509

THE 1971 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

FIRST SESSION

PART 2

FEBRUARY 22, 23, 24, 25, AND 26, 1971

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CONTENTS

WITNESSES AND STATEMENTS

MONDAY, FEBRUARY 22, 1971

AFTERNOON SESSION

TUESDAY, FEBRUARY 23, 1971

WEDNESDAY, FEBRUARY 24, 1971

THURSDAY, FEBRUARY 25, 1971

FRIDAY, FEBRUARY 26, 1971

SUBMISSIONS FOR THE RECORD

Monday, February 22, 1971

AFTERNOON SESSION

Tuesday, February 23, 1971

Wednesday, February 24, 1971

Thursday, February 25, 1971

SUBMISSIONS FOR THE RECORD—Continued

FRIDAY, FEBRUARY 26, 1971

THE 1971 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 22, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Sparkman, Humphrey, and Pearson; and Representatives Reuss and Widnall.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowsky, research economists; George D. Krumbhaar, Jr., minority counsel; and 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 annual hearings on the state of the economy by turning to a particularly difficult problem which has resulted from the combination of inflation and recession which we are experiencing—the problem of adequate financing for State and local governments. Our distinguished witnesses this morning are two valued members of our own committee, Senator Hubert Humphrey and Congressman Henry Reuss, and the Assistant Secretary of the Treasury, Murray Weidenbaum.

State and local governments had financial problems before we entered the current bout of inflation coupled with recession. There have long been serious imbalances in our fiscal system. However, it is the deterioration in overall economic conditions which has brought these fiscal problems to their current crisis state. As I stated at our earlier hearings on "Economic Prospects and Policies." the single most important thing the Federal Government could do to help States and localities would be to restore full employment with reasonable price stability.

The pursuit of policies designed to achieve full employment and price stability are, of course, the central function of this committee. Beyond this, the committee has an additional responsibility to evaluate proposals for changing the fiscal relations among various levels of government from the point of view of their overall economic impact and of the efficiency with which they are likely to achieve their stated objectives.

Much recent discussion has centered around the question of revenue sharing. But revenue sharing is only one of many possible ways of aiding States and localities. The list of alternatives includes: full Federal assumption of responsibility for public assistance programs; the return of more tax sources to the States; and the continuation and improvement of the currently much malined Federal programs of direct aid for particular purposes.

An important contribution which this committee can make to the discussion of these alternatives is to make clear the economic criteria which are fundamental to their evaluation. I would like to suggest the following criteria:

1. Income distribution: Does the proposed program have the effect of concentrating limited Federal resources where the need is greatest?
2. Economic stability: Is the proposed program designed to have a countercyclical impact—to support the economy in times of slowdown or recession?
3. Economic efficiency: Does the proposed program offer national benefits sufficient to justify the costs to the Federal Government?
4. Equity: Does the proposed program offer incentives to the States to adopt more progressive tax structures?
5. Discipline: Does the proposed program require the State to measure the B/C of public programs and leave whatever problems that should be left to the private sector or not done at all.

I would like to get the views of our witnesses on these criteria and to ask them whether there are other, equally important criteria which I have neglected.

We have this morning an expert panel. Congressman Reuss in addition to being for many years one of the most active and articulate members of this committee, is the author of the book, "Revenue Sharing: Crutch or Catalyst," one of the best studies available of the whole problem of aiding our States and cities and encouraging them to improve their structure of government. Senator Humphrey, whom we've recently had the great pleasure of welcoming as a new member of this committee, has, of course, unmatched experience at all levels of government and thorough knowledge of the problems faced by our States and cities.

Mr. Weidenbaum is an old friend of this committee. We published a paper of his in 1967 entitled "Federal Aid to State and Local Governments: The Policy Alternatives," which is precisely the subject we wish to discuss with him this morning. Mr. Weidenbaum, we may not all share your enthusiasm for the administration's revenue-sharing plan, but we all admire the vigor and the skill with which you argue the case for it.

In the absence of Senator Humphrey, it has been suggested by Congressman Reuss you might start off.

STATEMENT OF HON. MURRAY L. WEIDENBAUM, ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY

Mr. WEIDENBAUM. Thank you, Mr. Chairman, and particularly for those kind remarks.

It is always a pleasure to appear before the Joint Economic Committee and to participate in what must be one of the longest and most productive continuing economic seminars of modern times. It is in that spirit that I have prepared this statement on revenue sharing.

To begin with, we are all trying to deal with some very basic and difficult problems facing the American economy and the American society. The financial crisis now confronting so many of our cities and other State and local governments is very real. I use the term "crisis" both reluctantly and advisedly. One has only to read the recent testimony before this distinguished committee by some of the mayors of our largest cities to realize the depth and dimension of the almost overwhelming economic, financial, social, and political problems that threaten the vitality if not the very existence of major portions of our federal system.

I would like to recall just a brief excerpt of the straightforward but inherently dramatic account of Newark's financial condition by Mayor Gibson, given to this committee:

> Upon taking office in July 1970, I found an estimated deficit for 1971 of over 70 million dollars, or over 40 percent of the budget. The budget crisis was brought on by a 10 percent decrease in city revenues and an increase of 850 million in expenditures . . . largely the result of mandated appropriations for essential municipal services. To fill this gap through increased property taxes, we would have had to raise the present rate, already one of the highest in the nation, by 50 percent . . . . After months of study and consultation, we finally opted for a series of taxes on Newark's businesses and consumers . . . . We are aware that these are highly discriminatory and regressive taxes . . . but we had no alternative.

Of course, gentlemen, there is a real and effective alternative, and I will be presenting it. However, we must realize the inadequacy and often the perversity of the many prior attempts by the Federal Government to solve or even ameliorate the kinds of problems faced by Newark and other State and local governments.

This is not an after-the-fact rationalization that I am offering, on my part, of our specific recommendation. On the contrary, that was the conclusion of many years of prior study and experience on the part of those of us who have been most active in designing the revenue-sharing approach.

In my own case, I arrived at such findings in the research that I did while still in the private sector. I would like to quote briefly from the volume that sums up that work:

> The question arises inevitably as to the extent the grant-in-aid system is converting the states into veritable agents of the Federal Government. Is there the possibility that the states may become the civilian counterparts to the arsenal-like, government-oriented corporations in the military sphere? The actual extent to which Federal control and influence are exercised varies substantially both by program and region, but the cumulative effect is quite substantial.[1]

Indeed, my conclusion was hardly unique and is generally shared by those who have worked with or studied grant-in-aid programs. The real challenge, of course, is to come up with alternatives superior to the status quo. And here I must frankly state that most of the alternatives to revenue sharing that have been suggested recently are not new; in fact, they are precisely the ones that we had considered and, after careful examination, had to reject.

It was clear to us that further direct Federal assumption of local program responsibility or greater expansion of the categorical grant-in-aid system would fundamentally be futile in dealing with the underlying problems facing our State and local governments. To pump

[1] M. L. Weidenbaum, "The Modern Public Sector," New York, Basic Books, Inc., 1969, p. 15.

substantially more Federal dollars into the proliferating maze of narrow programs represents merely a reecho of that tired and ineffective response.

Furthermore, this extremely expensive suggestion is now being made by those who have questioned where we will get the money for revenue sharing; the inconsistency in their argument is striking, even though perhaps unintentional. Let us not forget that the overwhelming need is to strengthen, and not to weaken further, the ability of State and local governments to respond effectively to the urgent needs of our times.

Similarly, Federal tax credits for State and local income tax payments may seem like an easy response to this difficult question, but they do not hold up under examination as an effective device for bolstering the financial resources of State and local governments. Although no Federal funds would go directly to State or local governments, Federal revenues would be reduced immediately.

Incidentally, I find that there is great ignorance as to how a tax credit works. Nobody is suggesting a 100-percent credit for State and local income taxes against a person's Federal tax liability—for that would almost amount to a blank check on the Treasury. On the other hand, those who suggest a credit as low as 10 percent apparently do not understand the Federal tax system. Many taxpayers would be better off by merely taking the existing deduction for State and local taxes.

In any event, our hard-pressed States and localities would only benefit to the extent that a credit toward the Federal income tax softens taxpayer resistance and thus enables State and local governments to institute or raise income taxes above the levels otherwise politically acceptable. Let me be clear. I do not consider tax credits to be an evil thing. Rather, dollar for dollar, I believe that revenue sharing will be more effective in channeling financial resources to our States, cities, and counties. Clearly, a Federal credit for State and local income taxes will do little to help local governments who derive the bulk of their revenues from the property tax. At best, the benefits would be distributed in an uneven, hit-and-miss fashion.

In contrast, I make no claim that our revenue-sharing proposal is even close to perfect. I do state that it was very painstakingly developed. Many, many man-months of time and effort went into its design. The details were carefully worked out with knowledgeable representatives of Federal, State, and local governments, with private citizens, and with Democrats, Republicans, and independents. In both concept and detail, I believe that you will find it truly a thoughtful and nonpartisan plan offered in good faith.

Hence, I have been very pleased at the overall favorable and often enthusiastic response to our revenue-sharing proposal. Yet, I must confess a sense of dismay at the nature of some of the specific reactions. I am deeply concerned over the kind of intellectual environment in which there is a ready desire to believe the worst and a strong reluctance to accept facts demonstrating the contrary. My case in point is the role of the central cities in revenue sharing.

We have repeatedly shown that the central city tends to get a larger share—not just a larger total share but a larger per capita share—than suburban communities. That is true in each and every one of the 25 largest metropolitan areas in this Nation. Yet, I still see or hear the inaccurate charge that the administration's revenue-sharing proposal funnels the bulk of the money away from the central cities. There seems almost to be a Gresham's law operating here—bad information drives out good.

Let me once again try to explain as objectively as I can how this works. The sole factor determining the allocation of general revenue sharing among the cities and counties of a given State is the respective jurisdiction's share of the revenues raised by all cities and counties in the State. That is the fact. And, as it turns out, time and time again, the larger the city, the larger the per capita revenues it raises, and hence, the larger the per capita share of revenue sharing that it will receive. The Census Bureau statistics bear this out clearly.

This should not be surprising in view of the valiant efforts made by so many of this Nation's localities to deal with the problems facing them. The reductions in Federal income taxes that we have been experiencing are in striking contrast to the many, many increases of State and local income, sales and property taxes that have occurred in recent years.

Again, I urge the members of this distinguished committee to examine the question of revenue sharing from the point of view of how to best alleviate the financial crisis now facing so many of our State and local governments. As you may have heard, some have suggested that they would like to respond to this real problem but they are reluctant to breach the alleged principle of avoiding the separation of the taxing power from the spending power.

Now I thought I was the college professor who would come up with the theoretical arguments instead of the other way around. Certainly it is an interesting juxtaposition of roles. In any event, the $30 billion of Federal grants-in-aid this year surely represent a massive breach of that principle—a principle which, by the way, I do not recall in any political science treaties. What we are really talking about—the significant distinction between revenue sharing and the current aid system—is the delegation of power and decisionmaking. Given the gravity of the situation, I do not hesitate to approach what is certainly the most powerful legislative body in the world and suggest that $5 billion out of a $229 billion Federal budget be allocated for State and local decisionmaking. Perhaps I need to cite that earlier principle—noblesse oblige.

For the use of this committee, I have attached to my statement a detailed description of the general revenue-sharing proposal. I would now just like to emphasize three basic points.

1. We propose that a modest portion of the annual growth in Federal revenues be earmarked for general aid to State and local governments. These funds would come from the automatic expansion in budget receipts as the economy grows. Contrary to many inaccurate reports, the $5 billion program of general revenue sharing would neither require a rise in the tax rates nor a reduction in any existing Government programs.

2. The revenue-sharing money would be distributed to each State, city, and county in as fair and equitable manner as we have been able to devise. The allocation would be made according to the precise formulas contained in the Federal statute rather than be subject to the discretion of any executive branch official. As the money would be in addition to existing programs, each State, city, and county

would benefit, and benefit directly; each would receive revenue-sharing money in addition to any benefits, services, or money it is now obtaining from the Federal Government.

3. The States, cities, and counties receiving the money would make the decisions as to which purposes the funds should be directed. The Federal Government would not second-guess the local determination of local priorities. Financial reporting to the Treasury would be required simply to assure that the money was spent for a lawful governmental purpose and in a non-discriminatory manner. The local voters, rather than any Federal official, would review the wisdom and effectiveness of the expenditures.

There is another, perhaps more fundamental reason for my concentrating on the basic structure of our general revenue-sharing proposal, rather than on the specific details. In the 2 years that the administration has been working on this program, we have been meeting with a great number of people at all levels of government and throughout the private sector as well. The general revenue-sharing bill that has been introduced this month reflects in good measure many of the suggestions and ideas that we have received.

Surely, any comparison of the current bill with the one introduced in the previous Congress will demonstrate not merely our intent to listen but our willingness to take account of the suggestions and constructive criticism that we have received. It is in that spirit that I urge the members of this committee to examine the plan for sharing a portion of Federal revenues with State and local governments.

May I also urge that we not overlook the very broad and substantial area of agreement that has been achieved. For example, I am delighted to point out that the revenue-sharing bill introduced by my very distinguished fellow panelists—Senator Humphrey and Congressman Reuss—is consistent with our bill in so many important, vital, fundamental particulars.

To sum up, after the most careful examination, we believe that revenue sharing is a constructive, highly desirable method for strengthening our hard-pressed State and local governments and that it is the most appropriate mechanism available. I should add that in the studies we have performed, criteria very similar to the ones stated by the chairman at the outset of the hearing were used. In fact, the attachment to my statement and some of the work done since then have used very similar criteria such as income distribution, economic stability, efficiency, and equity. I think these are an excellent set of criteria and I believe that revenue sharing compared with the alternatives does rank extremely high.

Let me assure you that this administration has been and will continue to make a high-priority effort for the revenue-sharing program. We earnestly hope that you will join us in that bipartisan high-purpose venture.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Weidenbaum.

(The detailed description of the general revenue-sharing proposal, referred to in Mr. Weidenbaum's statement, follows:)

Highlights of REVENUE SHARING

REFORM
RENEWAL FOR THE 70's

CONTENTS

INTRODUCTION

Revenue sharing is the cornerstone of the President's plan to revitalize the American system of government. The plan for General and Special Revenue Sharing will provide State and local governments with an annual total of $16 billion in more flexible funds. Nearly $6 billion will be **new** money—above and beyond what the States and localities are now receiving. The plan will:

- Alleviate the fiscal problems of State and local governments by providing unrestricted additional revenues;
- Eliminate the present matching requirements and narrow purposes of categorical grants-in-aid which will be absorbed into the new Special Revenue Sharing funds;
- Allow more spending priorities to be set at those levels of government closest to the problems and the people;
- Reinforce both the responsibility and responsiveness of government, by providing State and local officials with both the flexibility and the funds to carry out their duties effectively.

State and local governments are facing a fiscal crisis today. We can no longer avoid this fact. The crisis exists here and now—and must be met head on.

WHY IS REVENUE SHARING ONE OF PRESIDENT NIXON'S SIX GREAT GOALS?

The principle behind President Nixon's program to revitalize the American system of government is that, given sufficient resources, our States and localities can be more responsive to the needs of the people and more responsible in the exercise of power than can the Federal Government in Washington. The cornerstone of this program is the President's proposal for giving broader and less conditional forms of financial assistance to State and local governments.

Revenue sharing is a proposal to reverse the trend by which the Federal Government's awesome revenue-raising powers have given rise to an awesome, centralized government bureaucracy. Its goal is to restore a proper balance to our Federal system. This program recognizes that growing demands for State and local services have far outstripped the State and local resources, despite their efforts to match income to expenditures. It recognizes that the assistance which the Federal Government has long granted to State and local jurisdictions has been given in a highly restrictive manner which has hamstrung the development of healthy government in a healthy community. Revenue sharing will help change this situation and restore initiative, creativity and citizen involvement in government closer to the people.

The alternative to revenue sharing is not a smaller Federal deficit. The alternative is higher levels of Federal spending for the same old programs which so often are ineffective.

The President's proposal calls for two major initiatives to help insure State and local governments the flexibility and the means to meet the challenges of modern America. They are General Revenue Sharing, the granting of unencumbered funds for State and local use, and Special Revenue Sharing, providing State and localities with broad flexibility for spending funds within areas of stipulated national concern.

This is a program for a progressive America. It is timely, urgent and essential. In the words of President Nixon in his State of the Union message,

> "The time has come for a new partnership between the Federal Government and the States and localities—

a partnership in which we entrust the States and localities with a larger share of the Nation's responsibilities, and in which we share our Federal revenues with them so that they can meet those responsibilities. . . .

"So let us put the money where the needs are. And let us put the power to spend it where the people are. . . .

"I have faith in people. I trust the judgment of people. Let us give the people of America a chance, a bigger voice in deciding for themselves those questions that so greatly affect their lives."

HOW WILL REVENUE SHARING BRING GOVERNMENT CLOSER TO THE PEOPLE?

Our great virtue—and our failing—in Washington is that we have the compulsion to treat everybody exactly the same way. Broadly speaking, money flows out in massively detailed categories with all the regulations exactly the same way all over the country. At the same time, there is great **diversity** in the nature of problems across the country—and even within a given State.

The problems of Chicago are very different from the problems of Carbondale. The problems of New York City are different from the problems of Syracuse. If we loosen the constraints on Federal money and provide more of it to the localities to spend as they see fit, then the people have a chance to use the money in a manner that fits their needs.

However, the advantages of revenue sharing go a great deal further than that. We all feel much better and much more confident, we commit more energy and have much more zest to make things work, when we have worked things out for ourselves. Then we are not doing something because we are told to do it, but

59-591 O - 71 - pt. 2 - 2

because we decided for ourselves that it was a good idea. When an achievement is made, we can say that this is **our** achievement, not the achievement of some distant manager.

Some have asked whether local governments can spend shared revenues intelligently. While that is a familiar question around Washington, it is not so familiar around the country for it simply does not fit the experience of most people on the local level.

George Shultz, the Director of the Office of Management and Budget, put it this way after a tour of factories in all parts of the Nation:

> "The thing that has struck me is that, when you say to the worker on the lathe, 'we want your ideas about how the work place should be arranged, how it can be made more productive, how it can be made more suitable, and how the company can prosper more,' you turn up all kinds of people who were not thought of as having any ideas. . . . Lo and behold, they have ideas, they have energy, they have capacity that the management never gave them credit for."

If we can only get the people of America to take a greater interest in local government, then the tremendous energy and intelligence of our people will make revenue sharing a great success.

WHAT IS THE PURPOSE OF GENERAL REVENUE SHARING?

The primary purpose of sharing Federal revenues with State and local governments is to alleviate the present fiscal crisis at the State and local level.

State and local expenditures have increased faster than their own tax revenues—15 percent faster during the last two decades. These governments rely mainly on property and consumer taxes, which generate revenues that do not grow as fast as the economy. New taxes and substantial increases in rates for old taxes have therefore been necessary to raise the required revenues. State and local governments debt has also risen rapidly—from $19 billion in 1948 to $135 billion in 1969. During the last two decades, new taxes or rate increases have driven State and local taxes from $105 to $380 per capita.

As a result of all these forces, States and localities face an estimated revenue gap of $10 billion in 1971, despite increasing Federal assistance and despite more than 450 major tax increases which have been adopted in the past dozen years by State governments alone.

The General Revenue Sharing proposal provides a simple solution to this problem. In sharp contrast to the growth pattern of State and local tax revenues, Federal Government revenues respond quickly to economic growth, increasing almost 1½ percent for each 1 percent increase in gross national product.

The size of the General Revenue Sharing program will be determined by taking a fixed percentage (1.3%) of the Federal individual income tax base. Initially this will provide a full-year outlay of $5 billion. This sum will grow with the future growth of the economy.

WHAT IS THE PURPOSE OF SPECIAL REVENUE SHARING?

The Federal Government has already responded impressively to the fiscal problems of the State and local governments. Federal aid has risen from $1.8 billion in 1948 to $30 billion in 1971—primarily in the form of narrowly-focused categorical grants. It is evident, however, that assistance in this form has not given State and local governments the kind of help they really need.

Highly restricted forms of Federal assistance have had a profound effect on the nature and structure of American government at all levels. This approach has produced a welter of specific narrow programs which are poorly coordinated and are often in conflict. It has meant a great deal of program delay and uncertainty. Most seriously, it has resulted in erosion in the authority and responsibility of Governors and Mayors. It has overcentralized decisionmaking and created nearly autonomous governmental bureaucracies, especially at the Federal level.

Special Revenue Sharing is designed to reverse these trends. The Special Revenue Sharing proposal recognizes there are broad areas of national concern where States and localities should be allowed the freedom to solve pressing problems in their own way. Under this program, the Federal Government will determine the general purpose of the funds while allowing State and local officials considerably more latitude in deciding how to achieve these purposes.

Special Revenue Sharing will take narrow categorical grant programs and replace them with new grants which are far less restricted. In place of 130 separate grant programs, $11 billion of shared revenues will be grouped under six broad headings and the State and local governments will be permitted to spend them as they see fit provided they stay within the assigned purposes.

State or local governments then can decide for themselves whether or not specific activities carried on under the categorical grant programs should be continued. Thus no present program deemed desirable at the local level need be terminated; in fact it can be greatly expanded with shared revenues. Furthermore, no State or community will receive less under revenue sharing than under the existing categorical grant programs. The Special Revenue Sharing fund is in fact $1 billion bigger than the sum of the old programs folded into it; this extra $1 billion will be used to hold each local community harmless against the possibility that new revenues might not equal the old ones. It should also be noted that existing Federal programs **not** folded into revenue sharing will **not** be cut back to provide revenue sharing funds.

Sources of Special Revenue-Sharing Funds

RURAL COMMUNITY DEVELOPMENT

- Extension Service—Extension programs for assisting in community development
- Extension Service—Extension programs for forestry production and marketing
- Extension Service—Extension programs for improved family living
- Extension Service—Extension programs for improved nutrition
- Extension Service—Extension programs for improved farm income
- Extension Service—Extension programs for marketing and distribution
- Extension Service—Extension programs for pesticides safety and rural civil defense
- Extension Service—Extension programs for recreation, wildlife, and natural beauty
- Extension Service—Extension programs for soil and water conservation
- Extension Service—4-H youth development programs
- Rural Environmental Assistance (formerly Agri. Conservation Program)
- Rural Water and Waste Disposal Facilities
- Forest Service Grants for Forestry Assistance—State and private forestry cooperation
- Great Plains Conservation Program
- Water Bank Program
- Resource Conservation and Development Program
- Tree Planting Assistance—State and private forestry cooperation
- Regional development programs—Coastal Plains Reg. Comm.
- Regional development programs—Four Corners Reg. Comm.
- Regional development programs—New England Reg. Comm.
- Regional development programs—Ozarks Regional Comm.
- Eco. Dev.—Development facilities (Public Works) Grants
- Eco. Dev.—Development facilities (Public Works) Loans
- Eco. Dev.—Industrial development—Loans
- Eco. Dev.—Planning assistance
- Eco. Dev.—Technical assistance
- Eco. Dev.—Operations and administration
- Eco. Dev.—Miscellaneous expired accounts
- Eco. Dev.—Economic development revolving fund
- Appalachian Reg. Comm.—Supplements to Federal grant-in-aid
- Appalachian Reg. Comm.—Development highway system
- Appalachian Reg. Comm.—Health demonstrations
- Appalachian Reg. Comm.—Land stabilization, conservation, and erosion control
- Appalachian Reg. Comm.—Local access roads
- Appalachian Reg. Comm.—Local development district assistance
- Appalachian Reg. Comm.—Mine area restoration
- Appalachian Reg. Comm.—State research, technical assistance—demonstration
- Appalachian Reg. Comm.—Vocational education facilities
- Appalachian Reg. Comm.—Salaries and Expenses

URBAN COMMUNITY DEVELOPMENT

- Urban Renewal—Projects
- Urban Renewal—Neighborhood development
- Urban Renewal—Certified areas
- Urban Renewal—Code enforcement grants
- Urban Renewal—Rehabilitation grants
- Urban Renewal—Community renewal planning grants
- Urban Renewal—Demolition grants
- Urban Renewal—Interim assistance for blighted areas grants
- Model cities—Supplementary grants
- Community development
- Grants for basic sewer and water facilities
- Rehabilitation loans

EDUCATION

- El. and Sec. Ed.—Educationally deprived children:
  - —Local educational agencies
  - —Handicapped
  - —Migrants
  - —State administration
  - —In institutions for neglected or delinquent children
  - —Incentive grants (new)
  - —Grants for concentration of disadvantaged children (new)
  - —Grants to BIA for Indian schools
- El. and Sec. Ed.—Supplementary services:
  - —Guidance, counseling, and testing
  - —Nonpublic school testing
  - —Supplementary education services and centers
- El. and Sec. Ed.—Library resources:
  - —School library resources, textbooks, and others
  - —Instructional materials
- El. and Sec. Ed.—Equipment and minor remodeling:
  - —School equipment grants to nonprofit private schools

—Strengthening instruction through equipment and minor remodeling

El. and Sec. Ed.—Strengthening State Depts. of Education:
- —Strengthening school administration training grants
- —Strengthening State Depts. of education:
  - —grants for special projects
  - —grants to States

El. and Sec. Ed.—School assistance in federally affected areas:
- —Maintenance and operation
- —Construction
- —Public housing (new)

El. and Sec. Ed.—Education of the handicapped:
- —Handicapped preschool and school programs

El. and Sec. Ed.—Vocational and adult education:
- —Basic grants to States
- —Consumer and homemaking
- —Cooperative education
- —Special needs
- —State advisory councils
- —Work study
- —Research—50 percent
- —Innovation

El. and Sec. Ed.—Department of Agriculture—Food and Nutrition Services—Child Nutrition Programs:
- —School lunch assistance
- —Non-food assistance
- —State administrative expenses

MANPOWER TRAINING

Manpower training services—Apprenticeship outreach

Manpower training services—Concentrated employment program

Manpower training services—Cooperative area manpower planning system

Manpower training services—Job banks

Manpower training services—Job corps

Manpower training services—Job opportunities in business sector

Manpower training services—Journeyman training

Manpower training services—MDTA institutional training

Manpower training services—Manpower E&D projects

Manpower training services—Manpower research, doctoral dissertation grants

Manpower training services—Manpower research—institutional grants

Manpower training services—Manpower research and evaluation

Manpower training services—Manpower research project grants

Manpower training services—Neighborhood youth corps

Manpower training services—Operation Mainstream

Manpower training services—Public service careers

Manpower training services—JOBS—low support

LAW ENFORCEMENT

Law Enforcement Assistance Administration:
- Grants for improving and strengthening law enforcement
- Discretionary grants

TRANSPORTATION

UMTA—Urban mass transporation fund:
- —Capital grants
- —Technical studies
- —University research and training

FAA—Grants-in-aid for airports (general fund)

FAA—Grants-in-aid for airports (trust fund):
- —Planning grants
- —Air carrier airport
- —General aviation grants

FHWA—Federal aid highways (trust fund):
- —Excludes Interstate system, interstate portion of grants for planning and research and the Interstate portion of Admin. research and bridges over dams
- —Primary highways
- —Secondary highways
- —Urban extension highways
- —Urban systems
- —TOPICS (traffic operations in urban areas)
- —Rural primary (special)
- —Rural secondary (special)
- —Emergency relief
- —Economic growth center highways
- —Bridge replacement
- —Highway safety grants
- —Planning and research grants and administration

FHWA—Highway Beautification (general fund):
- —Outdoor advertising control
- —Junkyard and control
- —Landscaping scenic enhancement
- —Administrative expenses

FHWA—Highway related safety grants

NHTSA—State and community highway safety (general fund)

NHTSA—Highway safety program—grants portion only (trust fund)

WILL STATE AND LOCAL GOVERNMENTS BE IMPROVED?

In order to increase the capacity of State and local governments to manage their own affairs and put the flexible funds provided under revenue sharing to the most effective use, the President is proposing a substantial reorientation and enlargement of the existing comprehensive planning program. The budget provides for a $100 million planning-management program which will help State and local governments to upgrade and expand their administrative capabilities. This is twice as much as was designated for this purpose in the old budget. As revenue sharing increases the responsibility of State and local governments to provide public services, it must also increase their capability to provide these services.

This program also recognizes an increased Federal responsibility to support innovative research into administrative and managerial problems which benefits the whole Nation. President Nixon's new budget would increase Federal support for:

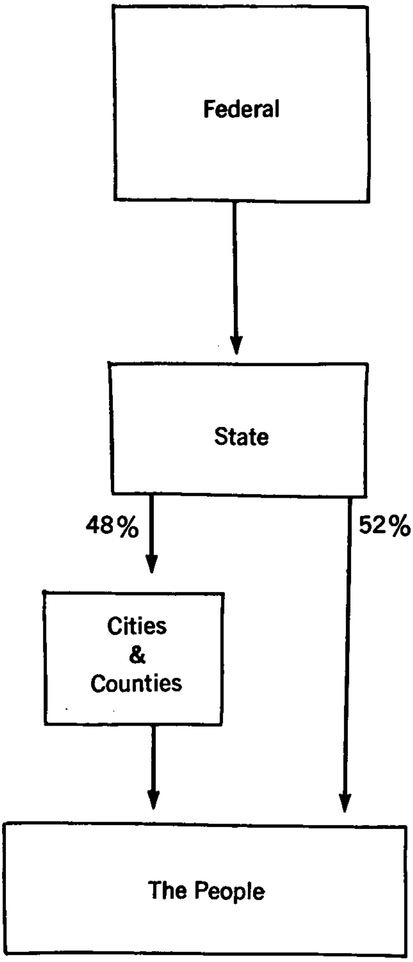
- basic research and analysis of regional and local problems;
- experiments and demonstrations of innovative ways to provide local public services; and
- the collection and distribution of information relating to these topics.

Research of this sort will help State and local governments to develop a better capacity for identifying needs, allocating resources efficiently, and strictly controlling funding. We should also remember that the best way to assure responsible government at the State and local level is by giving greater responsibility to State and local officials. The purpose of this program is to set the States and localities free to accomplish great successes which would not otherwise be realized.

WHO WILL RECEIVE THE FUNDS?

The direct recipients of shared revenues will be the general purpose units of governments: States, counties, cities and towns. Urban and rural America will share proportionately in general revenues; it will also benefit from a Special Revenue Sharing program. Furthermore, as States (and their legislatures) become more urbanized, State discretionary funds under revenue sharing will increasingly be available for dealing with urban problems.

The President's program for revenue sharing is designed to provide major benefits to the individual citizen through units of local government rather than unresponsive special districts and agencies. The individual will find his voice in government strengthened and the upward pressures on his State and local taxes reduced by a program of shared resources. The State and local governments will find their capacities to respond promptly to the changing needs of their communities enhanced. The many rigidities, requirements and delays inherent in existing Federal aid will be drastically reduced and in many cases eliminated. The Nation will be stronger because of the increased vitality of its State and local governments. Funds and functions will be better matched with each level doing what it can do best.



Average Pass-Through of Shared General Revenues

HOW WILL GENERAL REVENUE SHARING WORK?

The General Revenue Sharing fund of $5 billion (for the first year) will be distributed among the 50 States and the District of Columbia on the basis of population and "revenue effort." A State will be assigned a share of the total fund equal to its share of the Nation's population—but that sum will then be adjusted according to how well it has attempted to meet its peoples' needs through its own revenue-raising powers. A State that does an above average job on this score will have its share adjusted upward. This provision is designed to provide an incentive for States and localities to maintain and even expand their own tax effort when that is appropriate.

The distribution within a State among the State, county, municipal and township governments is not left to chance. If the governments choose, they can abide by the distribution formula prescribed in the General Revenue Sharing bill. This formula divides the fund among jurisdictions according to the portion of general revenues raised by each unit. The more revenue an individual State, municipality or county collects itself, the greater will be its share of the funds allocated.

All general purpose local governments no matter how small share in these funds. On the average, this distribution formula results in about one-half of the General Revenue Sharing total going to local governmental units.

This is the formula set-out in the President's proposal. But there will be an incentive for each State that is able to sit down with its local governments and work out its own distribution plan—one that will best suit its own particular requirements.

HOW WILL SPECIAL REVENUE SHARING WORK?

Federal funds will be allocated in special broadly defined areas of national concern, without any requirement of matching funds or maintenance of effort. This will end our current practice of badly distorting State and local budgets by forcing them to spend not just the Federal funds but local funds as well on needs which are determined in Washington.

Special Revenue Sharing, as a new term, requires careful definition. It is "revenue sharing" in that funds are provided automatically by formula, with the recipients given wide latitude in the use of these funds to suit their own particular problems and needs.

It is "special" in that the focus is on a special area of governmental activity—education, manpower, transportation and the like. This feature contrasts with "General" Revenue Sharing, which is available for **all** governmental purposes of the recipient jurisdictions.

Special Revenue Sharing funds will be distributed in various ways, depending upon what is appropriate in each broad program area. Existing programs which have been selected for conversion to Special Revenue Sharing are programs that deal with problems which are of high priority to the Nation but which are solved best at the State and local level.

One such program, **Law Enforcement Assistance,** is already in existence—another, for **Manpower Training,** is fully developed and will be resubmitted to the Congress. Four new Special Revenue Sharing programs—for Urban Community Development, Rural Community Development, Transportation, and Education—will be added in 1972. Ten billion dollars in resources for these six programs will come from converting some of the narrower categorical grants that exist at present, but additional new funds in the amount of $1 billion are also requested for Special Revenue Sharing use. The funds will be distributed in various ways according to formulas which are appropriate for each broad program area. It is important to stress the procedural flexibility of this new instrument.

The **Urban Community Development** program will directly reflect the Federal interest in the problems of our Nation's cities. But it will allow local officials to design solutions to their own unique problems.

The **Rural Community Development** program will represent a similar Special Revenue Sharing program to develop our Nation's rural communities in ways that are determined by their State and local governments.

The new **Education** program will draw together over 100 overlapping and contradictory program authorizations into a new Special Revenue Sharing program for elementary and secondary education. This program will provide support for educational activities in broad areas where the Federal Government has developed a strong interest in strengthening school programs over the years. These include vocational education, assistance to schools in areas affected by Federal activities, compensatory education for the disadvantaged, education of children afflicted by handicapping conditions, and general support. At the same time, the States would have full discretion as to **how** they would accomplish each of these major purposes.

The **Transportation** program will involve a Special Revenue Sharing fund which will be used to develop balanced transportation systems for urban and rural areas. Funding for the Interstate Highway System will remain Federal and will not be included in the Special Revenue Sharing program. Funds for the new transportation program will come primarily from converting existing DOT programs for other highways, beautification, urban mass transit, and airport planning and development.

WHAT RESTRICTIONS WILL BE PLACED ON THE USE OF SHARED REVENUES?

Of course, revenue sharing cannot and will not be the vehicle for any weakening of the Federal responsibility to insure equal treatment and opportunities for all. The President's revenue sharing proposal will include the same safeguards against discrimination which now accompany all other Federal funds allocated to the States.

In the case of noncompliance under General Revenue Sharing by a local government, the Secretary of the Treasury must first seek to have the State secure compliance. If the State fails or refuses to secure compliance, the Secretary may either refer the matter to the Attorney General or proceed by Title VI of the Civil Rights Act to administratively cut-off funds.

The details of the compliance procedures will be spelled out in rules and regulations established by the Secretary of the Treasury—they will include appropriate accounting requirements, the organizational arrangements for administering this responsibility, the reporting procedures that will have to be carried out by the States and localities to enable the Federal oversight and compliance activities to proceed effectively, along with timetables for plans, reports, and compliance actions.

There will be no matching nor maintenance of effort requirements under this program. This will mean that States and localities will be released from the straight-jacket in which current grants often place them.

The General Revenue Sharing proposal calls for no program or project "strings" attached to the use of the funds. Under Special Revenue Sharing, the only constraint is that funds must be spent for the broad purposes of the program. Federal review of funded projects and programs will be limited to this determination.

Program reporting will occur after—not before—funds are disbursed. Data will be collected for two uses: (1) compliance purposes (i.e., to protect against fraud and discrimination); and (2) to provide the Congress and the executive branch with needed information for analyzing program impact and making future decisions about the appropriate levels of aid.

WHAT IMPACT WILL REVENUE SHARING HAVE ON THE AVERAGE CITY?

Revenue sharing will have an impact on the day-to-day lives of all Americans. Too often, we find it difficult to translate nationwide programs and policies into terms which have meaning for individual citizens. In an attempt to overcome this problem, we have traced the influence of revenue sharing on a fictitious, but typical, American community, "Centerville." It is a city of almost 70,000 people situated in a metropolitan area with a population of less than 150,000. It is located in an average-size State of slightly more than 4 million people.

Like most American communities, Centerville has a limited selection of revenue sources. Property tax receipts make up the lion's share of tax revenues in the city, accounting for $4.7 million of the city's total revenues of $10.3 million. Aid from the State constitutes the next largest source of funds, accounting for over one-fifth of the total. Centerville also relies on a 1-percent sales tax which it has levied on top of the State sales tax of 4 percent, and on other charges for local services to its citizens. This combination of the sales tax, charges, and other miscellaneous income accounts for nearly another fifth of local revenues.

Centerville faces what might be termed a "scissors crisis"—caught between revenue sources that do not grow as fast as prices, and the rapidly escalating cost of services. The Mayor of Centerville promised to avoid yet another increase in the seemingly endless chain of property tax rates for the coming year. Yet he is faced with increased demands for new facilities and services (particularly sewer lines) in the growing areas on the outskirts of the city, redevelopment of the blighted downtown area, and better police protection and lighting in the older sections of the city to combat rising crime. Moreover, the city's school system is faced with the need to raise teachers' salaries to stay competitive with neighboring school districts, and is confronted with an emerging problem of drug abuse in the two local high schools.

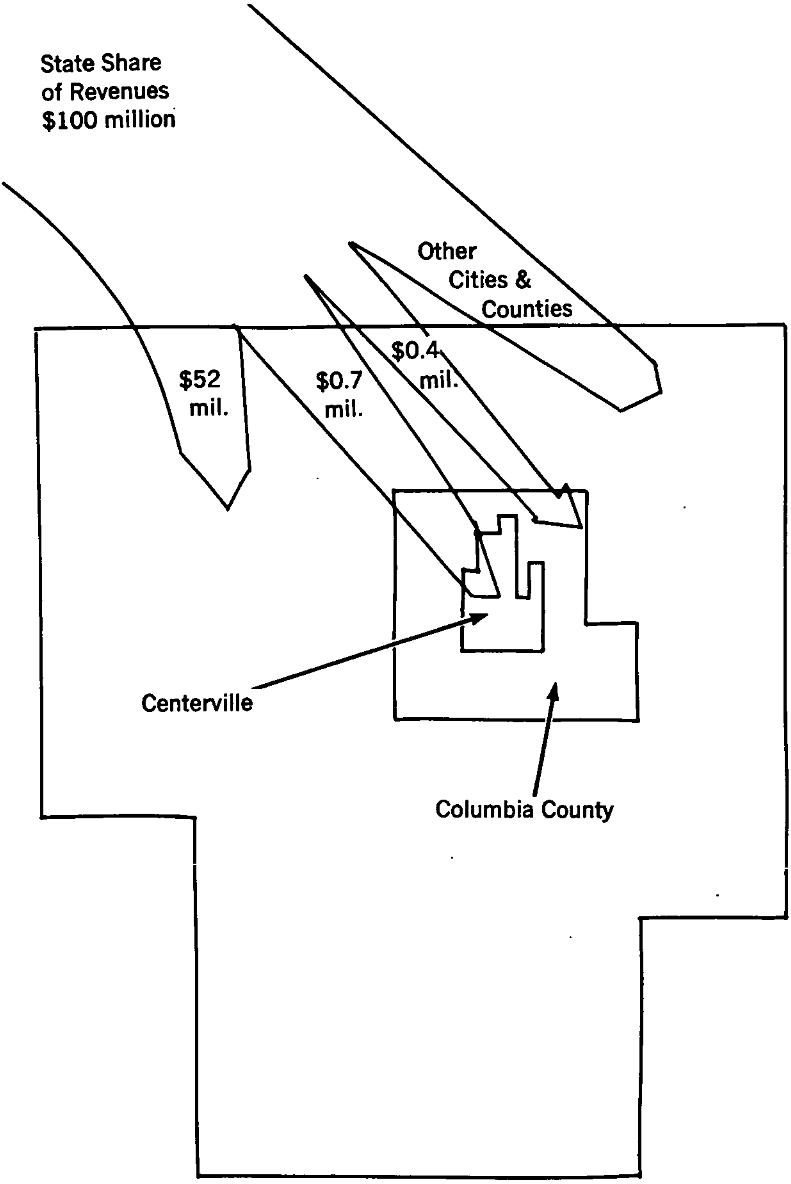
Impact of General Revenue Sharing

The enactment of the large, new General Revenue Sharing program by the Federal Government raises hopes that some of these service needs can be met without increasing taxes still further, although the Mayor is intent upon making the maximum effort with other revenue sources available to him.

The first Federal grant is made to the State. Based on the State population of 4 million people and an average level of revenue effort, the State receives a grant of $100 million. Since the State government raises almost 52 percent of all revenues raised in the State (including those at the local level), the State retains $52 million to use at its own discretion. (It is rumored that the Governor wants to set up a new system of community colleges in the State with the new, regularly-recurring revenue sharing funds; one of the first communities in line will be Centerville.)

The remaining $48 million of the General Revenue Sharing money is divided according to the revenues raised by all cities, counties, and townships in the State. Centerville receives a grant of $682,500—an increase of nearly 7 percent of its annual budget. This amount will be large enough to address many of the problems identified by the Mayor and the City Council for the year ahead. For example, it might provide all of the following:

- A 10-percent increase in police and firemen's salaries and an improved recruit training program;
- A $200,000 supplement to special Community Development revenue sharing funds to start separating storm drains from sanitary sewers in an effort to prevent further pollution of the Centerville River;
- A special experimental program for keeping low-income youth in school—in close cooperation with the city school systems;
- The launching by the city health department of a new family planning project in conjunction with the local



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office of Planned Parenthood;

- A concerted effort to clean up three small lakes and surrounding parks in the city—once heavily utilized by picnickers, fishermen, and hikers—but now badly polluted and a growing eyesore; and,
- The hiring of five additional aides in the City Department of Administration—jointly financed by funds from the new Planning-Management grant—to improve long-range fiscal planning, physical development planning, and the coordination of City Council policies.

Centerville will also benefit indirectly from the revenue sharing funds of more than $405,000 slated for the surrounding Columbia County. The county's share will approach 6 percent of its total budget, and will meet the 27-percent increase in welfare caseload that occurred during the year without requiring an additional increase in the county property tax. The county is also looking forward to an equivalent degree of relief from its mounting welfare costs which the enactment of Welfare Reform would promise beginning in fiscal year 1973.

In addition, the county hopes to provide:

- A new drug education program in cooperation with the city's school system and the county hospital (at $100,000); and
- Improvements in highways and traffic control systems in the middle of Centerville.

Impact of Special Revenue Sharing

Centerville also expects to reap the benefits of the new Special Revenue Sharing grants enacted during the year. There would be considerably more opportunity for local initiatives, without the cumbersome, time-consuming applications and waiting which had become so typical of Federal and State assistance programs in the past. Centerville plans to use each of the Special Revenue Sharing grants to undertake more flexible approaches to its problems:

- In **elementary and secondary education,** the city's school district plans to concentrate its discretionary resources on meeting the special educational needs of the poor and handicapped, especially during the first years of elementary school. One of the first steps will be to improve the teaching of reading.

- In **transportation,** the city-owned busline has been in the doldrums and the new Special Revenue Sharing grant for transportation would permit the purchase of new minibuses. These new buses will provide more frequent service—while at the same time allowing the city to experiment with new, lower bus fares to stimulate an increase in riders.

- In **community development,** Centerville plans to start revitalizing a four-block area in the heart of the city, involving the rehabilitation of several historic buildings and the upgrading of older rental and owner-occupied housing in the surrounding six-block area.

- In **law enforcement,** the city expects to allocate much of its Special Revenue Sharing money to the improvement of police-youth relationships and to streamlined juvenile court procedures.

- In **manpower training,** Centerville and Columbia County jointly will sponsor a broad program of work and training services for the area's unemployed and low-income workers to enable them to obtain meaningful and well-paid jobs. Centerville will also provide on-the-job training for 50 unemployed workers to fill vacancies in the city's expanding sanitation and parks department.

Centerville's problems are by no means over. There will be future cost increases. There will be additional requirements for new and better services. There will be further pressure on the property tax and on other levies. But the city will at least begin to overcome some of its service backlog. It will be able to start planning for future development in an effective and comprehensive manner.

Perhaps equally important, the citizens of Centerville will be able to take new pride in the new beginnings which their community will be able to make and in the fact that they will be able to participate directly in mapping the direction of its growth and future progress.

CONCLUSION

Revenue sharing will mean a great deal for our entire Nation.

- For our Federal system, revenue sharing will provide new strength by assigning services to the level of government best equipped to perform them;
- For the individual taxpayer, it will provide a stronger voice in how his tax money is spent locally, a new confidence in government as a result of more "citizen control," and the hope that the rising cost of government can be met without raising taxes;
- For the State and local governments, it will provide relief from the current financial crisis, will wipe out the rigidities and delays in Federal aid, and will build a new capacity to respond to local needs;
- For all our people, revenue sharing will provide a means of encouraging local diversity and experimentation within the framework of great national purposes.

This giant step—revenue sharing—is a central part of the administration's philosophy of involving people more actively in the decisions that affect their lives. The magnitude of the problem calls for a bold move; by acting decisively and without delay, we will strengthen our Federal system and fulfill the needs of our people.

FEBRUARY 10, 1970

APPENDIX A

State Receipts Under General Revenue Sharing

The following table shows estimates of the money which each State would receive during the first full year under the President's new General Revenue Sharing Plan.

	STATE TOTAL (millions)
Alabama	$82.0
Alaska	8.5
Arizona	51.5
Arkansas	43.0
California	590.0
Colorado	60.0
Connecticut	59.0
Delaware	13.5
D. C.	23.0
Florida	167.5
Georgia	107.5
Hawaii	23.5
Idaho	20.0
Illinois	220.0
Indiana	116.0
Iowa	74.5
Kansas	54.0
Kentucky	78.0
Louisiana	101.5
Maine	23.0
Maryland	92.5
Massachusetts	136.0
Michigan	229.0
Minnesota	107.5
Mississippi	61.5
Missouri	96.5
Montana	19.0
Nebraska	$39.0
Nevada	14.0
New Hampshire	15.0
New Jersey	154.0
New Mexico	32.0
New York	534.0
North Carolina	113.5
North Dakota	20.5
Ohio	212.5
Oklahoma	63.5
Oregon	57.0
Pennsylvania	246.0
Rhode Island	21.0
South Carolina	56.5
South Dakota	19.0
Tennessee	87.0
Texas	243.0
Utah	28.5
Vermont	12.0
Virginia	104.5
Washington	92.0
West Virginia	41.5
Wisconsin	124.5
Wyoming	11.5
United States	5,000.0

APPENDIX B

Details of the Special Revenue Sharing Programs

URBAN COMMUNITY DEVELOPMENT.—The 1972 budget proposes a substantial special revenue sharing program for community development in urban areas. It recognizes the Federal Government's responsibility to provide funds to deal with the problems of our cities in an amount which more than matches that previously made available for this purpose through categorical grants. It also recognizes that the form of these problems varies significantly from city to city, and that local officials familiar with the individual cities are in the best position to frame solutions to them.

The sources of funds for this special revenue sharing program are displayed in the following table. It is further proposed that the support of community action agencies (CAA's) be incorporated in the Urban Community Development program of special revenue sharing on a basis which allows CAA's a needed and appropriate transition period to full local control by January 1, 1973.

[In millions]

Description	Budget authority	Outlays
Items included in budget details for 1972:		
Department of Housing and Urban Development:		
Urban renewal	[1] $800	$1,300
Model Cities grants	[2] 70	450
Community development (special revenue sharing)	1,000	150
Grants for basic water and sewer facilities	[2] 100	170
Rehabilitation loans	[3] 50	36
Total, full-year basis and fiscal year 1972	2,020	2,106

[1] Estimated reservations financed by 1971 budget authority of $200 million and 1972 budget authority of $600 million.
[2] Estimated commitments financed by 1971 budget authority.
[3] Estimated reservations financed by 1972 budget authority and repayments.

RURAL COMMUNITY DEVELOPMENT.—Similarly, a special revenue sharing fund of $1 billion would be available to develop our Nation's rural communities as determined by their responsible State and local governments. This fund would replace a set of present, unnecessarily restrictive, categorical grants and other cost-sharing arrangements directed toward this same general purpose.

There is a high degree of variation among geographic regions of the country in the character of rural migration and the economic and social conditions of rural America. Under this new program, funds will be distributed to States for use in rural areas. The development projects appropriate for each community will be determined by State and local governments according to the needs of that community. Through this combination of special revenue sharing, local initiative, and local decisionmaking, rural areas can strengthen rural enterprise, increase economic opportunities for rural residents, and improve rural communities.

The table below shows the existing programs and new money which will make up the rural community special revenue sharing program. Rural community action agencies will be handled in the same way as their urban counterparts.

[In millions]

Description	Budget authority	Outlays
Items included in budget details for 1972:		
Department of Agriculture:		
Extension service	$149	$149
Rural environmental assistance (formerly agricultural conservation) program	140	150
Rural water and waste disposal facilities (grants)	[1] 42	61
Forest Service grants for forestry assistance	21	21
Great Plains conservation program	11	11
Water bank program	10	10
Resource conservation and development program (grants)	4	4
Tree planting assistance	1	1
Department of Commerce:		
Regional development programs (except Indians)	38	21
Economic development assistance (except Indians)	227	214
Appalachian Regional Commission	278	290
Subtotal	921	932
Additional amounts from general revenues:		
Full-year basis	79	43
Fiscal year 1972	(41)	(22)
Total, full-year basis	1,000	975
Total, fiscal year 1972	962	954

[1] Estimated obligations financed by 1971 budget authority.

Note.—Because of the special Federal relationship with American Indians, special provisions will be made for them.

ELEMENTARY AND SECONDARY EDUCATION.—More than any other Federal activity, the school-aid programs of the Office of Education reflect the excesses of the categorical grant system. The present 75 titles or authorities result in over 100 separate grant programs. The maze of set-asides, special conditions, priorities, plans, and approvals for these grants is bewildering to States and local school districts alike. It leads to a condition in which full-time coordinators must be appointed in order to maintain and obtain information about Federal aid. Federal aid is often provided for needs and purposes which have already been addressed by State legislation, yet the States are unable to transfer or convert the funds to other purposes that are going unserved. While these statutes routinely purport to prohibit Federal "control" of education, they surely impede local control. Bookkeeping requirements and "grantmanship" distract educators from the content and purpose of their important responsibilities to schoolchildren and to the public.

The administration proposes to draw together this wide array of overlapping and contradictory authorizations into a new special revenue sharing program for elementary and secondary education. This program will provide support for educational activities in broad areas where the Federal Government has developed strong interests in strengthening school programs over the years. These include vocational education, assistance to schools in areas affected by Federal activities, compensatory education for the disadvantaged, education of children afflicted by handicapping conditions, and general support. At the same time, the States would have discretion as to **how** they would accomplish each of these major purposes.

The table below shows the sources of funds for this program:

[In millions]

Description	Budget authority	Outlays
Items included in budget details for 1972:		
Department of Agriculture:		
School lunch program (excluding assistance for needy children)	$175	$171
Nonfood assistance (cafeteria equipment)	16	16
State administrative expenses	2	1
Department of Health, Education, and Welfare:		
School assistance in federally affected areas	440	487
Elementary and secondary education:		
Title I—educationally deprived children	1,500	1,440
Title II—library services	80	73
Title III—supplementary services	143	142
Equipmentt and minor remodeling		39
Strengthening State agencies	33	27
Education for the handicapped	35	34
Vocational education	384	382
Subtotal	2,808	2,812
Additional amounts from general revenues:		
Full-year basis	192	188
Fiscal year 1972	(96)	(92)
Total, full-year basis	3,000	3,000
Total, fiscal year 1972	2,904	2,904

MANPOWER TRAINING.—A special revenue sharing program for manpower training expenditures by State and local governments is particularly appropriate. It is consistent with the administration's earlier proposal to reform the structure of Federal programs in this area. This is a service area in which there is a high degree of variation among geographic regions in the character of unemployment problems, in labor market conditions, and in job needs.

Under this program, funds will be distributed to State and local governments on the basis of factors such as the size of the local labor force, the incidence of unemployment, and the proportion of low-income families and individuals. State and local prime sponsors will be responsible for developing new manpower services, drawing upon existing services available from public employment offices, local educational institutions, and welfare programs.

The table below shows the amounts involved in this program:

[In millions]

Description	Budget authority	Outlays
Items included in budget details for 1972:		
Department of Labor: Manpower training services	$1,565	$1,443
Subtotal	1,565	1,443
Additional amounts from general revenues:		
Full-year basis	435	307
Fiscal year 1972	(217)	(153)
Total, full-year basis	2,000	1,750
Total, fiscal year 1972	1,782	1,596

LAW ENFORCEMENT.—The Law Enforcement Assistance Act already provides broadly defined program support to States, with a portion of the allocated funds passed through on a mandatory basis to local government law enforcement agencies. Grants may be used in accordance with determinations of appropriate State agencies for a range of law enforcement and criminal justice improvements (courts, corrections, police, juvenile delinquency prevention and rehabilitation, addict treatment, public education, and statistics on crime). Funding proposed for this program in 1972 will increase over 1971 by $108 million in budget authority and $127 million in outlays.

[In millions]

Description	Budget authority	Outlays
Items included in budget details for 1972:		
Department of Justice: Law enforcement assistance formula grants	$497	$406
Subtotal	497	406
Additional amounts from general revenues:		
Full-year basis	3	3
Fiscal year 1972	(2)	(2)
Total, full-year basis	500	409
Total, fiscal year 1972	499	408

TRANSPORTATION.—A special revenue sharing fund of $2.6 billion would be available to develop balanced transportation systems serving local urban and rural areas. State and local governments would have the responsibility for determining the allocation of these funds to achieve this objective as appropriate in each area. A pass-through provision in the sharing formula will assure that local governments receive an equitable share of this fund. Federal funding for the Interstate Highway System will be maintained separately until the completion of that program. The present categorical grants for each type of transportation have led to an inefficient combination of systems in many areas. The new transportation fund would contribute to the balanced transportation system we all need.

[In millions]

Description	Budget authority	Outlays
Items included in budget details for 1972:		
Department of Transportation:		
Urban mass transit grants	[1] $525	$260
Airport grants (planning and development)	[2] 220	147
Highway-related safety grants	10	2
State and community highway safety grants	100	61
Federal-aid highways—excluding interstate system	1,645	1,412
Highway beautification	66	30
Total, full-year basis and fiscal year 1972	2,566	1,912

[1] Estimated obligations financed by budget authority of prior years.

[2] Estimated obligations financed by budget authority of prior years and by $15 million budget authority in 1972.

Chairman PROXMIRE. Congressman Reuss, proceed in your own way.

STATEMENT OF HON. HENRY S. REUSS, A REPRESENTATIVE IN CONGRESS FROM THE FIFTH CONGRESSIONAL DISTRICT OF THE STATE OF WISCONSIN

Representative REUSS. Thank you, Mr. Chairman. As Mr. Weidenbaum has just said, revenue sharing when compared with the alternatives has much to be said for it. That was, I think, the answer given by Winston Churchill when somebody asked him how it felt to be 85. He said: "Compared to the alternative it feels fine." Unless we do something about our States and cities there are not going to be any more States and cities.

On that common ground we, Senator Humphrey and I, want to express our appreciation of your scheduling a whole morning of the Joint Economic Committee's deliberations on this very central problem of revenue sharing. Senator Humphrey and I have prepared a comprehensive prepared statement and with the Chair's consent, we would like to introduce that into the record.

Chairman PROXMIRE. Without objection, the entire prepared statement will be printed in full at the end of your oral statement.

You may proceed any way you wish.

Representative REUSS. We will proceed briefly which, taken together, will not amount to twice as much.

Chairman PROXMIRE. Proceed.

Representative REUSS. We make three points. One, if we are going to have revenue sharing we had better get some revenue to share; and two, if you are going to have revenue sharing it shouldn't be used just as a crutch to enable our archaic State and local governments to hobble along in an inefficient way but instead as a catalyst to try to make them stand up straight and walk properly; and third, and here we are being optimistic, of course, we think that there is a combination, a compromise, of revenue sharing and some other things with particular reference to Chairman Proxmire's five criteria, that would not only make an economic and socially desirable package but a package which would have some considerable chance of being approved by this Congress.

First, he who wants to share revenues has got to answer the question: Where are we going to get the revenues to share? We were supposed to get them from the peace and growth dividend. But there is no peace and there has been no growth. We are now fighting not a one-front war but a three-front war. Last year was the first year in almost a generation when the real GNP went down, not up. The whole interest of this committee in its annual report is going to be on how to get this country back to a full employment without inflation posture and Senator Humphrey and I are certainly not going to tell our colleagues what we ought to say in our annual report, but it is enough for this morning to say that unless we produce a full employment without inflation posture there is going to be precious little revenue to permit any revenue sharing. Furthermore, to allow inflation to erode our growth rate not only keeps us from getting the Federal revenues we need in order to get adequate revenue sharing but it particularly hurts the States and cities which have seen their revenue sharply reduced and the cost of their services sharply increased as a result of inflation.

So we suggest that there are two things that are needed to be done to make revenue sharing a fiscally sensible proposal:

One, get the economy moving forward, so that the existing tax bite actually yields some revenues; and second, we have only accomplished half a loaf or less than half a loaf of the job of plugging tax loopholes in the federal system.

It was remarkable that we were able to do as much as we did do in the Tax Reform Act of 1969. But what is now needed is round 2 of tax reform. I compute that there are $6 to $8 billion world of loopholes remaining in the Federal tax structure which could very readily be plugged and that $6 to $8 billion of Federal revenues could then be used to do all the things that need to be done, including bringing the budget out of its tremendous present deficit position. It is a cause for sadness that the administration has not only indicated that there will be no message on further tax reform this year but started out the year by punching another $2 to $3 billion loophole in the Federal income tax structure by its entirely unnecessary easing of the depreciation rules for corporate business.

So what we need is a full employment without inflation economy so that we can get the revenues, and a plugging of tax loopholes so that we can get the revenues, if we are really serious about revenue sharing.

Now, let me turn to our second point, which is that revenue sharing offers a once in a lifetime opportunity to give the States an incentive to help reform their local governments, reform them in all the areas which have been pointed out over the years by the Committee for Economic Development, the National League of Cities, the National Municipal League, the Conference of Mayors, the National Association of Counties, the Advisory Commission on Intergovernmental Relations, and all the others, which have made the point that our Balkanized and fragmented and inefficient local governments do not give the people very good local government and are hideously costly in terms of what they do.

This isn't just a Democratic idea. I know that HUD Secretary Romney in his interesting testimony before this committee just last week had this to say:

> The community development this nation has experienced to date has fragmented and Balkanized our metropolitan areas into so many political jurisdictions that it is difficult if not impossible to mount an effective attack on current problems.

Well, the President's revenue sharing proposal, admirable though it is in many respects, permits this continued fragmentation of responsibility, inefficiency and paralysis.

As Mr. Weidenbaum has said, Senator Humphrey's and my bill is in many particulars parallel with the administration's bill. But it does differ from the administration's bill on this question of local government. We believe that revenue sharing can be used as a catalyst to reform local government rather than just as a crutch to permit it to go on as it has.

We do this by three or four fundamental departures from the administration proposal. In the first place, under our proposal, revenue sharing benefits would go to a State only if that State—by the second year of the program—filed with the President a State and local government modernization master plan and timetable for that particular State, drawn up by the Governor in conjunction with the leading legislators and the local officials and farm groups and business groups and labor groups, a charter which would enable the State for the next 20 years to progressively reform its own and its local government structure.

We don't mandate any particular kind of a plan. We don't mandate any Federal approval of the plan. We don't mandate any followthrough by the Federal Government to make sure that the State is observing its timetable. Just as in the Marshall plan, the United States said to the 20 nations of war-torn Europe: "You people come up with a plan and we will help you get your war-torn economies back on their feet." Just as the Marshall plan worked extremely well without detailed controls by the United States, so we believe that Humphrey-Reuss revenue sharing with reform would work without its constituting a real strain.

The plans, as I say, that the States would be asked to adopt need not be uniform, there are no requirements. We have a long laundry list or checklist of things that we think the State planners ought to look at. That doesn't mean they ought to have every one of them or indeed any of them in their plans. But we can envisage a golden age of State reform in which all the reform elements that have been so helpless in the States would finally have a chance politically to modernize their governments because a Governor would have a strong incentive to do this since he could point out that unless the State at least comes up with a plan they don't get the Federal money.

A second feature of the Humphrey-Reuss bill which we believe desirable addresses itself to the fact that nine or 10 of the States, including some big industrial ones today lack an income tax. This means not only that those States aren't making the tax effort they should, but it is particularly tough on States which do have an adequate income tax because the no-income tax States bid industry away from them on the old water plentiful, labor docile and no-income tax grounds.

The Humphrey-Reuss bill would give an almost irresistible incentive to States to enact income taxes and to keep them up to an average level because after the third year of revenue sharing, it double weights a State's income tax in the national distribution formula.

We think this is a vastly better way of getting income tax equality among the States than the so-called Federal income tax credits which were mentioned by the Chairman this morning. I am glad to see the administration and Secretary Weidenbaum agree with us that tax credits are really a very poor way of getting at it. Look how a tax credit will work. I come, as does the chairman, from the State of Wisconsin which has a high, around 10 percent, income tax. Say I pay around, let's rough it out, $5,000 a year to the State of Wisconsin income tax and about $20,000 income tax to the Federal Government. Under an income tax credit if it were 100 percent, I would get $5,000 reduced from my Federal income tax, it would go down to $15,000 that would help me, and I would relish it but in the short run it wouldn't help the State of Wisconsin and it would just mean that the Federal Government, with its progressive income tax was crimped by that amount. Any effect which it might have in the long run to equalize

State income taxes could much better be accomplished by linking income tax effort to revenue sharing. Revenue sharing linkage also has the desirable feature of enabling the Federal Government to help out States of lower per capita income, like Alabama, out of the National Treasury which I think is a good way to run a Federal system, and I am sure the administration does too or it wouldn't have proposed it.

So, an incentive to even out this income tax disequilibrium would be our second proposal.

Our third proposal relates to how these revenue-sharing funds are to be shared among localities. There, both the administration and the Humphrey-Reuss bill have a provision for allowing the States, with a majority of their cities and counties, to work out special distribution systems which I believe is a good thing. It is, however, when you get to the situation which unfortunately is going to be true in a great many cases and for some years, where they haven't worked out this special 10-percent bonus local redistribution, that Humphrey-Reuss and the administration come out differently. The administration would mandate the distribution of these local funds to every one of the Nation's 63,000-odd units of general local government, be they efficient or inefficient. Be they the most lilliputian and archaic suburb or hamlet, each gets according to its share of general revenues raised which means, incidentally that rich communities which have a lot of rich people and have a lot of general revenues get that much richer while if the poor get helped, they get helped only to the extent of the revenues they have been able to raise.

Under the Humphrey-Reuss proposal we encourage States to adopt a better form of local distribution. We invite them if they wish to favor communities with a lot of low-income families. We invite them to favor communities with larger populations. We invite them to favor communities which have shown a high disposition to tax their people in relationship to their income.

So we believe that our local distribution system is more effèctive and efficient.

The fourth, and last, major difference between the administration and the Humphrey-Reuss proposal is that the administration links its revenue sharing to a trust fund device. It says that a certain amount of the personal income tax base of the Nation each year shall be used as the total revenue-sharing pot. We, on the other hand, leave the matter to the decision of Congress. We believe that while revenue sharing is important, it is no more important than the national defense or Federal aids to education, or Federal antipollution programs or the whole sweep of other Federal activities. We have not been enchanted by the expansion of the tied appropriation of the Federal highway program which in some cases has meant that the States had to build highways when they would have preferred to build something else.

So while we depart from revenue-sharing purists in this particular, we believe it is a departure that can well be made.

Incidentally, it is a departure which sends the Humphrey-Reuss bill not to the Ways and Means and Finance Committees but to the Government Operations Committees of Senate and House whereon hangs a tale that I shall come to right now in the fifth and last point I want to make: I believe and Senator Humphrey believes that there is an economically just and politically feasible package that can be made.

Right now the administration has proposed essentially Heller-Pechman revenue sharing and, I regret to say, almost all the Democratic leaders and, particularly, on the Ways and Means Committee have said "no" for a series of reasons, some good, some not so good, which have been, I think, well covered in Mr. Weidenbaum's testimony.

Meanwhile, the Democrats are saying "Why shouldn't there be a Federal takeover of welfare as an alternative?" And here the administration has in effect said "no." Secretary Richardson has said it is too costly, that it is unfair and a veto would hang in the offing there. So what we are faced with is a situation where it is likely that the States and cities are not going to get anything, and believe me they are going to die on the vine unless as a nation we do something about their fiscal and organizational plight.

So what Senator Humphrey and I suggest as a sensible combination package, is take whatever sums are in the budget now and in the future for revenue sharing, $5 billion in the next fiscal year, very shortly $10 billion, take those $5, $10 billion figures, whatever they come to, and split them in some way between a phased Federal assumption of the responsibility for welfare now borne by the States and localities, and a revenue sharing package. You can do enough to assure that you have meaningful programs for both, and there is a lot to be said for both. For the welfare takeover, there is the fact that if you did it State and local communities would be protected against endless increases in the property tax. You would have a better welfare system, I hope incorporating the many excellent features of the President's Family Assistance Plan. You would reduce interstate competition for welfare which now allegedly causes poor people to migrate from one State to another looking for adequate welfare and you can channel the local share in many cases just where it is needed to the hard-pressed central cities.

Well, one may ask, if Federal welfare takeover is such a grand idea why not do it all the way and leave nothing for revenue sharing and leave revenue sharing out. We believe there are two answers to that. The revenue sharing concept permits, as we have said, the provision of incentives to State and local governments to modernize and reform themselves, and it is very difficult to attach such conditions to a welfare takeover proposal. Moreover, in quite a few States revenue sharing permits a surer way to help hard-pressed localities because in many States, Connecticut is one of them, the State handles almost all of welfare, 92 percent, 8 percent from the localities. Therefore, the hard-pressed Connecticut municipalities, and I know they are hard-pressed from having been there a week ago, the hard-pressed Connecticut localities would get very little under welfare takeover although by helping the State it would presumably enable the State to do more.

So we believe what you need is not just a welfare takeover or not just revenue sharing but a combination of the two.

Politically, this could be just what the doctor ordered. Let's see how it would work.

Mr. Mills, and the Ways and Means Committee, at least the Democrats on it, are leaning toward a Federal welfare takeover. That is clearly their business. Why shouldn't the administration withdraw its objection to that and let Ways and Means work its will.

At the same time, the administration, I think, is drilling a dry hole, if I may use a petroleum analogy, in the Ways and Means

59-591 O—71—pt. 2——4

Committee on revenue sharing. I don't think they are going to report it out but by happy accident, the Humphrey-Reuss bill is lodged in more congenial surroundings in the respective Government Operations Committees, committees with a long record of intense interest in the reform of government, Federal and local. They set up the ACIR, the Advisory Commission on Intergovernmental Relations, which has been behind all these reform movements.

So I think that if the administration gave some support to a Government operations bill, we could get out a rather nice package which, in its reconfiguration, the Congress would pass, of a combination of adequate amounts of Federal welfare takeover and adequate amounts of Federal revenue sharing with reform.

I would hope that we progressive Democrats would not let go by in negativism the chance of a lifetime. Here you have a conservative Republican Administration by the grace of God talked into the proposition of advocating revenue sharing with the localities and opposing Federal income tax credits. That means that you have a Republican administration coming out foursquare for progressivism in taxation; for loading less on the sales and property taxes on the poor fellow who pays State and local taxes; and not for dismantling the Federal progressive income tax system but for building in a political device which would maintain it and, at the same time resisting the blandishments of people who are plumping for tax credits which would, by and large, just benefit wealthy people and not really benefit State and local governments at all.

Why our friends in the AFL–CIO bought that one I will never know, and the sooner they lose it, as far as I am concerned, the better.

But here we have the chance of a lifetime. We progressive Democrats, if we were in power, and we proposed revenue sharing, such being the nature of politics the only people you would get to vote for it, by and large, would be the DSG types, the northern liberals, about a third of the Congress, and it would go down to ignominious defeat because Republicans would understandably say, "Look, this isn't our program, this is the program of a neo-New Deal Democratic government that wants to extend the progressive income tax and make that the big tax raiser for the Nation."

So if we are going to get a sensible governmental structure, we Democrats who have high hopes of changing things in the 1972 elections better move fast and lock it in because if we come to power, and our senses, and process such a program ourselves it isn't going to work.

Well, this is some plain talk then, on the economics and politics of revenue sharing, and I have taken quite a bit of time to do it. Thank you, Mr. Chairman.

(The joint prepared statement of Senator Humphrey and Representative Reuss follows:)

Joint Prepared Statement of Hon. Hubert H. Humphrey and Hon. Henry S. Reuss

How To Help the States and Cities

We appreciate this opportunity to present our point of view on how the Federal government can most effectively come to the rescue of the beleaguered state and local governments. This issue is central to the President's Budget and Economic Report. We would hope that it would also be central to this year's report of the Joint Economic Committee.

Last month a number of the nation's governors and mayors came before this committee and testified eloquently to the fiscal plight of their states and cities. No one on this committee, we are confident, doubts either the reality of state-local government's plight, or the need to effect large scale reorganization of our federal-state-local governmental system.

We make today three points:

I. If the Federal government wants to initiate revenue-sharing, it had better make sure that it has enough revenues to share.

II. Unless incentives are given to states to reform their own and particularly their local governments, and to move in the direction of modernized, fiscally equitable, and humanized local government, federal reveune-sharing will simply act as a crutch to perpetuate obsolete state-local governmental systems, instead of as a catalyst to induce modernization.

III. An *economically and socially desirable* package combining a phased federal take-over of the welfare system, and revenue-sharing-with-reform, could prove *politically feasible* in this Congress.

I. WHAT REVENUES?

He who would share revenues must first answer the question: Where *are* we to get the revenues to share?

These revenues were supposed to come from the peace-and-growth dividend. But there is no peace, and there is no growth. Instead, there is a widened war in Cambodia and now in Laos. Instead, the defense budget, after having headed downward for a couple of years, is now on the way up again, with an increase in outlays of $1.5 billion for the next fiscal year, and a whopping $6.9 billion increase in spending authority, which will mortgage budgets for years to come.

Instead of non-inflationary, revenue-producing growth, we have 6 percent unemployment, 6 percent cost-of-living inflation, and for the first time in many years, zero economic growth in 1970.

The Administration has come forward with an expansionary "full-employment" budget which proposes to reverse these trends virtually overnight. Even if we accept the Administration's $1065 billion estimate for GNP in FY '72, and its 9 percent growth prediction, our fear is that most of the 9 percent will be in inflation rather than in real growth. For the Administration refuses to use the tools the Congress has given it to keep inflation from eating up growth: a temporary freeze on prices, wages, and salaries *across the board* to permit the working out of voluntary wage-price guidelines with management and labor for the longer term.

Slow growth, eroded by inflation, does not and will not provide the revenues needed for adequate revenue-sharing—or adequate anything else, for that matter. Moreover, slow growth will intensify the plight of states and cities, which have already seen their revenues sharply reduced and the cost of services in their communities sharply increased as a result of inflation combined with recession.

So, for the sake of both direct and indirect relief for our cities, an adequate rate of non-inflationary growth must be restored to this country.

There is an additional way in which to attain some of the revenues that are needed—and a way that will add to the progressivity of an overall Federal state-local tax system which has grown increasingly less progressive in recent years.

That way is to finish the job of plugging loopholes in the Federal tax system which was timidly begun in the Tax Reform Act of 1969.

The Administration should immediately prepare, and forward for action to the tax-writing committees of the Congress, a Round II of tax reform designed to close those loopholes which have enabled wealthy individuals to escape billions of dollars in Federal taxes each year for decades past.

But the Administration has indicated that there will be no message on tax reform. Instead, the Administration has punched another loophole in the Federal income tax structure by easing depreciation rules across the board, thus depriving the federal government of some $2–3 billion in annual revenues. The revenues lost by this new loophole could surely have been more productively used by state and local governments.

If the Administration will not do the job of tax reform, Congress must.

More real economic growth to produce additional revenues from the existing tax system, coupled with a program of loophole plugging to augment these revenues, is a necessary answer to those who now oppose revenue-sharing on the ground that there is precious little revenue to share.

II. REVENUE-SHARING WITH REFORM

Money alone, however, is not the answer to the problems of our states and cities. State and local governments face not just a fiscal crisis; they also face an organizational crisis.

The great defect in the Administration's general revenue-sharing proposal is that it responds to the first crisis but not to the second. The risk in this approach to revenue-sharing is that the money sent back to the states and localities may not do much good for those most in need, and may do harm by giving out-of-date structures and practices a new lease on life.

The President has said he aims to give greater responsibility to State and local government. The question should be asked: "To which governments?" To the 600 towns, cities and villages in the state of Wisconsin each with less than 500 in population? To the 299 separate but overlapping governmental units in the Minneapolis-St. Paul area, each with taxing jurisdiction? To the several states which have not yet taken steps to increase their revenues by adopting the progressive income tax? To the states which have denied to their cities adequate taxing and borrowing powers?

HUD Secretary Romney said in his testimony before the Joint Economic Committee on February 17: "The community development this nation has experienced to date has fragmented and balkanized our metropolitan areas into so many political jurisdictions that it is difficult if not impossible to mount an effective attack on current problems." The President's revenue-sharing proposal permits continued fragmentation of responsibility, inefficiency and paralysis.

The President has also said he aims to rationalize federal aid programs for states and localities. What is the point, we ask, in streamlining the federal grant process if state and local governments remain mired in their own red tape, archaic fiscal practices and overlapping jurisdictions?

We have joined to put forward an alternative approach to revenue-sharing which we believe responds to both crises of state and local government, H.R. 1091 and S. 241. We see these advantages in the Humphrey-Reuss proposal:

First. Revenue-sharing and state and local government modernization are linked. In order to qualify for shared revenues in the second and subsequent years of a revenue-sharing program, the governor of a state must come forward with a modernization plan for his state and local governments.

For those who oppose "stringless" revenue-sharing, here is a string with a constructive purpose. At the same time, the string is not onerous. The flow of funds to a state is tied neither to the contents of the plan nor to progress made in fulfilling it. The governors can draw from a suggested check-list of reforms in the Humphrey-Reuss bill. The recommendations of numerous bodies stand ready at hand—the Council for Economic Development, The Advisory Commission on Intergovernmental Relations and the Citizens Conference on State Legislatures, to mention just three.

In the state of Minnesota, the legislature is considering authorization of full-scale studies of the metropolitan regions in the state—the goal, governmental reform. In the state of Wisconsin, the 1969 Report of the Task Force on Local Government Finance and Organization awaits implementation. In other states, similar plans and reports of task forces are awaiting the boost the Humphrey-Reuss revenue-sharing bill could provide.

Second. States lacking state income taxes are given a specific incentive to adopt them. (States at present without income taxes are Connecticut, Florida, Nevada, Ohio, Pennsylvania, South Dakota, Texas, Washington and Wyoming.) After July 1, 1974, a state's income tax revenues are counted twice in the formula that apportions funds among states on the basis of population and revenues raised in relation to total personal income in the state.

