old Heller revenue sharing plan is now being hailed as revolutionary by President Nixon and forwarded by him in almost its original condition?

Mr. HELLER. Well, it would do my heart more good if we didn't have what we in Minnesota would call the "Front Four" opposing it. If Mr. Mills, Mr. Byrnes, Mr. Mansfield, and Mr. Albert were just a little bit more favorable, I would feel just a bit better about it.

But I am glad to see the revenue-sharing program introduced because I do feel it supplies an important missing link in our federalism. Until we put at the disposal of the hard-pressed State and local governments, part of whose trouble is just sheer lack of funds, until we put at their disposal some of the superior fiscal power of the Federal Government, I just don't think they are going to be strong enough to hold up their end of the balanced federalism.

Representative REUSS. You also advocated at least 8 years ago the idea of the President having discretionary power to jiggle the Federal income tax rates. You may have noticed the other day the President jiggled the corporate rates, by rapid depreciation, to the tune of about a $4 billion tax reduction——

Mr. HELLER. That is not just what I had in mind.

Representative REUSS (continuing). For corporations. Now maybe he did this illegally. We can't pass on this here but at least you can have the satisfaction of knowing that Hellerite jiggling is now commonplace.

Mr. HELLER. Do I have to accept the "Hellerite jiggling?" [Laughter.] Well, as you know, I believe that fiscal policy in this country would operate a good deal better, a good deal more effectively, if the President had some limited powers for temporary tax changes particularly in the basic individual income tax.

Representative REUSS. Power includes the power to err. In this depreciation case, he sure erred, didn't he?

Mr. HELLER. My statement tries to make that clear. Yes; I think that was a mistake.

Representative REUSS. Another case of early academic scribbling is in this full employment balanced budget, isn't it?

Here we have an actual deficit which the administration admits will be on the order of $12 billion and which many say may be closer to $25 billion, and all of this is hailed as a balanced-at-full-employment budget.

Let me ask you in that connection if a so-called full employment balanced budget which, in actuality is a big deficit because you are operating at undercapacity, guesses wrong, and if at full employment, far from being in balance, it would have a considerable deficit, then the fiscal managers will have done a bad thing, will they not; then they will have overcompensated and started up an inflation again; is that not so?

Mr. HELLER. That is so, and, of course, this is one of the uncertainties in fiscal management.

I personally believe we should be aiming, if we believe the numbers that we see about the underutilization of human and physical resources in the economy, I personally believe for the time being, we should be aiming at a full employment deficit to get enough stimulus out of the budget.

But the wisdom of fiscal management is then to move taxes up sufficiently or slow expenditures down sufficiently so, as we approach full employment, we not only hit a balance—or if private investment spending is terribly strong—that we actually run a surplus to curb inflation and lubricate investment spending in the country.

So it is a tough job of management and I am not one to denigrate that for a moment.

Representative REUSS. But in any event as one moves, and one hopes rapidly, toward fuller employment, you are quite clear in your statement, and I certainly agree with you, that one needs a vigorous attack on inflation at the same time, otherwise you are going to get your growth thermometer looking beautiful, but it is all inflation, no real growth; isn't that so?

Mr. HELLER. That's right, and we will run into the same kind of stop-go economics that unfortunately the United Kingdom has exemplified all too well.

Representative REUSS. Now, my final question, that being so, and if, as you believe, long-term, wage-price guideposts worked out on a voluntary basis by labor and management are likely to be necessary for a full employment without inflation economy, wouldn't it be a good idea for the administration to put on an immediate temporary across-the-board freeze on prices, wages and salaries for 3 to 6 months, while it endeavors to work out with labor and management such a long-term policy? Labor has made it clear that it isn't going to adopt guideposts without such assurance of full employment without inflation, and the question I put to you is, are not the minor deprivations of economic freedom inherent in such a short-term temporary freeze less than the economic dangers of continued inflation or feckless and unfair jawboning which if it does anything at all just hurts the good guys and lets the bad guys go home free. Would you address yourself to that?

Mr. HELLER. Well, this I find a terribly vexed and vexing question, because unfortunately I can see both sides of it.

I tend to shy away from a wage-price freeze—that is the temporary freeze of the kind you talk about and the kind that I believe Arthur Okun has suggested, a freeze for 3 to 6 months while you set up a wage-price stabilization board, and work out the general concept of voluntary guidelines. Robert Roosa has also suggested something like this to break the inflationary psychology both on the wage and the price side. That part of it attracts me. The part that repels me is, of course, the people who would normally have come up for wage increases and price increases during those 6 months (*a*) will either be deprived, relative to those whose decisions fall outside the period of the freeze, or (*b*) may simply ignore it. We are talking about the kind of a wage-price freeze they had in Britain. In Britain they are a lot more disciplined in a sense than we are here. In spite of many of their difficulties, they are more responsive when the Government says, "Let's have a wage-price freeze," without an elaborate bureaucracy and set of controls. I would hope we had that much public self-discipline here, but I have my severe doubts. In other words, I am in an ambivalent position on this. I think we may be forced to something like this if inflation worsens.

It is certainly better than a long-term straitjacket of direct wage and price controls in spite of its own inequities and difficulties. Yet, it might just jolt us out of the inflationary psychology we're in. Consequently, whereas a year ago I was dead set against it, I would now say I have an open mind on it, still leaning against it but not ruling it out if we simply can't make the grade any other way.

Representative REUSS. Better ambivalent than adamant, I always say. [Laughter.]

Chairman PROXMIRE. It is a great honor and pleasure to welcome to the committee the distinguished Senator from Minnesota who served for so many years with great distinction in the U.S. Senate and has demonstrated tremendous competence in so many different fields. This is a committee, Senator Humphrey, which as you know has to assume responsibility in so many broad economic fields and it requires exactly the kind of talents you bring to it in greater abundance than anybody who has served on this committee in my view, so it is a great pleasure and honor to welcome our former Vice President, our Democratic candidate for President in 1968, Senator Humphrey.

Senator HUMPHREY. Thank you, Senator.

Mr. Heller, this is my first visit with the committee and my first opportunity to participate. This is very personal. I lost my very good friend Fred Gates this morning, who passed away, and also a very good friend of yours, and I was, needless to say, quite shaken by this because he was my closest friend.

I am not an expert in economics, Senator. My expertise is in being inquisitive about what goes on. I am a little inquisitive this morning about what I constantly hear, that things are so much better. I want to believe that, having been accused of being a congenital optimist, and I would like very much to see that they are better. But what is the evidence outside of the reduction in interest rates—which is surely a welcome development—that the fires of inflation are being dampened. For example, I see that postage rates for business are about to go up, transportation costs are about to go up, medical costs are going up, and at long last, the farmer, suffering for the last 6 months with low prices for cattle and beef and pork, his prices seem to be going up. Prior to December's figures, farm prices were the only thing that caused the cost of living index to go down. Farmers were being taken to the cleaners, with the lowest parity ratio since 1933—down to 6 percent. Farm parity is now moving up a little bit, and with service charges going up, I wonder just what is it in the wholesale price index that indicates we are on the road to some kind of stabilization in prices. I would welcome your comment on this.

Mr. HELLER. First of all, Mr. Chairman, before I address myself to Senator Humphrey's question, I want to say how honored I am and how delighted I am that he is at this hearing. I want to express my personal admiration and affection and respect, and agree with you a hundred percent that he will add a great deal to the economic wisdom of this committee in spite of the fact that he modestly says he has questions rather than knowing the answers.

With respect to the evidence on the ebbing of inflation, you are right, of course. You know we did get a terrible jolt in the fourth quarter. It isn't just administration economists, it is many of us outside of the administration who also expected that we would have a better price record by the end of 1969, and a better one than we had by the end of 1970. We were not as optimistic as the administration. My own forecast for where the inflation rate would lie was about a percent above the administration and a percent below the facts.

Insofar as we have any optimism about the performance of prices this year, it is based on two or three things. One, that as you take the longer run trends, take 2, 3 years now we are finding that the rise in prices in industrial commodities has been tapering down.

You are right, a part of the good record earlier in the year was at the expense of the farmer, no question about it, and that is probably going to go the other way now so that is going to be working against us. But the rate of increase in prices of industrial commodities has been slowing down.

Second, the overall wholesale price index has shown a reasonably good performance, again in considerable part because of food but not entirely.

But then going beyond the indexes themselves, some of the economic forces that are at work ought to give us some limited relief from inflation this year, even if we have a strong fiscal and monetary expansion.

The reason for that is that productivity is rising. You know even with the miserably poor performance that we have had in 1970, as far as production is concerned, we did have some increase in productivity, rather impressive increases in productivity per man-hour.

Now, even if we get a 3 percent rise in real output in 1971 rather than the 5-percent or so that the administration looks for, we will combine with the cost-cutting and payroll paring and modernization of a 1970 rise in the units of output in 1971. So with more units of output being produced without a corresponding rise in unit costs, there will be a more rapid rise in productivity. Third, there is every hope, and again one has to stress hope and expectation, that the average hourly compensation increase in 1971 will be somewhat below that in 1970.

Now this means that unit labor costs will not be rising as fast. The combination of higher productivity and slightly lower wage increases means that unit labor costs will not be rising as fast in 1971 as they did in 1970. That improvement has to go somewhere, either into rising profits or into a slower rise in prices. My guess is that, first of all, even in a rather sluggish economy this year we will have a good profits performance. Watch those quarterly figures, corporate profits after taxes will be 12 to 14 percent over the year-earlier numbers. Second, we will have a slower rate of increase in prices.

Now, I wind up by saying that this still comes out of an analysis of the economic factors rather than from any very encouraging price statistics we have had to date. Let no economist tell you that in the present economy—that is, on its new plateau with a bipartisan commitment to high employment and high growth—let no economist tell you that he has the surefire answer to what inflation is going to be in the next year or two.

We are operating in essentially a new environment, in a new environment in a narrow band around full employment, and the parameters, the equations we derive from past experience, have obviously gone wrong, again and again, and that goes for Democratic economists as well as Republican.

So every one of us who speaks about what is going to happen in the future about inflation must speak with some humility and also with fears of inflation breaking out again once we get close to full employment.

But in sum, my best judgment is that we will have some relief from the tightest or most intense inflationary pressures during this year, and we ought to use that year to put into play some honest-to-goodness tough White House wage-price restraint policy.

Senator HUMPHREY. Mr. Chairman, are we going to have Mr. Heller back at another time on revenue sharing?

Chairman PROXMIRE. I am sure we will have him back in the course of the year. But we have no scheduled hearings on revenue sharing coming up. Of course, that is outside of our committee in a sense in that the Ways and Means Committee and the Finance Committee will act on specific legislation. Feel free to ask him about revenue sharing.

Senator HUMPHREY. Do I have time?

Chairman PROXMIRE. I understand your time is just about up, but let me say we can have an additional round. We do have two very distinguished witnesses coming up and we hope we can hear them certainly but go right ahead.

Senator HUMPHREY. The only point I wanted to ask you in light of your advocacy of revenue sharing, my own conversion to it, and how much more we need to know about it is this: I was reading in the Louisville Times of Friday of this past week, a lead editorial. It discussed a meeting in Atlanta in which the Vice President was briefing Governors, city officials, supervisors, county judges, and other State and local officials. The article, incidentally, was brought to my attention by Judge Hollenbeck of Louisville—he would be a county supervisor out our way—in which the Vice President indicated, and I want to get the exact language because I do not want to misinterpret his comments or to misread them, but he indicated with revenue sharing we might even have an opportunity to reduce State and local taxes.

This set off a very heated discussion. The problem, as I see it, with revenue sharing, with the Front Four, and with some of those who may not be in the Front Four, is the lack of a definitive concept and program. We don't yet know what the administration really has in mind. My hope is that we would not choose up sides and oppose it until we really find out what it is the administration proposes.

Now I would appreciate any enlightenment you might wish to give us about what you think are standards or principles around which revenue sharing ought to be moved.

Mr. HELLER. Well, first of all, may I say, Mr. Chairman, while I realize that revenue sharing is not within the first competence, so to speak, of this committee, it could be, you know, a very effective economic instrument. Those mayors and Governors are simply panting for additional revenues. Even this huge $760 million tax increase that our Governor Anderson of Minnesota is asking for the coming biennium represents a very severe cutback of many State programs.

In other words, on that first point that you were raising—would this go into State and local tax reductions?—that very little of it would go into such reduction. It would, of course, go in part into slower tax increases than we otherwise would have had. We would be taking the good progressive Federal income tax and substituting it for increases, by and large, for State and local property, sales, and other regressive excise taxes. But most of it, I am sure, would go into better services.

The pressures are so enormous that the limits are really in the form of the available revenues, and if these revenues were increased we would be, I am sure, in a position to provide better services, and to strengthen the fibers of State and local government.

Now, I think the principles on which these revenues should be distributed are, first, that it should be on a per capita basis with, however—which I find missing in the Nixon program—an extra kicker of, say, 10 percent of the revenues for equalization for the poorest, say, 17 States. There is a great opportunity here for helping remove some of the terrible inequalities among different States, and I would like to see that part of it strengthened.

Second, I am glad to see the Nixon administration moving to something like a 50-percent passthrough to localities rather than some 30-some percent that the President had in his program as introduced in 1969. I think that is an important principle, that some of these revenues must be directed to those areas, especially the urban areas, which are so desperately in need of additional revenues.

And, third, I feel strongly that once they have those revenues the only way they can really contribute to more self-reliant, more independent State and local government is not to have any hamstrings attached. I don't like to put it "no strings attached" because I fear that could happen so far as civil rights considerations are concerned and so forth. I think there has to be rather tight control of that kind, and accounting controls, but State-local government should not be hamstung in the use of those funds.

Lots of those funds can be used for rather humdrum activities of Government that have a great deal to do with the quality of life, and yet are not subject to Federal grants-in-aid.

And a final point, I think it would be a tragedy if revenue sharing were made an excuse for removing the very constructive and positive Federal aid programs that we now have, and I think that has to be watched very carefully. Looking at the analysis of Federal aids in the special analyses section of the fiscal 1972 budget, I worry some about this. One wants to be sure that when we add the $5 billion of general revenue sharing, the totals of aids plus sharing really represent a real net addition of $5 billion beyond the natural up-trend of Federal aids in the past couple of years. Senator Goldwater in 1964 spoke of revenue sharing as a substitute for all Federal grants-in-aid. I think it would be a tragedy if that were to happen. We need a combination of Federal categorical aids, block grants, and revenue sharing. Thank you for the opportunity to let me make a little speech on revenue sharing this morning.

Chairman PROXMIRE. I might say, apropos of Mr. Heller's response, that I have told Governor Rockefeller, Governor Gilligan, Governor Lucey and several of the mayors that this committee will write to the mayors of the largest cities and all 50 Governors to ask them to give us an analysis of the impact of the administration's revenue-sharing proposal on all the programs they are getting, so we will have a response in a month or so and we will see how it cuts, how it is working.[1] I might say, while we are not having specific hearings on revenue sharing, the hearings we are going to have on the President's Economic Report will be directed to all problems. We will have Mr. McCracken, Secretary Connally, and Secretary Shultz up before us in the next few days beginning next Friday.

I would like to ask just one question. I might say incidentally apropos the question of the full employment budget or full employment surplus, success does have a thousand fathers and this committee recommended this policy back on the basis of a 1949 report in January 1950, I am informed, so the Government was in on it that early, 20 years ago—21 years ago.

Mr. HELLER. May I interrupt to say, Mr. Chairman, that although I referred to President Kennedy having introduced it into White House policy, I have on many occasions acknowledged the contribu-

[1] See footnote on p. 323.

tion of this committee and of the Committee for Economic Development in the development of that concept.

Chairman PROXMIRE. The one question I have, yesterday on NBC Mr. Burns said, I believe, "Psychology and confidence are more important than monetary policy at present and these factors have changed for the better in the last month or 6 weeks." Do you, in view of your different analysis of psychology and confidence, do you think monetary policy is expansive enough at present with the money growth only at 4 percent in the last several months?

We are having Mr. Burns up in the next few days, but I would like to have your views.

Mr. HELLER. Mr. Chairman, I don't think so. We need to have a monetary expansion of between 7 and 9 percent, at least for the time being, to be consistent with even getting to full employment by 1972–73.

However, I don't want to focus exclusively on the expansion of the monetary supply, nor is the Federal Reserve. Mr. Burns is quoted as saying something like, "I never was much of a monetarist and I am less of a monetarist than I was a year ago." Well, why? Because he found when the Fed about a year ago shifted increasingly to the monetary aggregates in a Friedmanesque or a Friedmanic way, that they had great difficulty in the management of that target, not only in hitting it but in trying to stick to it in the face of Federal Treasury financing that was going sour, in the face of the Penn Central situation, and so forth.

So I want to stress that in Federal Reserve policy we have to use the dual objective of monetary aggregates and interest rates. Thank heaven, at long last interest rates have been coming down. I don't think the long-term bond rates are down as far as they should be nor the mortgage rates. We have to use that dual objective and be sure our monetary expansion is sufficient to lubricate expansion and meet our interest rate objective. That is the way I would look at that.

And I would simply add this point: I hope he is right that confidence is improving but I want to repeat that confidence is generated by facing up to the issues. President Kennedy, it seemed to me, did the right thing when he said, "We are in a recession; let's recognize it; let's do something about it," and that this is far more effective in making the people of the country feel that they are going to have a better economic future than just to give out rosy forecasts that have very little possibility of fulfillment.

Chairman PROXMIRE. My time is up.

Congressman Brown.

Representative BROWN. Well, Mr. Heller, on that last remark if you were President of the United States or even that much less suspect position, the Chairman of the Council of Economic Advisers, and you saw what is happening in the stock market, the fact that you got private savings at an all time high and private debt considerably lower than it has been, what would be your public posture on the future of the economy?

Wouldn't you have a tendency to read with some degree of optimism the figures and the portents that do exist rather than try to look on the pessimistic side? I can understand the politics involved here but I am talking about the psychology of the economics.

Mr. HELLER. I am not talking about being pessimistic, Mr. Brown, but what I am talking about is laying on the table very clearly a candid analysis of the severity of our problems, and laying right on the table with it a program designed to meet those problems. Right now, there are serious deficiencies, especially on the wage-price front, in so doing.

Yes, of course, the performance of the stock market is a good portent. The high savings rate is a good portent only if you can get the consumer activated to use those savings. The nearly 7½ percent savings that he has been doing in the past year, which is 1½ percentage points above his normal savings, is one of the things holding the economy back because it reflected sluggish consumption. What you and I are really talking about is the question of how you can get him back to his 6-percent rate of saving and get him to move in a confident manner into the market.

Representative BROWN. But with that saving rate when he does move into the market, it certainly will be in a confident manner, won't it, because he won't be rapidly increasing his debt and, therefore, bringing pressure on the interest rates and starting us off into an inflationary spiral again.

Mr. HELLER. This is precisely why I put into my statement the comment if Mr. Nixon can in effect awaken this sleeping giant, the consumer, then the economy will move ahead faster than the standard forecasts.

Representative BROWN. We have to give the consumer some credit for intelligence, too, I think. When he sees things being discussed at a Federal level in a depressing way by public figures isn't he likely to be a little more conservative about his spending? In other words, when we finally get the conviction that perhaps the stock market is a sound portent of where we are heading in the economy, don't you think the consumer will move on, too?

Mr. HELLER. Just two quick comments on that. One problem, I think, with the consumer's pessimism is the fact that promises have been made again and again and again that inflation was going down and unemployment was going to go down, or at least not reaching anything like 6 percent. He has seen these forecasts which were reaffirmed again and again and again, just didn't pan out. So he has loss of confidence in that sense in the administration's policy, and he wants the administration to come clean with him.

Now, second, 20 percent of the people or the families of the country were affected one way or another by unemployment or cutbacks in wage income in the past year; that is, some member of the family was either unemployed or partially unemployed or lost overtime. And that is why 73 percent of the respondents to Mr. Gallup's poll last month said they expected unemployment to be even worse this year than last. If the President's policies do not pan out, if his forecasts do not pan out, that 6-percent rate of unemployment will rise, not fall. Once again the consumer will say, "Well, we have been told we were going to have a booming year,"—and $88 billion of increase is, you know, a pretty boomy year. If he sees that failing again, I just have very great fears that he will pull back into his shell.

I hope the President is right that we are going to have improvement, I hope that very much, but I fear for the consumer reaction and indeed the economic reaction if our hopes are once more unfulfilled.

Representative BROWN. Historically, Mr. Heller, in recent recessions, the price increase, the inflationary factor, has not leveled off until business activity has returned to previous levels. Is that a fair assessment of the pattern of recent recessions?

Mr. HELLER. There is a certain pancake effect, that is to say, the price increases continue for awhile after the economy is softening or actually going into a recession. But this time it has gone a whole year longer than one would have expected from past relationships.

Representative BROWN. And be a great deal less sharp. In other words, the impact of trying to cure this inflationary situation we got into between 1967 and 1968 has in the policies followed by the administration had a great deal less sharp impact.

Mr. HELLER. That is correct.

Representative BROWN. In other words, the thing has been leveling out more in the policies that have been pursued; isn't that right?

Mr. HELLER. Well, leveling out more in the sense that the rate of increase in inflation has at least slowed down. But the slowdown has come about a year later than we would have forecast from the past relationships, from the very kinds of reactions you are addressing yourself to concerning past recessions.

Representative BROWN. Which perhaps may have something to do with the strength of or the underlying psychology or the rather precipitant inflation that has been built up over the period of the last few years.

Let me ask you, I saw an article in the Wall Street Journal the other day. The headline was, "Many Analysts Claim 4 Percent Unemployment Rate Is Too Low a Target." They argue that the 4-percent unemployment rate in the full budget is less than the recent historical developments in terms of what the labor market can hold up. Do you have any comment on that? There is no point in my reviewing the whole article here, but the impact of change in the nature of employment and so forth was listed as, in a couple of columns in the Wall Street Journal, the basis of this statement.