Unlike the tax credit device, our approach will encourage adequate and equitable revenue efforts by states without penalizing states with a low income tax base. Moreover, by combining this approach with a program that includes sharing with local governments, additional funds for needy communities are assured. Under income tax credits, on the other hand, redistribution would be guaranteed only to cities having income taxes.

Third. Our procedures for allocation of shared revenues to localities provide the flexibility needed to encourage consolidation of inefficient units, and to take account of relative fiscal need and other differences state by state.

If a state does not choose to negotiate an allocation agreement with a representative number of its cities and counties, we would require that the state set aside an amount for its localities that will average over 50 percent nation-wide.

To this point we and the Administration both travel the path recommended by the national organizations of cities, mayors, governors and counties.

But then—if the negotiation does not come off—the Administration requires a mandatory distribution to all 63,000 local governments, whether rich or poor, archaic or efficient.

We instead allow distribution among localities pursuant to a state law which may take account of relative need, population, size and tax effort. We thus provide room to avoid a wasteful distribution, and leverage to bring about reform.

Fourth. We propose a four-year authorization and annual appropriations for revenue-sharing, rather than a permanent appropriation, as a percentage of the personal income tax base. We are sensitive to the need of state and local governments for some predictability in the revenues they will be receiving from the Federal government. But we are equally sensitive to the prerogative of the Congress, along with the President, to decide spending priorities in any given year. This prerogative has already been eroded by existing trust funds. We do not believe that it should be further eroded by what amounts to another trust fund for revenue-sharing.

Annual appropriations will, for example, permit the Congress to allot more or less for welfare assistance and revenue-sharing, depending on year-by-year needs, particularly if these two major forms of assistance to state-local government are linked in one package. At this point, if any priority is to be established among the programs proposing additional aid for states and localities, we believe welfare would have to be at the top of the list.

Further, a four-year authorization will give Congress an opportunity to review the use of revenue-sharing funds, and progress in the modernization of state-local government, before approving another multi-year authorization.

III. PACKAGE OF WELFARE TAKE-OVER AND REVENUE-SHARING

Finally, we must ask whether the annual sums suggested to be spent on revenue-sharing by the revenue-sharing purists—$5 billion or $10 billion or more—are best spent strictly on revenue-sharing (either of the Administration variety, or of the Humphrey-Reuss revenue-sharing with reform variety), or should instead be split in some fashion between revenue-sharing and a substantial (and ultimately total) federal take-over of the financial cost and administration of welfare.

We conclude that such a split package is not only *more desirable* from the economic and social standpoint, but *more feasible* from the political standpoint.

First. From the economic and social standpoint, the costs of welfare require additional federal support. The nation's welfare system is approaching a crisis.

The federal government now pays about $7 billion of an estimated $14 billion annual welfare cost. Astronomic increases are in sight. Putting, say, one-half of a generous revenue-sharing pot into a substantial initial federal take-over of financing welfare could provide a better welfare system, reduce the interstate competition which now plagues states seeking to have adequate welfare systems of their own, and channel the "local share" just where help is most needed—to those states and communities with the greatest welfare cost.

To the extent that funds are channeled to the states and cities by a federal welfare take-over, rather than by federal revenue-sharing, the agonies of apportioning the "local share" are avoided.

By an increased federal responsibility for welfare costs, many local communities would be protected against endless increases in the extremely regressive property tax, which falls largely on the homeowner. Instead, they could anticipate more adequate funds with which to pay their policemen, collect their trash, and perform all the other manifold daily tasks of local government.

If the idea of a federal welfare take-over is so good, one may ask, why have revenue-sharing at all?

There are two answers. The revenue-sharing concept permits, as we have said, the provision of incentives to state and local governments to modernize and reform themselves; it would be difficult or impossible to attach such reform conditions to a welfare take-over program.

Moreover, in some states revenue-sharing permits a surer distribution to hard-pressed localities than a welfare take-over, since in these states the local welfare contribution (and hence the prospect of relief from a federal take-over) is comparatively small.

Accordingly, there is a strong case for a welfare-revenue-sharing package, with a generous pot split in two portions of a size that will provide meaningful relief under both programs.

Second. From the political standpoint, if the revenue-sharing purists insist on all for revenue-sharing, and if the welfare purists insist on all for welfare take-over, the end result is likely to be a political impasse, with the states and localities consigned to outer darkness.

A fair number of leading Congressional Democrats are digging in their heels against revenue-sharing.

Equally, the Administration is freezing itself into a position of opposition to a federal take-over of welfare. The Secretary of HEW recently decried the proposal as too costly.

So the Congress may not act on revenue-sharing, and the Administration may veto a welfare take-over. This would be tragic for the states and cities.

But this need not be. A combination of Republican and Democratic ideas now floating around may prove politically feasible.

Let the Administration start to work out with the House Ways and Means Committee a proposal for a complete federal take-over of welfare, phased over several years. Let the Administration at the same time express interest in revenue-sharing-with-reform supported by annual appropriations. The Government Operations Committees in both houses may then be encouraged to get to work on the Humphrey-Reuss proposal and related proposals which have been referred to these committees.

Saving the states and cities from insolvency and obsolescence is too important a task to let it founder on the rock of political partisanship.

Chairman PROXMIRE. Thank you very much, Congressman Reuss. Before I call on Senator Humphrey, I want to do two things. The first is to assure Mr. Weidenbaum, who is outnumbered here two to one on this revenue sharing disagreement, and assure him that I am going to give him 5 minutes with unanimous consent of the committee, to rebut the disagreements which Congressman Reuss raised and which Senator Humphrey may raise, out of fairness when they both finish.

The second point I want to make is that the two men we have presenting revenue sharing are two of the most resourceful, innovative legislators we have, regardless of whether one may agree or disagree with their proposal this morning or in the past. As I understand it, these are the two men who introduced the Peace Corps which, I think, many people recognize as the most significant foreign policy innovation in the last 10 years, if not in the last generation. So it is most appropriate that men with this record should come before us this morning with this proposal.

Senator Humphrey, go right ahead.

STATEMENT OF HON. HUBERT H. HUMPHREY, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator HUMPHREY. Thank you, Mr. Chairman and members of the committee.

May I say first to Mr. Weidenbaum and members of the committee that I am not here in the spirit of argument but rather in the spirit of discussion and dialog. I don't really believe that as yet we have refined all of our thinking on the matters of revenue sharing, and my plea to the committees of the Congress, and to the respective partisan advocates and forces outside of Government is that we keep an open mind. I believe we are entered upon a period now of governmental crisis that demands action on the part of the Congress.

So even though Mr. Weidenbaum may find himself in disagreement with some of the things that Congressman Reuss has said and that I may say, may I assure him that my views on revenue sharing are about as nonpartisan as they can become, to the extreme. After all, revenue sharing as a concept was first advanced by Walter Heller, a distinguished citizen of my State of Minnesota, Chairman of the Council of Economic Advisers to President Kennedy and President Johnson, and Mr. Joseph Pechman, who is now with the Brookings Institution. I have known Mr. Pechman for a long time. He is a scholar in the field of finance, tax policy, and State and local government. So I claim no peculiar or particular expertise in this. I am just an interested, concerned citizen and Member of the Congresss, Mr. Chairman, and I want to present my views in that vein.

I have been a mayor of a city at a time when cities had fewer problems than they have now, and I have had a few years of experience in the Federal Government.

During my experience as vice president, Mr. Chairman, I worked carefully and closely with every mayor of every major city in the United States, and with many of the Governors and legislative leaders. This past year I was in San Juan, Puerto Rico, for the meeting of the National Legislative Leaders Conference. By the way, its headquarters are in Milwaukee. That conference represents the top legislative spokesmen, majority and minority leaders of House and Senate, of the 50 States and territories of the United States. So I have had an opportunity to become acquainted with the problems of local government in a fashion which I think is rather unqiue. As vice president I had 44 meetings with mayors and county supervisors, county commissioners at the local level. Many of those were at a regional level.

By the way, Mr. Chairman, none of them were what we call publicity meetings. They were all closed meetings where we sat together to discuss mutual problems of Federal and local government.

I am very close to the mayors of the Nation. I take some justifiable pride in that. I do not know whether it is some kind of non-dues-paying union that I once belonged to or not, but I know that their problems are immense. Incidentally, Mr. Chairman, I ask the same privilege that Congressman Reuss requested, that my prepared statement might be printed in its entirety in the record.

Chairman PROXMIRE. Without objection, the entire prepared statement willl be printed in full at the end of your oral statement.

Senator HUMPHREY. The first line in our joint prepared statement is that our cities are mortally sick and, Mr. Chairman, they are getting sicker.

I can discuss, and I will at any time that the committee so desires, some of my views as to what we might do in terms of governmental structuring in this country. But at this point in time, I must say that the cities, presided over by a mayor and governed by councils and commissions, are mortally sick—not just a weekend hangover, but mortally ill, and our States are in a chronic fiscal crisis, with few exceptions. They are suffering from severe and worsening financial malnutrition plus organic administrative impairment.

I must say at this point that there are very few States and cities that either do not need constitutional reform, charter reform, or modernization, but it is easier to get a camel through the eye of a needle than it is to achieve charter reform for a city government. I led several charter reform fights, and I want to tell you, if you think our troubles in Southeast Asia are difficult, try to reform a city charter. But these are things we will have to do.

We are now at a crisis point in government. Let me put for the record that I consider our Federal governmental system, which is not just the Government in Washington but our whole system of government—that it is becoming unresponsive, unworkable, that people do not know where to turn for assistance, for service; that the problems are multiplying.

I wish I could take this committee around this city and see the incredible lack of services for the people of the District of Columbia. It is not because the mayor of the city does not want to do something about these problems. It is just simply that the revenues are not there. Garbage is not being picked up, pollution is not being controlled. There are problems here that are staggering, Mr. Chairman, and I predict that unless we do something about it quickly, they are going to get totally out of hand, totally out of hand.

So that is why I am here. A mayor was testifying before one of the committees here a couple of years ago and they said, "Mr. Mayor, what do you consider to be the three most important problems facing your city?" He said, "Well, it is money, revenues, and funds," and basically that is what they are up against.

Here we have all this talk about law and order, gentlemen, and cities today are being forced to lay off policemen and firemen because there is no money.

We are having all of this talk about environment and pollution, and if you go over the cities of America today they are picking up the garbage at about one-half the rate that they did 2 years ago. Just simple services—let us not talk about how you are going to save the world, let us talk about how you are going to pick up the garbage. Let us talk about how you are going to be able to clean the streets. Let us talk about how you are going to pay for firefighting equipment, pay for police officers. These are simple but fundamental services, gentlemen, that today are going unmet and unfulfilled.

So I point out that what we have here is a plain lack of money.

I know it is always good to say who is at fault. But, gentlemen, when the patient is critically ill, there is no use in giving him a lecture that he drank too much, that he stayed out too late, that he abused himself, that he forgot to take care of his health. What he needs is help, and what revenue-sharing represents is a blood transfusion that gives the patient some vitality and a chance for rehabilitation.

What the Reuss-Humphrey or the Humphrey-Reuss bill does is to provide that economic plasma that can save the patient for a little period of time while we devise the incentives to get him to live a new life, to rehabilitate, to reorganize, to modernize. I can assure you, Mr. Chairman, that unless there are these built-in incentives for reorganization, for modernization, for improvement of government, for restructuring of government, there will be no amount of revenue-sharing that is going to save the municipalities and the States.

We have got to do a better job. We have to look at this thing cross the board, because the "government" that the people are talking about is not Washington. When I get letters and you get letters they talk about their taxes going up, and I write back and say, "Well, your taxes haven't gone up at the Federal level." They say, "Don't tell me that, Mr. Humphrey. I am paying so much more tax." All they know is they are paying taxes, they are paying property taxes, they are paying sales taxes, they are paying license fees, they are paying income taxes, and, Mr. Citizen, our constituents—and we are the same kind of people—we just talk about the "government." "The government is not doing its job, the government has broken down, the government is too costly, the government is unresponsive." This is what people are saying, and I must say that the Congress of the United States, which represents the people more than any other body, has simply got to come to grips with this, quit fooling around, and face up to the facts. We are in a crisis stage in terms of governmental structure and functioning.

Now, I am pleased, as my colleague here, Congressman Reuss has said that the administration has taken some initiative on this. I have said to administration spokesmen that I am not going to be in a knockdown, drag out battle with them over details. I frankly think it is so important to get something going. Even if we cannot get all of that we want. Even if the administration cannot get all that it wants, something has to come out of this Congress. And I do not mean 7 years from now, I mean something has got to come now.

I think of my own twin cities, Minneapolis and St. Paul, and I can tell you, Mr. Chairman, they are in dire, desperate need for funds. If we get another snowstorm out there, there is no money for street cleaning, there just isn't any money, and when I see what goes on here—we have people saying, "Well, we have got to build more houses, we have got to get more high-rises," but nobody ever thinks about putting in more sewage treatment plants, no one thinks about the social services that are needed as the population tends to grow by leaps and bounds.

So I am pleased the President is offering to Congress a plan providing the States and localities with critically needed funds. I want to help him.

Now, we have another proposition here which, I think, has real merit. In fact, I think it is better than the administration plan, even though the administration plan follows the outlines of Mr. Heller, a very dear and personal friend of mine, who has testified here many times.

But I know one thing, we cannot permit a stalemate between the Congress and the administration on this vital issue. Therefore, I appear to further the cause of revenue sharing.

My appearance, I hope, will be reassuring to the administration that some of us are not going to be locked into prescribed positions on the basis of what you believe to be political ideology. I am not an ideologist on these matters. I am appragmatist.

I am sure now, after the explanation of Congressman Reuss, that you know the general outline of the Humphrey-Reuss proposal, and I shall not go over that again.

One of the points that I would like to note, however, is a basic difference. We believe that the Congress ought to review revenue sharing just as it reviews every other large appropriation.

I believe that the Congress which provides the medicine that is needed for State and local government has the right to examine the patient regularly during treatment. That is the best way to put it. I just do not believe that you ought to keep dishing it out without taking a look.

I know it sounds good to say there are no strings attached. Everybody knows that there is always something attached when you start giving something to somebody else. You may not think there are strings, but there are.

I think we ought to provide a program that has incentives and some guidelines to it. And that is exactly what Congressman Reuss and I have tried to do.

Whether our incentives are the best ones, we can argue about that. Maybe not. Our bill provides direct funding to the States and localities, and it hints strongly in the authorizing legislation that State and local government reform would be a fine process to plan, institute, and implement.

We also provided what we call a dual approach. And aren't we pragmatists here in the Congress of the United States? Are we going to get hung up on an argument that "You will either do it my way or we won't do it at all," when we know that something has to be done? Now, the simple truth is that if the Federal Government takes over all of the welfare costs, it is not going to bail out many of the municipalities and States. It will be very helpful, particularly to some of the larger States, but I think the administration can make a pretty good case against that, Mr. Chairman, and I am perfectly willing to face up to the logic of a fair argument.

I happen to believe that the President's family assistance program contains principles which are meritorious. I believe we surely will want to look it over very carefully as to its adequacy, but if the Federal Government is going to impose upon the country or to set for the country standards of welfare assistance, then the Federal Government ought to be prepared to pay for those standards in light of what is the present situation in the States and localities.

Now, if we could reduce some of the costs of welfare assistance at local government levels, we really could provide for a much more equitable tax structure at the local level. Outside of the sales tax which I consider to be the most inequitable form of taxation the second most inequitable is what we call the property tax.

Mr. Farmer sitting out there in Wright County where I live. He maybe did not get a crop last year. He did not earn a dime, but he has to pay tax on his land as if he had earned income.

Our property taxes in the State of Minnesota went up 53 percent, Mr. Chairman, in the last 3 years.

People are being driven out of their homes. We talk about what we ought to do for the elderly—well, we have in State after State across this country, property taxes going up to where an elderly person, who has little or no income, cannot afford to stay in his own home. He has to leave his own home, and the next thing you do is to put him in a public assistance housing project. This is a sure way to raise costs.

Let us get with it. The fact is we ought to have a system here that permits people to live in their homes. We ought to have a tax system that is equitable and based on the ability to pay. If the Humphrey-Reuss program encourages a fair, progressive tax program at State and national levels—and I am pleased that the administration has rejected the so-called tax credit—the Congressman has put it so well, this is the most fortuitous moment we have ever had. We have a Republican administration that at long last has embraced the kind of progressive taxation policy that is rejecting out of hand palliatives that are inequitable, and coming around to a position that bears some semblance to equality of treatment and fairness in matters of revenue sharing and taxation.

I just want to endorse what Congressman Reuss has said about the welfare program. I realize that the House, in one of its committees, according to what I have read, has expressed an adverse reaction about revenue sharing.

Can't we have the good sense here, Mr. Chairman, to put these two together? Haven't we learned that sometimes compromise is an effective instrument in the legislative process? I know that if we could put together a program such as the Humphrey-Reuss bill, paired with welfare reform and Federal refinancing, that we could provide assistance to States and localities that would be of tremendous significance.

The welfare costs in many of our rural counties, Mr. Chairman, as well as in the metropolitan areas, are just devastating. And those welfare costs are going up and up and up, and something has got to be done about it.

I want to conclude on this: I have a few other ideas about what this Government ought to be doing. The President presents a budget to us, it is prepared in secret; it is more secret than the CIA or the FBI, till the Congress gets it.

I think it is about time that in our budget preparations we start to hold hearings around this country preparatory to the final budget. Governors and mayors and legislators and citizen groups ought to have something to say about what goes into the Federal budget before it comes to us in the Congress. Once that budget is tied into a nice little neat package and printed and sent down here with the Presidential seal on it and tied up in the nice tape that we can tie it up in, it is almost a foregone conclusion that much of it is going to be law.

No Governor, no legislator, no mayor, no city councilman ever gets a chance to get his input into that budget before it gets up here to Congress.

I also think, Mr. Chairman, that we ought to establish one way or another—we can get this done out of this committee by recommendation—a continuing dialog between the leaders of the Congress of the United States and the leaders of the legislative bodies of the States. Let us not rely on accidental social meetings to bring us together. Let us not rely on one conference a year. There is no reason at all why we should not be in closer collaboration with legislative leaders.

The President gets together with Governors. Well, let us have the leaders of the Congress start to get together with legislative leaders. We ask them to implement at legislative levels many of the programs that we initially enact here in the Congress. I think they are entitled to have some input.

This is my view, having been on an enforced sabbatical leave for the last 2 years. I have been out looking around the countryside. I do not believe that all wisdom is in Washington.

When I hear that you cannot risk giving this money to these mayors and Governors and legislators, well, they are very human. They are just like we are. If you give them too much money with no guidelines, they would like very much to be able to go around and reduce a lot of taxes and avoid their responsibilities.

Do not criticize them for that. They like to get elected, too, and it is hard to get elected saying you are going to increase taxes. Very few of us spend much time at that. But there is a lot of talent in local government. But talent in local government is absolutely of no use if you do not give them the tools to do the job.

I believe that mayors and city councils frequently know what is better for their city than the Senator from Minnesota. I really believe they have a pretty good idea of what they need. But what they do need more than anything else is something to do it with, and if we give them the chance they can do something about it.

So our program boils down to this: Modernization and reorganization tied in with revenue sharing; the Congress of the United States to take a look each year as to how the States are coming along as we do share revenue; revenue sharing blended in with the staged absorption of welfare costs; and I am for the total absorption of welfare costs ultimately by the Federal Government.

When the court knocked down residency requirements, and it is possible for a person to move from one State to another without any impediment as to your welfare costs, on the part of a State to which you have moved, then I think the Federal Government has got to teke a new look. In other words, gentlemen, the law of yesterday does not relate to the court decisions we have today, and we have to do something about it.

Well, I guess that is about it.

I must say that I am honored to be on board with Congressman Reuss on this, who has really been the mainspring of this legislation. I have been privileged to join him. I hope that I can be helpful.

(The prepared statement of Senator Humphrey follows:)

PREPARED STATEMENT OF HON. HUBERT H. HUMPHREY

Mr. CHAIRMAN, I am particularly gratified to appear before the Joint Economic Committee this morning. I thank you and the Committee for this opportunity. It is particularly appropriate that my first appearance before any congressional committee, since returning to the Senate, is before the Joint Economic Committee.

I am a junior member of this Committee and today we are discussing the economy and how revenue-sharing and welfare reform and financing relate to the economy. The peaked condition of the economy is certainly the matter of most domestic concern—and frankly, the health of the economy and the strength it affords to both protect and influence abroad, make meaningful solutions of any governmental problem dependent on a sound economy.

It is gratifying that my co-witness, Congressman Henry Reuss, is a member of this Committee. We share the same views on matters contained in our statement. And I must say, I feel particularly secure with Congressman Reuss right here. I fear no economic dragon, human or otherwise, with such a colleague. Congressman Reuss is a veteran of the economic wars—in and out of the Congress. I have followed his thinking on economic matters for years and trust economic policy-makers will continue to heed his advice, which, if followed more closely, can help this country avoid economic pitfalls.

Mr. Chariman, our cities are mortally sick. Our states in a chronic fiscal crisis. They are suffering from severe and worsening financial malnutrition plus organic administrative impairment.

They just plain lack money. It is not the time to consider where the blame lies or argued about the source of the original infection. The Federal system in our cities and states is in a critical condition. They need a crash program of economic transfusions. After immediate administration of this life-blood, the Congress can get about the business of devising a program of rehabilitation.

I support Republican proposals for revenue sharing. I am pleased the President has offered to the Congress a plan for providing the states and localities with these critically needed funds.

Congressman Reuss and I have another proposition for revenue-sharing. But both plans will provide the financial transfusion to save the patients' lives. We cannot permit a stalemate between the Congress and the administration on this vital issue. The time has come for action. We must face hard facts. We must decide swiftly on a program and then put it into effect immediately.

My appearance here today, therefore, is to further the cause of revenue-sharing—both as a concept whose time has come and as Congressman Reuss and I conceive it might work. Indeed, I fear that if we do not proceed to act swiftly, its time—its value, as a temporary palliative, will have gone. What then may be required is an extension of Federal involvement into local Government on a scale that would have the Founding Fathers literally spinning in their graves.

We here in Washington do not want this. Local Governments do not want this. The people do not want this. I hope that the Congress, in its wisdom, will act to prevent such an involvement, before the courts possibly compound the confusion by saying the Federal Government may not become so involved, without constitutional amendment.

My appearance here is non-partisan—almost, I must say, to the extreme. But providing this hiatus from financial collapse to our state and local governments, will at least buy us all enough time to get on with the streamlining, up-dating, and humanizing our Federal as well as state and local governments.

Quite candidly, we all realize Washington would be quite helpless without local governments. We need them perhaps more than they need us. Without them, as most integral factors in the total governmental equation, we would have chaos. Their health and effectiveness directly affect the Federal Government. And, more importantly, the people they serve, or fail to serve, are our people—and ultimately all governments are theirs.

I am sure the membership of this committee is aware of the basics of the Humphrey-Reuss Bill. It calls for a four-year authorization of from $3 billion the first year to $9 billion the fourth. Each fiscal year will require a separate appropriation from general funds and each State is required to file a master reorganization plan and a timetable for its implementation.

While this does amount to a nearly meaningless string in the authorization itself, I am sure that national organizations representing States, counties, and cities are aware of what goes on during the appropriations process. Appropriations committees in the House and Senate will be looking at the progress or lack thereof in the reform to which the States have committed themselves. I believe that the Congress, which provides the medicine, does have the right to examine the patient regularly during treatment.

This is why I believe the Humphrey-Reuss Bill is superior in conception to the various other proposals that have been forthcoming. The bill provides direct funding to the States and localities. It hints strongly in the authorizing legislation that State and local governmental reform would be a fine process to plan, institute and implement.

However, this hint is followed up with a yearly congressional review of actual funding. It is unpleasant to think of the States and localities being penalized for the failure of a few. However, I trust that pressures from their peers would be a strong convincing and motivating force.

In our prepared statement, we discuss the alternative of providing for a complete Federal assumption of the welfare costs throughout the Nation. I believe the Federal Government should assume these costs, and the sooner the better. In programs that are controlled through Federal standards, there should be Federal financing. This will be even more imperative when Congress establishes a guaranteed minimum income for all Americans.

Welfare costs should be assumed by the Federal Government and thus save the States and localities over $7 billion. Naturally, the greatest savings will be to those States that have the highest welfare burdens. This is as it should be. The number of those in need of financial assistance through welfare are also in need of a host of other State and local services. This demand on present tax revenues is one side of the coin. The other is a completely inadequate tax base. In other words, where need is the greatest, the tax base designated for social-needs revenues is the weakest.

So there is a basic equity to granting Federal welfare assistance to those in the greatest need. However, there are State and local governments that, while they do not have as crushing a welfare burden as New York, California, or New Jersey, they too need immediate financial aid. Rural areas, with no industrial tax base are one example.

The Humphrey-Reuss Bill, paired with a welfare reform and Federal refinancing bill, would provide assistance to both types of jurisdictions.

I urge the administration and the Congress to be flexible and to work together in a spirit of bi-partisanship. I have pledged my help in bringing together those urging one plan to the exclusion of the other. We can and must have both revenue-sharlng and Federal funding of welfare.

I expect my pledge of cooperation and conciliation to be taken on its face value. We cannot play politics with this issue. There exists a pressing national need that knows no politics. We are here to find a solution to the financial plight of State and local governments—and we will.

This country, when the need is great and the danger clear and present, has always closed ranks—presented a united front to those from without who would destroy or undermine our security. To no small degree will the maintenance of the civil peace here within the nation depend on Government becoming increasingly responsive to the needs of the people—and remaining responsive to the people.

I believe that implementation of the Humphrey-Reuss concept of revenue-sharing, and Governmental reform, in concept with Federal assumption of welfare costs, can help heal our social wounds and help cure Americans of this pandemic mononucleosis of the soul.

Mr. Chairman, I wish to thank you again for the chance to present our views on these matters. The professional caliber of both Members and staff of the Joint Economic Committee, has made this committee the most respected economic forum in the Nation. The professional economists and policymakers know and respect this committee. It certainly is no love feast to appear here as a witness, but the clash of ideas—debate of conflicting positions and the meeting of economic minds cannot help but continue to be of immense value to the Congress and the Nation.

Thank you.

Chairman PROXMIRE. Thank you, Senator Humphrey. Mr. Weidenbaum, we promised you 5 minutes to respond to those parts of the remarks by Congressman Reuss and Senator Humphrey that criticized the administration's recommendations. Go ahead.

Mr. WEIDENBAUM. Thank you, Mr. Chairman.

It is a personal pleasure to share this panel with two very distinguished Members of the Congress and this committee, and I greatly appreciate the fine and generous statements by Senator Humphrey and Congressman Reuss.

They have introduced a good bill, and I will not attack it. I note that some of the Members of the Congress, who are cosponsors of our bill, have also sponsored their bill. We have done nothing to discourage that. In fact, we hope that Messrs. Humphrey and Reuss and their cosponsors also will see their way to cosponsor our bill.

In their fundamentals, the two approaches go down the very same path. Of course, in some specifics, they differ, but I do not think we should get hung up on that.

I do think, of course, that ours is a better bill, although I would suspect that it could be bettered yet by further changes and improvements.

With reference to some of the points raised, in the two preceding statements, I do believe that our bill, our approach, provides an important incentive. It is a tax effort incentive which essentially means that revenue sharing would go in large proportion to those State and local governments that are doing the most to help themselves, using their own resources.

Incidentally, we are cognizant of the proliferation of governmental units, and, hence, the local portion of the bill as we have drafted it is limited to general purpose local governments, that is cities and counties, far fewer than the 63,000 figure. No matter how meritorious, sewer districts, fire districts, and other special districts do not qualify for direct participation in our local formula for revenue sharing.

A further point, even though we have drafted a bill which would be a long-term commitment in terms of a permanent appropriation, as we all know, no Congress can bind another Congress. Given the reports that the Treasury will be making to the President and the Congress on the efforts on revenue sharing, each Congress will be free to modify it in any way they wish. But we do believe it important to get away from the stop and go approach characteristic of so many grants-in-aid programs, and instead move to a system whereby State and local governments can engage in some longer term planning and project development. This will be a major increase in the efficiency and the effectiveness of their expenditures, and the financing arrangement within the administration's bill would provide just for that.

I should emphasize strongly as I can that this is, as best as we possibly could achieve, not a bipartisan bill but a nonpartisan bill. We literally spent many, many, not man-days, but man-weeks, man-months working with Governors, mayors, State and local officials of all political persuasions, and private citizens, taxpayers, scholars, again of all political persuasion, independent voters, to obtain not a partisan advantage but as good a revenue-sharing bill as it was possible.

Let me just conclude by saying that this Nation clearly needs revenue sharing. We need it now, and the administration welcomes your support in a mutual and nonpartisan effort.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Weidenbaum and gentlemen.

All three of you gentlemen, of course, are committed to this, and you are all eloquent and persuasive. But I do think we have to consider one of the basic objections that has been made against revenue sharing.

This is a permanent program you are proposing, not an emergency program to come to the rescue of the cities that are in, we all agree, serious plight now.

We had earlier hearings this year in which we had the mayor of Newark, the mayor of New York, Governors and others appear, and there was no question that they are in a desperate plight now.

There is now a question as to whether or not we should have a big permanent program which, as Mr. Weidenbaum says, will grow as revenues grow, and could grow even more rapidly if the pressure from the mayors and legislators and Governors and so forth, is effective.

The reason I ask that is because of some studies, one by Richard Musgrave, who is recognized as a competent economist, which questions whether or not in the next few years we are going to have the kind of needs overall from the States and cities which you gentlemen have implied that we may have.

Their estimate, for example, the estimate of Mr. Musgrave and his colleagues is that in 1975 State and local expenditures will be about $191 billion, and that is allowing for increased workloads due to a rising population and for quality improvement, and so forth. Revenue, including Federal aid, under present programs, would be about $174 billion, leaving a deficit of $17 billion.

Of this amount, they point out that $11 billion will be covered by normal borrowing, leaving a gap of $6 billion. They say this is only slightly above what the administration revenue-sharing program would add annually by 1975. Alternatively, it could be met by a 5-percent tax increase in rates at the State and local government level, an increase that could well be reached, given their past record of rate increases.

I would like to have the reaction to the criticism—the reaction of each of you to the criticism—that this really is not needed on a full-time basis.

Mr. Weidenbaum.

Mr. WEIDENBAUM. In all of the examinations that I have made, not just of State and local government as a statistical abstraction, but visiting, talking to, working with individual States, cities, and counties, I believe that the situation is not nearly as rosy as apparently my good friend Mr. Musgrave might indicate.

I believe that when you look at the pressures on State and local governments, the case is very persuasive for utilizing a portion of the progressive income tax.

Chairman PROXMIRE. Have you made any demographic studies or other studies indicating the number, for example, of the population that would be of school age, the number who would be retired, and so forth, 5, 6, 7 years from now to determine whether or not, in fact, we will have a growing burden or a lesser burden?

Mr. WEIDENBAUM. Yes; and, of course, when you give weight to the changing distribution, particularly the greater emphasis on college education which is, by far, the most expensive form of education, I find a continuing upward pressure on State and local spending.

I am familiar with studies such as these, and inevitably they underestimate the expenditure pressures. The key way they underestimate the expenditure pressures is that time and time again there is the often unstated assumption that the current situation really remains as it is; that is, the current programs and responsibilities of State and local governments.

Chairman PROXMIRE. This is an excellent response in theory but I just wondered if there is a solid study to contradict the fact, the figures, that have been proposed here?

Mr. WEIDENBAUM. Hence, Mr. Chairman, I look at the estimated requirements to meet, say, pollution control and mass transportation, I need go no further than the very substantial volume of studies, commissioned by this committee several years ago, as to the long-term capital financing requirements of State and local governments. These were not percentages of GNP sort of approach, but detailed evaluations from the ground up. I believe when you look at these real world estimates of the needs, the bonafide needs of State and local government, that there is a persuasive case for a long-term effort such as revenue sharing.

Certainly, individual cities such as Newark, such as New York, such as St. Louis, in the here and now, point out their very real financial problems. But I do believe when you look at the nature of their tax systems, they are regressive; that is, income in elastic tax systems, in relation to their program expenditures. This is not only a real but a continuing problem we face.

Hence, we believe it was very important to come up not with a quick fix, but with a durable long-term program. That is precisely why we have tied our recommendations on revenue sharing not to a specific dollar figure over the years, but to the Federal tax base.

Chairman PROXMIRE. Before I call on Mr. Reuss, I would like to ask you, Mr. Weidenbaum, if you would consider if the Treasury has not already made this kind of study, and others have not, if you could come up with some kind of study like the urban coalition budget which they have offered in the last few days spelling out the services, required, what this would mean in terms of revenue sharing or what alternatives there are. If you think this is too ambitious, and many may think it is too ambitious, but something that would give us the facts and figures so that we could consider this on the basis of something other than an eloquent appeal to emotion, something that would spell out the services that are to be provided and where they should be provided and so forth.

Mr. WEIDENBAUM. I shall be pleased to do so.

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

[Extract from *Prospects for Reallocating Public Resources: A Study in Federal-State Fiscal Relations*, by Murray L. Weidenbaum, November 1967, American Enterprise Institute for Public Policy Research, Washington, D.C. 20036, pp. 25 to 29]

FEDERAL-STATE-LOCAL FISCAL RELATIONS

The preceding analysis of the magnitude of potential availability of federal funds leads to the central question to be considered in this study—the fiscal relations between the federal government and state and local jurisdictions. The contrast between the federal outlook and state-local fiscal potentials is striking. Budget deficits have been and are likely to continue to be the traditional financial concern of the states and their subdivisions. The underlying reasons are not difficult to identify.

As has been demonstrated in the public finance literature, the federal tax structure is on balance mildly progressive, while those of the state and local governments are in general proportional or regressive.[1] There is no necessity, for the purposes of the present undertaking, to examine the general desirability of progressive or proportional or regressive taxation. Our concern is limited to one of the objective results emanating from these different tax structures. By definition, the tax payment rises faster than the taxpayer's income under a progressive revenue structure. The opposite of this situation normally takes place under a regressive system. Under the latter circumstances, as the taxpayer's income rises, his absolute tax payments go up but at a slower rate than his income.

TABLE 4.—ELASTICITIES OF MAJOR CATEGORIES OF STATE GENERAL REVENUE (IN RELATION TO GROSS NATIONAL PRODUCT)

Revenue source	Elasticity estimates		
	Low	Medium	High
Property taxes	0.7	0.9	1.1
Income taxes:			
Individual	1.5	1.65	1.8
Corporate	1.1	1.2	1.3
Sales taxes:			
General	.9	.97	1.05
Motor fuel	.4	.5	.6
Alcoholic beverages	.4	.5	.6
Tobacco	.3	.35	.4
Public utilities	.9	.95	1.0
Other	.9	1.0	1.1
Auto license and registration	.2	.3	.4
Death and gift taxes	1.0	1.1	1.2
All other taxes	.6	.65	.7
Higher education fees	1.6	1.7	1.8
Hospital fees	1.3	1.4	1.5
Natural resources fees	.9	1.0	1.
Interest earnings	.6	.7	.8
Miscellaneous fees and charges	.6	.7	.8

Source: Compiled by Advisory Commission on Intergovernmental Relations from a variety of sources. Cf. Advisory Commission on Inter governmental Relations, "Fed ral-State Coordination of Personal Income Taxes," October 1965, p. 42.

[1] The most recent and comprehensive studies are W. Irwin Gillespie, "Effects of Public Expenditures on the Distribution of Income," in Richard A. Musgrave, ed., *Essays in Fiscal Federalism* (Washington, D.C.: Brookings Instiution, 1965) and George Bishop, *Tax Burdens and Benefits of Government Expenditures by Income Class, 1961 and 1965* (New York: Tax Foundation, Inc., 1967).

Hence, during periods of economic growth, the receipts from the progressive federal tax structure rise at a more rapid rate than the gross national product or total personal income. This was one of the most significant findings of chapter III. The reverse of this situation normally takes place at local and state levels (see Table 4). Most of their tax sources do not rise as rapidly as the income base. The typical state and local tax structure is less elastic than the federal; that is, it is relatively less sensitive to changes in the level of economic activity. Only by adjusting assessment ratios and increasing tax rates do the yields of property taxes keep up with the increases in gross national product.[2] Other major state-local revenue sources, such as general sales taxes, tend to be proportional to the volume of business activity. Specific excises, licenses, and other similar sources yield increases in revenues far less than the rate of overall economic growth. Only individual and corporate income taxes, a relatively unimportant source of government income at state and local levels, tend to be relatively elastic in relation to changes in the tax base.

A basically different situation prevails on the outgo side.[3] A typical example is the requirement for public education, which is generally the largest program area for state and local jurisdictions. The public education budget continues to increase far more rapidly than either population as a whole or the gross national product. The major causes are not difficult to identify, such as the rapid rise in the school-age population. This trend is continuing as the influence of the post-World War II baby boom is felt first by elementary schools, then by secondary schools, and ultimately by colleges and universities.

TABLE 5.—PUBLIC EXPENDITURES FOR EDUCATION (SCHOOL YEARS. BILLIONS OF 1965-66 DOLLARS)

Year	Total	Elementary and secondary schools: Total	Expenses	Current outlays	Capital interest	Higher education institutions: Total	Current expenses	Capital outlays
1955 to 1956	16.6	13.8	10.0	3.5	0.3	2.8	2.2	0.6
1960 to 1961	23.1	18.5	14.6	3.3	.6	4.6	3.5	1.1
1965 to 1966	35.1	26.1	21.5	3.8	.8	9.0	6.5	2.5
1970 to 1971	43.0	31.3	26.6	3.6	1.1	11.7	9.7	2.0
1975 to 1976	50.9	35.8	30.9	3.5	1.4	15.1	13.1	2.0

Source: Office of Education, U.S. Department of Health, Education, and Welafre, "Projections of Educational Statistics to 1975-76" (Washington: Government Printing Office, 1966), pp. 68-70.

It should be noted that average costs per student are higher at each more advanced stage of formal learning. The United States Office of Education—on the basis of fairly conservative procedures and methodology—has projected an increase of 56 percent in public expenditures for education for the period 1965-75 (see Table 5 for details). State and local governmental units likely will have to assume the major share of this projected increase. At present, for example, federal moneys account for only 8.3 percent of total public expenditures for education.

The continued movement of people to new suburban areas, requiring expensive new public facilities for many localities, constitutes another major source of expansion for state and local public services.

The Advisory Commission on Intergovernmental Relations has pointed out that in recent years state and local spending has been rising at the rate of 8-9 percent a year, strikingly faster than the nation's output of goods and services. The commission believes that the recent rate of increase in expenditures of state and local governments can be expected to persist at least for some years because the forces that produced it continue to be operative and additional ones are developing.[4] Hence, the fiscal prospects for state and local governments differ fundamentally from those of the federal Treasury.

Joseph Pechman has presented a rudimentary but quite moderate statistical analysis of the situation. He reasons that if the gross national product grows at 5 percent a year and revenues of state and local governments (including federal

[2] See Dick Netzer, *The Property Tax* (Washington: Brookings Institution, 1965), ch. VII.
[3] This section is based in part on M. L. Weidenbaum, "Federal Resources and Urban Needs," Samuel Warner, ed., *Planning for a Nation of Cities* (Cambridge: M.I.T. Press, 1966).
[4] U.S. Advisory Commission on Intergovernmental Relations, *Federal-State Coordination of Personal Income Taxes*, October 1965, p. 3.

grants-in-aid) keep pace with this growth, state and local receipts would reach about $88 billion by 1970. But if state and local expenditures grow at the rate of 7 percent a year—which Pechman contends is conservative—they would reach $103 billion by 1970, leaving a gap of about $15 billion.

On the basis of a later and more detailed examination of specific state and local expenditure programs and revenue sources, Mushkin and Adams reach a conclusion similar to that of Pechman. On a conservative evaluation of state and local governmental revenues, including rising receipts from federal grants, they estimate the state and local revenue gap as reaching $19.6 billion in the fiscal year 1970. On the basis of more optimistic revenue assumptions, Mushkin and Adams estimate the revenue gap in 1970 at $13.9 billion.[5]

A more recent study, it should be noted, yields substantially different conclusions. The Tax Foundation estimates that the yields of current state and local taxes will be adequate to cover the expenditure requirements that the Foundation estimates. However, it appears that the Tax Foundation bases its estimates on the implicit and restrictive assumption that few if any new programs will be initiated by state and local governments during the coming decade.[6]

Higher tax rates and assessment ratios, new taxes, increased grants-in-aid from the federal government, additional debt creation, and deferral of some programs are the five primary routes which state and local governments have utilized in order to maintain their financial solvency in the face of rising expenditure demands.

To be sure, each of the existing sources of funds will continue to be utilized to the extent that they can be, but some of them have severe limitations. For example, the indebtedness of state and local governments has grown very substantially since the surpluses accumulated during World War II were used up. Total state debt rose 339 percent from 1950 to 1964, and that of cities and other local governments increased by 236 percent during the same period.[7] Further increases often are limited or prevented by constitutional debt ceilings and similar legal restraints. The imposition of new taxes and raising the rates on existing sources appear to encounter increasing voter resistance and accentuate problems of interstate competition.

On the other hand, it is clear that federal aid in the form of specific grants will continue to expand. The antipoverty program and the recent and relatively general programs of aid to education are indicative of future trends. However, it is unlikely that existing federal grants-in-aid programs, which were budgeted at about $13 billion in the fiscal year 1966, will increase sufficiently to enable state and local governments to bridge the gap between revenues from existing taxes and the rising expenditure requirements of established functions.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. On the question the professor raised, Mr. Musgrave's proposition, that by 1975 the State and local governments will be $6 billion a year in the hole, and why not repair that $6 billion hole by increasing their taxes, as opposed to the Federal Government coming to the rescue: leaving the arithmetic aside for a moment, and accepting it as valid, I would say unhesitatingly, yes, the Federal Government should put up the $6 billion rather than the State and local governments. I say this because State and local governments would have to raise it by the property tax on the homeowner, the sales tax on the housewife, and all the other regressive local and State taxes, whereas the Federal Government can better raise it because it is seized of the progressive inclme tax.

I believe that $6 billion gap should, under our Federal system, be filled by the Federal income tax rather than by State and local regressive sales and property taxes for two reasons:

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[5] Joseph A. Pechman, "Financing State and Local Government," in American Bankers Association, *Proceedings of a Symposium on Federal Taxation,* New York, 1965, p. 76. Selma J. Mushkin and Robert F. Adams, "Emerging Patterns of Federalism," *National Tax Journal,* September 1966, pp. 236–40.

[6] Elsie M. Watters, *Fiscal Outlook for State and Local Government to 1975* (New York: Tax Foundation, Inc., 1966).

[7] *Facts and Figures on Government Finance,* Thirteenth Edition, 1964–65 (New York: Tax Foundation, Inc., 1965), p. 15.

One, equity, ability to pay—that is what we Democrats at least, and I think increasingly both parties say should be the hallmark of just taxation.

Second I want to prove old Karl Marx wrong. Karl Marx's thesis was that capitalism would run out of spending power on the part of the consumer and, hence, you would have these agonies, and the final disappearance of the free enterprise system. I would like to prove the old boy wrong, by getting into our Federal system a system of taxation which did not get so much out of the poor man's spending power via the property and the sales tax, but met the expenses of government to the largest possible extent by taxing and taking away from those who have more and who would not spend usefully at either consumption or investment that which is left in their pockets by a curtailed income tax.

Chairman Proxmire. If by 1975 the Federal Government is doing what Senator Humphrey indicated he hoped they would, they would be picking up the full welfare burden, then it will be more than $6 billion, substantially more, as I understand it, on the basis of projections under these circumstances, what need would there be for revenue-sharing or would you disagree and feel that only part of the welfare burden should be picked up by the Federal Government and the remainder should be revenue sharing?

Representative Reuss. I believe that by 1975 the Federal Government should be picking up about $5 or $6 billion on revenue-sharing and about $5 or $6 billion on a welfare takeover.

Chairman Proxmire. Then you would say, this would imply, that the services, local services, should be expanded by $5 or $6 billion above the projections made by Musgrave and others or that there should be $5 or $6 billion of local tax reductions.

Representative Reuss. I should think a combination of it. Instead of talking about local tax relief, I would prefer to be a little more honest and talk about an end to the constant increase of State and local regressive taxes. If we can just hold it a few old folks may still be able to live in the old home.

Chairman Proxmire. You see, the arithmetic, unless you can show the arithmetic is wrong—and it may be—he says there is a $6 billion need, and you say you do not quarrel with that, and then you say, provide $5 or $6 billion of revenue sharing and $5 or $6 billion of assumption of welfare, and the implication is that you are giving them twice as much as the Musgrave studies suggests they may need.

Representative Reuss. I think Mr. Musgrave's arithmetic is like $5 or $6 billion too optimistic. If, however, it is exactly right, then I would let the State and local governments reduce their property and sales taxes which would be much better, in my judgment in terms of a going economy than to have Uncle Sam reduce the progressive income tax.

Chairman Proxmire. Let me say before I call on Senator Humphrey, this brings us to a point that none of your gentlemen have raised, but it is in the back of the minds of all of us, and that is the biggest objection is the unwillingness of most Members of the House and Senate to vote the taxes for the mayors and Governors, even if in one's own party, to spend and take credit for in reducing local taxes. After all, we may be building up one of our future opponents. [Laughter.]

Senator HUMPHREY. Mr. Chairman, what you have just said is a very real consideration; there is no doubt about it.

I am sure that way back, if not in the subconscious, let me say at least in the recesses of the mind, there is this wondering about whether we are going to bail them out. We did not get them into the trouble, and they are going to take credit for better administration and for the goodies of life back home. You can understand why a Congressman or a Senator does not want to be held accountable either for the large appropriations or the tax schedule that is required.

But I think we have got to start to believe in this country; that in this Nation there is mobility of the people.

One of the reasons why I have long supported many of the Federal programs is because people move. A man who lives in South Carolina today is going to be living in Colorado tomorrow, and particularly is this true of young people and the corporate business community. We have corporations hiring thousands and thousands of our best people coming from our universities and colleges saying, "Well now, we will start you out in New York, but we want you to go to Seattle 2 years from now." So there has to be some uniformity of social services in this country and of community and governmental services.

We cannot afford to have breakdowns in different areas of America. We are paying a terrible price for it on the basis of segregation, Mr. Chairman. We are paying a horrendous price for past mistakes and we have made mistakes all over, in rural America, urban America, north and south, and we are now beginning to find out with the Interstate Highway System, with the corporate structure we have, with the airplane and automobile, that people just do not stay where they were born and where they went to high school. They move around this country. All the more reason for what I call the more equitable sharing of national resources in these areas that we call States and localities which, in this day and age, are just convenient jurisdictions for the application of the rules of government and effectuating social services.

We are coming into a period of increased urbanization. And I'm going to take on Mr. Musgrave. I do not believe his figures. I do not believe them because I have been out around with the folks. It costs more money when a man moves into a city than when he is out there in the countryside. It is just more expensive, and there is not a bit of evidence in the last 20 years that shows that localities and States are getting better off.

Now, unless you can prove to me even as they have added on revenue schemes and taxes, the fact of the matter is that when these cities grow and these metropolitan areas grow, it costs more for the social services. Present services we have today are abominable, they are just lousy, and we do not have the programs and services going on that ought to be going on.

Now, I realize we have a number of grants-in-aid programs. I think we can help a great deal. For example, if we pass health insurance programs, we can relieve States and localities of a great deal of health costs. No doubt about that.

If we absorb some of the welfare costs, like Congressman Reuss and I talked about, it is going to be very helpful.

Federal aid to education and, by the way, I do not want revenue sharing to be an excuse for dismantling a number of programs which this Congress has declared our national priorities.

We do have a nation, we do not just have the Twin Cities or Minnesota or Alabama or Kansas or Wisconsin or New Jersey or someplace else; we have a country to take care of, and I think we have to think in those terms.

Now, Mr. Musgrave can come to me, and I will come to him, but I have not seen any evidence that is very relieving as to what the cost of government are going to be except that they are going up, up, up. Inflationary cost alone affect local government severely.

Mr. Chairman, we do not even have parking in our cities. Take a look at this place. You cannot park a car around here. The only people who can park here are the ones who get up early enough. We do not even provide parking in this city for our constituents who come down here. All over America it is the same way. Nobody ever figures out if you put 12 million new cars on the road where they are going to stop. No one figures out what we are going to do about these things. There is no national planning, and if Mr. Musgrave has a plan which will show me that the cities and the States are not going to be seriously off in 1975, he is the best thing I have read since Isaiah.

I just do not believe that you can show it except perhaps theoretically. But what is the evidence? Everytime we build an airport, Mr. Chairman, in 10 years it is too small. Everytime we plan a super highway, from the time it is built, it is too crowded.

There are just some people in this country who do not understand that we continue to grow and have babies and problems in this America. This country is growing, and what is more, it is going to continue to grow, and what we really need to be thinking about is how we are going. We need to be planning ahead 10 years as to what kind of revenue systems we need to meet these needs.

Everytime you put up a highrise apartment, Mr. Chairman, you increase the cost of Government. Everytime that we put a new automobile on the street we increase the cost of Government.

The welfare costs in this country which we now talk about as being horrendous are pitifully low in some places. In some parts of America people on welfare are treated like they are subhuman. And I do not think this country is going to stand for it.

I think when these 18-year olds start to vote and these 19- and 20-year olds, they are going to say, "Listen, you are not going to keep somebody on welfare for $75 a month."

Despite Mr. Musgrave, there is nothing in the books, that tells me it is going to cost less tomorrow than it cost today. Even if we put in the prorated growth of our economy, in terms of what we call a full employment economy, it is not going to cost less.

May I add here again that the best kind of revenue sharing I know is to get this country back to work again. One of the reasons the cities are in serious trouble today, more than ever before, and the States, is that revenues are down, the take is down, and the Federal Government's take is down.

I hear a lot of people say or ask where are we going to get the money. Well, the fact is, we are going to have to borrow this money until we get this economy going.

We are losing $60 billion a year because we have been diddling around, letting the economy go into the doldrums. When we get that $60 billion plus, with the growth rate, we will have more revenues. I am sure Mr. Musgrave is thinking about that except, as Congressman

Reuss said, most States, because of the nature of State and local government cannot have a local income tax very well without literally killing your city. You just cannot do it.

So, therefore, in a city what you have for you tax base are the license fees, sometimes you get a prorated sales tax that they kick back to you, your liquor fees, your real estate property tax, the worse possible tax system to kill off a free enterprise system and to kill off a system in which we believe in some kind of private initiative. The Federal Government has the best tax system, and it needs improvement.

Chairman PROXMIRE. Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

I would like to compliment all three of you gentlemen for your testimony, and which shows the common goals and objectives. I am sure we can well afford to work together in order to produce something during this coming session of Congress.

My mind wandered a little bit when you were talking about parking and traffic in Washington. I would just like to, for whatever it is worth, say this: I think it is a disgrace that Congress won't tackle the problem they have created by deciding that everybody is entitled to a garage here on the Hill regardless of whether they are a part-time employee or somebody else. It is the most expensive parking of all kinds, and what we are doing is utterly ridiculous.

We are not trying to encourage club riding like we used to have during World War II. But traffic has multiplied to the point where we are being stifled and stagnated and everybody is disgusted by it, but nobody wants to give up driving his own personal car to work.

Chairman PROXMIRE. We all ought to run to work. [Laughter.]

Representative WIDNALL. I am not sure of that. But it seems to me that we ourselves have failed in the leadership in some of these things where we could well have cut the cost and eliminate some of the stagnation and stifling which have taken place.

Now, our first panelist, in his statement, said:

> My comparison of the current bill with the one introduced in the previous Congress will demonstrate not merely our intent to listen but our willingness to take account of the suggestions and the constructive criticism that we have received.

Now, what would you point to to show that you have been doing this? I cannot particularly pick this out in the proposals being made by the administration.

Mr. WEIDENBAUM. I am pleased to do so, Mr. Widnall.

First of all, the most substantial change is a larger share for local governments. In the earlier bill, the one introduced in the 91st Congress, on the average, cities and counties received about 30 percent of the money, and the State governments received 70 percent, although that varied State by State.

We were requested by State and particularly local officials to redress the balance, to work for as close to a 50–50 distribution of the money as we could. We had drafting sessions with representatives of the Governor's conference, the mayor's conference, the League of Cities, National Association of Counties, State legislatures, city managers. We worked out in detail the very specific local sharing arrangement in the new bill which provides, on the average, that 48 percent of the funds go to cities and counties, and 52 percent to the States.

This, as I say, was worked in close cooperation with State and local governments. This is the single biggest change, the larger local share.

A second change, and again a companion to that, was expanding the local option. We had a local option in the old bill, but, frankly, it was very hard to trigger it into action.

The idea of the local option, briefly, is that if we had our druthers, we would rather see the people in a given State decide on how to spend revenue-sharing money rather than having it spelled out in the Federal statute. The Federal statute ideally should provide for the State-by-State distribution, and the people within the State take it from there. We develop again jointly with the State and local governments, a specific, we believe, a very workable local option; a majority of the cities and counties can get together and, subject to the approval of the State legislature, agree on a different plan for distributing the revenue sharing money in that State, one that is more suitable to their particular local situation.

In fact, there is a 10 percent incentive for them to do so, to get this local option into operation, because we do think we get a better revenue sharing bill if the people in that State determine how the money is distributed within the State rather than determining it in any national statute.

Finally, we were urged, particularly by the cities, to have a specific civil rights clause in the statute. Last year we just assumed that existing civil rights protection would be afforded to revenue sharing.

However, in good measure, as the result of the urging of the city organizations, we put in a very specific civil rights nondiscrimination section in the new bill so that there would not be any question on the subject.

Of course, in addition to those were some relatively minor changes, but these, I may add, were the key points raised by the States and localities that we worked with and, hence, these are the main changes that we have incorporated.

I cite them mainly to indicate our very openmindedness in revenue sharing.

I should add, Mr. Widnall, that I heard reference to the work of Walter Heller and Joseph Pechman, the work they had done in revenue sharing.

It is true that my two old friends certainly have contributed a great deal. But I think, if you examine the administration's revenue sharing bill in detail, you see a lot more than the simple Heller-Pechman plan.

First of all, under the Heller-Pechman plan, all of the money went to the State legislatures. Again in a burst of nonpartisanship, you see under our plan that almost half the money goes to local governments. There are not nearly as many local governments that are Republican as we would like to see [laughter], but we thought a fair nonpartisan bill calls for including in a major way our local governments. This is certainly a major innovation on the part of the administration.

Representative Widnall. More and more, as inflation has continued, we are feeling pressures to bring out wage and price controls and possibly, rent controls and other types of controls. We are going to have measures in the current Congress and very soon, to continue the voluntary setup that was passed, enacted, by the Congress recently.

We still have not appropriated any money to take care of any type of controls in operation from either the voluntary or the mandatory methods, and I do not see how you can honestly do a job on this unless Congress is willing to face up to the fact that in order to accomplish anything you have to have employees designated for the purpose, working on it, so you can move into it right away.

We have a very urgent situation here at the present time, and to kid around more and more, was we have done with "Well, we will take the piggy off this one's back and put it on another one's back," and not really solve the situation or face up to it properly, this is just going to place our country in an even more precarious position than it is right now.

I hope that both the House and the Senate will face up to the fact that they are going to have to appropriate money to at least set up the framework and get it going.

It is perfectly ridiculous to say you have done something when you do not appropriate any money to cover it.

What are your views about it?

Mr. WEIDENBAUM. I would respectfully wish to defer Treasury comments on matters of general economic policy until Friday morning when Secretary Connally will make his maiden appearance before the committee. He will be in a position to give you a very full and clear exposition of the Treasury views on that matter.

Representative WIDNALL. I respect your wishes in that matter.

Some comment was made, I believe by Senator Humphrey in connection with sewage treatment plants and the fact that these are needed vitally throughout the country and I heartily agree with this.

As one who has, as Congressman Reuss can tell you, been very much in the lead, with a few others, in trying to do something about it. How are we going to meet the needs in this field if every time that you look at the figures on sewage treatment plants it is not just for new material that would go into a plant, but the tremendous increases that are now taking place in wages and fringe benefits, and others of those who are working?

You did not even attempt to catch up unless you increased the appropriations, and you are going backward. What do you suggest?

Senator HUMPHREY. Congressman, I am afraid we are not in the situation of how we are going to do it, I just tell you we have to do it. It is sort of like your sister or your brother or your wife gets sick, you take care of them, and we just have got to face up to this. We have got to be able to pay for these matters, and we have got to be able to finance them on a basis that is a little more sensible than we are doing.

What is this feeling by the Congress that we have to appropriate everything at once.

I buy an apartment and I have a 30-year mortgage. If I had to pay for that apartment at one time I would be out of business. Why doesn't the Congress of the United States and local governments—by the way, they do it when they issue bonds, they put long-term bonds out—why don't we start to build sewage disposal plants and other things on the basis of 30-, 40-year datelines. We really ought to start operating like a business does.

It just appalls me at times that we continue to operate as if we have to put cash on the barrel for everything. You know, we built a sewage disposal plant in the Twin Cities 35 years ago. When I was mayor of the city of Minneapolis, I served on that particular board that governed what we called the sanitation district.

Well, when we put our share of the money in, we did it on the basis of 20- or 30-year bonds.

But when you get something from the Federal Government we have to come down and say, now we have to have it this year, th whole ball game for that plant. There is not a city in the country that can do it.

The cities, at least, have that much sense, they do project it out on long-term financing; A.T. & T., long-term financing; everybody does long-term financing except when the Federal Government gets in business. I think one of these days we are going to have to take another look at the budget of the Congress on capital improvements, improvements of the capital structure of this country—long-term financing. We must have some faith in the country. It is not going to disappear tomorrow morning.

Representative WIDNALL. What you are saying is a lot of the cure is right here in Washington by changing our methods of doing business.

Senator HUMPHREY. I think some of it is here, I think there is no doubt about it, and I think we are going to be compelled to do it ultimately. This is what is going to be necessary on capital improvements.

I surely look with disfavor in most instances, unless there is a crisis, upon what we call the immediate services of Government, through long-term financing. But surely with capital improvements we ought to start devising an amortization process just as we do in business on capital improvements. But we are not quite ready to do it yet, I guess. We just continue to talk about it.

Mr. WEIDENBAUM. Mr. Widnall, may I point out that the President's environmental message earlier this month presents a comprehensive long-term program for improvements in the environment. Specifically, the President repeats his recommendation that he made to the 91st Congress for the congressional creation of an Environmental Financing Authority which would assist local governments in the long-term financing of important antipollution devices.

Representative WIDNALL. Thank you. My time is up.

Chairman PROXMIRE. Senator Sparkman.

Senator SPARKMAN. Thank you, Mr. Chairman.

I have listened to all of the statements with a great deal of interest, and I must say I end up I know not where. As a matter of fact, I have joined in cosponsoring the general revenue-sharing proposal in the Senate. I think I explained to Mr. Weidenbaum in my office one day that I thought I had a much better plan that I have advocated for many years, and that was a cession on the part of the U.S. Government in the field of taxation, but apparently we are not going to bring that about.

It seems to me that some of the areas of taxation that the Federal Government has could be ceded to the States and the local governments.

By the way, yesterday a gentleman whom I admire greatly, who has had long years of service in the government, and who is now retired, got to talking with me about this matter at church. He said, "You know, I have studied this whole thing, I have come up with a proposition that I think is the best and would be the easiest to administer of all, and that is that the Federal Government give to the States the cigarette tax," and he made some pretty pungent remarks on this idea.

I simply mention that, among other things, because there are many, many different plans and, of course, there are objections that can be found, I suppose, to all of them.

Sometimes I get so completely bewildered that I become almost downcast.

I was talking to somebody recently on the subject of housing, and he told me that a survey of the housing situation in New York has been made—Bill Widnall, Bill Proxmire, and I are all working on this all the time—and when the report came up it said that it was absolutely impossible to solve the housing problem in New York, it was so enormous.

I sometimes listen about this revenue-sharing, and I get the idea that, perhaps, the situation with the cities and local governments has become about the same.

I think, however, that the people generally in this country want to see some kind of revenue sharing worked out, and I hope we will be able to do something along that line.

By the way, Mr. Weidenbaum, I want to ask you this question: I notice you have commented several times this morning about the civil rights requirements and, I believe, you say in your statement that guidelines will be issued. I want to find out if those guidelines are going to apply uniformly throughout the United States.

Down in my section we have had a lot of bad experience with guidelines that do not coincide with the provisions that my friend, Hubert Humphrey, wrote into the Civil Rights Act, and I just want to find out if we are going to have uniformity in these requirements.

Mr. WEIDENBAUM. I appreciate the opportunity for clarification, Senator.

First of all, the Treasury Department will not be in a position of imposing guidelines on anyone. The statute as drafted provides the same language that now applies to Federal grants-in-aid and, if I may just read it:

> No person shall be excluded from participation in, be denied the benefits of, or be subjected to discrimination on the base of race, color, or national origin under any program or activity funded in whole or in part with general revenue-sharing funds.

This, of course, I assure you, applies across the board, north, south, east, or west. It is a nondiscrimination program. Certainly the Treasury Department would carry out the spirit as well as the letter of that nondiscrimination provision.

However, we do not envision the creation of a Federal bureaucracy to set up guidelines or review plans.

The whole emphasis in revenue sharing is to avoid setting up new bureaus, new Federal overhead activities. The entire program is so set up that it can work more automatically than any program we now have because basically the whole philosophy of revenue sharing is local decisionmaking, local determination. Hence, there is less Federal involvement in this program than in almost any other Federal activity I can think of.

Senator SPARKMAN. When we get to the special revenue sharing part of it, as I understand this, and I had the privilege of talking with some of you, and I have been down to the White House a couple of times for briefings. As I understand it, these programs will replace or supplant the categorical grants being used now, but will be done in such a way that there will be no loss in the amount that we have provided to be spent on these other grants; is that correct?

Mr. WEIDENBAUM. Yes, sir.

Incidentally, I have been talking about in my testimony the $5 billion of general revenue sharing. That is the bill that has been introduced; that is the bill that you cosponsored, I note with pleasure.

The administration is currently working on six special revenue sharing bills. These have not yet been fully developed.

The idea there is to take about one-third of the existing grants-in-aid and to consolidate them into six broader, more general purpose, so-called special revenue sharing bills, one for transportation, one for elementary and secondary education, and so forth.

It is our firm intention that for each State and each city, they will get under the six special revenue sharing bills at least as much as they are getting under these specific grants-in-aid which would be consolidated. This is what the President has called a hold harmless clause.

Hence, this is where the total amount of special revenue sharing comes to $11 billion in the first year, although if you add up the individual grants-in-aid being consolidated, they only come to $10 billion. The extra $1 billion is needed to assure this hold harmless provision.

Senator SPARKMAN. Another thing I think we all would be interested in is that your general revenue sharing, the $5 billion, is a revenue measure and will start in the Ways and Means Committee out of the House of Representatives, and then when it comes to the Senate will be before the Finance Committee.

These other matters are more or less reorganizing programs, and they will go before the various legislative committees of the Congress; is that correct?

Mr. WEIDENBAUM. Yes, sir, that is my understanding. Of course, the determination as to which committee is assigned a bill we would not presume in the executive branch to influence in the slightest.

Senator SPARKMAN. No, I realize that; it is a matter for each House to decide for itself, to which committee it should be referred.

Congressman Reuss, I notice in the joint prepared statement, you said that there are existing loopholes in our tax bill that would amount to between $2 and $3 billion, or was it more than that?

Representative REUSS. I suggested $6 or $8 billion.

Senator SPARKMAN. $6 or $8 billion.

I read a newspaper column, I think it was just this morning, that said it was about $50 billion a year. Did you read that?

Representative REUSS. Yes. These estimates differ and, of course, it depends on what you are doing. My $6 or $8 billion from plugged loopholes—and I have a complete list of them and, perhaps, with the Chair's permission, and just on my own behalf, I could insert it in the record at this time.

Chairman PROXMIRE. Without objection, it will be inserted in the record.

(The information referred to follows:)

REPRESENTATIVE REUSS' $6 BILLION TAX REFORM LOOPHOLE-PLUGGING PACKAGE

1. Eliminate percentage depletion in excess of cost for oil, gas, and other minerals—Revenue gain—$1.2 billion.
2. Eliminate deduction for intangible oil and gas drilling expenses—Revenue gain—$750 million.
3. Eliminate percentage depletion on foreign oil and gas wells—Revenue gain—$100 million.
4. Tax capital gains on property transferred at death—Revenue gain—$3.1 billion.
5. Unify gift and estate taxes into a single transfer tax—Revenue gain—$200 million.
6. Eliminate payment of estate taxes by redemption of Government bonds at par—Revenue gain—$100 million.
7. Tax generation-skipping trusts—Revenue gain—$150 million.
8. Increase capital gains holding period to 1 year—Revenue gain—$150 million.
9. Terminate capital gains treatment for stock options—Revenue gain—$150 million.
10. Tax interest on State and local bonds (with compensating subsidy to States and localities)—Revenue gain—$100 million.

Representative REUSS. My list is composed of mainly down-to-earth Treasury recommendations of the last 4 or 5 years which somehow or other were lost in the shuffle on the first big Tax Reform bill of 1969.

You get your $40 or $50 billion figure, if you contemplate a total review of the Federal income tax system which would, perhaps eliminate deductions entirely. However justified it may be in theory, this does not seem to be politically realistic. So my modest $6 to $8 billion is constructed—and I do think it would do an enormous amount of good to get that loophole money into the Federal revenues—so you do not hurt the economy very much by doing it.

You do not damp down consumer spending power or real capital investment because most of that money that escapes the tax collector goes into bidding up the price of existing assets or into gambling casinos in the Bahamas or other not very productive outlets. So it gives you the most bang for a buck in terms of loophole plugging.

Senator SPARKMAN. Thank you very much. My time is up.

Chairman PROXMIRE. Senator Pearson.

Senator PEARSON. Mr. Chairman, let me make a personal reference in order to ask a question. I just came from a weekend in Kansas seeking to explain and to endorse revenue sharing. I wish I had had the benefit of this hearing before I went. But the question put to me place after place was how do you have revenue sharing when you do not have any revenue and, I thought, the comment you made was to the same point.

The question in Kansas came out of the background of where we have a law shich says that no budget expenditure can be made unless it is itemized in the budget; and parallel with that there is a provision that we cannot make an expenditure unless you have unencumbered cash in the State treasury. This was part of the new bold program that Alf Landon adopted in 1934, and which got him the Republican nomination in 1936. We still live with it, and I understand why they ask a question about how do you have revenue sharing without revenue.

But I do not think you speak from the same kind of background or philosophy, but do I understand you to mean that revenue sharing is only a viable instrument at times when you have a balanced budget or is not feasible when you have a budget called a full employment budget? This, particularly, I think is relevant when you put the revenue sharing into the hands of Congress each year to make a judgment on it, and when you endorse the gradual acceptance of the Federal Government of welfare expenditures to the tune of $7 billion, and I think you know what is on my mind now, the inconsistency that I understood you to make.

Representative REUSS. I appreciate your asking me this question because it gives me an opportunity to make my views clear.

Now, I do not for a moment suggest that revenue sharing or any other expenditure of the Federal Government in a year of less than full employment, such as we are now unfortunately having, should be on a balanced budget basis.

What I meant when I said that we must get revenues to share is that in the future if we are going to expand revenue sharing or Federal expenditures via a welfare takeover or via anything else, we are going to need adequate revenues, and we are only going to get those if we do the things to get our economy moving forward again that we discussed.

So for the next fiscal year, when we are going to have on an income accounts basis a very severe deficit, although not on a full employment basis in this next year, I believe we should have revenue sharing and a beginning of Federal takeover of welfare, even though all of this results in a budget deficit.

Senator PEARSON. Well, let me ask one further question. There was another inconsistency, and maybe I search for them in order to find a question, but as I understand the whole concept of revenue sharing, it is to give the States a greater freedom to determine their own priorities, to recognize that, as Senator Humphrey said, there is a great deal of wisdom in the local governments and in the city governments, and I find the great emphasis you place on here is the best, maybe the last, chance we will have to make the local governments, I think you said, stand up and walk straight, to make them reform, and this seems to me very much inconsistent.

The kind of system we have involves in it the right to be wrong and the freedom to make mistakes, and so forth. I find an inconsistency, although I agree we ought to reform and they ought to reform, but to tie it up with reform, even though you say your reform program is just sent up and does not have to be agreed to. How do you measure that against the concept of revenue sharing or giving the local government greater freedom or great ability to set their own priorities? Senator Humphrey or Congressman Reuss?

Representative REUSS. Let me take a short try at it and, I am sure, the Senator will try to add something.

I do not believe, Senator Pearson, there is the slightest inconsistency between these two bills, the Humphrey-Reuss approach to revenue sharing, just like the administration's, lets the revenue-sharing money be spent at the complete, utter, absolute discretion of the States and localities for good purposes, foolish purposes, or whatever.

In this connection, I might say that I have confidence in the State and local legislators and executives not to spend it foolishly.

Senator PEARSON. Pardon me, you see the point was made that local governments have enough wisdom and wit to spend this money wisely, but they do not have enough wisdom and wit to reform their governments.

Representative REUSS. I now go on to meet this second point.

It is not local or State legislators who are appropriating vast sums for unnecessary military overruns, for supersonic transports, for multimillion-dollar payments to corporate farmers. That is legislators at a different level who seem to do that.

But getting at the point of the string, our bill does not impose any string on the expenditure of these funds by State and local governments.

All we say is that we want the States to go through the intellectual exercise of working out a proposed reform plan for the next 20 years. Whether they stick to that plan is no concern of Uncle Sam's. But we think that progressive-minded State Governors and officials who have tried, sometimes unsuccessfully, and I can think of several in your State of Kansas, to do what you and I agree ought to be done in local government, we need to give them some support. If they can come before their States and say, "Look, my fellow citizens, we must try to work out a reform master plan for the next 20 years, and we will do our best then to try to stick to it," I think we would be helping them and we would not be imposing any kind of a string because if they want to come up with a very pro forma one, one that is not very inspiring but simply takes what is in the old cigar boxes and puts them into a new form, they still get their money. But we would hope we would give an opportunity for some ferment, for some leadership, by State and local officials who want to lead. So it really is not a string.

Senator HUMPHREY. Might I comment on this, Senator Pearson, because I think your point is well raised.

I did say that I thought there was a good deal of competence and ability in State and local officials. Some do not have it and some do. As a matter of fact, the reason I say it is that a large number of these local and State officials seem to find their way into the Senate and the House and the executive branch of the Federal Government.

Some of them go into private industry and they show real ability. But many of them are also severely restrained and restricted by built-in constitutional limitations, constitutional restrictions, and charter restrictions.

You are going to say, "Well, why don't they do more about it?" Sometimes the reason they do not do more about it is they try and they cannot succeed.

But, I believe that one of the strengths of our bill, a bill introduced by Congressman Reuss and myself, is that you, as a Senator, or any Member of the House or the Senate, as these moneys are being allocated each year, can take a look at what is being, what has been, proposed, and kind of take a look over here to see how things have been going, and this is sort of an encouragement to the States to do a better job. While we prescribe certain sums of authorization for fiscal 1972, and so on up the line, there is a chance that that could be changed, you know.

As somebody said, no Congress binds another, and I believe incentives are much better than a compulsion in this instance.

I do not think the Federal Government can, under revenue sharing, really compel that you revise your State constitution. I think right away this would be counterproductive, but there are movements underway from citizens groups throughout this country to modernize State government and many of them are doing it, and many a city today is taking a good look at its governmental structure out of sheer necessity. I believe that with some more work on the part of the Federal Government and the State governments that much can be done to improve programing, much can be done to improve governmental structure.

I cannot promise any quick plan or any quick results, but I do know this, if you said to me before I came in here today to testify that I would have to give you a pretty good idea of what I had in mind, I would come in with a better testimony than if I just walked in the door and said, "Let me talk to you."

I think just the fact that a plan of action is presented helps.

We have listed here on page 6 of the Reuss bill in our table here what we call State direct actions, proposed strengthening of State governments, and the State action affecting localities. These are just suggestions. I want to make this very clear.

As is said in high quarters, I want to make this perfectly clear, I want to have it noted, that these are but suggestions, they are not compulsory, they are not mandatory, but they are suggestions which hundreds of people and organizations over the years have made about how you might improve local government.

In my State of Minnesota, I am happy to report to you we now have a State planning authority. This took place under the previous administration in the State, and that State planning authority is for the first time projecting some long-term developments in the State of Minnesota, and every single budgetary item must fit into that plan, and that planning program, even the matter of conservation, wetlands, and so on. Simple things out in the countryside must fit into what they are developing as a State program of development.

We are not being that tough. We are simply saying that when you get the revenue, don't just follow the old bad habits. Would you mind at least coming up and indicating that you know there is a better way. Whether you do it or not is highly questionable, but just the thought sometimes that there might be a better way is a little helpful.

That is, plus the fact I can see Chairman Proxmire and yourself and others, taking a look at this plan that was presented, and as you come up for the new appropriation for revenue-sharing, somebody is going to say, "But, you know, Governor, you didn't do very much about your program that you presented to us. It was a nice idea. Might we suggest that you get busy on it. This is what you presented, or have you changed your mind?"

What is going to happen, that gets into the local newspapers back home and on the radio and the television, and I do not think you ought to underestimate the feelings of people back home as to what they are wanting out of their State and local governments. Once that Governor and legislature file a plan of modernization, a long-term program of use of revenues and how they are going to reorganize or modernize the State and local government, at least he is on record and you can come up to him and remind him every once in a while of the promises that he made, sort of like New Year's resolutions, I regret to say, but it is nice to remind them.

Senator PEARSON. And the campaign promises.

Senator HUMPHREY. Better than campaign promises, slightly better.

Senator PEARSON. Thank you.

Chairman PROXMIRE. Mr. Weidenbaum, in 1967, you did prepare a paper for this committee on this issue. The title of it was, "Revenue Sharing and Its Alternatives: What Future for Fiscal Federalism?"

The criteria you developed then were income distribution, resource allocation, and economic stabilization, similar to the criteria that you suggested this morning.

In that study, however, in 1967, you concluded that block grants with an equalization feature would do the most to help poor States. Straight tax sharing without an equalization feature would do the least.

You also concluded that direct Federal programs or program grants have an important stabilization effect. You did not find much to choose from among the alternatives in terms of your third criterion, resource allocation. Let me quote from your conclusion, this is what Mr. Weidenbaum said in 1967:

> The choice among the various alternative means of channeling Federal aid to the State primarily becomes a matter not of examining the intrinsic merits of each alternative but rather of determining the relative emphasis to be placed on such basic objectives as income redistribution, resource allocation, and economic stabilization.

Since 1967, when you left Washington University, you have entered an administration which is for revenue sharing.

Now, without being critical, how would you reconcile your 1971 view with your 1967 view?

Mr. WEIDENBAUM. Live and learn, I believe, is the phrase, Mr. Chairman.

I should like to point out that the initial study I did for the Joint Economic Committee in 1967 whetted my appetite, and while I still was at Washington University——

Chairman PROXMIRE. Then you were an objective, unbiased observer.

Mr. WEIDENBAUM (continuing). I did further work on revenue sharing.

In fact, I would like to quote from memory, but there is a short passage in my book, "The Modern Public Sector" which I completed just before joining the administration, and there is a section there which, going through that same sort of analysis, weighing the pros and cons, makes two conclusions:

One—and I am paraphrasing—a major advance would be accomplished by consolidating a good many of the individual grants-in-aid into several broad areas.