Mr. HELLER. Well, my colleague from the University of Minnesota who is now on leave to the Brookings Institution, Prof. George Perry, has in a very interesting statistical analysis shown that at any given unemployment rate today, because of changes in the labor force, we probably have more inflationary pressure than in the past. Thus, we have a tighter labor market with a 4-percent unemployment rate today, than we did with a 4-percent unemployment rate 10 years ago.

Representative BROWN. Less flexible.

Mr. HELLER. Yes.

Representative BROWN. Why?

Mr. HELLER. Because the composition of the unemployed group is such that, when it is weighted according to age, sex, family status, and wage levels, 4 percent unemployment today would really mean—I would put it that 4 percent today represents less of a reservoir of training and experience than 4 percent would have meant 10 years ago. Now that is a rather discouraging conclusion. I don't think it means that we should therefore give up the 4-percent unemployment target. It means we have a tougher problem of training and retraining, a tougher problem of adjusting jobs to people and people to jobs, a tougher labor market policy problem than we might have thought previously.

So I am not for a moment underestimating the difficulty of returning to 4 percent unemployment. As a matter of fact, I have been emphasizing that difficutly partly in the light of those new data. I don't mean by any means it is impossible nor do I think we should weaken or undermine our unemployment target.

Coming back to your point of why is it taking so long to subdue inflation, since you quoted the Wall Street Journal, I, too, will quote the Wall Street Journal. To my dismay they said, "Mr. Walter Heller says inflation has sunk its roots deep," and then went on to say, "He ought to know, since he had a hand in the gardening." In the light of my persistent push for a tax hike from late 1965 on, that struck me as one of the unkindest cuts of all. But the truth of the matter is that we are in a tougher situation than we were 5 years ago or 10 years ago. And being economic adviser to the President in 1971 is in that sense a tougher job than it was in 1961.

Representative BROWN. Very generous concession.

Mr. Chairman, I would like to suggest, if I could, that the committee might at some point consider, since we have moved more into a full employment budget in this administration than the Kennedy administration, involving our witnesses sometime in a discussion on both sides of this question of whether 4 percent is a realistic figure and what might happen to the inflationary factor, because I think it is worthy of some significant study.

Mr. HELLER. May I say, Mr. Brown and Mr. Chairman, when you do, I hope you will hear witnesses like Professor Perry and others who have been doing these superb studies at Brookings. These Brookings Papers on Economic Activity apply the most modern methods of econometric analysis and are written by scholars with a keen eye and sensible judgments about current developments. They take a new look at the parameter we have been using to see whether we are using sensible ones in the setting of policy.

Representative BROWN. If we have a labor market that is structured to the extent we have 4-percent unemployment in a certain category in our society and yet we still have sharp inflation, we have got a real problem it seems to me and it deserves some study.

Chairman PROXMIRE. We do indeed. I want to apologize to Joe Califano and James Farmer for waiting so long.

Senator Percy would like to ask just one question.

Senator PERCY. I have just one question and one comment. I do realize we are running late. I think the question of unemployment is very much on our minds. Could you give us the benefit of your own experience as to what the historical course of unemployment recovery has been—the rate of recovery following a recession—and what that might mean as to an estimate for unemployment in the first half of 1971?

Mr. HELLER. Well, Senator Percy, the rate of recovery on the unemployment front has depended on the kind of recession you had prior to that recovery. When it is primarily an inventory recession, we recover fast. For example, in the very substantial slowdown in 1967, we had a swing of something like $22 billion in the rate of inventory accumulation, but final demand held up. That meant that as the inventory situation corrected itself, output and employment bounced back fast. In those situations, unemployment drops rapidly, and output increases rapidly. But this current recession is one in which there has been—excuse me, I promised not to use the word "recession"—in the slowdown of 1967–70 there has been comparatively little inventory shrinkage. That is to say, very little of it can be explained in terms of the lesser accumulation of inventories and, consequently, I don't think we can expect the same kind of snapback that we had in some of the earlier recessions that were primarily inventory recessions.

So I can say only that in inventory-type recessions there is a quick snapback. But in the kind of gradual slowdown we have had in 1969–70, there is no reason to believe we will have anything but a gradual improvement in the unemployment picture. Indeed, my fear is that if we don't expand faster than about a 3-percent rate this year, which is a standard forecast outside of Government, that unemployment rate which we have now may still rise. It may be early 1972 before we find the unemployment rate getting down below 5½ percent.

Mr. Chairman, I want to apologize. I know you have two extremely distinguished and competent and informative witnesses, and I am sorry that my part of this session has taken this long.

Chairman PROXMIRE. We want to thank you, Mr. Heller. You have been a great educator of Presidents and you also certainly continue to be a superlative educator of Congress, for those of us lucky enough to have been on this committee. You have certainly done a fine job in every respect.

Mr. HELLER. Thank you very much and I want to thank you particularly for allowing me to appear first since I have to leave early.

Chairman PROXMIRE. Our next witness is Joseph Califano. Mr. Califano served as special assistant to President Johnson from 1965 to 1969. In those years Mr. Califano accomplished more than a great many other people. In our domestic policy we made great strides, and Mr. Califano was actively involved in the formulation and discussion of economic policy, he was right in the center of this, and he brought a great deal of wisdom and commonsense to his task.

Mr. Califano, I know you had strong views about economic policy then, and I know you still do, I don't doubt that you still do. We are delighted to have you here. Please proceed.

STATEMENT OF JOSEPH A. CALIFANO, JR., ATTORNEY, WASHINGTON, D.C.

Mr. CALIFANO. Mr. Chairman, I am delighted to be here. I appreciate your generous comments. It is a privilege to be invited to testify before this distinguished joint committee of the Congress. Over the past several days, this committee has heard testimony concerning the impact of our Nation's present economic policies on the cities and States of our Nation, as well as testimony concerning the impact of these policies on the consumer, the working man, and the poor.

Others more expert in economics have testified in depth about the policies that have brought about our present economic crisis. Governors and mayors, far more familiar with the financial crises of State and local government, have testified about the impact of present economic policies on their ability to provide basic services, as the simultaneous combination of inflation and recession increases the cost of services and materials that they must buy to meet the needs of the people they serve and decreases the tax revenues available to purchase those services and materials.

You have invited me to testify generally on the need of our Nation for an incomes policy and the manner in which any such policy should be conducted, with particular emphasis on the role of the Office of the Presidency. That this Nation urgently needs an incomes policy should hardly be a matter for dispute. Increasingly, distinguished economists and financial leaders—from Walter Heller and Arthur Okun, former Chairmen of the Council of Economic Advisers, to Arthur Burns, current Chairman of the Federal Reserve Board, his immediate predecessor, William Martin, and the CED—have all urged the adoption of a national incomes policy. In the context of appropriate and effective fiscal and monetary policies, a national incomes policy, vigorously pursued, could be the decisive factor in renewing the relationship between productivity and price and wage increases.

THE ROLE OF THE PRESIDENT

The role of the President in a national incomes policy was recognized during the latter years of the Eisenhower administration. Both the 1957 and 1958 Economic Reports specifically discussed the problem. In transmitting his 1958 Economic Report to the Congress, President Eisenhower himself stated:

> Business managements must recognize that price increases that are unwarranted by costs, or that attempt to recapture investment outlays too quickly, not only lower the buying power of the dollar, but also may be self-defeating by causing a restriction of markets, lower output, and a narrowing of the return on capital investment. The leadership of labor must recognize that wage increases that go beyond overall productivity gains are inconsistent with stable prices, and that the resumption of economic growth can be slowed by wage increases that involve either higher prices or a further narrowing of the margin between prices and costs.

In the early 1960's and throughout the years of the Johnson administration, the Office of the President took an increasingly active leadership role in conducting a national incomes policy. The Eisenhower injunctions were given more precise content in the concept of wage-price guideposts spelled out in the 1962 Report of the Council of Economic Advisers In the 1966 report, the Council specifically recommended that the wage-price guideposts be set at a specific figure—3.2 percent for that year. The 1967 report of the Council provided a comprehensive review of how the guideposts policy had worked and the governmental activities followed to promote guidepost adherences. For example, that report pointed out that the Council had become involved with perhaps 50 product lines for which price increases were either imminent or had been announced by one or more firms.

In his 1968 Economic Report, President Johnson appointed a Cabinet Committee on Price Stability composed of the Secretaries of the Treasury, Commerce, and Labor, the Director of the Budget and the Chairman of the Council of Economic Advisers. This Committee produced a number of studies, published in early 1969, covering a variety of areas including manpower policy, industrial structure, competition policy, and the construction industry. In its report to the President on December 28, 1968, this Cabinet Committee strongly recommended a continuation of the earlier wage-price efforts and the incomes policy that had evolved over more than a decade of experience, and recognized the importance of Presidential leadership in carrying out such a policy.

At his own peril, President Nixon abandoned, abruptly and arbitrarily, the incomes policies and the role of the Office of the President in pursuing them that had evolved out of the experience and actions of his three immediate predecessors. At his first press conference, 7 days after he took office, President Nixon informed big business and big labor that the lid was off, that he did not agree with his predecessors that the Office of the Presidency had a legal, political, and moral responsibility to inject the public interest in major wage and price decisions. Responding to a reporter's question, the President literally told big business and big labor that their goals should be not what was best for the Nation, but what was best for themselves. Let me quote from that January 27, 1969, press conference:

> I do not go along with the suggestion that inflation can be effectively controlled by exhorting labor and management and industry to follow certain guidelines. I think it is a very laudable objective for labor and management to follow. But I think I am aware of the fact that the leaders of management, much as they might personally want to do what is in the best interests of the Nation, have to be guided by the interests of the organizations that they represent.

With that exhortation, President Nixon established for big business and big labor a public-be-damned, what's-good-for-General-Motors-is-good-for-the-country environment that has cost our citizens dearly over the past 2 years.

The President abandoned the momentum of moral, political, and economic leadership that had evolved out of the search of Presidents Eisenhower, Kennedy, and Johnson for the appropriate role of the Presidency in a national incomes policy. Until the irresponsible 12.5-percent price increase proposed by the Bethlehem Steel Co. 2 weeks ago, the President sat silently, as company after company increased their prices at will, without regard to market forces, and as union after union demanded wage increases in a desperate attempt to keep pace with rapidly rising prices.

Let me cite first a few examples of what has happened in the past 2 years in the absence of any presidentially led incomes policy. I use for the most part August 1970 numbers because they are the latest figures in detail on the wholesale price index that were available to me.

From December 1968 to August 1970,[1] the price of zinc rose 14.3 percent, a 20-month period. Throughout the entire 5-year period of the Johnson administration, the price of zinc rose only 3.7 percent.

From December 1968 to August 1970, the price of steel mill products rose 13.7 points on the wholesale price index, an increase of 12.6 percent. During the entire 8-year period from 1961 to 1968, the price of steel mill products rose only 7.1 percent. This 12.6-percent increase in 20 months does not even take into account the whopping 6.8 percent increase in structural steel prices that "gratified" administration sources last week.

From December 1968 to August 1970, aluminum ingot increased 11.9 points on the wholesale price index, an increase of 11.5 percent.

[1] August 1970 is the date of the latest published government figures showing the complete detail of the wholesale price index.

While aluminum prices fluctuated during the 8-year period from 1961 to 1968, these prices were the same in 1968 as they were in January 1961.

From December 1968 to November 1970, the consumer price index for new passenger cars increased 7.7 points, an increase of 7.5 percent; in the last year alone the increase was 5 percent. In the 8-year period from 1961 to 1968, there was actually a slight drop in the consumer price index for new cars.

The 1968 wholesale price index for refined petroleum products averaged 100.3, virtually unchanged from the 1957–59 base period. By December 1970, the wholesale price index for refined petroleum products had soared to 109.9, an increase of 9.5 percent in just 2 years.

These are not isolated examples. As Arthur Okun, former Chairman of the Council of Economic Advisers and senior fellow at the Brookings Institution, has indicated in a comparative study of wholesale prices of products responsive to the Johnson administration incomes policies and ignored by the Nixon administration, the presence of Presidential leadership is critical.[1]

Particularly where highly concentrated industries are involved, only the Government—and sometimes only the President—has sufficient power and stature to protect the public interest. Even General Motors was unable to roll back steel price increases 2 years ago.

As the Nixon economic policies have taken much of the demand steam out of the economy, prices and wages in competitive industries without corporate concentration or strong labor unions have responded. Thus, for example, farm prices are down; similarly, unskilled labor costs in nonunionized areas—e.g., in the case of some farmworkers—are also down.

This is not the case where business concentration is heavy or labor unions are powerful. Prices in concentrated industries are not responsive to textbook concepts of economics. They are responsive only to the decisions of a few corporate leaders free of any market pressures. As sales—and hence profits—went down due to the cooling of the economy, the corporate presidents and staffs of companies in concentrated industries were able to choose—and the choice was entirely theirs independent of the marketplace—to increase prices in the hope of making larger profits on fewer sales, rather than decreasing prices in the hope of enlarging the number of sales. The big unions reacted in much the same way. Concerned about increasing unemployment due to the cooling economy, they did not decrease wages to provide more or the same number of jobs for their members. Rather, they opted—and again the choice was theirs, not an economics textbook response to market conditions—to increase wages as much as possible as a cushion against present and future inflation and against the time when some of their members might be unemployed.

The lack of Presidential leadership and the absence of a coherent incomes policy have turned what otherwise might have been merely mediocre economic policy into an economic disaster for our Nation. Continued inflation and increasing unemployment are starving into submission only the weakest and most competitive segments of busi-

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[1] Okun, "Inflation: The Problems and Prospects Before Us," pp. 45–53 (Brookings, 1970).

ness and labor in our economy. If this leadership vacuum persists in the Office of the Presidency, the impact may be further to insulate concentrated industries from market forces and push competitive sectors of our economy to levels of concentration inconsistent with the national interest.

TOOLS NOW EXIST TO CONDUCT INCOMES POLICY

I recognize as well as anyone that in the area of economic policy, a President is often held politically responsible where he lacks authority commensurate with that responsibility. Yet there are many tools available to a President who has the will to pursue a vigorous incomes policy.

As this committee and the Congress seek to provide the Office of the President additional tools to deal with our economic crisis, they must at the same time demand that the President use the tools he now has.

I have deliberately refrained from using the term "jawboning" because it is singularly misleading. To be sure, the persuasive powers of the Presidency are enormously important in terms of the success of any incomes policy. But the President has a great deal more than verbal power at his disposal. It might be helpful for me to give a few examples of the kinds of activities in which the Johnson administration engaged:

The stockpile provided important assistance in rolling back or holding the price of copper, aluminum, mercury, and other materials. The Federal Government today holds some $6 billion in stockpile materials, many of which can be sold on the open market to ease temporary shortages or roll back proposed price increases. In other words, the Government has the capability of providing competition in some concentrated areas where none exists today.

Import quotas can be lifted or relaxed largely by the stroke of a Presidential pen—as was done with respect to oil and hides during the Johnson administration and as President Nixon has done with respect to Canadian oil and threatened with respect to steel.

As lumber prices increase, the President has the authority to open up more timberland. Both Presidents Johnson and Nixon have exercised this authority.

With the price of food increasing, the Department of Defense, with its enormous purchasing power in this area, can have a major market impact. You may recall that merely by withdrawing from the butter market for a few months in 1966—painful as that was for all of us—the Secretary of Defense was able to roll back an increase in the price of butter. Similarly, as egg prices increased in 1966 and 1967, the Department of Defense, simply by shifting from the purchase of large eggs to the purchase of medium-sized eggs, was able to reduce and stabilize the price of eggs in the private consumer market. The Agriculture Department, of course, can have enormous impact on food prices, for example, through marketing orders and price support programs.

In the late summer and early fall of 1966, furniture prices began to rise sharply. In talking to furniture manufacturers, we discovered that the shortage of hardwood available for furniture was largely responsible. On October 7, 1966, a few weeks after that discovery, we ordered the General Services Administration to stop purchasing high-grade hardwood furniture, thus relieving the hardwood shortage and, incidentally, saving about $3 million per year for the American taxpayer.

Each year, prior to automobile pricing decisions, the Chairman of the Council of Economic Advisers and I met with representatives of the three major auto companies to impress upon them the public interest in their pricing decisions.

The Secretary of Transportation was directed by the President to contact all Federal transportation regulatory agencies to ask them to hold rate increases to a minimum. In turn, those agencies with counterparts at the State level, like the Federal Power Commission, contacted State regulatory agencies and asked them to do the same.

Verbal persuasion itself was of enormous assistance. For example, meetings with representatives of the newsprint, molybdenum, gypsum, and nickel industries, as well as others, resulted in rollbacks, eliminations or delays in price increases.

On word of an impending price increase, telegrams were sent from the White House urging price restraints to manufacturers as diverse as those of sulfuric acid, cartons, cellulose, chlorine, castors, soda, glass containers, air conditioners, household appliances, and even men's undewear and women's hosiery. There were at least 50 such product lines contacted in 1966 alone.

Meetings were held by Cabinet officers, members of the Council of Economic Advisers, and White House staff with hosts of manufacturers, including manufacturers of textiles, television sets, fertilizers and farm machinery.

In the copper industry, several programs were combined: Copper was released from the stockpile to ease the immediate shortage and relieve the immediate price pressures; the Office of Emergency Planning invested funds to encourage long-range copper exploration; Ambassador Harriman and State Department officials were dispatched to Chile to reach an agreement concerning the world market situation of copper.

When excise taxes were reduced, the President set up a team to monitor industry activities to make certain the tax reductions granted by the Congress were passed along to the American consumer.

With respect to interest rates, beginning in September of 1966, every issue of Government securities was reviewed by a task force composed of representatives of the Treasury Department, the Council of Economic Advisers, and the White House staff, and then submitted to the President for his personal approval before issuance. As a result, we deferred in time or reduced in amount several projected issues of Government bonds and notes.

When there was pressure on the capital markets, Governors, mayors, and large corporate presidents were called to the White House and sent personal notes urging them to forego and delay projected capital investments—and to report back to the President what they had done. As far as the Federal Government is concerned, as you no doubt recall, the President delayed Federal highway and other Federal capital expeditures.

Federal pay increases were carefully reviewed to make certain they were noninflationary and on at least one occasion—the star route carrier bill—the President vetoed legislation which contained an inflationary wage increase.

The list is long, but by no means exhaustive. The point is simply to demonstrate that there is a great deal that a President can do in this area with powers presently at his disposal.

President Nixon has the same opportunities that former President Johnson had. It is most important to note that today President Nixon is operating in an economic environment of weak demand, rather than the boom atmosphere of 1966–68. Measures to deal with prices and wages systematically cannot assure against inflation when the overall economy is strained. But they can make the crucial difference in a sluggish, or even well-balanced, economy.

Let me give just two current examples, Mr. Chairman. Should the proposed depreciation rule changes become effective, the President has the opportunity to require corporations who receive the enormous benefit of $2.3 billion in tax relief in this fiscal year and $4.1 billion in the next, through his new depreciation rules, to pass some of those savings on to the American consumer. This is the year of sugar quota legislation—one of the richest tournaments in Washington. The President can have a significant impact on the sugar market and those products of which sugar is a part through the kind of legislation he fights for in the Congress.

INCOMES POLICY COUNCIL

Because there are so many opportunities and so many programs on wages and prices, I recommend the establishment of an Incomes Policy Council, chaired by the President and including as members the Secretaries of the Treasury, Commerce and Labor, the Chairman of the Council of Economic Advisers, and the Director of the Office of Management and Budget.

The Council should have as an Executive Director an Assistant to the President for incomes policy. It would absorb the work of the present National Commission on Productivity and the interagency Regulation and Purchasing Review Board, but its function would by no means be limited to reviews of past price and wage decisions and the issuance of ex post facto inflation alerts. The functions of the Council would be:

To develop specific wage-price guidelines, to provide an economically feasible and equitable standard against which the action of Government, industry, and labor can be judged.

To examine every Government policy and program and every significant decision of the Federal Government in terms of its inflationary impact, to make certain that programs of the Federal Government are used to ease inflationary pressures, for example, by relieving potential bottlenecks and by driving unjustified price increases down through use of Government stockpiles.

To issue Presidential guidelines with respect to broad policies of the regulatory agencies, particularly those relating to rate increases, at the Federal and State levels, and, where necessary, to provide in specific rate increase cases information concerning the inflationary impact of potential rate increases.

To represent the public interest in all major wage and price decisions and to place on the bargaining and board room tables of our large labor and corporate organizations the viewpoint of the Federal Government as the representative of the individual American citizen.

To call to Washington any industry or union contemplating inflationary wage or price increases and bring home to the representatives of that industry the importance of recognizing the national interest in their decisions.

To conduct a broad study of concentrated industries with a view toward recommending policies that will make them responsive to the economic needs of our Nation.

I prefer this approach to the immediate imposition of wage and price controls, even on a selective basis, largely because so many respected economists, administrators and attorneys with experience in prior wage and price control administrations have concluded that such controls are too often counter-productive and arbitrary, with a tendency to distort economic growth.

I do not underestimate the difficulty of the task before any President in implementing the policies I suggest. Unemployment has risen from 3.3 percent in December 1968 to 6 percent in December 1970. Inflation, which averaged 2.25 percent over the 8 years of the Kennedy and Johnson administrations, has averaged 6 percent over the last 2 years. Interest rates are easing, but they have reached during the past 2 years the highest levels in over a century. Inflationary wage increases are all too often the rule, rather than the exception—and it is difficult indeed to tell the working man that he must limit himself to wage increases that will not even keep pace with the decline in the value of the dollar he earns. The year of 1970 was catastrophic for our economy: This Nation experienced, hand in hand, the first decline in economic growth since 1958 and the worst inflation since 1951.

Against this background, none should underestimate the difficulty of the task that lies before the President. Yet none of us, least of all the President, can fail to recognize the overriding urgency with which he must assume that task.

CONCLUSION

Economic policy is the cornerstone of our domestic programs and foreign policy. A stable, growing, prosperous economy provides the revenues that can command the resources so urgently needed in the public sector for housing, health care, education, manpower training, and income maintenance programs for the disadvantaged among us. This same economic policy can provide the resources needed to protect our national security and provide aid to the less developed nations of the world.