I go on to name them, transportation, and so forth. I believe we now call these special revenue sharing. I cite that to indicate that the philosophical theoretical, analytical work came first, and the specific recommendation second.

In the next paragraph of the same chapter of my book "The Modern Public Sector," I say in addition, apparently we did not sell enough copies and no one has one here that they could loan me to get the exact words, but the second paragraph says, the second thing that needs being done is a program whereby we take a portion of Federal revenues and they are distributed to the States without program strings. This is what we call general revenue sharing.

I believe, if you look at that last, most comprehensive study that I did, just before joining the administration, you will find spelled out as clearly as an academic ever can, the case both for general revenue sharing and for special revenue sharing.

Chairman PROXMIRE. But in terms of your first category, your first criterion, income distribution, in terms of equity, in terms of assisting the poor States, your conclusion in 1967 was that the block grants with an equalization feature would do the most, and it makes sense to me.

Why wouldn't that do more than a per capita income sharing of the kind the administration has proposed, revenue sharing?

Mr. WEIDENBAUM. Keep in mind, Senator, what I referred to as block grants then, using the old-fashioned superceded Heller methodology or concept, is what we now in modern terminology refer to as revenue sharing.

So the block grant—that I discussed in the study for this committee—is what we now call, corresponds to what we now call, general revenus sharing. I do point out, if you take the State-by-State distribution of our general revenue-sharing bill, you will find that it is mildly equalizing, that is, if you compare the distribution of income across the United States before and after the general revenue-sharing bill, you will see that this objective of a more equitable income distribution is achieved through the general revenue-sharing program.

Chairman PROXMIRE. Doesn't it make more sense, just from a commonsense standpoint, if the Federal Government picked up the welfare costs, recognizing that poor States, with higher unemployment, with larger numbers of people who cannot work, even if the jobs were available, that this would do more for those poor States and those cities, more for the city of Newark, more for the other localities and States that urgently need money, than if you simply shared revenue on the basis of a per capita basis, whether it goes to Westchester or Harlem?

Mr. WEIDENBAUM. No, Mr. Chairman. First, there are two key points to make.

First of all, in most cases the welfare burden is not borne by the city. It is borne by the State or the county, primarily. Hence, even though a welfare reform program, whether it is the administration's well-conceived family assistance program or any other, will lift the welfare burden in good measure from the States and, to some extent, the counties——

Chairman PROXMIRE. I do not want to interrupt you, but isn't it true you are arguing——

Mr. WEIDENBAUM (continuing). But it won't help the big cities which devote their expenditures not to welfare but to other programs.

Hence, we really think that a combination, a package, is necessary, both the family assistance program to truly reform our archaic welfare program and, two, a general program of general aid to State and local governments, that is general revenue sharing. I point out in my testimony that it is not the Westchesters, it is the city of New York that gets the largest per capita share in the New York metropolitan area, and I believe there is a source of great misunderstanding there.

Under our bill, the central city gets a bigger per capita share.

Chairman PROXMIRE. They get a bigger share, it is mildly equalizing. Why should we provide funds, any funds, to cities and other areas that are doing well? Why should a well-to-do suburb or reasonably well-to-do suburb, get any of this sharing? Why is this a sensible, logical way to meet our needs? They do not need it.

Mr. WEIDENBAUM. There are several key reasons. They get down to the heart of what we mean by the future of a federal system.

First of all, I have been a citizen of a number of these supposedly wealthy suburban communities, and we do have our problems.

First of all, we too are taxpayers, both Federal as well as State, as well as local taxpayers.

Two, we have our problems, too.

And, third, a truly general revenue-sharing bill should not draw the line at any size of city. For example, we examined carefully the recommendations that revenue sharing should be limited to cities of over 50,000 population.

Chairman PROXMIRE. I am not talking about that. I am talking about need; I am talking about not providing revenue sharing to those cities that have a substantially higher per capita income than the national average.

Mr. WEIDENBAUM. The answer that I must provide is that we do not think that arbitrarily any city or county local government should be excluded. The neutral measures that we have developed, it does turn out, do funnel far more proportionately to the poor central cities than to the affluent suburbs.

You take the city of New York. The per capita share of revenue sharing is something like two or three times the per capita share to the so-called affluent suburbs.

But let me make a more important point. You take any so-called affluent suburb, you examine it in detail, Mr. Chairman, and you will find it, too, has its pockets of poverty; it, too, has its problems of inadequate governmental services to the entire area. If we are, as I believe we all are, concerned with strengthening, not weakening, our Federal form of Government, a truly general revenue-sharing bill should bolster all the cities, all of the counties, all of the States in this Nation.

Chairman PROXMIRE. Well, I have another answer to that. But let me go to something else. I think this is the most—I will yield to the Senator.

Senator PEARSON. Isn't it also true that although you have Newark, there are some cities, communities, counties, States, that really are not doing all they should in raising their taxes and broadening their base?

Mr. WEIDENBAUM. Yes, sir. That is precisely why we have a tax effort factor.

Senator PEARSON. And a need only would possibly, I suggest, Mr. Chairman, end up rewarding some community that has not fulfilled its full responsibilities.

Mr. WEIDENBAUM. Yes, sir.

Senator PEARSON. I thank you.

Senator HUMPHREY. Mr. Chairman, may I comment, in our bill, as you know, we have special consideration for those States that make the supreme tax effort. In fact, even on the income tax we have, where a State comes in and has an income tax effort, we have, a much larger return for that particular State, so we insist upon States and localities putting forth their maximum effort.

The other point I would make is that the affluent suburb under revenue sharing, the affluent suburb, is taxed, the people who are affluent in the suburbs are taxed, by Uncle Sam, which taxes more equitably, and the affluent suburbs that are taxed by State and local governments to get the money frequently are only taxed by a sales and property tax and not an income tax. So in a sense, we do draw from the affluent suburb for Federal revenues which, in turn, are shared and on a basis, may I say, where the needy people or where the needs are the greatest, they get the largest amount of money. We share back on a progressive taxation basis the revenues which accrue under that basis.

Chairman PROXMIRE. Let me ask you about something else that is probably the most commonly given reason for objecting to revenue sharing, and that is we do not have the revenue to share. We share a deficit. I think that no matter how you look at it, unfortunately or fortunately, depending on your viewpoint, revenue sharing has a low priority with this Congress. It is going to come in at the end of other things after they are taken care of, perhaps not at all.

So under these circumstances, it seems to me, we need to take a hard look at what else we would cut back, where we would get the money for this if we would go ahead with other programs more generously than the President asked us to do.

The National Urban Coalition is the one that came in with the alternative budget. I think this is the best contribution that any group has made in the priorities field in a long time. They have hard figures and they show where the money comes from and they project it over the years, and they indicate a very ambitious program of beefing up our human services substantially which is going to come from several sources, eventually from an increase in taxes, but that will be in 1974.

Before that, they argue that we have to cut back military spending, and they argue for a $16 billion cutback.

This is not an irresponsible figure picked out of the air. This is on the basis of a very careful consultation with former Defense Department officials, able and responsible men who spell out precisely where the cuts should come. It is not just saying that we are spending too much in that area.

I just wonder if you gentlemen have any notions. Now, Mr. Weidenbaum you represent the administration that proposes to increase military spending, and I just wonder if you can give us some notion of how you reconcile a budget which asks for more for military spending and seems to be a little soft, if we probe deeply at all, on some of these human programs.

What would be your response to this very serious problem of where the money is coming from?

Mr. WEIDENBAUM. Mr. Chairman, we have given this a great deal of thought. I do not mean to offer a cute or clever answer. Of course the money is coming from the U.S. Treasury. But, more specifically the administration has developed and is presenting to the Congress a total budget on both the revenue side as well as on the expenditure side that we think both meet the needs of the Nation and the requirements of economic stability.

What do I mean by that? The total of revenues, the total of expenditures, has been set in terms of making a maximum contribution to expanding the economy, expanding employment and, hence, revenues of the Treasury, at the same time, insuring that progress is made on the important anti-inflation front.

We do that by gearing the very substantial increase in expenditures budgeted for fiscal 1971 and for fiscal 1972, substantial increases in expenditures, but we keep those expenditures within the revenues that would be generated when the economy is back in full employment.

If we can keep to that when the economy does reach full employment in the foreseeable future—the sooner the better, of course—the real budget will be in balance.

That I submit, Mr. Chairman and members of the committee, is both a responsible and a forward looking budget policy. Once you adopt that policy then where you find money for any specific program, whether it is revenue sharing or any other, is a matter of priority.

Given that $229 billion level of Federal expenditures, which are the high priority programs that should go into that, the $229 billion, of course, is the level of expenditure consistent with full employment revenues.

Well, we earnestly believe that within that $299 billion revenue sharing does deserve a high priority, and that is where it goes into the budget rather than some lower priority program.

Senator HUMPHREY. Mr. Chairman, might I comment on that?

Chairman PROXMIRE. Senator Humphrey.

Senator HUMPHREY. I think that you raise the question that is in the minds of practically everybody, and we cannot ignore it, we have to come to grips with it.

First of all, any of the programs that are scheduled in the budget that is before us will have, in part, deficit financing. I happen to believe, as an individual Senator, that a great deal needs to be done in this country in the field of education, in the care and the help to the handicapped, the mentally retarded, physically disabled, and I intend to have something to say about it before this year is out, and I think there are other areas that we need to do much more in than we are doing.

I think these are wise investments. I think failing to do something in this is eating the heart out of our country, and really weakening us as an economy and as a people, and so there are in this full employment budget, there is a contemplated deficit—I forget what the figure was—what do you contemplate?

Mr. WEIDENBAUM. $11.6 billion.

Senator HUMPHREY. It will be bigger than that because—you can rest assured of that.

Mr. WEIDENBAUM. Congress willing.

Senator HUMPHREY. $12 billion deficit on the basis of what the administration projects, many of which will be deficit financed. Let us say the administration is asking for $5 billion in revenue sharing. The Urban Coalition presents a budget. I compliment them, too. I think your rference to that budget is commendable. We ought to study that proposed budget very, very carefully.

They estimate that you can cut defense expenditures approximately $16 billion; is that correct, Mr. Chairman?

Chairman PROXMIRE. That is correct.

Senator HUMPHREY. I think we ought to take a big, good, hard look at those defense expenditures. I am not reckless about national security, and do not intend to be. I do not think any man ought to be. I think we must keep in mind the needs of national security.

But if the Urban Coalition group that has had the benefit of the counsel and advice and study of some of the best minds in this study on budgetary problems, particuarly defense items. If they can come up with a budget that indicates that you could cut $16 billion out of the defense budget of the administration, I think we ought to take a good, hard look at the defense budget.

Let us say we could save $3 billion, $4 billion out of that. That would help answer your question, would it not, Mr. Chairman?

Chairman PROXMIRE. It would indeed.

Senator HUMPHREY. Indeed it would, and I think we have to ask ourselves at this time if what I have said is true; namely, that we are in a crisis of government—and I think we are—we have to ask ourselves where is the best defense to be made, and I submit that anybody who travels around this country today knows that our cities are in total disarray.

They are at a critical stage. Services are breaking down and people are in trouble. They cannot even walk safely on the streets. Health problems are growing by quantum jumps, I mean public health problems, not only personal health problems.

All right, then, let us take a look. If we have to make some choices, and we may have to make some choices here, let us keep in mind where the real needs of the country may be and where you can make some real adjustments in the budget, and I am prepared to do that.

I am so strongly committed to the concept of helping our local and State governments in meeting the needs of the governments, because by the way, that is the government that affects most people's lives; the government that most people are dealing with every day is the government that is right next door to you—these governmental structures have got to have the tools and the resources to do the job, and I think that their breakdown may be more significant to our national security, Mr. Chairman, that whether or not we get a new aircraft carrier, and I think we ought to be taking a good, hard look at how many commitments we have made and whether we ought to cut back.

I say this as one who has been in Congress long enough to have some responsibility for commitments that were made. But there comes a new day, just as has been said here about our present situation, live and learn, live and learn. The sooner you get out of Vietnam, the sooner you will be able to save some money in the defense budget. That is a fact.

I surely cannot come to this committee and say that this administration is responsible for Vietnam. I do not say that. I just simply say there is a time to make some new decisions. I think we have to take a look at whether we need all the money that is programed for the SST. I think we ought to take a look and see whether the space budget—don't misunderstand me, I do not think we ought to willy-nilly chop at them, but we ought to carefully examine it.

May I say to Mr. Weidenbaum, the Congress in the last few years, the 91st Congress in particular, was responsible for some reordering of our priorities, and I do not think the country is worse off. I think the country is better off because men like the chairman of this committee and others did help reorder some of the priorities of our country.

So we need to look at that budget. I am not stuck with all these figures. I think the total that Mr. Weidenbaum has talked about makes some sense, I mean this is the full employment budget.

You know, it certainly relieves me a lot, having been a man who had to vote for deficit financing so long, to finally find that we have legalized it, moralized it, cleaned it up, made it acceptable. I have been walking and working in economic sin for 20 years on budgeting.

Now I find out that all the time I really was not such a bad boy at that. I really was a full employment budget now and did not even know it. I want to thank this administration. They have just helped me out so much. I do not think the sin is less, but it is not as bad as the fellow, talking about sin, he said he always enjoyed what he was doing except when he started to realize that it was wrong. And now we begin to realize it is not even wrong. I could have given you the real story, Mr. Chairman, but not for the record here. [Laughter.]

Chairman PROXMIRE. Let me ask if you might include in your response an answer to this question because it is related to what I am asking about. I can see a national interest in education, in income maintenance, and pollution control, and so forth. The Federal Government should help pay for those programs in proportion to national benefits and, heaven knows, we have to go a long, long way to meet any kind of a real standard in these areas.

I think all of us recognize we would like to have more in each of these areas. It gives us a sound basis for Federal aid for particular purposes.

But, it seems to me, we should leave it to the States and the localities to tax and spend for services that are purely local in nature. Revenue sharing does not do this, does it? It does not make any distinction between national benefits and local benefits.

Mr. WEIDENBAUM. Mr. Chairman, I submit there is proper national interest in libraries. We have library grants; in mental health, we have mental health grants; in sewage control, we have sewage control grants; I can go through 500 different ones. But, I submit, there is a more overriding national interest, and that is in the basic strength and health and future of our Federal form of government today. Hence, the national interest in revenue sharing is the future of our State governments, of our city governments, of our county governments, I submit, that the $5 billion investment out of a $229 billion budget is a reasonable, moderate investment in the future health of our form of government. I think it is eminently defensible on that basis.

Chairman PROXMIRE. Of course, it does have an appeal to all of us. Federalism has served us well, but it does not have the same kind of bite, the same kind of substance, that we can understand as does education, pollution control, these other things, and I just wonder if this is the way to strengthen it.

Let me ask you two other quick questions. In terms of the criteria set forth under economic stability, your program, Mr. Weidenbaum, seems to do exactly the opposite. It seems to be supercyclical because you say revenue, shared revenues, would grow with the growth of the economy. In other words, if the economy does not grow—and it did not grow last year, it did not grow for 10 years in the thirties—it could very well not grow for a period of years.

Under those circumstances presumably you would share less as cities and States need more and, as the States needed less you would share more; isn't it counter-cyclical in that sense?

Mr. WEIDENBAUM. Mr. Chairman, we did detailed studies of this very question, and that is specifically why we recommended the tax base, not tax collections, not a percentage of the GNP. If you examine this carefully you find that over the years this has been a very stable element in the economy. It grew last year, even though the economy did not grow as rapidly as we would like.

Chairman PROXMIRE. The economy did not grow at all.

Mr. WEIDENBAUM. In dollar terms, it did.

Chairman PROXMIRE. In real terms.

Mr. WEIDENBAUM. This year it will grow even more rapidly. I do think when you look at the state of local budgets, of State budgets, you see tremendous fluctuations in their revenues due to changes in the economy. The addition of revenue sharing to their budgets will induce a very substantial element of stability, far more than they have at the present time.

Chairman PROXMIRE. The other problem that puzzles me and troubles me a lot about the administration's proposal—and I just could not vote for it unless you modified it along the lines that Congressman Reuss and Senator Humphrey have proposed to us—and that is there is nothing that would encourage States to adopt more progressive tax structures that I can see. They have a clear encouragement for that, and I think the most serious problem in our State and local governments in many ways is the fact they have regressive taxes that are just unfair and, as they try to provide more services, they hurt the very people who need assistance. We see this again and again, and your proposal does not seem to get at that directly and explicitly, and the Reuss-Humphrey proposal does. I think this is a great strength of it.

Mr. WEIDENBAUM. Mr. Chairman, I suggest you examine the tax effort provision. As it turns out, as that tax effort provision works, a State such as Wisconsin, with a progressive income tax, with dependence in good measure on income taxes, you will see those States get a relatively high tax effort compared to——

Chairman PROXMIRE. I do not know how you do it. We rate only 23d or 24th in tax effort, although we have one of the two or three most progressive tax systems in the country. Tax effort relates to tax yield which might relate to regressive taxes on the income of the people. It may be a very regressive tax structure that raises relatively high taxes.

Mr. WEIDENBAUM. You will find that in the administration's bill, Wisconsin would get a bonus, so to speak. That is, as a result of the tax effort factor. That is a larger share than would otherwise be the case. I submit if you look at the States with heavy dependence on income taxes, you will find that they tend to have an above-average tax effort factor. They do well under our bill. Hence, you will find, I believe, that there is a built-in incentive there, indirect to be sure, but effective nonetheless.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. I would like to make several comments, if I may.

The trouble with the administration's proposal is that it is as advantageous for a State to get more revenues by cruel and regressive taxes as it is by benign and progressive taxes. So that those States which have so far caused all the interstate disequilibrium that hurts this country so much would be encouraged to keep on doing wrong.

May I say that the 4-year budget proposed by the Urban Coalition and reported in yesterday's newspapers, which caught my eye as it did that of the chairman, and which seemed to me to be a very good and forward-looking projection for the next 4 years, may I say that that proposed budget, by happy coincidence again, adopts the same revenue-sharing figures as the Humphrey-Reuss bill, $3, $5, $7, $9 billion over the period, and cranks in over that period an almost total Federal takeover of welfare.

In so doing—and this is the compromise that Senator Humphrey and I have been advocating this morning—I believe, you get the most help where it is needed in the least wasteful way. You help the welfare-stricken cities like Newark, but if you do it just by the welfare approach then 50 percent of your help goes to Massachusetts, New York, and California.

Chairman PROXMIRE. This is all based, however, on a drastic reduction in military spending, elimination of the supersonic transport, reduction in many other programs which are likely to be hard to reduce.

You might cut the military, I hope we can, I doubt we can, cut it more than $6 or $7 billion, in which case you are in a position where it is hard to do all of these things that you gentlemen are proposing.

Representative REUSS. To the extent that you want us to do what you and I want us to do and what the Urban Coalition suggests we want to do, then we have to be less generous with the welfare takeover, and the revenue sharing, instead of getting a nice, three, five, seven, nine component, you will get a limping, three, four, four and a half, four and three-quarters program, and you are not going to come near taking over welfare.

But I think it is significant that the Urban Coalition has apparently realized tlat the best way to get money where it is most needed is by a combination of the two, and that both revenue-sharing and welfare takeover in greater or lesser degree is necessary.

Chairman PROXMIRE. Gentlemen, I want to thank all of you for a superlative job.

I will yield to Senator Pearson.

Senator PEARSON. Let me make one point which is sort of a defense for the administration in the field of military expenditures. They are up in this budget. But, Mr. Weidenbaum, isn't it true that in relation to the total budget and in relation to the GNP—that is a good measurement—percentagewise the defense part of this budget is down over last year.

Mr. WEIDENBAUM. Yes.

Senator PEARSON. $36 billion versus $34 billion.

Mr. WEIDENBAUM. Indeed. In fact, if I may go further, Senator, this budget represents a first—this is the first time that I can recall in American history where we wound down a war and came out with a lower level of real military spending than prior to the war. In other words, you take——

Chairman PROXMIRE. The first time in all American history when you wound down a war and predict a sharp economic expansion as the war is winding down.

Mr. WEIDENBAUM. Bear with me.

Chairman PROXMIRE. You are expecting vigorous economic recovery with Vietnam scaled down in withdrawal. It does not make any sense.

Mr. WEIDENBAUM. You take the total of the military budget for fiscal year 1972, adjust for inflation, and in real terms you have a lower level of defense spending than before the Vietnam war.

Chairman PROXMIRE. A little.

Mr. WEIDENBAUM. You could never make that statement for Korea, World War II, World War I, the Spanish-American War, the Civil War, the Revolutionary War, or any other time in American history. This, I submit, is a real first.

Senator PEARSON. Mr. Chairman, just let me say that I have never really believed that with the end of the Vietnam war we are going to have less of a military budget, and I want to be on record also as saying once again this year I want to look at the military expenditures, but they were moving in what I thought was the proper way, greater expenditure percentagewise for human needs as distinguished from military needs.

I thank the chairman.

Chairman PROXMIRE. Again I want to thank you gentlemen very, very much for a superlative and most helpful presentation.

Senator HUMPHREY. Thank you.

Chairman PROXMIRE. The committee will stand in recess until 2 o'clock this afternoon, when the committee will hear from the Secretary of Labor, Mr. Hodgson.

(Whereupon, at 12:40 p.m., the committee recessed, to reconvene at 2 p.m. the same day.)

AFTERNOON SESSION

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Our witness this afternoon is the Honorable James Hodgson, Secretary of Labor.

Mr. Hodgson, when you appeared before our committee last summer you had held your present office for only a very brief period. You've been in office for a while now, and you have had to face some very difficult problems, for your department is the one which has to cope most directly with many of the human costs of our economic difficulties. These human costs are of great concern to this committee, and while we don't want to put you on the spot, we do want to cover with you this afternoon as many problem areas as possible.

Your negotiations with the construction unions over wage settlements and the possibility of wage and price controls in that industry have been very much in the news lately and, of course, we want to discuss this new policy thrust, with all of its far-reaching implications.

We want also to discuss the collective bargaining outlook throughout the economy. Do we face the prospect of further major strikes? What can we do to reduce the possibility of strikes? Is there a need for new labor legislation?

We want also to discuss manpower programs. Where do we go next after the President's veto last year of the comprehensive manpower training and public service employment bill? How can we move quickly to provide training; to provide jobs; and to provide State and local governments with the financial resources to hire the additional workers they so badly need?

And, then, finally, we want to discuss unemployment compensation. Major new legislation in this area was passed last year. Is it being implemented with sufficient rapidity? Did the legislation go far enough, or do we have a further legislative task ahead of us?

I've outlined quite an agenda here, Mr. Secretary, and even so, I'm sure I have not covered all of the problems about which the committee members feel concerned. Some of them will be here later. As you know, we had a late session this morning and ended a short while ago, and some of them will be back.

You may proceed, Mr. Hodgson, with your statement in any way you wish. Then we will turn to questions. If you would like to abbreviate your prepared statement or skip any part of it, it is rather detailed, the entire prepared statement will be printed in full in the record at the end of your oral statement.

STATEMENT OF HON. JAMES D. HODGSON, SECRETARY OF LABOR, ACCOMPANIED BY MALCOLM R. LOVELL, JR., ASSISTANT SECRETARY FOR MANPOWER; AND GEOFFREY H. MOORE, COMMISSIONER, BUREAU OF LABOR STATISTICS

Secretary HODGSON. Thank you, Mr. Chairman.

You have placed a number of rather meaty and juicy morsels in that platter you served me. I will try to be responsive to a number of them in my statement, and, in our question session later on, I am sure we can elaborate on many I have not covered sufficiently.

I will attempt upon occasion to boil down some of this testimony, If I may, but I would like to start by directly reading from it for several minutes.

I welcome this opportunity, and I will restrict my statement to a review of the circumstances of 1970 and an estimate of the prospects for labor markets in 1971. I want to allude to some of the related programs which the Labor Department proposes for 1971. As you are aware, the President is to present the manpower message to the Congress shortly, and this will provide a more comprehensive and rounded statement of the administration's position, than I am able to do at the moment.

CURRENT SITUATION AND PROSPECTS

The present level of unemployment is by all odds too high, but I believe the prospects for an improvement this year are good. Last year's rise in unemployment was indeed greater than had been anticipated.

One source of difficulty was the abnormally large increase of almost 2 million in the civilian labor force during the year, not only because of the large number of veterans released from the Armed Forces but also because of the unpredictably sharp increase in the number of of women seeking employment. However, total employment stabilized during the second half of the year. The decline in total employment was limited to a drop of less than 1 percent over a 3-month interval, March to June. The latest figures, for January, indicate that nearly all this loss, the loss of employment, has since been recovered.

One of the special features of the recent slowdown was the tendency for the relative increase in unemployment to be greater among the more highly skilled, including professional engineers and technicians. This was, in large part, due to the impact of defense and space program expenditure cuts, which had a disproportionate effect on industries and localities specializing in defense and aerospace products.

The 1969–70 policies of fiscal and monetary restraint brought about a reduced pressure of demand in general, which had its first impact in the early months of 1970 upon durable goods manufacturing, and which spread throughout the manufacturing sector by midyear. The experience of 1970 has been uncomfortable for the Nation, and difficult for many out of work. But we have achieved some cooling of the rate of inflation and reordered the Nation's priorities. We now have a base from which to build an economy of healthy growth.

The President set the tone for this building effort when he said in his economic report to the Congress: "The key to economic policy in 1971 is orderly expansion." This is to be accomplished by operating, to quote the President again, "within a range where both unemployment and inflation are moving unmistakably downward toward our goal."

This goal includes a projected rise of somewhat more than 4½ percent in total real output between 1970 and 1971. It is an achievable growth rate not without precedent. I will develop from this point on in my testimony further information bearing on this.

I want to now skip to the point in my prepared statement where I observe that it would be a msitake for me and for the Nation to minimize the seriousness of an unemployment rate in the vicinity of 6 percent. Yet some elements of the 1970 economic slowdown are sufficiently different than previous similar periods to be worth of mention. First, it should be noted that the period of unemployment experienced by most of the unemployed has been relatively short; the average duration, now about 10 weeks, is low by historical standards. In earlier periods it climbed as high as 17 weeks. Negro and disadvantaged workers have suffered increased unemployment as every group has, but significantly less than in other periods of slowing demand.

Now, I will refer to the section of my prepared statement that starts thusly: We have a situation in which the growth of output is coupled with continued progress in the fight against inflation. The measure of our success thus far in that fight is modest but real. If the automobile industry is excluded from consideration in the abnormal fourth quarter of 1970, the GNP deflator, which is the most comprehensive measure of price movement, dropped from an annual rate of increase of 6 percent in early 1970 to just over 4 percent in the latter half of the year.

The Consumer Price Index change showed the same tendency. Wholesale prices during the past 6 months were moving upward at less than 2 percent per annum for all commodities; and consumer prices at less than 5 percent. Both rates were below those that had been reached in early 1970. This last result occurred in part because the rise in food prices was relatively slight throughout 1970, in welcome contrast to the sharp advances of 1969.

Now, let me refer to some of the activities of the Productivity Commission that the President has appointed.

The Commission's efforts thus far are what I would call of an iceberg nature, that is, a little showing above the surface, but much of substance beneath. Current projects involve the measurement of productivity, case studies of productivity improvement, practices in collective bargaining relating to productivity improvement and protection of workers against adverse effects of technological change.

We are gratified that productivity began to move upward in the second quarter of 1970. Past experience in situations like this, indicates that the rise in productivity will continue. For this reason, our estimate is that a resulting smaller rise of average unit labor costs will serve to moderate the pressure of prices. Hence our guarded optimism on the prospect for recovery with disinflation.

In speaking of averages, I remain quite aware of exceptions. For example, the wage bargains reached in the construction industry in recent months have been such as to increase pressures on prices. Therefore, they call for separate policy treatment. In the steel industry, too, there are strong forces making for a major bargaining confrontation and I am well aware of the potentially adverse impact of a severe steel strike on our recovering economy.

The determination of the administration to achieve the growth target in 1971 is reinforced by the ability and willingness to use the measures that are needed. We will reduce unemployment. We do not believe we will be doing it in a way that will rekindle the fires of inflation.

In my prepared statement, I go on further to remark about some of the things that my colleagues have mentioned to this committee earlier, but I would like to shift now to the second part of my testimony, which has to do with our manpower program contributions to the 1970 economic scene.

In 1970, the Department of Labor used a two-pronged strategy to deal with the fall off in job opportunities and the shift in labor markets. First, we pressed for and succeeded in getting a new Unemployment Compensation Act that not only expanded benefit coverage to nearly 5 million additional workers but lengthened the period during which States could pay such benefits by 50 percent.

In this way we sought to broaden and strengthen further the role of unemployment compensation as a cushion during a period of economic slowdown. Second, we sought to tailor and rapidly adjust our manpower program efforts to deal with the changing economic conditions 1970 presented.

I mention what this strategy involved. We feel that we have had a measure of success in all these efforts and that our manpower function has demonstrated a capacity to meet shifting needs through shifting its emphasis and program objectives.

Now, let us discuss the President's manpower revenue-sharing plan for just a moment.

The President will be sending his manpower special revenue-sharing program to the Congress shortly. It will set forth the administration's proposals for a total manpower effort and just how this effort should mesh with the overall strategy of economic expansion during the coming year. The message will include legislative proposals addressed to both the type of manpower program authority needed and an administrative mechanism designed to carry out the program effectively. Because this is still in a formative stage, I am not prepared to comment further on this legislation at this time. However, I do want to let you know that administration proposals shall be forthcoming.

Next, we will discuss the President's 1972 budget.

Here, the basic administration attack on the current higher level of unemployment, of course, is stimulation of a healthy national economy. The President's full-employment budget has been presented to the Congress as a sound route to provide the expansion needed for more employment opportunities as the pace of the economy quickens.

Manpower is a major component of the President's new revenue-sharing proposals in two ways. There is proposed $5 billion in "new" money for what is called general revenue sharing. These additional resources would then be available for channeling in several directions, including manpower programs, with the decision exclusively a State and local matter. The $11 billion for special revenue sharing would be used in blocks by States and localities for six broad subject areas, including manpower training, as you know.

Included in the President's proposal for special sharing is $2 billion, annual rate, for manpower programs. This covers almost $1.6 billion in existing programs plus an additional $400 million. This money is to be used broadly in these same types of programs by the States and cities. It deserves mention, it seems to us, that States and cities normally spend more than 50 percent of their income for employment costs. The multibillion-dollar revenue-sharing program proposed by the administration will accordingly serve to create innumerable job opportunities and meet existing employment expenses in a part of the public sector where the need is acute.

Now, I would like to move to a discussion of the institutional training program. The institutional training program provides classroom vocational training to help the unemployed and underemployed. The fiscal year 1972 program is planned at a level of $324.9 million to provide 146,600 training opportunities.

We talk about the Job Corps, how it is designed not only to provide this tye of training to youth but also to provide an improved environment in which to gain skills needed for employment beyond the vocational area. Job Corps is planned at a level of $196.2 million for 26,200 year-round training opportunities.

Also included in existing programs are work experience programs which supply both a source of income, and training. These are the in-school and summer programs funded at a total of $235.5 million and designed to provide 508,900 enrollment opportunities to young people who are still in school. The out-of-school program and Operation Mainstream provide work opportunities for youths and adults. The former is geared to young people who have dropped out of school who are in the 16- and 17-year-age bracket. The latter is designed for older workers. Funding for these programs is proposed at $165.8 million for 48 900 enrollment opportunities.

Now, along with a program of this nature, we have almost $84 million that will be used for out computerized job placement "Job Bank," for labor market information and technical assistance as well as for research, demonstration and evaluation programs designed to improve our manpower programs.

I would like to comment briefly on the President's welfare reform proposals because they are an integral part of the effort to meet human needs and to move people off welfare rolls into the world of work. Here we are projecting in the 1972 budget $197 million for 154,000 training opportunities in the welfare area under current legislative authority. This is, as you know, the so-called WIN program. With the enactment of welfare reform legislation proposed by the President which, I most earnestly urge this Congress to accomplish, we could expand and would expand this effort significantly.

Now, let us discuss planning to meet contingencies that we have undertaken, because while we have been seeking new legislative authority we work within existing program constraints to respond quickly and positively to changes in the overall economic and social setting in which manpower programs operate. This means that manpower programs are under continuous review and are modified, as warranted, to keep them responsive to changing needs.

As the unemployment rate moved upward during early 1970, contingency plans were placed in effect. The Manpower Administration, through its regional administrators, reviewed State programs and labor conditions. Redirection of obligated but not yet started skill training programs into occupations less vulnerable to the economic slowdown was accomplished.

We go on to describe further how we have done this, and there is quite an extensive treatment of the various ways that we have allocated moneys that were at one time scheduled for one kind of training but were moved into what we thought were expenditures more appropriate for the changing times presented by 1970.

I would like to move on then to a discussion of public service careers programs, and how we have implemented and enlarged those programs.

As the employment effects of the economic slowdown were felt, some workers who had completed manpower training programs lost their jobs, and some of those completing training had difficulty in finding jobs. As an emergency measure to meet these new conditions, a new supplemental training and employment program—we call it STEP—was established as an element of the Department's public service careers program.

I describe the STEP program here in the next couple of paragraphs.

The important thing about the program is that it allocated $39 million for fiscal 1971 providing an estimated 17,700 work opportunities.

Now, the public service careers program—PSC—began operations in mid-1970 and was broadened during the year. In addition to STEP and the familiar new careers program, the core of PSC is conceived of as a public service counterpart to the JOBS program in private industry. The purpose is to open opportunities for disadvantaged workers in regular jobs with Federal, State, and local governments by helping to overcome both institutional and personal barriers to their employment. Eligibility has recently been extended to long-term unemployed. Guaranteed immediate employment for enrollees, coupled with training and supportive services, carries out the basic program commitment to "hire now, train later."

PSC benefited from the substantial reallocation of manpower funds toward the end of fiscal 1970 which raised the PSC budget to a total of

$87 million. For fiscal 1971, nearly $127 million in new obligational authority is allotted to the program to provide 66,800 enrollment opportunities.

I have cited the PSC as an example of shifts in types and funding levels of programs to indicate our capacity for responsiveness to economic change. Many other manpower programs have been similarly refocused to get the most effective use of each program dollar.

I would like to discuss the jobs for veterans program we have instituted.

Our shifts in national priorities have increased the need to support the efforts of veterans to find jobs. We have responded by developing a national program designed to call to the attention of employers the available skills among this group.

Our efforts in this area have had a highly satisfactory initial response. We think it is a promising program.

Now, a brief discussion of services for professional and technical workers.

For the first time in many years, as I indicated, unemployment began to affect professional and technical workers, as well as blue-collar workers and the unskilled. When you look at it over the preceding 12 to 15 years, the job market for this high-talent personnel was really quite tight and, as a consequence, the regular labor market services for this group diminished during this period. With the abatement of intensive demand for such workers associated with the change in national priorities, we have taken steps to rebuild an active labor market service for them.

The new National Engineers Registry located in Sacramento is a case in point. We have also conducted reorientation seminars through the American Institute for Aeronautics and Astronautics in more than 30 cities. And we are undertaking some conversion training for engineers and technicians caught in very narrow technical specialities.

Mr. Chairman, you mentioned unemployment insurance, and I would like to comment a bit about our extended unemployment insurance benefit program.

These amendments to strengthen the Federal-State unemployment insurance program, have already been responsive to the needs of thousands of workers. The unemployment insurance program now provides that States may automatically adjust their programs to changing economic conditions. Many States have responded quickly to enact implementing legislation to participate in the extended benefit program. I would like to insert in the record at the end of my prepared statement a report of the status of legislation and use of extended benefits for each State.

Briefly, the report shows that, as of February 19, 1971, 15 States have enacted Federal-State extended benefits legislation. Fourteen of them are now paying benefits. These States have about 45 percent of covered employment in the Nation, and about 60 percent of the insured unemployment. The President and the Labor Department have undertaken wide ranging effects to urge all States to enact enabling legislation in this sphere. While only three States, Arkansas, Kansas, and Washington, have enacted legislation conforming to all other requirements of the Employment Security Amendments of 1970, virtually all of the other States have the necessary bills either introduced into their legislatures or under preparation for introduction shortly.

The earliest possible date on which any State's extended benefits could take effect was October 11, 1970. During the last 3 months of 1970 unemployed workers received an extra $40 million in extended benefits.

We estimate that, by July 1971, unemployed workers will have been provided with some $300 million in spending power through the new extended benefits program. This is in addition to the $4 to $5 billion in benefits which will be paid during this fiscal year through the regular unemployment insurance program.

Mr. Chairman, briefly, what I have tried to provide for this committee is a statement of the current labor market situation, an indication of the direction of manpower proposals which will be forthcoming, and some of the Department's efforts to meet changing conditions.

I know that this has not been responsive to all of your initial concerns, and I would expect to develop that responsiveness in subsequent questions.

I thank you for the opportunity to meet with the committee this afternoon.

(The prepared statement of Secretary Hodgson, together with the report dated February 19, 1971, referred to above, follow:)

PREPARED STATEMENT OF HON. JAMES D. HODGSON

Mr. Chairman and members of the Joint Economic Committee, I welcome the opportunity to present my testimony before the Committee's hearings on the President's Economic Report. I shall restrict my statement to a review of the circumstances of 1970, and an estimate of the prospects for labor markets in 1971. I will allude to some of the related programs which the Labor Department proposes for 1971. As you are aware, the President is to present the Manpower Message to the Congress shortly, and this will provide a more comprehensive and rounded statement of the Administration's position.

The current situation and prospects

The present level of unemployment is by all odds too high, but I believe the prospects for an improvement this year are good. Last year's rise in unemployment was indeed greater than had been anticipated.

One source of difficulty was the abnormally large increase of almost two million in the civilian labor force during the year, not only because of the large number of veterans released from the Armed Forces and but because of the unpredictably sharp increase in the number of women seeking employment. However, total employment stabilized during the second half of the year. The decline in total employment was limited to a drop of less than one percent over a three-month interval, March to June. The latest figures, for January, indicate that nearly all this loss has has since been recovered.

One of the special features of the recent slowdown was the tendency for the relative increase in unemployment to be greater among the more highly skilled, including professional engineers and technicians. This was, in large part, due to the impact of defense and space program expenditure cuts, which had a disproportionate effect on industries and localities specializing in defense and aerospace products.

The 1969–70 policies of fiscal and monetary restraint brought about a reduced pressure of demand in general, which had its first impact in the early months of 1970 upon durable goods manufacturing, and which spread throughout the manufacturing sector by midyear. The experience of 1970 has been uncomfortable for the Nation, and difficult for many out of work. But we have achieved some cooling of the rate of inflation and reordered the Nation's priorities. We now have a base from which to build an economy of healthy growth.

The President set the tone for this building effort when he said in his Economic Report to the Congress: "The key to economic policy in 1971 is orderly expansion." This is to be accomplished by operating, to quote the President again, "within a range where both unemployment and inflation are moving unmistakably downward toward our goal." This goal includes a projected rise of somewhat more than 4½ percent in total real output between 1970 and 1971. It is an achievable growth rate not without precedent. It will make possible, before the end of the year, a pronounced downward movement in both the number of unemployed workers, and the unemployment rate. At the same time, as is characteristic of recovery periods, productivity growth is likely to be above average, and this will have favorable effects upon unit costs and prices. In addition, we are witnessing, in the first quarter of 1971, a continuation of an upward movement in the growth of real output that began last summer and was interrupted by the widespread effects of the GM strike.

It would be a mistake for me or the Nation to minimize the seriousness of an unemployment rate in the vicinity of 6 percent. Yet some elements of the 1970 economic slowdown are sufficiently different than previous similar periods to be worthy of mention. First it should be noted that the period of unemployment experienced by most of the unemployed has been relatively short; the average duration, now about ten weeks, is low by historical standards. In earlier periods it climbed as high as 17 weeks. Negro and disadvantaged workers have suffered increased unemployment as every group has, but significantly less than in other periods of slowing demand.

Employment in the services industries grew in the course of 1970 and will continue its growth next year. Finally, the resumption of real growth throughout the economy in 1971 will once again serve to induce an increase in employment in the good-producing industries.

This adds up to a situation in which the growth of output is coupled with continued progress in the fight against inflation. The measure of our success thus far in that fight is modest but real. If the automobile industry is excluded from consideration in the abnormal fourth quarter of 1970, the GNP deflator, which is the most comprehensive measure of price movement, dropped from an annual rate of increase of 6 percent in early 1970 to just over 4 percent in the latter half of the year. The consumer price index change showed the same tendency. Wholesale prices during the past six months were moving upward at less than 2 percent per annum for all commodities; and consumer prices at less than 5 percent. Both rates were below those that had been reached in early 1970. This last result occurred in part because the rise in food prices was relatively slight throughout 1970, in welcome contrast to the sharp advances of 1969.

A contributing factor to the persistent inflation has been the disappointingly low productivity gains in 1969 and early 1970, in conjunction with the high rates of increase in hourly compensation. Indeed, our deep concern about inflation was the primary reason for the President's establishing the National Commission on Productivity. Higher productivity is needed to help us to hold the line on costs and prices, to contain inflation and to keep us competitive in international trade. Higher productivity can contribute to the speed with which we can achieve the Nation's qualitative goals too—such things as improving our urban transportation, rebuilding our cities, and cleaning up the environment.

The Commission's efforts thus far are of an iceberg nature, that is, little showing but much of substance beneath. Current projects involve the measurement of productivity, case studies of productivity improvement, practices in collective bargaining relating to productivity improvement and protection of workers against adverse effects of technological change.

A gratifying improvement in productivity began in the second quarter of 1970. Past experience indicates that the rise in productivity will continue. For this reason, our estimate is that a resulting smaller rise of average unit labor costs will serve to moderate the pressure of prices. Hence our guarded optimism on the prospect for recovery with disinflation.

In speaking of averages, I remain quite aware of exceptions. For example, the wage bargains reached in the construction industry in recent months have been such as to increase pressures on prices. Therefore they call for separate policy treatment. In the steel industry too, there are strong forces making for a major bargaining confrontation and I am well aware of the potentially adverse impact of a severe steel strike on our recovering economy.

The determination of the Administration to achieve the growth target in 9171 is reinforced by the ability and willingness to use the measures that are needed. We will reduce unemployment. We do not believe we will be doing it in a way that will rekindle the fires of inflation. The testimony of my colleagues in the Administration has dealt fully with fiscal and monetary policies. I would now like to outline some of the manpower measures that the Labor Department is preparing, to deal with the situation as we see it now and as we expect it to be in 1971.

Manpower program contributions to the 1970 economic scene

In 1970 the Department of Labor used a two-pronged strategy to deal with fall-off in job opportunities and the shift in labor markets. First, we pressed for and succeeded in getting a new Unemployment Compensation Act that not only expanded benefit coverage to nearly five million additional workers but lengthened the period during which states could pay such benefits by 50 percent. In this way we sought to broaden and strengthen further the role of unemployment compensation as a cushion during a period of economic slowdown. Second, we sought to tailor and rapidly adjust our manpower program efforts to deal with the changing economic conditions 1970 presented. This strategy involved concentration on job centered manpower programs, on shifting our training emphasis away from occupations of declining opportunity to areas of still strong potential capacity for growth and on stepping up our labor market activities to shorten the time between jobs for those who became unemployed. We feel we have had a measure of success in all these efforts and that our manpower function has demonstrated a capacity to meet shifting needs through shifting its emphasis and program objectives.

Below we set forth some of the upcoming manpower developments and prospects as we see them and elaborate on the scope and thrust of various important program efforts.

The President's manpower revenue sharing plan

The President will be sending his manpower special revenue sharing program to the Congress shortly. It will set forth the Administration's proposals for a total manpower effort and how this effort should mesh with the overall strategy of economic expansion during the coming year. The message will include legislative proposals addressed to both the type of manpower program authority needed and an administrative mechanism designed to carry out the program effectively.

The President's 1972 budget

The basic Administration attack on the current higher level of unemployment, of course, is stimulation of a healthy national economy. The President's full-employment budget has been presented to the Congress as a sound route to provide the expansion needed for more employment opportunities as the pace of the economy quickens.

Manpower is a major component of the President's new revenue sharing proposals in two ways. Five billion dollars is proposed in "new" money for *general revenue sharing*. These additional resources would then be available for channeling in several directions, including manpower programs, with the decision exclusively a State and local matter. The $11 billion for *special revenue sharing* would be used in blocks by States and localities for six broad subject areas, including manpower training.

Included in the President's proposal for special sharing is $2 billion (annual rate) for manpower programs. This covers almost $1.6 billion in existing programs plus an additional $400 million. This money is to be used broadly in these same types of programs by the States and cities. It deserves mention that States and cities normally spend more than 50 percent of their income for employment costs. The multi-billion dollar revenue sharing program proposed by the Administration will accordingly serve to create innumerable job opportunities and meet existing employment expenses in a part of the public sector where the need is acute.

Existing programs provide a broad range of services designed to help people get jobs. The JOBS (Job Opportunities in the Business Sector) program encourages private employers to "hire, train and retain" the disadvantaged and to upgrade the underemployed. In Fiscal Year 1972 we are proposing a program level of $260.5 million which will fund 136,900 training opportunities. The Public Service Careers program takes much the same approach with public and non-profit employers. The proposed FY 1972 level is $125.8 million which will fund 66,800 training opportunities.

The Institutional Training program provides classroom vocational training to help the unemployed and underemployed. The Fiscal Year 1972 program is planned at a level of $324.9 million to provide 146,006 training opportunities. The Job Corps is designed not only to provide this type of training to youth but also to provide an improved environment in which to gain skills needed for employment beyond the vocational area. Job Corps is planned at a level of $196.2 million for 26,200 year-round training opportunities.

Also included in existing programs are work experience programs which supply both a source of income, and training. There are the In-School and Summer programs funded at a total of $235.5 million and designed to provide 508,900 enrollment opportunities to young people who are still in school. The Out-of-School program and Operation Mainstream provide work opportunities for youths and adults. The former is geared to young people who have dropped out of school who are in the 16 and 17 year age bracket. The latter is designed for older workers. Funding for these programs is proposed at $165.8 million for 48,900 enrollment opportunities.

Finally, we are continuing our efforts to establish a full range of manpower services for the disadvantaged in selected poverty areas. A total of $172.8 million is being requested for such efforts which will provide 36,800 training opportunities.

Along with these programs, almost $84 million will be used for our computerized job placement "Job Bank" program, for labor market information and technical assistance as well as for research, demonstration and evaluation programs designed to improve our manpower programs.

In addition, the President's welfare reform proposals are an integral part of the effort to meet human needs and to move opeple off welfare rolls into the world of work. We are projecting a 1972 budget of $197 million for 154,000 training opportunities in the welfare area under current legislative authority. With enactment of welfare reform legislation proposed by the President, which I most earnestly urge this Congress to accomplish, we would expand this effort significantly.

These basic features of the President's budget, with respect to manpower programs, give us a clear indication of the efforts which this Administration intends to exert in providing an increase in the number of job opportunities, a better quality of those opportunities, and a more productive national work force.

Planning to meet contingencies

While we continue to seek new legislative authority, we work within existing program constraints to respond quickly and positively to changes in the overall economic and social setting in which manpower programs operate. This means that manpower programs are under continuous review and are modified, as warranted, to keep them responsive to changing needs.

As the unemployment rate moved upward during early 1970, contingency plans were placed in effect. The Manpower Administration, through its Regional Administrators, reviewed State programs and labor conditions. Redirection of obligated but not yet started skill training programs into occupations less vulnerable to the economic slowdown was accomplished. Monthly reports were prepared detailing actions planned or taken to adjust program operations to shifting labor market conditions. To help meet the need for employment opportunities for manpower training graduates, a new Supplemental Training and Employment Program (STEP) was established.

At the same time, $49 million in fiscal 1970 funds were reallocated to increase institutional training under the Manpower Development and Training Act. Training projects appropriate to the changed conditions were set up, with particular emphasis on the high-priority fields of health services, law enforcement, environmental control and construction.

In early FY 1971, an additional redeployment of resources was initiated to help meet human needs associated with rising unemployment. Manpower funds totaling $28 million were made available for use by those States and areas most severely affected. Thus, extra funds were given to states identified as having the greatest need for new resources.

Public service careers programs implemented and enlarged

As the employment effects of the economic slowdown were felt, some workers who had completed manpower training programs lost their jobs, and some of those completing training had difficulty in finding jobs. As an emergency measure to meet these new conditions, a new Supplemental Training and Employment Program (STEP) was established as an element of the Department's Public Service Careers Programs (PSC).

STEP provides enhancement of employability through short-term work experience with public or private nonprofit agencies as well as a temporary source of income. Eligible workers must be disadvantaged, not entitled to unemployment compensation, and have a special need to practice their skills—because in most cases these were only recently acquired in training completed within the last year. If a job is still not available after a 13-week STEP enrollment, the worker may be re-enrolled for an additional 13 weeks. STEP projects have been funded in 28 States. A total of $39 million has been allocated to the program for fiscal 1971, to provide an estimated 17,700 work opportunities.

The Public Service Careers Program (PSC) began operations in mid-1970 and was broadened during the year. In addition to STEP and the familiar New Careers Program, the core of PSC is conceived of as a public service counterpart to the JOBS program in private industry. The purpose is to open opportunities for disadvantaged workers in regular jobs with Federal, State, and local governments by helping to overcome both institutional and personal barriers to their employment. Eligibility has recently been extended to long term unemployed. Guaranteed immediate employment for enrollees, coupled with training and supportive services, carries out the basic program commitment to "hire now, train later."

PSC benefitted from the substantial reallocation of manpower funds toward the end of fiscal 1970 which raised the PSC budget to a total of $87 million. For fiscal 1971, nearly $127 million in new obligational authority is allotted to the program to provide 66,800 enrollment opportunities.

I have cited the PSC as an example of shifts in types and funding levels of programs to indicate our capacity for responsiveness to economic change. Many other manpower programs have been similarly refocused to get the most effective use of each program dollar. An important example is the development of trade adjustment assistance to aid workers displaced by increases in imports. Over 7,000 workers have benefited from assistance under the Worker Adjustment Assistance program. This effort enables the Nation to pursue a liberal trade policy while avoiding placing an undue hardship on those whose livelihood is directly affected.

Jobs for Veterans

Shifts in national priorities have increased the need to support the efforts of veterans to find jobs. We have responded by developing a national program designed to call to the attention of employers the available skills among this group.

Our efforts in this area have had a highly satisfactory initial response. In order to follow through with this program we have expanded the veterans' service component of the various State Employment Service Offices in order to provide necessary technical assistance to the returning veterans.

This effort complements other manpower training programs which are designed to assist the veteran.

Services for Professional and Technical Workers

For the first time in many years, unemployment began to affect professional and technical workers, as well as blue collar workers and the unskilled. Over the preceding 12 to 15 years, the job market for high-talent personnel was quite tight and as a consequence regular labor market services for this group diminished. With the abatement of intensive demand for such workers associated with the change in National priorities, we have taken steps to rebuild an active labor market service for them.

The new National Engineers Registry located in Sacramento is a case in point. We have also conducted reorientation seminars through the American Institute of Aeronautics and Astronautics in more than thrity cities. And we are undertaking some conversion training for engineers and technicians caught in very narrow technical specialities.

Extended unemployment insurance benefits

The Employment Security Amendments of 1970 (P.L. 91–373) to strengthen the Federal-State unemployment insurance program, have already been responsive to the needs of workers. The unemployment insurance program now provides that States may automatically adjust their programs to changing economic conditions. Many States have responded quickly to enact implementing legislation to participate in the extended benefit program. I would like to insert in the record at the end of my statement a report of the status of legislation and use of extended benefits for each state.

Briefly, the report shows that, as of February 19, 1971, 15 States have enacted Federal-State extended benefits legislation. Fourteen of them are now paying benefits. These States have about 45 percent of covered employment in the Nation, and about 60 percent of the insured unemployment. The President and the Labor Department have undertaken wide ranging efforts to urge all States to enact enabling legislation in this sphere. While only three States, Arkansas, Kansas and Washington, have enacted legislation conforming to all other requirements of the Employment Security Amendments of 1970, virtually all of the other States have the necessary bills either introduced into their legislatures or under preparation for introduction shortly.

The earliest possible date on which any State's extended benefits could take effect was October 11, 1970. During the last three months of 1970 unemployed workers received an extra $40 million in extended benefits.

We estimate that, by July 1971, unemployed workers will have been provided with some $300 million in spending power through the new extended benefits program. This is in addition to the $4 billion to $5 billion in benefits which will be paid during this fiscal year through the regular unemployment insurance program.

Mr. Chairman, briefly what I have tried to provide for this Committee is a statement of the current labor market situation, an indication of the direction of manpower proposals which will be forthcoming, and some of the Department's efforts to meet changing conditions. I thank you for the opportunity to meet with the Committee this afternoon.

U.S. DEPARTMENT OF LABOR,
MANPOWER ADMINISTRATION,
Washington, D.C., February 19, 1971.

LEGISLATIVE AND TRIGGER STATUS OF STATES UNDER THE EXTENDED BENEFITS PROVISION OF PUBLIC LAW 91-373, AS OF FEB. 6, 1971

State	Trigger on date	Week when extended benefits would be first payable	Number of weeks through Feb. 20, 1971, extended benefits have been payable	Approximate values of trigger indicators as of Feb. 6, 1971 (percent)	
				[1] A	[2] B
Group I: [3]					
Alaska	June 27, 1970	Jan 29, 1971	3	12.31	120
Arkansas	Jan. 2, 1971	July 4, 1971		5.11	146
California [4] [5]	May 16, 1970	Dec. 20, 1970	9	7.14	179
Connecticut [4]	Aug. 15, 1970	Oct. 11, 1970	19	7.71	265
Idaho	Jan. 16, 1971	Jan. 31, 1971	3	5.23	134
Kansas	do	do	3	4.61	227
Massachusetts [4]	July 11, 1970	Oct. 11, 1970	19	7.04	201
Michigan [4]	Feb. 28, 1970	do	19	7.53	283
New Jersey [4]	Nov. 21, 1970	Jan. 3, 1971	7	6.01	151
New York [4]	Dec. 26, 1970	Jan. 10, 1971	6	5.20	165
Oregon [4]	Nov. 21, 1970	do	6	7.24	155
Pennsylvania	Jan. 16, 1971	Jan. 31, 1971	3	4.53	169
Rhode Island [4]	Jan. 31, 1970	Oct. 11, 1970	19	7.85	206
Vermont [4]	Dec. 19, 1970	Jan. 3, 1971	7	6.56	206
Washington [4]	Nov. 29, 1969	Oct. 11, 1970	19	13.72	243
Group II: [3]					
Kentucky [6]	Feb. 6, 1971			4.08	136
Louisiana [6]	do			4.07	125
Maine	Oct. 31, 1970			7.13	173
Minnesota	Jan. 30, 1971			4.36	212
Missouri	Jan. 23, 1971			4.35	163
Montana	Jan. 9, 1971			5.64	131
Nevada	Dec. 19, 1970			5.46	144
New Hampshire [6]	Feb. 6, 1971			4.09	329
New Mexico	Dec. 5, 1970			5.04	164
North Dakota	Jan. 23, 1971			5.49	129
Oklahoma [6]	Feb. 6, 1971			4.00	163
Puerto Rico [4]	June 20, 1970			10.81	129
Tennessee	Jan. 23, 1971			4.39	137
Utah	do			4.44	122
West Virginia	do			4.61	122
Wisconsin	Jan. 9, 1971			4.96	202
Group III [3]: None					
Group IV [3]:					
Alabama				3.95	152
Indiana				3.76	225
Ohio				3.74	224
Hawaii				3.62	181
South Carolina				3.51	173

[1] Average IUR for 13-week period ending February 6, 1971.

[2] Percentage rates of IUR in footnote 1 above to arithmetic mean of corresponding IUR's in 2 preceding years.

[3] These groups are defined as follows: Group I—States which have enacted necessary conformity legislation to provide for Federal sharing of extended benefit payments effective Oct. 11, 1970 or later. Group II.—States which have not yet enacted such legislation, but which would have already triggered on in accordance with the trigger indicator provisions. Group III.—States which have enacted such legislation and are not now triggered on but exceed State trigger indicators of 3.5 percent of 115 percent under A and B, respectively. Group IV.—States which have not yet enacted such legislation and are not now triggered on but exceed the State trigger indicators specified in Group III above.

[4] Trigger indicator values include claims of State extended benefit programs then in effect.

[5] California data estimated.

[6] Kentucky, Louisiana, New Hampshire, and Oklahoma have triggered on based on preliminary data.

Chairman PROXMIRE. Thank you, Mr. Secretary, very much for a comprehensive and useful statement.

Mr. Secretary, the administration seems to have moved in to try to persuade the construction industry to adopt policies that would moderate the inflationary impact in that industry.

As I understand it, they have urged the industry to work together, management and labor, to try to adopt policies that would come up with some kind of a reasonable limitation on wage increases so that prices would not increase, at least not increase nearly as much as they have in the past.

One of the stories that I have read—several of the stories that I have read—have indicated that the administration has indicated that under the law that we have passed, Congress passed last year, the administration would seriously consider putting into effect a wage-price freeze in the industry or possibly a guideline that would be proposed by the President.

What is the situation in this industry?

Secretary HODGSON. I can tell you a good deal about it historically and I can tell you approximately where the thing stands at the present time.

I cannot tell you our ultimate disposition of it because I met with the President this morning, and some of his other advisers, and we are going to defer until some time later in the early part of this week to make the final judgment on this subject.

Chairman PROXMIRE. You say some time later this week, but it will be the early part of this week?

Secretary HODGSON. The early part of it; that is correct.

Chairman PROXMIRE. When you say final judgment, you are talking about whether or not you move toward a freeze or whatever you do do.

Secretary HODGSON. Mr. Chairman, I can assure you we are going to do something. Just what it is we are going to do, we will be announcing in the early part of this week.

Chairman PROXMIRE. All right, sir.

Secretary HODGSON. We have observed that in the past 2 years the increases in wage levels in the construction industry are one of the many problems that industry has. They have had problems of rising strike levels, problems of high interest rates that have had an adverse effect on homebuilding particularly—a whole series of problems.

So we tried to do something about each of them. We established a Construction Industry Collective Bargaining Commission, a tripartite commission, that has been working very hard on two particular facets of the industry's problem. One is to get more trained manpower available for the industry and we have been making some progress on that.

We are also trying to do something about what we call the patchwork system of collective bargaining that exists in the industry, and we are determined to see if we can get some industrywide agreement on ways to regionalize or expand the areas that a bargain will cover in the industry.

With regard to the second facet we have gone as far as to get recognition of the problem, but we have not reached any resolution of how we should go about solving this problem.

Then, noting as we did that starting in early 1969 and continuing in each of the succeeding half-year periods, the level of wage increases in the industry was far exceeding the average levels in the Nation, and progressively getting higher rather than receding, we decided, at the President's direction, to call together leaders in the industry in early January of this year, to call their attention to this problem and to ask them to produce a solution or a way of getting at the problem for us within 30 days.

In spite of intensive efforts to do just this, we found that they were unable to come up with a resolution. There are some severe problems in doing this on a voluntary basis that evidently are just too difficult for the parties to do.

As a result, I went to Miami this last weekend, as you properly indicate, and had an extensive discussion with the members of the building trades unions, and I have had several discussions with the leading contractors and contractor associations to see if some sort of a consensus could emerge of what action might be taken on it.

We do not have anything conclusive to report on the results of that discussion because, as I said, we are not yet prepared to say in which direction we are going to go.

I will say two things: First, we will definitely be doing something about this problem; second, we do not contemplate overall wage and price controls for this Nation.

Chairman PROXMIRE. Now, you say you are keeping your options open, in effect, and one of those options, I take it, is a wage freeze, a wage-price freeze, or just a wage freeze for the construction industry, is that right? That is an option you are keeping open.

Secretary HODGSON. It is one of the things that has been discussed.

Chairman PROXMIRE. Well, you have just now ruled out in the closing part of your answer, you ruled out having a comprehensive wage-price, price-wage control system for the Nation.

Is it possible to simply put this into effect for a single industry and limit it to that industry, is it fair, is it fair to ask the people in that industry to forgo any kind of a wage increase when they are suffering inflation; they have to pay for, more for what they buy, and is it fair in view of the many other costs the construction industry has in addition to onsite labor costs?

Secretary HODGSON. Well, equity is one of the considerations we are struggling with in this matter.

There is no such thing, I suppose, in the wage field as complete equity. I am sure that many people who have not been privileged to get the increases that construction industry people have been able to get in many cases in the last couple of years may feel that they have been inequitably dealt with.

Equity is a somewhat elusive commodity. It is one thing we have to weigh, but we have to weigh it in connection with other considerations, and we will.

Chairman PROXMIRE. Do you feel that the wage increases in the construction industry have been so great that they represent the kind of a bellwether, a kind of magnet, attracting wages in other industries; is that one of the reasons why you feel you have to step in and move in this case?

Secretary HODGSON. Well, I think anyone familiar with the developments in collective bargaining, as most of you people are, know there is a tendency for bargainers to examine what is going on elsewhere when they sit down to bargain. They do not bargain in a vacuum; they examine the results of bargaining in the construction industry and other industries, and that bargaining is one of the ingredients that affects what they do.

It certainly is one of the ingredients that affects the demands that are made upon bargainers. So, clearly it is a consideration.

Chairman PROXMIRE. Now, it seems to me there is at least the potentiality of more decisive action with respect to wages in construction by the Nixon administration than by the Johnson or Kennedy administrations. I think this is an interesting possibility, at least we have not had anything yet, but you have indicated we may.

Let me ask you this: You have ruled out comprehensive wage-price controls, but does this indicate that in other areas—after all, construction isn't the only area where we have excessive wage increases that greatly exceed productivity increases—is it possible this may be a pattern, that you may move into other areas where you feel that the wage settlements have been out of line?

Secretary HODGSON. Well, that is kind of an "iffy" question, I suppose, but my response would be this: The construction industry is the one that is under consideration for this kind of concern at the present time, and the only one at the present time.

Naturally, any wage movement in any major sector of the economy will be followed closely and examined, but I do not have any predictions to make as to what further actions or what further industries will come under our scrutiny to the similar extent that construction is at the present time.

Chairman PROXMIRE. You see, you are in the position of facing, all of us know, a very serious and profound wage settlement in the steel industry in a few months. Many people feel that will be the most significant settlement in 1971. It could have a great bearing on whether we have continued serious inflation or not.

Would you rule out the possibility that this same approach might be used with respect to the steel crisis if the settlement there seems to be getting out of control?

Secretary HODGSON. I would not rule it out, but I would not rule it in, either.

It seems to me that each one of these situations has to be looked at independently.

Chairman PROXMIRE. You say you are working on every aspect, or other aspects, at least, of construction costs. I am glad you are, and I hope you are working with some vigor on it, because, as I understand it, the cost of labor for home construction, for example, is only about 18 percent of total costs. It is not the major cost at all.

Secretary HODGSON. That is correct.

Chairman PROXMIRE. Further, as I understand it, less than 20 percent, at least a small proportion of homes, are constructed by union labor, so if we are moving into bringing the cost of housing under control, there are other areas that would seem to me to be much more significant, and it is hard to blame the rise in construction wages for the increased cost of homebuilding. Do you agree with that?

Secretary HODGSON. We are not taking the villian approach to any part of this. We are working on it as a problem.

Chairman PROXMIRE. What are you doing besides this concerted and clear-cut action you are taking with respect to wage settlements?

Secretary HODGSON. Well, we are heartened, of course, by what is happening to interest rates. We also have a land-use study, proposal and, as I said, we have been endeavoring to and have made considerable progress in feeding new trained workers into construction training in the various different construction fields and attempting to develop new sources for the construction industry.

Certainly one of the most promising of the latter is the large number of veterans who are coming out of the services these days, all possessing a certain amount of skill.

We have one program in that connection that should interest this committee. You may have learned of it. It is called the transition program. Several of the unions in the country, and many of the employers, are providing skilled training in the various different construction trades to servicemen in the last 6 months of their period of service, doing it on their service base, and enabling them when they get out of the service to come out with the kind of skill that will expedite their entry into the regular world of work.

Chairman PROXMIRE. I want to get into that a little later in my second round.

Let me ask you this: Caspar Weinberger, Deputy Director of the Office of Manpower and Budget, is quoted in this morning's paper as having said:

> I don't believe that there is at this point any feeling that there is any necessity whatever to offer to employ everybody who is unemployed.

Do you agree with that?

Secretary HODGSON. Well, Mr. Weinberger, of course, always has to look at things from the vantage point of his functional assignment, and he does it very capably.

I guess that I would agree with it as long as he means no country really manages to have everybody employed. The concept that everybody must be employed, and the Government must insist on it, is not realistic. No country has continued that sort of a program for a very long period.

Chairman PROXMIRE. Well, shouldn't the Federal Government feel its responsibility to do its very best, to do everyhting within its power, to provide an opportunity to work for those who want to work? There is a considerable difference of opinion as to whether we ought to have a Family Assistance Plan, family income, but I think there is very little difference of opinion that if somebody wants to work they ought to have a chance to do so.

Secretary HODGSON. Well, I think the principal question is how we go about doing that.

Chairman PROXMIRE. I agree with that. But, you see, if a man as powerful as Mr. Weinberger is, would disagree that we should go about doing it, and it seems to me he does that when he says there is no necessity for us to offer a job to everybody who is unemployed, I just wonder if he is really on all fours with what you and I seem to agree should be a goal, an objective, of this Government.

Secretary HODGSON. Well, I don't say the golden objective of this Government should be to put everybody to work, but I do say we should try to institute policies, as we are attempting to do, that will get us back on the road of increased employment; we certainly believe that is the direction we are going.

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

Senator Pearson.

Senator PEARSON. Mr. Secretary, if the Government should decide on a wage and price freeze in the construction industry, by what authority would you act? Is it by, under the standby legislation passed by Congress last year or the Defense Production Act?

Secretary HODGSON. Well, Senator, until we decide really which course of action we should take, I cannot tell you. The only possible authority that the President would have, if there was going to be what you described as a wage-price freeze, would be under that act.

Senator PEARSON. The act passed by Congress last year?

Secretary HODGSON. Yes.

Senator PEARSON. Let me ask you a question in a general discussion with you, if I may, about the viability of collective bargaining in the country today in the economic climate that we live in.

I take it that the administration's position is by virtue of the legislation proposed for the transportation industry that—we will use the airlines, for example—when they shut down for a strike, the loss is permanent, they never make it up again, and they bargain from a very weak economic condition today.

We have the President's proposal as to the last best offer which, I think, is probably a very good one, but what about collective bargaining beyond the industries that directly affect the public interest? Is it generally still a viable tool of—everybody understands the equity of it, but is it still a usable tool to settle labor disputes with the problems of management in this country?

Secretary HODGSON. Well, Senator, I spent most of my professional life in collective bargaining.

Senator PEARSON. May I interrupt you to say that in my own State I just have a feeling, a sense that businessmen have generally given up.

Secretary HODGSON. This worries me, Senator. I know there is a little of that attidude around, and it worries me.

I think, perhaps, it is understandable because bargaining is a very difficult, awkward, and distinctly burdensome process for those who engage in it.

But, on the other hand, it is a very worthy concept, and it is a concept that allows for a bringing together of forces in the resolution of problems in a way that I do not think modern civilized Western nations have been able to improve upon.

There are ruptures that occur in the fabric of any institution, and there are some in the collective bargaining fabric in this Nation. But the fabric itself is of good, solid stuff, and I would hate to see us let either temporary conditions or localized concerns turn us aside from what is, I think, an enormously effective institution in this Nation.

The growth of our economy has been as great, if not greater, during the period of collective bargaining which has been in effect as a legalized tool in this country as any period of history.

So I think it is one we should look to see what can be done to improve it. But I would be wholly opposed to setting it aside as a continued viable instrument.

Senator PEARSON. I take it—and maybe this is a little bit of a digression from your specialty—but I take it that the so-called full employment budget, with a deficit of $11.6 billion, assumes by the administration that the so-called excessive demand type of inflation is now under control, and that the continuing rise in the cost of living is relative to the so-called cost-push type of inflation. Is that an accurate interpretation?

Secretary HODGSON. I thinkit assumes that weare bringing the inflationary spiral under control. We are headed in the right direction. We have problems, but if we pursue our expansionary activities in a sound and orderly way we can continue to head that way. We have a great confidence that we are improving productivity, and that the improvement in productivity will serve to minimize the inflationary effect of the wage increases that are negotiated.

When we couple the downward trend in prices which will serve to moderate the levels of wage increases needed by employees to maintain living standards with improving productivity to increase the actual results from capital, we feel that we have got this thing headed in the right direction, and it is promising.

Senator PEARSON. You made reference to the increased labor force, and cited the veterans. I quite understand that. I think these same young men would be entering the labor force whether they are coming out of school or whether they are returning from the armed services. But the question I want to ask you is in relation to increased labor force. So far as it is measured by the number of women who are in the labor force, is this really a new direction or does it come about because of the high unemployment figure or because of inflation, or is it a sort of new development in the labor force?

Secretary HODGSON. I would like to comment on the veterans' circumstances and the women in the labor force aspect of your question.

The problem with returning veterans is that the numbers coming out of the armed services this last year are significantly higher than the number entering. This is a new characteristic, this was not the case in the mid to late sixties.

With regard to women, there has been a dramatic increase in the proportion of women who enter the world of work in recent years. This is not new, and a certain amount was predicted.

The amount, though, that occurred this last year was beyond what we have considered normally predictable.

The reason why this occurred is subject to speculation. There seems to be just an increasing tendency for the little woman these days to decide that she wants to go out and enter the world of work, and she is doing it in greater numbers than ever before.

Chairman PROXMIRE. Mr. Secretary, there was no mention in your prepared statement of the collective bargaining outlook. According to the Labor Department figures, at least 4.8 million workers will be negotiating new wage union contracts in 1971. That makes it a heavy bargaining year, just as heavy as 1970 was.

Deferred wage increases in 1971, that is, already contracted for in prior year contracts, will average 7.8 percent this year, far higher than in 1970.

Now, this is a background against which new contracts will be negotiated. Workers who bargain this year will naturally want to match, naturally increase, what other workers have received in past years, they will want at least 7.8 percent more.

In this difficult situation, why do we need guidelines only for construction workers? There are 530,000 construction workers—that is only about 11 percent of the 4.8 million—who will come up for renewing their contracts this year.

There are 400,000 steelworkers, 700,000 gas, electric, and telephone workers, and so on.

Doesn't the whole economy need a comprehensive wage-price guideline approach rather than just confining it to the construction industry?

In the absence of that kind of an approach, can't we expect to have strikes and stoppages and/or settlements that will be highly inflationary, all of them?

Secretary HODGSON. Your figure was 7.8 percent for the deferred increases this year. Now, probably, if the deferred increases were down under 5 percent you would not find that too awkward.

For manufacturing it is under 5 percent. Deferred increases in manufacturing are 4.9 percent, but the deferred increases in construction are almost three times that, 13.3 percent.

If you took construction out of that 7.8 percent, you would get those deferred increases down to a remarkably modest figure by traditional terms. So this is one of the reasons why construction deserves special attention.

Chairman PROXMIRE. You are not going to get that deferred increase, it is already part of the contract. You would not expect to do that, would you?

Secretary HODGSON. The object is to see that we do not perpetuate that.

Now, with regard to the second aspect of your question, one assumption was that there is somewhere an incomes policy guideline ceiling concept that would have the effect of, No. 1, stopping or reducing strikes and, No. 2, truly moderating the Nation's wage patterns.

There is, as you know, a very large body of opinion that does not think this is so. In fact, most of the economists I am familiar with who have studied the effect of these things as used not only in this country but in most Western nations, have come to the conclusion that if this were possible—if it were possible to make these things work, and work with full effectiveness, they would be used more widely than they are.

I would like to cite the experience of our neighbor to the north this last year. As you know, or may know, the Canadians put into effect a 6-percent wage ceiling in May of this year. Within 2 months thereafter they were getting major settlements from 10 to 20 percent.

The Government itself in October settled with a group of its own employees for 10 percent, exceeding its own guidelines of 6 percent, and they junked the whole thing in December.

In a period of peacetime it is not easy to make these things work, and it is not easy to make them work without extensive administrative apparatus, without the possibility of such things as rationing. We doubt development of the kind of support that would be needed to make these things work without a period of national emergency.

Chairman PROXMIRE. I would agree wholeheartedly myself—many disagree—I think, perhaps, the majority of the American people disagree, with the view you have expressed, and the view, which I share, that we are not at the point where we should have mandatory wage-price controls.

What I am asking, however, is if we could not work out some kind of voluntary guidelines—we had them, as you know, from 1962 through 1966, and many people, many economists, most, feel they made a contribution. They cannot do all the job, by any means.

But when you have a situation where fiscal and monetary policy have eliminated the excess demand from the economy, and the real thrust is from cost-push, excessive wage settlements, it seems to me this is precisely the time that they could do the most good.

I might point out to you that the figures I have indicate that deferred wage settlements in finance are 6.9 percent, that is, almost 7 percent; warehousing, wholesale and retail trade, almost 7 percent, 6.7; finance, insurance and real estate 7.5 percent; transportation 11.4 percent. So, construction is not alone, it is not so far, so terribly far, out of line with the tremendous increases in other industries. You are right about manufacturing. It is not nearly as high.

But this is why, it would seem to me, we ought to be thinking in terms of a broader attempt to restrain unwarranted price increases if we can have any bite in holding down inflation, cost-push inflation.

Secretary HODGSON. As you know, we have preferred, and continue to vastly prefer, the use of fiscal and monetary measures to handle this matter.

Chairman PROXMIRE. They have not worked at all. Fiscal and monetary policy has done a great job in increasing unemployment and slowing down the economy, bringing interest rates down, but they certainly have not done much on inflation, and we are in a position now where with 6 percent unemployed, and the kind of outlook we have for the coming year, in the view of many economists it seems to me it is hard to rely any further on monetary and fiscal policy.

Secretary HODGSON. One of the interesting things, of course, about the guidelines that you mention is that they occurred in years when there was 5 percent unemployment all the time.

Chairman PROXMIRE. We have 6 percent now.

Secretary HODGSON. That is right. And the minute they got down below 5 percent the guidelines ceased to work.

Chairman PROXMIRE. Exactly. That is why it seems to me we have a situation now where—they could not work in 1967, 1968, 1969, perhaps the first part of 1970, for the very reason you have indicated.

Secretary HODGSON. We intend to get the unemployment rate down there without that, Senator.

Chairman PROXMIRE. Well, I hope you are right, I hope and pray you are right, but you certainly have a lot of skeptics.

As you are well aware, the President vetoed the comprehensive manpower legislation passed by Congress last year. The bill was the Labor Department's major legislative effort for the past 2 years. Its veto really leaves our manpower programs in limbo.

Would you state what, in your judgment, were the great defects of this bill which made the veto necessary.

Secretary HODGSON. First, I would like to put in a plug. I would not say that the manpower bill was the major Labor Department's legislative effort in the past 2 years. Actually, our major effort in the last 2 years was in an area where there had not been any legislation and where the Nation badly needed it, and where we got some—

occupational health and safety. We got a great act in occupational health and safety, and it is going to be a great thing for the American worker and the American workingman, and we are very pleased.

Chairman PROXMIRE. I was happy to support that. It was my recollection—I may be wrong—that the Congress wanted to be a little tougher than the administration did but, at any rate, we did get a good act.

Secretary HODGSON. Thank you.

What needs to be understood, it seems to us, about this manpower bill you discuss is that it was not vetoed because of indifference to need but because of what we thought were a couple of basic conceptual flaws in it. In order to describe them I think I should perhaps first establish a couple of key points.