Thank you very much.

Chairman PROXMIRE. Well, thank you, Mr. Califano, for detailing the specific efforts of the President while you were serving as his assistant. Most impressive. I had no idea, I didn't know, I don't think it was generally known, each year the Council of Economic Advisers would meet with the heads of business before they made their price decisions. Was this widely known?

Mr CALIFANO. Most of the items on this list except for the price fights were not publicized.

Chairman PROXMIRE. I am delighted you publicized them this morning. They should have been because it gives us a lesson in what we can do in a free enterprise economy in which we do have areas where because there is concentration of power it is possible for prices to be fixed, and they are fixed. Nobody questions the fact they are fixed in the steel industry; they are fixed to a certain point and to the last decimal point. All the other companies fall in line within a matter of days.

The experience in the steel industry was documented by Mr. Means and Mr. Blair when they appeared before this committee earlier, not only in the steel industry but in most concentrated industries. They pointed out that since 1968 this has been peculiarly an inflation in the concentrated industries, industries that are especially subject to jawboning by the President. There are decisions made by the individual without respect to what the market is. Prices go up when the market gets soft.

As I recall, in 1966 the administration pretty much abandoned wage-price policy with the settlement in the airlines strike. It appeared to me that the administration just threw in the sponge and said, "Well, there is nothing we can do now." At any rate, we did before that time have a price—I should say a wage guideline aim of something like 3.2 percent, if you will recall. The administration seemed to drop that, seemed to think that under the circumstances 1967, 1968, there was nothing they could do. What was the story?

Mr. CALIFANO. There was a great deal of discussion as to whether we should put a specific number on the wage-price guidelines. We did not drop the concept and, as I tried to indicate here, we continually worked on the problem of keeping wage increases in line with productivity increases, and holding prices.

We became concerned that a specific number might become counterproductive in the kind of a boom situation which we had, and that any such guideline would be the absolute minimum that anyone would require. If we raised the guideposts, say, to 4 percent or 3.9 percent, that would mean everybody would start at 4 percent or 3.9 percent. Therefore, we decided to drop the specific number. Whether we were right or wrong, I am not certain.

Chairman PROXMIRE. In light of that experience, Congressman Reuss and I sponsored legislation to make Presidential determination of annual guidelines a legal requirement. If that had been in effect in 1967 or 1968, would it have worked under these circumstances or would we simply have had to suspend the law?

Mr. CALIFANO. It is difficult for me to answer that, Mr. Chairman. I am not sure we were right in what we did: and I think today, for example, clearly in view of the economic situation we have, there should be a specific guidepost. Whether it would have been counterproductive or not in 1968 and 1967 I am just not certain. I really can't answer that.

Chairman PROXMIRE. I like your proposal for an Incomes Policy Council chaired by the President. I think it is very important to put the President right at the center, the heart of it. There have been a number of proposals to have some kind of a wage-price board; but unless you have the moral and publicity power of the President, it seems to me you are not going to have an effective operation. So I think that is a good proposal.

Mr. CALIFANO. It is also terribly important, Mr. Chairman, in terms of moving the Government to have the power of the President clearly behind policies that are being implemented. In ordinary circumstances the Department of Defense does not, to use one of the examples I used in my oral statement, like to change the way it is purchasing eggs; and it won't unless there is someone who has enough power to tell DOD to do it.

Chairman PROXMIRE. You contend that considerable ground has been lost in the last 2 years. Under these circumstances, do you think if we should establish that kind of a board now with President Nixon the head of it, it would be effective?

Mr. CALIFANO. Absolutely, Mr. Chairman. I think this present situation is the ideal kind of economic situation in which to use such a board. I think that if you had that kind of a board and a full-time staff, you would really be able to ferret out many more opportunities than even I have mentioned here or used here.

I had a member of my staff, Stanford Ross, who did nothing else for about 2 years but work on ways in which the Government could affect directly wages and prices.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN. Mr. Califano, I missed the significance of the explanation that you gave to the abandonment of the 3.2-percent guidelines. When did that occur? What broke the back of those guidelines?

Mr. CALIFANO. As the chairman indicated, we had a problem with an airline strike, and an airline wage settlement, in 1966 which busted through the guidelines. The last prior problem had been with the steel industry and with the steel unions in August of 1965. After bringing them down to the White House, and with a superhuman effort in patriotism, in my judgment, by I. W. Abel, the union held to that 3.2-percent settlement.

We began to become concerned after dealing with the machinist union in the airline strikes, that if we set another number, which would have to have been adjusted upward at that time, we would be setting a floor and that the floor would apply to everybody. Now, as you know, it is the overall productivity increase that is important, some agreements come in below it and a few can come in above it. And because there was such a booming economy, we were concerned that applying a number at that time would have been a mistake. Since I am not an economist, I am not qualified to answer in economic terms whether we were correct or not.

Today, I think we have a different kind of situation and that a specific guidepost should be set. I think, for example, that most of the people who were advising President Johnson to abandon a number in 1966 and 1967 would have urged him to have a specific guidepost today.

Representative BROWN. Well, in point of fact wasn't it because the budgets began to get badly out of whack in 1967 and 1968 and you could look down the road and see that and knew you couldn't hold those guidelines at all? It wouldn't do any good?

Mr. CALIFANO. Well, I made, in effect, that point in my statement.

Representative BROWN. Yes.

Mr. CALIFANO. Incomes policy alone, outside of the context of sound fiscal and monetary policies, is not going to solve the inflation problem.

Representative BROWN. So you really have to relate your efforts to what is happening within the economy generally; I suppose that is what you are saying?

Mr. CALIFANO. That is my point, yes.

Representative BROWN. Let me ask you: In view of what was happening in the economy in the late days of the Johnson administration, would you really think the imposition of the steel import quotas——

Mr. CALIFANO. Pardon me.

Representative BROWN. As I understand it, the increase in the price of steel that you criticized recently is related to some extent to the import quotas, voluntary import quotas. In the last days of the Johnson administration, didn't the administration negotiate some voluntary import quotas and try to——

Mr. CALIFANO. I believe we did. At the same time, however, I think, if you will go back over that record, you will find that we talked to the steel industry executives and the union leadership—or the people negotiating those quotas, and the Secretaries of Commerce and Labor talked to them—and told them that in our judgment these would be lifted and used as an economic tool if they were used in any way as an excuse to increase prices.

I assume that President Nixon still hasn't decided whether to lift these quotas or ease them, at least at this point in time. Moreover, we are not just addressing the recent increase in steel. Steel has gone up fantastically. As soon as we left office, shortly after the January 27 press conference, that was the time to have eased those quotas.

Representative BROWN. Wait a minute. Wouldn't it have been nice maybe not to impose them at all? They were imposed the last week you were in office and you already knew what was happening in the economy and to prices. In the context of what you said about the picture of the economy at the time, it seems to me to be a funny decision to have reached at that point.

Mr. CALIFANO. I think—I don't want to leave the impression that a decision was made in the last week on the basis of 10 days' study. If you go back to 1962—1964, the Council of Economic Advisers, particularly Otto Eckstein, had done an enormous study of the steel industry, including the import quota problem. I think it was one of the most thorough ever done, certainly the most thorough done by the executive branch. From that time on we were constantly, the Council of Economic Advisers and the Departments of Labor and Commerce were constantly, looking at this problem. We talked seriously about steel quotas and almost imposed them in early 1966, then abandoned the idea. So it is not a decision that was just made in the last 2 days of an administration. It is a difficult and complicated problem.

My point was that when a decision was ultimately reached, which I think the records of Government agencies that were working on it will probably show to be sometime in the fall of 1968, there were discussions with both management and labor leaders telling them clearly that at least as far as we were concerned we were willing to try some kind of modest quota system, but that if there were any increases in prices as a result of that we would not hesitate to lift those quotas to bring the prices down.

Representative BROWN. Well, I just think it is an odd decision, perhaps as odd as that butter decision which has an impact on the small guy much more impressive than it seems to have merited at the time.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Mr. Califano, I thoroughly agree with your recommendation that an Incomes Policy Council ought to speedily develop specific wage-price guidelines. In doing that, shouldn't a maximum effort be made to develop them with the consultation and agreement of management and labor?

Mr. CALIFANO. Yes, Mr. Reuss. I should have mentioned in connection with the proposals that you made, for example, to have management and labor and a group of wise men, I would contemplate that group existing as a complementary group to this Incomes Policy Council so that there would be discussions like that and there would be advice coming into this group from the private sector.

Representative REUSS. If you do that, and we are agreed that one should, I would anticipate, and here perhaps we differ, that really it would be a good idea to have a temporary 3 to 6 months across the board freeze on prices, wages, and salaries, because labor has made it clear, and I think understandably, that they are not going to adopt a voluntary guidepost at a time when inflation is continuing.

You, however, come down, as I read it, against the immediate imposition of wage and price controls. In your statement you give as your reason:

> * * * because so many respected economists and administrators and attorneys with experience in prior wage and price control administrations have concluded that such controls are often counterproductive and arbitrary, with a tendency to distort economic growth.

Now, we had testifying before the Banking and Currency Committee within recent months the top men on price control in the two examples we have had; namely, World War II and the Korean war, Prof. John Kenneth Galbraith for World War II, Mike DiSalle for the Korean war, both of whom very clearly testified that such controls should be imposed at once, that they aren't counterproductive, and under the present situation that they wouldn't distort economic growth.

The only former wage and price control administrators that I know of who are against controls today are Mr. and Mrs. Richard M. Nixon. Do you know of any others? I honestly don't, I can't think of any.

Mr. CALIFANO. Well, most of the economists, including Mr. Heller, and I expressed——

Representative REUSS. He wasn't a former wage and price control administrator.

Mr. CALIFANO. No; I am sorry, that is a misleading word, I don't mean administrators in terms of the individuals who had run——

Representative REUSS. Well, you said with experience.

Mr. CALIFANO. OPA.

Representative REUSS. Prior administrations; and I will admit that is good criteria.

Mr. CALIFANO. I was thinking of people who had worked in the administrations like Walter Heller or Ben Heineman, for example. I was about to say my partner, Paul Porter, but I am not sure where he stands on this issue so I will let him speak for himself.

I will tell you what happened to me. I made a speech about a year or so ago in which I said we ought to really take the money out of the private sector and pump it into the public sector at a much higher rate than we are now doing, to spend it on our current needs. I said that I was personally willing to do that with enormous tax increases and World War II-type controls, if such actions were necessary because the problems were so desperate, and the Hellers and Ecksteins and Porters of the world descended on me and said, "You never have lived through wage and price controls, you don't know what it is like," and I certainly am not qualified to make the judgment as an economist that you are making.

Representative REUSS. Let's take the three situations you are presenting. One is a temporary 3 to 6 months freeze across the board, work out your adjustments during that period and hopefully end up with a permanent agreed to system.

As Walter Heller pointed out this morning, there are some injustices there. The fellow who was about to get a price or wage increase, but has not, has to wait.

It seems to me the dangers and evils of the other two alternatives are worse. The evil of just letting inflation run rampant, which is just what it is doing now, is so obvious and so pervasive that we don't even need to discuss it. That hits almost everyone except a few profiteers. It particularly hits old people, young people, wage earners, you name them.

The evils inherent in capricious jawboning such as the President seems now to be engaged in include all the evils of rampant inflation, because it really doesn't work, and on top of that you penalize that good guy, union or corporation, who holds his price down while everybody else gets theirs.

So really there isn't any perfect alternative. Somebody gets hurt on every alternative. I believe that fewer people would get hurt on a temporary wage-price freeze than under any of the other two alternatives. Do I persuade you in any way?

Mr. CALIFANO. You persuade me to the point that I suppose if you put into effect and got moving the kind of incomes policy council I am thinking of in the real world of Government bureaucracy, it would take several months to get it off the ground. You have got to change the thinking of a whole bureaucracy that has now had 2 years of thinking one way, you have got to get some staff people. Just the sheer mechanics would take weeks or months and, perhaps, it would be helpful to have the freeze you propose during that interim period. To be honest, I never thought of it precisely in these terms before—to place some kind of a voluntary freeze——

Representative REUSS. I didn't say "voluntary freeze"; I said "mandatory".

Mr. CALIFANO. Some kind of freeze on wages and prices, using the authority the President now has, for a short period of time.

Representative REUSS. Thank you.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Mr. Califano, I have studied your statement very carefully. I think it is very helpful for you to document the economic calisthenics that went on at the White House to hold down prices. But when you look at this imposing list of attempts to put that kind of personal pressure on industry, and when we recognize the dismal failure we have had over 35 years now in trying to control prices of the six basic crops, and when we think of the thousands and thousands of products, would it not have been really easier for the Johnson administration to admit there was a war on, to impose a war tax, and not run up a deficit of $4 billion in the 1966 fiscal year, of $9 billion in fiscal 1967, and $25.2 billion in 1968? You made no mention of those economic atrocities imposed upon the economy of the country and as to whether or not they have any relationship to the inflationary pressures that we have been experiencing in these past 2 years. Would not it have been easier to tax the people to pay for the war that was on and not just promises that we could have both guns and butter at the same time?

Mr. CALIFANO. In late 1965, as Walter Heller indicated, there was general agreement among the President's economic advisers that a tax increase would be appropriate in early 1966. The President called in, I remember this vividly in my mind, called in the joint leadership of the Congress on a bipartisan basis, the Senate and House, and the chairman and ranking member of the Ways and Means and Finance Committees. He had Gardiner Ackley outline in great detail the need for this tax increase. He then spoke heartily in support of it, and I think anyone who was there will tell you that, and then went around the table and asked what the chances were of passing it. I remember Carl Albert saying, "Mr. President, you will get about 15 votes combined in both Houses," and Jerry Ford saying, "Mr. President, you won't even get that."

Now, faced with that problem, a decision was made to table as much out of the economy as we could and, if you recall, we took about $6 billion out. We accelerated corporate tax payments. We postponed the reduction of excise taxes. We did everything short of a surcharge that we felt we couldn't pass.

The following year, we proposed the surcharge, and we began the long exhausting fight, which took about 18 months, and to which the President devoted half of his speech withdrawing as a candidate from office. People tend to forget that that speech was not solely devoted to Vietnam. Half of that speech was on the urgent need of this Nation for a tax increase. So, 18 months after we proposed it, 2 months after the President himself had withdrawn in part to convince the Congress and the American people, he was asking this tax increase in the most apolitical manner possible, we got a tax increase passed. Now, I don't think there is much more we could have done in a practical world.

I don't think President Nixon made the right decision in abandoning the surcharge in January 1969. You will recall that in our budget we proposed the continuation of the 10-percent surcharge, and a continuation of spending on domestic programs, many of which you and many others espouse.

Now, our economic people talked at that time to their chairman, Mr. McCracken. I believe the President himself talked to David

Kennedy. Charley Zwick, our director, talked to Budget Director Mayo. They were all in agreement with us on the economic need to continue that surtax under that budget we had proposed.

Now President Nixon made a judgment to drop it. I am not faulting him for dropping that although I wish we had fought harder for it. But knowing how hard it is to get tax increases like that passed, I don't fault him for that in any personal sense.

I think there is no question but that this country can afford guns and butter. It just doesn't have the will to take the money out of the beer and lipstick economy sector and put it in the public sector, and all of us have to do everything we can to develop that will.

Senator PERCY. Since you have been quite free in your opinions of President Nixon, I will be quite free in my opinions of what went on at that time because I remember very vividly that I was running for office and I came out for a tax increase and I was elected.

Mr. CALIFANO. I should have mentioned that I remember that distinctly.

Senator PERCY. Because the people believed it was necessary and right. That was the first time I had ever heard that President Johnson, although he believed in a consensus, was reluctant to say what was right for the country and twist some arms and get it done. He could get things done through that Congress when he wanted to, and yet at that time he simply did not face up to it. I mention it not to go back into history but to simply say I think we have got to have the courage and guts to do what is right.

Mr. CALIFANO. That is right.

Senator PERCY. And I hope when we face this new budget now and we have this new terminology for Keynesianism I hope we are going to have the strength to have a surplus at the time of full employment and really reduce the national debt.

I would like to ask why in your statement you use the date of 1966 all through these examples. I don't find any date other than 1966. That flurry of activity was a tremendous exercise but it seemed that after the guidelines were broken then it wasn't quite as active a period for that type of consultation with industry.

Mr. CALIFANO. No, that is my fault. Actually, in terms of contacts with industry and labor, they increased in 1967 and 1968 rather than decreased. For example, we had throughout those 3 years weekly meetings on prices in which we examined all the prices and reports of potential increases that were coming in. I merely picked the year 1966 out in one case to illustrate 50 contacts.

You will recall even in August 1968 when good old Bethlehem Steel Co. came in with a price increase, I suppose at the time they thought the President wouldn't or didn't have the power to do anything. They engaged in an enormous battle with them with what little power we had left as a lame duck, and won.

Senator PERCY. I think we should point out for the record that despite all these activities, inflation was 4.2 percent in fiscal year 1968, it went up to 5.4 percent in 1969 which was a year over which the Nixon administration didn't have any control.

But that pricing consultation of the Council of Economic Advisers with industry still continued. Although I will say I fully support what was done before, I was pleased when the President did move this last time on steel prices. I think the moral force of the President must be brought into play and in that respect we certainly do concur although I don't overestimate how much it can accomplish if you don't do some of the really basic things. No matter how much you jawbone, if you run a $25 billion deficit, in full employment, it is pretty hard to get the economy back on a stable basis.

Thank you very much for being with us.

Mr. CALIFANO. Thank you.

Chairman PROXMIRE. Thank you, Mr. Califano, for an excellent job, controversial but very, very interesting and most helpful to us. It is so good when a man who can speak with authority can tell us exactly what was done. As I said many of these things are not known, are known now thanks to you, and I think they can be very helpful to the administration as well as to us.

Mr. CALIFANO. Thank you.

Senator PERCY. Mr. Chairman, can I make a comment on Mr. Brown's question?

Chairman PROXMIRE. I would like to point out Mr. Farmer has been waiting so patiently. It is almost 12:30, I don't want to impose on him or Mr. Califano, but go right ahead.

Senator PERCY. I hope in your memoirs you will tell us why in accordance with Mr. Brown's question, steel quotas were imposed in the last days of the administration and whether it was an economic or a political decision.

Representative BROWN. Mr. Chairman, I would like to ask a question. Relative to sharp increases in consumer and wholesale prices in 1966, did the Johnson administration ever seriously consider imposition of strict wage and price controls?

Mr. CALIFANO. We looked in enormous depth at the existing powers of the President in that area and particularly examined the Trading With the Enemy Act to try to find out whether or not the President then had authority to impose wage and price controls. We ultimately decided that if things got bad enough you could make an analogy to, in effect, what Roosevelt had done, which was he imposed wage and price controls under the Trading With the Enemy Act on the same day that he asked Congress to bless it. While there might have been an enormous fight over the issue of legal authority if we had moved, I think we would have moved in that direction. The decision not to impose them was largely for the reasons that Mr. Heller generally outlined. All the economists in the Government said the distortions would be too great and too severe and what have you.

Representative BROWN. Thank you.

Chairman PROXMIRE. I can't resist saying, Mr. Califano, if I had been in the position, if I had been in the position of being on the Wage-Price Review Board you suggest, I must say it would take an awful lot of wisdom to come up with a recommendation for a wage guideline today. Inflation, as you say, is 6 percent, what do you do. You can't recommend a cut in real wages so it's got to be 6 percent, it has to be more than that, they have a lot of catching up to do, and anything over 6 percent is inflationary, so it is tough.

Mr. CALIFANO. Yes.

Chairman PROXMIRE. Thank you very, very much.

Mr. CALIFANO. Thank you very much.

Chairman PROXMIRE. Our final witness this morning is Mr. James Farmer. Mr. Farmer is well known nationally for his leadership in the fields of education and civil rights. He was founder of the Congress of Racial Equality and provided it with his able leadership for many years. Most recently, he has served as Assistant Secretary of Health, Education, and Welfare in the present administration. Mr. Farmer, we're all conscious of the need to do better, much better, in the fields with which you've been concerned. This set of hearings has made us more intensely aware than ever of the difficulties State and local governments face in providing the services that need to be provided. The President has just presented some major new proposals which the Congress must evaluate. I feel very fortunate that you could be here this morning to share your knowledge of our social and economic situation and give us your recommendations. And I want to apologize for having detained you so long. You are a very, very patient man. Again, welcome. Go right ahead in your own way.

STATEMENT OF JAMES FARMER, FORMER ASSISTANT SECRETARY FOR ADMINISTRATION, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Mr. FARMER. Thank you, Mr. Chairman.

Mr. Chairman, and members of the committee, I don't speak as an economist. You have had a number of economists testifying and no doubt you will be having more in the course of your deliberations. But if I have any expertise at all, it is having some knowledge of what is transpiring within the ghetto communities, the black community, and the barrios, and the communities of American Indians, and to some extent the white poor as well, and possibly some which has validity as to what ought to be done now.

I want to congratulate the chairman and the committee for calling hearings on the present crisis situation in the Nation so early after the convening of the new Congress.

I also want to commend the administration for embracing the concept of a full employment budget. Now perhaps we can confront the more fundamental questions: Employment where? and full employment for what? If those are important issues for the Nation as a whole, they are nothing short of critical for the ghettos and the barrios of America.

Economically speaking, the black, Chicano, Puerto Rican and Indian communities are disaster areas. Unemployment in those minority communities are disaster areas. I don't want to be in a position of being a prophet of doom but I do think it is important for us to understand the urgency of the present situation. Unemployment in those minority communities is more than twice as high as the national average—over 12 percent, and indeed as high as the national rate in some years in the depression years and going up. Among black and Spanish surnamed youths, 18 to 25 years of age it is higher still, in some localities between 25 and 30 percent. And that is only part of the disaster.