The administration is wholly convinced of the need for and the value of manpower programs—federally financed manpower programs. We think this is borne out by the constantly increasing amount of money in each year that we have invested in such programs.

The veto of the manpower bill certainly does not change this administration's conviction. The present manpower programs will not be sacrificed. This bill did not have that effect, and new ones are going to be instituted. The question is really not whether or not we should have a strong and growing manpower program, but what the objectives of the program should be.

The administration is dedicated to manpower policies that will help the unemployed worker become employed. That is the whole thrust of it.

Chairman PROXMIRE. Employable or employed?

Secretary HODGSON. Employable and employed.

Chairman PROXMIRE. I am sure about the first; I am not sure about the latter.

Secretary HODGSON. All right.

In our view, then, the public employment should be used for the basic purpose of improving the individual's capacity to move into a regular private or public job, because money spent in this way becomes an investment in human potential. So if we want to describe this succinctly, we might say that public employment should serve as a halfway house for the unemployed individual, be an intermediate phase between a period of unemployment—or absence of employment—and employment.

The work in question should be preparatory for the real world of work, not a substitute for it, and the work should be of limited duration—a bridge to be crossed toward something better, not a permanently subsidized job.

From the standpoint of sound manpower policy, it seems to us that putting money in a man's pocket is not enough. We ought to give him some competence, some confidence—confidence that he can make it in the real world of work.

We have noticed that much of the impetus for public employment this past year was from our cities. The cities have tremendous needs for services, and they felt this kind of employment could provide it. But the way to respond to this need is not to create a separate category of federally subsidized employees, but help the cities meet their needs for regular employees through revenue sharing.

We are apprehensive about this business of creating what amounts to a vast permanent substrata of federally subsidized employees that are in a category apart from regular local government employees.

This group could be branded, as some previous groups have, as second-class citizens.

So, in summary, on this subject of public employment, the features of the vetoed bill were unsound as manpower policies, and were wrong to meet the demand of our cities. This was part of our concern.

There was a second deficiency of categorization. We know that one of the impetuses for the administraton's manpower bill the last time was to decategorize these manpower programs. Well, unfortunately, the bill that the President was faced with perpetuated categorical programs; indeed, it seemed to us that it added to them.

I think the arguments concerning the problems of categorical programs have been received enough times. It just seemed to us that this kind of categorization was unwise in such circumstances.

Chairman PROXMIRE. You see our reaction here, at least the reaction of many in the Congress who favored this bill, was that manpower training is vitally important and critical, especially now that we have the shift of people from the defense industry and aerospace, and so forth, to other industries.

Secretary HODGSON. We will be coming forward with a bill.

Chairman PROXMIRE. It would mean a great deal if people cannot get a job once they are trained and the jobs are not available.

We have a situation, as you know, of growing unemployment. It is one thing to make a man employable but something else that is terribly discouraging, a bitter experience, for a person who has gone through for what to him is a tough discipline of working to be trained, and then find there is no job for him. The disillusionment that develops out of that, it seems to me, is pretty cruel.

Your prepared statement describes the administration's public service careers program which is to be funded at $125 million in fiscal year 1972. The bill the President vetoed would have provided $1 billion for public service employment in fiscal year 1972.

The National Urban Coalition has just recommended spending $1.1 billion on public service employment in fiscal year 1972. The Urban Coalition proposal would have provided 250,000 jobs. Your program provides 67,000 training opportunities; $125 million is only $1,865 for each of the 67,000 training opportunities. So you are really going to put most of the cost on States and local governments; right?

Secretary HODGSON. No. With our revenue-sharing bill we will be placing the cities and States in a position where they can fund a great deal of this kind of program. Whether they want to do it in training or whether they want to spend it in public employment, of course, will be up to them, but there will be a great opportunity there for this sort of thing. However, it won't create a federally subsidized field, they will be able to put them into regular jobs.

Chairman PROXMIRE. The revenue-sharing program is going to have to do all kinds of things. This, by itself, of course, would absorb a great deal of the $5 billion that is being shared.

Secretary HODGSON. We are going to have a lot of big revenue-sharing features in the manpower bill itself, but I cannot tell you what the formula will be.

Chairman PROXMIRE. In addition to what would be funded anyway?

Secretary HODGSON. We have already proposed an additional $400 million-plus, as you noticed.

Chairman PROXMIRE. That $400 million is in addition to how much that was provided for manpower programs before last year?

Secretary HODGSON. Almost $1.6 billion for fiscal year 1972, and now we are going to bring it up to $2 billion.

Chairman PROXMIRE. It was how much before?

Secretary HODGSON. Almost $1.6 billion.

By the way, I should introduce to this committee Assistant Secretary for Manpower Malcolm Lovell and the Commissioner of the Bureau of Labor Statistics, Geoffrey Moore, on my left.

Chairman PROXMIRE. Well, at any rate, it would seem to me in view of the size of unemployment, and in view of the reconversion problems, and what you have spoken so eloquently about, the number of people being demobilized, we know are going to be demobilized from the armed services, and the cutbacks we are going to have in that area, it seems to me your program is just inadequate. It just is not big enough to do the job.

Secretary HODGSON. Well, the combination of the jobs that will be created through our expansionary program, and the utilization of moneys in revenue sharing, would seem to us to be the principal ways we should proceed.

There is also, as you know, in the family assistance plan a provision for using public employment as a way of moving people off of welfare into the world of work, and that is another companion feature.

Chairman PROXMIRE. That is another problem, though. That seems to me it means you should have a still bigger program.

Suppose the family assistance plan or a similar bill is enacted. Do you have the funds for it, the skilled personnel, the overall setup to meet the demand for training?

You say in your prepared statement you would expand this effort significantly. What does that mean, and how would you do it? What happens when you train people and the jobs are not there?

Secretary HODGSON. If the jobs are not there, we shift the training to where they are.

During the last year, for instance, the service sector of the economy grew by several hundred thousand jobs, while the overall economy softened. So we moved the emphasis into the service sector. This is one way that we can keep our manpower programs attuned to the needs of the times.

There was something in the earlier part of your question that eludes me. What was that?

Chairman PROXMIRE. Well, it related to the FAP program, the family assistance program. Would you have the skill, the personnel?

Secretary HODGSON. You have a good point when you question how rapidly we will be able to build up and supply training under that program.

Chairman PROXMIRE. Right.

Secretary HODGSON. And, of course, how rapidly we can do it is bound to be one of the limiting factors as in any Government program.

We will not try to go beyond our capacity to do it. But we have a good base in the Manpower Administration of the Labor Department.

It has grown and is in good shape; it is well able to take on this assignment and do something with it. We would not have proposed that as a significant feature of the family assistance plan if the situation had been otherwise.

For example, right now aren't we projecting 180,000 WIN program trainees?

Mr. LOVELL. We will build up to that. We are aiming for 125,000 enrolled by the end of this fiscal year and by the end of the next fiscal year——

Chairman PROXMIRE. You have mentioned several times now the unemployment of those who have finished their service in the military.

The Labor Department recently announced that the unemployment rate among Vietnam veterans has reached almost 8 percent, 7.9 percent. The Labor Department has also indicated that 1 million more veterans would be released from the military this year.

You announced late in January that a jobs for veterans program had been established in the Department of Labor. From press reports, I understand you have mailed letters to businessmen throughout the country asking for them to help in placing those veterans. Have you taken any other action?

Secretary HODGSON. Oh, yes.

Chairman PROXMIRE. What have you done?

Secretary HODGSON. 900,000 letters have gone out, and the response was very heartening.

For another thing, we added better than 300 veteran referral and placement specialists to the staffs of State employment services throughout the Nation. But one of the great things we have done is to expand our participation in the transition program to help outgoing veterans as they enter the labor market.

Chairman PROXMIRE. Do you have any specific manpower training programs for veterans?

Secretary HODGSON. Yes; the transition program is specifically for veterans. However, Mr. Chairman, let me go on to add that for each veteran there is a full range of manpower services available administered by the Department of Labor through the affiliated State employment services. They are continuing efforts to help veterans day in and day out. This could include the wide range of services available through the public employment service—counseling, testing, labor market information, job development, referral to training, and placement in jobs. As you know, according to published policies of the Department and of the U.S. Training and Employment Service, veterans have preference over nonveterans in referrals to job openings. Similarly, veterans have priority for referral to manpower training programs, provided, of course, that any other priorities or eligibility requirements established by the authorizing legislation are observed.

In fact, Mr. Chairman, Federal statutes require that a veterans employment representative be stationed in each public employment office, specifically to insure that veterans receive the maximum placement and counseling services available. In addition, each newly separated veteran may be entitled to unemployment compensation benefits for veterans.

These activities and services to veterans are an integral part of the daily public employment service operations. The new staff members and the jobs for veterans program are intended to improve and expand these services.

In view of the committee's interest in services to veterans I would like to note that Mr. Lovell recently testified before the Senate Veterans' Affairs Subcommittee. He provided a rather detailed statement of the services available to veterans. I would like to transmit a copy of this testimony to your committee, Mr. Chairman, for inclusion in the record as you see appropriate. That statement provides information on activities other than the transition program.

Chairman PROXMIRE. How big a program is that?

Secretary HODGSON. Pardon.

Chairman PROXMIRE. How big a program is that?

Secretary HODGSON. Do you want to respond to that?

Mr. LOVELL. Well, the transition program, I do not have the exact figures in terms of numbers.

Secretary HODGSON. He can get that for you, Mr. Chairman. I did not bring that with me.

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

The transition program is a Department of Defense program providing counseling, education, vocation training, and job information service to separating military personnel during the 6 months prior to discharge. The Department of Labor participates in the vocational training component of the transition program by financing training opportunities through Manpower Development and Training Act (MDTA) funds.

The MDTA part of the program has grown from $995,000 to fund 1,880 training opportunities in fiscal year 1968 to $4 million for 11,800 training opportunities in fiscal year 1970. For this fiscal year 1971 about $5½ million has been earmarked to provide about 16,250 opportunities.

Chairman PROXMIRE. It seems to me since the administration has stressed that one of its top priorities is conversion from a wartime to a peacetime economy, that manpower training is right at the heart of it.

Secretary HODGSON. That is why we strengthened this program. Let me say the American veteran is a very saleable commodity in the labor market. He is a prize resource to U.S. employers.

So our problem, and one of the principal objectives of jobs for veterans program, is to apprise potential employers of potential employees—who they are, how many there are, and where they are.

The problem with the veteran does not seem to be that he remains unemployed or that he exhausts his unemployment benefits. In fact, as you say, over a million get out of the service each year, and out of that million, only about 20,000 exhaust their unemployment benefits. They get jobs, but it takes them too long, in our judgment, to get them.

It takes the veteran somewhat longer than a nonveteran from the regular work force to find a job. For this reason we are stepping up our promotional effort, and we think it is going to be marked by considerable success.

Chairman PROXMIRE. I hope you are right. I hope we will take a look at the National Urban Coalition budget, and in this respect they propose $1.9 billion on a conversion program in fiscal year 1972. Your administration proposed $216 million, in other words, they are proposing eight or nine times as much. This is not a wild-eyed group of revolutionaries; these are people with excellent reputations and people who have had great experience in government and business. They are responsible people, and they propose so much more than you do for conversion, and I wonder if you could be as confident, if your confidence is as justified as you seem to feel it is, that you are going to be able to provide jobs for these returning veterans.

Secretary HODGSON. Well, there are always some whose proposals go beyond a balanced labor market approach. The Labor Department is faced with developing an overall concept. And a proposal such as you mention zeros in on but one of the problems.

There will be some that will exceed what we have in mind, but we have tried to present a balanced program—one which faces the needs as they are—with a strong push toward those deserving particular attention.

Mr. Lovell would like to add something to this.

Chairman PROXMIRE. Of course, I might point our before Mr. Lovell answers, one reason is because the Urban Coalition also proposes that we cut back on military spending far more than the administration does. They propose a $16 billion reduction over the next few years and, of course, the President proposes an increase, so they would have more people to find jobs for, more people to reconvert.

Secretary HODGSON. Thank you.

Mr. LOVELL. I certainly do not think I should criticize what my former colleagues in the Urban Coalition are recommending. But let me point out that this administration is talking about a budget which will provide considerably more money—and $11 billion deficit under the full employment concept, which we expect could result in about 3 million jobs being created this next year—additional jobs, that is.

We are talking about revenue-sharing of $5 billion of new money, of family assistance of $4 billion, and manpower programs of $2 billion. All of these will really be considerable efforts. Many of them will create jobs. Certainly with respect to the $5 billion of general revenue sharing, at least half of that amount would be in new jobs, if we project in terms of historical efforts. I believe it could be considerably more than that today if the need is as great as the mayors have stated.

With respect to veterans, we shall follow established policy of the Department to assure that they are given first priority in referral to jobs and training in which they meet the eligibility criteria.

In terms of the training, their rights under the GI bill are such that additional moneys under manpower are, perhaps, less needed by them than by other groups. But we are trying to look at this in a balanced way.

We think the amount of money that is going into these efforts is considerable—many, many billions, indeed. It is always nice to put in more, but at some point judgments have to be made in terms of the relative priorities.

Certainly if the Defense Budget could stand being cut by that much, I am sure everyone in the administration would like it. I think it is a matter of judgment. I have confidence in what the President and our foreign policy people are recommending on that.

We all hope some day this money is going to be available for needed programs, but I do not think it is fair to say that this administration is not taking some very serious measures, and recommending the allocation of very considerable resources for this problem of job creation and manpower training.

Chairman PROXMIRE. Before I yield to the Senator from Kansas—and I will do that right away—I am somewhat skeptical about the notion that the $11.6 billion deficit will provide more jobs. We had an $18 billion deficit last year which provided so little that we now have over 5 million of our people out of work, far more than we had at the beginning when that deficit started to work, so the deficit itself, I question very seriously, that it can do very much.

Mr. LOVELL. Well, not the deficit. It is the extra money that is going in.

Chairman PROXMIRE. All right. Anyway you look at it, we had that extra money going into last year and what good did it do, nothing but more unemployment.

Senator Pearson.

Senator PEARSON. Mr. Secretary, every time the tax credit manpower program is introduced in Congress, it is very popular and everybody cosponsors it, and it is promoted on the basis that this is specific manpower training, a given industry hiring a given man for a given job as distinguished from hiring a lot of carpenters when new houses are built, and so forth.

What comment do you have on that kind of an approach?

Secretary HODGSON. I wish we knew how to do it well, Senator.

Senator PEARSON. What good is there in the tax credit?

Secretary HODGSON. It is one of the most attractive ideas around. It would minimize the amount of administration a pearson had to deal with; it would mean that the people doing the training would not be burdened with the kind of reports and constraints they now work under. It is an appealing prospect.

So far, however, we just haven't been able to come up with a way of developing this concept that doesn't result in the Government duplicating training that industry is already taking care of. And we have no guarantee that if we did come up with a good way, that the amount of training would actually increase.

If we could find a way to do that, it would be a very attractive idea. We have even thought of such ideas as an incremental increase—that you get tax credit only for the amount you increase over your present level of training, but there are monstrous inequities in this approach. One company may have done a lot of training in the previous 2 years, and another one very little. You reward the one that did not, who should have been doing it, and you penalize the other one. So there are just tremendous complications with this approach. I like the idea, but I do not know how to get it done.

Senator PEARSON. Well, we really—when I say "we," I am talking about the Congress—have done very little about economic conversion, it seems to me, and I am not talking about the downturn of general economic conditions, but I have to always make a broad reference in my mind in Wichita, Kans., it is not 10.3 percent unemployment, it is about 17,000 people, and changes of technology, changes in Defense procurement of the weapons system that is obsolete by the time that it is deployed.

It seems to me that the Department of Defense is a most inadequate shop to deal with this problem.

Do you have any recommendations that deal generally with economic conversion that have to do with not only transition periods from war to peace, but just the technology that is involved?

Secretary HODGSON. I suppose one of your principal concerns would be the circumstance involving high-technology people——

Senator PEARSON. Ph. D.'s that are in grocery stores today.

Secretary HODGSON. There is reason for that concern. The percentage of people who are unemployed in that group is not abnormally high, but the percentage is so much higher than it has been, since at least 1957, that it is a subject of very serious concern.

What has happened is that since Sputnik, there has been actually a minus labor market for engineers and scientists, and great numbers of these engineers and scientists have flowed from traditional employment in, say, universities or corporations, into the defense and space industries.

I would suppose that since 1957 the numbers of engineers and scientists in the defense and space industry have at least doubled. Now, these people came from somewhere. There had been jobs for them there. The problem now is to help them find their way back.

Senator PEARSON. A complaint was made a few years ago that the space program was depleting everything else.

Secretary HODGSON. I can tell you, as one who recruited tens of thousands of these engineers, I know that they came out of other places and, as I say, their problem is to find their way back. One of the troubles is that most services aimed at bringing together the engineer or the scientist and the company that needs him have dried up. For this very reason, we had to establish this national registry. We had to go out and establish a series of workshops in each of the areas where there is heavy unemployment in these groups to teach these people how to tap a labor market, how to reenter, how to get into it. It is happening, but is happening slower than we would like.

I might say, and I don't know whether there has been a public announcement of this or not, but the President has become so concerned that he has called for a conference of the top leaders from engineering and scientific associations around the country to be held at the White House on March 3, to consult on how we might better do this job.

Senator PEARSON. I want to thank you very much, Mr. Secretary. I do not have any further questions.

Chairman PROXMIRE. You indicate, Mr. Secretary, that you think we can get a $1,065 billion GNP in 1971. The Council of Economic Advisers and the Director of the Office of Management and Budget think we can achieve that. I asked Mr. Shultz about this, and he seemed to indicate that we could rely on a sufficiently stimulative monetary policy to do the job.

Then I asked the man in charge of monetary policy, Mr. Burns, about this, and Mr. Shultz may wish all kinds of things, but Mr. Burns is the man who has more influence over it than any other man.

I asked Mr. Burns, "Do you think there is a monetary policy which will guarantee us, that is, assure us, of a 4½-percent growth of real output in 1971?"

Mr. Burns replied, "I know of no such monetary policy."

What do you rely on? If the Federal Reserve Board won't do it, who will?

Secretary HODGSON. Well, Mr. Burns is a redoubtable economist, and I would not quarrel with him an instant.

Chairman PROXMIRE. He is also in charge of our monetary policy.
Secretary HODGSON. Right.
I am more persuaded by what I see when I examine the years that followed previous years of economic slowdown, the so-called recovery years. In those so-called recovery years it was seldom that anyone had a growth rate, a real growth rate, of less than 4 percent, and on a couple of occasions it went up above the 4.5 that you mentioned.
Chairman PROXMIRE. Recovery from what?
Secretary HODGSON. From a previous year of economic slowdown.
Chairman PROXMIRE. Economic slowdown or from a previous period of recession?
Secretary HODGSON. It all depends on what you label these points. Some would label them recessions, some slowdowns, some people would differ with my label for current circumstances.
Chairman PROXMIRE. I think the administration would argue this is the mildest slowdown we have had by far.
Secretary HODGSON. Yes, we do, and I think the figures bear that out.
Chairman PROXMIRE. In that case, there is not so much to bounce back from. It would be different if we had a serious recession for 3 or 4 years, and there had been a decline in real growth for 3 or 4 years. But this was one year in which we had no growth, so you are not bouncing back from much to begin with, and how do we do it when we are in a period of economic recovery? We don't.
We have had unemployment increasing. It is true there was a reduction in the figures for December, we got an improved diminution in unemployment to 6 percent, but I think we have to go quite a way before we are assured that we are in a period of recovery. I hope we are.
Secretary HODGSON. I am glad you expressed that hope.
Chairman PROXMIRE. I really do.
Secretary HODGSON. And when you are talking about knowing, there is a difference in judgment as to what the future may bring, and what we believe it will bring. I do not know that it will, Mr. Chairman, and I do not think that either Mr. Burns or Mr. Shultz expressed anything as a certainty. But both of them have given their own estimate of the circumstances.
I think that the possibility of reaching 4.5-percent real growth that is implicit in the $1,065 billion budget is exemplified by at least two things. It is that in 7 years out of the years since World War II we have done better than that, and the real growth rates in all of the recovery years, 1949, 1958, 1954, and 1961, were at least 4.1 percent, and one was as high as 9.6 percent. I do not—I cannot say this is going to happen.
Chairman PROXMIRE. They usually were not in periods in which we were winding down a war.
Secretary HODGSON. Indeed they were; 1954 was when we were winding down the Korean war.
Chairman PROXMIRE. That was pretty much out of the way in 1954.
Secretary HODGSON. I think the circumstances are very similar.
Chairman PROXMIRE. In your prepared statement you say with respect to general revenue sharing—I'm asking you this because this

morning we had excellent testimony on revenue sharing—in the manpower area, and I quote:

> These additional resources would then be available for channeling in several directions, including manpower programs, with the decision exclusively a State and local matter.

How much evidence do you have, how much evidence is there, that States and localities can make decisions in this area in terms of national needs, and how wise is it to rely on State and local governments to do this when we have, after all, the mobility of our labor, which is one of our resources, and also one of the resources of the unemployed, the fact that they can move from Kenosha, Wis., if there is a layoff, to some other part of the country where people are working?

Secretary HODGSON. Well, first of all, I think that we should have a certain proportion of revenue sharing designated for manpower needs as we are proposing. This will assure an opportunity at the local level to select and choose from the various programs those manpower programs which are needed for that particular locality. I separate that from general revenue sharing.

But I believe it is worthwhile to note that revenue sharing does provide an opportunity for local areas to spend more if they want to in this area, and to spend it to meet their local needs. If we look at their normal expenditures, 50 percent or better of their normal expenditure is for employment. It seems obvious to me that the employment opportunities that will be created by the general revenue sharing are just manifest, and apart from separate manpower programs.

Now, I guess I have not been back along the Potomac as long as most who are here, and so I still have a lot of faith that the people in the cities and States around the country are conscientious in their efforts to deal with their problems and have the capability for doing so. I think that it is easy, too easy, to underestimate their capability.

Chairman PROXMIRE. I have that faith, but I just wondered how wise it is in view of the problems we run into again and again, especially on reconversion, the problem that Senator Pearson referred to in Wichita, the problem in every other city that has a big aerospace operation, the local manpower program based on their particular immediate problems would not be as wise, it would seem to me, as a program which would provide people to be trained for jobs that exist some other place when there are no local jobs.

Secretary HODGSON. Of course, I suppose they got that way, Senator, because of Government procurement policies.

Chairman PROXMIRE. Oh, sure, that is right, and we would like to help.

Let me ask you this: your statement stresses the importance of improved productivity. I certainly agree it is important. But is the outlook as bright as you make it sound? There was a sharp productivity drop in the fourth quarter. No one has yet convinced me it could be entirely due to the auto strike. How do you explain it?

Secretary HODGSON. I cannot explain it. That was a long strike, and an auto strike or a major strike of short duration in even a major industry can be said not to have a significant effect. This sometimes happens because there is a certain amount of anticipatory activity that can be engaged in by the parties. But a long strike has very widespread effects. This was a long strike, and you simply cannot underestimate the effect of that strike.

Chairman PROXMIRE. Of course, the productivity cuts both ways, does it not? If the productivity improves, and it improves sharply, it means as production increases you have the same number of people producing more, so you do not need as many people, jobs will not increase in relation to the increase in production. We have to have a much bigger increase in production to get more jobs if productivity improves than we would if productivity were stable or dropping. So productivity improvement is essential to hold down prices, but productivity improvement will make it harder to provide more jobs.

If the productivity outlook is good it means the employment outlook may not be good.

Secretary HODGSON. If you really follow that to its logical conclusion, the best thing we could have in this country is zero or minus productivity.

Chairman PROXMIRE. No, no.

Secretary HODGSON. And I do not think that is what you or really any of us mean.

Chairman PROXMIRE. Of course not. I am saying, though, this is a problem. You are right, under the present circumstances we should be able to look forward to an improvement in productivity, but that is going to make the task of providing more jobs that much more difficult, it is going to mean much more effort and work.

Secretary HODGSON. This is something I want to talk about, the confidence factor. Confidence is an important factor in the private sector—that is still where eight out of 10 jobs in this country are. These various expansionary measures the President has taken and the various proposals we are making, all of this should add to confidence. The fact that productivity is improving is another thing that increases the confidence of the private sector to expand and to sponge up the human resources that are available. So productivity improvement actually has the effect of reinforcing the confidence of business that it is on the right road, that it can expand, and that it can increasingly have greater outlays for capital. This feeds on itself. Productivity is very important.

Chairman PROXMIRE. I know it is essential, but the fact is in many months—and it can last a year or more after your recovery begins in terms of more production, unemployment can increase, and this is the reason——

Secretary HODGSON. That is true.

Chairman PROXMIRE. Because it means you are getting more production out of the people you have.

Secretary HODGSON. At the same time, when one looks at the recovery periods, one can see that employment has increased rapidly and the employment rate has gone down as much as a percentage point and a half in 12 to 18 months during the periods after the cresting of unemployment.

Chairman PROXMIRE. You speak of the Productivity Commission, you compare it to an iceberg. I find that a very apt comparison, cold, immobile, invisible. We are all eager to see not just the tip of the iceberg but more than the tip. Could you have it thawed out and get it to move a little faster, in your view?

Secretary HODGSON. I think the Commission is going through the organizing and generative processes that organizations of this kind normally have to go through, or at least that I find, from being here along the Potomac, that they seem to go through. It is like the introduction of a major new product. The period of time it takes to develop the product, get it and test it and then put it into production, seems to take longer than it should. But when it gets into production it really rolls. I think that is what is going on now.

Chairman PROXMIRE. Mr. Burns told us how this worked in World War II. He said it was a great activity that we had productivity councils all over the country, and they did a marvelous job. Of course, we had patriotism working then as, perhaps, we do not have in the same way now, but people very concerned about World War II being over and anxious to get into production, and he indicated that he would favor that kind of much more aggressive and much more widespread and comprehensive effort to achieve improvement in productivity.

How do you feel about that kind of suggestion?

Secretary HODGSON. Maybe we will have to consider something like this. We are trying to attack some very fundamental things—the proportion of the Federal Government's money that should be spent on research and where in research it should be spent to produce the greatest productivity in succeeding years. It may be that we have started with things that have greater long-range impact than momentary impact.

Mr. Burns, I believe, was talking about the kind of thing that was necessary to generate the tremendous productivity needed to fight a war, where tremendous new weapons systems were needed practically overnight.

But the idea of regionalizing some of our activities in order to call attention to the need for improved productivity is a reasonable one, and I think we ought to consider it.

Chairman PROXMIRE. It has been called to my attention that years of sharp rapid rise in output and employment, such as the years you referred to, 1949–50, 1954–55, and so forth, were years of sharp reversal of inventory policy, from liquidation to accumulation, sometimes as large as 2 to 4 percent of the Gross National Product.

Since 1970 witnessed no inventory liquidation, how can you forecast a 1971 increase in output of the kind you have stated?

Secretary HODGSON. I am not familiar with the sequence in regard to liquidation that you are referring to.

Chairman PROXMIRE. That is what happened, of course, during the recession period, liquidation of inventory, and then recovery from that, and recovery involved building up depleted inventories which had a lot to do with increased production.

Secretary HODGSON. I did not think inventories were considered to be unusually high now.

Chairman PROXMIRE. I am talking about the fact there has not been the liquidation we have had in the past.

Secretary HODGSON. I would like to ask Mr. Moore to comment on that.

Mr. MOORE. I think you are correct that inventory investment has not declined in this period of slowdown. It can, nevertheless, increase substantially from the level where it now is.

I think it is true, in most earlier recoveries, that periods of this sort have been characterized by an increase in inventory investment. But it does not seem to me that is the whole source of economic growth in this country in periods of this type, and there are many other sources—the recovery in residential construction, for example—which can be of major importance, and we do not have to count entirely upon inventory investment to provide that growth.

Chairman PROXMIRE. We are counting on rather a small rise, I understand, very small rise.

In 1970, with respect to unemployment compensation, Congress enacted major improvements in that program, unemployment compensation program. Coverage was extended to 5 million more persons. Extended benefits will now be automatically provided when unemployment is high. You seem to be rather optimistic on how this is moving.

I understand this legislation will not be fully effective until 1972. I understand that only three States as yet have taken full conforming action. What can be done to speed up and to encourage the States to take this action?

Secretary HODGSON. Well, full conforming action involves all details of the plan, but the States which have taken the first important step of getting themselves into a posture where they can pay extended benefits cover 60 percent of the Nation's work force. But I agree, that we still ought to be working on the States that have not yet enacted legislation.

I know that they all have bills up or in the hopper to get that kind of legislation going forward. The Governors will be in town tomorrow, and I plan to talk to them on that subject.

Chairman PROXMIRE. Do we need further legislation?

Secretary HODGSON. I do not think so at this time.

Chairman PROXMIRE. About how many workers are still not covered?

Secretary HODGSON. Mostly farmworkers, domestic workers, and State and local government employees.

Chairman PROXMIRE. Can you give us the numbers roughly of the private sector in employment that are not covered by unemployment compensation?

Mr. LOVELL. I would say in the private sector, all but about 4.1 million—the farmers and in the main domestic workers are not covered, but I would say all but about 7 percent of the private sector.

Chairman PROXMIRE. All but 7 percent.

Secretary HODGSON. Yes, and we are studying what we might be able to do in the farmwork area. That is the one place we might want to do something.

Chairman PROXMIRE. What percentage of those unemployed in 1970 were eligible for unemployment compensation benefits?

Mr. LOVELL. I do not have that figure. We will submit it.

Secretary HODGSON. We will get that for you.

Chairman PROXMIRE. Would you estimate it, roughly 50 percent?

Mr. LOVELL. It is a little high now.

Secretary HODGSON. Traditionally, I would think it would be less than 50 percent.

(The information referred to above follows:)

On the basis of the number of persons filing initial and continuing claims, during calendar year 1970, 44.3 percent of the total unemployed workers were eligible for unemployment compensation.

Chairman PROXMIRE. I understand that in most States average benefits are less than 50 percent of wages. Will you ever succeed in getting the States voluntarily to raise this or should we have a Federal law setting minimum benefits as a percent of wages?

Secretary HODGSON. Our position is definitely to encourage the States to go forward and increase benefits. A number of States are doing so each year, but it is just a constant process that you have to keep at.

Chairman PROXMIRE. We are still a long way from getting 50-percent benefit payments on the basis of wages.

Is the duration of benefits long enough, in view of the outlook for continued high unemployment?

Secretary HODGSON. We think that by increasing it by 50 percent under the extended benefits program during periods of economic slowdown, we have gone a long way toward meeting that need. It will be long enough, by and large, for most States.

One of the fascinating things, Senator—and I commented upon it in my testimony—is the nature of unemployment during this period of time.

The average length of unemployment is lower than it has been in previous periods of economic slowdown, being now down around 10 weeks rather than up around 17 or more, as before. In fact, it has only increased during this period by about 3 weeks. This means that much of today's unemployment is what we would call transitional unemployment—a period of time between jobs rather than the long, grinding unemployment where one waited and waited for a call from the factory to come back to work.

Chairman PROXMIRE. Senator Pearson.

Senator PEARSON. Something went by me rather quickly. Did I understand, Mr. Secretary, that you thought there would be a rapid rise in inventories during this year?

Secretary HODGSON. I think Mr. Moore commented on that subject.

Senator PEARSON. The reason I asked, I am not trying to catch you in any inconsistency, but my attention was addressed to the President's Economic Report which said after the catchup on the auto strike and stockpiling in anticipation of the steel strike that there would not be much of a variance in sales and inventories in 1971.

Mr. MOORE. Well, I would say that there would be some increase in the rate of——

Senator PEARSON. At least in the last half.

Mr. MOORE. There would be some increase in inventory investment, that is, the accumulation of inventories, but since they have not been decumulating, I do not expect them to accumulate at a very rapid rate.

Senator PEARSON. One further question; Mr. Secretary, as a layman, I am always a little bit surprised by the effect the General Motors strike had. What would be the effect of a steel strike of like duration this year?

Secretary HODGSON. It would be extensive.

Senator PEARSON. As great as?

Secretary HODGSON. The prospect is a very dim one, obviously. We are looking into it now to see what that might be, but we are also making a retrospective review of the General Motors strike to see just what the reasons were, why it had such effect, and where those effects were felt principally.

Senator PEARSON. Did it surprise experts, too, the effect of the General Motors strike?

Secretary HODGSON. I think the principal thing that surprised us was the length of the strike.

Senator PEARSON. The fact that this economy was in such a weak position at that time that it really accentuated the effect of it; is that right?

Secretary HODGSON. Well, it certainly was a setback to what was in our view at that time a strong indication of recovery.

Senator PEARSON. Thank you.

Chairman PROXMIRE. Did you say that a steel strike, the prospect of a steel strike, was a dim one?

Secretary HODGSON. No, I meant a gloomy one.

Chairman PROXMIRE. Do you mean it is a dim prospect we will have it or it is a dim prospect if we have it?

Secretary HODGSON. It is a gloomy prospect to face.

Chairman PROXMIRE. You were not making any judgment as to whether it is likely or unlikely?

Secretary HODGSON. No, but I said in my statement the forces are there, and they concern us greatly. We are working quietly with the parties to find out if they are doing all they can to minimize the possibility of a strike. But we don't have anything specific beyond that to indicate at the present time whether there will or will not be.

Chairman PROXMIRE. Mr. Abel has said that a cost-of-living provision is absolutely mandatory if the steelworker is going to settle without a strike.

In your judgment, would such a cost-of-living provision be consistent with anti-inflationary policy or would it be wrong?

Secretary HODGSON. I can't answer that—whether or not they arrive at a cost-of-living provision is up to them.

Chairman PROXMIRE. You have no position on that?

Secretary HODGSON. I have no position against it certainly.

Chairman PROXMIRE. Thank you.

One other question: I understand that the Labor Department does not have good data on wage rates for nonunion workers, and the spread between union and nonunion rates. What data do you have on average earnings or average hours worked by nonunion workers?

Secretary HODGSON. Mr. Moore, do you want to see what you can describe or contribute to that one?

Mr. MOORE. We do have some data on union and nonunion wage increases in manufacturing, but we do not have similar data for construction workers.

Chairman PROXMIRE. Well, the widely quoted contract settlements of the 13- or 18-percent increase may cover only about half of the construction workers.

Before the administration embarks on a wage-price policy directed solely at the construction industry and construction workers, don't you think you should have more, know more, about the wage and union structure in the industry?

Mr. MOORE. Well, I should mention that we do have information on average hourly earnings of construction workers, but this includes both union and nonunion labor. The rate of increase that those earnings——

Chairman PROXMIRE. You have, you say, pretty good figures on the nonunion, the average hourly pay of nonunion workers, is that right, as well as union?

Mr. MOORE. No. We have it for the total union plus nonunion, and the rates of increase that those totals have been showing, which combine both union and nonunion workers, have been in the neighborhood of 8 percent per year.

Chairman PROXMIRE. Is that now about $5.40 an hour?

Mr. MOORE. I think it is in that neighborhood.

Chairman PROXMIRE. So if they work their 1,400 hours or so, it works out to $8,000, $8,500 a year, which means that the average construction workers could not buy the $30,000 house he is building.

Secretary HODGSON. Well, there are a great many construction workers, of course, who are working more than that.

Chairman PROXMIRE. A lot working less, obviously, too.

Secretary HODGSON. We get the average number of hours by taking the number of people who work in the industry at any part of the year. That industry is like a lot of others, there are a lot of flow-through people who work in the industry part of the year, or work only part of the industry workweek.

The only thing I would say to that, Senator, is that the seasonality problem that produces this short-time work in much of the construction industry is not any greater now—in fact it is probably a little bit less now—than it was in times past, and in times past the industry did not get the similar differential in increases over the remainder of the industrial groups.

Chairman PROXMIRE. Did you say you did or did not have figures on the average number of hours worked in the construction industry?

Secretary HODGSON. What have we got on that?

Mr. MOORE. Well, we have—you mean annually?

Chairman PROXMIRE. Yes, sir.

Mr. MOORE. No, I do not have that information with me.

Chairman PROXMIRE. You do not have it.

Mr. MOORE. No, but I can supply it, although it may not be an up to date figure.

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

The 1969 *Consumer Income Report,* from the Current Population Survey (Series P 60 No. 75 dated 12/14/70) states that male year-round full-time workers in the construction industry had mean earnings of $8,481. The comparable figure for durable manufacturing is $8,362. The 1970 figures are not yet available. These figures are for both union and nonunion workers.

Secretary HODGSON. The amount of information on the construction industry, Mr. Chairman is really remarkable for its paucity, not only with regard to wages but also with regard to productivity.

Chairman PROXMIRE. I admire you for your honesty, but what does that mean? It means we are moving in on an industry with the prospect of a wage-price freeze, or at least extensive wage-price controls and you do not know much about it, you do not have data.

Secretary HODGSON. We know about it enough to know that something ought to be done about it, Mr. Chairman.

Chairman PROXMIRE. Well, do you?

Secretary HODGSON. Yes.

Chairman PROXMIRE. If you do not have the facts, how do you know?

I read those articles in the Reader's Digest, too.

Secretary HODGSON. We actually know quite a bit, and from several sources. We meet on the average of once every 3 weeks with the construction industry collective bargaining commission, which is a tripartite group. It reviews what is going on in wage bargaining. We have information from the mediation and conciliation service, which gets reports on all bargaining throughout the country. We know what is happening with wage patterns in construction vis-a-vis wage patterns elsewhere, and they are sufficiently excessive to demand considerable attention.

Chairman PROXMIRE. My argument was that there undoubtedly are areas where you would not intervene because wages are so low, so pitifully low, so inadequate, even though they did have a big percentage increase, you would not feel that it was wrong, in fact you might applaud it, I would, if some areas, some hospital workers, some laundry workers, and some agricultural workers and others are getting pitifully inadequate pay, and they could get big percentage increases which would still leave them way behind the rest.

We have an industry on which we do not have the data of how long people work, what the average pay is, or whether the average worker is able to support a family on his income, and it seems to me to raise some questions about the wisdom of moving ahead.

Secretary HODGSON. We do have some information about seasonality. It is not a worsening problem; it is actually improving.

Senator PEARSON. Mr. Secretary, let me ask you this: Of what influence is it or what is the influence of the Government action in relation to Federal employees' increase in salary, military pay, cost-of-living provision, and social security, what effect does that have on all of these labor negotiations? I do not want to talk about the increase in salary of Congressmen. I had a constituent who wrote me raising Cain about that, and I wrote him back and said that I was not even here to vote on that, I was in Japan at an agricultural trade conference. And he was a very reasonable fellow, he said, "Yes, you went all the way to Japan to keep from voting on that question."

But, seriously, what is the effect of what we are doing here?

Secretary HODGSON. I think if the Congress continues to stay with the concept that they are presently employing, the Civil Service Commission setting Federal standards, there is a comparability to the private sector. If they continue to stay with this concept, it would be hard to say that Federal Government rates play a leading role in moving the wage patterns of this country forward. Comparability by definition should mean a paralleling, not a forward movement kind of thing.

Senator PEARSON. Just as an aside, I accept comparability so far as wages, and not if we had comparability so far as numbers, because many of our bureaus, it seems to me, have two people doing the job of one person, and that is something else again.

Secretary HODGSON. We have a very small Department of Labor.

Chairman PROXMIRE. May I just say we had the Secretary of Agriculture up here the other day, and we pointed out that whereas we had 64,000 employees in 1952 in that Department with 9 million farmers, today we have 4½ million farmers, and we are going to have 87,000 employees. In other words, it used to take one employee to handle 150 farms, now one employee handles 50 farms.

No matter how you look at that and no matter how you alibi it or excuse it, we do have a case of galloping bureaucracy in the Department of Agriculture that we ought to get at.

I am glad to hear you say you do not have that in the Department of Labor.

Secretary HODGSON. I do not say we do not have it. I just say we have the smallest Department in Government.

Chairman PROXMIRE. Well, Mr. Secretary, I want to thank you very much for a fine job you and your colleagues did.

Secretary HODGSON. Thank you.

Chairman PROXMIRE. Tomorrow morning at 10 o'clock we will meet in this room to hear Alan Greenspan, Arthur Okun, and Paul Samuelson.

(Whereupon, at 4 p.m., the committee adjourned, to reconvene at 10 a.m., Tuesday, February 23, 1971.)

THE 1971 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 23, 1971

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

The committee met, pursuant to recess, at 10 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire and Pearson.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowsky, research economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

We have heard from many experts over the past weeks, from hard-pressed officials of State and local governments, from former Federal officials, and in the past week from top Federal officials who occupy office now.

Despite efforts by administration spokesmen to paint an optimistic economic picture for the year ahead if they could, the overall outlook, in my view, is not good. Even the administration people seem to be stuttering as to this outlook. The Federal Reserve Chairman considers the forecast of $1,065 billion GNP for 1971 "optimistic," in the sense, I took it, that his experts did not think it would be fulfilled.

While he assured us they would keep money easy, and that promise was not clear, he was emphatic that monetary policy could not do the job alone. Fiscal policy may be inadequate; and we definitely need an income policy which it is high time incomes policy be placed on the "respectability" list, so far denied it by the executive. We also have on the record a prediction by staff people at Commerce that foresees continuing high inflation and unemployment.

Today we begin a series of hearings involving private experts. These are the top economic interpreters in the country. Alan Greenspan is a well known adviser to the administration. Arthur Okun, former Chairman of the Council of Economic Advisers, is no doubt well qualified to handle answers to our most pressing problems of inflation and unemployment. Paul Samuelson is one of the most dedicated members of the economic fraternity, and I want to congratulate him on the great honor he recently received, the Nobel Prize in economics. All three are great economists. We look forward to their assessment

59-591—71—pt. 2——9

of the administration's program. I am sorry to say Mr. Okun has been called to appear before another committee of Congress, and so I hope the committee members will allow us to let him off.

As you experts know, this year's economic report did not present the breakdown in GNP which former councils did present. At first the explanation was that it was not needed. Then it became more evident that the figure of $1,065 billion of GNP for 1971 came from a little "black box" which did not require knowledge of the principal demand elements. Finally, the Council did give us some numbers, and I want you to spend a little time discussing the reasonableness of the estimates.

The witnesses realize the time problem, and they will keep their oral comments to 10 minutes or so. Their prepared statements will, of course, be placed in the record in full.

Mr. Okun, will you go right ahead.

STATEMENT OF ARTHUR M. OKUN, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. Okun. Thank you, Mr. Chairman.

This is the seventh consecutive year that I have testified before the Joint Economic Committee in the hearings on the Economic Report of the President. Each new invitation is a privilege which I deeply appreciate.

Let me begin by interpreting the current posture of fiscal and monetary policies; then evaluating these policies in light of the economic outlook; suggesting additional fiscal steps that might be considered if the Congress does not share the administration's optimistic view of the outlook; and discussing the need for a systematic incomes policy.

In my view, the Council of Economic Advisers has focused the spotlight properly in its emphasis on the position of the full employment budget. I believe that the full employment surplus is a valuable indicator—indeed, the best simple indicator—of the impact of the budget. It tells us where the fiscal thermostat is set; in contrast, the actual budget deficit or surplus tells us how much the fiscal furnace is working in response to the economic weather.

On the national accounts basis for fiscal 1971, the actual deficit is projected at $15 billion, while the full employment budget has a surplus of about $5 billion. The difference between the two is a $20 billion shortfall of Federal revenues resulting from the slump in the economy. The large actual deficit is a sign of a cold economy and not of a hot budget.

Although the full employment surplus can tell us where the fiscal dials are set, it cannot tell us where the dials ought to be set in any particular year. When private demand is particularly strong, a large full-employment surplus is required in order to avoid an inflationary boom. On other occasions, when private demand is exceedingly weak, a full-employment deficit would be desirable.

It is relevant that a majority of economists who have appraised long-run patterns of saving, investment, and credit flows conclude that, in an average year, the budget should contain a full employment surplus of moderate size—on the national accounts basis, perhaps between one-half and 1 percent of GNP.

That tentative conclusion implies that a full employment deficit should be viewed as a temporary prescription for invigorating a weak economy, and not as a regular diet. It also means that a bare balance in the full employment budget is a somewhat more than normal dose of fiscal stimulation.

Measured against that standard, the administration's fiscal formula of a zero full-employment surplus for fiscal 1972 can properly be viewed as stimulative. But a careful look at the budget reveals that it is somewhat less stimulative than the criterion of full-employment balance might suggest.

First, the administration budget is on the unified basis, if balance has been aimed for on a national account basis, which is the concept most economists prefer, that a loan would leave roughly $5 billion of extra elbow room for expansionary measures.

Second, the stimulation of the fiscal program will occur late in the period, bunching in the first half of calendar 1972. As the Council of Economic Advisers told this committee, the full-employment surplus on the national accounts basis for calendar year 1971 is almost exactly the same as the $6.7 billion level of 1970. Thus in terms of its impact on calendar year 1971, the fiscal program is thus best summarized as supportive or, at most, very modestly stimulative.

The current thrust of monetary policy is distinctly in the expansionary direction. Despite the significant slowdown in monetary growth in the last 4 months, the behavior of interest rates and money market conditions and the rapid growth of bank reserves and time deposits demonstrate the Federal Reserve's intent and actions to promote recovery.

To be sure, if the sole concern of the Federal Reserve had been the growth of the money supply, it would have tried much harder to maintain that growth in recent months. And if it had made that extra effort, short-term interest rates would have declined even more sharply than they have in fact. Indeed, the Treasury bill rate might be as low as 2 percent.

I do not believe that a 2 percent bill rate would be providing much extra help for recovery today, and I can understand a preference for a more gradual and more sustainable relaxation of credit conditions, which would help to prolong the downward movement of key long-term interest rates.

That strategy, if I guess it correctly, has important implications for the future. During the forthcoming months of economic recovery, private demands for cash balances should revive. Just as the sluggish demands for active cash in recent months contributed to the unusually low 3 percent growth rate of money, a welcome revival of these demands could call for unusually rapid growth of money, perhaps at a rate far above 6 percent from some period of time.

So long as economic activity is not threatening to exceed a desirable path of orderly expansion, I would expect the Federal Reserve to meet these demands. Under these conditions, I expect the Federal Reserve to maintain credit conditions favorable to a further decline in long-term interest rates, which are still too high for healthy economic growth.

In short, the posture and intent of Federal Reserve policy will face its real test when credit demands revive. I hope and I believe that monetary policy will pass that test.

I should like to suggest respectfully that the Joint Economic Committee could perform a service by clarifying its own position on appropriate guidelines for monetary policy. In 1968, the committee stated:

In normal times, for the present, the desirable range of variation (of the growth of the money stock) appears to be within the limits of 2 to 6 percent. * * *

The present situation is not "normal times," and I would urge the committee to consider correcting any inference that it views 6 percent as a ceiling on the appropriate growth of the money supply in 1971. I myself would stress a further reduction of long-term interest rates as a key objective of monetary policy, rather than any pinpointed target for monetary growth.

Taking all this together, I believe that current fiscal-monetary policies are, on balance, providing a somewhat more than average amount of fuel for the growth of the economy.

But the big question is, is that enough fuel for the current situation? And the answer to that question depends on the prospects for private demand.

If private demand is as strong as the administration's economic forecast for 1971 implies, then current policies would provide plenty of stimulus. The administration views private demand as a Jack-in-the-box, ready to pop up after having been held down.

In sharp contrast, the overwhelming majority, I should say near unanimity, of economists outside the administration view private demand as stuck-in-the-mud, expecting a below-average growth of real output in 1971, despite the above-average injection of fiscal-monetary fuel. I share that view. So far as I can see, the only buoyant area of private demand is homebuilding. Most other areas still reflect, to a degree, the impact of the tight fiscal-monetary policies of the not-so-distant past.

If 1955 provides a historical prototype for the jack-in-the-box view, then 1962 is a good example of stuck in the mud. The recovery for the 1960–61 recession never got rolling out of the mud, and the actual pace of economic activity fell short of most forecasts and especially short of the rather optimistic prediction made by the Kennedy administration.

The stuck-in-the-mud view points to a gain in GNP for 1971 of $70 billion—or at most $75 billion—while the administration forecast calls for an $88 billion gain. Both views of the outlook agree that 1971 bill be a year of distinct economic recovery as measured by output, employment, and real income. Both also agree that the average unemployment rate in 1971 will exceed that of 1970. Yet the extra margin in the administration forecast is enough to make 1971 a very different kind of year from the one I envision. In the stuck-in-the-mud view, the gap between our potential and actual output will remain close to where it is now, and the unemployment rate will remain where it is now, with no major downtrend during the course of the year. In the jack-in-the-box view, however, the gap will be cut substantially during the course of the year and unemployment will decline substantially.

The critical difference between the two views of the outlook in that they give different answers to the question of whether fiscal-monetary policies are adequately stimulative. If I viewed the jack-in-the-box pattern as the probable outcome for 1971, I would certainly not recommend a more expansionary fiscal program than the administration has established. Nor would anyone else; I have yet to hear the administration's targets criticized as insufficiently ambitious.

On the other hand, if the President's advisers regarded the stuck-in-the-mud pattern as the likely outcome, I must assume that they would be pleading for more expansionary action. And that verdict would have overwhelming support. Few Americans would be satisfied with a year in which unemployment and wasted production remained close to current levels.

In line with my views on the most probable course of economic activity in 1971, I would favor the provision of extra fiscal-monetary fuel now. I could make this recommendation more confidently if I could dismiss the jack-in-the-box scenario as impossible, rather than assessing it as improbable. But it is not impossible. Accordingly a case might be made for holding the jury until the evidence on the shape of the year is crystal clear. The trouble with such a course is that it would cost valuable time, however, and a clarification might take an unusual amount of time under the special circumstances of today. It may be especially difficult to diagnose the true significance of the economic statistics for early 1971, because of the stoppage and resumption of General Motors' output.

I believe that it is important to start planning, and, indeed, to start action, for additional fiscal stimulus now, on the prudent assumption that the Nation will not get the lucky breaks required to realize fully the administration's forecast.

A temporary injection of added fiscal fuel is desirable now to help private demand get out of the mud. But the flow of fuel should be reduced once the private economy gets rolling in high gear. In planning prudently for a constructive full-employment deficit in 1971, it is vital to plan as well for a full-employment surplus when that becomes appropriate. There are serious problems in designing the kind of temporary additional stimulus we need.

Many possible expenditure or tax measures that would assist recovery in 1971 would add even more to fiscal stimulus in future years, when stimulation may be exactly the wrong medicine. The administration's largest single expansionary action to date adds $2 billion to corporate cash flow this year; but it also commits $4 billion a year of Federal funds permanently as an addition to corporate funds.

I wish I could hand you a list of added Federal program efforts that would provide quick and efficient additions to private income this year without necessarily committing the Nation to large further expenditures in future years. I do not have such a list. At most, I can dare to mention—as questions rather than answers—some areas that you might wish to explore. Could a Federal job program be designed to go into action in 1971 and to be phased down in a timely fashion as the labor market improves? Could the Congress promptly implement a special program of unemployment insurance benefits that would provide relief to the growing number of longer term unemployed? Would it be possible to build into some Federal grants-in-aid to States and localities an extra allowance based on the size of excessive unemployment, so that the allowance would automatically fall to zero when full employment was restored?

If the opportunities for temporary stimulus through efficient and prompt Federal expenditures are not adequate, the tax side should be explored. Two possibilities come to mind. A personal income tax reduction of $4½ billion has already been legislated to take effect in January 1972 and January 1973.

Some or all of those tax reductions could be made effective in 1971. The second possibility relates to the proposed increase from $7,800 to $9,000 in the taxable earnings base for social security taxes. Deferring that increase until 1972 would prevent a drain on the economy of about $2½ billion in the second half of this calendar year.

Whatever the course of stabilization policy, prices and wages will continue to rise at a disturbing rate in 1971. Nonetheless, some modest deceleration of prices should take place this year regardless of whether the economy follows the jack-in-the-box or the stuck-in-the-mud scenario. In either case, more action is needed both to reinforce that deceleration during 1971 and to insure against a reacceleration whenever our fiscal-monetary efforts succeed in restoring full employment.

The Council of Economic Advisers mentioned "The administration's new, more active program for restraining price and wage increases. * * *" I welcome this change in the administration's attitudes. I also was encouraged by Chairman McCracken's consideration of ways to make wage-price policies "more systematic and comprehensive and to provide more adequately for their management. * * *"

Such efforts are urgently needed. The rather erratic and sporadic actions of recent months are much better than nothing, but they should be replaced by a clearly enunciated and carefully formulated program of wage-price restraints.

I would again endorse the creation of a small special advisory board on wage-price restraint. A key assignment for that board should be the setting of speed limits on wages and prices. Such standards are essential if private parties are to understand what kind of action on their part will serve the national interest. Under present circumstances, the standard that seems most relevant to new wage agreements is the size of the last wage settlement reported in the press. A similar unfortunate emulation effect seems to influence some price decisions. "Follow the leader" decisions give us a wage-wage spiral and perhaps even a price-price spiral on top of our wage-price spiral.

Standards that set forth the public interest—and that includes the true long-term interests of business and labor—in an appropriate deescalation of price and wage hikes could provide a genuine alternative to "follow the leader."

In my opinion, we do not need mandatory direct controls on wages and prices, at the present time or in the foreseeable future, across the board or selectively, in any area—and that includes construction. After putting such complete faith and trust for so long in the perfection of the marketplace, the administration is apparently considering the extreme selective measure of a mandatory freeze on wages and prices in the construction industry.

This is puzzling. An old saying reminds us that a devout man who loses faith becomes the most vehement atheist. I hope that saying is not applicable to the administration's view of the marketplace.

In summary, the administration's targets—orderly and vigorous expansion combined with continued deceleration of prices—deserve the Nation's full support. But the achievement of those targets in 1971 under current policies is not, in my view, a prudent and realistic expectation. To narrow the gap between the probable outcome and the targets, I would emphasize the following needs:

(1) Carefully controlled measures of additional temporary fiscal stimulus that would help the economy get rolling and would phase out when it gets into high gear;

(2) Pursuit by the Federal Reserve of a sufficiently generous monetary policy to help reduce further our key longterm interest rates; and

(3) Development of a systematic and comprehensive incomes policy, short of direct controls.

Chairman PROXMIRE. Thank you, Mr. Okun.

We will place your prepared statement in the record at this point.

Mr. OKUN. Thank you, sir.

(The prepared statement of Mr. Okun follows:)

PREPARED STATEMENT OF ARTHUR M. OKUN *

This is the seventh consecutive year that I have testified before the Joint Economic Committee in the Hearings on the Economic Report of the President. Each new invitation is a privilege which I deeply appreciate. I should like to offer my views on over-all economic policy to the Committee by a) interpreting the current posture of fiscal and monetary policies; b) evaluating these policies in light of the economic outlook; c) suggesting additional fiscal steps that might be considered if the Congress does not share the Administration's optimistic view of the outlook; and d) discussing the need for a systematic incomes policy.

The administration's fiscal program

In my view, the Council of Economic Advisers has focused the spotlight properly in its emphasis on the position of the full employment budget. I believe that the full employment surplus is a valuable indicator—indeed, the best simple indicator—of the impact of the budget. It tells us where the fiscal thermostat is set; in contrast, the actual budget deficit or surplus tells us how much the fiscal furnace is working in response to the economic weather. When the full employment budget is in surplus and the actual budget is in deficit, we know that the economy is cold and that the furnace has been triggered on automatically. On the national accounts basis for fiscal 1971, the actual deficit is projected at $15 billion, while the full employment budget has a surplus of about $5 billion. The difference between the two is a $20 billion shortfall of Federal revenues resulting from the slump in business and personal incomes. The large actual deficit is a sign of a cold economy and not of a hot budget.

Although the full employment surplus can tell us where the fiscal dials are set, it cannot tell us where the dials *ought* to be set in any particular year. When private demand is particularly strong, a large full employment surplus is required in order to avoid an inflationary boom (or an extremely tight monetary policy). On such occasions, a full employment budget with a scant balance would be too expansionary. On other occasions, when private demand is exceedingly weak, a full employment deficit would be desirable. It is relevant that a majority of economists who have appraised long-run patterns of saving, investment, and credit flows conclude that, *in an average year*, the budget should contain a full employment surplus of moderate size—on the national accounts basis, perhaps between ½ and 1 percent of GNP. That tentative conclusion implies that a full employment deficit should be viewed as a temporary prescription for invigorating a weak economy, and not as a regular diet. It also means that a bare balance in the full employment budget is a somewhat more than normal dose of fiscal stimulation.

Measured against that standard, the Administration's fiscal formula of a zero full employment surplus for fiscal 1972 can properly be viewed as stimulative. But a careful look at the Budget reveals that it is somewhat less stimulative than the criterion of full employment balance might suggest. First, the balance applies to the full employment budget on the *unified* basis. Aiming for full employment balance on the *national accounts* basis (the concept most economists prefer) would leave roughly $5 billion of extra elbow room for expansionary measures. Second, the stimulation of the fiscal program will occur late in the period, bunching in the first half of calendar 1972. As the Council of Economic Advisers told this Committee, the full employment surplus on the national accounts basis for

*The views expressed are my own and are not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

calendar year 1971 is almost exactly the same as the $6.7 billion level of 1970. In terms of its impact on calendar year 1971, the fiscal program is thus best summarized as supportive or, at most, very modestly stimulative.

Current monetary policy

The current thrust of monetary policy is distinctly in the expansionary direction. Chairman Burns reassured this Committee last week that no change in monetary policy should be inferred from the significant slowdown in monetary growth from an annual rate of 6 percent during the first nine months of 1970 to 3 percent in the last four months. The behavior of interest rates and money market conditions, and the rapid growth of bank reserves and time deposits demonstrate the Federal Reserve's intent and actions to promote recovery.

To be sure, if the sole concern of the Federal Reserve had been the growth of the money supply, it would have tried much harder to maintain that growth in recent months. And if it had made that extra effort, short-term interest rates would have declined even more sharply than they have in fact. I would infer that the Federal Reserv e probably considers its actual strategy to be conducive to more sustained favorable developments in credit markets than a strategy which might have pushed the Treasury bill rate all the way down, perhaps to 2 percent today, with a large rebound later. I do not believe that a 2 percent bill rate would be providing much extra help for recovery today, and I can understand a preference for a more gradual and more sustainable relaxation of credit conditions, which would help to prolong the downward movement of key long-term interest rates.

That strategy, if I guess it correctly, has important implications for the future. During the forthcoming months of economic recovery, private demands for cash-balances should revive. Just as the sluggish demands for active cash in recent months contributed to the unusually low 3 percent growth rate of money (demand deposits and currency), a welcome revival of these demands could call for unusually rapid growth of money—perhaps at a rate far above 6 percent for some period of time. So long as economic activity is not threatening to exceed a desirable path of orderly expansion, I would expect the Federal Reserve to meet these demands. Under those conditions, I expect the Federal Reserve to maintain credit conditions favorable to a further decline in long-term interest rates, which are still too high for healthy economic growth.

In short, the posture and intent of Federal Reserve policy will face its real test when credit demands revive. I hope and I believe that monetary policy will pass that test.

I should like to suggest respectfully that the Joint Economic Committee could perform a service by clarifying its own position on appropriate guidelines for monetary policy. In 1968, the Committee stated: "In normal times, for the present, the desirable range of variation [of the growth of the money stock] appears to be within the limits of 2 to 6 percent . . . ." The present situation is not "normal times," and the exceptional circumstances point toward the desirability of abnormally generous monetary growth. I would urge the Committee to consider correcting any inference that it views 6 percent as a ceiling on the appropriate growth of the money supply in 1971. I myself would stress a further reduction of long-term interest rates as an objective of monetary policy.

If I add together my view of the budget and my hopeful interpretation of the intentions of the Federal Reserve, I believe that current fiscal-monetary policies are, on balance, providing a somewhat more than average amount of fuel for the growth of the economy.

The outlook for economic activity

The big question, however, is whether stabilization policies are providing an adequate amount of fuel in our current situation—with production at least $50 billion below our full employment capacity, and with the highest unemployment rate in nearly a decade. And the answer to that question depends on the prospects for private demand.

If private demand is as strong as the Administration's economic forecast for 1971 implies, then current policies would provide plenty of stimulus. The Administration views private demand as a Jack-in-the-box, ready to pop up after having been held down. It can point to examples when the economy did pop up like a Jack-in-the-box after a recession. Once recovery was firmly under way, it had self-reinforcing effects on consumer and business demand. In 1955, which was the outstanding case, the actual performance of private demand far outstripped the expectations of forecasters.

In sharp contrast, the overwhelming majority of economists outside the Administration view private demand as stuck-in-the-mud, expecting a below-average growth of real output in 1971, despite the above-average injection of fiscal-monetary fuel. I share that view. So far as I can see, the only buoyant area of private demand is homebuilding. Most other areas still reflect, to a degree, the impact of the tight fiscal-monetary policies of the not so distant past. I expect business spending on plant and equipment to continue to be sluggish as a result of weak markets, low profits, and excess capacity. Because inventory investment did not nosedive during the 1970 slump, it is not likely to snap back strongly during 1971 and will not provide the lift that it did in earlier peroids of recovery. I see no compelling evidence that the recent sluggishness of consumer spending is about to change dramatically. We may find ourselves in a vicious circle: the consumer is not likely to become enthusiastic about spending on big-ticket items until the unemployment situation improves; while the unemployment situation is not likely to improve significantly until and unless the consumer becomes more enthusiastic about spending.

If 1955 provides a historical prototype for the Jack-in-the-box view, then 1962 is a good example of stuck-in-the-mud. The recovery for the 1960–61 recession never got rolling out of the mud, and the actual pace of economic activity fell short of most forecasts and especially short of the rather optimistic prediction made by the Kennedy Administration.

The stuck-in-the-mud view points to a gain in GNP for 1971 of $70 billion (or at most $75 billion) while the Administration forecast calls for $88 billion. Both views of the outlook agree that 1971 will be a year of distinct economic recovery as measured by output, employment, and real income. Both also agree that the average unemployment rate in 1971 will exceed that of 1970. Yet the extra margin in the Administration forecast is enough to make 1971 a very different kind of year from the one I envision. In the stuck-in-the-mud view, the gap between our potential and actual output will remain in the $50 to $60 billion range, and the unemployment rate will stay close to 6 percent with no major downtrend during the course of the year. In the Jack-in-the-box view, however, the gap will be cut substantially during the course of the year and unemployment will decline, although still remaining close to 5 percent at year end.

The critical difference between the two views of the outlook is that they give different answers to the question of whether fiscal-monetary policies are adequately stimulative. If I viewed the Jack-in-the-box pattern as the probable outcome for 1971, I would certainly not recommend a more expansionary fiscal program than the Administration has established. Nor would anyone else: I have yet to hear the Administration's targets criticized as insufficiently ambitious. On the other hand, if the President's advisers regarded the stuck-in-the-mud pattern as the likely outcome, I must assume that they would be pleading for more expansionary action. And that verdict would have overwhelming support. Few Americans would be satisfied with a year in which unemployment and wasted production remained close to current levels.

In line with my views on the most probable course of economic activity in 1971, I would favor the provision of extra fiscal-monetary fuel now. I could make this recommendation more confidently if I could dismiss the Jack-in-the-box scenario as impossible, rather than assessing it as improbable. But it is not impossible. Accordingly a case might be made for holding the jury until the evidence on the shape of the year is crystal clear. The trouble with such a course is that it would cost valuable time, however, and a clarification might take an unusual amount of time under the special circumstances of today.

Unfortunately, because of the recovery from the automobile strike, it may be especially difficult to diagnose the true significance of the economic statistics for the early months of 1971. Because of the sheer arithmetic of the stoppage and resumption of General Motors' output, the increase in GNP during the first quarter is bound to be simply gigantic. Automobile product will take a huge jump, not only reversing the $12 billion drop of the fourth quarter but also reflecting a considerable makeup of the output lost during the strike. As a result, GNP may jump by well over $30 billion, without necessarily indicating a significant strengthening of the economy, apart from the automobile sector. The pattern of consumer and investment demand outside of automobiles in the first quarter should provide some clues, but it is unlikely to be decisive. Nor is next month's Commerce-SEC plant and equipment survey likely to be as revealing as in some years when investment is the key area of uncertainty. The big question mark for 1971 is the consumer, and mid-year might come before it is clear whether or not the consumer is popping up in line with the Jack-in-the-box scenario. Hence, I believe that it is important to start planning, and undeed to start action, for additional fiscal stimulus now on the prudent assumption that the Nation will not get the lucky breaks required to realize fully the Administration's forecast.

A menu of additional fiscal measures

A temporary injection of added fiscal fuel is desirable now to help private demand get out of the mud. But the flow of fuel should be reduced once the private economy gets rolling in high gear. In planning prudently for a constructive full employment deficit in 1971, it is vital to plan as well for a full employment surplus when that becomes appropriate. These are serious problems in designing the kind of temporary additional stimulus we need. Many possible expenditure or tax measures that would assist recovery in 1971 would add even more to fiscal stimulus in future years, when stimulation may be exactly the wrong medicine. The Administration's largest single expansionary action to date—the liberalization of depreciation allowances—exemplifies such an unfavorable time pattern: it adds $2 billion to corporate cash flow this year; but it also commits $4 billion a year of Federal funds permanently as an addition to corporate funds.

I wish I could hand you a list of added Federal program efforts that would provide quick and efficient additions to private income this year without necessarily committing the Nation to large further expenditures in future years. I do not have such a list. At most, I can dare to mention—as questions rather than answers—some areas that you might wish to explore. Could a Federal job program be designed to go into action in 1971 and to be phased down in a timely fashion as the labor market improves? Could the Congress promptly implement a special program of unemployment insurance benefits that would provide relief to the growing number of longer term unemployed? Would it be possible to build into some Federal grants-in-aid to States and localities an extra allowance based on the size of excessive unemployment, so that the allowance would automatically fall to zero when full employment was restored?

If the opportunities for temporary stimulus through efficient and prompt Federal expenditures are not adequate, the tax side could be explored. Two possibilities come to mind. One arises because a reduction in personal income taxes (a rise in the personal exemption and standard deduction) has already been legislated to take effect in January 1972 and January 1973, totalling about $4-½ billion. Some or all of those tax reductions could be made effective in 1971. Bringing permanent tax reduction into effect one or two years ahead of schedule is attractive because it does not sacrifice Federal revenues provided under existing law for the longer run. The second possibility relates to the proposed increase from $7,800 to $9,000 in the taxable earnings base for social security taxes. Deferring that increase until 1972 would prevent a drain on the economy of about $2½ billion in the second half of this calendar year.

The wage-price front

Whatever the course of stabilization policy, prices and wages will continue to rise at a disturbing rate in 1971. Nonetheless, some modest deceleration of prices should take place this year regardless of whether the economy follows the Jack-in-the-box or the stuck-in-the-mud scenario. In either case, more action is needed both to reinforce that deceleration during 1971 and to ensure against a reacceleration whenever our fiscal-monetary efforts succeed in restoring full employment. Under present circumstances and institutions, the long-term price outlook at high employment looks just as bleak as our near-term price prospects.

The Council of Economic Advisers called your attention to "The Administration's new more active program for restraining price and wage increases . . . ." I welcome this change in the Administration's attitudes. I also was encouraged by Chairman McCracken's consideration of ways to make wage-price policies "more systematic and comprehensive and to provide more adequately for their management . . . ." Such efforts are urgently needed. The rather erratic and sporadic actions of recent months are much better than nothing, but they should be replaced by a clearly enunciated and carefully formulated program of wage-price restraints. Such a program should include comprehensive and effective use of the Government's powers as a purchaser and as a regulator to serve the cause of price-cost stability; and it should develop a voluntary system of wage-price restraint by big business and big labor.

I would again endorse the creation of a small special advisory board on wage-price restraint, a proposal first made by Congressman Reuss and recently supported by Chairman Burns and by the Committee for Economic Development. A key assignment for that Board should be the setting of speed limits on wages and prices. Such standards are essential if private parties are to understand what kind of action on their part will serve the national interest. Under present circumstances, the standard that seems most relevant to new wage agreements is the size of the last wage settlement reported in the press. A misguided notion of equity seems to apply that no workers shoud get a smaller wage rise than the workers who preceded them. That standard influences the unorganized as well as the organized sector of the economy, if the casual evidence I hear about is at all indicative. A similar unfortunate emulation effect seems to influence some price decisions. "Follow the leader" decisions give us a wage-wage spiral and perhaps even a price-price spiral on top of our wage-price spiral. Standards that set forth the public interest—and that includes the true long-term interests of business and labor—in an appropriate deescalation of price and wage hikes could provide a genuine alternative to "follow the leader."

In my opinion, we do not need mandatory direct controls on wages and prices, at the present time or in the foreseeable future, in any area—and that includes construction. After putting such complete faith and trust for so long in the perfection of the marketplace, the Administration is apparently considering the extreme selective measure of a mandatory freeze of wages and prices in the construction industry. This is puzzling to me. An old saying reminds us that a devout man who loses faith becomes the most vehement atheist. I hope that saying is not applicable to the Administration's view of the marketplace.

Summary

The Administration's targets—orderly and vigorous expansion combined with continued deceleration of prices—deserve the Nation's full support. But the achievement of those targets in 1971 under current policies is not, in my view, a prudent and realistic expectation. It seems more likely that, under present policies, the Nation would continue to experience an unemployment rate near 6 percent and a $50 to $60 billion shortfall of output below potential throughout 1971. To narrow the gap between the probable outcome and the targets, I would emphasize the following needs:

(1) carefully controlled measures of additional temporary fiscal stimulus that would help the economy get rolling and would phase out when it gets into high gear;

(2) pursuit by the Federal Reserve of a sufficiently generous monetary policy to help reduce further our key long-term interest rates; and

(3) development of a systematic and comprehensive incomes policy, short of direct controls.

Chairman PROXMIRE. Mr. Samuelson, we shall be glad to hear from you at this time, sir.

STATEMENT OF PAUL A. SAMUELSON, PROFESSOR OF ECONOMICS, MIT

Mr. SAMUELSON. Gentlemen, my first duty is to state the probabilities for 1971 economic growth, unemployment, and inflation. And my second duty is to propose the public policies that are called for in the light of that diagnosis. In a way is not my task here today a laughably easy one? The President and his team—the Council of Economic Advisers, Mr. George Shultz, and others—have forecast that money GNP will grow lustily in 1971, so lustily that by the second quarter of 1972, long before election time:

(1) Unemployment will be down to 4½ percent from the recent 6.2 percent peak.

(2) The rate of price inflation will be down to 3 percent per annum,

and all this will happen with:

(a) A budget deficit for fiscal 1972 of only $11½ billion;

(b) An expansion by the Federal Reserve of the money supply that—and here I quote from the Economic Report, but that is obviously a document already out of date, made obsolete by some of your hearings, more is expected of Arthur Burns now than on February 1—is "to continue at the 1970 rate," which I take to mean in the range of 4- to 6-percent per annum.

With this cheerful diagnosis before me, I have nought to do but pull out my rubber stamp, approve and applaud the Nixon administration's proposals, and advise the Joint Economic Committee to go into hibernation until next year when we meet to Oh and Ah over the new agreeable miracles to be revealed to us by the President at that time.

You can tell from my language that I am indignant at the spectacle to which we are all being exposed this year in the realm of economic information casting. On many an occasion I have given academic grades to various people in the Government. I think you have a duty as the Joint Economic Committee also to give grades. And I think that your committee will be derelict in its duty if you do not call attention to the rather curious, if not cynical, philospohy of forecasting which, in its quantitative magnitude, has no precedent in my memory.

I have followed very carefully for the last 25 years, since the Employment Act of 1946, all of the official forecasts of the Government. And it is revealing no secret to say that Treasury estimates of of tax revenues, with their presupposed GNP, have not always been completely accurate. The errors have tended to be in one direction, namely, to make the deficits predicted in advance look a little bit less.

Nevertheless, we all know what the ordinary margin of error and bias has been. And it seems to me this year we are being treated to a quantum jump in the bias in terms of the evidence now available to us.

So let me say that the economic welfare of our great Nation is too serious a business for this comic opera forecasting.

Now, let me say why I say that. On the basis of a careful review of all the evidence now available—this means surveying the various analyses of business and academic economists, and I may say, economists of all political persuasions—but taking into account all of that evidence, leaving the profession of economy and going to financial people, to Wall Street, and so forth, going to the official surveys, and then looking at the case put up by the Government for its own estimates, I have to respectfully submit that no responsible jury of informed persons can agree that the Nixon team forecast of money GNP for 1971 in the neighborhood of $1,065 billion is warranted.

Now, let me be clear. This does not mean that it will not happen. I am often asked when I lecture, is this possible, sir? And I say everything is possible in economics. And I know a professor who believes in it.

So we may have a $1,065 billion GNP this calendar year. But if we do I will not come before you and eat humble pie and say I was wrong, because on the evidence that is now available, including the evidence offered by the administration, this is not a warranted figure.

Not only is the Economic Report of the President lacking in the buttressing of this estimate, but it would take a jury of semanticists to decide whether or not the Council of Economic Advisers is in fact in the Economic Report stating that such a forecast represents their view of the most probable, the median, the mean or any other kind of estimate of GNP. That the heart of the three doctors of philosophy constituting that distinguished board may not have been in such a gratuitous boost in the likely numbers, is suggested to me by the key passages which I will read from the Economic Report, I think page 84:

There is a considerable body of opinion that expects the gross national product for 1971 to be in the range between $1,045 billion and $1,050 billion, which would be an increase of 7 to 7½ percent above that for 1970. This is a possible outcome.

That is a true statement. Just because the experts say something is going to happen does not mean it necessarily will not happen.

But then they go on to say: "However, it seems more likely that with present policies the outcome would be higher than that"—and I take that to mean that the three doctors of philosophy really believe that the best estimate is higher than the range $1,045 to $1,050 billion. But they spoil it all by going on to say: "And it could be as high as $1,065 billion."

So I tried this out on a jury of semanticists. And I said, "Is there anyone here that will interpret that statement to mean that the group making it thinks that the most probable modal outcome, or median outcome, or mean outcome, or geometric mean outcome, or any of the methods of central tendency that have ever been determined by statistics, is what $1,065 billion represents?"

And the jury of semanticists, after a very short deliberation, came back and said, "If you can get that to mean more than a third quartite estimate in their minds, you are already pushing the truth."

Now, this suggests—but I do not want to go into this—that there might be something to various newspaper dispatches suggesting there was an agonizing reappraisal made for high policy reasons overruling the technicians on the Council of Economic Advisers. I understand, for example, you have been assured in testimony by Mr. Shultz, No. 2 man to the President in domestic matters, that he at least has had his confidence increased in such predictions as this by some work of a distinguished member of his staff, a man with a Ph. D. degree, a man with a professorial appointment, Mr. Arthur Laffer. It is true that Mr. Laffer is only 30 years old, but by the time Newton was 30 years old he had discovered the calculus and the system of the world, and also proved by Biblical analysis that the number of the beasts is an integer which I have forgotten.

So leaving all ad hominem considerations aside, we now have in the public record the forecasting equations. La Place spoke of his world equation. Well, Mr. Arthur Laffer has a three-equation model. As he said, it is so simple that even administration people can understand this particular model.

He also apparently has a very good record in political forecasting, which prepared him for this new endeavor.

It is not for me to do so, but it is now in the public academic record what these equations are, and I think you should put in the Congressional Record the form of these extremely valuable equations, because if these equations are correct, I can assure you that the management of the American economy is a very simple matter from now on in. And if they are correct, you really should consider, if we do not achieve the kind of goals which we are speaking of, a very severe chastisement of the Federal Reserve Board, because it turns out that the Federal Reserve Board can increase the money supply and get instant action.