Ghetto and barrio underemployment is an even larger problem. In many ghettos in major metropolitan areas approximately 40 percent of the work force are either unemployed or underemployed—that is working part time or earning less than a minimum wage. Those who don't work would like to in most cases, indeed. A number of studies, including one done by Rand Corp., show that 70 percent of welfare mothers, for instance, would prefer employment to staying home. But among those who do work, even full time in the ghettos and the barrios, few earn more than $82 per week, and most earn considerably less.

The conventional response to the ominous facts is, of course, to blame the victim. "If only they'd stay in school," some say, "they wouldn't have these problems." The facts, however, hardly bear out that contention. Some recent studies done by Bennett Harrison and others for the National Civil Service League showed that for the ghetto youth each year of education beyond the eighth grade is worth only about $1.50 per week in the paycheck. In other words, if one goes beyond 8th grade and finishes high school and gets a diploma, this means only about $6 a week more income than the individual who dropped out after 8th grade.

The league researchers found that each year of college for the ghetto kid added 50 cents a week to the paycheck in the first few years after college—only 50 cents.

So the inner cities are in what I would term, speaking as a layman, of course, a depression, not merely a recession, a depression in the midst of an affluence which is rendered more heartbreakingly visible on television. In the next couple of years as young black men return from Vietnam, the chances are twice as great for them as for their fellow veterans who are white that they will be returning to no jobs. I think the Nation must not allow this to happen. But how do we prevent it? Where will the jobs come from?

They certainly will not, in my opinion, come from the manufacturing industries. Nor will they come in sufficient numbers from anywhere else in the private sector. Not with automation and cybernetics through which we are producing more and more goods with fewer and fewer people. The new jobs, I believe, must come from expanded public services employment. The private sector, as Mr. Harold Sheppard points out in a staff paper for the Upjohn Institute. is now beginning to ask "if Government itself has done enough to create and provide job opportunities in the public sector."

As manufacturing jobs are declining, especially for unskilled and semiskilled workers, public service jobs are increasing. The former, that is the manufacturing jobs, dropped 4 percent from 1956 to 1963, while State and local government jobs increased during the same period by 77 percent. It is estimated by the National Civil Service League that between now and 1975 the growth of public service jobs in the field of education will be 42 percent, in health 70 percent, in sanitation 86 percent, in hospitals 144 percent, in welfare and related fields 97 percent, and so on.

Training programs aimed at preparing the poor for industrial jobs have generally had little success. There are a number of exceptions. Among them, of course, are the Reverend Leon Sullivan's Opportunities Industrialization Centers, which first locate the job, then train the recruit for it. Most others have failed because the jobs are declining and those that exist are far from the ghetto, often indeed in the suburbs, and while experiments on reverse commuting are useful, so far they have not really succeeded. I do think, however, such experiments ought to continue.

If it does not appear feasible to transport the ghetto's poor to suburbia for jobs, why not offer tax incentives to firms prepared to build plants inside the ghettos as has been proposed? This should be tried, especially if the firm is prepared to share control of the plant with the community; and I think the firms ought also clearly to be prepared for the controversies which may develop. We would be well advised to expect no large-scale or dramatic results.

Large-scale results can be expected only in the public sector. The public sector cannot desert the city. And if the public services are expanding now, that growth is by no means keeping pace with the need. In 1965, Arthur Pearl and Frank Reissman estimated in their book "New Careers for the Poor," that 5 million new paraprofessional jobs were needed adequately to deliver quality human services to the urban citizens. Since then, others have agreed with those estimates. Five million new jobs in health, education, welfare, recreation, safety, and so forth. Here then is an ideal area for revenue sharing.

The need can be seen not only in the population growth of the cities, but also in our current failures adequately to deliver services to the urban poor. A good index to the extent to which we are delivering health services is the infant mortality rate, and in the ghettos and the barrios it is two to three and a half times as high as in the rest of the Nation; and it continues to be high, with variations from month to month and season to season. In education, and generally speaking, their reading and computational skills are considerably below grade level when they attend ghetto and barrio schools. There is now abundant evidence from countless pilot projects that skillful use of paraprofessionals can improve the quality of the service and its delivery to the target community. This evidence with full documentation can be provided for the committee if and when it is needed.

Self-evident is the fact that by performing tasks previously done by professionals but requiring lesser skills and training, paraprofessionals can supplement the inadequate supply of professionals in medicine, education, social service, and the other human services. I think there is no question but that there is a shortage of supply, except in the field of education, where now we are confronted with what appears to be a surplus of teachers. But that, I think, means a surplus over and above what we are prepared to pay for because, after all, the pupil-teacher ratio is still very, very bad. It is not a surplus in terms of the need, such as wiping out illiteracy in the country.

Self-evident, too, is the fact that a public service employment program making extensive use of paraprofessionals not only can provide jobs en mass for the ghetto and barrio poor, but by combining work and training can provide upward mobility for those persons who were hitherto immobile.

What I am suggesting, therefore, is a new careers model for a public service job development program. You will recall the Scheuer amendment, in 1966 I believe, to the Economic Opportunity Act, which suggested, not only suggested but mandated, the building in of career lattices so that nonprofessionals can, with training on the job, become paraprofessionals. Finally, through additional training and by lateral progression, enter professional ranks.

For "new careers" become new careers only when career lattices are built in so that a nonprofessional may become a paraprofessional and on up in the professional ranks. A teacher aide may become a teacher, and that, by the way, is happening in a number of HEW programs. A nurse's aide may become a nurse, and that similarly is happening in a number of programs which have been negotiated by trade unions: State, County, and Municipal Employees, for one; and local 1199 in the private hospital field, for another; and a battlefield medic may become a physician with more training, more education, and more experience as is now being attempted in a number of pilot projects sponsored by the Public Health Service.

Only through such promotional motion can we avoid the charge of dead-end jobbing.

The family assistance plan is a sound concept, but how is it possible without a public service job development plan? It doesn't make much sense to force or cajole women to enter the job market where there are no jobs. It just adds to the frustration. In addition, day-care centers will be needed, even required, by FAP; but who will man them? Who will take care of the children?

I do not suggest a massive public service career program as a panacea. There are no panaceas, least of all for all the ghettos and barrios of the Nation. I suggest it instead as one step that, because of the crisis, needs to be taken now on a long journey.

There are many other steps. We cannot, for example, long defer serious efforts toward economic development of the inner cities. This has not moved rapidly. Here again is a field day for revenue sharing, but the moneys I feel ought to be earmarked or I would doubt that they would get there.

In addition to providing funds for economic development, the Federal Government can encourage the use of private funds for the same purpose by insuring loans to and guaranteeing investments in the inner city. I believe, if I am not mistaken, the Federal Government does that to encourage American industry to invest in some foreign nations. Why should we not similarly encourage investments in underdeveloped areas of our own country?

It is shameful that the gigantic pension funds of industry and labor have not been used for socially constructive purposes. Those are enormous funds, and I realize by law some 75 percent of the funds' money has to be used for safe investments, but there are 25 percent of it free or approximately so, and while it has been some time since I have looked into the amount of those pension funds, if my memory serves me correctly, industrial pension funds have reached something like $40 billion, and in addition trade union funds have reached at least half of that amount. I think that only the Government can free up the use of those funds.

I would suggest also that from those banks who lust after the enormous Federal deposits; that is, the tax money, withholding taxes, and so forth, that the Federal Government deposits in banks—and I understand that there are little if any criteria for such deposits—there ought to be a quid pro quo such as requiring the banks to invest in inner city economic development loans in order to qualify to receive those deposits.

Mr. Chairman and members of the committee, I think we must now revive the dream in those who know only nightmarish reality.

Chairman PROXMIRE. Thank you very, very much, Mr. Farmer. It is interesting that Senator Stevenson when he was treasurer of the State of Illinois did that, as I recall, with State funds with great success.

Mr. FARMER. Good.

Chairman PROXMIRE. And the big banks were greatly encouraged to invest in inner city areas where they could provide jobs and provide development. I think you open up a most helpful area when you suggest the Federal Government, which has so much more in the way of funds than the State has, and it does deposit largely on the basis of political considerations, I know in instances where it has to be done, it should likewise do it in a constructive way in helping solve one of our pressing inner-city problems, capital investments.

Did you find it possible in your position as Assistant Secretary of HEW in charge of administration to move the bureaucracy in any significant way to initiate and carry out enthusiastically policies and programs to help the poor?

Mr. FARMER. I found it very, very difficult. My expertise was not with the bureaucracy, and my experience had not been with the bureaucracy except from the outside seeking to prod it.

Now, this is not an attack upon the administration per se because it is the nature of the bureaucratic animal in any administration in a large government, nor is it an attack upon the individual bureaucrats, because I found, sir, that most of the civil servants were dedicated human beings, dedicated persons who wanted to do what was right, but there was a built-in tendency to follow the course of least resistance which is to do things as they have been done and to thus resist change. I believe almost by definition institutions, of which a bureaucracy is one, resist change.

Chairman PROXMIRE. Have you any ideas based on your experience how this can be done to provide a greater degree of motivation and incentive and maybe risk-taking in terms of the career of the bureaucrat? You say the line of least resistance, also the safest line. After all, if a bureaucrat sticks his neck out he would be in trouble.

Mr. FARMER. This, Mr. Chairman, I think we need to get the point over today, if people don't stick their necks out they are in more serious trouble because of unrest in the Nation.

Chairman PROXMIRE. What can we do up here on the Hill to encourage greater innovation and greater activity on the part of the administration? We pass these laws and, as you indicated in your response, we don't get this kind of vigorous response we would like, and again it is not a partisan question.

Mr. FARMER. Well, I think one way you can do it is demand an accounting, and monitor a bit more closely than is currently being done, what is happening on the legislation. One of the concerns in this regard that I have had is that we go through the motions, we spend the money, we make the effort, but nothing really changes, and I think that it ought to be monitored, each program should be monitored, every step of the way to find out whether we are accomplishing what we set out to do.

I looked, for example, at title I, and I think HEW is fully aware of the failures of title I in the past. But title I money, in most cases, has not gotten down to the people for whom it was intended. Now Secretary Richardson and his predecessor Secretary Finch are aware of it and are trying to do something about it. A task force has been set up; this should have been done long ago, and ought to be done more rapidly now.

Chairman PROXMIRE. In view of the frustration and bitterness which you properly describe with respect to people who are trained for a job and then find there is no job there, what was your reaction to the President's veto of the job training bill on the ground, as I understand it, these would lead to dead end jobs? Did you think that was well taken?

Mr. FARMER. No, I was opposed to that veto. I think it was ill advised, and I hope now the President, the administration, will come up with a specific proposal, manpower proposal, and I trust that their proposal will have built into it the public service careers.

Chairman PROXMIRE. You point out properly this is where the expansion is in our society.

Mr. FARMER. I think it is.

Chairman PROXMIRE. The jobs are declining in manufacturing, at least in relationship to the growing population, but growing in these other areas. Among other things President Nixon's priorities for the coming fiscal year include cutbacks in funding for OEO, model cities, urban renewal, manpower programs, and other programs that focus directly on the problem of poverty and urban decay. Now in fairness, I should point out while he is cutting back in some of these areas he is providing for revenue sharing as a generalized kind of addition. I don't know how this adds up in terms of the arithmetic of it, but the specific directed fund for these purposes seem to be reduced.

What is your evaluation of the switch from specifically targeted programs to general program funding for the problem of poverty and urban decay?

Mr. FARMER. I didn't get the last part of your question.

Chairman PROXMIRE. What is your evaluation of the switch from specifically targeted programs to general program funding for the problems of poverty and urban decay?

Mr. FARMER. You mean revenue sharing?

Chairman PROXMIRE. Yes.

Mr. FARMER. I am endeavoring to keep an open mind in line with the kind of suggestion that Senator Humphrey made in questioning Mr. Heller. I want to keep an open mind, although I have very negative reactions to it at the outset. My reactions are the fact that it might be in a way turning the henhouse over to the fox, putting the fox in charge of it in terms of civil rights. Anyone who has spent as many years as I in the civil rights movement is not inclined to—how shall I put it—to allow the Governors of some of the States of our country to decide how Federal tax money is to be spent. I do not think, if I may use a name, Governor Wallace, for example, would be my choice as the keeper of the purse strings or in a share of the Federal purse strings, and this is my concern, and I keep an open mind. Perhaps safeguards can be built in, perhaps they will be built in, but I have to know what they are, I have to see what the program is before I can support it or oppose it.

I need to know, for example, whether if the funds which are being shared are being used in a discriminatory manner or any portion of them are being so used, whether those funds will then be withheld from the offending State or the offending city.

Now, I look on the concept with much interest and favor because I see that the cities are declining, and we as blacks are inheriting them, Mr. Chairman. We are inheriting bare bones, and I think that any ethnic pride that my community, black community, may feel, at the demographic and population trends which indicate that by 1990 blacks should be in a majority in 25 major cities, must be tempered by the fact that the fiscal base has moved away, and the middle-class flesh has been moved away from those bones, so how are the cities to survive? Some way must be worked out for Federal funds to get to the cities and to the States. But I want to see the specifics and the details of the President's program before I can commit myself on it.

Chairman PROXMIRE. My time is about up. If Mr. Brown will permit, let me have just one quick follow-up question. You referred of course to one Governor, Governor Wallace. I would like to have your impression of how this might work with Governors who—where you didn't have this kind of a situation, which I think all of us would recognize, but with more typical Governors. Don't you still have quite a serious problem on the basis of the record, without referring to personalities, hasn't it been true that both in the Governor's mansions and in city halls there has been considerable reluctance to act aggressively and vigorously to provide service for the poor?

Mr. FARMER. I think that is true. It is definitely true. They are subject to more immediate political pressure from their State or from their city community. Therefore, many of the poor, including the ethnic poor, black, Puerto Ricans, Chicanos, and Indians, have, as a consequence, had to bypass city halls and State governments and go to the Federal Government as the friend in court, as an advocate in the last resort. And if we lose that then I think we are in serious trouble.

Chairman PROXMIRE. My time is up. Congressman Brown.

Representative BROWN. Mr. Farmer, I want to congratulate you on what I think is a very positive statement, and has some very specific suggestions; and I would just like to observe that I would think that the passage of a national health insurance program would benefit this program of the preparation of paraprofessionals for jobs in the fields of medical service particularly, which is a growing field and one that is very important to the whole society.

Mr. FARMER. Yes.

Representative BROWN. I want to go on to another point that you made, but I also think that the questioning that the chairman has pursued with you here is most important. I would like to see us develop, if we could, at a Federal level, some method of evaluation of success of programs and also some better methods of evaluating the success of these Federal programs, which means some effort to reform the Civil Service System to improve the quality of the work that comes out of that system. Bureaucratic lag, and the bureaucratic drag that you spoke of are a problem for us in our society, not just at the Federal level but perhaps at all levels.

You suggest the use of pension plans and the effort to assist persons least able to assist themselves, so to speak, from the standpoint of training and their capacity to find jobs. How could you square though, the requirement of these pension plans for the employees that are covered by them to make as much return as possible with the propect of risk or the perhaps low return that might be involved in an investment in a ghetto area or the city areas? That is a problem that impresses me a little, and it seems to me to require things such as tax-exempt foundations that we have in our society that have already made their money, so to speak.

Mr. FARMER. Well, I think there is a built-in safety valve there in that law, as I understand it, that requires that a certain percentage, I think it is close to 75 percent in most States, of the pension funds be used in remunerative investments. But there is about 25 percent in most States, which is free to be used as the investor sees fit, and I think that trade unionists, who at least had an idealistic beginning and should still be idealists, ought to be interested in having their funds put to the most useful purpose while they are being held for them and the same ought to be said for business, or industry. Industry has an equal responsibility to be concerned about what happens in the city; in fact all of us have a stake; if the cities go down the drain then we all lose.

I, for example, sir, would like to see the Nation assume as much responsibility for the cities' viability as we have already assumed for the viability of the farms. We have made that a kind of national commitment; all of us subsidize farmers to see that the farms don't go under. I think it is just as important for the cities to remain viable and perhaps they ought to become centers of intellect, intellectual development and experimentation and of culture and of recreation, so that all of us can share in that and, perhaps, feeding the spirit and the mind of man is as important as feeding his body.

Representative BROWN. Perhaps in addition to industries we ought to encourage the educational institutions to move to some degree in the cities, or at least a greater degree.

What do you think about the tax-exempt foundations and more specific requirements for their investment in the development of cities and ghetto areas economically?

Mr. FARMER. Well, many of the tax-exempt foundations are giving grants to programs in the inner city which are very helpful but I would be in favor of requiring that a certain share of their funds be invested in such programs.

Representative BROWN. You have suggested also tax incentives to firms prepared to build plants in inner cities.

Mr. FARMER. Yes.

Representative BROWN. Do you have any types of suggestions as to which would be significant and most helpful?

Mr. FARMER. No; I would leave that up to economists to work out, and I understand the administration is planning to present such a program. I think it ought to be presented and I think it ought to be pursued. I would not suggest public service careers as being the one solution to the problems, because there is no one single solution. We have got to try everything. We have got to cover the waterfront.

Representative BROWN. The problem of the city as a separate political entity from the suburban area, and you put it very well when you said middle-class flesh has been stripped off the bones of the city.

raises a question in my mind, though, about the situation of political separation and in revenue sharing whether the money should be shared with the local political subdivision or whether it should be shared with the State, what the taxing base ought to be for local municipal operations. It seems to me what you have said should encourage us in a social sense to move toward the development of metropolitan government to get the tax revenues out of locations where the revenues can most easily come, and expend them in those areas where they are most severely needed.

Mr. FARMER. Well, I certainly think that funds ought to be expended according to need. In fact, I am concerned about the revenue-sharing plan as proposed and, as I understand it, in that it speaks of per capita sharing rather than sharing by need, and some formula needs to be worked out which includes need.

Now you mentioned the metropolitan plan for the cities. I am sure our cities are moving in that direction. Say, from Boston down to Washington there will be one huge metropolitan area and so on, but I must share with you the fact that the black community is concerned about the timing of this development. At a time when the black community is on the threshold of considerable political power, this is seen by the young blacks as being a changing of the rules when we are about to win a ballgame, as it were, if you follow me there.

Representative BROWN. I do. I know what you are saying, but I look at the proposals for tax revenue usage here in Washington as an example, where the Mayor has proposed a certain commuter tax because that is where the income seems to be in the suburban area.

Mr. FARMER. Yes.

Representative BROWN. That is the individual income, and yet the need for a lot of the services that are utilized by the suburbanites is in the city. Further complicated I hear that it is not just municipal government in the city center and municipal government in the suburban area but also the District line which separates the District of Columbia from the State of Maryland and the State of Virginia. But that problem of combining tax resources and tax usage, it seems to me, would encourage us to go toward a metropolitan type of government that would make these two things or bring these two things more into balance.

Mr. FARMER. Well, that may be. I think, however, that a good case, a valid case, can be made for taxing commuters without necessarily having commuters vote. I don't think that Mayor Washington suggested that commuters ought to vote in the next Washington election and I wouldn't expect them to for the reasons I indicated earlier.

Representative BROWN. What about revenue sharing in this context? Do you think we can work out a solution to that part of the problem?

Mr. FARMER. I think we must.

Representative BROWN. Do you have a suggestion as to what it might be, the solution?

Mr. FARMER. Well, I think one part of it is sharing it according to need. I don't think that Westchester County in New York, for example, ought to receive as much as Manhattan County because obviously the need is not as great there. Nor do I think Montgomery County here ought to receive as much as the inner city of Washington, D.C., in return. I think that that would, in fact, be not equalizing but would be discriminatory.

Representative BROWN. My final thought, Mr. Chairman, it seems to me that some kind of a per capita income related per capita tax effort could come up with that kind of a formula. In other words, if a metropolitan center had low per capita income but made a high per capita tax effort, the basis there that would——

Mr. FARMER. Yes. Didn't Mr. Heller in his testimony suggest some sort of formula like that, combining need with per capita?

Chairman PROXMIRE. I just have one more quick question. President Nixon has proposed that we reorganize seven existing departments and several independent agencies into four departments. This would include adding on HEW and, the question I would ask, can HEW expand its management any further to do a competent job or more competent job?

Mr. FARMER. Well, my offhand reaction was no, it could not. Much of the discussion I had heard and shared an interest in was in splitting up the monster. I do not think that by making it larger we simplify the administration of it or its management.

Chairman PROXMIRE. It is a great pleasure and honor to have you before our committee, and you have done an excellent job.

Mr. FARMER. Thank you.

Chairman PROXMIRE. The committee will stand adjourned until Friday when we start our hearings on the Economic Report. The Subcommittee on Economy in Government will hold hearings tomorrow on the foreign military assistance program.

(Whereupon, at 1 p.m., the committee was adjourned until Friday, February 5, 1971.)

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

INVESTMENT BANKERS ASSOCIATION OF AMERICA,
Washington, D.C., February 9, 1971.

Hon. WILLIAM PROXMIRE
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Because the Investment Bankers Association of America is intimately involved in the financial affairs of State and local governments, we would like to express our support for the emerging consensus that Federal revenue sharing is needed to alleviate the fiscal crises of these governments. As you know, the case for greater Federal assistance to States and localities is based on the lack of balance between their revenue-raising capabilities and expenditure requirements. This "fiscal mismatch" has left State and local governments in a continuing budgetary crisis.

To be most effective, we believe any plan to share Federal revenues among the levels of government should meet the following criteria:

1. Assistance should be periodic and predictable, allowing recipients sufficient time and certainty for the planning of its expenditure.

2. Distribution of such funds should be flexible enough to permit their use where the needs are greatest and broad enough in scope to embrace all general purpose governments as potential recipients.

3. Distribution procedures should encourage cooperation among all levels of State and local government and should enhance their sense of mutual as well as individual responsiblity.

4. Such assistance should be extended freely and without constraints beyond those normally accompanying the prudent and constitutional expenditure of public funds.

It is our opinion that Congress should give prompt and favorable consideration to the revenue sharing concept.

Sincerely yours,

FRANK P. SMEAL.

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