In the same quarter in which the money supply is increased you get a tremendous effect, and not only that, but you get all the effect you are ever going to get in that quarter.

Moreover, just in case you think that expanding the money supply in amounts beyond, if I may say so, the rather stupid formulas that this committee set forth some years ago—but I have already been a public scold on that matter—but if you leave those ranges, you do not court inflation, because if you look at the price equations, and actually go through a few exercises, you find that a lot more steam in the boiler than anybody has proposed has almost no cost in terms of extra inflation—you know, price increases go from 3.6 percent to 3.8 percent.

And that is a very small price for a nation to pay to get unemployment going down and great increases in real output.

Well, I consider this a ludicrous performance, and I am not surprised that most of the administration witnesses have been busily engaged in saying that the estimate is not due to such reduced form equation estimating.

I may say that the greatest grievance that anybody has against these equations will be that of monetarism. If you hear testimony in the Cook County School of Monetarism you will hear screams of pain because all of the findings of 150 years are now negated by the Laffer finding. This is kind of ironic, poetic justice, because it is the crypto-positivist method which the monetarists have been using which Laffer has now pushed to extreme.

The Federal Reserve Bank of St. Louis' black-box model is to be believed by us because it works. It produces the results. Just as Stalin once said, "How many regiments does the Pope have?" in this field of econometrics some are satisfied to ask, "How big is your R squared of explained variance?" They boast of their R squared of 0.6. We now have in the Laffer model R squares of 0.96.

Of course, this is helped along by a little seasonal irregularity. My distinguished colleague here, Mr. Okun, has spoken of the 12 months of Christmas theory. I always thought that it was part of the spending habits of American people that they spent 40 percent of the retail dollar in the holiday season. It has something to do with Christianity and the winter solstice. But it turns out to be in the Laffer model that the Federal Reserve pumps out money during those months is the cause of that Christmas business. And what is good for December is supposed to be good for every month of the year if you believe in such a black-box reduced-form method of estimation. I call this dousing. Up in New England where we come from we have people with a little twig who can find water. Ask them how they can do it, and they say, never mind, it works. Much of monetarism has always been a dousing theory. It works.

Well, it now works so well that we have what I think any intelligent person has to regard as an absurdity. And this despite the fact that there is at least a one-sixth probability that Mr. Laffer's numbers will be correct, namely, that we will have $1,065 billion. But there is also a one-sixth probability that the number of $1,045 billion is too high. And you cannot go by possibility in any intelligent planning with respect to the future.

Now, in concluding this summary statement, I have to use a new methodology to evaluate the possibility that the next Nixon-team estimates are to be regarded merely as targets for policy and not some other forecasts of what is in fact likely to take place under the policies that the administration is recommending to the Congress and the Federal Reserve.

Now, we have had a speech by Mr. Herbert Stein which suggests something of this interpretation, although maybe it is not a correct quotation of the present council's position.

We had testimony by Mr. Paul McCracken before you.

I suppose we ought to extend to Mr. Herbert Stein that same charity which some people extend to Fidel Castro when he predicts that Cuba will produce 10 million tons of sugar in 1970. It is not that any informed reasonable person expects that this is the most likely thing to happen—and of course in Cuba it did not happen—but giving such a cheerful number may be thought to have something of a self-fulfilling character about it and repeating such uplifting numbers may cause the workers to cut cane faster, and may encourage Wall Street and U.S. corporate enterprises to expand their spending plans for 1971. And perhaps in accordance with such a philosophy, the Council for Economic Advisers may come to you next year, and they may be able to say that things would have fallen even further short of the goal if they had not elevated the sights of the Nation.

Now, I think that that is in fact bad procedure, not because of any esthetic desire for semantic clarity for truth, but it is not true that you can preform these bootstrap operations, self-fulfilling measures by deliberately falsified elevated estimates.

And again, although analogies are not perfect, I give you the case of Castro's Cuba. No doubt about the 10 million goal, they would not have had 8½ million, or whatever the number of tons was last year. But this year they may not even have 5 million. You can shoot your bolt. You can have 28 million share days in Wall Street. Or you can have a short-term shot in the arm by statements of this sort. But I think that careful analysis of the role of psychology and of confidence in a modern macroeconomic system suggests that if that is the philosophy behind this, that that is an extremely misguided philosophy, for which the Nation will pay, and to which you gentlemen ought to call attention in some terms of disapprobation.

Now, there is a further point. Just as a collective bargaining contract is a living document, the Economic Report of the President is completely obsolete. And each new hearing develops new versions.

The argument as made is not as I vulgarize it. It is that the goals of the Government are these numbers, those are feasible goals, those are the best feasible goals. And they are part of Government policy. And therefore Government policy will take place to achieve them.

Now, there is a logical trap here. It is the trap of Gilbert and Sullivan's Mikado. You remember when someone has committed a crime and the Lord High Executioner—I wish that Henry Reuss were here to give us the exact lines—is to behead the man. He is reluctant to do so, being a very agreeable fellow. And he is able to avoid doing so, because he said, after all, the Mikado's will is law, the Mikado is all powerful. For him to say a thing is done is just as if it were done. Therefore it is done, and therefore I do not have to do it.

Now, if the Council of Economic Advisers came to you and said, these goals will be realized, because if they are not realized, the $11½ billion deficit we are speaking of will be immediately jumped and be replaced by an $18½ billion deficit, or a $23 billion deficit, whatever is needed to achieve the goal. And if they came to you and said—and this is now the other fellow—that Mr. Arthur Burns will create agreeably through the Federal Reserve, or make whatever amount of money is needed—no longer are we talking about a quotation which I quoted from the February 1 document, we are talking now about 6 to 9 percent, or if it is not 9 percent, then maybe 11 percent is what is needed—then I would say that is more than a self-fulfilling bootstrap operation, it is part of a determined effort to change the means so as to release the targets.

I see absolutely no evidence—and you have given none—that that is in fact what the administration intends to do, to have a flexible budget and to come in each month as the statistic develops, and if any shortfall takes place between the scheduled route and where the economy is, that they are going to come in with the efficacious new proposals.

Well, to the defense, then, that it is your duty under, say, the 1946 act to give what are desirable targets, and that this justifies departures from that which the current bulk of the evidence will support. I have to give the simple response, such tactics will merely introduce from the the military sphere into the economic the concept of the credibility gap.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Samuelson.

Mr. Greenspan, please proceed.

STATEMENT OF ALAN GREENSPAN, PRESIDENT, TOWNSEND-GREENSPAN & CO., LTD.

Mr. GREENSPAN. I appreciate being invited here, and I trust that my views will add to the dialog.

As has been indicated, my view of the general economic outlook is much the same as that of the two previous speakers, so I will not take too much time on it.

First, the inflation excesses built up during the late 1960's are rapidly diminishing. I think it has taken quite a long time, but the evidence is finally becoming credible.

This is not to say that there have not been structural changes which have made it more difficult than it has been in the past to dampen inflationary pressures. Certainly, the time frame today in which conventional anti-inflationary policy can be expected to take hold has lengthened from what it was, say, a decade ago, for several reasons.

First, profit margins are sharply lower. This has meant that the ability of slowed demand to immediately reflect itself in declining prices in a number of industrial areas has been markedly reduced. When the disinflationary process began in 1969 profit margins were already subnormal and have since rapidly retreated to their post-World War II lows. Accordingly, the capability of margins to absorb downward price adjutsments has been and will continue to be limited.

Second, the wage structure has become far less flexible than it was, say, a decade ago. The average length of contract initiated in the late 1950's for factory workers under major collective-bargaining agreements was approximately 2 years. By 1965, it had risen to 2 years, 9 months.

Another element contributing to the lengthening of the overall wage adjustment process during the past decade has been the changed balance of bargaining power in the building trades. While building trade union wage rates have always been higher than comparable rates for near equivalent maintenance crafts in manufacturing, the gap has widened dramatically.

Over the past decade, building trades wage increases have continually run far higher than those in manufacturing. Nonetheless, it is probable the construction wage trends have exerted a strong pull on industrial wages. This may account for a good deal of the surprising strength in manufacturing wages in the face of rising unemployment.

I do not believe that it is any great mystery why, for example, building trades wages are skyrocketing—apparently independently of the underlying forces of supply and demand for labor. This is a classic exercise in monopoly power through control over the flow of workers onto construction sites. De facto exclusive hiring halls and restricted entry into the unions have, I believe, been the main vehicles for controlling supply. Moreover, strikes are very costly to builders, but far less so to workers who I gather have little difficulty in obtaining temporary work in adjacent communities.

All of this suggests that the process of disinflation will take longer than it has in the past. But do we really have a choice? What we need is patience and perseverance in the implementation of an economic piolicy that will get at the root causes of inflation.

I am often told that some form of incomes policy can speed up this process. The problem is that there seems to be two types of policies which are often indiscriminately listed under a classification of incomes policies: those which are attempting to get at the causes of the admitted structural rigidities in wages and prices and those which only fight symptoms. I am certainly in favor of repealing the Davis-Bacon Act and any legislation which has contributed to the building trades monopoly power.

This is the only way to make free collective bargaining again viable in this industry. It would also have a salutary effect on all collective bargaining. So-called jawboning and voluntary wage-price review boards are symptom fighters and in my judgment cannot work. There is a great deal of skepticism of the efficacy of such policies even among those who advocate them. But it is argued that we should at least try. This assumes that the cost of failure of such policies is zero. If it is not, then we have to be very careful in projecting economic policies into areas of high risk.

If such programs fail, the fear that inflation is out of control or has a life of its own could easily emerge. This could introduce a major element of inflation psychology into the economy, something which I do not believe exists today.

I am more concerned, however, that failure of any set of so-called voluntary controls will propel the Government toward mandatory wage and price controls which can be made to work. I assume that they work, for example, in the Soviet Union—but I also think it is instructive that the economy does not.

Such controls, which would presumably be described as temporary, would be very difficult to ever unwind since they would create a whole new set of imbalances in the economy. Once in place it would then be argued that even though the controls are unfair, counter-productive, et cetera, decontrol would create chaos. New York City's rent control is a classic case. A more recent example is the controls on U.S. foreign direct investments.

I am not overly concerned that we are about to move in this direction at the moment. The rate of price inflation should recede in the months ahead and the debate on incomes policies lessen. My concern is not with 1971, but with 1973.

I believe that disinflationary policies are necessary for another 6 or 9 months if we are to defuse whatever significant inflationary forces remain. The stage would then be set for a resurgence of balanced, noninflationary, economic growth into 1973 and beyond.

However, I am most concerned that the economy will be given insufficient time to convalesce from its bout with inflation. Current expansionary policies in my judgment are premature and run too high a risk of realining inflationary forces. With a hard-won victory against inflation virtually in hand, it would be tragic to let it slip away.

I think the economy has bottomed out, but to date the signs of any significant rebound are singularly lacking. Unless a marked and surprising acceleration of the recovery materializes rather quickly the administration's GNP forecast of $1,065 billion appears out of reach.

If, as is likely, the economy fails to meet this stated goal, pressures to run an even more expansionary budget will multiply. Implicit in such recommendations is the belief that fiscal policy is discretionary; should the budget become too expansionary, it is argued it need only be scaled back. It is this view of budget control which is open to serious question.

Those who believe that fiscal policy is still discretionary—at least on the restraint side—I fear are in for a rude shock.

The administration's budgetary restraint of a year ago broke down under severe political pressures. Unless some major changes are soon initiated in the budgetary decisionmaking process, the problems of fiscal restraint will be even more difficult to surmount the next time around. This will be especially true if restraints on spending are eased further in the near future.

I was encouraged by Chairman Burns' statement here on Friday that ". . . the Federal Reserve will not become the architects of a new wave of inflation." However, there is a limit to the extent to which tight monetary policy can neutralize an inflationary Federal budget.

The fiscal problem is being created by the ever-increasing proportion of Federal expenditures which are so-called uncontrollables. Increases now absorb approximately half the fiscal dividend; that is, the annual increase in full employment revenues at existing tax rates—currently at approximately $18 billion.

On top of this, in recent years the rate at which new programs with their own built-in expansions have been initiated has sharply increased. Judging from the programs now under consideration for health, welfare, revenue sharing, et cetera, the sum of increases in past built-ins plus new programs should soon be running chronically in excess of the fiscal dividend. That is, we will be saddled with a chronic full employment deficit.

The source of the difficulty comes from the ever-increasing number of fiscal constituencies; that is groups of individuals receiving payments in cash or in kind on a continuing basis under an ongoing Federal program. We now have tens of millions receiving social security, veterans' benefits, farm subsidies, public assistance, et cetera. The list is long and continues to grow.

Aggravating the problem of the expansion in fiscal constituencies is the fact that it is almost impossible to eliminate or even pare programs once they are underway. Curtailments do occur, but only rarely. As a general rule, the number of individuals included in a fiscal constituency and the amount of funds received tend to behave as a ratchet—always increasing or holding stable, never declining. Whether a particular program actually resolves the problem to which it is addressed appears to be of little moment once the constituency has formed.

So long as Government functions are general and citizens have a diffuse relationship with their Government, the problem is of limited significance. But, as soon as strong associations with specific programs emerge, the pressure on the Congress and on the executive branch to expand these programs and to create new ones becomes seemingly irresistible. Anyone who has analyzed the voting patterns in a general election in this country is fully aware of the election in this country is fully aware of the electoral clout of such special interest groups. Why the ratchet exists, therefore, is no mystery; why it is a real threat to the whole structure of our budgetary process should be evident.

A corollary of the proposition that the growth rate of benefits to fiscal constituents tends to chronically exceed the fiscal dividend is that the benefits ultimately induce a strain on the tax-raising capacity of the system. But tax increases only postpone the problem. At some point, a rationing of benefits among the various fiscal constituencies must arise, inducing a confrontation for the limited funds available.

Until recently, the burgeoning constituency programs have been a problem largely for the developers of the Federal budget. But now the numbers are beginning to move beyond the realm of priority juggling and program restraint. During the past year or two, new programs have been squeezed into the budget by severely contracting the military establishment and by running substantial deficits.

However, further reductions in the Pentagon budget are probably going to be difficult to generate. Were it not for the ratchet, we might expect the increase in ongoing programs to be offset by reductions in older, seemingly less desirable, programs. But, if we are unable to do away with even some of our most peripheral programs—I clearly remember the flap over the attempted abolition of the Tea Tasters—the potential leverage from priority substitution is surely limited.

If the budgetary difficulties are severe at the Federal level, they are mild in comparison with the problems facing our State and local governments. The pressure for ongoing funding of these governments by revenue sharing, or its equivalent, is another element which will delimit the degree of discretion in fiscal policy.

If the fiscal collision which I envisage is to be avoided the Congress must pass a total appropriation and expenditure bill and must construct a method of reallocating funds appropriated under previously passed individual bills so that they conform to the final totals. Unless something along these lines is initiated this year, the Congress will be forced to take far more drastic action at a later date.

I regret the current move toward expansion and believe it is premature. But, the far greater danger is to allow the underlying budgetary trends to go unchecked. By 1973, unless fiscal policy regains the capacity to assume a posture of restraint as well as expansion, we run extraordinary risks on the side of inflation. A resurgence of inflation under such conditions would almost certainly set in motion an inexorable drift toward controls and greater regimentation of the economy.

A great deal is clearly at stake: not the least is the continued existence of our free enterprise system.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Greenspan.

Your prepared statement will be included in the record at this point.

(The prepared statement of Mr. Greenspan follows:)

PREPARED STATEMENT OF ALAN GREENSPAN

The inflation excesses built up during the late 1960's are rapidly diminishing. It has taken a long time, but the evidence here is finally becoming credible. Analysis of recent price movements still yields mixed results though the trend in the rate of inflation is down. In any event, a significant across-the-board slowing in prices is usually only the last stage of the disinflationary process. Far more relevant has been the remarkable decline in short-term money market rates as the Federal Reserve has pressed its moderately expansionary monetary policies. Had inflation expectations been solidly built into the decision making process of the economy, I doubt that so rapid a decline in short-term rates, or for that matter long-term interest rates, could have been engineered. The virulent inflation of recent years has apparently not left an irreducible residue of inflation psychology plaguing the American economy.

This is not to say that there have not been structural changes which have made it more difficult than it has been in the past to dampen inflationary pressures. Certainly, the time frame today in which conventional anti-inflationary policy can be expected to take hold has lengthened from what it was, say, a decade ago for several reasons.

First, profit margins are sharply lower. This has meant that the ability of slowed demand to immediately reflect itself in declining prices in a number of industrial areas has been markedly reduced. When the disinflationary process began in 1969 profit margins were already subnormal and have since rapidly retreated to their post-World War II lows. Accordingly, the capability of margins to absorb downward price adjustments has been and will continue to be limited.

Secondly, the wage structure has become far less flexible than it was, say, a decade ago. The average length of contract initiated in the late 1950's for factory workers under major collective bargaining agreements was approximately two years. By 1965 it had risen to two years, nine months, and has remained in that area with small variations since. Moreover, the impact of cost-of-living escalation clauses on changing wage structures was a far larger factor in the late 1950's than in recent years. Thus, in the late 1950's as price inflation began to ease, the feedback of slowed consumer price increases on the wage structure was relatively dramatic. Also, the shorter length of contracts which were heavily front-loaded brought down the rate of wage increase in manufacturing rather quickly.

Another element contributing to the lengthening of the over-all wage adjustment process during the past decade has been the changed balance of bargaining power in the building trades. While building trade union wage rates have always been higher than comparable rates for near equivalent maintenance crafts in manufacturing, the gap has widened dramatically. Over the past decade, building trades wage increases have continually run far higher than those in manufacturing. Nonetheless, it is probable the construction wage trends have exerted a strong pull on industrial wages. This may account for a good deal of the surprising strength in manufacturing wages in the face of rising unemployment.

I do not believe that it is any great mystery why, for example, building trades wages are skyrocketing—apparently independently of the underlying forces of supply and demand for labor. This is a classic exercise in monopoly power through control over the flow of workers onto construction sites. De facto exclusive hiring halls and restricted entry into the unions have, I believe, been the main vehicles for controlling supply. Moreover, strikes are very costly to builders, but far less so to workers who I gather have little difficulty in obtaining temporary work in adjacent communities.

But while the general time frame of wage adjustments has increased over the past decade and low profit margins make it difficult for employers to absorb increased wages without increasing prices, there are still some offsets to this seemingly bleak outlook.

First, the very fact that margins are currently abnormally low has strongly encouraged attempts to improve productivity. Although wage rates are bound to continue to expand at an inflationary rate over the next six to nine months, accelerated productivity gains should make some dent in the rate of increase in unit labor costs and hence in the rate of price inflation.

Secondly, although the collective bargaining agreements generally set the broad framework of base rates and skill differentials, there is some leeway available to managements to shift workers to lower paid classifications (most often in the normal turnover process), thereby realizing smaller increases in average wage rates than are specified in the contracts.

Also, there is the very substantial proportion of the labor force which is nonunion. The evidence does suggest that in periods of margin contraction and rising unemployment some slippage in nonunion rates is likely. However, the flexibility of nonunion wage patterns is not as great as is often suggested.

Finally, since most union contracts are front-loaded, there is reason to believe that, given relative ease in labor markets, average wage rate gains in manufacturing, and perhaps to a lesser extent in nonmanufacturing, can be expected to simmer down appreciably. I know of no new economic law that postulates that growth in wage levels can never return to the more modest 3% to 5% rates of only a few years back.

All of this suggests that the process of disinflation will take longer than it has in the past. But do we really have a choice? What we need is patience and perseverance in the implementation of an economic policy that will get at the root causes of inflation.

I am often told that some form of incomes policy can speed up this process. The problem is that there seems to be two types of policies which are often indiscriminately listed under a classification of incomes policies: those which are attempting to get at the causes of the admitted structural rigidities in wages and prices and those which only fight symptoms. I am certainly in favor of repealing the Davis-Bacon Act and any legislation which has contributed to the building trades monopoly power. This is the only way to make free collective bargaining again viable in this industry. It would have a salutary effect on all collective bargaining. Jawboning and so-called voluntary wage-price review boards are symptom fighters and in my judgment cannot work. There is a great deal of skepticism of the efficacy of such policies even among those who advocate them. But it is argued that we should at least try. This assumes that the cost of failure of such policies is zero. If it is not, then we have to be very careful in projecting economic policies into areas of high risk.

If such programs fail, the fear that inflation is out of control or has a life of its own could easily emerge. This could introduce a major element of inflation psychology into the economy, something which I do not believe exists today.

I am more concerned, however, that failure of any set of so-called voluntary controls will propel the government towards mandatory wage and price controls which can be made to work. I assume that they work, for example, in the Soviet Union—but it is instructive that the economy does not. Such controls, which would presumably be described as temporary, would be very difficult to ever unwind since they would create a whole new set of imbalances in the economy. Once in place it would then be argued that even though the controls are unfair, counterproductive, etc., decontrol would create chaos. New York City's rent control is a classic case. A more recent example is the controls on U.S. foreign direct investments.

I am not overly concerned that we are about to move in this direction at the moment. The rate of price inflation should recede in the months ahead and the debate on incomes policies lessen. My concern is not with 1971, but with 1973.

I believe that disinflationary policies are necessary for another six or nine months if we are to defuse whatever significant inflationary forces remain. The stage would then be set for a resurgence of balanced, noninflationary, economic growth into 1973.

However, I am most concerned that the economy will be given insufficient time to convalesce from its bout with inflation. Current expansionary policies in my judgment are premature and run too high a risk of reigniting inflationary forces. With a hard-won victory against inflation virtually in hand, it would be tragic to let it slip away.

The economy has bottomed out, but to date the signs of any significant rebound are singularly lacking. Aside from the pickup in auto sales, reflecting the catch-up from the General Motors strike, consumer markets have remained sluggish. This should soon change. The high rate of layoffs during the past year has induced grave concern over job security. The concurrent frightful rise in fixed household commitments raised major uncertainties over whether familes could make ends meet. As a result, consumers retrenched, first by increasing the savings rate and secondly by downtrading, i.e., buying the lower-priced lines. Downtrading has hit virtually every consumer market from automobiles and appliances at one end to vacations and recreation at the other.

But with the economy flattening out, job layoffs are fewer and the rate of inflation is slowing. Consumer confidence should gradually return, boosting retail markets and turning the economy higher as the year progresses. But unless a marked and surprising acceleration of the recovery materializes rather quickly the Administration's GNP forecast of $1,065 billion appears out of reach.

If, as is likely, the economy fails to meet this stated goal, pressures to run an even more expansionary budget will multiply. Implicit in such recommendations is the belief that fiscal policy is discretionary; should the budget become too expansionary, it need only be scaled back. It is this view of budget control which is open to serious question.

Those who believe that fiscal policy is still discretionary (at least on the restraint side), I fear are in for a rude shock.

The Administration's budgetary restraint of a year ago broke down under severe political pressures. Unless some major changes are soon initiated in the budgetary decision-making process, the problems of fiscal restraint will be even more difficult to surmount the next time around. This will be especially true if restraints on spending are eased further in the near future. I was encouraged by Chairman Burns' statement here on Friday that " . . . the Federal Reserve will not become the architects of a new wave of inflation." However, there is a limit to the extent to which tight monetary policy can neutralize an inflationary federal budget.

The fiscal problem is being created by the ever increasing proportion of federal expenditures which are so-called "uncontrollables." Increases now absorb roughly half the fiscal dividend, i.e., the annual increase in full employment revenues at existing tax rates (currently at approximately $18 billion). On top of this, in recent years the rate at which new programs with their own built-in expansions have been initiated has sharply increased. Judging from the programs now under consideration for health, welfare, revenue sharing, etc., the sum of increases in past "built-ins" plus new programs should soon be running chronically in excess of the fiscal dividend.

The source of the difficulty comes from the ever increasing number of fiscal constituencies, i.e., groups of individuals receiving payments in cash or in kind on a continuing basis under an on-going federal program. We now have tens of millions receiving Social Security, veterans' benefits, farm subsidies, public assistance, etc. The list is long and growing.

Aggravating the problem of the expansion in fiscal constituencies is the fact that it is almost impossible to eliminate or even pare programs once they are underway. Curtailments do occur, but only rarely. As a general rule, the number of individuals included in a fiscal constituency and the amount of funds received tend to behave as a ratchet—always increasing or holding stable, never declining. Whether a particular program actually resolves the problem to which it is addressed appears to be of little moment once the constituency has formed.

So long as government functions are general and citizens have a diffuse relationship with their government, the problem is of limited significance. But, as soon as strong associations with specific programs emerge, the pressure on the Congress and on the Executive branch to expand these programs and to create new ones becomes seemingly irresistible. Anyone who has analyzed the voting patterns in a general election in this country is fully aware of the electoral clout of such special interest groups. Why the ratchet exists, therefore, is no mystery; why it is a real threat to the whole structure of our budgetary process should be evident.

A corollary of the proposition that the growth rate of benefits to fiscal constituents tends to chronically exceed the fiscal dividend is that the benefits ultimately induce a strain on the tax-raising capacity of the system. But tax increases only postpone the problem. At some point, a rationing of benefits among the various fiscal constituencies must arise, inducing a confrontation for the limited funds available.

Until recently, the burgeoning constituency programs have been a problem largely for the developers of the federal budget. But now the numbers are beginning to move beyond the realm of priority juggling and program restraint. During the past year or two, new programs have been squeezed into the budget by severely contracting the military establishment and by running substantial deficits. However, further reductions in the Pentagon budget are probably going to be difficult to generate. Were it not for the ratchet effect, we might expect the increase in on-going programs to be offset by reductions in older, seemingly less desirable, programs. But, if we are unable to do away with even some of our most peripheral programs (I clearly remember the flap over the attempted abolition of the Tea Tasters), the potential leverage from priority substitution is surely limited.

If the budgetary difficulties are severe at the federal level, they are mild in comparison with the problems facing our state and local governments. The pressure for on-going funding of these governments by revenue sharing, or its equivalent, is another element which will delimit the degree of discretion in fiscal policy.

It might be hoped that an acceleration in the growth rate of the economy, thereby generating higher tax revenues, would be one way out of our dilemma. Unfortunately, the probabilities lie in the other direction. Most of the official projections of the gross national product, and hence of the tax base, presuppose a growth in productivity which is little more than an extension of past history.

But, improved technology and gains in output per man-hour are scarcely automatic. I find it difficult to believe that today's increasing de-emphasis on the value of material goods and of economic growth per se will not impair the advance of technology. Certainly, the growth consciousness of the 1960's is now lacking as a national priority. Moreover, there is a great danger that the profit motive, so critical to the advance of productivity, will gradually be undermined as businessmen are pressed ever more forcefully to focus their attention on growing urban and environmental problems.

Although productivity is advancing satisfactorily at the moment as business attempts to prevent further deterioration in profit margins, the underlying growth of technology and productivity is very likely to fall short of the trends of past decades. Any significant short fall will severely impair our future tax base and worsen the fiscal problem.

If the fiscal collision which I envisage is to be avoided the Congress must pass a total appropriation and expenditure bill and must construct a method of reallocating funds appropriated under previously passed individual bills so that they conform to the final totals. Unless something along these lines is initiated this year, the Congress will be forced to take far more drastic action at a later date.

I regret the current move toward expansion and believe it is premature. But, the far greater danger is to allow the underlying budgetary trends to go unchecked. By 1973, unless fiscal policy regains the capacity to assume a posture of restraint as well as expansion, we run extraordinary risks on the side of inflation. A resurgence of inflation under such conditions would almost certainly set in motion an inexorable drift towards controls and greater regimentation of the economy.

A great deal is clearly at stake: not the least is the continued existence of our free enterprise system.

Chairman PROXMIRE. I thank all of you gentlemen for a most competent, interesting, and helpful statement.

Mr. Okun, as I indicated, I understand you are going to have to leave, so I will proceed first with you.

You indicated that the budget as proposed had a full employment surplus of about $5 billion. This contradicts the position taken by the administration. I take it because you are measuring it on the national income accounts basis and not on a uniform budget basis; is that the difference?

Mr. OKUN. Yes, indeed. My figures come directly from the estimates that one can put together from the administration. There is no inconsistency except in terms of what bases are measured.

Chairman PROXMIRE. Who do think that the national income accounts basis is a better economic measure of the impact of the budget?

Mr. OKUN. The national accounts basis is really the one which economists have always used in fitting the Government together with saving and investment in the private sector. Any judgment that an economist has about what full employment surplus might be appropriate on the average or its effect on the economy is really based on a national accounts view of the world. The differece between the national accounts and the unified budget consists of several items: one is the presence of some loan items in the unified budget, which are excluded from the national accounts basis, since they do not involve income directly for anyone. That is not to say that they do not matter. But they matter more like a kind of monetary policy than like fiscal policy. They change the flows of credit. They do not add to or subtract from the private income stream directly.

A second difference is that the national accounts basis reflect tax liabilities of business when they accrue rather than when they are paid. And this seems to be more consistent with the way businessmen view their own tax liabilities and their impact on spending decisions. They are smart enough to do their accounting on an accrual basis. They do not confuse the actual payment of the tax with the liability under the tax.

Chairman PROXMIRE. It is your best judgment there would be a $5 billion surplus, which means it would be a more or less restraining fiscal impact—or how could you describe it? Let me just indicate what is in my mind.

Mr. McCracken indicated that the actual surplus or deficit is important, but not as important as the change from year to year, period to period. And he said it was about the same in 1971, calendar 1971, as in calendar 1970. And we concluded from that that there is quite a neutral fiscal impact. Would you make that conclusion, or would you come to the conclusion, in view of your analysis of the national income accounts, that this is not neutral, but restraining, negative?

Mr. OKUN. We may have to convene the board of semanticists again. I think both the level and the change are of some significance. Neutral may not be an inappropriate word. You can call it supportive, as I used that word, if you believe that perhaps the level of that surplus for calendar 1971 is a little smaller than one might expect to be required on the average over the long run. It is certainly not strongly expansionary, and I do not think the administration characterizes it that way. What expansion there is in the way of a change downward in the full employment surplus seems to be concentrated in the first half of calendar 1972. I suspect we will need it then. But I would like it better sooner than later.

In any case nobody can ask the full employment surplus to tell you what the right fiscal policy is. There is no particular reason why zero ought to be a correct number. Indeed it has been said about the actual budget that it almost never ought to be exactly in balance.

Chairman PROXMIRE. One of the reasons that has been given, the only reason that I have seen that seems to have any solid substance behind it, is that you ought to have some measure, some limitation on deficits, and if you have at least a deficit limitation, that you will try and reach a full employment balance, and then perhaps you can get more confidence in the business community and elsewhere that we are not going to engage in the kind of endless deficits that Mr. Greenspan, for example, seems to fear and be concerned about. If there is no limitation, if you say that as long as the economy has slack in it, and substantial unemployment and unused capacity, that we ought to run a substantial deficit at full employment, then the feeling is that you are not going to be serious with controlling inflation. Do you put any stock in that argument or not?

Mr. OKUN. I think one should show that he intends to be serious about controlling excess demand when that becomes a problem.But the problem today is dealing with inadequate demand. And thebest remedy for that problem is a fiscal policy which is clearly stimulative, so it does not take a board of semanticists to declare that. And that means in the present situation a full time employment deficit.

Chairman PROXMIRE. How big a deficit would you suggest, roughly?

Mr. OKUN. I would say $3 to $5 billion, in other words, $8 to $10 billion of additional fiscal stimulus for this calendar year over and above what the administration is calling for. That is, a $3 to $5 billion deficit on the national accounts basis for calendar 1971 would give me a better picture of the economic outlook than I have now.

Chairman PROXMIRE. I take it that you would put that also in the context of a flexible fiscal program such as you suggested in your prepared statement, in other words, a job program to be phased out if possible as the year goes on, and perhaps a little more restraint later if the economy is picking up well. If not, you might push the job program harder. Is that what you had in mind?

Mr. OKUN. That is precisely it, Mr. Chairman. I would make every effort to have all of the additional stimulus take the form of things which were clearly temporary, which might be renewed if that turned out to be desirable, but which would not lead to a long-term problem.

I share some of Mr. Greenspan's concern about commitments in budget that will lead to inappropriately stimultive fiscal policy when we do not need it. I think, we can do what we need to do now and build in the safeguards that prevent us from making mistakes on the other side later.

Chairman PROXMIRE. Do you think there is much difference between the stimulus that could come from the additional job program, for example, and the stimulus that could come from the kind of tax policies you suggested? For example, I understood you to say that we might not put into effect the increase in social security tax, or we might bring the reductions that we will have in 1972 in income taxes into 1971, and get stimulus that way. Do you think there is any difference between that kind of a policy on the one hand and the JOBS program on the other?

Mr. OKUN. I think the main difference is one of social priorities rather than economic effect. Both would help to raise the probable outcome of GNP. I think there is a preference for trying to focus the assistance on the people who are suffering most from the slump in the economy. And that leads me to put the JOBS program and the unemployment benefits higher on the list than the tax reduction.

Chairman PROXMIRE. Let me ask you about the monetary aspect of your presentation. Are you telling us that the impact of monetary policy depends not simply on what the Federal Reserve Board does but what the public, business, and so forth, do with the funds that are available, that the Federal Reserve Board can follow an easy monetary policy, but if there is no real demand for the fund it is not going to have a great deal of economic impact at the moment, it might later, it might be storing up impact. But when that comes the Fed cannot control it, and we cannot control it. it depends on public confidence and that kind of thing, is that correct?

Mr. OKUN. That is surely correct, although I would not go to the extreme of saying that we were in the situation of pushing on a string by any means today.

Chairman PROXMIRE. It sounds like that. Why isn't what happened in the last few months pushing on a string? It seems that the Federal Reserve Board has, as all of you agree, made funds available, and it indicates a drop instead of a pickup. There has been some growth in housing. But that has been very erratic. Business borrowing has not picked up. Just yesterday it was announced that machine tool orders are lower than they have been in a long time.

Mr. OKUN. I think all things considered, the recovery in housing has been most encouraging. It has been the one piece of good news. Even though January represented a drop from December, a 5- or 6-month view shows a very strong rebound.

Chairman PROXMIRE. We have not gotten all the dispute settled, and there is a dispute on what the interest rates are. The staff of the banking committee cannot get them up to date. But at least you have a moderation in the rate, a much more decisive drop in the prime rate than you have in the long-term housing mortgage rates.

Mr. OKUN. I would expect that availability has changed quite dramatically, in the mortgage market. I hear reports of quite marked changes in the down payment requirements and the terms on conventional mortgages. Those changes are part of the effect the Federal Reserve has. I think perhaps the string, if there is one in the present circumstance, may be the money supply narrowly defined in terms of demand deposits and currency. The Federal Reserve created a lot of reserves for the banking system in recent months, and those reserves have been employed. They have been employed primarily to support the growth of time deposits rather than demand deposits. People gear their cash balances pretty closely to transactions needs. When the economy is not going anywhere they do not have growing transaction needs.. But I would guess that the kind of policies that keep credit conditions easy, keep short-term interest rates low, and keep bank deposits growing, will ultimately have an effect in bringing down long-term interest rates, and encouraging the financing of additional business spending, and maintain——

Chairman PROXMIRE. What you are telling us is that the timing is out of control.

Mr. OKUN. That is right.

Chairman PROXMIRE. We get the impression that it is always a perfectly natural attitude on the part of public officials, I suppose, to get more confidence from the public in their policies to say that they can do a certain thing, that if they adopt a certain policy they are going to get results. What you are saying is that you will get those results perhaps over a period of time, and you have no control over it, it depends on a number of things that we cannot order. You have a more precise control over fiscal policy, even though the general wisdom we have been getting from public officials—I mean from the administration—is that we should rely on monetary policy in the short run. You are saying not so, we are probably going to get better results if we try to use tax policy and spending policy to stimulate the economy in the short run, is that correct?

Mr. OKUN. Yes; that is correct. I am putting primary emphasis on additional fiscal measures and hoping that the Federal Reserve will continue to implement the kind of strategy it has had, which I think will mean more rapid growth of the narrowly defined money supply in the months ahead.

Chairman PROXMIRE. Let me be sure I understand the very good questions you have put in your prepared statement and your answers to them. You ask: Could a Federal job program be designed to go into action in 1971, to be phased down if the labor market improves? I take it as one of the Nation's outstanding economists, and former chairman of the Council of Economic Advisers if you were sitting in Congress you would favor such a program, and you would push such a program, is that right?

Mr. OKUN. The position of that program at the top of my list reflects my own views, providing it could be designed to start rapidly and to phase down rapidly.

Chairman PROXMIRE. And in your best judgment it can be, on the basis of what you know now? Because you know a lot more now.

Mr. OKUN. I do not know as much as I should about job programs, I must confess. I think it can be done. I think it will have to be very carefully designed to serve its purpose. There is danger of launching a very-slow-acting program which would help us when we least need it. I think you really have to put the emphasis on quick starts and prompt reversals if you want it to serve the purposes of aiding the recovery.

Chairman PROXMIRE. How about unemployment insurance benefits?

Mr. OKUN. I gather the problem there is the relationship to the State programs. As I understand it, some changes were enacted last year, which are still not in effect, because it takes some State ratification.

Chairman PROXMIRE. That is right. Yesterday we had the Secretary of Labor. He said only three States passed completely conforming legislation. But they are all in session now, and he is hopeful that within the next few months they will get that much better cooperation.

Mr. OKUN. An effort should be made to get the States to provide that cooperation.

Chairman PROXMIRE. Then the Federal grants-in-aid in States and localities with extra allowances based on the size of excessive unemployment. This would be, I take it, a regional approach, is that right?

Mr. OKUN. It could be that, relating it to the excessive unemployment in the region as well as to that of the Nation. I think one would want to look at the kind of grant programs and look at the kind of activities. One reads continuously of stories where States are having to cut back because they are being hit by the slump in two directions, lower revenues and increasing needs. And this is one way the Federal Government can carry out its responsibility for good management of the national economy by providing the States and localities with a little insurance against the slump, by offering some extra funds. The idea I have is completely applicable to almost any type of program. It can be put into general revenue sharing, to make the size of the kitty depend on the national unemployment rate, so that the mayors and the Governors get an extra unemployment compensation benefit, as it were, when national unemployment is high.

Just from a technical point of view, this would not change the full employment deficit by one nickel; its effect would be zero at full employment.

Chairman PROXMIRE. I know your time is about up. I presume from what you have said you would put more emphasis, you would put a higher priority on the expenditure than on the tax side of it, is that correct?

Mr. OKUN. In terms of my view of social priorities rather than my view of "bang for a buck" fiscal stimulus. By the latter standard, I would think the tax measures would be quite effective.

Chairman PROXMIRE. And if politically it is not possible to cut the spending it might be possible to cut the tax, which we took, it would have roughly the same economic effect.

The last question I have—and I am going to ask the other gentlemen to respond to this, too—I will ask you first, so that you can make your other appointment. What is your estimate for gross national product 1971? And give us, if you can, the major demand estimates on how much of the growth of GNP is real and how much is inflationary.

Mr. OKUN. The $1,045 to $1,050 billion range characterizes my views. And I put it right in the middle; $1,047 billion might be an illustrative number. And that is 7-plus percent growth of money GNP, which I would break down into a little less than 3 percent in real terms, and a little bit more than 4 percent in prices.

Chairman PROXMIRE. Less than 3 percent in real terms and more than 4 percent in pricing?

Mr. OKUN. A shade less than 3 percent in real terms.

Chairman PROXMIRE. Just one other question in that connection. The council's forecast is an increase in consumption of over 9 percent. Do you have an estimate in that area? That is asking you something you may not have done much thinking about.

Mr. OKUN. The number on consumption that Chairman McCracken used is about $11 to $12 billion higher than what I would see as most likely. I think you highlighted properly the fact that the biggest difference is the view of the consumer. It is the consumer who really has to be the jack-in-the-box to make the administration scenario come through. And I see no evidence at present that anything like that is happening to the attitude of the consumer.

Chairman PROXMIRE. Thank you Mr. Okun. I appreciate your coming. And I understand the House Banking Committee just called, and they expect you in 10 minutes. And that is about the time it will take you to get over there. Thank you very much.

Mr. Samuelson, let me ask you first for your figures on the GNP as broken down between real growth and inflation.

Mr. SAMUELSON. Well, I am just going to give some back-of-the-envelope numbers. I am not myself in the business of producing self-consistent forecasting of all of the components. But it seems to me that on the basis of the evidence now available to us a number like a trillion and 50 dollars is a reasonable central tendency of what is justified in money terms. That means that no one should be surprised if it is not in the interval of a million and 45 to a million and 55 dollars. About half the probability is shere, and about half the probability is that your precision is such that it will be either above or below. Now, sticking with that median number of $1,050 billion, as I review the behavior of price inflation, I am inclined to agree with Mr. Greenspan, there are some signs that the work is behind us, but I cannot agree with the quantitative emphasis in his statement of how sure we can be about this or how quantitatively important it is.

Specifically, the bulk of the forecasters—and I include in this computer forecasts—assume that by the end of the year we will be below 4 percent on the price front. Mind you, they do not have the optimistic expansionary figures of the Government, and that is part of their story. To me I think that the bulk of the computer forecasts and the judgment forecasts have been wrong for about eight quarters. There are some honorable exceptions to this. And they have been too optimistic. That suggests to me that they may well be wrong again, and that one should have a certain degree of pessimism on how much progress is being made on the inflationary front.

Therefore, the number I have given you—I have not worked out the arithmetic—is 7 or 7½ percent, and I think the deflator is going to grow by at least 4-plus percent; remember, in year-to-year comparisons we have last year held to those numbers. That brings me to less than 3 percent real growth.

I may say, by the way, that if you take the four quarters ahead viewpoint, from New Year's of this year to New Year's of next year, the picture looks a little bit better, because you have washed out the bad third and fourth quarters in those numbers.

Chairman PROXMIRE. But if you have 3 or less than 3 percent, which both you and Mr. Okun estimate for the real growth economy, doesn't this mean, in view of the national growth of the labor force and the productivity, and so forth, that we are going to have increasing unemployment in the coming year?

Mr. SAMUELSON. What it means is that unemployment on the average in 1971 is going to be higher than it was in 1970.

But I will remind you that we already got in the last half of 1970 a very considerable increase of unemployment, to 6.2 percent in the immediate post-GM strike. So some of it we have had. For this purpose it is better to look four quarters ahead. And there it seems to me that unemployment at 6.2 percent may have peaked out, but that since we must grow at about 4¼ percent in order just to hold our own with the demography of the problem, with the cost improvements, with the productivity improvements which are typical of the first year of recovery, that I do not see that by the end of the year we will be at 5 percent or below 5 percent.

Chairman PROXMIRE. Why doesn't that logic lead you to the conclusion that unemployment is likely to remain around 6 percent for the year, 6 percent in January—1 month December to January does not mean very much, I think you would agree—you have just indicated that we need about 4 percent growth to stay even. You predicted about 3 percent growth. And then you have also indicated that productivity is likely to improve as it usually does in recovery. The logic of that would lead me to conclude that it would be 6 percent in July.

Mr. SAMUELSON. As I read the experts in the roundup in December, half of them say it is going to be nearer to 6 percent than it is to 5 percent, and half of them say it is going to be nearer to 5 percent at the end of the year than it is to 6 percent. If I have to side with one group or the other, I would think it is going to be nearer to 6 percent. But I want to point out to you that the recent 6.2 percent peak surprised everybody. They were explained away for months by the administration as due to the GM strike, which did indeed confuse things. And actually there may be something aberrant or temporary in the highness of the numbers. I will remind us all, that the labor force itself is a very volatile thing.

Chairman PROXMIRE. You know what the administration told us. They said that the impact of the General Motors strike had about a four-tenths of 1 percent adverse impact on employment, or unemployment. Therefore, absent the GM strike, December unemployment would have been 5.8 percent. Of course, the January unemployment, therefore, represents a rise, correcting for the GM strike. And for that reason I am just wondering whether or not is is safe or fair to feel that we have peaked on unemployment. I doubt it.

Mr. SAMUELSON. No, I do not think it is at all sure. And I want to say that events, it seems to me, have clearly falsified the quite understandable view of the administration in October and November that the base level of unemployment was lower than we now think the base level of unemployment was at that time. This is no judgment upon what the strike itself has done, because part of that discrepancy may be that the strike simply concealed from us all that the unemployment had claimed beyond what almost any expert would have thought in September was appropriate for those months.

Chairman PROXMIRE. Will you give us your estimate on the consumption increase? As you know, Mr. McCracken estimated an increase of 9 percent in consumption which would be the biggest increase since 1948.

Mr. SAMUELSON. I do not have the detailed consumption estimate. But let me say that given my statement that GNP of $1,050 billion seems to me the reasonable ball park, such a consumption estimate, it seems to me, is out of line with that. You must remember that some forecasters and I do not say this by way of censure, I think we should notice it by way of clarification—believe that it is right to forecast the total, and then by filter-down theory decide later how to allocate it among the components, and not even to care very much about this allocation since they regard the total as more accurate than the breakdown.

Chairman PROXMIRE. Yes; I did not argue about that. When we got that kind of a response from McCracken and Shultz I did not say this was wrong, but I did say we would like to know what the breakdown is. And they did not give it to us in the economic report, the Shultz statement or questioning. Mr. McCracken very helpfully gave us a letter a week ago in which he did make a breakdown.

Mr. SAMUELSON. Which we have not seen.

But if I were given the assignment of office boy to McCracken, and say we have come up with this $1,065 billion number, to justify it in terms of components, I would certainly throw most of it in consumption, because no man can say nay to me on this. It is always very volatile, and there is a lot of wishful thinking in it. Volatile durable consumption items might go up if people are liquid and optimistic. I would put the emphasis on housing. There is a little objectivity to that. It is very hard to be optimistic with respect to fixed investment expenditures, and to be optimistic—that is the word on inventories—is to invite the charges that excesses are being built into your expansionary program. So you are left, almost by exhaustion, in every sense of that word, with the problem of throwing it to consumption.

But in response to your question, do I see something in the propensity, say, of the counselor which suggests that he is about to change his habits of the last couple of years? my answer to that is, broadly, no. We did expect about every cyclical rebound that there will be some lessening of apprehension, and there will be some increase in consumption, and some fall in the savings picture. But I do not myself find the intrinsic elements as good for the automobile industry for other reasons. I am impressed by the evidence given in the Brookings Panel papers by Mr. Saul Hymans of the University of Michigan that based upon consumer sentiment, based upon the stock of new automobiles, that we do not have coming to us a great auto year in 1971, and certainly not for domestic sales.

Putting all these things together, I would not think myself that the administration overall forecast gains in credibility very much by their attribution of a very strong consumption.

Chairman PROXMIRE. One of the arguments in their favor, however, is that we have had an extraordinarily high savings rate in the last year or so. I understand it is 7.4 percent. And all their prediction of a 9-percent increase in consumption assumes is that it diminishes to 6.9 percent. And that does not seem to me to be far out of line historically on the basis of even fairly recent experience.

So as you say, it is not impossible.

Mr. SAMUELSON. I would simply say that as one of the members of the Council of Economic Advisers and one of the greatest experts on consumption spending, I respect that view. But I would also say that out of experience you cannot regard any recent trend in a magnitude like that as being necessarily out of line, and with great confidence you can assume that it is going to come back to some previous channel, because it is very hard—as in the stock market, I am told—to find those channels of natural value toward which everything is bound to reside.

Chairman PROXMIRE. Mr. Greenspan, will you give us your estimate?

Mr. GREENSPAN. I turn out to have exactly the same general overall GNP number as Mr. Okun, $1,047 billion. Despite the fact that I am arguing that the rate of inflation is coming down, which it is, I have a somewhat higher price inflation and lower physical volume than he does. I have a 4.4 percent increase in prices over the year, and a real growth of only 2.6 percent. Part of the reason is what Mr. Samuelson indicated; namely, that there was a substantial forward thrust coming from the quarterly pattern of 1970 which distorts the figure. The 4.4 percent is obviously a higher number than one would get looking at the quarter-by-quarter averages for the year. Nonetheless, there is a modest continuing decline in the rate of inflation in the forecast we are using.

Chairman PROXMIRE. That 2.6 percent is really—that would, I would think, lead just inevitably to continued unemployment at this high rate of 6 percent or so?

Mr. GREENSPAN. That is correct.

But let me reemphasize what Mr. Samuelson said. We have very considerable difficulty in reconciling the relationships between the levels of real activity and the unemployment rate, in part because the total labor force is a highly volatile figure.

And I might add, in the context of the period immediately ahead, we have had an extraordinarily large decline in the Armed Forces during the past year, presumably a very substantial proportion of which went into the civilian labor force, and would other things equal, tend to increase the unemployment rate.

The existing budget projects a far slower rate of decline from here in the total Armed Forces. And that in and of itself would exert some dampening effect on the tendency of unemployment to go somewhat higher.

Nonetheless, putting all the numbers together, we do not see material improvement in the unemployment rate from current levels until very late in the year.

Chairman PROXMIRE. You say that there was a slower demobilization rate of Armed Forces over the next year or so, and a layoff from the defense contractors, and so forth?

Mr. GREENSPAN. I am sorry, I am talking about the Armed Forces only. If you take the total number of military personnel, we had a very substantial decline—over 400,000—on a 1970 calendar year basis in the total number of people in the Armed Forces. And the rate of decline this year will be cut by a third according to the existing budget.

Chairman PROXMIRE. What puzzles me, Mr. Greenspan, about your position is that you do take the gloomiest position of all on real growth, and yet you take the most restraining position in terms of what our fiscal policy should be and what our monetary policy should be too, I assume?

Mr. GREENSPAN. That is correct.

Chairman PROXMIRE. You seem to have a much greater concern about inflation, although you did also indicate that you thought that most of the inflationary momentum had gone out of the economy. Now, isn't this a pretty hardhearted position to take? How do you defend it?

Mr. GREENSPAN. No, on the contrary, I think that in the full context it is a policy which I am convinced would contribute to the well-being of the Nation as a whole.

In the first instance my basic concern is that we do not consider fiscal policy, or for that matter, monetary policy, in a long enough time frame. If we are wholly capable of reversing policies and able to expand and contract with some degree of discretion, then I would not be terribly concerned. But I think we would have difficulties if we overexpanded, and I think we would have grave concern about what the implications would be. What essentially concerns me is that it is very easy in the current environment to expand, and it is very difficult to turn it off.

Chairman PROXMIRE. Is it so easy to expand? It seems it has been very difficult in the last year. We did not grow at all in the economy.

Mr. GREENSPAN. I did not mean the economy, I meant expanding the Federal budget. I am talking about policy instruments.

I am not saying here that unemployment is good or something which is desirable, or even something which we like to create for the purposes of causing prices to come down. I think that is a most unfortunate formulation which many people have used.

My fundamental concern is that the tradeoff in the current rate of unemployment, is not against inflation, but against the rate of unemployment in the future. If we embark upon a policy at this stage which reinflates the system, after we have come a considerable way down the road in defusing the inflationary forces that now exist, we court a very unfortunate situation. Unemployment could conceivably be forced considerably higher as a consequence of the attempt to curb inflation at the later date. Or worse, we will find ourselves moving toward regimentation, which is scarcely to the benefit of anybody. It is my concern about the future implications of current policies which gives me great pause at the moment.

Chairman PROXMIRE. You put a whale of a lot of emphasis on this vague psychological attitude. Way back in February of 1970, exactly a year ago, Mr. Burns said that excess demand was out of the economy, we had no more problem of excess demand. As you know, he is a thoughtful, conservative, competent judge of the economy, and I think he is probably right about that. Now, we have waited a year. And unemployment has increased rapidly. The economy is operating far, far below capacity. And we are losing a great deal of production we otherwise ought to have. And yet you said, wait another 6 or 8 months. In the meanwhile you have all the social problems seriously aggravated by the slowdown in economy.

Mr. GREENSPAN. I certainly agree with that appraisal of the current state of affairs.

Chairman PROXMIRE. How long do you have to wait after you have found that there is no excess demand in the economy before you move a year, a year and a half?

Mr. GREENSPAN. I would not agree with Mr. Burns that the excess demand had been evaporated out of the economy a year ago, although I grant you that it certainly is the case now.

The problem is that because of the issues which I raised in my prepared statement, I think the time frame has extended. I would be delighted if we could find some means by which we could very simply just regenerate the economy, eliminate all of the unemployment and all the problems which we have.

I do not seriously believe that we have that option. If we had it I would certainly agree with an expansionary policy. I have a grave concern that that option does not in fact exist, that our only choice is to absorb the difficulties of a sluggish economy a relatively short time longer so that we finally effect a defusing of the remnants of inflation.

Chairman PROXMIRE. Do you favor the administration's budget, their fiscal policy now, do you think that that is about right, or do you think that spending should be cut back further?

Mr. GREENSPAN. I do not have major concerns about the budget now. I think that if it did not expand from here, if it were kept under control, it would not have very grave consequences. I am mainly concerned that if the administration's $1,065 billion goal fails to materialize they will be propelled to move in a far more expansionary direction.

Chairman PROXMIRE. You think this is all right if they do not go any further, $229 billion of expenditure you would take, but no more?

Mr. GREENSPAN. I would agree with Mr. Okun, we do not really know the implications of the various mixes. My choice right now would be to make only minor changes in the current budget. That is all I would consider as desirable at the moment.

Chairman PROXMIRE. And monetary policy you feel is about right?

Mr. GREENSPAN. I feel monetary policy at the moment, considering what we have been confronted with, is appropriate.

Senator PROXMIRE. Then you endorse the Federal Reserve Board policies and the administration's policies, you think they are right economic policies for the President? Do you think we could go too far if we engage in either more spending or vice versa?

Mr. GREENSPAN. Let me say that I am not terribly certain, as I read the public press on what the Federal Reserve is saying and what the administration is saying. I think they are in agreement at the moment. But I could conceive of possible divergencies later.

Chairman PROXMIRE. I think that is right. I think what the administration says about monetary policy is not very important, it is what Mr. Burns says that is important. Mr. McCracken says that if we have a short fall as the years go on we will have to rely on monetary policy to pick up the economy, and Mr. Burns indicates that you should not rely that much on monetary policy. You just cannot do it.

Mr. GREENSPAN. I would agree.

Chairman PROXMIRE. Mr. Samuelson, I did not ask you about the monetary policy of the Federal Reserve Board as expressed by Mr. Burns. You are familiar with Mr. Burns' testimony?

Mr. SAMUELSON. Yes.

Chairman PROXMIRE. Do you support it?

Mr. SAMUELSON. I give very high marks to the Federal Reserve for its 1970 behavior. This began just before Chairman Burns became the new Chairman. I think they handled extremely well the Penn Central liquidity panic crisis, which could have been a very serious thing. They did it by 19th century wisdom of disregarding all straitjackets on the rate of growth of the money supply, for whatever period of time would be needed within the short run to meet that crisis, to be sure it did not spread unnecessarily, so that sound companies like Chrysler would not be carried down by companies with ancient problems like Penn Central.

I cannot agree that we are now in a position of pushing on a string. I do not believe in instantaneous response to the stimulation of money. But I think if you must use simple images—and I do not know why one must—but if one must, you should think of it as a tube of toothpaste. When the tube of toothpaste is very full, as in times of very high interest rates and very tight money, then the slightest pressure upon the tube transmits itself very quickly into the economics of the paste.

Chairman PROXMIRE. Once that paste gets out you cannot get it back into the tube.

Mr. SAMUELSON. That is the trouble with analogies.

But when you are using monetary policy to stimulate the economy which itself is having downward shifts in demand for its products, then you are more like a somewhat empty toothpaste tube. In order to get that toothpaste out you do have to push. But it is not true that you get that satisfying response instantaneously. And you have to push hard.

Now, I cannot agree with Professor Okun that per se bringing bill rates down to 2 percent is an undesirable thing. There are times when you have a very weak economy—I think, for example, of 1953–54, when the present Chairman of the Federal Reserve Board sat in a different position, and some of his colleagues and himself were more of the opinion of flooding the market with liquidity. The only way to get this to show itself up after a lag in increased real spending is by forcing very hard. And I will remind you that that—what was it, stuck-in-the-mud period of 1962 when Mr. Okun contrasted with the very snappy recovery in 1955? Itself was due in part to the fact that Secretary Dillon, Under Secretary Rosa, in particular, were very concerned to keep the bill rate from going down; 3 percent was the bare downline, not below this, for international reasons. So you do not use the historic method when the economy reacts sluggishly to monetary policy to apply more monetary policy until it begins to react.

And so I think, if the pessimists tend to be correct, and we find that in component after component of overall spending there tends to be weakness well beyond that of the administration, and even beyond that that we are discussing, that the Federal Reserve should push very hard.

As I heard Mr. Burns, he said rates well above 6 percent, say, of the money supply, annual rates of growth, long maintained, or maintained for a long period of time, are a bad way of running the railroad. I did not hear him say—and in my case I would not say—that in pushing a recalcitrant economy through the valley of retardation and recession into a healthy expansionary movement, that on such occasions one should not have the rate of growth of the money supply for periods of 3 months, 6 months, be in the neighborhood of 7, 8, and 9 percent.

I am sorry we ever got into this game of looking at simplistic things like short-run rates of growth of the money supply.

I ought, by the way, to say that the 2 to 6-percent level, if you have got to have a 4-percent range, you fellows have got it wrong, and biased on the lower side for the epoch of the late 1960's and the early 1970's.

Now, I am presuming that you do not want to be stuck with your past formulas. So if you have got to have a formula, and you are going to start castigating the future Chairmen of the Federal Reserve Board if they go beyond it, I suggest that when condoning creeping inflation, and without for a moment ceasing to put pressure against the rate of the creep, you must face the fact that on the basis of everybody's extrapolation, including those who are in favor of more patience, more sluggishness for a longer period of time in order to purge the system of its inflationary momentum, that even though forecasts still are talking about money rates of increase of 3 percent, you are an utter optimist if you talk of a 2½-percent increase in prices.

So when you consider the real needs of the economy just to hold it open, if you consider any real needs of the economy to catch up for this investment in breaking the inflation, when you put the irreducible amount of price increase, when you consider that you have been baled out, your formula has done a great deal of harm, except that there has been a strong upward trend in the velocity of the circulation of money.

One of the weaknesses that I find in monetarists is that they are not very monetarist in terms of an important variable, the velocity of the circulation of money.

Taking all these things into consideration, par for the course would be more like 3 to 7 percent or 3½ to 7½ percent, with judicial departures from that range in the short run which are quite justifiable, particularly since by my philosophy you would often have later reversals, which by attacking procedure atone for those departures, so that over a long period of time you are achieving reasonable goals.

Chairman PROXMIRE. In the very short run Mr. Burns explained to us that as of the last holiday weekend, this month, that they increased the money supply by $4 billion, that even if there were no further increase after the 19th of February, a little more than halfway through the month, you would have a 7-percent increase annual rate in the month of February in the money supply. And of course in the quarter it would work out perhaps to less than 6 percent.

You talked about our stupid rule. I do not know if you really were serious about calling it stupid. I suppose you were. As you know, we did not intend that——

Mr. SAMUELSON. Could I modify the record and say "ill-conceived"?

Chairman PROXMIRE. Well, as I have told you, we did not intend that to be a flat limitation of any kind. All we wanted was an explanation from the Chairman whenever he increased the money supply more than 6 percent, or failed to increase the money supply at least 2 percent. He could do it all he wished. We would not necessarily criticize him. But we wanted to be informed about it, that is all.

You suggest apparently that you would have a better range if you had 4 to 8 percent?

Mr. SAMUELSON. I said if you must have range I think 3½ to 7½ percent would be a better range.

Chairman PROXMIRE. What is wrong with being informed on this, having the discipline of the Federal Reserve Board?

Mr. SAMUELSON. Excuse me, I am informed three times a week on this subject, because a messenger comes from the Federal Reserve Bank in St. Louis with the latest wiggle in the number. And you have that same access to information.

Chairman PROXMIRE. We did. But you are an economist and you spend all your time on this kind of thing. And we have 20 members on this committee, and they spend their time in many other things. If there is an unusual situation where they do vary the rate, say, 7½ percent, or below 3½ percent, under those circumstances it seems to me that if economists can be told why we would be better off.

Mr. SAMUELSON. If you think the public construed your remark to be simply a continuing interest in the subject—it was said that the committee had turned monetarist, and now believes in a more regular increase in the rate of the growth of money supply.

Chairman PROXMIRE. That was less than half right.

Mr. SAMUELSON, did you write that great book "Foundations of of Economic Analysis," which is certainly a major contribution to economic literature, before you were 30?

Mr. SAMUELSON. Yes, I did.

Chairman PROXMIRE. You wrote that before you were 30?

Mr. SAMUELSON. I did.

Chairman PROXMIRE. It shows that you and Laffer are in the same class.

Mr. SAMUELSON. That is right.

Chairman PROXMIRE. You made a great contribution before you were 30.

Mr. SAMUELSON. It is astute of you to notice that.

Chairman PROXMIRE. The astuteness is on the part of one of our staff members, as I am sure you would suspect.

Could you address yourself specifically to your second duty and propose what public policies are called for in the light of your diagnosis?

Mr. SAMUELSON. Let me say there is a slight difference of position between Mr. Greenspan and myself. He approves of the present policies because the administration will not release its target goals. He has given you cogent reasons why he thinks that those policies will not reach those goals, and he thinks that that is right, because it would do harm for 1973 and for the long run if they were to achieve their goals. I am just the opposite. I disapprove of their present policies because I do not think it will reach their goals.

I realize that there are fundamental tradeoffs. But if you examine the logic of let us sweat this out by retardation until it is over, I think first you will find that we rarely get the complete story. I have seen worked out what this means in terms of unemployment numbers. And it means a menu of choice which, if offered to the American people, they would never take. And I think the last election is an indication of that.

Let me further say, because I really do not want to be present without registering dissent, that I do not regard the expansion of Federal spending programs, with tens of millions of people, under social security and the veterans and the welfare, and the farm programs, as a perversion of democracy. I regard this as a fulfillment of democracy. I think that these constituents—I quite agree, if you examine voting patterns you will find that it is out of the interests of these particular groups that these happen—I think that has the system working as a system ought to work. As I look at the veterans benefits, for example, I say to myself, veterans are simply getting what human beings ought to get, and which human beings—I think for example, in the field of medicine, and I think in the field of retirement income—which human beings in countries much less affluent than ourselves, as, for example, Scandinavia, now get. And I cannot begrudge the veteran his getting that. Rather, I think it is not that he should not be getting it, but that the American people should themselves be getting more of this in a regime of affluence. I do not regard the present—what is it, 29 percent of the money GNP goes into Government expenditure—whatever it is—I quite agree that there are pressures to have this expanded. I welcome those pressures. I do not think that man evolved of the slime and the trees to arrive at 29 percent and stop at that particular level. And let us make no mistake about it, to fight inflation by means of conducted slowdown is to put the burden of the fighting of inflation upon particular groups.

Now, you have a bad habit—and now I am really not criticizing—of having economists testify before you after they are well beyond the age of 30. On the verge of senility you get invited—I can speak with passion on the subject—you get invited to be a sage.

Let me say that there is a whole constituency of younger economists—and I am not talking about new left economists, but the bulk of economists who will say, "Do a cost benefit analysis on mandatory price-wage controls. They are inequitable, they are ineffective, they are inefficient. The costs are of the magnitude of billions of dollars of equivalent GNP." And then they will say, "But now look at our present system, in which we solve the problem by stop-go driving. There are tens and even hundreds of billions of dollars of lost output."

And they will say, "When you consider these two forms of balance sheets, you can only come out with a conclusion in favor of direct wage-price controls."

Now, that is not my position. But I think that the position of sweating out the unemployment for as long as it is necessary invites that position, and that position is becoming increasingly popular. And it is a blemish on our present mixed economy that no mixed economy in the world—I am speaking now of Scandinavia, all four countries, I am speaking of Holland, Western Germany, France, Italy, Japan, Belgium, and the United Kingdom—not one of them has found a way of having an incomes policy which can be agreed upon by a jury as a really good thing. Now, that does not invite as its corollary, have no incomes policy, have laissez-faire, because the laissez-faire gives us the bad Phillips curve. Indeed Mr. Greenspan has given us a great number of new reasons as to why that is a worsening in fact.

And so I think that you do run some risks on the side of inflation when you reexpand.

Everybody I have heard testify before you has in my judgment belittled even the shortrun risks, because it is said again and again that with unemployment still above 5 percent, you will have the outer impression upon the right of wage increase. I do not think, immaterial of the rate at which you are reducing the level of unemployment even though it is well above 5 percent, you can say that there is no reescalation of the rate of inflation. But when I weigh priorities, when I compromise with all the evil, I come out with the view that we should regard the shoe of unemployment and slow growth as the most pinching shoe at this time.

Chairman PROXMIRE. What does that mean in terms of policies, the JOBS programs, and tax policy?

Mr. SAMUELSON. It means that I would be despondent if I did not think that the Congress was in fact going to overrule the President and have more expansionary pubic expenditure programs than are called for in his programs, just as we would be in worse shape at the end of this year if Congress had not again and again overruled the last budget in the face of vetoes, and in the face of legislative whips, arguing in the wrong direction.

Chairman PROXMIRE. Would you agree that we ought to have about an $8 to $12 million more deficit in the full employment budget as Mr. Okun seems to imply?

Mr. SAMUELSON. I would think that $5 to $10 billion more of deliberately planned expenditures would be in order. I would not put the high premium that Mr. Okun has upon only expenditures which can be tucked into the year 1971 and phased out, although I do look with great favor on, for example, postponing the social security tax increase; that is a very good thing to do.

You asked two of the witnesses whether there were any differences between tax impact and expenditure impact. And I would concur what I understood to be this general tenor of answer, that by and large on the first approximation, they are the same "bang for a buck," although I think expenditure on goods and services has a little more bang for the buck than transfer expenditure.

But I would mention one exception to this first appropriation. We have had an increase in the planned deficit because of the speedup of depreciation. This is calculated in the first year to lose $2.6 billion.

Since I favored the investment tax credit in the beginning and since I favor suspending the investment tax credit, and not the gratuities repeal of the investment tax credit, I can see that a case can be made for some windfall to the liquidity position of business by means of faster depreciation for tax purposes.

But let me say that all the experts whom I talked to—and I now think of people in the machine tool industries, and in the investment estimating game—very few think you are going to get much of a bang for your buck of that particular thing, although it appears that its full value, of course, appears in the deficit as we calculate it. And Mr. Arthur Burns in his testimony said that he would even go and give the investment tax credit in addition. I would not myself say that the first priority is for this much of an increase in aid to business based upon the prospect of bringing back private investment in, let us say, the next 18 to 24 months. There are much more important corollaries, I would think.

Chairman PROXMIRE. Do both of you agree or disagree with Mr. Okun that there should be no freeze—that was his position—on construction wages or prices? He opposed overall wage-price controls, and he also said specifically that he opposed the construction industry freeze which the administration seems interested in. And they are also asking Congress, I understand, to extend their authority so that they could impose this in other areas too.

Mr. SAMUELSON. I did not agree with his formulation. I have an open mind. And an open mind is often an empty mind. And I think in this case that may be so. But the fact that they have gone to some selective sector which he regarded as a virulent swing from religion to atheism does not bear that interpretation in mind. We know the construction sector has been one of the most flagrantly antisocial sectors, by almost any test that you can give to price and wage performance in terms of the shortages, and so forth. Although I am not an expert in this, I think we might learn something, on the lukewarm benediction, by experimentation in that line.

Chairman PROXMIRE. Mr. Greenspan.

Mr. GREENSPAN. I would agree with Mr. Okun.

Chairman PROXMIRE. That we should not impose the controls?

Mr. GREENSPAN. We should not.

Chairman PROXMIRE. Mr. Greenspan, you say that neither guidelines nor jawboning nor mandatory price and wage controls can work. Does that mean you oppose the administration's recent action in the steel situation where they spoke out to reduce a 12-percent increase on some kind of steel product?

Mr. GREENSPAN. Yes, Mr. Chairman, I do. I do not think that basically resolves the problem that caused the pressure on prices, namely, for a number of reasons the margins in that industry have deteriorated extraordinarily.

Chairman PROXMIRE. The main objections that many of us have is that you have concentrations in some of these industries that enable industrial leaders to increase prices even when demand is diminishing or when they are operated far, far below capacity. And of course you have labor unions so powerful that even though there is excess labor, they can get wage settlements that are highly inflationary. Could you just ignore this and assume that this is something that you cannot do anything about? You have this distortion that Mr. Samuelson has spoken about in construction, and you have it in transportation with the teamsters, and you have it in steel, and you have it in oil, automobiles, and many other areas, where there is no attempt even to justify the increases or the call on the administration to show what their costs are.

Mr. GREENSPAN. You have to distinguish basically between two cases. I think that for the reasons I indicated earlier, in the construction area it is clearly an exercise in monopoly, and one can see other cases of it where it exists.

Chairman PROXMIRE. Why don't you do something about it?

Mr. GREENSPAN. I think we should. But I do not think it is a question for a wage-price freeze——

Chairman PROXMIRE. Antitrust?

Mr. GREENSPAN. I think that what really would have to be done is to eliminate the causes. Mr. Burns indicated on Friday that he would be in favor of legislation which would eliminate our exclusive hiring hall practices in the construction trades. That I would certainly agree with, because I think that eliminates one of the fundamental causes of the problem.

I am always concerned with actions which only get at the symptoms, because they essentially displace the problem, not solve it. I do not think that, for example, attempting to put the freeze on construction wages, will work. I have no doubt that you could make it function. But I am not sure about prices. I do not know what prices in construction really mean. But I think a freeze does not resolve the problem, it merely displaces it. There is a cause for these things. Why not get to the root of them? I will certainly grant that it will take a little longer, but I am not certain that we have really any great alternatives.

Chairman PROXMIRE. Mr. Samuelson.

Mr. SAMUELSON. I would like to register a strong dissent in connection with the steel pricing incident. It seems to me here is a clear case where you are not getting the symptoms, you are getting the causes. The steel industry is protected by a voluntary quota. The only muscle which the President used was the threat of removing that—I should not say only, he also spoke for procurement—but removing that voluntary quota. I would have thought that any red-blooded believer in the free private enterprise system would have welcomed the decline in margins of profit in an industry which is developing a clear lack of comparative advantage over time. And to keep an umbrella of protection against foreign competition in order to maintain the price margins in that industry it seems to me is inexcusable from the standpoint of efficient market pricing.

Chairman PROXMIRE. Why only to steel, why not extend that to oil? We have the oil quota limitation which is equally——

Mr. SAMUELSON. Except for the conservation aspect with respect to oil, and the arguments that have to do with those, let me make a very careful study and extend my remarks to that. I did not see in Mr. Greenspan's statement anything but labor monopoly. I do not remember what specifications you had——

Mr. GREENSPAN. Let me say this. I do not agree with quotas. I was responding to the question on the particular action of attempting to get down the price by jawboning. If the question were rephrased with respect to freeing the market, I would answer it differently.

Mr. SAMUELSON. I may also say that a 12-percent increase was turned into a 6-percent increase. With more victories like that we are going to be in real trouble. This at a time when the Japanese steel industry is lowering its costs, when the industries in Europe are lowering their costs vis-a-vis the American cost. The steel industry is going down exactly the road which our protective agriculture is going down internationally, and which domestically our railroads have gone down. Prices are being raised, in order to maintain the margins. And I think that that is a perversion of the way that a margin price system works.

Chairman PROXMIRE. Of course, what makes that theory very hard to implement politically is unemployment. It is very hard to say to people who represent States that have heavy steel producing, and have heavy unemployment too, you have got to just take the rigors of free enterprise and permit the importation of steel from Germany, Japan, and elsewhere, when it is going to mean even worse unemployment.

Mr. SAMUELSON. May I introduce into the record a small piece I wrote for opposite the editorial page of the New York Times last fall.

Chairman PROXMIRE. It will appear in full in the record at this point.

(The article referred to follows:)

[From the New York Times, Friday, Oct. 30, 1970]

ECONOMIC POLICY IS AN ART—THE NEW NOBEL PRIZE ECONOMIST SAYS NIXON HASN'T GOT IT YET

(By Paul A. Samuelson)

Item. The Prime Minister of Singapore, Lee Kuan Yew, when passing through Cambridge recently, asked me why an advanced technology like America's should insist on producing low-productivity textiles and common shoes. I touched a nerve of a New England radio audience when I quoted my answer. "We should move our resources to more efficient uses and turn over to the developing countries primitive activities that any emerging economy can do with low-wage labor."

Item. The single question I am most asked when lecturing abroad is this: "Professor Samuelson, doesn't America's prosperity depend upon Cold War expenditures and imperialistic ventures like that in Vietnam?"

Since I keep but one set of books, I give the same answer that I use in the advanced graduate seminar: "When Lenin and Rosa Luxemburg advanced the thesis of capitalism's dependence on outside markets for its prosperity, William Howard Taft was President and Maynard Keynes still a dilettante undergraduate at Cambridge. In the old-fashioned laissez-faire economy, prosperity was indeed a fragile blossom. But for a modern 'mixed economy' in the post-Keynesian era, fiscal and monetary policies can definitely prevent chronic slumps, can offset automation or under-consumption, can insure that resources find paying work opportunities. The two fastest-growing mixed economies have been Germany and Japan—both stripped of their colonies and forbidden to have armies—which is empirical proof of Keynes' theoretical refutation of the imperialism thesis."

I want later, as they say in court, to connect up these items with the barrage of criticisms that economists generally levy against the Administration's current economic policies. I concur in these indictments but wish to state fairly the defenses that the Nixon team can claim.

1. President Nixon did inherit the inflation resulting from his predecessor's stealthy acceleration of the Vietnam war.

2. Under the guise of gradualism, the new team eschewed a policy of sharp deflation involving heavy and prolonged unemployment in a doctrinnaire attack on inflation.

3. The trade-off between full employment and price stability does constitute a cruel delemma for any Administration, Democratic or Republican. No mixed economy has been able yet to find a satisfactory "incomes policy."

Here the defense must rest, and the prosecutor take over.

1. By last spring it became obvious to all post-Keynesians, monetarists and practical men that the Washington game plan had gone awry. Inflation had been more stubborn than realized, less quenchable by modest once-and-for-all rises in unemployment. Unemployment is worse than expected by everyone's calculations including those of the Administration itself, unemployment will continue to grow well into 1971.

2. The Federal Reserve deserves high marks for moving all year long toward easier money. It helped avert a liquidity crisis in the wake of the Penn Central failure and Wall Street decline. Chairman Burns explicitly disavowed any monetarist straitjacket on the rate of growth of the money supply.

3. Congress, ever respondent to voter distress, shifted toward a more expansionary budget policy. Again and again, over the President's veto and in the face of his legislative opposition, Congress voted public programs which—if they had not been passed—would have left us and the President in a far worse situation than that that now prevails.

It is the turn of the judge and jury. What is to be done?

The President is making the tactical error of fighting three economic battles at the same time: The battle against inflation, the battle against further unemployment, the battle of winding down the economic resources going into Vietnam, aerospace, and the Cold War generally.

The art of economic policy is that of proper priorities and quantitative dosages.

First. The highest priority should now be given to restoring vigorous real growth. Further rises in unemployment should no longer be treated philosophically. Inflation is, to the expert's eye, finally abating a little. It is overly simple to believe that it will flare up dramatically unless we go the whole route of blood, sweat, and tears.

Second. It is false to alibi the rise in long-term unemployment as the inevitable price for winding up the Vietnam war and cutting back on unproductive aerospace programs. Of course, a conversion period has to take place. Of course, people with particular skills and localities specialized to particular activities must inevitably suffer in any wide scale redirection of economic resources.

It is unnecessary and inexcusable to permit the war's windup to induce macroeconomic stagnation. A modern mixed economy can afford peace. But if President Nixon reverts to the economic ideology of William Howard Taft, he will strike a blow against the viability of the mixed economy and in favor the pre-1915 Leninist ideology. The Brazilians, Ghanians, Congolese, Indians—to say nothing of the French, Italians and Princetonians—will take note of the consequences.

And the gallant fight against protectionism, which Richard Nixon and 4,000 economists have been waging, will founder if its major premise is denied—that resources shifted out of inefficient industries will be able to move to more productive work and not onto the roles of the chronically unemployed.

EDITOR'S NOTE.—*Professor Paul A. Samuelson of M.I.T. has just been named a Nobel Prize winner for his economic theories.*

Mr. SAMUELSON. In that article I gave one of the powerful reasons for taking some visible action on the side of longer run inflation, and the fact that the protection system is burgeoning under unemployment, because the whole argument for the healthy division of labor for the free trade is based upon the major premise that you transfer people from inefficient sectors of the economy to efficient ones. And if in fact you are transferring them to the dole and to the breadline, then the whole major premise is violated.

The second reason I gave—and I think it is very relevant, it will be in the record there—is that we have had a lot of talk particularly before the November elections that it is the wind-down of the Vietnam war which is causing the unemployment, and what is all the fuss about. Now, this precisely falls in with the accusation made by enemies of our system who say that our mixed economy cannot afford peace, that we depend upon imperialistic ventures. That is bad economics, I may say. But it becomes bad economics only if there is a macroeconomic fulfillment of the high employment, high growth goals of the Nation as a body in the 1946 act.

So aside from the human suffering that is involved in the sweating out theory of fighting inflation, we have two very strong reasons right now for the long-run health of our mixed economy why the policy judgment should be made on the side of the expansion rather than the status quo.

Chairman PROXMIRE. Will you give us a clearer picture of your income policy position. I am not sure of the extent to which it is voluntary income policy you favor.

Mr. SAMUELSON. I do not favor mandatory price-wage controls across the board at this time. I regard them as extremely effective, but I regard them as springing leaks very soon and becoming ineffective and becoming inequitable. And far from the Nation being saddled for the rest of time by them, after 18 months we will have tried them and have abandoned them, is my prophesy. And I think that we are going to have worse emergency situations than are confronting us right now, and I would say this is very strong penicillin, and you should not use it for whooping cough but for the pneumonia that may come.

I should say, though, that there is a large and reasonably younger part of your economic fraternity who are veering toward that solution.

Chairman PROXMIRE. Do you see any halfway house?

Mr. SAMUELSON. Yes.

Chairman PROXMIRE. Do you favor the kind of voluntary price-wage guidelines we had in the 1960's?

Mr. SAMUELSON. I see a halfway house, more than verbal utterances, more than figurative slaps on the wrist. But in an era when the demand-pull aspects are ebbing, as everybody's forecast suggests, then I think that strong, Presidential leadership, which does involve bringing people to the White House, and it does involve on occasion pillorying before the court of public opinion particular executives, and particular industries, who have not been particularly all that much worse or different from other industries, but who are in vulnerable positions, I think that this can make a marginal contribution. I would not exaggerate the contribution.

I would also say that I get more than my share of crackpot mail. And recently it has been running very strongly in favor of hanging the union—it used to be hanging union leaders, and now it is hanging the rank and file of the unions. And I do not think that you can have what that estimable correspondent of the New York Times suggested in an article in the New York Times Sunday magazine section which was reproduced in Look, wage controls alone, if it comes it will come as a part of a package. And you have to have price and profit conditions too.

Chairman PROXMIRE. Mr. Samuelson, in the years I have been on this committee—and I have been on the committee almost half of its existence—there has never been a more incisive or vigorous criticism of both the projections and substance of the President's Economic Report than that given by Mr. Burns and by you. And whether one disagrees or agrees with your position, I think that the Congress is indebted for the competence and understanding and ability you bring to this criticism. And it is most useful.

And I want to thank you, Mr. Greenspan, very much too. You gentlemen have been very helpful and informative.

The committee will stand in recess until tomorrow morning, when we hear from Vice President William Butler, of the Chase Manhattan Bank, Prof. Otto Eckstein, and Prof. Robert Eisner.

Thank you very much.

The committee is now adjourned.

(Whereupon, at 12:20 p.m., the committee adjourned, to reconvene at 10 a.m., Wednesday, February 24, 1971.)

THE 1971 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 24, 1971

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

The committee met, pursuant to recess, at 10 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senator Proxmire; and Representatives Reuss and Brown.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowsky, research economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Again today we hear from private economic experts on the situation which faces us now and the portent for what lies ahead. Of course, we had many days of hearings, not only from the administration witnesses, but also in earlier weeks from State and local officials and experts in such fields as welfare policy and the general problem of poverty.

The general and specific problems which we have examined present a truly alarming picture of the domestic economy. There has not been one witness, public or private, who foresees the possibility of significantly reducing unemployment in the next year; it will remain, unless there are rather substantial policy changes, above 5 percent.

Indeed, we had testimony from top economists yesterday that suggests to me that a rate close to 6 percent is more than just likely, given the present virtually sole dependence on fiscal and monetary policy.

In Mr. Eckstein's statement this morning he makes the remarkable statement that for several years—I repeat for several years—we are likely to have unemployment above 5 percent.

This serious unemployment situation has resulted from policies aimed at reducing aggregate demand for the purpose of getting inflation under control. However, as almost all of our witnesses have testified, there seems little evidence that in the near-term future the rate of inflation will be reduced to tolerable levels. I am fully aware that the administration is now taking a more active role in the wage-price decisionmaking, more particularly with yesterday's announcement suspending the application of the Davis-Bacon Act.

I would like to ask you gentlemen about that and about the alternative of a freeze in construction wages and prices later.

However, today, in our dialog I hope we shall pay particular attention to financial aspects of the economy, since our witnesses are particularly expert in this area.

Mr. Butler has been for some time vice president, economist for Chase Manhattan Bank. He was senior economist for McGraw-Hill, and adviser to the Rockefeller Brothers.

Mr. Eckstein is currently professor of economics at Harvard. He has been a member of the council of economic advisers and for some time was technical director with the staff of the Joint Economic Committee, producing that monumental work, Employment, Growth, and Price Levels.

Mr. Eisner is also an old-time Government man. He has been an economist with the OPA and other agencies. He is an expert in the theory of the business cycle and investment behavior. Currently he is professor of economics at Northwestern University.

You may proceed, Mr. Butler, in your own fashion. If you decide to delete any material in your oral testimony, that will be all right because the whole statement will appear in the record.

Go ahead. You have a concise statement. We will be happy to hear from you.

STATEMENT OF WILLIAM F. BUTLER, VICE PRESIDENT AND CHIEF ECONOMIST, THE CHASE MANHATTAN BANK

Mr. Butler. I want to try to register one fundamental point: The U.S. economy must avoid another stop-go pattern. I believe that the economic policies of the administration and the Federal Reserve are designed toward that end.

I agree generally with the Council of Economic Advisers' view of the economic outlook. Their figure of $1,065 billion is on the high end of our range of projections. Yet I believe it is within the range of possibility. The standard forecast frequently—if not typically—has been $20 billion too low (which, with the growth in the economy, implies a declining percentage error).

However, even $1,065 billion leaves much to be desired. It would mean that unemployment would remain high and the utilization of other resources low. It would mean that the economy might not regain its full potential until the end of 1972, if that soon.

In theory, action could be taken to improve prospects.

With production below potential—with slack in the economy as shown by high unemployment and low utilization of productive capacity—it can be argued that measures to promote more rapid growth would not be inconsistent with continued efforts to get inflation under control. Exercises with econometric models, along with simple arithmetic with the GNP numbers, suggest that growth could be quickened this year and next if:

First, monetary policy were eased enough to support an 8–9-percent increase in the money stock; and second, fiscal policy, through more spending or tax cuts, were to produce a deficit $10–$15 billion greater than would be implied by a balance in the full-employment budget. This would mean actual Federal deficits in fiscal 1972 on the order of $22 to $27 billion. The latter would be the largest since World War II.

Again in theory, these expansionary policies might well serve to lower the rate of unemployment to 4 percent or so by late 1972. Because of the long-time lags involved between changes in monetary and fiscal policies and their impact on the economy, an expansionary turn in policies might not preclude continuing progress in reducing the rate of inflation.

However, and this is the rub, to adopt such expansionary policies now would call for an about-turn to slower monetary growth and a balanced full-employment budget some time in 1972. Otherwise, inflation would begin to accelerate again, with some lag, and the restrictive policies of the past 2½ years would go for naught.

On the record, such attempts at fine tuning simply have not worked. Instead of steady growth they have produced a stop-go pattern along these lines:

Starting from a state of recession and high unemployment, highly expansionary monetary and fiscal policies are set in motion.

Such policies are carried on past the point of full utilization of the Nation's productive capacity.

The result is inflation.

In time, the domestic and balance-of-payments impacts of inflation force the authorities to act.

By then, inflation has bred a wage-price spiral which is exceedingly difficult to get under control. So the authorities must jam hard on the monetary and fiscal brakes.

The result is recession, or at best an extended period of slow growth and high unemployment.

This stop-go pattern characterizes in varying degrees all industrialized nations. Some have sought to break the pattern by the use of various forms of incomes policies—wage-price freezes, wage-price guidelines and the like. In no country have such efforts met with more than transitory success.

What, then, can be done to break out of the stop-go pattern? Postwar experience in this and other nations suggests that the most important requirement is to keep monetary and fiscal policies on a steady course. It is clear that stop-go arises predominantly from wide swings in monetary policy from aggressive ease to severe restraint, along with very large shifts in the full-employment budget from deficit to surplus.

This should not preclude some discretion in monetary and fiscal matters. But experience shows that policies should not depart very far, for very long, from basic trends. Our lack of knowledge of leads and lags in policy changes, our political inability to use fiscal policy in a flexible manner, and the state of our statistical intelligence combine to make efforts at fine tuning destabilizing. Fine tuning is likely to produce more unemployment and more inflation over time than would result from a steady hand on monetary and fiscal controls.

Incomes, policies, properly applied, might make some contribution. There is little evidence that jawboning or elbow twisting does much good. But a set of guidelines for responsible wage and price action could bring the force of public opinion to bear on wage or price increases which went beyond the guidelines.

Finally, more could be done along what are termed "structural lines." This would include efforts to accelerate the growth in productivity, improve the efficiency of labor markets, increase training and retraining, expand foreign trade, and deal more effectively with monopoly or bottleneck situations.

In the postwar period, economic policies have succeeded in establishing a floor under the economy by greatly moderating recessions. The task ahead is to affix a roof which will contain inflationary forces.

A steady course in monetary and fiscal policies could maximize employment over time and do so in an atmosphere of tolerable price stability and balanced economic growth. There may be periods—I hope, short—when unemployment is too high. I have suggested that we should reward more adequately those that perform the valuable service of being unemployed in the interest of general growth and stability. This would require more adequate unemployment compensation.

I believe there is some chance—small, but not negligible—that the policies of the administration and the Federal Reserve will work better and quicker than has been believed. This could happen if the illusive, but very important, element of confidence were to improve in strong fashion. This is to underscore the point that Arthur Burns made here last week. Given confidence, consumers have the ability to spend more and business could find the funds to invest more. While this is not a prediction, one should not rule out the possibility that such an improvement in confidence could hasten recovery.

I yield to no man in my concern over the human costs of unemployment. However, I believe the course I am suggesting—a steady hand on the tillers of monetary and fiscal controls—will maximize employment over time and do so in an atmosphere of reasonable price stability and balanced economic growth.

While I do not believe we can fine tune in the current study of the art I would hope that we could in time sharpen the tools of forecasting and monetary and fiscal controls so that we could make steady progress in minimizing the fluctuations of the business cycle. As these problems are solved we can turn our attention to the more fundamental matters of using the proceeds of economic growth to improve the quality of life in America.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Butler.

Mr. Eckstein.

STATEMENT OF OTTO ECKSTEIN, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY, AND DATA RESOURCES, INC.

Mr. ECKSTEIN. Mr. Chairman, it is always a pleasure to be back with the Joint Economic Committee.

You have now had so many witnesses in the hearing that I thought I would focus on a few items that have not been focused on more than once or twice before, and enter my testimony in the record as I wrote it, with your permission.

There are four or five issues which I would like to focus on a little bit more explicitly. The first issue is the very shortrun outlook of the economy: Are we now on the $1,065 billion track, or a lower track?

I agree that it was possible that through a series of good fortunes on private and public spending we might have gotten to the $1,065 billion GNP, but the year now is 7 weeks gone. To reach the administration's goals, the first quarter GNP should be on the order of $1,028 billion. The conventional forecasts are clustered around $1,020 billion for the first quarter, about $6 or $8 billion less. The retail sales of January and the first half of February, the surprisingly slow catchup of car sales after the GM strike, the modest gain in payroll employment, production, and personal income, now make it appear that the first quarter gross national product will range between $1,015 and $1,017 billion, which is yet another several billion below the consensus forecasts.

We are meeting on the 24th of February and there are another 5 weeks to go in the quarter. So trying to gage the economic trend is a little bit like gaging elections from early election returns. But we have learned that most of the times these early returns are pretty indicative. And the quarter is 7 weeks old, and it is simply not headed for that good an outcome.

For the rest of the year, the basic forecast is well known, and I will not repeat it. We share it. But let me just tell you of our own experience in our own forecasting organization. When I appeared before this committee last July I projected a GNP for 1971 of $1,045 billlon. Around the turn of the year the figures began to look better, and we revised our forecasts upward a couple of billion. But as we look at the situation today we have retreated back down to that $1,045 billion.

Now, there are several questions about that forecast. It is much too early to have a really accurate concept about what 1971 will be precisely. But we do note a number of things.

In the investment area we know that interest rates are low and operating rates weak. These are negative factors. We are confronted by new surveys which suggest that 1971 may surprise us with a 10- or 11-percent gain in investment. We are aware of those too, and we take our own poll——

Chairman PROXMIRE. I hesitate to interrupt you in the middle of your statement, Mr. Eckstein, but did your poll hint at what Mr. Rinfret's recent poll found? What Mr. Rinfret pointed out was that manufacturing investment is likely to rise very little, or decline, but nonmanufacturing business investment; that is, commerical and utilities, and so forth, is going to really take off. And what it suggested was that there may be a bias in some of these polls omitting the very heavy investment in the commercial and nonmanufacturing sector of the economy.

Did you take that into full account? He had a pretty comprehensive sample. He was going to get 90 percent. He says he has 40 percent now.

Mr. ECKSTEIN. We did take that into account, indeed all professional forecasters are aware of the continued increases in telephone investment and electric utilities investment. On the other hand, there is expected certainly in real terms a substantial loss and money terms a small loss in commercial construction, office building, in many centers, especially in New York. In manufacturing we expect a small decline. When you add it all up you do not come out with a minus, but you do not wind up with a $10 billion gain. In our own poll of companies we asked this specific question: Has your company revised its investment plans since the Government survey, which projected a 2-percent gain?

And we got a unanimous response of no.

We then went on to ask: Will you increase your investment spending on the strength of the depreciation changes, which as you know really do provide an extra incentive to investment and the answer we got was, yes, in 1972.

But if you look at the construction contracts for December and the advanced durable goods orders for capital spending, they do not portray a 10- or 11-percent advance in investment. It may happen, but so far I would describe it as a hope.

On the consumer, the current evidence suggests that retail spending will be modest, and that the savings rate in the first quarter will again exceed 7 percent. Now, sentiment does seem to be improving. people are influenced by what the Government says, and confidence can be slowly rebuilt, no doubt. But so far the consumer has not changed his mind. It may happen, we all hope it will happen, but it has not happened so far.

The other elements are fairly conventional by now. You wind up with the kind of forecast we have, a $1,045 billion.

Let me go on to another key point. And this is the question of the mix of policy. Is this an expansionary policy? I think it is in total, but it is on the monetary side that the expansion centers. And, of course, the administration has only a very limited control over the monetary side of the policy.

The fiscal policy calls for a balanced full employment budget.

A balanced policy is not one of great expansion. It is a very small change toward expansion in the sense that last year we ran a bit of a full-employment surplus, which will now be wiped out. But I think it is best characterized as neutral.

If you look at the level of the proposed budget it rises at the same rate as the GNP, which again I would characterize as an essentially neutral dimension.

The net lending of the Government agencies, which is not reflected in these budget figures is larger, but no larger than in recent years. One element which is a bit different is orders for Government procurement, which will rise a bit this year, since the defense budget is now being reoriented from manpower and operations toward major procurement.

One other element must be considered. The President's proposals were not received all that enthusiastically by Congress initially. And I expect that it will take some time before a workable compromise is worked out which lets some kind of revenue sharing, or some kind of family assistance, or some kind of solution to the State and local problem be worked out. My own guess is that it will take all of this year before a dollar is spent on any of those problems. Congress would really have to rush to have a stimulus in 1971 growing out of any of these proposals.

So I would say this is a neutral fiscal policy. If you turn to the money side, a rate of increase of 6 percent or more would be expansionary. My testimony contains a table which shows that policy has been quite easy compared to previous recessions on the downside: The money supply had a pretty good rise during the economy's slide, but 6 percent would be substantially beyond the experience on the recovery side.

Now, the question is, How far can you go? I am enthusiastic in endorsing an easy money policy up to this point. I assume they will keep it easy, given the continuous slack in the economy.

But can you really expect the Federal Reserve to raise the money supplies by 8 or 9 percent to attempt to achieve full employment when the fiscal policy is not on the same track?

First, they are not likely to do it, in any event. A number of questions would be raised. You have to ask yourself this question. Does it make a difference whether expansion comes through the fiscal or the money route? And I think there really are several reasons for not letting the mix get out of kilter on the side of easy money.

First of all, of course an expansion based on money is based on credit. What you are really doing is, you are making credit very available, and you load up the banks with reserves so that they are encouraged to make loans.

In the last expansion, easy money caused the growth of mergers, which permanently change the structure of the manufacturing industry and raise concentration. Those mergers would not have occurred in that volume if the stock market had not been driven up and paper became so valuable; that is, if the stocks had not become so inflated

The growth of conglomerates particularly was an outgrowth of this easy money episode. So you have excesses of this kind. You had the commercial paper episode. You cannot predict exactly in what way a policy of very rapid increase of money will ultimately create a distortion in the economy. It does not repeat, but sooner or later some excess does develop.

More generally an expansion based on credit as opposed to a growth of sales or a growth of income essentially raises the leverage of business. You are asking them to borrow money rather than to obtain the revenue from higher sales. And you then get onto a track where you have to raise money continuously just to keep the whole thing moving forward. You hope that ultimately the sales can be stimulated so that they will grow into this credit-created expansion, but it is obviously a higher risk strategy that if you do it by letting markets grow naturally.

Finally, it makes a difference to the poor, it makes a difference to the income distribution whether you go one way or the other. As one member of the administration explained it according to the paper yesterday, the theory is that easy money will raise the value of private wealth, will raise the value of common stocks, and this in turn will raise consumer spending on durable goods.

In our own econometric studies we agree that this is an avenue of expansion. A high stock market does stimulate consumer spending. But from an income distribution point of view it is an odd way to do it, you are stimulating the economy by raising the price of common stock, the wealth of the rich, when you could do it in other ways by lowering income taxes.

For these reasons I think an imbalance of this type would be a mistake.

What should we do? Suppose just for a moment we do have some influence over events, and say, so you did want greater progress on employment and you wanted to do it on the fiscal side. Well, the obvious measure is to delay the imposition of the higher social security taxes, the change in the base, which goes with the improvement in benefits which has not yet been enacted. All that has to be done is to to delay a year the rise of the base beyond $7,800. This would be a measure which would be actuarially sound. The trust fund does not need that money this year.

Furthermore, it would have a side benefit on the inflation side, because it would raise the expendable wages of labor by delaying this extra tax. So to the extent that there is an influence of taxes on wage claims—and recent experience suggests that there is—this would have a small side benefit on the inflation side.

If that is not enough, we could cut taxes. And whether you cut it on the low or the high end of the income scale is a political question. I endorse a temporary tax act. Or we could spend more money and move ahead with the public employment programs, fund educational programs—there are a variety of ways we could operate on the spending side, although we do have to consider whether the spending will come soon enough.

The final point I want to raise today is the question of inflation and what can be done about it. As I see it, there are three test areas for the administration in the inflation area. The first is in construction. The President has just announced that he will suspend the Davis-Bacon Act.

Now, I see nothing wrong with that. I remember in my own days in Government I once mentioned in the Office of the Secretary of Labor that this act should be suspended. And at that time a silence fell over the room. This was obviously something unspeakable, which was so far removed from political feasibility that only an academic temporary thing in the Government would advance it. And now they have done it. But it has come late. The construction wages are out of sight. The period when skilled workers were shipped to Vietnam to build ports and airfields, the period when the Minuteman silos were built in the West, are over. So the current impact of the Government on construction is not so great. Especially after public expectations buildup that was created in the days before the action was taken. I think you would have to say that the President has just blinked.

It is understandable why he did so. The construction unions are very powerful. As I rode up to testify, I passed the headquarters of one of them, across the square. They are a lot closer to the Congress than I am. But given the situation and the way that it was done, the Davis-Bacon Act suspension is obviously inadequate to the problem.

The second area is health. The President's message was very good in emphasizing, adding to the supply of health, as well as adding to the financing. It is too early to tell what the specifics of the program will be in the proposals, whether this time, unlike the last, when we put through medicare and medicaid, we will have a more balanced approach.

The third area of testing is steel. The President has rolled back a price, and having discovered that it can be done, will roll back other prices.

I was a bit perturbed by the quickness with which the steel import quota negotiations were reinstated. The next test quotas will come in the fall. The steel import quotas will presumably be largely used up by the prestrike hoarding.

Suppose there is a strike. Will the administration then elect to let more steel in to meet the needs of the economy. or will it settle the strike on expensive terms?

There is a tool here for price stability, and I hope it will be used.

These are very specific tests. If you look at it more broadly, I think today, with no excess demand and unemployment at 6 percent, inflation has to be viewed as essentially a political problem. There is no great mystery on what needs to be done. We do not need at this late stage complete wage-price controls, but we certainly heed an incomes policy, by which I mean a set of readily understood principles of what is responsible price and wage behavior. My own belief is that such a policy has to be developed by Government, that private citizens boards or management and labor boards are unable to develop such principles. The whole experience with such private institutions as the Labor Management Advisory Committee of the last administration is negative. A private institution does not have the power to carry its own constituency and put forth its principles, it is a political task, and should be done by the Government.

One could add to those limited areas where the Government does have strong influence and can act selectively, such a construction. Certainly the Defense Production Act should be extended. And we should not be scared of acting selectively. We have created this monster of across-the-board wage-price controls which nobody wants. This has paralyzed us in any more limited action which might be effective.

Chairman PROXMIRE. Are you saying that wage-price controls in the construction industry might be feasible, and we should not reject them out of hand?

Mr. ECKSTEIN. That is right.

Now, the real question on this set of issues is whether it can be done. And that is why I say it is essentially a political question.

Does the Congress have any more real interest in tackling the powerful producer groups than the administration?

Now, these are economists questions, and they are really questions that we should be asking the Congress rather than the other way about. I think it is a very important question, because in fact we will not seriously take the steps that will get us back to full employment until there is a lot more progress on the inflation side. My own crude rule of thumb is that until the rate of wage increase is down to 5 or 6 percent, and the rate of increase of profits is no greater than the gain of the gross national product, so that there is no shift in shares toward profits, this economy will suffer with substantially more unemployment, and it will pay a very substantial social cost for doing so.

Chairman PROXMIRE. Thank you very much, Mr. Eckstein.

Your prepared statement will be placed in the record at this point.

Mr. ECKSTEIN. Thank you, Senator.

(The prepared statement of Mr. Eckstein follows:)

PREPARED STATEMENT OF OTTO ECKSTEIN

The shift of Administration policy toward expansion is cause for rejoicing. The adoption of the principle of the full employment budget is a major step forward in philosophy. Targets have been set for GNP and for improvement in prices and employment. Nonetheless, many questions remain about the path of the economy itself and about the meaning of the policy. In my testimony today, I shall try to contribute to public discussion by focussing on these questions:

(1) Is the Administration forecast possible or probable? What would the economy be like if things worked out so well?

(2) What are the ingredients of the conventional forecast? What are the risks that surround it?

(3) What is the proper role of econometric models in forecasting and in policy formation?

(4) How expansionary is the Administration's policy?

(5) Are we slipping once more into a policy mix which relies on monetary instruments to carry too much of the stabilization burden?

(6) Finally, what more could be done on wage-price policies?

FORECASTS

At the turn of the year, the Administration forecast for a Gross National Product of $1,065 billion for 1971 was possible; at this time the odds are lengthening. While our own forecasts, produced by use of the Data Resources 400 equation model, have been lower, we developed a simulation in November which sketched a path to full employment. A possible upward shift in the spending tendencies of consumers and business, lower interest rates, and a $7½ billion personal tax reduction would have sufficed to reach that goal, and implied a 1971 GNP of $1,065 billion. After the Administration program was announced in January, we ran another feasibility test. If business and consumer spending propensities were at the upper end of the range of historical experience throughout the year a $1,065 billion GNP was still possible. This simulation is summarized in Table 1. This simulation contains a saving rate averaging 6.4%, housing starts of 1.9 million, and Federal revenue and expenditure estimates within about a billion of the official figures.

TABLE 1.—SIMULATION OF THE TARGET GNP

	1971:1	1971:2	1971:3	1971:4	1971 year
GNP	1,028	1,059	1,075	1,095	1,065
Consumption	652	667	681	693	673
Business fixed investment	106	108	110	112	109
Residential construction	36	39	39	39	38
Inventory change	2	9	6	7	6
Net exports	3	3	3	3	3
Government purchases	229	232	236	241	235
Unemployment rate	5.9	5.3	5.0	5.2	5.4

But while possible, the Administration forecast is becoming less and less probable. The economic upturn in the first quarter is not proceeding at the necessary rate in the first six weeks of the year. The Data Resources forecast was revised upward from $1,045 to $1,047 billion in January on the strength of Christmas retail sales, high December housing starts and the changed stance of policy. This was our first pward revision in over a year. However, as the January figures became available, we have had to retreat a bit, and now back down to $1,045. The major elements in this small retreat are these:

(1) The catch up surge of automobile sales developed very slowly, and there is still a serious question whether the catch up will be of the full magnitude that has been widely assumed.

(2) Retail sales in January and in the first half of February barely exceeded the levels reached last summer despite the increases in prices.

(3) The probability of a steel strike is high, which will cut production and may raise imports.

(4) Initial congressional response to the President's program proposals suggests that the political impasses will not be resolved speedily. Therefore, new programs will not have a positive effect on the economy in 1971.

Our analysis of the fragmentary data for the opening quarter of the year suggests a current best GNP estimate of $1,015 to $1,017 billion. This is several billion dollars less than most recent forecasts. It is far less than the GNP required to reach an annual average of $1,065.

Our most recent forecast remains in the consensus range. The essential ingredients of the conventional forecast are these:

(1) Business fixed investment will not rise by more than a few percent following the several years of extraordinarily high investment.

(2) Military spending will change little in total.

(3) Consumers are expected to remain cautious, but the saving rate will fall somewhat.

(4) Housing will recover strongly.

(5) Net exports will improve little or deteriorate.

(6) State and local spending will rise at its very substantial historical trend.

TABLE 2.—DATA RESOURCES FORECAST OF FEB. 15

	1971:1	1971:2	1971:3	1971:4	Annual 1970	Annual 1971
GNP	1,017	1,042	1,053	1,070	976	1,045
Consumption	643	657	669	679	617	662
Business fixed investment	102	104	105	105	103	104
Residential construction	36	38	39	38	30	38
Inventory change	4	8	0	3	3	4
Net exports	4	4	4	4	4	4
Government purchases	228	231	236	240	221	234
Unemployment	6.0	5.8	5.6	6.0	5.6	5.8

RISKS

Every sophisticated consumer of forecasts recognizes that the future cannot be predicted precisely. The dramatic economic surprises have come from two sources: (1) Unexpected changes in defense spending, and (2) periods of extreme monetary stringency. These two risks appear rather low for 1971.

Some private forecasts are beginning to say that business fixed investment will be up as much as 8 or 10% this year on the strength of improved confidence and more liberal depreciation policies. To assess this possibility, we have polled a group of industrial companies. The responses showed that while there is some improvement in sentiment, investment plans have not been revised since the December Government survey and depreciation reform will have little effect until 1972.

An upswing in consumer spending is possible and some of the surveys report improved consumer attitudes. Spending has not improved so far; the consumer saving rate in the first quarter appears to be continuing at 7% or more.

The weakness of the projected recovery appears to go counter to previous experience of sharp cyclical upswings. Table 3 shows that the large first year GNP gains after past recessions are largely due to swings in inventories. Because the "stretched recession" of 1969–71 lacked the normal cyclical downswing, the upswing also is likely to be milder. The projected gain in final sales is at the historical average, even though the GNP rise is below normal. Unfortunately, the high inflation rate keeps real growth of sales also below normal.

TABLE 3.—PERCENT GAINS OF GNP AND OF FINAL SALES IN RECOVERY

Years	GNP rise	Final sales rise
1949–50	19.4	7.1
1954–55	10.3	7.0
1958–59	11.0	6.7
1961–62	8.7	7.0
1970–71	[1] 7.0	[1] 7.0

[1] Estimate based on DRI Forecast, Feb. 15: see table 2.

The absence of a large decline in plant and equipment spending, the rise of housing that has already occurred, and the limited swing in the federal budget also argue for the absence of the normal, sharp upswing.

On the negative side, the major risk for 1971 rests in the inflationary trend.

If our economy is a market economy, at least loosely defined, persistent high unemployment and industrial slack will soften price and wage trends. For a variety of reasons, the inflation rate has been singularly unresponsive to slack since 1969. Our forecast projects that the classical forces will have some effect, and continue to slow the inflation. If they do not, real-purchasing power will be eroded, cutting real growth and employment gains, and limiting the freedom of expansionary policy.

THE ROLE OF ECONOMETRIC MODELS IN FORECASTING

During the recent forecasting season, government and private forecasts relied increasingly on econometric models. The public might expect these computer calculations based on historical relationships to produce more uniform answers: some words of explanation are in order.

Forecasts are often described as having been produced by a particular model. This is not a correct statement. Forecasts are only produced by people, who may, or may not employ an econometric model as one of their tools. Such forecasting contains a substantial element of judgment: the choice of economic theory to be embodied in the equations, the exact form of the equations, the choice of interval over which the equations are fitted, the use of current information in the solution process, correction for observed error patterns, as well as the choice of policy assumptions, of course. The use of large models assures an internal consistency in the figures and makes fuller use of the available statistical evidence.

I make these cautionary comments because the public and policy makers interpret models as a kind of "black box" which turns out answers. If these answers then prove wrong—as all forecasts will—the method itself may be discredited. Econometric forecasting is little different from traditional forecasting. Properly used, the method is simply an addition to the forecaster's tool kit which makes possible certain new kinds of analyses of the data.

The recent forecasts based on monetarist models follow a different philosophy. The model is treated as if it were the true theory, and that the theory was so precise that there need be no recourse to other information then the few time series of the model. Such exercises can be illuminating for scientific purposes, for improving our understanding of the economic process. However, they are not sufficient for forecasting since they inadequately reflect the initial conditions, make no allowance for observed errors in the equations, and leave no room for the largest part of the information that is actually available about future developments.

ASSESSING THE POLICY PLAN

The expansionary component of the Administration's economic policy lies on the monetary side. A fiscal policy of balance in the full employment surplus can be characterized as essentially neutral. In the last 11 years we have run 3 deficits and 7 surpluses in the full employment budget. The cumulative total is a net deficit of $14.9 billion based on OMB estimates. Comparable figures were not available for earlier years. Other estimates indicate that there were surpluses from 1955 to 1960. As a first approximation, a policy of balance would neither add nor substract from purchasing power if there were full employment, i.e. the government would spend no more than its full employment income.

There are a number of qualifications to be added to this crude evaluation. The small decline in the full employment surplus is expansionary. The growth of expenditures is a significant dimension. In fiscal 1972, the budget will grow at the same rate as GNP, which can be defined as neutral. In the defense area, the volume of orders is as important as the volume of spending, and with the switch to major procurement, there is probably a small net stimulus in the defense budget. The lending activities of government also add a pertinent dimension, including the lending activities of the housing agencies that are no longer officially classified within the budget. While these activities continue at a high level, their total volume in fiscal 1972 will be no greater than in 1971. The nature of the expenditures is also pertinent. While in the long run grants-in-aid are also spent, their immediate impact is probably weaker than government purchases of goods and services. The current budget shows no increase in the latter category, relying mainly on the growth of grants and of transfers to persons. When combined with the political uncertainties of reaching any decisions this year, the net impact of the 1972 budget is neutral rather than expansionary.

Monetary policy, on the other hand, is very expansionary in the Administration's plan. A rate of growth of the money supply of 6 to 9% is high within the range of historical experience. Since the period of the money stock freeze in 1969, policy has been relatively easy. Table 4 compares the growth of money in previous recessions.

TABLE 4.—MONEY GROWTH IN RECESSIONS

Cycle dates	Annual rates of change	
	Peak-to-trough	12 months after trough
November 1948 to October 1949	0.7	4.3
July 1953 to August 1954	1.5	3.1
July 1957 to April 1958	0	4.2
May 1960 to February 1961	1.3	1.9
September 1969 to November 1970	4.5	[1] 4.0

[1] 2 months.

While the extreme financial conditions created by the combination of rapid inflation and zero money growth required a catch-up in the money supply, a growth beyond 6% over the next twelve months would be extraordinarily expansionary compared to previous experience.

The extreme ease of monetary policy in the last four months can be seen more clearly from the drop in interest rates. The yield in long term bonds fell an unprecedented 230 basis points before it reversed in the face of the reality of a heavy calendar and continued inflation. Short-term interest rates have fallen even more dramatically, without reversal so far. These rates were led down by the managed drop in the sensitive Federal funds rate which indicates more clearly than any other indicator the extent to which open market operations and lower reserve requirements have removed the pressure from the banking system. I believe that we owe this ease to the inroads of monetarism. I doubt that the Federal Reserve would have permitted so sharp a drop in interest rates if the policy had not appeared so moderate by the monetarist gauges.

I applaud the policy of ease that has been followed. With the economy still showing only flickers of recovery, a prudent policy arranges to have credit easily available and interest rates falling. But it is a mistake to rely so heavily on a continuing policy of great ease during the economic upswing, even a relatively weak upswing. We have seen repeatedly that extremely easy money creates distortions in the financial system which lead to instability in the economy later on. For example, during the recent long upswing, the ease of credit stimulated large swings in the stock market, which in turn created a wave of mergers of American corporations which have heightened industry concentration, promoted the growth of thinly capitalized conglomerates, and encouraged a volume of stock market activity that the securities industry could not handle.

It makes a difference to the quality of an expansion whether it is fueled by fiscal or monetary policy. Lower taxes or higher spending change the incomes of households and businesses. Some of these income changes are converted into spending, which, in turn, stimulates production and employment. The economic position of households and businesses becomes more secure.

Easy money, on the other hand, encourages the use of credit. The initial stimulus to the economy may be the same, but the impact on the economic security of households and businesses is different. Credit-financed spending results in leveraged economic positions. If the income-expenditure balance deteriorates for any reason or credit becomes scarce and costly, the cutbacks in spending can become severe. Of course, the American economy has thrived on the growth of credit. Housing, utility investment and much of consumer durable purchases are credit-based—and properly so. But it is a question of degree and balance. If total credit growth, rather than income growth, is to lead economic expansion, then the vulnerability to disturbances is greater, and the expected duration of the growth phase is shorter.

The testimony by Chairman Burns suggests that the Federal Reserve System will not accept responsibility for single-handedly restoring full employment at an early date. This is a reasonable position. With unemployment likely to exceed 5% for several years, policy should be easy, but should not go beyond the 5–6% range in money growth. If we really mean to return to the neighborgood of full employment next year, we will need full employment budget deficits.

NEW POLICIES AGAINST INFLATION

As a long time advocate of incomes policy, I am pleased that the Administration has now moved some steps toward policies that would speed up the end of a wage-price spiral lingering on through the recession. The list of potential measures including the Wage-Price Review Board is well known and there is no need for me to repeat them. Let me only offer these additional comments.

(1) The government faces three particular areas of testing this year. The first is in construction. Hopes have been raised that the President will take a strong stand to bring an end to the abnormal wage trend of this industry. Without solution in this area, industrial wages cannot slow down significantly. The second area is medical care. The President's message on health emphasized the supply side properly. It remains to be seen if the measures finally enacted show a similar balance between augmenting demand and supply.

The third area of testing is in steel. The President was successful in achieving a partial roll-back in steel prices last month. But the Administration backed off rather quickly from the use of its main lever in this situation, the relaxation of the import quotas. It would be desirable to have continuous monitoring of situations such as steel, oil, and textiles where domestic price structures are propped up by import control programs. Such monitoring would inject the viewpoint of price stability into both price and wage decisions.

(2) As the government becomes more active in its use of its powers to promote price and cost stability, the need for an incomes policy, for principles defining responsible behavior become more acute. One of the criticisms of a policy of selective intervention is that it is unjust. Business and labor have the right to know at least in general terms, what is acceptable price and wage behavior. Such principles must be formulated by government. The entire experience of asking the leadership of business and labor to develop the policies has been negative. The American economy is not organized so tightly that the leadership can deliver its constituency, even if it had the inclination to do so. The Congress and the Administration must share the task of developing the policy.

(3) Incomes policies can be effective only if the government has powers to which it can turn if voluntary efforts fail. Where the government props up market, these powers are already at hand. Extension of the standby wage-price powers of the Defense Production Act could strengthen the government's hand, would speed up the deceleration of the wage-price spiral, and make possible the return to full employment at an earlier date.

Chairman PROXMIRE. Mr. Eisner, we shall be glad to hear from you at this time, sir.

STATEMENT OF ROBERT EISNER, PROFESSOR OF ECONOMICS, NORTHWESTERN UNIVERSITY, AND RESEARCH ASSOCIATE, NATIONAL BUREAU OF ECONOMIC RESEARCH

Mr. EISNER. Mr. Chairman, for me, too, it is ever a pleasure to be back before the committee.

I have several professional papers that I would like to make available, one dealing with the fiscal and monetary policies considered for the 1971 budget, and another paper on "What Went Wrong?"

As to my statement this morning: Unemployment is too high. Output is too low. Price inflation is too great. All of this is essentially acknowledged in the economic report. The proposed remedies have a sound core in the expert professional thinking of the members of the Council but seem unfortunately to have become enshrouded in a mixture of wishful thinking and political sugarcoating and timidity.

The first central fact to face is that our current difficulties stem from the escalation of the war in Southeast Asia begun in 1965. It is this that brought on the inflation. As the report reminds us, in 17 years from 1948 to 1965 prices increased by some 31 percent, a per annum rate of growth of no more than 1.6 percent, and a good bit of this rerelated to upsurge at the start of the Korean war. Our strong economy has suffered from significant inflation only as a consequence of wars. And ironically, our very success in bringing the economy to the point of full employment in 1965 made the subsequent escalation of war expenditures the particular disaster to price stability that it became. The sine qua non in ending inflation, and it is truly more difficult than spokesmen of the past and the current administrations would have had us believe, is a speedy termination of our involvement in the war in Southeast Asia and the avoidance of any new splurge of inflationary defense spending. For the war has been inflationary in several key respects:

(1) It involves an obvious contribution to money income and demand without a corresponding addition to output available to the private sector of the economy.

(2) To the extent it is supported by the draft, it entails a hidden cost which may be viewed roughly as the substantial difference between the income received by draftees and "reluctant volunteers" and the lost output of all those out of the civilian labor force because of the draft or the threat of the draft.

(3) It contributed to general increases in prices and wages as expanding defense industries competed for resources.

(4) Not unimportantly, it contributes to an inflationary psychology.

It is of course true that expenditures for our involvement in Southeast Asia have been reduced and that the real rate of defense expenditures has likewise been reduced. It is important to see these as steps in the right direction. But we are suffering a hangover from past excesses, and any faltering in these steps, let alone a reversal of direction, can prove disastrous.

President Nixon has been reported to have become a "Keynesian." I would wish that he were a better one. The public espousal now of a full employment budget is to be commended. But it was suggested in a bolder form over 20 years ago by an excellent economist not usually considered either a Keynesian or fiscally irresponsible. In 1948 we could have found the argument, by Milton Friedman, that:

> The budget principle might be either that the hypothetical (tax) yield * * * at a level of income corresponding to reasonably full employment * * * should balance government expenditure * * * or that it should lead to a deficit sufficient to provide some specified secular increase in the quantity of money.[1]

For as I am sure members of the present Council are fully aware, there is nothing sacrosanct about a balanced full employment budget. The Keynesian lesson and, I should hope, the lesson from all economists, must be that the budget is an instrument in attaining and maintaining economic health and not an end in itself.

A balanced full employment budget may in some situations prove inflationary and in others not sufficiently stimulatory. In view of the unemployment that has developed and the discouraging slack in capacity well noted by the Council, the 1972 budget, and the economic report which accepts it, manifest a timidity which entails a reckless gamble with the jobs and well-being of a significant segment of the American people. A Bureau of the Budget chart presented with the President's budget portrays us as $1.4 billion in surplus on a full employment basis in fiscal 1971 as against the $0.1 billion surplus estimated for the 1972 full employment budget. But it is clear that the 1971 budget was not sufficiently expansionary to prevent—or it was sufficiently constraining to achieve—6 percent unemployment and the first annual decline in real GNP in a long time.

How then can the proposed budget which differs by being only $1.3 billion less in surplus than the 1971 full employment budget prove

[1] "A Monetary and Fiscal Framework for Economic Stability," *American Economic Review*, 1948, reprinted in Milton Friedman, *Essays in Positive Economics* (Chicago, 1953), p. 137.

sufficiently stimulatory to be "self-fulfilling"? A healthy and growing economy may require a significant Federal budget deficit which, as Friedman suggested more than two decades ago, may be financed by increases in the money supply to accommodate the needs of a growing economy. Alternatively, and more realistically under the current institutional structure, the deficit would contribute to an increase both in the quantity of money and in interest-bearing Federal debt. Some Council projections interestingly foresee a Federal surplus of $25 to $32 billion on a national income accounts basis or some 2 to 3 percent of gross national product by 1975 and 1976. With the shrinking projected proportion of Federal Government claims on available GNP, this hardly promises to be a self-fullfilling full employment budget.

The major new item of stimulatory fiscal policy claimed by the administration is the $2.7 billion reduction in taxes resulting from arbitrarily "liberalized" depreciation allowances. This is a major topic in itself. But I can testify that none of the considerable body of research in which I have engaged over the years regarding both determinants of business investment and the effects of increasing depreciation allowances leaves any reason to believe that this tax concession will prove significant in stimulating the economy. Capital expenditures are undertaken by business in anticipation of the profits to be realized from them. Giving business such a major tax concession will have little effect on the profitability of new or additional investment.

In this connection, one may recall recent remarks by Murray Weidenbaum, Assistant Secretary of the Treasury for Economic Policy, calling attention to "tax aides" which might well be considered akin to direct Government expenditures in their effects on the budget. It is hard to reconcile a $2.7 billion sacrifice of tax revenue from our generally largest and most capital-intensive companies with the crying public and private needs we are told that we are unable to meet as we restrict expenditures to full employment revenues.

Given the fact that the overall full employment budget is little more stimulatory than that of last year, which we ended with 6-percent unemployment, and the further fact that if we discounted as we should the effects of liberalized tax depreciation, the total budget might actually appear less stimulatory, it is indeed hard to see that the $1,065 billion forecast of 1971 GNP is a reasonable one. Monetary policy is easing. I for one would like to see it ease considerably and regret very much the recent extreme tightness.[1] But it hardly seems reasonable to expect our new monetary policy this year to bring about the surge in gross national product which the Council reports as a "reasonable expectation."

I might just interpolate that the Council is looking for a 9-percent increase in the money value of gross national product. There tends to be apparently about a 3-percent increase in velocity, as it is usually measured per year on a trend basis. And yet there is talk of perhaps having a 5- to 6-percent increase in the money supply. It hardly would seem as if this rate of expansion of the monetary supply would

[1] It should have been clear before and it should certainly be clear now that tight money has very discriminatory effects which dominate any imagined gains for the economy as a whole. In particular our recent experience made a mockery of the goal of $26 million housing units explicitly called for in the Housing and Urban Development Act of 1968, as we are reminded in the Council report. Yet an interesting appendix to the report also reminds us that the largest manufacturing corporations rode out the "liquidity crisis" very well.

would lead the economy—as Dr. Eckstein indicated, the forecast seems to be relying not on fiscal policy to pull the economy ahead, and yet the monetary policy anticipated would be at best just keeping pace with the needed, expected growth of GNP. Either the economy is about to recover on its own, or we should be looking for fiscal and monetary policy to stimulate the recovery.

Chairman Proxmire. You would call the monetary policy neutral instead of stimulating?

Mr. Eisner. I would say that the monetary policy which we seem able to anticipate seems at best neutral. If you are looking at a 9 percent GNP, I cannot see a 5- or 6-percent growth in the money supply as stimulatory. In fact, it may be generous to suggest that in terms of the philosophy, because if easy money would be lowering the rate of interest as one would hope, I think that the possible effect would be to decrease the velocity.

Suggestions in the President's report that inflation is beginning to end and similar reports from administration spokesmen for quite some time are uneasily reminiscent of the "prosperity-is-just-around-the-corner" statements of over a generation ago. The sad fact is that with all the cost in unemployment of human and physical resources there has been little to show in the way of halting inflation.

I know the administration one month will look at one index seasonably adjusted and the next month look at another one unseasonably adjusted, but the GNP price deflator, which rose 4.7 percent from 1968 to 1969, increased 5.3 percent from 1969 to 1970 and some 5.9 percent in the fourth quarter of 1970 according to the latest revision.

Inflation is a stubborn ailment, as any council should advise a President and a public ready to make a benefit-cost analysis of military ventures in Southeast Asia or elsewhere.

The Council report points to some solutions, but they can only be achieved if the pointing has some effect. In particular, the Council ascribes some price increases to "insulation from market forces * * * due to acts of commission or omission by the Federal Government. This may be true, for instance, in industries that are protected from foreign competition by import quotas or voluntary arrangements with similar effect." If we are serious about fighting inflation, we should take full advantage of a free enterprise, competitive system. Elimination of Government-imposed restrictions on foreign competition would in itself prove a giant step in the way of ending price inflation. (Even the threat of such removal can cause some price restraint.) The Government itself could exercise its huge economic and monosonistic powers and refuse to pay exorbitant prices, whether for defense gadgets or highway or building construction. Every private purchaser must decide whether something he contemplates buying is worth the price.

The Government must learn to do likewise and indeed has the economic power to force prices down. One can only wonder what political considerations or manifestations of a huge, bureaucratic-military complex prevent it from exercising that power. But further, the Federal Government has been contributing to inflation by many of the measures designed to counteract inflation. Thus, continuation of excise taxes on items such as automobiles, air travel, telephone service, and many others serves largely to keep prices on these items higher than they would otherwise be. Tight money in the recent past notoriously raised interest costs, directly increasing prices as measured in the service components of our price indexes and contributing to higher costs, particularly in capital-intensive industries, which raise other prices of final product indirectly. A second giant step in the direction of combating inflation would be the systematic elimination of tax and monetary policies that themselves contribute to higher costs. This might well have a multiplier effect if used as an incentive for further price reduction by producers. One might, for example, contemplate a scheme whereby excise taxes on automobiles were removed for those producers that made some corresponding additional reduction in their price before tax.

There is much sound economics in the Council report but much of it seems somehow tenative and cautious. Perhaps the Council cannot be too aggressive about policies by which the administration is not ready to stand, or which the Congress would not adopt. But there is no good reason to tolerate substantial unemployment going on well into 1972, if not further, just because, having arrived at the point of espousing a full employment budget, it seemed too audacious to suggest that even such a budget might better be in substantial deficit. The Council suggests in a number of places that unemployment is related to defense cutbacks, although it also acknowledges that a great deal of it is not reasonably so related. But after literally decades of recognition of the problem of reconversion, with specific proposals such as those of Senator McGovern in the hopper, why has the administration not been able to come up with a program for retraining and relocating people or doing whatever else is necessary to enable us to realize the goal of prosperity and full employment with peace which has been frequently proclaimed?

And as the Council reports, in various cases where industries are protected from foreign competition or, we might add, other instances where Government practices tend to raise prices or keep them from falling, "the Government has the instruments at hand for correcting the problem."

This economy has the capability of maintaining full employment and reasonable price stability without war. It is time for the administration and the Congress to get on with the job.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Eisner.

And thank you, gentlemen, for very fine statements, and for a very interesting variety of views on the economy and what we ought to do about it.

As I understand it, Mr. Butler, your position is that our present fiscal and monetary policies are about right—is that a fair statement—and that you feel that we should be very cautious about a more expansive fiscal policy or a more expansive monetary policy, and you come down hard against incomes policy?

Mr. BUTLER. No, I think there is some room for incomes policy. Again, you have to define it. I would define it in terms of a set of guidelines. The guideline I would suggest would be the average increase in productivity for the economy as a whole, plus a cost-of-living adjustment.

Chairman PROXMIRE. I misunderstood that. That is good to hear. You then do favor definitely an incomes policy, an incomes policy which would be close to what we were working toward in the 1962–66 period, of recognizing the productivity increase, and then making adjustment for it?

Mr. BUTLER. Yes.

Chairman PROXMIRE. Would you agree that I was fair in saying that you support the administration's fiscal and the Federal Reserve monetary policy as being about right?

Mr. BUTLER. That is correct.

Chairman PROXMIRE. And Mr. Eckstein, you seem to feel the need for more stimulation, and you specifically suggested that we postpone the increase in social security taxes and perhaps some other excise taxes. You did not favor apparently an increase in expenditures beyond what we have now, at least overall expenditures. And you seem to favor the Federal Reserve Board's present monetary policy. And also, as does Mr. Butler, you favor an incomes policy along the same line, not fixing wage and price controls, although not ruling it out, but at the present time a guideline policy, is that right?

Mr. ECKSTEIN. No, I showed a bit more sympathy toward raising spending. I warned against raising spending carelessly. It may do little good in 1971—that is, we cannot afford to write off 1971 and plan for prosperity in 1972.

Chairman PROXMIRE. I understood you felt that you ought to have a more stimulative fiscal policy?

Mr. ECKSTEIN. Yes.

Chairman PROXMIRE. I understood that you confined that largely to a postponement of tax increases rather than an increase in spending. But you favor both?

Mr. ECKSTEIN. That is an easy thing to do. Let me give you one example.

There is a good deal of desire for some kind of public employment program. I see no reason, in a period of 6-percent unemployment, with no immediate solution of the problem, why States and counties should not be given some money to experiment, to see whether they can put unemployed people to work in useful areas such as in sanitation and education. I would not favor a multi-billion-dollar program, before we had a bit of experience with it. There is no reason why something should not be done immediately.

There are spending possibilities on the education side, not new programs, fuller funding as well as programs to help cities.

There is some risk here that the administration will take a very negative position on funding present programs, with the good intention of reforming them at a later date. But there is 1971 to worry about too.

I am concerned with efficiency in government. And it has been our experience over and over again that we launch programs for the sake of fighting recession after the recession is over. But there is no general economic argument at this time to be particularly tough on spending.

Chairman PROXMIRE. But you seem to favor some kind of a jobs program, public service jobs in the cities, did I understand you to say that?

Mr. ECKSTEIN. That is right.

Chairman PROXMIRE. Now, Mr. Eisner, No. 1, you feel that the way to combat inflation is to end the Vietnam war, you feel that is the most important action psychologically and economically?

Mr. EISNER. I think that is a major factor to which not sufficient attention has been given.

Chairman PROXMIRE. And with the Vietnam war over—we would have a more serious conversion problem if we end it more promptly. And you favor a decisive expenditure policy of stimulation?

Mr. EISNER. Yes.

Chairman PROXMIRE. Do you favor the tax proposal that Mr. Eckstein has made, postponing the social security tax increase?

Mr. EISNER. Yes; that is generally a good idea. But I would say that I think you will get more immediate effect from expenditures by government than from taxes. There is a fair amount of evidence that cuts in taxes take some time to percolate through the economy. There is not an immediate demand for workers. So I would be more sympathetic with what Mr. Eckstein has just suggested, having the Government move in with expenditures for more States and localities to hire the unemployed, to look toward the desirable programs that the administration and the Congress have been reluctant to go into.

Chairman PROXMIRE. And on the monetary side, you are the one out of the three witnesses this morning who seems to fault the Federal Reserve Board. You feel they should be more expansionary than they tend to be. Is that your position?

Mr. EISNER. I do not agree with Mr. Burns precisely——

Chairman PROXMIRE. Well, on the basis of what has been done.

Mr. EISNER. On the basis of what has been done, I would say they are moving in the right direction, but not sufficiently, I think they are too cautious. Nobody has a crystal ball and can say what is going to happen to GNP. But I ride with Mr. Eckstein on the predominant body of forecasts. I will stand by my words in my statement, that being cautious in this regard is really being reckless with people's jobs and livelihoods. The fact is that if we have 6 percent unemployment, there is a very substantial cost attached to this, not only to the unemployed, but to the economy. And if I were to err I would err in the direction of being too stimulative, toward putting these people back to work.

Chairman PROXMIRE. Mr. Burns made a strong case before this committee, and I think Mr. Eckstein has put it as well as any witness we have had, that is that the monetary stimulus may seem moderate with the increase of 5 percent last year, the actual change in interest rates has indicated that we have perhaps a soft demand for money, and that the credit is available now, and that the Federal Reserve Board is much more aggressive than it has seemed to be, and if we go further we might be storing up inflationary troubles in the future.

I thought that Mr. Eckstein made a pretty persuasive argument this morning about being—not being too far on the side of monetary expansion.

Mr. EISNER. I suspect Mr. Eckstein and I agree that monetary policy is not the strongest weapon to use. And generally I think I would agree with the point he made, that this could have some substantial distribution effects frequently ignored. But here we have a case in the way of redressing the balance. Interest rates are still far above their traditional levels. And we already have caused great losses to a number of people who have invested in bonds, particularly, and in stock.

We have also had some very bad distributional effects, allocational effects, in terms of mortgage terms and housing construction.

Chairman PROXMIRE. They could not have come down, as fast as they have, at least the short-term rates.

Mr. EISNER. Short-term rates can move rapidly. The big problem is that long-term rates, for good and substantial reasons, are stubborn. In the last week bond prices have been falling and long-term rates rising. And it takes a steady hand here.

Mr. Butler has a point. If the Fed keeps going up and down with its monetary policy, it is hard for any investor to have confidence in what the long-term future will be. And why buy a long-term bond just because the Fed. is easy for 2 weeks or 2 months, and then they may tighten up again? If they tighten up again, that drives bond prices down.

Chairman PROXMIRE. I am glad to get that expression.

Then I take it you gentlemen pretty much agree that the monetary policy has to be right, and it ought to be stable?

Mr. EISNER. I think monetary policy should not be allowed to get in the way of the expansion of the economy. It should at this point lead the economy. And I would like to see a steady long-term growth of monetary supply, and fiscal policy to iron out the fluctuations.

Chairman PROXMIRE. Mr. Butler, with no controls and a relatively mild incomes policy, and inflation as your principal target, wouldn't your policies lead to continued unemployment above 5 percent? Is this a fair policy to follow in view of that serious consequence, that the people who have to pay the price of fighting inflation are the ones who are the least able to pay it, the unemployed?

Mr. BUTLER. I think that is right in the current situation. However, I would argue that you would have lower unemployment over a period of years with reasonably steady monetary and fiscal policies than you would have if you pushed too hard at the moment and get back into another period of serious inflation, and then have to jam on the brakes again. I think we want to get onto a steadier course. The cost of this may be somewhat higher unemployment in the next year or so, but I would argue less unemployment over the next several years.

Chairman PROXMIRE. You spoke of unemployment compensation as one way to curb on this. We did pass unemployment compensation legislation last year. It has not been made effective yet.

The legislatures are just now meeting and beginning to put it into effect. Would you go further than that? That provides, as I understand, about 50-percent benefits. Would you increase the benefits, and extend the length of coverage and the amount of coverage? And then how would you meet the problem of the millions of people who are coming into the work force, and therefore would not get unemployment compensation? That would be the young people, the veterans coming back from Vietnam, and so forth.

Mr. BUTLER. I would say the action taken last year is certainly a step in the right direction.

As to the people coming into the labor force, I think this is a very serious problem. I would again look to some structural changes, greater labor mobility, greater knowledge and greater training, overtime, a great deal of that.

Chairman PROXMIRE. My time is up.

Representative BROWN. Mr. Eisner, I am a little confused on your position now. I understand from looking over the testimony you have given, and also that Mr. Butler has given, that you kind of favor a whisky-coffee action here, something to sober us up; and then if we get too sober, something to stimulate us again, and that Mr. Butler would have us not quite as stimulated or subdued.

But you said, I understood, in response to a question by the chairman, that you thought the Fed moving up and down the monetary supply too rapidly was dangerous. Did I understand you to say that?

Mr. EISNER. I think there is a case against fluctuation in Federal monetary policy.

Representative BROWN. Too rapid a fluctuation you mean?

Mr. EISNER. Too rapid; and in general I have long advocated, from a somewhat different point of view than Mr. Friedman, the notion that we should keep the money supply growing adequately and substantially to meet the needs of a growing economy. And at this point, when we are trying to get out of a hole, I would have the money supply perhaps increase somewhat more rapidly, also to make up for the extreme tight money we had over a year or so ago.

Representative BROWN. Do I understand you to suggest that you would use the monetary supply as sort of the basic undergearing for growth, and the fiscal activities of the Federal Government as the fine-tuning effort of the economy? I do not see how that really can work that well. It seems to me that it is much more difficult to get into and get out of the Federal program. God knows—both God and practically everybody knows—that once a Federal program gets started it is just almost impossible to turn it, or to cut them back. You know, cutting back is even more difficult than terminating. I get a lot from your testimony that you have a pretty good flavor of the political here. You know that the attitude taken by many Members of the Congress is that if you even fund a program at the same level as last year, that you are crippling somebody who was working in that program for some useful purpose. So how can you use the fiscal approach of the Federal Government for this fine-tuning? I do not understand that.

Mr. EISNER. Well, fine-tuning of course is a phrase that has caused a lot of people a lot of difficulty. I think there are many limitations as to what the Government can do to stabilize in any event, because there are lags.

One of the problems of these lags relates particularly to monetary policy, but relates even to some fiscal policy. You have unemployment now. And you want to get rid of it sometime before the end of 1972. The one way to do it is to give the unemployed people work. You can give them work either by having the Government directly hire them or having the Government buy the services that have to be produced.

Representative BROWN. What would you have them do?

Mr. EISNER. This depends upon the decision that the Congress has to make. Perhaps there are more schools needed. They can make money available so that the schools can be built.

Representative BROWN. Would you have aerospace engineers lay brick for schools, is that what you are telling me?

Mr. EISNER. Where you have a particular pocket of unemployment of that type——

Representative BROWN. Take Seattle, for example. You have a particular pocket of unemployment in Seattle. What would you do in Seattle?

Mr. EISNER. In Seattle, where there are people that have to be retrained and people that have to be moved, you have to have a Government program which would provide, first, information as to other jobs, and second, training facilities, and credit. These are structural problems in the economy.

Representative BROWN. How long does it take to gear up to have a retraining program, in other words, hire the people to retrain? I would like a specific example. I am talking about the aerospace engineers who are out of work. What could you retrain them to do? If it is bricklayers you have to find people who know enough about laying bricks and who can relate it to an aerospace engineer and tell him how to lay brick and get someplace where he can lay brick. Now, that takes time, money, structure from Federal Government, and so forth, not to speak of the time that it takes for the Congress to enact a program, which everybody knows—you know, we move kind of slowly. We could not even get the social security bill through last year. So it takes us a little time to operate here.

Mr. EISNER. The first question, I think, is one to which the Congress should address itself, how long it takes to act. And once the things are enacted——

Representative BROWN. You know how fast the Senate is moving to reform the filibuster rule. If we have got to reform ourselves before we act we have got more of a problem.

Go ahead.

Mr. EISNER. At this point I can only suggest what is desirable. It seems to me that it is up to the wisdom of Congress to find a way to act.

It is, I would say, a very sad and scandalous situation where there are hundreds of thousands of people unemployed, for example, in the aerospace and defense industries, to build up a tremendous lobby to keep unnecessary, worthless projects going, and swelling our military budget, simply because the society has not provided them any other adequate way to make a living.

Representative BROWN. On the military expenditures, that has all been sharply cut back. And some people argued that our unemployment policies are caused by the cutback in Federal program.

But that is one of the things that you are advocating, as I understand it, and that is a sharp cutback in military expenditures. So that would be fine tuning in the economy at this time. And the real impact of that cutback was about a year and a half ago—I beg your pardon—the real cutback was about a year and a half ago, and the impact is being felt now. That is where I am lost on the fine tuning. It seems to me that that is not productive.

Mr. EISNER. Certainly the cutback in military expenditures is not going to be stimulatory to employment. I have suggested that a good bit of price inflationary pressures have come from the past buildup of the military. I think Mr. Eckstein referred to this before.

I am also suggesting that it would be very important to facilitate such cutbacks, that we provide mechanisms so that there is not a built-in political pressure opposing them. I think the reality must be apparent to everybody, and certainly the Members of the Congress. If you come from a district where people are employed in defense industries, or aerospace, the individual can see no alternative. He wants his job. And I think it is up to the Government to provide an alternative so that we do not put ourselves in that kind of an impasse.

Representative BROWN. The Government giveth and the Government taketh away—or maybe it is the other way, the Government taketh away and then giveth.

Let me get to the question of social security taxes as a means of stimulating the economy, versus some kind of an investment character credit, or a program that has been suggested in the $2.7 billion on the change in depreciation allowance. What is the relative position—we have talked in previous hearings here about the importance of psychology in the society—what is the relative position of the psychology of the average consumer, and the psychology of the average businessman, based on his relative liquidity? It occurs to me—and again I do not mean to pick on Mr. Eisner, but I go back to your testimony where you seem to pooh-pooh the importance of business profitability as an investment stimulant. And this $2.7 billion depreciation schedule change—it seems to me that part of your problem today has to do with the fact that a lot of fairly solid businesses got into a liquidity crunch in recent months, and they want to take a little time to get out of that crunch. They want to get the cash in hand before they reinvest, or at least the prospect of profit before they reinvest.

Now, relative to that, what about the average consumer? Is he getting out of that crunch also, or was he ever in it that deep, or was he out of it sooner? Could you comment on it?

Mr. EISNER. On the liquidity situation, I would like to refer you to the admirable appendix to the economic report on corporate liquidity in 1969 and 1970. And the appendix makes it quite clear that the leading corporations in the country did not suffer severely from liquidity crunch. I don't see that is evidence that they cut their expenditures. We believe in the profit system and believe that it operates correctly. What we should be believing is that business invests when it increases its profits, it acts in such a way as to increase revenues.

You take the airline industry running with a lot of excess capacity. Any airline that would now go ahead and order new planes because it has increased depreciation allowances would be awfully foolish. You can suggest that somehow businessmen are the victims of a mistaken psychology, they do not operate to make a dollar, but if they happen to have money in their pocket, they throw it away. I refuse to believe that about them. I do not think it is true.

Representative BROWN. If they happen not to have money, they would like to get some of it in their pockets before they throw it away. And the thrust of your testimony is that they will not invest unless you give them additional profitability——

Mr. EISNER. I think there is a distinction between giving them additional money and additional profitability. The current change in depreciation allowances has a minimum effect on increased profitability. I am not one who advocates trying to expand private investment at this point. I think there are many places where we would do better to increase expenditures, investing in human capital and brains——

Representative BROWN. You think there is sufficient liquidity in industry now for them to go ahead and expand if they want to, is that correct?

Mr. EISNER. Yes. I think lack of liquidity has not really hurt business plant and equipment spending. The tightness in liquidity has certain direct effects, it has injured construction and it has made it more difficult for small business rather than large business. But the effect on total spending has been minimal. I will not say that it has been nonexistent. I think those economists that have studied depreciation allowances and other forms of tax incentives have looked upon these as incentive effects. The depreciation allowances would increase investment to the extent that it makes expected profit from investment, from future investment, not what has been done in the past, more profitable.

Representative BROWN. You do not think there would be any advance—my time is just about up—my time is up—you do not think there would be any advantage, however, in the stimulation of making your operation more economic; in other words, putting in devices that would cut the cost of your product regardless of whether or not your market for the product increased, which, as I understand, would increase profitability?

Mr. EISNER. There is no reason why business could not do this to begin with.

Representative BROWN. Except that they do not have the money, maybe.

Mr. EISNER. Business can borrow money. Look at your report. Large corporations that account for the great bulk of investment can always go to the market and get money, though they may have to pay 7, 8, or 9 percent. But they are not going to go to the market even at 2 percent if the investment is not profitable. There has to be a buoyant, profitable economy for business investment to go ahead.

You can take firmer stimulatory measures—and I am not advocating them. But what would be more effective would be the investment tax credit approach, and one which would involve marginal investment, and not what one would undertake anyway, not 7 percent on an old investment but 7, 14, or 28 percent on investment beyond, say, 90 percent of the average of the last 4 years, with perhaps further adjustment for new or growing firms. With this $2.7 billion in depreciation tax savings that the administration is giving away, they will be lucky if they get a few hundred million dollars of increased investment this year, though perhaps some more next year. It is just frankly, I think, a huge giveaway with very little effect in terms of stimulating investment in private equipment, if that is what you want.

Representative BROWN. Let me just observe at the conclusion—I operate a little business, and we just made a substantial investment in order to save ourselves some costs in the operation, in the hope of making additional profit. We were awfully glad that this proposal came along as it did, because it is going to help us pay for that investment. And it made the investment look a lot smaller.

Chairman PROXMIRE. Gentlemen, I would like to ask each of you to give us your forecast for the size of the gross national product in 1971.

We will start off with Mr. Butler, and then Mr. Eckstein, and then Mr. Eisner.

Mr. BUTLER. Our figure is a $1,052 billion.

Chairman PROXMIRE. And how much of that is real growth and how much of it is inflation?

Mr. BUTLER. Almost 4 percent inflation, and 3 to 3½ real growth.

Chairman PROXMIRE. Mr. Eckstein.

Mr. Eckstein. Our forecast is on the record in the testimony, a GNP of $1,045, a rate of price increase of 4 percent, and a rate of real growth of 2.9.

Chairman Proxmire. Mr. Eisner.

Mr. Eisner. I have no personal forecast. I might simply observe that in the light of the forecasts of those who have gotten into it, it can only appear that the Council's report at $1,065 billion is a figure that somehow was contrived to meet the cosmetic needs of not showing too great a deficit in the actual budget. But I am not aware of any reliable independent evidence that would suggest that the figure would run that high.

Chairman Proxmire. You think it is too high, but you do not have a figure?

Mr. Eisner. I do not have my own, no.

Chairman Proxmire. Do you have any feeling at all about the mix of real growth and inflation we are likely to get?

Mr. Eisner. Again, I do not have any independent notion, except to suggest that prices have not—the rate of price inflation has not slackened in any measure as it was indicated it would, and I see no great reason to expect a major slackening this year. So if we hit the 9 percent that the Council suggests or the Pressdent suggests, we would be lucky to have a price inflation component of much less than 5 percent.

Chairman Proxmire. The testimony we have had recently has indicated that if you calculate the full employment budget on a national income accounts basis, that it is going to be in surplus for fiscal year 1972, and certainly in surplus in calendar year 1971. Arthur Okun says that full employment surplus would be in surplus around $5 billion. Others have indicated an even higher surplus than that.

Mr. Okun also argues that the national incomes accounts basis—I am talking of course about the full employment budget—Mr. Okun also argues that the national incomes accounts basis is the best way to figure it, it is likely to give you the best picture of the impact of the budget on the economy.

Now, under those circumstances, and in view of the figures I noticed this morning, in calendar year 1971 the calculation by Maurice Mann, who is a very competent economist, a former official in Mr. Shultz' shop, now bank president, his estimate is that we are going to have a $4 billion full employment surplus in the first half of 1971, and an $8 billion surplus in the second half of 1971, under these circumstances, and in view of the fact that there is not much change between the 1970 and 1971 calendar year, the budgetary impact, would you say that this is—I would like to ask each or you gentlemen and Mr. Butler first—that this is a stimulative or a neutral budget?

I think Mr. Eckstein has already answered the question. I think he said he thought it was neutral.

Mr. Butler. These figures surprise me. Actually I have not looked recently. But our estimates come out with a small full employment deficit for fiscal year 1971. I do not see how you would get the sort of surpluses——

Chairman Proxmire. I am talking about a different measure. I am talking about national incomes accounts instead of a unified budget. The unified budget the administration and the Okun analysts are in agreement on. And he says they are also in agreement on the national incomes account, but it is a different measure. It measures the expenditures on an accrual basis, and so forth.

Mr. BUTLER. I am talking about a full employment budget.

Chairman PROXMIRE. Yes, so are they.

Mr. BUTLER. And our latest estimates would show a small deficit for fiscal year 1972. So I do not understand——

Chairman PROXMIRE. We are both talking about full employment budgets. But two different kinds of full employment budgets. No. 1, you have a unified budget, which is the way that the administration has reported to us. And they reported that it will be just about in balance, a little deficit. And then with national incomes accounts budget we see a different measure. And that seems to be in surplus. At any rate, what is your conclusion on this fiscal policy?

Do you think it is expansionary, neutral, or restraining?

Mr. BUTLER. I think it is moderately expansionary. And I would not be concerned if it were somewhat more expansionary, but not too much more.

Chairman PROXMIRE. Mr. Eisner.

Mr. EISNER. I am not at all surprised by those incomes account budget surplus figures. They are not inconsistent with what I pointed out with regard to the administration's own figures on its fiscal budget. And I do not consider it sufficiently expansionary.

Of Course, whether a full employment budget surplus deficit is expansionary depends on a number of other factors, including, for one thing, the total rate of Government expenditures, and how the economy is growing.

Another way to look at the fact of the expansionary or nonexpansionary rate of the Federal Government is the rate at which Government expenditures are increasing. If you expect a kind of multiplier effect to pull the economy forward, you would want Federal expenditures, particularly for goods and services, to be increasing at least at as rapid a rate, perhaps a more rapid rate than you would expect the economy to increase. And as I recall—I may be able to find the figure—the Federal Government expenditures are to be increasing from fiscal 1971 to 1972 at about an 8-percent money rate, which is apparently less than the rate of the growth of the gross national product.

Chairman PROXMIRE. Assuming inflation at 4½ percent, that would be a real expenditure increase of about 3½ percent?

Mr. EISNER. That is right, which would be less than the real rate of growth you would want simply to keep the economy on an even keel, let alone to have it recover from the recession.

Chairman PROXMIRE. That is a different measure, of course. But would you assume that this is a neutral fiscal approach?

Mr. EISNER. I would say that. And I would say it is an improvement, at least it is not contractionary, but it is not particularly stimulatory.

Chairman PROXMIRE. Let me ask you gentlemen this question. Having set what all you gentlemen regard as an ambitious target, will the administration achieve it with policies it proposes? I take it that in view of your predictions you assume they will not. Is that right, Mr. Butler? Your prediction is that we will get to $1,052 billion, and what is pretty far below the administration's proposal.

Mr. BUTLER. Actually we project a range. And the upper end of our range would be pretty close to $1,065 billion. And I think it is worth remembering that the standard forecast is intended to have a somewhat downward bias. I think in the last 10 years it has been off by about $20 billion.

Chairman PROXMIRE. That is right. And they have been off in one way only, they have not been off on real growth, in fact they have been on both sides on real growth. They have been off on inflation and they have constantly underestimated inflation.

Mr. EISNER. That is right.

Chairman PROXMIRE. If we have a $1,065 billion average this year. And it is made up of 6 percent inflation and 3 percent growth. We are all going to be disappointed and we will have the present unemployment.

Mr. Eckstein, I think this is the question that develops out of your paper this morning. If the administration does achieve a $1,065 billion budget, will it be a good thing? With your paper you have presented here this morning, I take it that with your estimate of a $1,065 billion, to get there you would have to have a lot perhaps more inflation than it was anticipated?

Mr. BUTLER. Certainly, if you got it through more inflation that would be a bad thing. I think there is some chance——

Chairman PROXMIRE. How can they get it without more inflation on the basis of your analysis?

Mr. BUTLER. I think the only way you could get it would be if you had what I think is unlikely, but not impossible. And that is a fairly strong improvement in confidence which leads to greater consumer spending for durable goods, and to a somewhat greater business investment than is shown by most recent surveys. But I think this could produce it in real growth.

Now, I do not rule out this possibility, but I do not consider it very probable at the moment.

Chairman PROXMIRE. Let me put it a little bit differently, then. Policies which would assure the likelihood of your achieving $1,065 billion would, in the judgment of many, perhaps yourself, require an increasing degree of stimulation, fiscal and monetary. Would it be desirable to engage in that increased degree of stimulation fiscal and monetary? I take it from your remarks earlier that it would not be.

Mr. BUTLER. It would not be.

Chairman PROXMIRE. Mr. Eckstein, do you think, No. 1, that the administration policies will achieve a $1,065 billion, it is conceivable they could? And if not, would it be desirable for them to adopt policies which would achieve this?

Mr. ECKSTEIN. It is very unlikely that the gross national product will reach $1,065 billion for the year. Policies could be more expansionary. More expansionary policies, combined with good luck, could still get us to $1,065 billion. But given the basic kind of assumptions that most forecasters, including ourselves, make, dramatic expansionary policies would be necessary to avoid this inflation, the inflation which seems to continue without relief.

Chairman PROXMIRE. Mr. Eisner.

Mr. EISNER. I would agree with what Mr. Eckstein said. But I would just add quickly that we should have, I think, a nonexpansionary policy on the price side. We need some bold action freeing ourselves from the constraints that apparently no one likes to buck.

Chairman PROXMIRE. What are they?

Mr. EISNER. Well, the tendency is to protect the prices of producers, and trade unions in some cases, that want their prices protected.

Chairman PROXMIRE. What action should we take to prevent the price increase?

Mr. EISNER. I believe we should remove import quotas and all restrictions on foreign trade, and remove Government price supports wherever they exist, and remove Government contributions to price maintenance. We should think seriously about the fiscal mix involving eliminating excise taxes, taxes on services of various kinds that raise prices. This, combined with increased Government expenditures for worthwhile causes, may well permit us to get the increase in real product we want without a very costly increase in prices.

Chairman PROXMIRE. I must say, Mr. Butler and Mr. Eckstein, you gave me predictions Mr. Eisner did not. But might I be pessimistic on the side of what is going to happen to unemployment this year. You estimated, Mr. Butler, we would have 3 percent real growth, and Mr. Eckstein a little less than that. Three percent growth means no more jobs, as I see it, unless we have a deplorable productivity situation. Is that a fair statement, that you can expect for us to have about 6 percent unemployment throughout the year?

Mr. ECKSTEIN. Well, the rate of growth we are speaking of is year over year. Now, the average unemployment last year was not that high. The forecast that I offered would leave room for some small improvement, that is, by year end——

Chairman PROXMIRE. How do you get improvement if you have a 2.9 real growth? When you consider the fact that you have a bigger working population we all expect that, the demographic effects are clear, we have more people coming into the work force. And you are also going to have some increase, say a 2-percent increase in productivity, which is less than the average. And then you get no more improvement in unemployment, do you?

Mr. ECKSTEIN. If we turn to table 2 of my prepared statement, the unemployment rate last year——

Chairman PROXMIRE. Let me say that all of your statement, including your tables, will be in the record. They are very fine tables.

Mr. ECKSTEIN. Thank you. The unemployment last year averaged 5.6 percent. The unemployment rate in 1971 will average higher. The quarterly pattern, however, is not one of steady deterioration. In the first half of this year unemployment will improve. Then if the second half does not have some fortunate event not now foreseen, the unemployment will creep up again toward the end of the year.

Chairman PROXMIRE. So you think it will be about the same average as it is now, it will improve and then creep up again, after averaging about 5½ percent, something like that?

Mr. ECKSTEIN. That is right.

Chairman PROXMIRE. Mr. Butler.

Mr. BUTLER. Our figures are generally in line with that, Mr. Chairman.

Chairman PROXMIRE. I appreciate your frankness, gentlemen. But you certainly have a very very grim outlook for the working people.

Let me ask you about the suggestions that we have had recently on what should be done to provide jobs.

First, let me ask Mr. Eckstein. How would you feel about the following five proposals.

Do you favor all of them, some of them, or none of them:

1. A job program should be put into effect quickly, and phased out when the employment picture improves.

2. A special program of unemployment insurance benefits for the long-term unemployed.

3. Incorporation of an extra allowance in the Federal grant in aid programs based on the size of the excess unemployment would be a regional program where you have heavy unemployment.

4. Immediate introduction of the income tax 'cuts now scheduled for 1972 and 1973 under existing legislation.

5. Something you have spoken of, of course, deferral of the proposed increase in social security tax base.

Mr. ECKSTEIN. I would pick the last of those as the most desirable, because it is simple and immediate. And there really is no good argument against it as I have encountered it.

Of the others, whether we should have strengthened long-term unemployment insurance programs that really compete with the family assistance program—you might accomplish goals more efficiently by family assistance programs.

The extra allowance in regional grants—of course, there is ample precedent for that in the Appalachia program. It would be a very minor program. That is, at the moment you presumably would aid Seattle. I live in the midst of a depressed area, Lexington, Mass. I do not see where Lexington, Mass., has a particularly strong case to get a more generous grant than anybody else. So I have limited enthusiasm for that.

On the JOBS program, as I mentioned, I do favor it. I do not believe the JOBS program can be raised to a multi-billion-dollar level within 1971. But at a time like this I see no good reason why it should not be given a fair trial.

Chairman PROXMIRE. Unemployment insurance?

Mr. ECKSTEIN. As I say, it competes with the family assistance program. I would prefer going that route. There are problems in building on the State systems.

Chairman PROXMIRE. I missed you on income tax cuts, advancing those from 1972 to 1971.

Mr. ECKSTEIN. Well, income tax cuts would have a stimulating effect, indeed they might even have a substantial effect in 1971. Congress still has the option whether to give the tax cut in the lower or the upper end of the scale. I think it is inferior to the social security delay, which is not even a cut, it is just an inaction. But it would have real merit.

What is more, if we cut taxes for 2 years or a year with possible renewal, it would prompt consumer spending. After all, we are looking to the consumer to lift this economy. We know that investment has been overdone, and it may not rise rapidly even if the most optimistic view is accepted. The consumer is handicapped by the fear of unemployment. And a small tax reduction would be welcome.

Chairman PROXMIRE. My time is up. I would appreciate it if other members of the committee would permit Mr. Butler and Mr. Eisner to respond briefly.

Representative BROWN. Sure.

Chairman PROXMIRE. Mr. Butler.

Mr. BUTLER. I think I would agree with what he said. I think the best thing would be to postpone social security. I would favor a

JOBS program along the lines that he indicated. I see no reason—I think it would be useful to accelerate the reduction in income taxes. Unemployment insurance I am in favor of. I am not so concerned about the interfering with the family income.

These are about all the things that I see that could be done that would have some impact on this year and next year, and would not have adverse consequences in the longer run.

Chairman PROXMIRE. Mr. Eisner.

Mr. EISNER. I will say for the immediate shortrun effect, if you want to meet the unemployment, the jobs program would be the more direct.

I would have some concern about not undercutting a general welfare family assistance income maintenance program.

I would think that on the tax route deferral, the deferral in the social security taxes would be the more effective measure.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Gentlemen, you no doubt have been struck, as I have, by the fact that consumer saving has recently been in excess of 7 percent of consumer income, contrasted with a longer term, perhaps more normal, higher spending rate of perhaps 6 percent. If consumers change their spending-savings pattern from 7 percent down to 6 percent, that would mean an extra $8 or $9 billion worth of consumer spending power in the country today. Leaving aside other considerations for the moment, that would be a good thing, would it not? Wouldn't that tend to make recovery more likely and unemployment down, and do so by a better method than just cranking out endless new money? It is much better to have real cash on the barrelhead than inflated credit which may come around to haunt one.

Mr. Eckstein, would you agree with that general proposition?

Mr. ECKSTEIN. Yes. It would be the most fortuitous event that could befall us in the economy. It has not happened so far.

Representative REUSS. Let me now give my curbstone guess as to why consumers are saving more than 7 percent of their income instead of saving a percentage point more or less than that and spending it. I think there are four main reasons. One is social and psychological, the fact that we were in a three-front war, and the fact that the great social cleavages still persist back home.

The second cause I would assign for it is the fact that there is something like 6 percent unemployment, and a lot of people that are afraid of losing their jobs, or a second job in the family, are going on short time.

A third cause is the inflation itself. Formerly inflation was supposed to produce a lot of spending, but not this inflation, because this inflation occurs at a time when there is vast excess capacity both in plant and manpower in the economy, and therefore instead of people spending, people seem to be saving inordinately.

The fourth series of reasons for this abnormal saving, in my judgment, is the consumer movement, the environmentalist movement, the generation gap, and so on. People seem to be more suspicious of Madison Avenue. People seem to find industry producing more and more of what they regard as schloch, not worth spending your money on. People are more environmentally aroused, in seeing less environment-devouring consumer goods.

I would like your comment on those four hastily compiled categories to see whether anybody would add to or subtract from them.

Mr. Butler, would you markedly differ from that list of alleged causes?

Mr. BUTLER. No, I think they are all very important. I think there are perhaps one or two other items. One is a reduction in overtime pay. And that is particularly important in financing purchases of autos and other durable goods.

And then I think there is a certain amount of uncertainty, particularly in the auto field, and to the new devices that are going to be put on cars, there is some feeling that it might be better to wait and get one next year with the approved controls, et cetera. But I think the factors you have listed are the important ones.

Representative REUSS. That production and overtime pay, would that really be relevant? Because if your overtime is reduced you do not get the income, and hence the base on which the 7-percent saving saving is figured is less. Or are you suggesting that people use that overtime pay as the extra spendable part of their income, and when that goes they get very conservative?

Mr. BUTLER. Yes, that is the idea.

Representative REUSS. I thank you.

Mr. Eckstein.

Mr. ECKSTEIN. The only other factor I think could be added is the stock market, which did go down a lot last year, and even though it came back the public still does not seem to have gotten over it. It certainly was very harmful to the demand for expensive housing, and probably hurt the sale of cars, jewelry, and travel.

Representative REUSS. To follow through on that, I saw a little squid in the Wall Street Journal or some place the other day which said that luxury spending has not seemed to have gone down. I notice Niemann Marcus had a completely equipped Noah's Ark. I do not know whether they sold that or not. But one would need to look into that a little more.

Mr. Eisner.

Mr. EISNER. I am inclined to look less at psychological factors affecting the ratio of what we called income saved, and pay more attention to other elements of what we should call income but which do not count as income. And in terms of the tax factors, the curious fact is that in measuring percentile income we exclude a major amount of what economists would call income. Economists would call income what we can consume while keeping intact the real value of our assets.

Wheu a person decides on consumption, if he is rational, he looks not only at the current income as measured but at his total income, that is, the accumulation of his wealth, whether it is in the form of business expense allowance or a contribution to his pension, or a contribution in the form of a tax option, or the gain in the value of his assets; he looks to his total wealth picture. And these fluctuations we see in the savings income ratio I think largely reflect fluctuations in these other items. So if you would find that expectation of future incomes rising, if you would find valuable assets rising, which means a gain in net worth substantially, you would be consuming more out of your current personal income.

I might add that I am not really at all convinced that the ideal way for the economy to improve is to have people consume more out of their income. That involves a value judgment as to what the product mix of society should be. And I am fairly well persuaded that Mr. Galbraith has a point, that our economy should be better off if we paid more attention to public needs and less attention to private needs, and to the suggestion——

Representative REUSS. If I may interrupt at that point, that is why I put in other-things-being-equal clause in my question, because if you decide on a value judgment basis that the Government ought to tax consumers more, and put it into schools, hospitals, parks, the environment rather than schools, then you make that value judgment.

To the extent that these four little categories that I have set up are what prevents a better balance of consumer spending and saving than the one we have today, the remedies of course have been suggested to the extent, that if it is war, Professor Eisner would say, stop the war. To the extent that it is unemployment, Professor Eckstein would say, among other things, get on with the program of providing jobs. That sounds simple, and it is simple. But it could be right.

To the extent that it is inflation, the members of the panel would say, let us have a real incomes policy and wage price policy and back it up by standby wage price powers.

And finally, to the extent that its productive mechanisms call for producing so many goods which are either shoddy or which damage the environment, industry has a part to play too.

Let me turn now to the international situation.

Mr. Butler, the official settlement figures—our balance of payments last year were certainly huge, a total official settlements deficit, without the benefit of special drawing rights, of something like $10.7 billion, of which $9 billion was an increase in the liabilities of the United States to foreign and central banks and official monetary institutions.

The increase on the official settlements basis of that order 5 or 6 years ago would have been the occasion for a good deal of alarm, would it not?

It is noteworthy that that increase in official liability $9 billion, comes close to the $11 billion or so that we now have in goals.

What is your view on the new thinking about balance of payments? Has that been supplied, Mr. Krouse of Brookings, Gottfried Haberler of Harvard, and some others, who were saying that we really should not be so concerned about these deficits that the world is not coming to an end, I am sure?

Mr. BUTLER. A good part of the official settlements deficit last year reflected a return flow of Euro-dollars from U.S. banks primarily. The Federal Reserve, by setting this floor under bank holdings of Euro-dollars, has virtually stopped that flow. In our estimate the official settlements deficit of this year is something like $3.7 billion, or about the same as the rest of our liquidity deficit.

Now, it is still a fairly large deficit. It means that foreigners in one way or another are going to have to increase their dollar holdings again by an amount, I think, which many regard as sort of inconveniently large.

On the other hand, there are countries running surpluses, and to the extent that they run surpluses this tends to work back toward a U.S. deficit. And I think one remedy lies not in our hands but in the hands of countries such as Japan. They are running rather large deficits at the moment. And to the extent that they do so, I think we will have deficits.

I am not greatly concerned about this in the short run. I think we have got our heads so firmly wedged in their jaws that there is nothing they can do about it. But other countries will add to their dollar holdings this year, and my guess would be next year.

I do think we have to look at the U.S. deficits in a different way than we have in the past. These two bottom lines of liquidity in the official settlements accounts, I think, have a limited meaning for a country such as the United States. I would hope that over time countries in surplus would act to reduce their surpluses. I am thinking primarily of Japan at the moment, although there may be some other lesser ones. And this would produce some reduction in the U.S. deficit.

I would guess that with the growth in world trade and investment you could find willing holders of as much as $2 billion a year.

I think the problem is to get the $3.7 billion this year down over time.

But again I think a lot of options lie with other countries and not so much with ours.

One final point is that as I remember the figures, the outflow on Government accounts last year was $7.7 billion. And I wonder whether we can in a tenable fashion continue to have a $7.7 billion Government deficit—whether one option may not be to review those accounts to see what reductions might be possible?

Representative REUSS. And the greatest of these is military, is it not?

Mr. BUTLER. Yes.

Representative REUSS. My time is up.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN. Mr. Eisner, I want to go back to a suggestion you made about price supports as one of the methods, or one of the proposals for Government acts at this time. You were suggesting that these be removed as a method of lowering the Government costs or a method of lowering prices generally?

Mr. EISNER. Essentially it is a matter of lowering prices.

Representative BROWN. What kind of price supports do you have in mind?

Mr. EISNER. I would have in mind all kinds of price supports. I really have not—I am not prepared to itemize the particular ones.

Representative BROWN. Let me ask you specifically. Are you talking about agricultural price supports?

Mr. EISNER. I would include agricultural price supports.

Representative BROWN. A low-labor cost area on the farm and a low-profit margin area at the farm level?

Mr. EISNER. Yes. I do not——

Representative BROWN. Where the cost of the commodity has very little part of the cost of the manufactured goods? I am lost as to why that would be so effective.

Mr. EISNER. If we are concerned about equity, about income distribution, I would look for direct income subsidies to people that we feel need income support. I think particularly in a period where we are concerned about rising prices, the direct answer to rising prices is not to have the Government go in, as some of my colleagues have said, some more agreeable than I, to interfere with markets, in the way of price and wage controls and incomes policies, we should have the Government first eliminate the measure that it has been supporting to keep prices up.

If we want prices down, let them come down. Let American business and American farmers face competition and American labor face competition.

Representative BROWN. So I presume you support the action taken in the Davis-Bacon Act matter yesterday?

Mr. EISNER. I support that action, although with the caveat that I wish this were part of a general policy and not simply one particular action. Again, I am in sympathy with the objectives indicated by the Council in its report, and by the President, to try to permit competition to work, and allow the free market to bring prices down. I find a tremendous gap between the stated objectives and performance.

Representative BROWN. The question I think, really boils down to, how abruptly would you do this? Would you take off price supports tomorrow, for instance, if you could?

Mr. EISNER. This is a problem of companion measures to be undertaken to remove distress. To some extent because our markets are not perfect, workers take time to move into new jobs, and the Congress might well want to devise a policy of a gradual reduction. I think this can be done if people have the intent to work it out in a reasonably efficient manner. I would try to reduce or eliminate these restrictions as promptly as possible and not allow particular selfish interest groups to obstruct it when it is not in the general interest.

Representative BROWN. I would only suggest to you that is seems to me that the case of the Davis-Bacon Act and what it applies to is quite different from the removal of price supports in a low income, low-labor cost business, and also in a low-profit margin business, where the price supports have very little impact on the total cost of the finished product, where the real costs involved are in another area of the conversion by manufacturing of these items.

But let me just say that this is evidence of one other part of the difficulty of controlling the economy with what amounts to fiscal manipulation by Government. The political resistance which is implicit, I think, in both the Davis-Bacon Act and the suggestion that we take off price supports, makes it very difficult to use that as a method of regulating the economy. And I just have to make that point. I realize that that is more our problem than it is yours.

Let me ask you about the nature of the unemployment, and all three of you, if you will, the nature of the unemployment which we are experiencing now, and its impact on consumer spending. The nature of the unemployment grew out of the cutbacks in the defense contract business initially, and in some of the other more sophisticated businesses.

Let me predicate the question with this. It seems to me that if you get into a sharp and generalized recession, that consumer spending might for a time actually—consumer savings might for a time not increase as people dipped into their savings to carry them through a short-range period of unemployment, particularly if this were true of these people who had very limited savings in the first place, if they were the ones impacted by the recession.

Now, with reference to what—I forget what Mr. Eckstein called it, I think a spreadout recession, or some such term—with reference to what has occurred in the economy over the last year and a half, and the nature of the unemployment, do you have any comment on the impact of that with reference to savings?

Mr. ECKSTEIN. The main novelty of unemployment at this time is managerial and professional unemployment. Some of this is related to the reduction in military spending. I think more of it is related to the financial squeeze of last year, and the fact that this recession came after 10 years of expansion, so that management had a chance for 10 years to just grow and grow and grow, people who were laid off had never thought of themselves as in any way economically vulnerable.

These people also have a great capacity to fall on their feet. In Massachusetts we have thousands of engineers and physicists who have been laid off. And most of them do not stay out of a job very long. A person that is highly educated and trained does find some other kind of occupation. Even in this economy they find something else to do.

There is no doubt that this has frightened a lot of people who have been spending their incomes and borrowing as much as they can. A person in the middle bracket has a good deal more discretion of what he does. And the fear of being laid off is very widespread.

So that is one of the contributing factors to consumer caution.

Representative BROWN. What you are saying in effect is, rather than buy a Cadillac, you go out and buy a Ford station wagon?

Mr. ECKSTEIN. Or fix the old one.

Representative BROWN. Go ahead.

Mr. ECKSTEIN. In other respects the unemployment at this time is not particularly odd. The only group that is doing significantly better than one would expect from past relationships is black women. The unemployment of black women is about 2 percent lower than you would have expected from the 1958 or 1961 recession.

Black men are suffering the usual double the white rate. So the usual dimensions on unemployment are not all that different, with that one exception.

Representative BROWN. What has been the history over the country recently, at least while we have been an industrialized nation, the average rate saving?

Mr. ECKSTEIN. Six percent in the United States.

Representative BROWN. How far do you go back?

Mr. ECKSTEIN. That is just going back to 1950.

Representative BROWN. What was it prior?

Mr. ECKSTEIN. In World War II it got over 25 percent.

Representative BROWN. Because of the shortage of goods and the enforced savings—not enforced, by encouraged savings?

Mr. ECKSTEIN. In the long run you really push the ability of statistics to tell you what it was. It is claimed that the figures have been stable for decades, that something like 6 percent has been saved, back to the Civil War.

Representative BROWN. Do you have any statistical information, or can any one of you three distinguished economists give me some idea that, as savings cannot stabilize forever at a figure which is considered aberrational, 7 or 7½ percent, how long is this kind of savings rate likely to continue before money burns a hole in somebody's pocket? I mean, that is another statistic that certainly goes fundamentally into this whole ground where our economy is going, and it seems to me just as significant as some of the other statistics which have been given. And it relates certainly to this figure of where the economy is headed.

Mr. EISNER. I would really like to see less attention to this particular saving rate, because people can save in various ways. For one thing, of course, the Government in a sense saves for us. We save to provide for our future. If unemployment benefits or social security benefits or retirement benefits are increased, there is a kind of saving taking place as far as the individual is concerned which would reduce his need for personal saving.

A great deal of saving has really taken place by corporations, and as far as the individuals are concerned, by their investment in the stock of corporations.

Representative BROWN. Wait just a minute. You said something I think is very interesting. You said that when there is a great deal more security provided by the Federal Government—I think I am being fair in what you are saying—that the saving rate might not be as great because people would not have to save as much. That does not seem to be historically true, if what Mr. Eckstein said is correct, that the savings rate would be 6 percent, taken all in all over the years, and now it is 7 percent. I do not follow this, Mr. Eisner.

Mr. EISNER. People save to provide presumably for their future, for their retirement largely, to some extent for an estate. And if they are rational—and we presume they are—they do not burn a hole in their pockets with money. In fact, they do not really save in the form of money. They save in the form of being entitled to pensions, they save in the form of security. And the trouble with the savings ratio we are talking about is that it is a ratio of personal saving to personal income, which is a rather peculiar measurement and leaves out a great deal of saving that takes place. And I would say, therefore, that we can expect the saving rate as we measure it to change as other components of saving change.

It would not make any sense, for example, for individuals to save as large proportion of their income if all businesses were required to provide a private pension fund which was considerably larger or if the Government provided more.

Representative BROWN. We have had more and more private pension funds, we have more and more Government care in this regard, and the saving ratio has not changed. I am lost here.

Mr. EISNER. There are many factors at work. To the extent that there is more saving by business for individuals, then the individuals will have less need to save for themselves. As we get wealthy, we may tend to save more. Saving depends upon the rate of growth, and the age distribution of the population.

It is the young that will save for their retirement years. As the age distribution levels off you will have a low proportion of saving.

Mr. ECKSTEIN. Could I add a footnote to that? From an outlook point of view, it is remarkable that we sit here with the longest period of high savings in the postwar period. We have not had a 7-percent savings 2 years in a row—in fact only one in the postwar period. So all the signs point to a return to normalcy.

On the other hand the kind of considerations that Senator Proxmire mentioned remain at present. And even though you really expect the savings rate to be low, given the great number of young families who should be stocking up on durables and buying homes and all the rest, there is no economic law that says it cannot stay high for 2 or 3 years. There are other countries that have higher rates and other countries that have lower rates.

Representative BROWN. I am going to go back to an exchange you had with Congressman Reuss about the public versus private spending. Can you give me a distinction on public spending versus private spending? Are we talking about the purpose of the spending, about who controls the spending? Can you explain that to me?

Mr. ECKSTEIN. Usually we find private spending to be where the actual outlay is controlled by a private party.

Representative BROWN. We are talking about control, is that correct?

Mr. ECKSTEIN. I think that is the essential distinction.

Representative BROWN. In other words, recreation, is that public or private spending?

Mr. ECKSTEIN. The building of a park is public. Going to a movie is private.

Representative BROWN. Going to a park is a private decision. You are talking about the decision factor. This goes into the worthy versus unworthy spending, but I am not sure I fully understand either. Is there a relation as between what is worthy spending and what is unworthy spending and public versus private spending?

Mr. ECKSTEIN. Only in the minds of men. It is a question of value judgment.

Representative BROWN. OK. Recreational spending, is that worthy or unworthy?

Mr. ECKSTEIN. It depends on the nature of the recreation.

Representative BROWN. It depends on whether it is public.

The reason I find this fascinating is that it seems to me not an economic question but a philosophical question as to what is worthy or unworthy spending. Public spending and private spending are not really worthy or unworthy on their face. I would suggest, Mr. Eckstein and gentlemen, that the war in Vietnam was not a private spending decision—maybe it was—it is a public spending decision. And it is not, I think you will all agree necessarily, a worthy decision, because it is public. So I find some difficulty in the question of whether it is more worthy or unworthy to have our spending controlled at the public level. And that is what we are talking about as opposed to the private level.

It seems to me that if we can work this economy in some way so that we can get personal spending balanced without having the Government or some other elite authoritarian, knowledgeable, worthy organization, make the decisions, that we might be just as well off. As a matter of fact, we might be better off, we can work it out so that we can maintain a balanced economy that is not an inflated or a deflated economy and still leaves some freedom to the individual.

In that regard I would like to ask for a philosophic comment, or an economic comment, either way. Are we, in this extended recession that Mr. Eckstein described, better off or worse off because it has extended? And would you suggest that it has been extended as the result of Federal policies, or extended because of its own nature, or private decisions? Can you comment on that, please? Because it seems to me in the past we have had some sharp recessions which have worked out some of the economic problems that have built up in the past.

Some of these poor Keynesians that we had manipulating the spending in 1968—I think there were some poor Keynesians around there, if I understand Keynesian economics, people who were spending in the face of a better than full employment picture into a $28 billion deficit. But can you comment on the nature of this extended recession?

Mr. ECKSTEIN. There are two sides of that. From a prosperity point of view, to have the various negative elements or recession stretched thinly over 3 or 4 years reduces the risk of a more serious disaster. The fact that housing fell early and recovered, inventories never really did decline, investment was going up while other things were going down, reduce to down risk of a severe recession, or, God forbid, a depression. You did not have any panicky fear of depression as you had in 1958, except in the stock market. That is very good in a way.

On the other hand, there is a nagging question whether you would have had a bigger impact on inflation if there had been more of a shock.

Representative BROWN. Are the benefits to be received from this situation in terms of getting out of it, or the costs of getting out of it?

Mr. ECKSTEIN. No doubt it is harder to fight inflation by this method then by the conservative, cold shower, frightening recession.

Chairman PROXMIRE. It has been called to my attention, gentlemen, that the savings function is to some extent a product of what we do in housing. Housing distorts the picture, perhaps, to some extent. That is, when there is relatively little investment in housing as compared to past experience. The saving increases, because as the consumer makes an investment in housing, and he has to pay for that over a period of time, his expenditures increase, and his savings diminish. Because savings are calculated on a net basis. Would this be an important factor, in view of the fact that we have had a housing industry in the doldrums during the latter part of the sixties, with everything else going up, would this be one of the explanations as to why savings are as high as they are, and would it also be proper to say that in view of the fact that the administration is already calculating a very sharp increase in housing—and I would agree with them, I think they are right, they estimate a 38-percent increase in housing, and I do not think that is at all beyond the possibility, and in fact likely—that if we get that, we will get a diminution in savings. All right, but that will not be reflected in any additional increase in gross national product?

Mr. ECKSTEIN. We find in our econometric studies that for every house built, about $800 is spent for something else—appliances, drapes, or furniture and whatnot. There is some stimulus out of that, but it is not decisive.

Chairman PROXMIRE. Would that explain the difference between a 7- and a 7.3-savings rate?

Mr. ECKSTEIN. No, it would not be on that order of magnitude.

Chairman PROXMIRE. Now, I would like to ask you, Mr. Eckstein—you have one of the clearest and most thoughtful analyses that I have read of the so-called econometric model. I am delighted that you put that in. I think you skipped over it in your presentations. I would like to read part of it and see if it applies to what has been called, maybe unfairly, the little black box of the administration that Mr. Okun mentioned. Here is what you say:

The recent forecasts based on monetarist models follow a different philosophy. The model is treated as if it were the true theory, and that the theory was so precise that there need be no recourse to other information than the few times series of the model. Such exercises can be illuminating for scientific purposes, for improving our understanding of the economic process. However, they are not sufficient for forecasting since they inadequately reflect the initial conditions, make no allowance for observed errors in the equations, and leave no room for the largest part of the information that is actually available about future developments.

Now, would you apply that, or would you not, to the model that has been used allegedly in the Department of Budget and Management to base the administration's forecast for the GNP?

Mr. ECKSTEIN. Yes, the comment is applicable.

Chairman PROXMIRE. And what is your analysis of that forecast? Can you give it to us now, or would you prefer to do it for the record?

Mr. ECKSTEIN. It can be done very quickly. The model is interesting, and novel. It is scientifically of such interest that one would want to see it in circulation, discussed and debated. It is a serious piece of work. It produces forecasts of that order of magnitude. There are a number of methodological questions which this is not the right forum to debate, which the economists can settle among themselves. As a forecasting device—and I am a professional forecaster—as a forecasting device it simply has the faults I have recorded here. Unless you are a true believer that there is one very precise theory which dominates human affairs—and you just survive as a forecaster with that philosophy.

Chairman PROXMIRE. The heart of this forecast was the argument that a 1-percent increase in the money supply, and the assumption that the Federal Reserve has in the past provided a given increase in money supply over a given time, but a 1-percent increase in the money supply would provide a 1-percent increase gross national product, no lag, definite, precise, and sure.

Mr. ECKSTEIN. That particular feature of the model poses the critical methodological questions. Now, the use of seasonally corrected data is not a bad idea in principle. We have all recognized that seasonal corrections filter out a lot of truth that lies in the information. But when you operate without seasonally adjusted data, you create a bunch of other problems, of which the most central one is that you may attribute causal economic relations to what is really only seasonal. Every Christmas business goes up, and the money supply is increased by the Federal Reserve to accommodate. In department store retail sales the activity goes up. The seasonally unadjusted GNP goes up as well, of course.

Well, if you then derive an equation from that, you would find that the two are closely associated. But you do not know whether the GNP is casusing the money supply, whether it is the money supply that is causing the GNP, or whether it is Christmas that is causing both. If you then attempt to raise the money supply as if it were Christmas every month, you may not get Christmas every month. That is really the heart of the controversy about this model.

Chairman PROXMIRE. And you can extend it and say the assumption is Santa Claus, and we can make Christmas every month, or the Federal Reserve can.

Mr. ECKSTEIN. If you actually give people the money, that might work out. But you do not give them the money, all you do is give the banks the reserves, and flood them with the ability to lend.

Now, again, let me emphasize that the novelty of working with unadjusted data is a contribution to knowledge. And if that paper came to the academic journal that I edit at Harvard I would probably publish it. But whether I would run the country on the basis of it, that is another question.

Chairman PROXMIRE. I think both of those conclusions are warranted.

One final question. Yesterday we had an eminent Nobel Prize winner economist, Mr. Samuelson, who did a fine job, as you gentlemen are doing today. And he came to a different conclusion than you appear to have come to on monetary policy. He said that when you get to a situation when the economy has been in recession, he compared monetary policy to a tube of toothpaste. And he said, when the toothpaste is just about out of the tube, you have to press harder to squeeze toothpaste out of it. And under present circumstances we have to press harder on monetary policies to get results.

He said that he would not object to short-term interest rates approaching zero. He said this would not shock him, and if necessary to do the job, he feels that that might be desirable policy. Do you agree with this, or would that much of an interest rate drop give you cause for concern?

Mr. Butler, would you like to get that first?

Mr. BUTLER. I would not be concerned with the decline in interest rates. I think the problem with a more rapid increase in the money supply than is now contemplated is the subsequent consequences. I think if you had the ability to step up the rate of monetary growth at the moment, and then put it back down at precisely the right time——

Chairman PROXMIRE. That is interesting, because I said, the problem that concerns me about that tube of toothpaste is that you can never get the toothpaste back into the tube. And he said, that is the trouble with analogies, that they are not appropriate. But it seems to me you ought to get that paste back into the tube, you have got it all over the sink and it will cause a lot of trouble in the future.

Mr. BUTLER. I agree with that. But it is pretty hard to get it back in. And I think this is a problem with fiscal policy, if you pushed this very hard now, I think you have got to be prepared to turn it around at precisely the right time. And I do not think we know what precisely the right time is.

Chairman PROXMIRE. What you are saying in general today is that fine-tuning is extraordinarily difficult, and that you believe in the gradual approach over a period of time, and you simply have to accept some costly penalties, but if you do not do that you are in deeper trouble?

Mr. BUTLER. That is right.

Chairman PROXMIRE. Mr. Eckstein.

Mr. ECKSTEIN. As you know from my previous history with the committee, I basically believe in expansion. And I think more times than next the Federal Reserve is too tough. But in recent months they have let the Federal fund rate, which is the most sensitive rate in the short-term money market, go down and down. Yesterday it was down to 2 percent, which is not far removed from the goal. The long-term rates have gone up in the face of the continued inflation. But the short-term rates have continued to be hammered down. So I do not see how you can criticize the Federal Reserve on that score.

To get it close to zero, as it has been at times in the past is a mistake. The banks have gotten more aggressive in the conduct of their business compared with other days, they are not the sleepy organizations that they were. To flood the newly ambitious banks, with their holding companies and desire to develop business, with unlimited reserves at no cost so that they can have free capital virtually without limit, could have an impact on the structure of the economy that we did not experience before.

Chairman PROXMIRE. Mr. Eisner.

Mr. EISNER. I would agree with Professor Samuelson, we should try to lower interest rates. I find it difficult to follow the notion that easy money would somehow be inflationary while other stimulatory measures would not be. The point is, we are trying to increase spending, public or private. Easy money would be subject to the criticism that it increases spending. Whenever people spend more there is a danger that the increased spending results in increases in prices perhaps as much as increases in output. But I see no critical difference in the effect there. If the increases in spending cause businessmen or homebuilders to find money easier to borrow and to spend more, that may drive prices up.

Chairman PROXMIRE. The difficulty is that you have that excess credit available, and it is hard then to reverse it—or is it?

Mr. EISNER. No, the excess credit is effective in the economy only to the extent that it is used to buy goods and services.

Chairman PROXMIRE. What I am concerned about is that you keep pushing it out and pushing it out and you get to a point where your economy then begins to take off and move. And you store up a lot of inflation.

Mr. EISNER. We cannot have it both ways. We are trying to get the economy to move. And to get the economy to move you have to have more spending. You can bring it back by monetary policy or fiscal policy. I was suggesting that the only counteraction is to see that the Government does at least remove the kind of restrictions that prevent competitive forces from holding prices down. And that we can do. But we have to run some risk of inflation from the spending side if we want to get rid of the unemployment and the low output. And I think the risks are no greater by expanding in the monetary direction than the fiscal direction, although I also am persuaded that the monetary route is not likely to be as effective. I think the difficulty is that it is a long path from buying securities and making money available to spending on goods and services which is our objective.

Chairman PROXMIRE. I have got a suggestion from the staff which pushes my analogy a little far. They say that the answer, when you press hard on this monetary tube, and you get too much toothpaste out, is to unroll the tube, cut off the end of the tube, stuff toothpaste back in, and then reroll the tube. It is about that difficult, I am afraid, when you get the excess credit out.

Mr. BUTLER. You would have a pretty messy tube.

Chairman PROXMIRE. That is right.

Mr. EISNER. I say, though, seriously, you really can get the money back in. There I think Congressman Brown is correct, if you want to reverse, it is easy to reverse on monetary policy, you simply sell securities in the open market, although you may not like the effect on the economy in terms of suddenly drying up sources of credit and residential construction.

Chairman PROXMIRE. You have got a lag, though. And one of the troubles we had with it was not only fiscal policy, on which Congressman Brown is really right, but that it was most harmful to have a deficit at a time when we had full employment.

You also had a monetary policy that seems to me to have been much too easy part of that time.

Congressman Brown.

Representative BROWN. I am fascinated by this idea of no interest rate on money, because that, of course, obviates liquidity as a problem for anybody. And I would like to have an arrangement like that in my business, because I would not have to make any profit, and when you lose money you can just go get more money, and you can keep your business operating. Is that right? Do I lose the point of it? Maybe I have learned more about toothpaste tubes than about economics in the last few minutes. But I read that memo, and I thought it said, give the tube back to the staff and let the staff get the toothpaste back in the tube.

Mr. ECKSTEIN. The rate we are speaking of is the Federal funds rate. The financial institution will impose a structure of charges beyond that. When the Federal fund is zero, the prime rate will still be considerable.

Representative BROWN. And I get the billions in this process, is that what you are telling me?

Mr. ECKSTEIN. That is right. It is the other end of it, the raw material of the banks. The cost of money would be virtually free, putting them at a considerable advantage in the business community.

Representative BROWN. Then I should get out of my business and get into the banking business. I think you could push it even further, that the Federal Government could take the money, and then I would really be in business, because I could make a profit in borrowing, they would pay me to take the money.

It seems to me that is a limit—the only reason I push it to that limit and beyond is that there is a limit in this regard, just as—and you can push that back—there is a limit to how far you can stimulate, and how rapidly you can stimulate or how slowly you can stimulate is really the matter at issue here. The question of how rapidly you are going to have to stimulate from the Government side to get $1,065 billion versus what may be your confidence in the ability of this 7-percent savings rate to be turned around by the individual decision of 200 million people, or whatever the economic units are, is what we are concerned about here.

Now, I have to suggest that maybe the speed of stimulation could have an overflow effect at the end of whatever the cycle of stimulation is. Would you not agree with that, Mr. Eisner, or are we that clever in the ability to turn stimulation into control mechanisms? And can you explain 1968 to me in that regard?

Mr. EISNER. I cannot maintain we are that clever. To begin with, though, we face a real cost in the lost output of unemployment people and resources. As far as 1968, I think, and before 1968, 1966, and 1967, that was a very unfortunate period. And I am on the record as being somewhat critical of some of my colleagues, and not favoring the policy being pursued with its costs. And I think it is certainly true that there should have been higher tax rates to finance the escalation of the wars.

But one of the points I have maintained is that in line with our objections to the limitations of fine tuning, it would have been impossible, no economist could rightly say that we can guarantee against inflation with the kind of massive escalation of Government expenditures in that period, on top of a relatively full employment economy. And I think economists, by the way, should not indulge in politics one way or the other, but they should state for the public, for the administration, what the consequences are, and not say that we can escalate a war and it is not going to cost us, we can have a great society, and if we raise tax rates we will not have inflation. I do not think any economists have any business suggesting that. There should be much more public rebuke of the administration for suggesting that that was likely.

Representative BROWN. Hear, hear. I agree with you 100 percent. The only thing that has to be said, I think, as a codicil to that is that we operate in a political arena, and I do not mean just the Senator and myself, I am talking about the whole Government. And so I think if there is a tendency to err it is on the side to resist that difficult part of the Keynesian decision, where you take money out of the economy or try to put a lid on the economy, or on the other hand, as has been suggested, I think, by Mr. Butler, there is a tendency to err on the side of overstimulation when a problem develops within the economy because it becomes, not an economic decision in terms of attaining stability, but a political decision in terms of, my God, let us get out of this trough we are in, because we will suffer if we do not; and if we do not do it quickly, the problem, then, becomes at the other end of the scale, How do we get it under control, and balance the situation at the other end?

Let me ask, however, in that regard, if, then, there is maybe some more merit than has been generally given consideration in the idea of stimulating what the consumer might do—and here I refer not just to the corporate consumer, but also to the private consumer—I had better say it the other way—the private consumer and the corporate consumer, the business consumer. Are we taking into account or not the possibility of using a flexible tax policy in this regard? You gentlemen have all suggested in one form or other. And I would just like to ask as to whether or not the idea of stimulating corporate spending by a tax reduction is more effective than a general tax reduction for everybody, or whether the social security nonpayment of taxes is more effective than generalized tax reduction. I am a little concerned—regardless of the nature of whether the social security tax comes from, who pays it—I am more concerned about the sanctity of the social security program and whether you are taking money—whether you are using that as a fiscal mechanism, I am a little concerned about that. I did not think that is really the kind of policy that I would want to get into. I would like to keep the social security a little more sacred than that.

But what about the fiscal mechanism of tax reduction across the board generally, either a flat rate across the board, or a rate changeable with the needs of the individual and the society, and his project of spending the money if he gets the tax reduction?

I would like to have all of you comment on that.

Mr. EISNER. The tax variation can tend to be less effective because of the transitory nature of tax changes, and not having as large an impact on spending as we would expect from a permanent tax increase.

Representative BROWN. Just a minute, Mr. Eisner. Let me pursue that with you. The transitory nature of tax changes, what about the transitory nature of fiscal spending, which is the other side of that problem? Isn't that all tax——

Mr. EISNER. I am glad you put it precisely that way. If by spending we mean the Federal Government simply giving someone more money, that again may prove to be transitory. If the Federal Government, or any government, immediately spends the money to buy goods and services to have production undertaken, that production is undertaken. So if the Government were to go out and spend a billion dollars to build a road or to build schools, that road and those schools are being built as the money is being spent, and workers are being employed doing it. If a billion dollars are given to people in the way of tax reduction, they may spend some of it, they may spend all of it, they may spend it promptly, or they may spend it later.

Representative BROWN. In other words, you may curb the savings right up to, 9 or 10 percent——

Mr. EISNER. My written article calls attention to what happened in 1968 when the imposition of a surcharge had the effect very largely of changing the saving rate that was measured rather than changing consumption as we wished.

Representative BROWN. Just a minute. Wouldn't that depend on the savings rate that you got when you injected the money? In other words, if your savings rate is, say, down to 5 percent, and you inject money in, you might push that savings rate back up to 6 percent. It might resist going higher. On the other hand, if it is 7 percent, or plus 7 percent, as it is now, which we have identified as aberrational, or I assume that we conclude that it is relatively aberrational, if you inject your money into the economy by a tax reduction, wouldn't the tendency be to think that that money would find its way moving through the economy rather than by increasing savings?

Mr. EISNER. This may depend on several features. I would not refer to it as injecting money into the economy. That is something else again.

Representative BROWN. Not take it out?

Mr. EISNER. Yes. And I think it may make a difference what tax rates are affected. As Mr. Eckstein did point out, there is evidence that lower income people do not have much discretion. And I think if you are to change a tax rate there is an argument there for changing the social security tax, but not increasing the social security base.

Representative BROWN. The social security tax rate that you are suggesting, is not that also affecting industry?

Mr. EISNER. To the extent that it affects industry I think would have less of an effect on spending. For here is the other distinction I would make. Individuals tend to spend. All of our theory and evidences suggest that individuals will spend. One of the prime determinants of their spending will be their income.

Representative BROWN. Excuse me just a minute, but that is exactly the point I was making about the unemployment a minute ago. I concur in that. Go ahead.

Mr. EISNER. But a prime determinant of business spending, if the businesses are rational, is not their income position, but what the spending will do for their profit. Profitability is the correct word, but it means not what you happened to have earned, although that may well influence an individual business in terms of liquidity concerns, and I think small businesses much more than large, because they will have liquidity concerns. But it would be foolish for a large business to go out and spend more to expand its factory, to accumulate inventory, simply because it has the money.

Representative BROWN. Of course, it would. But it is not unknown, I think, that a business may hold off on going out and making such an investment until it gets its liquidity position back in a safe position. Is that correct?

Mr. EISNER. To some extent. But years ago I interviewed a lot of large business executives. I have done a lot of work on empirical data, and econometric estimation. I do not want to discount it completely. There is a substantial myth about this, which does injustice, I think, to the profit system. The myth is that you spend money when you have it. If that is the way we operate we are not doing any better than the Russians with their bureaucratic system, where any time a manager has money he will spend it. Our notion is that they spend to maximize profit and to reduce costs. And it is true of course in this case.

Representative BROWN. Would you apply that to the individual consumers?

Mr. EISNER. The individual consumer is spending to maximize his own welfare. And his major constrant is the income he has. But of course it is not just the income he has this year, it is the income he will spend in the future, it is the wealth he has. And these psychological factors then will operate. If he expects he may be unemployed next year he is likely to spend less out of his current income than if he looks forward to a growing prosperity.

Representative BROWN. Would you suggest that the increase in the savings rate might have something to do with whether or not the consumer anticipates that prices will be radically higher, or just a little higher, or essentially the same?

Mr. EISNER. Yes. Although this operates two ways. You have to keep sight of both. One way is that if he expects prices to be higher next year he may try to spend now rather than wait for higher prices. On the other hand, if he expects his own income is not going to go up as much as prices, he may say, prices are going to be higher, my income will not be higher, and I may not be as well off next year, and I had better not spend so much now, I had better keep more for next year. And both factors have to be kept in mind.

Representative BROWN. The question I would like to go back to again is whether a generalized tax reduction across the board in some way might not be as desirable as the nonpayment of the social security tax increase, or in effect fiscal policy.

Mr. Eckstein.

Mr. ECKSTEIN. We have just reformed depreciation. And this is in effect a $4 billion corporate tax reduction, at least in terms of money. So I feel we have taken a major step to facilitate liquidity and provide some extra incentive to investment, and I think it will have a significant effect at some point.

Now, fiscal policy is really a question of finding opportunities where you can do something. It always turns out that in the spending area they are very limited. Most things take too long, and there are questions of efficiency. On the tax side, it is a major undertaking to change the tax system or to get a tax cut or increase through the Congress. The social security matter is really the great opportunity at the moment. Of course, you——

Representative BROWN. You are saying simply because it is there?

Mr. ECKSTEIN. It is there, and it is easy, although you certainly would want to consult the actuaries of the Social Security Administration before you accept my judgment on it. It is my impression that the system could stand that year of delay of the tax increase without violating any of the rules which apply to that trust fund.

Representative BROWN. How long did you say, 1 year?

Mr. ECKSTEIN. At least 1 year. I will not say longer than necessary. The system has run a very substantial surplus in recent years, which was not intended. And the recent benefit increase was offset by a tax change which has gone into effect, it is now a question whether the new benefit increases require a coincident tax change. My own arithmetic suggests that by actuarial principles the funds can easily stand it.

Representative BROWN. Do you think it is a good habit to get into?

Mr. ECKSTEIN. Well, we already last year raised the benefits before the taxes. So we have lost our virginity already.

Representative BROWN. Do you think that is a good precedent to establish?

Mr. ECKSTEIN. Actually it is not a precedent that is new.

Representative BROWN. Let me ask you the impact on consumer spending.

Mr. ECKSTEIN. What it would mean actually is that come July or August, September or October, instead of raising the earnings base and then continuing withholding through those months, you stopped withholding the payroll tax as you do every other year. People are not thinking about that now. But in the ordinary course of events we will find that when we have finished with the auto catch-up and the steel hoarding—and maybe have a steel strike when the economy is slowing down again, we will be prolonging withholding of social security taxes.

Representative BROWN. You do not think that somebody in an article in the Reader's Digest or some place like that would start worrying about whether the social security system was actuarially sound if you started fiddling around with it as an operation of the economy?

Mr. ECKSTEIN. I think the actuaries of that administration would approve it.

Representative BROWN. I did not ask you that question. I have asked you twice, do you think the consumer is going to worry about somebody fiddling around with the social security system, or if he is going to decide whether, instead of saving 7 percent for his old age he ought to save 10 percent? The reason I ask the question is because a couple of years ago somehow or another there was a lot of talk going around about whether or not the social security system is actuarially sound. And I answered mail until it ran out of my ears trying to explain that the social security system was actuarially sound in terms of the money being there when we got old. And it can happen. My question is whether you think it might. And I think the answer is fairly obvious.

Mr. ECKSTEIN. I think one would have to persuade the constituency of the social security system—I not only mean the aged, but the people who follow it closely—the people who would write those Reader's Digest articles—that the move that was being made was within the principles of the system. I am not advocating a subordination of those principles for the sake of stabilization policy, which I believe would be a mistake. But the point is that even within the rules that have been devised, the tax could be delayed.

Representative BROWN. I would suggest that we assign that responsibility to the same person in the Government, the Government economist who has been assigned the responsibility of getting that saving down to 7 percent.

Mr. Butler, would you like to comment on my suggestions as to a generalized tax reduction as opposed to a social security or a tax deferral?

Mr. BUTLER. Well, I am all for greater flexibility in the tax system. I think it is one of the very useful things that could be done if it were politically possible. But I think you would have to have flexibility both ways if you were to reduce taxes. You might have to be willing to increase them next year. And I think that is a little harder to do.

Representative BROWN. Just like holding down Federal spending increases, a political decision? Do you think that we should consider it as opposed to fiscal policy changes in terms of spending?

Mr. BUTLER. I think if we could get some sort of an agreement on the rate of flexibility perhaps giving the administration greater discretion to change the taxes both ways, I would be in favor of that. I fear that if you put in a temporary tax cut this year that would turn out to be permanent. So you would have a problem later on.

Representative BROWN. Suffice it to say that this is a whole package, then, of policies, is it not? We have got the depreciation allowance, we have got the possibility of an investment tax credit, we have got excise taxes that we can take off or put on or increase or decrease. I am not sure that I am totally sold on excise taxes. I think there is a corporate benefit for the airlines in taking off excise taxes on airplane tickets, but I am not sure that that is going to be the same genre as the generalized tax reduction in terms of stimulating the economy or in terms of the social security stimulating economy. I think fundamentally the generalized tax reduction across the board would be more stimulative than social security—than not adding, in what might be called timely fashion, a security tax increase with respect to the actuary of the social security system. Certainly fiscal policy plays a part and monetary policy plays a part.

And I think the discussion has been invaluable in terms of exercising perhaps our differences of opinion as to which steps ought to be taken at this time, and how rapidly they should be taken. And I am one who found the testimony quite interesting.

I appreciate you gentlemen being with us today. Thank you very much.

Chairman PROXMIRE. I want to thank you, gentlemen, so much for very fine statements and most responsive replies to our quesions. You have certainly contributed very well to our record.

The committee will stand in recess until tomorrow morning at 10 o'clock, when we reconvene to hear Prof. Karl Brunner, Prof. Robert Lekachman, and Mr. George Perry. That will be in G-308.

Thank you, gentlemen.

The committee is now adjourned.

(Whereupon, at 1 p.m., the committee adjourned, to reconvene at 10 a.m., Thursday, February 25, 1971.)

THE 1971 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 25, 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, Javits, and Pearson; and Representative Blackburn.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowsky, research economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

We are happy to announce this morning that we have a new member of our committee present, Congressman Ben Blackburn, Republican, of Georgia. Mr. Blackburn has been on the House Banking Committee for some years, and is a most distinguished member. And in many ways he is a kindred soul as far as I am concerned, because electing a Republican in Georgia is like electing a Democrat in Wisconsin, maybe harder. In fact, I understand that Mr. Blackburn is the first Republican ever to be elected in his congressional district. I am delighted to see the two-party system working so well south of the border, and I hope it continues to work as well as it has recently in our State.

In the hearings that have been held to date during our annual series, the committee has been disabused—with the exception of the testimony of the Council of Economic Advisers and Mr. George Shultz—of any expectation that a gross national product of $1,065 billion will probably be realized in 1971.

Chairman Arthur Burns termed the administration's figure highly optimistic, and Nobel Laureate Paul Samuelson said, "No responsible jury of informed persons can agree that the Nixon team forecast of the money GNP for 1971 of $1,065 billion is warranted."

Yesterday Prof. Otto Eckstein submitted a prediction revised as of February 15 totaling $1,045 billion. Like sentiments have been expressed by virtually all the other private witnesses appearing before us this week.

Viewed in detail, the prospect looks even gloomier. As of the end of 1971, this country is likely to be suffering still from an unemployment rate of over 5 percent and from excessive annual increases in prices.

Given the political pressures that are certain to arise from persistent high unemployment, particularly if the administration target projection appears to be out of reach as the year progresses, demands for more vigorous expansionary policies will tend to grow. But if we try to pump up the economy quickly without carefully designing manpower programs in advance, the danger will arise that the rate of inflation will persist at an unacceptable level, or even increase.

Today we have with us as one of our witnesses, Mr. George L. Perry of the Brookings Institution, who argues that the tradeoff between inflation and unemployment has become more adverse in the past decade. I am confident that Mr. Perry was seeking, as an economic analyst, an explanation for the failure of inflation to subside more rapidly in the face of high unemployment. In a political context, however, his analysis can easily be turned on its head.

This worsened tradeoff between inflation and unemployment can be used as an excuse for tolerating higher levels of unemployment for longer periods than we were willing to allow in the past. The low-income workers who are currently unemployed as a result of the administration's anti-inflationary policies had no part in the decisions that fueled the inflation, but these individuals involuntarily bear the heaviest costs of attempting to get the economy back on an even keel.

Some economists, including apparently Prof. Robert Lekachman from the State university of New York at Stony Brook, another of today's witnesses, believe that the present social costs of fighting inflation can be reduced substantially by the use of a wage-price freeze and/or subsequent guidelines. Many of this group also believe that guidelines will be necessary if the performance of the American economy is to be satisfactory in the future.

Our third witness is Prof. Karl Brunner of Ohio State University, a noted monetarist. I understand his position is that of opposition to the use of wage-price guidelines of any type. I am sure you are all concerned about minimizing the combined social costs of inflation and unemployment, and I look forward to a profitable discussion.

Mr. Perry, why don't you lead off. And I might say that you can handle your testimony any way you wish, if you wish to summarize it, your entire statement will be printed in full in the record.

And that applies to the other two panelists also.

Mr. Perry, we shall be glad to hear from you at this time, sir.

STATEMENT OF GEORGE L. PERRY, SENIOR FELLOW, BROOKINGS INSTITUTION [1]

Mr. PERRY. Thank you, Mr. Chairman.

I have prepared a fairly brief written testimony. So let me talk quickly from it.

Repeatedly during the last 2 years we heard the official forecast that inflation would soon recede and that the policies being followed were adequate. It was a bad forecast. The policies were not adequate, and inflation is stronger today than it was 2 years ago. Now we have acquired an unemployment problem to go with inflation and again we

[1] The views expressed are my own and are not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

are told that the policies being pursued are adequate and will reduce unemployment sharply in the near future. I think the administration's unemployment forecast is mistaken and that accepting it will again make policy complacent when it should not be.

I hasten to emphasize that I am not criticizing the administration for failing to forecast how stubborn inflation would be—we all failed in this to some extent—but for refusing to pursue a forceful incomes policy that would have made its forecast more probable and minimized the unemployment cost of bringing inflation under control. And now I would urge a more expansionary fiscal policy in order to make the meaningful reduction in unemployment that is being forecast more than a very chancy longshot.

You have had ample testimony questioning the $1,065 billion GNP forecast for 1971. My own view is that GNP is more likely to be some $15 billion lower than this with the policies that have been proposed. The Economic Report argues that the Government's high forecast is based on policies designed to bring it about which we private forecasters could not have anticipated. But the fact is that the fiscal policy implied in the new budget is not particularly stimulative and is little changed from present estimates of the fiscal stimulus in this year's budget.

The administration has properly highlighted the full employment surplus in the budget as an indicator of its fiscal policy. But the indicator tells me policy is not right today. On the national incomes accounts basis, the full employment surplus will increase slightly between fiscal years 1971 and 1972, from $3 billion to $4½ billion. Between calendar year 1970 and calendar year 1971, the full employment surplus will decline slightly, from about $6½ billion to $5½ billion. Neither of these changes is substantial enough to indicate an important shift in the thrust of fiscal policy. And the modest full employment surpluses throughout the period do not promise the push needed to overcome the clearly lethargic state of private demands in prospect today. If we want a rapid enough expansion to reduce unemployment substantially, the right thing to do today is run a full employment deficit. This means there is room for several billion dollars worth of additional expenditures in the fiscal 1972 budget now before the Congress.

With fiscal policy offering no major new thrust to the economy, the administration's reliance on monetary policy to help achieve the projected $1,065 billion GNP deserves closer attention. Discussions of the 1971 outlook have centered around one summary measure of monetary policy—the needed rate of growth in the money supply. I believe monetary policy is a good deal more complicated than attention to that summary measure alone suggests; at a minimum, interest rates should get equal billing. Also easy money takes time to work its effects on the economy. But even skirting these issues, it seems unrealistic to characterize recent growth rates of the money supply—say up to a 6-percent rate—as consistent with a $1,065 billion GNP. We have to allow for a nearly 4½ percent growth in the money supply simply to accommodate the expected increase in prices. Although historical experience has varied a great deal, we should certainly expect that more than an additional 1½ percent of money supply growth would be associated with the 4½ percent real GNP growth in the forecast. Indeed, with the lags that many studies indicate, it would take a great deal more than an additional 1½ percent, since recent monetary growth rates have been modest, especially after adjusting for price increases. Finally, the need to keep interest rates low in order to promote a rapid GNP advance adds to the evidence that an exceptionally rapid growth in the real money supply would be needed.

Quite apart from whether the Federal Reserve could bring about the forecast GNP advance by doing its best to pump money into the economy at some rapid predetermined rate, it seems doubtful that exceptional rates of monetary expansion are being contemplated. If monetary policy is to help provide a strong economic expansion we can hope that fixed speed limits on the growth of the money supply be at least temporarily suspended, and that policy continues to keep credit markets easy and push down long-term interest rates.

If both fiscal and monetary policy support expansion vigorously, I would expect the economy to outperform the present consensus forecast. And this is what we should all hope for.

Turn now to the problem of our stubborn inflation, I am convinced that the need for a direct attack on it is greater than ever and greater than most people had thought. Most obviously, inflation is still with us after 2 years of a deliberate slowdown in the economy which has raised the unemployment rate to 6 percent. It takes a very close look at the data, and perhaps a little wishful thinking, to discern any improvement on the inflation front. In the fourth quarter of last year, the consumer price index rose at a 5½ percent annual rate, industrial wholesale prices rose at a 4½ percent annual rate, and the GNP deflator (which was adversely affected by the automobile strike) rose at nearly a 6-percent annual rate. But more fundamentally, some recent research based on the composition of unemployment convinces me that the tradeoff that we face between inflation and unemployment has worsened. In the absence of direct policies to improve the tradeoff this will leave us accepting much more unemployment than we like if we are really to contain inflation or accepting much more inflation than we like if we are really to reduce unemployment to near the 4 percent level. If I can briefly summarize the research behind these conclusions, it will help to indicate the nature of the problem and what might usefully be done about it.

The tighter labor markets become, the faster average wages rise and the more inflation we get. This is what lies behind the observed concept of a tradeoff between inflation and unemployment. But in recent years, the aggregate unemployment rate has been given an increasingly inaccurate picture of labor market tightness compared with earlier periods. Both because their productivity is lower and because they offer fewer hours of work, unemployed women, and even more importantly young people, represent a smaller increment to the available labor supply than do unemployed prime-age men (25 to 64 years old). Thus they exert less downward pressure on average wages than do unemployed male workers in the prime-age group. It is important to take account of this because in recent years of high employment—such as 1968 and 1969—the proportion of all unemployment accounted for by prime-age men has gone down sharply. In 1956, 38 percent of the unemployed were prime-age men; in 1969, only 23 percent. Between the same 2 years, the fraction of the unemployed of both sexes who were under age 25 rose from less than a third to a half.

In order to take account of this changing composition of unemployment, I have created what I call a weighted unemployment rate which assigns different weights to different individuals in the labor market. These weights stand for how large an effective labor supply each represents, and hence how much downward pressure each brings on wages when unemployed. By contrast, the official unemployment rate gives each worker an implicit weight of one, implying, to take an extreme example, that an unemployed teenager looking for part-time work has the same effect on labor supply as an unemployed 30 year-old man. The weighted unemployment rate shows labor markets were much tighter in 1968 and 1969 than the official unemployment rate would have led one to believe.

Although the number of young people and women in the labor force has grown sharply over this period, it is not this change in the composition of the labor force that has caused this result, but rather the relative deterioration of the unemployment rates in these groups. Where in 1956, the unemployment-rate for all workers under age 25 was three times as great as the unemployment rate for prime-age men, in 1969 it was five times as great. The unemployment rate for prime-age women went from 1.6 times to 1.9 times the prime-age men's rate between these years. As a result, in 1969 the aggregate unemployment rate of 3.5 percent was made up of disproportionately high unemployment rates among those workers that exert disproportionately small downward pressures on wages, alongside extremely low unemployment rates for prime-age workers that created very strong upward wage pressures. I estimate that with these discrepancies in unemployment rates for different groups, and particularly the high rates experienced by young workers, today we face about 1½ percent faster inflation for any given aggregate unemployment rate than we did in the 1950's.

I should stress that I would not regard as normal a labor market in which unemployment rates were the same in all groups. There are good reasons to expect higher unemployment rates for some groups of workers than for others. We have always observed higher unemployment rates for young workers and for women than for prime-age men. It is not the existence of differences that matters here; it is the way these differences have grown. And it is not only undesirable in itself that some groups experience such a bad employment experience; but as these results indicate, it is undesirable for the inflation-unemployment tradeoff that we have to live with.

I draw two lessons from these results, one general and one quite specific to them. The general one is that we need an incomes policy to help us deal with inflation even more today than we used to. This follows simply from the evidence that the inflation-unemployment tradeoff has deteriorated. If you think you are a bit ill and a doctor prescribes some unpalatable medicine, you might choose the mild illness in favor of the cure. But if you get evidence that the illness is a good deal more serious, you should be more willing to take the medicine. I think we are in that position with respect to inflation on the basis of these findings. An incomes policy may not address the sepcific source of the deterioration of the tradeoff that I have referred to; but to the extent that the tradeoff has deteriorated for whatever reason, the need to try to improve it by any means is that much greater.

The same study that identified this worsening tradeoff confirmed that the wage-price guideposts had helped contain inflation during the years they were used. It showed that during the 1962 to 1966 period, inflation averaged roughly 1 percent a year less as a result of the guideposts than it would have averaged without them. This was very nearly the same impact I had estimated for the guideposts in an earlier study.

The second lesson I draw from these findings does follow from the particular source of the deterioration I have pointed to. The normal workings of labor markets as unemployment rates dropped has not been successful enough in reducing unemployment among certain groups in the economy, particularly among young people. This is counter to what most people had expected. I certainly admit it is counter to my own expectations. One would have though that as labor markets for prime-age male workers grew tighter and tighter employers would turn increasingly to secondary workers and their unemployment rates would be reduced disproportionately. That unemployment disparities grew rather than growing smaller as the overall labor market tightened is thus the surprising thing. It means we have to regard the unemployment of young people as a particular problem which will not be solved by aggregate demand expansion alone. Trying to bring down unemployment in these groups by expanding aggregate demand further and further led us to an extremely inflationary overall labor market without a sufficient improvement in the unemployment experience of these groups. We need programs specifically aimed at improving the employment situation of young people. If we can do this, it would improve the aggregate inflation-unemployment tradeoff substantially, permitting us to operate the economy at high employment levels without repeating the inflation experience of the late 1960's.

One barrier to employment of young people is the minimum wage law. I believe it would be helpful if it did not apply to them. But the most direct way to get at the employment problems in the young age groups is through a public employment program. It may be the only way to make a really big improvement. I would hope such a program would be structured to encourage mobility into private sector jobs. I would hope it would provide training in useful work skills. I would hope it would involve badly needed and useful work rather than boondoggling. But I would not be disuaded if we could not reach the ideal in such a program. The alternative is worse.

Some might argue that the changed composition of unemployment makes unemployment a less important problem than it was. This amounts to saying that those workers to whom I have assigned low weights for analyzing the inflation problem should also be assigned low weights on some equity scale that tells us whose unemployment to ignore. But these are two quite different things. In my weighting, a prime-age woman counts for about half as much as a prime-age man; but this is a technical statement about their comparative impact in a measure of overall labor supply, not a statement that a man's unemployment should concern us twice as much as a woman's. Boys under age 20 have only one-fifth the weight of prime-age men in my weighting; but this does not imply policy should be equally concerned about the unemployment of one man or five youths. In short, the weighting scheme I have used to explain inflation carries no necessary implication about who should be unemployed.

One could argue that society's greatest responsibility is to provide an attractive labor market for young, new entrants into the work force. This would be the last step in fulfilling its acknowledged responsibility to prepare the young for a productive adult life. Yet this implies that individuals with the lowest weights in the present measure—and the highest unemployment rates of all age groups—would get the highest social priority for their employment.

In closing, let me reiterate four main points:

The Government's high GNP forecast runs the risk of making us too complacent about how much policy push we need today. We need more than is now contemplated.

The tradeoff between inflation and unemployment has worsened and specific anti-inflation policies are needed.

Programs to reduce the unemployment of young people would be particularly helpful in improving the inflation-unemployment tradeoff. A public employment program for young workers would thus be a useful weapon against inflation.

There is good evidence that wage-price guideposts were effective in containing inflation and a new, forceful incomes policy should be instituted now.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Perry.

Mr. Lekachman is our next panelist. You may proceed, sir.

STATEMENT OF ROBERT LEKACHMAN, PROFESSOR OF ECONOMICS, STATE UNIVERSITY OF NEW YORK AT STONY BROOK

Mr. LEKACHMAN. Thank you, Mr. Chairman.

I will follow my comparatively brief prepared statement, I will skim and skip.

In a very large percentage of instances I find myself in agreement with Mr. Perry.

Chairman PROXMIRE. Then the entire prepared statement will be printed in the record at the end of your oral statement.

Mr. LEKACHMAN. I do not see any need to do more than to add my vote to the litany of complaints about the first 2 years of the President's economic policy. It has been clearly a failure. There is no need to reiterate that.

I do, however, want to concentrate on the reasons why Nixon's economic policy Mark II is only marginally superior to its discredited predecessor. Here the President's celebrated remark "I am now a Keynesian in economics," ought to be evaluated. Keynes himself had an opinion worth reporting about the durability of economic ideas and the relationship between such ideas and political reasons. In a closing paragraph of the general theory published at the end of 1935 he had this to say:

> . . . the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from all intellectual influences, are usually the slaves of some defunct economist.

It would not have shocked Keynes even to consider the possibility that 36 years later he is somewhat defunct himself. He was the owner of one of the century's most agile minds. He would have expected that his own theories require drastic revision. Indeed he would be leading the revision if he were still alive.

This administration's Keynesianism—and here I agree entirely with Mr. Perry—is timid even by the criteria of 1935.

The budget deficit is entirely too small. And it is hard to understand exactly how the administration came to its conclusion.

I suggest that conceivably the presence of Mr. Shultz is a personal explanation.

An alternative explanation is the pessimism which any detailed inquiry into the components of gross national product is likely to produce.

It is true that consumer savings rates out of disposable income are historically quite high. But to infer from that they are going to drop seems to me entirely unfounded.

There is little sign that investment is boming, housing aside.

And in fact it is very, very puzzling even as a target, to understand how the administration produced this particular figure. I have read stories of a magical monetary model which is in high favor in the White House. But its magic is certainly undemonstrated, and until it is demonstrated, subject to some skepticism.

I come to a further point here. If by some chance the path of economic expansion is more rapid than most private economists believe it will be, that is to say, if events seem to follow the time path which the administration forecasts, the administration's simple-minded Keynesianism is going to come to further difficulty.

My assumption is that any real rapid growth is going to intensify inflationary pressures, pressures which have not subsided at this point. I find it very hard to believe that Mr. Arthur Burns, a cautious man, is going to underwrite a new inflationary impetus by expanding the money supply at the minimum 6 percent rate which Mr. McCracken and his colleagues appeared to favor.

What is unhappily quite possible, it appears to me, is a scenario of the following variety: an acceleration of price inflation, if the economy expands fairly rapidly, a reduction by the Federal Reserve in the rate at which it creates new money; and finally, either a replay of the Treasury-Federal Reserve confrontations of the Truman era or a retreat by the White House even from its modest fiscal expansion. Either outcome is guaranteed to nip an emerging recovery long before it flowers. Once faith and hope are excluded, there is no special reason to anticipate a noninflationary expansion of the character predicted by the administration's advisers.

I turn next to a more desirable economic policy. And here it seems to me that there are four elements. The first is a deliberate target of a substantial deficit in the full employment budget, at a guess of the order of $8 to $10 billion.

There seems to be some danger, judging from recent administration statements, that the old orthodoxy of a conventionally balanced budget is now being replaced by a new orthodoxy, that the full employment budget must always be in balance. This seems as foolish a guide to policy, very nearly, as the one which it replaces. The budget is an instrument of economic stabilization. And the sums that are required as deficits or surplus should be those which are evoked by desirable policy.

The second requirement of sensible policy in this room is a strongly expansionary monetary policy. The Federal Reserve Board is notoriously independent. I would parenthetically like to see it become less independent. But it is as of now certainly an independent agency. As I said, I find it difficult to imagine Mr. Burns permitting the requisite expansion save in the presence of the third element of desirable policy, which is a workable income policy. This is what I take it would reassure Mr. Burns and his colleagues. He has been in fact sending up smoke signals ever since at least his Pepperdine College address in December to the President about the desirability of an incomes policy.

The fact of the necessity of an incomes policy is related to a circumstance that economists are not invariably willing to assign proper weight to. This is the fact that this is, to say the least of it, an economy which is imperfectly guided by market forces. Prices, incomes, employment, are heavily influenced by the decisions of the giant oligopolies which dominate manufacturing and utilities, the major unions, which face them across the collective-bargaining tables, and the AMA teaching hospital complex which determines the structure of medical cost.

The potentates who run these organizations are of course influenced by market forces. Nevertheless, typically they exercise considerable discretion in their response to market exigencies. Thus it was that Bethlehem Steel, in the midst of a spell of flagging sales and fierce foreign competition, could propose to raise many of its prices over 12 percent. It knew that at least in the absence of public intervention, its rivals would happily follow its lead. There would be no unseemly price competition.

Although Presidential intervention halved the projected price escalation, there is still something odd about increased prices in the place of flagging sales.

Equally odd from the standpoint of a belief in competition has been the ability of construction unions to bargain for wage increases as large as 25 percent in the presence of 11-percent unemployment among their members.

Both cases are illustrations from the large universe of the reality of market power. Bethlehem was able to choose quite deliberately higher prices and lower sales. The construction unions tacitly chose fewer jobs at higher wages over more jobs at lower wages.

We have known ever since 1776 at least that the only thing which makes the greed of businessmen tolerable is the pressure of competition upon them. Where the competition is lacking, there is no such protection.

The argument is compelling, then, either for militant antitrust—which I do not take to be a live political option in our time, whatever its merits—or the gross incomes policy.

On the incomes policy issue, I think that a good deal more is required than jawboning or even a combination of jawboning with the resurrection of the wage-price guideposts.

I agree that the guideposts had a perceptible anti-inflationary impact in the middle sixties. But they operated at their best in an era which is substantially different from ours, a period which trailed after 8 years of slow economic growth, three recessions, and high average rates of unemployment.

Although the social costs of Eisenhower's economic policy were much too high to encourage repetition, it must be conceded that 8 years of frugality certainly did rid Americans in the early 1960's of the inflationary expectations that they had harbored. Today the inflationary expectations are back. There has been a long period in which people who bet on inflation won their gamble.

The need arises today, therefore, for stronger medicine in the shape of mandatory controls. My own preference here combines a dash of Robert Roosa with a dram of J. K. Galbraith, which is to say to me it makes sense to freeze wages and prices for 6 months or so and to employ the time to design a set of selective wage and price controls a la Galbraith.

I share Galbraith's view that the place to impose price controls is where the market is least free. This, happily, is administratively convenient as well. It is far easier to regulate Fortune's 500 industrial corporations and the unions with which they deal than it is to supervise a myriad of small businessmen and merchants.

If the economy in 1971 is to move into a vigorous recovery, monetary and fiscal policy must march in step. It is almost certain that the prerequisite for such disciplined harmony of movement is administrative restraint of the key wage and price decisions. Such restraint will allay the inflationary fears of the central bankers and encourages the White House to persevere in its promise of budgetary stimulation.

The fourth pillar, it seems to me, of sensible economic policy this year harks back to Mr. Perry's remarks. It is clear that we need a sensible manpower policy. I agree that unemployment is not yielding adequately to purely aggregative measures. And I share a favorable view of public service employment. And I deplore the fact that the President during the last session vetoed a measure which would have made a start in this direction.

By preference, I would extend the public service employment to more groups than the youthful.

I bear in mind that only a few years ago President Johnson's Automatic Commission made a survey of the unfilled public service jobs by the criteria of staffing at that time, no higher criteria. At that time there were 5,300,000 public service jobs unfilled for want of funds on the part of the parks, museums, law enforcement agencies, and so on, to fill those jobs. I scarcely think that the deficit is smaller now.

I conclude, then, simply by stating, or restating, the four targets:

A full employment budget deficit in the $8 to $10 billion range.

An expansionary monetary policy, possibly monetary growth at rates between 7 and 8 percent for the year.

A wage-price freeze, gradually relaxing as selective controls are introduced.

And finally, a manpower policy which attacks some of the components, the most recalcitrant components, of unemployment, preferably by the technique of public service employment.

Thank you.

Chairman Proxmire. Thank you, Mr. Lekachman.

Your prepared statement will be inserted in the record at this point.

(The prepared statement of Mr. Lekachman follows:)

Prepared Statement of Robert Lekachman

There is no need here to reiterate the failures of the initial Administration game plan. Mr. Nixon's original promise to control inflation without significantly increasing unemployment has been translated in real life into 6 per cent unemployment and consumer price inflation of approximately the same figure. The tale is as familiar as it is dispiriting.

I intend today to identify the reasons why Nixon economic policy Mark II is only marginally superior to its discredited predecessor. Here the President's celebrated remark, "I am now a Keynesian in economics", ought to be evaluated within the context of the present adequacy of Keynesian policy. Keynes himself had an opinion worth recalling about the durability of economic ideas and the relationship between such ideas and political action. In the closing paragraph of *The General Theory of Employment, Interest and Money* published in England at the end of 1935 he had this to say:

". . . the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from all intellectual influences, are usually the slaves of some defunct economist."

It would not have shocked Keynes, the owner of one of the century's most agile minds, to observe that after a third of a century his theories of economic behavior and economic policy required drastic revision. Were he still alive, he would no doubt be leading the revisionists.

Certainly this Administration's Keynesianism is timid at least even by the criteria of 1935. The Administration now estimates a budget deficit of $18.6 billion in fiscal 1971. Obviously this substantial sum was too small to overcome the forces of recession as the unemployment and output statistics demonstrate. Hence it is not intuitively obvious why a substantially smaller deficit of $11.6 billion for fiscal 1972 should be the salvation of the economy. The difficulties in the path of aspiring true believers are accentuated by the refusal of both the Council of Economic Advisers and the Office of Budget and Management to make the detailed sectoral forecasts upon which administration economists have in the past relied.

One explanation of the omission might be the presence in the White House of a powerful surrogate for Dr. Milton Friedman, the puissant Dr. George Schultz. An alternative explanation is the pessimism which such detailed inquiry is highly likely to instill. The respected University of Michigan continuing survey of consumer attitudes and intentions identifies few signs that ordinary Americans, afflicted by uncertainties about prices and jobs, are about to turn cheerful, run to the stores, and happily increase their burden of debt. Indeed wistful expectations that consumers will save less and spend more appear to be based on little more than the historical observation that in most years consumers have saved smaller percentages of their disposable income than lately they have been doing.

Will business investment be the answer? According to recent surveys, business spending on capital goods, a key element in any sustained expansion, will increase only moderately during the rest of 1971. If, as is now anticipated, dollar expenditures on capital goods rise by under 2 per cent, real investment will of course shrink, possibly by as much as 3–4 per cent. Nor are the revised depreciation rules a panacea. At Harvard, Professor Dale Jorgenson's econometric inquiries lead to the conclusion that in the short run the new rules will have little impact. I might observe parenthetically that this new $2.5 billion boon to corporations deserves inclusion in the next compilation of tax expenditures made by the Treasury. Although the tax expenditure notion was a parting Democratic gift by Stanley Surrey to the incoming Administration, its usefulness transcends partisan considerations.

The insufficiency of budgetary stimulus and the implausibility of consumer and investment revival, compel me to share the widespread skepticism in my trade about the ability of the economy to travel within hailing distance of the President's three 1971 targets, GNP of $1,065 billion, inflation tapering to 3 per cent by year's end, and unemployment obediantly declining by the same date to below 5 per cent. Unless Congress, as I believe and hope it will do, supplies the additional budgetary stimulus, there is nowhere visible the expansionary forces upon which the Administration rather mysteriously is counting.

Here I come to the major signs of decrepitude in the Administration brand of simple-minded Keynesianism. If by some chance the rate of economic expansion picks up speed, in dutiful accord with the projections of the magical new monetarist model in high favor in the Office of Budget and Management, the White House will collide with a major uncertainty, the willingness of Dr. Arthur F. Burns and his Federal Reserve Board colleagues to underwrite a new inflationary impetus by expanding the money supply at the minimum 6 per cent rate favored by Dr. McCracken and his colleagues at the Council of Economic Advisers. What is unhappily quite possible is a scenario of the following variety: an acceleration of price inflation, a reduction by the Federal Reserve in the rate at which it creates new money, and finally either a replay of the Treasury-Federal Reserve confrontations of the Truman era or a retreat by the White House from fiscal expansion. Either outcome is guaranteed to nip an emerging recovery long before it flowers. Once faith and hope are excluded, there is no special reason to anticipate a noninflationary expansion of the character predicted by the Administration.

The contours of workable economic policy are not very difficult to sketch. Sensible economists and politicians accept the death of laissez-faire and do not flinch from the facts of economic power. Prices, incomes, and employment are heavily influenced by the decisions of the giant oligopolies which dominate manufacturing, the major unions which face them across collective bargaining tables, and the AMA-teaching hospital complex which determines the structure of medical costs. The potentates who run these organizations are of course influenced by market forces. Nevertheless, typically they exercise considerable discretion in their responses to market exigencies. Thus it was that Bethlehem Steel, in the middle of a spell of flagging sales and fierce competition from foreign steelmakers, could propose to raise many of its prices over 12 per cent. It was securely protected from any unseemly price competition from its rivals in the American industry and certain that these rivals would speedily follow Bethlehem's price lead. Although Presidential intervention halved the projected price escalation, there remains something odd about increasing prices in the face of declining sales. Equally odd from the standpoint of competitive theory has been the ability of construction unions to bargain for wage increases as large as 25 per cent despite 11 per cent unemployment among building trades workers.

Both cases are almost random illustrations of the realities of market power. The concentration of this power enabled Bethlehem to choose higher prices and smaller sales in preference to lower prices and larger sales. The same circumstance permitted the construction unions tacitly to bargain for fewer jobs at higher pay rather than more jobs at lower wage rates. As Adam Smith wrote in 1776, what renders the greed of businessmen harmless and even socially beneficial is the pressure of competitive markets upon costs and prices. Where this pressure is absent for want of competitive markets, the argument is compelling either for militant anti-trust enforcement and consequential fragmenting of large corporations or for vigorous incomes policy. Since I take public support for radical anti-trust to be imperceptible but public approval of wage and price control to be substantial, I find economic logic and political feasibility in harmony.

Effective incomes policy in 1971 implies a good deal more than a revival of jawboning or even a combination of jawboning with the resurrection of the wage-price guideposts. Although there is growing evidence that the guideposts did have a perceptible anti-inflationary impact, they operated at their best in an era different from ours, a period which trailed after eight years of slow economic growth, three recessions, and high average rates of unemployment. Although the social costs of Eisenhower economic policy were too high to encourage repitition of the experience, it must be conceded that eight years of frugality certainly did rid Americans of inflationary expectations.

However, inflationary expectations remain a fact of life in the present. The need arises, therefore, for stronger medicine, in the shape of mandatory controls. My own preference combines a dash of Robert Roosa with a dram of J. K. Galbraith. Which is to say that to me it makes sense to freeze wages and prices for six months and employ the time to design a set of selective wage and price controls a la Galbraith. I share Galbraith's view that the place to impose the controls is where the markets are least free. This is of course administratively convenient: it is far easier to regulate *Fortune*'s elite list of the top 500 industrial corporations and the unions with which they deal than it is supervise myriads of small businessmen and merchants.

If the economy in 1971 is to move into a vigorous recovery, monetary and fiscal policy must march in step. It is almost certain that the prerequisite for such disciplined harmony of movement is administrative restraint of tht key wage and price decisions. Such restraint will allay the inflationary fears of the central bankers and encourage the White House to perservere in its promise of budgetary stimulation.

The final component of successful post-Keynesian economic policy focuses upon employment. My co-panelist Dr. George Perry has recently conducted an important inquiry into recent changes in the Phillips curve trade-off between unemployment and inflation. The labor force is now composed of a growing percentage of female and young workers. Both groups suffer from higher than average unemployment rates. An implication of this demographic shift is the tendency of prices to stir menacingly at overall rates of unemployment which are unacceptably high, on the order of 5 per cent. A decade or so ago, the danger point was 1 or even 1½ per cent lower.

What follows is not the counsel of despair that we should give up on either employment or inflation. The moral is different. Sophisticated policy which successfully reconciles low rates of unemployment with successful price strategy requires attention to manpower as well as to incomes. Unfortunately the President vetoed a promising Congressional initiative, last session's attempt to authorize a modest number of public service jobs in hospitals, parks, museums, law enforcement agencies, and schools. Only a few years ago, President Johnson's automation commission estimated that there were over 5 million unfilled jobs in the public sector at existing levels of staffing and administration. In 1971 the number is unlikely to be smaller. A good public employment program would serve two desirable ends. It would alleviate the chronic manpower shortages to which public agencies are prey and it would cope with a component of unemployment peculiarly intractable to monetary and fiscal policies.

Briefly to recapitulate my four recommendations, I begin with the identification of a need for substantially more fiscal stimulus from the federal budget than the President contemplates. At a guess, a full-employment budget deficit of $10 billion would make a proper target. After Congress has done its work, I hope that Paul Samuelson will be moved to repeat the praise of your body which he expressed last year in the wake of Congressional additions to White House budget requests.

The rate of monetary expansion should rise to something over 6 percent, possibly as high as 8 percent.

An incomes policy fully equipped with sharp teeth is essential partly to mollify the monetary authorities, but still more to mitigate the inequities which attend continued inflation.

Finally, the assault upon unemployment must contain structural as well as aggregative elements, notably manpower training and public sector employment. As a Democrat I recall with a certain pleasure that the 1968 platform of my party incorporated a pledge to move toward a condition in which the federal government would become the employer of last resort. Even though the 1968 presidential race turned out badly, the voters were prudent enough to retain Democratic majorities in both houses.

It is something, I suppose, that that practical man, Mr. Nixon, has attached himself to an economic policy which was quite up-to-date two or three decades ago. This is not enough. The post-Keynesian universe demands attention to the facts of economic power and the circumstances of groups unable to protect themselves in markets partly free and partly privately dominated.

Chairman PROXMIRE. Our final panelist is Mr. Brunner.

Go right ahead, Mr. Brunner.

STATEMENT OF KARL BRUNNER, PROFESSOR OF ECONOMICS, OHIO STATE UNIVERSITY

Mr. BRUNNER. Thank you, Mr. Chairman.

THE INHERITANCE OF INFLATION IN 1971

I. A RECOMMENDATION OF THE JEC AND A LOST CHANCE IN 1967

The Joint Economic Committee recommended several years ago that monetary policy maintain a monetary growth between 3 percent and 5 percent per annum. It is unfortunate that the committee's concern for a less volatile behavior of monetary growth was disregarded by our policymakers. Our present state is essentially the consequence of this disregard.

From the trough in 1961 until the end of 1964, we experienced a singularly stable expansion. The average rate of increase of the Consumer Price Index averaged around 1 percent per annum over this period. The rate of increase of the wholesale price index hovered around zero. It is probable that the true average of relative price changes was approximately zero over the first half of the 1960's. Our economy enjoyed thus an expansion of output and employment combined with a remarkable stability of prices and long-term interest rates. A new phase began in 1965. Prices accelerated sharply until the late fall of 1966. The Fed responded to this danger with a restrictive monetary policy initiated in the spring of 1966. This policy retarded substantially the growth of output and affected with remarkable speed the movement of prices. The Consumer Price Index decelerated from a rate of increase reaching 3.6 percent per annum in the third quarter 1967—relative to the corresponding quarter 1 year before—to a rate of 2.6 percent per annum in the second quarter 1967. The rate of increase of the wholesale price index actually fell from approximately 4 percent to a small negative rate. The inflationary demon sprung on our economy in early 1965 was effectively exorcised in the first half of 1967.

Our policymakers were offered at this time a remarkable opportunity. The incipient inflation had been broken with minimal social cost. The retardation of economic activity while definitely observable and unmistakable, remained a minirecession and was never canonized by the National Bureau of Economic Research. The unemployment rate responded less than at the time of the passing retardation in 1962–63 following the moderate deceleration of monetary impulses in 1962. The adoption of a stable monetary growth centered in the range subsequently discussed by the Joint Economic Committee would have radically changed the course of events. Such a strategy could have assured both comparatively stable price indexes and a sustainable expansion in output and employment.

This issue was discussed over the years before the policymakers and advisers adopted the course of inflation in 1967. Hindsight only confirms our persistent concern expressed on repeated occasions about the exaggerated responses of monetary growth mostly attributable to monetary policy. The responsibility clearly lies with the Board of Governors and the Council of Economic Advisers. The latter appeared to have little interest in monetary policy beyond "accommodation and support" of a given fiscal stance. The Federal Reserve System on the other side remained strongly influenced by its traditional money market conception. This conception influenced the large acceleration of the money stock over the year 1967 in response to the rising pressure of Treasury borrowing. This monetary acceleration doubled within two quarters the relative growth of real GNP to 5 percent per annum—relative to corresponding quarter of the preceding year. Prices responded sharply to this inflationary turn of monetary policy. The rate of increase in consumer prices went from 2.6 to 6.4 percent in the first quarter of 1970, whereas wholesale prices accelerated from a small negative rate to almost 5 percent per annum in the first quarter of 1970.

II. THE DILEMMA RESULTING FROM THE LOST OPPORTUNITY

By the spring of 1968, the inflationary danger was clearly recognized. The temporary surcharge on taxes was justified as a measure designed to remove the inflationary pressures imposed on our economy by the Federal Government's financial policy. The Council of Economic Advisers persistently argued on behalf of this tax policy without much attention to the monetary policy required for a moderation of inflation. There emerged in spite of all the forecasts based on the tax policy, no "overkill," nor an "overcool" and the forecasts used by the policymakers were thoroughly rejected by ensuing events. Prices continued to climb. The rate of increase of wholesale prices almost doubled from the second quarter of 1968 to the first quarter of 1970, whereas the Consumer Price Index still accelerates from around 5 percent per annum to around 6.5 percent per annum. It should be noted however, that the major price indexes clearly show a decline in the rate of accleration. The tax surcharge thus seemed to exert a minor effect expressed by a smaller acceleration in the price movement. Nevertheless, the acceleration of inflation measured by the price indexes continued.

The failure of the fiscal policy measure passed by Congress in the late spring 1968 became clearly recognized during the winter of 1968–69. Policymakers were confronted with a serious choice, either to continue the inflation or attempt to lower it substantially. If the choice were restricted between a stable inflation at moderate rates—that is relative to the Latin American and similar experiences—and the termination of inflation within a short period one could easily prefer the stable inflation. The welfare loss under such a regime is probably smaller than the welfare loss associated with a termination concentrated over a short period. But stable inflations belong to the rarified air of learned exercises. The inflations of our observable world usually suffer a pronounced instability. Most of the actual welfare loss attributed to inflation is probably the result of such instability and not so much the result of inflation. The decision to initiate policies effectively designed to extricate our economy from the inflationary heritage is consequently well justified. One should realize however, that this second attempt cannot be expected to yield results at the same speed as the first attempt in 1966–67. The required policy emerged in the first half of 1969. The money supply decelerated gradually from the high rate of growth reached by the end of 1968. The deceleration tightened in the spring and early summer and continued until the turn of the year 1969–70. In spite of widespread skepticism and a growing sense expressed by the media that "the economy had become intractable," output—measured by real GNP—continously decelerated from 5 percent per annum in the last quarter of 1968 to a negative rate less than −1 percent per annum in the second half of 1970. The economy turned around actually in the fall of 1969.

Output thus clearly responded to the monetary policy initiated during the winter of 1968–69. The retardation of economic activity was also clearly expressed by the substantial increase of the unemployment rate. This rate of increase exceeds by now the increase observed during the retardations of 1966–67, 1962–63, and even 1957–58. It remained however, smaller than the rate of increase of the unemployment rate in 1948–49 and 1953–54. It is noteworthy however, that the retardation expressed by the unemployment rate is relatively large at this stage when compared to the retardation in total output. This may be attributable to the large shifts in the composition of Government expenditures. These shifts induced unemployment independent of the monetary deceleration.

Throughout the retardation of economic activity all price indixes registered further increases. There emerged consequently a growing sense revealed in many discussions that prices behave in a unique and unprecedented manner. The economic retardation appeared to exert no effect on price movements and the social cost associated with the policies pursued appeared to have been in vain. The combination of rising prices and rising unemployment seemed puzzling and was frequently interpreted to indicate a fundamental flaw in our policies. It was particularly argued that we require a two-pronged attack assuring simultaneously expansion of economic activity and a substantial moderation of price movements. The usual proposal seems to involve fiscal and monetary policies pushing the economy to absorb the slack accumulated last year and supplemented by an income policy restraining effectively the price movements.

III. AN EVALUATION OF CURRENT PROSPECTS

1. *The responsiveness of prices*

The recent concern about the behavior of prices is probably the dominant reason behind the rising clamor for an income policy. It appears consequently appropriate for a suitable evaluation of income policy to consider the recorded price movement more carefully. There is no doubt that recorded prices moved quite sluggishly over the past 1½ years in response to monetary deceleration. This movement contrasts remarkably with the speed and magnitude of responses in price movements to the restrictive monetary policy pursued in 1966. The recent sluggishness should however be carefully interpreted. In particular, there is no ground to believe that prices are insensitive and unresponsive to changing market conditions and market pressures. We note for instance three periods of pronouned decelerations of price movements over the postwar period. We also noted a lengthy period of stability in the price levels. The timing of the deceleration differs somewhat for the major indices. For the GNP deflator the first period begins in the second quarter of 1948 and ends 1 year later. The second period begins in the first quarter 1951 and terminates with the first quarter of 1955. This was a 4-year deceleration which depressed the rate of increase from 8.3 percent per annum to almost zero. The third period begins in the first quarter of 1957 and ends in the third quarter of 1961 and depressed the rate of increase from 4 percent per annum to 1 percent per annum. In all cases deceleration was initiated by suitable monetary-fiscal policies. In 1948 a highly restrictive monetary policy overwhelmed a very expansionary fiscal policy and induced an economic downswing which depressed the GNP deflator from about 7½ percent per annum to around minus 2 percent within a single year.

In 1951 several factors operated simultaneously to moderate market demand. We note that monetary acceleration was substantially lowered, and fiscal policy became less expansive. Moreover, the Treasury-Federal Reserve accord introduced new uncertainties into the credit market and thus raised money demand. Lastly, the inflationary anticipations unleashed with the outbreak of the Korean war rapidly eroded during 1951 in the absence of accelerated monetary-fiscal impulses. The third period was dominated by a comparatively restrictive monetary policy, interrupted for only 9 months in 1958 by a sharp acceleration. Similar observations occurred in the 1930's. The consumer price index decelerated from almost a 5 percent per annum rate of increase in the second quarter of 1937 to a negative rate of minus 2.7 percent per annum. The deceleration of the wholesale price index over this period was even more dramatic. It moved from a rate of increase above plus 10 percent per annum to somewhat less than minus10 percent per annum.

These observations clearly indicate that price movements do respond to changing market conditions. However, they do not move uniformly in response to a given change in the market conditions. Several factors govern their speed and timing. The magnitude and length of the inherited inflation, the magnitude of economic retardation, and the public's uncertainty concerning the Government's policies should be mentioned among the major influences. Our recent inflation certainly appeared much more gradually than any of the previous accelerations of price movements. Some of the previous movements also reached a higher peak (1951). Our recent experience confronted us, however, with an acceleration of price movements over 4 years, as against at most 1½ years in case of the previous experiences. Modern communications systems also contributed to disseminate information about this experience more widely and rapidly. The public's anticipations of inflationary movements were consequently raised by a larger margin in our recent experience. The vagaries of Government policies over the past 5 years and the failure of the highly propagandized tax policy of 1968 probably accelerated inflationary anticipations even further over the year 1969. These uncertainties tend also to entrench inflationary anticipations. They became consequently less sensitive to shortrun changes in market conditions. This was reflected in a widespread disbelief that the monetary policies pursued since early 1969 could retard economic activity. The financial press reported in the first months of 1970 that a majority of executives discounted any prospects of a substantial retardation. These anticipations offset the effect on prices usually expected from retarding economic activity.

Moreover, the retardation remained comparatively small. The rapid responses of prices in 1937, 1948, and 1957–58 were purchased at a substantially larger social cost expressed in terms of output and employment losses. The fantastic growth rate of real GNP (14 percent per annum) reached in the fall of 1950 (relative to the fourth quarter of 1949) offered a substantial range of deceleration in output before depressing activity into a recession. But this range was almost completely used up in response to the policies introduced in 1951.

The conditions examined are not sufficient to explain the peculiar sluggishness of price responses in 1970. It is, however, noteworthy that the acceleration clearly ended for all major indexes by the beginning of 1970. Moreover, the Consumer Price Index definitely decelerated. We observe in 1970 for the first time since 1961 a reduction of the rate of increase (relative to corresponding quarters in previous years) over three succeeding quarters. The tide has apparently turned. This much should be acknowledged, even with the full recognition that the inflation has become quite entrenched and the inherited momentum more protracted than visualized in 1969.

There remains one last aspect to be considered, however. This aspect is particularly important in view of the arguments recently made on behalf of income policy. This device was particularly justified as an instrument designed to constrain price movements. Such constraint seemed required in view of the exceedingly sluggish response of prices to the economic retardation.

It should be emphatically understood that this argument on behalf of an income policy imposes a heavy burden on a shaky foundation. It is important to recognize that our price indexes are poorly designed as estimates of the actual movement of prices. This is not the place to elaborate the major construction errors implicit in our available indexes. It should only be noted here that the faulty construction imparts probably a positive bias to the indexes. One particular aspect of their construction need be considered for our problem, however. Indexes are essentially based on list prices or prices announced and collected from the sellers. It has been established on the other hand that actual prices paid by buyers frequently diverge from the prices recorded for the indexes. This phenomenon has been systematically explored by George Stigler and Kindahl in a book published last year by the National Bureau of Economic Research. The results of this examination bearing mostly on the wholesale price index establish that recorded prices measure the movement of actual prices in a satisfactory manner in periods of expanding markets. In periods of faltering demand serious divergencies emerge, however. These discrepancies between listed and actual prices are fostered by an asymmetrical cost to the supplier of announcing lower or higher list prices.

The increasing attention granted by various political bodies to the officially recorded price movements raised the political cost to many suppliers of raising the list price. In case of longer run anticipations involving an upward drift in prices, suppliers will use every opportunity to raise list prices, even in case the current market situation does not warrant an increase in price. The increase in list price is actually offset in many cases, as exemplified by Stigler and Kindahl by a larger discount. Such discounts can be easily adjusted in response to market conditions without attracting the wrath of Presidents and the attention of the public. The experiences initiated with the guidelines in 1962 and the uncertainties suffered in the context of persistent proposals for wage-price guidelines sharpened in recent years the potential divergence of reported and actual prices.

The larger the probability of wage-price guidelines the greater becomes the incentive for suppliers—including labor unions—to revise recorded prices upwards at the first opportune moment in order to improve the calculation basis for the threatened application of guidelines. A rising decibel level of the discussion disseminated by the media bearing on income policy and wage-price guidelines thus strengthens the potential divergence of actual and recorded price movements. This response on the part of suppliers contributed probably to the sluggishness of the recorded prices. The results presented by Stigler and Kindahl suggest in particular that actual prices decelerate more than recorded prices whenever markets weaken. This discrepancy could easily be larger at this occasion than on previous occurrences. We would have to conclude that our observation of a comparatively unresponsive price movement is based at least to some extent on poor and inadequate measurement procedure. Of course, we possess only limited evidence. This evidence has been confirmed by casual spotchecks of recent evolutions in actual price quotations made by the financial press. Still, the evidence and supporting analysis is sufficient to cast substantial doubt on the official price indices. A rational approach to policy would suggest that Congress appropriate some funds to a suitable agency with the explicit instruction to collect relevant data and construct a price index which is a substantially more reliable measure of actual price movements. A reliable measure of the rate of inflation is surely a prerequisite for any rational action designed to dampen inflation. The recorded price movements thus yield a dubious and questionable basis for the case on behalf of an income policy.

2. Income policy and its alternative

Two major arguments on behalf of an income policy are encountered. One argument refers to the movement along a stable Phillips curve, and the second argument refers to the adjustments in the position of an "unstable" Phillips curve in response to the dynamics of inflationary anticipations. The first argument emphasizes that rising price levels tend to emerge at utilization levels substantially below capacity. It follows that an acceptable unemployment rate is unavoidably associated with a persistent rate of inflation. This relation has been formalized by the Phillips curve connecting the rate of increase in prices or wages with the unemployment rate. Rationalizations of this connection most frequently explain it in terms of market power associated with key labor unions or key industries.

An income policy is then proposed as an antidote and control over this market power. It is particularly argued that a well guided application of an income policy can be expected to lower the Phillips curve and thus lower the inflation rate associated with any given rate of unemployment. It promises thus to resolve the dilemma confronting the policymaker and legislator who wishes high employment but still a gentlemanly rate of inflation. This argument was particularly used by the CEA of the Kennedy administration to justify the wage-price guidelines and is again proposed to cure the present state.

The first argument essentially justifies wage-price guidelines as a relatively permanent institution. The second argument advances income policy as a deliberately short-run and temporary instrument. It is essentially based on the recognition that the public's revisions of inflationary anticipations in response to current experiences and events modify the position of the Phillips curve. In particular, the more rapidly inflationary anticipations are revised downwards in response to antiinflationary policies, the smaller is the resulting increase in unemployment over the transition period. Entrenched inflationary anticipations imply on the other hand that a given retardation of economic activity moves the economy along a Phillips curve persisting in a high position. Antiinflationary policies thus involve in this case a relatively higher social cost. A temporary income policy should thus be instituted in order to break inflationary anticipations and convince the public now that prices will decelerate. This would affect contracts and plans made now for the future and dampen the deceleration in current output and raise the level of future output.

The two arguments for an income policy are thus radically different and deserve a separate examination. Still, both arguments support essentially the same institution and similar procedure. This justifies an examination of some aspects which are common to both ideas. For our purposes we should consider first the question of effectiveness. My survey of the literature yields substantial caution and reservation even on the part of the protagonists arguing for the institution. Statistical studies are quite inconclusive. They yield a variety of results which contradict each other. Moreover, even the best statistical results are derived in the context of regression equations which remained untested and without any relevant discriminating evidence. It is noteworthy that this inconclusive nature of the statistical results supports a contention that wage-price guidelines are useless. Income policy did not moderate inflations in other countries and no hard evidence has been assembled that it effectively "lowers the Phillips curve". The comparatively stable price-level from 1961 to the end of 1964 seems better explained by the substantial erosion of inflationary anticipations resulting from the lengthy deceleration of price movements from 1957 to 1961. In summary, there is no rational basis to expect any measurable effect of an income policy on price movements over the next 12 months.

One aspect of the second argument merits some special attention. It properly emphasizes the role of inherited inflationary anticipations in our current situation. But before we apply an extended activism of the Federal Government in order to convince the public to readjust its anticipations correctly over the short run and not only in the future at a higher social cost, we should remember the major cause for the comparative intractability of inflationary anticipations. A volatile behavior of Government policies creates sufficient uncertainty to induce substantial hedging, encouraged by discussions of new strategies and flurries of apparent activities emitted by Government agencies. A formal reaffirmation by Congress of the JEC's original recommendation bearing on the course of monetary policy followed by a public declaration of the board accepting this recommendation could break longer run inflationary anticipations at least as effectively. Moreover, it would have more beneficial, longer run consequences on our monetary policymaking.

The dubious benefits of an income policy are associated on the other side with some probable social costs. Two consequences involve such costs. The actual execution of an income policy seems to be centered around some guideline number. Most commentators suggest that positive deviations from this number should be frowned upon and should evoke some "friendly, noncoercive discussions." The comments also suggest that it should be obvious by immediate inspection which increases in prices and wages are "against the public's interests." The discussion contained in previous reports published by the CEA or papers published by members of the CEA or the staff remain somewhat vague in this respect. They provide little information about the use of a single guideline number to judge price changes required for the continuous reallocation in order to achieve a more efficient use of our available resources. A rigid application of a single number actually obstructs the market processes tending toward a more appropriate use of resources. And a flexible application opens the door for an arbitrary policy with substantial incentives to expand lobbying, invest more resources to negotiate with the administrators of the guidelines" and acquire influential friends in political circles. The Bobby Baker effect would find a vaster range of operation and more leverages to use in Washington.

The uncertain effect and the probable social cost associated with an income policy yield little ground indeed for its introduction. Do we therefore have to lean back and let things run their course? Most definitely not. There exists an alternative to be pursued by the President and Congress. This alternative proposal is based on the recognition that there exist substantial pockets of market power. But this recognition yields a radically different conclusion than the first argument on behalf of an income policy. Almost without exception the market power results from restrictive legislation or restrictive practices encouraged or supported by Government policies. The market power of unions in the construction industry has been fostered and strengthened by Government policies and regulations. This increasing market power is clearly reflected by the large rise of wages in this industry relative to average manufacturing wages. Moreover, it is also reflected in a trend decline of housing construction over the last two decades. The restricted supply was further confronted by Government supported programs which expanded demand. Prices were bound to move rapidly, simply as a result of the Government sector's policies. A similar pattern explains the massive increase in prices and costs in the health industry. This rise was also fostered by restrictive supply policies combined with policies expanding demand. I submit that the Joint Economic Committee prepare a list of market positions which derive substantial protection from existing Government policies. Such a list would include the import quotas on steel, the import quotas on meat, on oil and a variety of other commodities. High tariffs on major consumer goods could also be mentioned, particularly tariffs on automobiles. Moreover, major pieces of legislation which assure positions of private market power or foster Government directed cartel prices should also be examined in such a list. Not the least of course, Congress and President could usefully reconsider the operation and governing conception of major regulatory agencies.

No doubt, this is a vast undertaking and its execution would raise our welfare substantially. Actually, as an alternative to income policy immediate actions are available without lengthy deliberations. A removal of all import quotas and suitable actions of the U.S. Tariff Commission could exert a measurable effect on price movements within a very short period. Here is an alternative available which would definitely decelerate price movements. It also would erode the private market power and thus constrain the price movements resulting from such power also in the future.

These actions would lower the position of the Phillips curve. So why is it not considered? The usual argument emphasizes that this alternative is politically not feasible whereas an income policy appears quite feasible. It is probably true that it is easier to institute an income policy than to eliminate restrictive supply policies. But the argument does not end here. Those who argue for a temporary income policy seem to believe that existing arrangements are politically hard to remove whereas new arrangements can be easily terminated whenever desired. And those who argue for a more or less permanent income policy seem to suggest that it will not create a new set of vested interests and associated Bobby Baker effects. The balance of social costs and welfare gains remains clearly with the supply policy as against an income policy. This consideration is strengthened at this stage by a felicitous timing. The opening of a supply policy during the winter 1969/70 would have imposed an additional burden on our economy at a time of a clear retardation. But the prospects are different now. We face an expanding economic activity and thus a much better climate for the reallocation of resources unleashed by measures of supply policy. Lastly we should not let the concern for a "worsening balance of payments" be misused to obstruct the program.

This concern has already been overused in the last decade to justify inappropriate actions or inaction. The balance of payments is a separate issue which can be dealt with separately.

3. The expected expansions

The increase in economic activity necessary to alleviate the resource effect of a supply policy seems somewhat disputed in our public debates. Most observers argue that the increase in GNP outlined by the Council of Economic Advisers is too large. The CEA anticipates a 9-percent increase in nominal and about a 5-percent increase in real GNP. Three major econometric models yield forecasts between 6.7 percent and 7.2 percent for nominal GNP and 2.8 percent and 3.7 percent for real GNP. My own assessment yields a result substantially nearer 7.2 percent than to the CEA's forecast. Nevertheless, the CEA forecast is not entirely unreasonable. We should remember that our forecasts present a single estimate based on the average of a distribution of forecasts with varying probabilities. In the context of my own assessment, the CEA's forecast does not fall into a range of ludicrously vanishing probabilities. Several observations actually increase the uncertainty concerning the magnitude of the expansion. The most important is the divergent movement of the exclusive and the inclusive money stock (adjusted for CD's). This divergence is also a heritage of past policies which render a reliable interpretation at this stage more difficult. Fortunately, these adjustments will soon be absorbed by the system and the two money stock figures will move closer together. But in case the inclusive money stock operates with substantial weight, the CEA's forecast could actually be realized. It should be noted that the rate of increase in real GNP from fourth quarter of 1970 to the fourth quarter 1971 implied by the forecast is not beyond reasonable experiences. We observe in four postwar upturns that real GNP rose over four quarters after the trough by at least 7.6 percent. Three out of the four upturns measured more than 8 percent.

There is of course an understandable temptation at the moment to err in the pursuit of our actual policies on the expansive side. A rapid expansion would promise a lower rate of unemployment. But a sufficiently rapid expansion would also assure failure of our anti-inflationary policies. The deceleration of price movements now underway would disappear. With the inherited sensitivity of inflationary anticipations and the pervasive uncertainty about government policies; prices would probably accelerate again. It should be noted that supply policy offers at this stage an additional advantage. An extensive use of supply policy would permit a more expansive course of monetary-fiscal policy without endangering the ongoing deceleration in prices. The combination of expansive monetary policy and supply policy could thus be effectively exploited for the aims professed by the protagonists of an income policy. There is one substantial difference, however, it would probably be more effective and contribute to a larger welfare gain.

Once the expansion process has been set in motion without endangering the deceleration of prices, the monetary authorities will have to adjust their course very carefully. As prices decelerate the monetary growth required to induce a sustainable real expansion must be gradually revised. A persistent monetary growth along the path initiated early 1970 would slowly yield by the middle or late 1972 a renewed inflationary problem. The monetary authorities must also avoid on the other hand a premature lapse in monetary growth. The line initiated since early 1970 should be pursued for some time. The retardation in monetary growth over the recent months can only be noted with some apprehension. One wonders whether our monetary authorities revert to a "money market conception" accompanied with the usual declaration that they cannot control the money stock. For the immediate future we must therefore guard against lapses in monetary growth below the 5 to 6 percent trend for the exclusive money stock, whereas for the balance of the year we must avoid an acceleration beyond this benchmark, combined with a gradual deceleration below this mark as prices decelerate.

III. SUMMARY

The South American solution to the inflation problem is probably the major danger posed by our inherited inflation. This solution means a permanent inflation, in our country, of course at a gentlemanly rate of about 3 to 4 percent on the average. This permanent inflation would, however, be quite unstable. Periodic attempts to terminate inflation induce retardations of economic activity.

Realizations of the social cost associated with lowering the rate of inflation tend to make persistent attempts somewhat unlikely however. We could easily join the club of stop-go inflations and suffer the welfare losses associated with such policies. We still have an excellent chance to avoid this cycle of events, but it will require substantial fortitude and political courage by the policymakers. Several proposals were made in the paper which could be usefully developed to guide our stabilization policies. They are assembled in conclusion as follows:

(*a*) Rational anti-inflation policy should be based on reliable information concerning actual price movements. This information is at the moment not available. The price indexes available are poorly designed to estimate the true price movements. It seems quite inappropriate to base far-reaching policies on a foundation of shaky information. Congress would find it, therefore, useful for its own purposes of assessing the adequacy of policies pursued to appropriate sufficient funds for the proper measurement of price movements. An incremental appropriation of $20 million could probably do the job.

(*b*) In lieu of an income policy, I submit to the committee the adoption of a vigorous supply policy. Income policy combines little effect on price movements with a social cost resulting from the manner of its operation. A supply policy on the other hand would surely strengthen the deceleration of prices and actually improve our economic welfare. Moreover the present phase appears almost optimal for the execution of a supply policy.

(*c*) The Joint Economic Committee should strongly reaffirm its original recommendation of 1968 concerning monetary policy. Such reaffirmation should be guided by the recognition that it was precisely the disregard of this recommendation which shaped the inherited problem. The committee should also apply all its powers of persuasion to obtain a public declaration by the Board of Governors accepting responsibility for controlling monetary growth in a manner consistent with the recommendation.

These proposals do not assure the removal of most problems confronting the committee. That would be a disaster from some point of view. But they could extricate us with a moderate cost, and some gain, from the past inheritance and guide our policies to avoid a repetition of past experiences.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Brunner.

Mr. Brunner, what is your forecast for GNP average in 1971?

Mr. BRUNNER. My forecast in the sense of an average or best estimate is slightly more than $1,050 billion.

Chairman PROXMIRE. And how much of that would be real growth and how much inflation?

Mr. BRUNNER. The real growth should be about 3½ percent on a course of monetary policy maintaining the monetary growth in a close range not exceeding 6 percent per annum. The rate of inflation should average around 4 percent over the year.

Chairman PROXMIRE. Three and a half to 4 percent would be real growth and about 4 percent inflation, or something like that?

Mr. BRUNNER. Yes.

Chairman PROXMIRE. Mr. Lekachman, do you have a forecast?

Mr. LEKACHMAN. Not really a forecast, simply a disbelief that we are going to get 9 percent growth as the Council believes. I am not really prepared to say by how far off the target we will be.

Chairman PROXMIRE. Mr. Perry, do you have an estimate?

Mr. PERRY. About 4½ inflation, 3 percent real growth.

Chairman PROXMIRE. And that would be about a $1,050 billion?

Mr. PERRY. Right.

Chairman PROXMIRE. What is real growth?

Mr. PERRY. Three percent.

Chairman PROXMIRE. You estimate 3 percent. And you estimate 4½ inflation?

Mr. PERRY. Right.

Chairman PROXMIRE. Now, Mr. Brunner, in view of the fact that we expect to have a substantial increase in the work force for the next year in demographic figures on age and the number of people leaving school to come into the work force, the expectable increase in productivity would suggest that a 3½-percent real growth in the economy would result in no reduction in unemployment percentage, it would be about the same, 5½ or 6 percent, something like that; is that about right?

Mr. BUNNER. Yes. I would expect that the unemployment rate would decline but not dramatically. My assessment would be that the rate of unemployment, which is now around 6 percent would not fall below 5 percent by the end of the year.

Chairman PROXMIRE. As a matter of fact, if your real estimate is correct, it would be around 5½- or 6-percent average during the year

Mr. BRUNNER. With some qualification. We should note that the effect on unemployment from monetary deceleration was reenforced by substantial shifts in Government expenditures. The latter affected most particularly the market for professional skills. This supplementary effect gradually disappears this year. Without this effect the unemployment rate would have stayed probably below 6 percent. An average rate nearer to 5 percent than 6 percent could thus be feasible this year and consistent with the real growth indicated.

Chairman PROXMIRE. And Mr. Perry, would you suggest that it would stay about 6 percent?

Mr. PERRY. That is right. I think we would end the year about where we are now.

Chairman PROXMIRE. Mr. Lekachman does not give us an estimate, but I take it from your evaluation of the administration's estimate that you think unemployment would remain about the same?

Mr. LEKACHMAN. I would consider it quite possible that it would be higher at the end of the current year than it is now.

Mr. BRUNNER. Would Professor Lekachman make a bet about that?

Mr. LEKACHMAN. A small bet.

Mr. BRUNNER. Words are cheap.

Mr. LEKACHMAN. I will gladly make a bet with you.

Mr. BRUNNER. Five dollars even bet.

Chairman PROXMIRE. I do not know that we can countenance that.

Mr. BRUNNER. I hope I will have more success in collecting my bet than in the last 2 or 3 years.

Mr. LEKACHMAN. I would be delighted if I lost on those terms.

Mr. BRUNNER. So would I.

Chairman PROXMIRE. At any rate, gentlemen, you all leave us with a pretty gloomy outlook for 1971, with unemployment remaining high, and not much real recovery at all. And I think that the proposals by Mr. Perry and Mr. Lekachman are consistent with such an evaluation.

Mr. Brunner, you would tell us that we just have to keep a stiff upper lip and accept this unemployment. It is not hard for us, we expect to be employed at least for the next few years, and you have got your tenure at Ohio State University. But for millions of Americans this is a hard, cruel, rough prospect. And I just wonder if it is ethical or morally right and politically possible to follow policies that will give us continued unemployment and expect the burden to be borne by the people who are the most defenseless in our society.

How do you defend that position?

Mr. BRUNNER. Let me assure you that I have always been opposed to tenure, but I have been quite unsuccessful in convincing some of my colleagues and the administration. I think it is a device that burdens the taxpayer.

Mr. LEKACHMAN. That is one on which you and I agree.

Mr. BRUNNER. Good. The question bears on a particular aspect of the supply policy discussed in my opening statement.

This aspect emerged in a spirited discussion at the occasion of a visit by Mr. Henry Reuss in our department last February. A vigorous supply policy offers an opportunity to pursue a more expansionary monetary policy without endangering the deceleration in prices.

This would be an additional bonus.

Chairman PROXMIRE. I understood you to say, however, in your statement, that we should follow monetary policy of about a 5- or 6-percent increase in monetary policy, but as the year goes on we should diminish that and bring it more in line with the 3 to 5 percent, and that therefore monetary policy would be less expansive, and if we did start progressing we would tend to turn the screws on again.

Mr. BRUNNER. Under the present circumstances, with no serious attempt at a supply policy, the appropriate benchmark over the nearer future remains 5 to 6 percent per annum. With a vigorous supply policy on the other hand, we could raise monetary expansion for a time without endangering the deceleration of prices.

We obtain thus an additional welfare gain from the application of supply policy. The question posed still deserves some further examination. The inherited state confronts us with a very unfortunate dilemma. We have already lost one opportunity to break an incipient inflation. At the moment there is another opportunity to moderate the rate of inflation substantially. But every attempt at moderation of the rate of inflation involves social costs partly revealed in the form of temporary unemployment. Many inflationary experiences yielded ample evidence concerning this dilemma. This dilemma can become severe on occasion and explains the pervasive occurrence of somewhat volatile inflationary experiences. And the social cost of such experiences are quite substantial. It appears thus appropiiate to pursue our present opportunity to move the economy into a range of moderate inflation.

The social cost described in the question unfortunately exists and should be fully understood. Several aspects of this cost still need to be considered however. First, the actual cost is probably wider distributed over our society than indicated by the unemployment figures. Secondly, the distribution of the social cost is a separate issue from its occurrence associated with a systematic policy to curb inflation. Arrangements involving the use of (positive and negative) taxes, and manpower programs can be effectively used to redistribute the social cost of an anti-inflationary policy.

There is no reason why the cost should stay concentrated on a particular social group of our society.

Chairman PROXMIRE. That is fine. That is an alternative I argued and suggested. As I understood it you did suggest that we follow more liberal trade policies. And I would agree with that.

Mr. BRUNNER. Yes.

Chairman PROXMIRE. You proposed abolishing oil import quotas. I have been fighting for that for years with no prospect of winning, and I do not see any prospect of winning this year or the next. I am opposed to the restrictions on steel imports and so forth. I think they would be good. But again I do not think it is a politically practical means now.

Now, if you say that we should follow policies of manpower training, policies of providing jobs, public service jobs—I notice the President just today, in the newspapers this morning, says he favors a program of providing 250,000 public service jobs, with an $800 million appropriation. This seems to be in line with the policies suggested by your other colleagues on the panel this morning. But it did not seem consistent with what you were telling us earlier. But I am glad that you are amending that to say that you would favor, I presume, this kind of additional fiscal action.

Am I putting words in your mouth?

Mr. BRUNNER. No. There are two aspects which you mentioned there. First, we should continue a policy designed to moderate the inherited rate of inflation. This will still be a difficult task and needs substantial courage and determination. It would be dangerous to trade the shortrun benefits of lower unemployment for the serious longer run problems associated with a volatile rate of inflation.

But once we follow the course of a determined anti-inflationary policy, your problem must be faced. How do we distribute the social cost equitably? Separate measures must be exploited for this purpose as a supplement to the anti-inflationary policy. Such measures could also include programs encouraging the readjustment of labor services with respect to quality, type, and location. One should therefore note that an anti-inflationary monetary policy is quite consistent with some policies which effectively redistribute the social cost of an anti-inflationary policy.

It is noteworthy in this context that a supply policy also bears on the level and distritution of this cost. It could be used at this time to lower the burden imposed on many households. I find it somewhat disturbing to hear rather frequently how unrealistic a supply policy is. Existing institutions and regulations may be difficult to remove, but this applies also to the arrangements instituted by the proposed income policy. They will foster new vested interests in the bureaucracy and the business community. It appears more appropriate to loosen up present restrictions and avoid introducing new constraints which do not operate without social costs.

Chairman PROXMIRE. Let us keep it up. I am glad you are giving us some support. But I am not optimistic about putting that into effect.

My time is just about up. I would like to proceed further if I might with Mr. Perry.

I think this is one of the finest contributions we have had in a long time, in years, in understanding the tradeoff between unemployment and inflation, which is the problem which has puzzled the administration and puzzled the Congress, puzzled all of us. And this insight you have given us this morning in your very helpful analysis shows that because of the current big influx into the labor market of young people and women—and minority groups, I suppose, would also be in the same kind of category—people are much harder to fit into available jobs. And under those circumstances the tradeoff means that if you are going to have stable policies you might have to settle for something like 4½ percent unemployment or something of that kind, unless we have structural programs of the kind you propose of training people to do this work.

My time is up.

Mr. Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman.

This is my initial meeting with the committee, and I must say I am fascinated with some of the testimony. As I drove in this morning I did not realize I was going to be advised by two economic morticians that the American price system was dead, and we were just waiting to put it in the coffin.

I do find myself a little more sympathetic with Professor Brunner's analysis of things.

I would like to ask a question of Professors Perry and Lekachman: As I recall, in the last year of the Johnson administration, we had a full-employment deficit close to $24 or $25 billion. Now, you gentlemen should have been in economic orgiastic ecstacy over that sort of thing. How do you explain the inflation that followed that year?

Mr. LEKACHMAN. I would be glad to comment on that.

I am prepared to say a bad word about President Johnson's economic policies at any time, certainly. It was clear to me at the time—this is not hindsight—as it was clear to others, that the escalation of the Vietnam war in mid-1965 urgently required a change in fiscal policy. If the President wanted to pay for his hobby, it was necessary to raise taxes at that time. And his refusal to raise taxes is what indeed stimulated inflation and caused the full-employment deficit that you refer to. It was in my view a highly irresponsible conduct of economic policy by the President, which I take it was based on the President's possibly justified feeling that the rest of the country was not as willing as he to pay the cost of fighting the Vietnam war. But it was exceedingly bad policy.

Representative BLACKBURN. You do agree, then, that in a time of full employment, at least, heavy deficits can trigger inflation?

Mr. LEKACHMAN. Indeed.

Representative BLACKBURN. Professor Perry.

Mr. PERRY. Your criticism of that deficit is very well taken. I am not sure what we said that would imply otherwise. I think the point is that if you want a simple measure of fiscal policy, look at the full-employment budget. But having looked at it, you then decide what to do with it. In the year 1968, what you should have done with it was run a full-employment surplus. In a year like 1971 what you should do with it is run a full-employment deficit.

When the economy needs stimulation because unemployment is too high, that is the time to stimulate with a full-employment deficit. And vice versa; run larger full-employment surpluses than normal when you want to slow the economy. I do not think there is anything unsymmetrical about the measure at all.

Representative BLACKBURN. Let me make this observation. Both of you pronounced the President's, this administration's fiscal—and I suppose Federal Reserve policies—as being ineffective.

I do not know where my figures came from or where your figures came from. But the figures I have seen indicate that during the first half of the year 1969, inflation was running at an annual rate averaging 6.4 percent; in some months it was higher, and of course in some months it was less. During the last half of 1970, that is, the 6 months that just ended the first of January, the annual rate of inflation over the 6 months' period averaged 4.9 percent. The Wall Street Journal shows the economic indicators as indicating that the retail level of inflation during the month of January on an annual basis would run approximately 3.6 percent. Now, to me there is a trend there. How you can so easily pronounce the policies of the present administration as being totally without effect in the face of these figures is somewhat questionable. I wonder where you get your figures and where I get mine.

Mr. PERRY. I do not say that they are totally without effect. I expect that inflation is going to slow down in 1971. I think the expectation that was announced when the administration first came to office in 1969 was that inflation would soon be over. Six months later the same statement, it would soon be over. The point is that the forecast has been consistently wrong.

The expectation was that by now we would have inflation of perhaps 2½ or 3 percent, and we have inflation of more like 5 percent. I do not think that we have a disagreement on the fact that a little slowing is detectable in some of the indexes. You get a good month, you get a bad month. I think that statements on this have sometimes proven embarrassing, because we have had some good months during 1970, followed by a much worse month. As you look at the period as a whole, the progress on the inflation front has been extremely disappointing. It has been much slower than any forecast that was being made, and certainly much, much slower than the administration kept telling us it was going to be. That is the whole nature of the criticism.

Representative BLACKBURN. I do not suggest that it is tolerable. But I do notice that although you pronounce that the present policies are totally ineffective, you do admit that it is slowing down. In fact, you stated in response to a question from the chairman that the rate of unemployment in your estimate would be approximately 4 to 5 percent, which is approximately 2 percent more than it was during the first 6 months of this administration, so I appreciate your candor to some extent.

Now, Professor Brunner, I would like to ask you, do you have any thoughts that perhaps the continuous nature of inflation is due to the psychology that was built into the American public during the last 3 to 5 years, that is to expect inflation as a way of life?

Mr. BRUNNER. May I refer shortly to the question concerning the so-called ineffectualness of present policies. Several aspects should be noted in this respect. Mr. Perry noted correctly that a larger deceleration of prices was anticipated in 1969 by several groups. Possibly, chairman of the CEA are congenitally disposed to be somewhat optimistic.

Mr. Okun asserted, for instance, in October 1968 that price movements had clearly decelerated. Most important for our issue concerning the responsiveness of prices is the reliability of our price indexes as measures of inflation. These indexes may be well constructed for some purposes, but not for purposes of reliably measuring the rate of inflation. This unreliability would be most relevant over a period of economic retardation just experienced. Tentative evidence presented in recent work by Stigler and Kindahl suggests that the actual deceleration is probably larger than the deceleration recorded in our official price statistics. While prices appear definitely less responsive over 1969–70 than in 1966–67, one should beware to perpetuate a fallacy of "nonresponsiveness" based on inadequate statistical information.

Representative BLACKBURN. Are you saying that those who use the indexes are using figures which reflect a lesser deceleration in prices than you believe is actually occurring?

Mr. BRUNNER. That is right.

Representative BLACKBURN. When perhaps the actual sales prices would be notably less?

Mr. BRUNNER. That is right.

Representative BLACKBURN. And if it were possible to record the actual price of goods sold, it would indicate that the rate of inflation of the last 6 months of last year was perhaps even a percentage less than what we have recorded?

Mr. BRUNNER. Possibly. But this remains a very uncertain problem in the absence of relevant price statistics.

Mr. PERRY. The wholesale price index is derived in substantial part by recording list prices. The consumer price index is not. The consumer price index is arrived at by shoppers buying things in stores.

Mr. BRUNNER. The consumer price index has some problems similar to the wholesale price index and some of its own in addition as a measure of the rate of inflation. At this stage I should return to your question about the psychology of inflationary anticipations. Professor Lekachman emphasized correctly the role of inherited inflationary anticipations. These anticipations remained moderate in 1967. But they accelerated subsequently and became quite entrenched and stubborn. The uncertainties of Government policies over the last 5 years contributed substantially to this development. So we face currently the problem of how to break these inherited anticipations.

Until last spring the business community was generally unwilling to accept the signs of an economic retardation. The retardation initiated in the fall of 1969 modified assessments more substantially by the late spring of 1970. This recognition lag expressed in many utterances by economists and business executives contributed probably to the lesser responsiveness of price movements last year. The reassessments in business plans spreading last spring and summer through the economy contributed probably to dampen gradually the inherited inflationary anticipations. But the policies to be pursued from now on could substantially influence the speed with which inflationary anticipations are revised downward. A solemn reaffirmation of the Joint Economic Committee's proposal of March 1968 combined with an extensive supply policy could effectively moderate inflationary anticipations.

Chairman PROXMIRE. Senator Pearson.

Senator PEARSON. Mr. Perry, in your study as to the interrelationship between unemployment and inflation, does that lead you to still accept the 4 percent unemployment as full employment?

Mr. PERRY. Let me start by giving you an indirect answer. I do not think it is for me to decide where the interim full-employment level ought to be defined, because it is going to be accompanied by a certain amount of inflation and will represent a compromise between our inflation and employment goals.

Senator PEARSON. What I was trying to say is that, suppose we use this figure of 4 percent as full employment. Now, from your study the relationship between inflation and unemployment, is 4 percent still a good figure for measuring it?

Mr. PERRY. If you take an inflation target and say full employment is the point where we have no more than some specified minimum of inflation, then at the moment you would have to settle for a higher unemployment target than before. This is because you are going to get more inflation at 4 percent today than you used to think you were going to get. This follows if you allow an inflation target to settle how far you can push employment.

But nothing has happened to make unemployment any less onerous as a result of my study. It simply says, it is a tougher world than we thought. Rather than setting an inflation target and letting that define full employment, you can go the other way and say, we have had to change our estimate of the inflation we accept at full employment; we still accept 4 percent unemployment, but we are going to have to learn to live with more inflation than we thought. For this reason, the question of what your target should be is not one that I would care to settle here. I can only point out that there is more inflation associated with the old target than there used to be. But that is not itself a reason to abandon it.

I think the more important implication of my study is that, because we do not want unemployment or inflation to the extent we can avoid either, we should do something structurally about these very great disparities in unemployment rates; that simply aggregate demand policy alone is not going to solve the unemployment problem to the same extent it would have earlier.

Senator PEARSON. I apologize for coming late today and not hearing all your statement. But in your emphasis on employment programs for the young, and in the attempt to find some alternatives to the draft, a proposal has been made of a national service system, Peace Corps, VISTA, armed services, conservation work, et cetera. But the big problem that people who think about this come up with is that there just are not enough opportunities, there are not enough jobs, there are not enough things to do to go into that kind of a system. What sort of a public service employment concept do you have for the young people who make up this increasing work force in the country?

Mr. PERRY. I find it hard to accept the verdict that there are not enough jobs. In the last resort, even a job that we might consider intrinsically not very useful is after all better than dead end unemployment. That leads you, in the case of young people particularly, into perhaps a whole life style that we do not care for, getting started in a way of life that I think is far more troublesome for society later on, even just viewing it in that narrow way. So any job is desirable. But I think that there are intrinsically useful jobs to be done. Professor Lekachman referred to a study in 1968 which pointed to opportunities for 5 million new public jobs in the kind of areas that the public is now concerned with.

But I think he can probably describe the kind of jobs that were envisioned at that time better than I can.

Mr. LEKACHMAN. You probably need to do some restructuring of job specifications. I would assume, for example, that a substantial program of public service employment would proceed hand-in-hand with further articulation of para-professional movements in hospitals, schools, and the like. And I think an imaginative combination of money and job redesigns would disclose an enormous number of jobs that are crying to be done in the understaffed hospitals, the understaffed schools, and even the law enforcement agencies. I assume there would be substantial opportunities. It is the constant cry of mayors and Governors all over the country that the public services are starved. And I would suggest that this would be one opportunity to feed them a slightly more nutritious diet.

Senator PEARSON. Let me ask you to educate me a little bit in regard to this last question. And that is, in what I am sure is an oversimplistic view of economic problems, I have developed the notion just as a layman that the kind of inflation that we had when this administration came in was the excessive demand type, where the supply of money is greater than the supply of goods produced and services produced and offered for sale, and that the fiscal and monetary policies put into effect by this administration had an increased rate of inflation, but that cost-push productivity problems had really been great fire, the new fire under inflationary pressures.

Now, am I wrong about that? And if I am wrong, or if I am partially right even, what about the proposal you make of greatly increasing the supply of money through the Fed?

Mr. LEKACHMAN. Let me say first, Senator, that I agree with your description of the sequence of inflationary measures. And I assume, therefore, that if one is going to have both rapid expansion and a sharp reduction of unemployment, without inflation, that it is going to be essential to follow one of two strategies. One is the strategy that Mr. Brunner, as I understood his testimony, was advancing, which is a radical free market strategy, I assume, although Mr. Brunner did not mention this specifically, that along with the trade policy alterations there would also be far more effective antitrust prosecutions.

Well, that is a possible strategy. I agree with Senator Proxmire that this is politically implausible, but I turned to what seems to me to be the only viable alternative, a very effective incomes policy which permits and legitimizes the expansionary monetary and fiscal policy. I do not see any prospect for success of the administration's expansionary, moderately expansionary fiscal policy, unless there is something done to control or revive inflation. My assumption is that if the economy really begins to take off, implausible as this appears to me that it would very quickly restart a rapid inflation, and that therefore either it will not be allowed to take off, by a cautionary Federal Reserve policy, or we will have to do something about an incomes policy.

Senator PEARSON. I take it you disagree with Mr. Burns, who says that the shortage is not of money but of confidence in the country today—I am sure you disagree with that?

Mr. LEKACHMAN. At the present time I find myself in reasonable agreement with him. But I suspect the accord is temporary, because if expansion really begins to pick up, this presumably will reflect a change in the confidence factor to which Mr. Burns alluded. And then Federal Reserve policy will become strategic. Right now he may well be right, that even if the Federal Reserve pumped more money into the system, it would have relatively little short-run effect.

Senator PEARSON. Thank you.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Like Senator Pearson, I too have had other responsibilities this morning. But I have gone over your statements, and I find them very interesting.

Professor Lekachman is a very distinguished New Yorker, and we are glad to have him here to hear his views.

I would not accept the fact that a strict antitrust enforcement and a reduction of the quotas and the defeat of the effort to impose new ones which we were successful in last fall is out of the question politically. But I agree with you, Professor Lekachman, that you cannot rely on that alone. And you have to consider the length of time that it takes to win antitrust cases, et cetera. But I do think that it should not be laid aside. I think that the rescission of the antitrust laws, which is urgently required, plus effective action, is a necessary element of your program, because I am with you on an incomes policy. I think it is critical. And I agree with the reasons for it. Public service employment, et cetera, will not do what needs to be done, though I am all for it.

But I would like to ask you this question. Don't you think that your incomes prescription is much too tight for this economy? You want to freeze things for 6 months, and then deal selectively with the problem, and you also want to essentially oppose the incomes policy on what you call the oligopolies. Well, the oligopolies have a way of resulting—like the Ho Chi Minh Trail. It is not one trail; it is 50 or 100. And it is the same with oligopolies, when you take into account their suppliers, and you start to deal with unions, you think you have a national union, but you don't, there are lots of locals.

I was going to ask you this. Don't you think that the best prescription—and we are in a deep crisis—the best prescription would be to fight the quotas, to endeavor to give the American business the competition which supposedly will sharpen it up, that you have—and incidentally, you have to keep an eye on domestic reserves in that connection, especially oil—and at the same time to have an incomes policy more or less like what the CEA recommends, the Wage-Price Board, which will start with flexibility. It may not be as effective, I agree with you on that. But if you couple the two you avoid the strait-jacket, which could also do two things:

One. Involve a terrible political reaction—remember that Truman was swept out of office in 1946 exactly on that reaction; and

Two. Introduce such rigidities in the economy as would make the remedy perhaps worse than the disease.

Mr. LEKACHMAN. Let me say, Senator Javits, that the combination that you are advancing is very substantially preferable to any policy which thus far has emanated from the Administration. I think that this would hold some promise of success.

I am making a guess, frankly, about its adequacy. And the guess really is related to apprehension that any substantial expansion in the economy will greatly increase inflationary pressures, so greatly as to make essential the legislative endorsement of guideposts, and some sort of an independent body outside of the Council of Economic Advisers would make this inadequate. Still, if such a combination policy had the effect of suiting Mr. Burns and his colleagues at the Federal Reserve, I would find it tolerable. I would assume that there would be rather more inflation than is desirable. But I would assume also that the Federal Reserve would maintain an expansionary policy. Such a policy is an essential of recovery. So that if I were presented with a choice between present policy and the policy you advocate, I would not hesitate for a moment, I would choose your policy even with some douts of its adequacy.

One point also, on the freeze there is no question that any time you freeze wage-price relationships you are freezing a whole collection of inequities. This is one reason I would assume that the freeze would be very brief, because the pressure on both Congress and the President to modify it and to release industries from its rigors would be such that it would stimulate creative ingenuity both in the executive and the legislative branches.

Mr. BRUNNER. May I comment, Senator?

Senator JAVITS. Please do.

Mr. BRUNNER. It is of course correct that a very expansionary monetary policy raises the likelihood of a new inflationary pressure. Such a policy would reinforce our trend into a persistent and volatile inflation. While guarding against this danger, we should also recognize some relevant orders of magnitudes concerning real GNP. It is instructive to compare the implication of the CEA's forecast with respect to the quarterly increases in real GNP for the fourth quarter this year as against the fourth quarter of last year adjusted for the GM strike. The forecast implies an increase in real GNP which is slightly above the rate of increase observed in 1961–62 within the first four quarters of the upswing. The rate of increase was approximately 7.7 percent in the first quarter 1962. In spite of the rapid acceleration of real GNP, the wholesale price index fell and the other major indices decelerated over the same period relative to corresponding quarters in the previous years. The movement of real GNP after the initial acceleration will, however, significantly shape the further development in prices. The initial acceleration cannot be allowed to continue if one wishes a substantially smaller rate of inflation.

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

Chairman PROXMIRE. Thank you.

Mr. Perry, as I mentioned earlier, the President has announced—just announced, it was in the paper this morning—a rather substantial, 250,000 JOBS program, requiring $800 million. Does this meet in any part your suggestions for training people who have low skills and are not qualified for the work force now?

Mr. PERRY. Well, it certainly is a step in that direction. I have had no time to study any of the details of that proposal.

Chairman PROXMIRE. Do you have in mind a larger program than the administration is proposing?

Mr. PERRY. Yes; I think you have to talk about a larger program.

Chairman PROXMIRE. How big?

Mr. PERRY. I think you are probably talking about a million jobs.

Chairman PROXMIRE. A million jobs. Well, if you have the same ratio that would be a $3 billion plus program.

Mr. PERRY. That is not even a lot of money. The only sort of new fiscal program the administration has proposed at the moment is to change depreciation guidelines for business firms. That is of a comparable order of magnitude in cost. And I just cannot imagine that it is of a comparable order of magnitude of social importance.

But there is another point about the cost of public employment. You should just consider the net cost, in effect the implicit subsidy in providing the job. It may be that you are going to give someone a $2 an hour job, and his productivity will be only a $1.70 an hour. Then the real cost of that is the 30 cents, not the $2. So even the budget cost greatly exaggerates the cost of providing this employment.

Chairman PROXMIRE. There is a further saving, too, isn't there, in that a person might be on unemployment compensation, and he might be on welfare?

Mr. PERRY. That is right.

Chairman PROXMIRE. Any number of payoffs.

Mr. PERRY. Whether it shows up or not, he is clearly a great cost to society if he is going to be on unemployment or welfare. If he is not, the cost may be less obvious. He may be knocking over old ladies and taking their handbags. But you cannot pretend that you can avoid the problem of having people without jobs by not doing anything about them.

Chairman PROXMIRE. Isn't this kind of a program—I do not want to press it too far, but isn't this kind of a program, even though it does result in the expenditure of money, likely to have some compensating effect on the anti-inflationary side, inasmuch as you make more people more productive, so that they are producers rather than just consumers?

Mr. PERRY. Absolutely.

Chairman PROXMIRE. If a person is alive he has to consume a certain amount, but if he is working he is producing something.

Mr. PERRY. There is really something sick about an economy that has involuntary, nonfrictional unemployment in it. We are always a little bit sick in this respect, so we tend to accept it, but I think we accept it much more than we should.

Chairman PROXMIRE. Your estimate of guideposts was considerably more optimistic than that of Mr. Brunner, and also considerably more optimistic than a study that I thought was one of the best made about this by Mr. Sheehan of your shop, Brookings Institution. This study indicated that under the best circumstances he thought it could make a contribution; that is, incomes policy and wage-price guidelines of 10 percent to combat inflation. You said you thought it could make a contribution of reducing the rate of inflation by 1 percent, which would be much more than one-tenth of the way?

Mr. PERRY. Yes. And what is more——

Chairman PROXMIRE. Why were you so much more optimistic?

Mr. PERRY. That is the way the facts look to me. I have studied this in several contexts, most recently in connection with this other analysis of the unemployment situation and its impact on inflation. It is admittedly a difficult statistical matter to discover how much the guideposts did in the course of explaining the whole history of inflation. But that is my estimate after a lot of study.

Chairman PROXMIRE. The Okun study was pretty encouraging in that respect too, wasn't it?

Mr. PERRY. Yes.

Chairman PROXMIRE. His analysis showed that much of the inflation we have had in the last couple of years has been in the concentrated sectors, we did not have as much inflation in the concentrated sectors in the early sixties. But in the last 2 or 3 years it has been in just exactly the areas where the wage-price guidelines policy would have their bite?

Mr. PERRY. Yes, that is right. He showed rather convincingly, I think, that as soon as President Nixon took office and made a very definite pronouncement that we were not going to have any more of this wage-price guide-posting, that a number of industries, precisely where you would have expected this news to have this effect, went up in their prices much more than industries as a whole; the increases looked selective in that sense.

All this evidence is somewhat fragmentary. As a result, many people keep saying we do not know much about it; we do not have much experience with this; you are just guessing that it will buy you 1 percent or something else. That is absolutely right. We do not have much experience. And what is more, what effects you will get will depend on the vigor with which the policy is pursued if it is ever adopted. But you still have a best estimate. You still think it will do some good, and what you really have to ask is, what is the alternative? To buy yourself 1 percent improvement in inflation by the present kind of policy, which is to slow down the economy and raise unemployment, which costs you about 1 million in unemployment. That is a simple estimate of what that route costs. The incomes-policy route may be equally beneficial, or might do more or less than this in slowing inflation. In any case, whatever little inconvenience it is to someone, the cost of trying it is a lot less than the cost in unemployment of going the other way.

By the way, I think the experience at the start of the Korean war would be well worth closer study. The experience there was really remarkable. We had a tremendous surge of inflation, with everything going through the roof. And suddenly controls were instituted. Everyone who was involved in that will tell you that within a short period of time we ran the economy at very low unemployment rates. Yet most prices and wages came off their ceilings, bottlenecks or shortages were rare, and we had relatively little inflation.

Chairman PROXMIRE. I think it was 1953 when we had less than 3 percent unemployment, something like 2½ percent.

Mr. PERRY. That is absolutely right.

Chairman PROXMIRE. And an inflation of only about 2 percent, or something like that. It was a remarkable year.

Mr. PERRY. And we really had more the threat, than the hard bite, of controls.

Chairman PROXMIRE. It has never been analyzed to my satisfaction.

Mr. PERRY. Nor to mine. That whole period actually was very satisfactory in terms of the combination of inflation and unemployment that we achieved.

Mr. BRUNNER. May I comment on the statistical result, Senator?

Chairman PROXMIRE. All right, sir.

Mr. BRUNNER. George referred to some interesting statistical studies. I wish to emphasize that these results provide no evidence on behalf of an income policy. The divergent results obtained in separate studies actually support the contention that the measured effect attributed to an income policy results more from pure chance than from a systematic effect.

Moreover, two considerations bear substantially on the interpretation of the statistical results. It should be noted that the results apparently favoring an income policy are consistent with a radically alternative hypothesis. This alternative emphasizes the erosion of inflationary anticipations in the early 1960's relative to the second half of the 1950's. This erosion resulted from the economic slack accumulated by 1960–61 and not from a spotty guidelines policy.

Another problem is more pervasive and fundamental. It should be recognized that all the results are relative to the statistical framework used. Without exception, these frameworks, expressed by the regression equations, have not been subjected to systematic assessment.

In summary, I find the evidence with respect to incomes policy at best very tenuous. On the other side, we do possess strong evidence that a vigorous supply policy would quite effectively brake the inherited rate of inflation.

Chairman PROXMIRE. What I think we need, and need badly, is to get away somehow from this paralysis that we feel, because we feel that we cannot get inflation under control without increasing unemployment. And this is something that is just politically unacceptable.

I would disagree vigorously with the position taken by Mr. Lekachman earlier that the administration is likely to snuff out recovery for fear inflation is going to get a grip on it. You may feel that way, but I have been in politics a while, and I do not think this administration is so much concerned about too much recovery, I think the nightmare they have is that come November 1972 we will have heavy unemployment. If you have more inflation, well, it is too bad, and people do not like it, but very few administrations have been turned out of office for inflation if you have got prosperity.

It seems to me the real likelihood is that the administration is going to keep pushing policies that will expand the economy.

Mr. LEKACHMAN. I defer to your judgment, Senator. But I would simply add that Mr. Nixon's wishes may not coincide with Mr. Burns' policies.

Chairman PROXMIRE. Fiscal policy can be expensive, too, of course. The administration has no control over that.

Mr. LEKACHMAN. You need a monetary validation of an expansionary fiscal policy. And I would question, whatever President Nixon's political exigencies, whether necessarily the Federal Reserve would underwrite these necessities.

Chairman PROXMIRE. Then I was getting around to another point. I would like to ask Mr. Perry, why wouldn't an economist spend more time analyzing some other trade-offs rather than simply the trade-off between unemployment and inflation? One good trade-off that has been suggested pretty emphatically today by Mr. Brunner is the import policy. That is one. But I do not think we have had adequate analysis in that area. We have a difference of opinion on it. Mr. Brunner made a good initial contribution here this morning, but I would like to see some real studies on it.

Another is measuring the effect of Government procurement especially defense procurement, on price stability. I do not think that has been analyzed. We have been after the Council of Economic Advisers for an analysis of the effect of defense spending. It is not partisan. Because the Johnson Council is even worse. They did not give us anything. This Council has given us very little.

Next, measuring the impact of industrial concentration on price stability, Gardner Means has done something, John Blair, and a few others, but not enough. And I think if we had that kind of analysis it would help us a lot in achieving the kind of antitrust policy that we just vaguely referred to as something which we would like to have, but we would like to have the statistical basis and the argumentative basis for it if it is going to become effective.

And also I think, while you gentlemen have discussed very learnedly the trade-offs on different types of incomes policies, we can use more studies in that area too. Why haven't we had more study?

Mr. PERRY. I agree with you. In an earlier and somewhat longer draft of my remarks, I listed some of the things you have talked about. I think that economists have much less disagreement with all the things you have cited than about some of the other things we have talked about. The one place on which I agree with Mr. Brunner's testimony this morning is in his insistence upon worrying about the supply side, and that getting rid of restrictions would be useful. I think there is analysis on this, but it is rather hard to price it out in terms of what any one thing it will give you on the Consumer Price Index.

But I think there is no question that the policy on trade quotas is very important. The regulated industries are regulated in a way which frequently encourages inflation. Government pay and procurement policies are frequently, I think, too permissive. Every one of these areas is important for the present inflation problem.

It is hard to put a price tag on any one item, just to answer why we perhaps do not throw numbers out as readily on these questions as on some others. But I think they are very important.

Chairman PROXMIRE. Congressman Blackburn.

Representative BLACKBURN. I just want to make this observation about my impression of the events of the early 1970's. When we had the outbreak of the Korean war we still had a heavy percentage of the population that was smarting under the shortages of World War II. They had a pentup demand, and they had a lot of money. And suddenly they saw the specter of no new automobiles, no new tires, and no more sugar and no more meat. And they went out and started buying things with the idea that they were not going to go through another World War II experience of shortages, at least they themselves were not. I think it was an abnormal situation that presented itself that created a rise there.

We have had some discussion about stronger antitrust enforcement. I am wondering this. Certainly we do have laws on the books that we hope will prevent one manufacturer or any combination of several manufacturers from completely controlling, say, the chemical industries in our country, or the electrical industries, although we did find there were some agreements among the chief electrical suppliers in existence several years ago that did go against our laws, and they raised the prices of a lot of our electrical supplies. Has anyone given any thought to the power of some unions to control the wage rates in some industries, particularly the automobile industry, increasingly in the trucking industry, and perhaps in some of our other industries? Has anyone thought about what we can do about that problem?

Mr. PERRY. Sure. I think the problem is altogether symmetrical. I am concerned about the market power and the ability of some unions to raise wages excessively. Indeed, I think that any time you talk about an incomes policy and a wage-price guidepost policy, it is very important that you treat wages and prices symmetrically, both because both pose a problem, and because you cannot expect compliance from one side and not from the other. You are absolutely right. And I think the President's actions on suspending Davis-Bacon, for instance, are to be applauded.

Mr. LEKACHMAN. I would add only that in the main I agree with Mr. Perry. I would add also on this, though, that in, say, the automobile industry, which you have cited, I think the danger looks to me a little bit different, and not untypical of this kind of industry. When business is good what you have is at times something close to a charade, that is to say, the unions press for very substantial gains, and the companies are screaming and kicking all the way, and then in the end, with or without strikes, they grant substantial gains, and then pass on to the public rather more than the gains that they have accorded the unions.

This is a process of implicit bilateral extortion. And I think that this occurs fairly often, under good demand conditions at any rate, in many of the manufacturing industries. And I am as concerned about the union share in this as the business share.

Representative BLACKBURN. Don't you think that there is a possibility that we could well price ourselves out of the market? Every time I go to get a new car I am more and more impressed by the price tag than I was the previous time. Aren't we going to encourage our people buying from the automobile industry to, either keep their old automobiles for a long period of time, or buy an import since it is beginning to look more attractive?

Mr. LEKACHMAN. I would say that in our sort of society we almost have a choice between two radical policies. Because I would take really vigorous antitrust enforcement as a radical policy. I would assume that it would involve fragmentation of some of our larger corporations. And that is a radical proposal.

I think that would be followed in a symmetrical way by a curtailment of the power of unions to bargain nationally.

Representative BLACKBURN. How would you curtail that? Would you allow the unions to operate only within a given geographical area?

Mr. LEKACHMAN. Confine them to individual plant negotiations conceivably. I have not really given adequate thought to that.

Representative BLACKBURN. I was thinking that a national union can still play one company against the other.

Mr. LEKACHMAN. Yes, economists have demonstrated that you get rather less than wage gains under some conditions where you have national bargaining. The construction industry in a way is illustrative of what can occur.

And just to complete the radical choices, Congressman, it seems to me that you do not adopt a truly radical free market policy which we have not in my lifetime at any rate experimented with.

Then it appears to me that there is very little alternative but to increase governmental intervention into the making of private wage and price decisions. I see no real alternative.

Representative BLACKBURN. I must say my own philosophy would be to avoid government intervention since when I look at the way of life that we have and compare it with the way of the life of controlled economy, I do not want us to become a controlled economy. Despite the deficiencies and inequities that we have in this country we are still so far ahead of the rest of them that I will take our problems any day.

Mr. BRUNNER. I wish to comment on the case concerning the electrical equipment industry mentioned in passing before. We all remember the collusive behavior prosecuted several years ago. This event offers an excellent case study of the role of governmental institutions and policies. Some of my colleagues at UCLA at the time examined the case in some detail. It emerged that prevalent procedures of governmental agencies partly conditioned the collusive responses. There exists consequently a major problem confronting many governmental agencies which bears on their operating procedures. One wonders to which extent such procedures foster price rigidities and malallocation of resources, both curable by suitable supply policies.

I also noted Senator Proxmire's interesting comments which appear to contain some material for a graduate student's thesis. There exists however, an incidental aspect of these comments on the reliable measurement of price movements. It should be noted that the National Bureau of Economic Research published recently a pioneering study by Professor Stigler and Kindahl, which assesses the reliability of the wholesale price index. The difference between actual and recorded price movements is almost dramatic. It is most interesting to observe that an index of actual prices associated with the electrical equipment industry shows a substantial decline over the period 1960–1965 compared to the component incorporated into the official index.

Representative BLACKBURN. I have no further questions at this time.

Chairman PROXMIRE. Senator Pearson.

Senator PEARSON. Mr. Chairman, your comment about defense spending and procurement leads me to ask one further question. And that is say, first, I am persuaded that we have really failed as a Congress and as a government to take care of the reconversion problems of industry. I am working on a piece of legislation now, it will not do very much, I am afraid, but it gives me some figures that I have in my mind that 10 percent of the work force is related to defense production, 22,000 prime contractors, and 100,000 new subcontractors, a thousand defense installations, close to 6,000 cities with a defense plant that they rely upon. And then in some of the weapons systems today technology outruns production, and you have systems that are obsolete by the time you get them to deployment. And then you end up—like in Wichita, Kans., where we have Ph. D.'s working in grocery stores in this sort of transitional period.

I think we have failed to face up to this. And I would just ask the panel, Mr. Chairman, if they have any suggestions as to how we could take care of this kind of problem. It is a waste when a young man does not have a job. It is an enormous waste when a very skilled physicist, expert at high temperature metals, or something, is working in a gas station. Have you any ideas?

Mr. PERRY. Why not put him to work on the pollution issue? Everyone is terribly worried about it. The fact is that very little research has been done in the pollution areas because only a small and fragmented industry has developed around the problem of controlling it. Now all of a sudden we find ourselves glutted with technical manpower.

If these guys are half as smart as they are supposed to be, then switch their interests slightly. I think this is an excellent place for the Government to get to work and start both using this glut of technical manpower and working on a problem that we talk about but we do not do anything about. I think research in this area would have a very high payoff, because very little work has been done.

Senator PEARSON. I recall some years ago that we were all criticizing the space program because it was drawing in all the technical knowledge and the experts away from other areas where they said they needed them. But I think there is a legislative proposal to see if you cannot provide for some local government technical help in this field.

Would anyone else like to comment?

Mr. LEKACHMAN. I would only add to this that clearly you have a very large problem with the retraining of technical manpower. And people who are operating as space scientists may need to be shifted; it may be more than a slight shift, to the problems of solid waste disposal, for example. It requires both a shift of attitude, and it also requires, I suspect, training periods of varying lengths which somebody is going to have to pay for.

Mr. BRUNNER. Your question refers to an issue of substantial importance. Large changes in the composition of Government expenditures impose a considerable uncertainty and social cost on the economy. The readjustments forced by large shifts in Government programs lower for some time employment and output, even at an unchanged total rate of expenditure.

The relative instability of many governmental operations and programs has affected over the past decades numerous cities, social groups, and a variety of institutions. Policies directed to the efficient use of our resources in order to improve the general welfare of our country should moderate this instability. Such moderation may be difficult to achieve under the present circumstances. George Perry's suggestion seems worth pondering in this respect. We should particularly remember that the larger the number of crash programs, even for "good purposes," the greater is the instability we build into the Federal budget. This instability extracts a substantial social cost.

Senator PEARSON. And the great surge out of Sputnik that pulled out these people from this field and directed them there, is that how the Government institutes a program that loses momentarily and fails to change with the times and conditions? I was using the example of the Government programs after Sputnik, where the great emphasis is on engineers and technical people.

Mr. BRUNNER. This is an example.

Senator PEARSON. Is that the kind of Government program that sort of loses momentum and becomes a detriment rather than an advantage in training our people? I thought you were making the point as to the instability of Government programs. And I asked you if our great emphasis on engineering personnel after Sputnik is an example of what you are talking about?

Mr. BRUNNER. The point I wish to emphasize is the relative instability built into many programs. In case this instability would not impose a burden of adjustment involving both private and social costs, we could disregard this instability. But the adjustment burden exists. The costs can be reduced in several ways. One seems suggested in your question. This involves the interrelation of resource uses in succeeding programs. It certainly seems important to examine how the instability mentioned can be effectively reduced, or its social cost mitigated.

Senator PEARSON. Thank you, Mr. Chairman.

Chairman PROXMIRE. Mr. Lekachman, you join a long list of distinguished economic witnesses who urged something with which I disagree. I would like to catch you up on it. Mr. Heller, Mr. Okun, Mr. Eckstein, Mr. Samuelson, Mr. Eisner yesterday, and now you say we ought to run a full-employment deficit. And you suggest a rather large one. And they were pretty consistent, they wanted a full-employment deficit of $8 to $10 billion. This would mean either cutting taxes now sharply, or increasing spending, or doing both. I challenge that. Because I do think that there is something to the notion that people are going to get the feeling that we are not serious about controlling inflation.

I think also when you look at the historical record, in 1954 and 1955, for example, we had a full-employment balance, and maybe a slight surplus, and yet the real GNP rose by 7.6 percent in four quarters. In 1958–59 we had a surplus at least as large as now in national incomes accounts, and yet the real GNP rose then by 9 percent in four quarters. Is it necessary for us to—is demand so weak now that we have to have a full-employment deficit of the size you are suggesting, go that far overboard, with all the psychological effects, with all the dammed-up prospects for future inflation that this implies?

Mr. LEKACHMAN. Anybody, of course, who is making a suggestion is doing some guessing, Senator, obviously. And my guess is that demand is weak. I do not see, looking at the major components, sufficient thrust either from the present forecast Government deficit in any sort of accounts, or in either consumer demand or likely investment demand. These are guesses. And such as they are, they are the ones that I find most plausible.

But I would add a further point. Even if events turn out more cheerfully, I do not think we will have done badly by increasing Government expenditures rather than cutting taxes—that would be my perference—or a variety of programs, coupled, that is to say, with the kind of incomes policy which would make the control of inflation a credible target. I agree with you that in the absence of a quite strong and vigorously applied incomes policy, a deficit of the size that we are speaking of would surely have severe inflationary effect.

Chairman PROXMIRE. I am reminded that a similar panel in 1958 made the same kind of observation; we didn't have that deficit but then the GNP took right off and we had a vigorous recovery.

Mr. LEKACHMAN. It could happen. It is conceivable. But I would not feel myself disconcerted if the economy began to recover, possibly even at the 9-percent rate, and we also drastically expanded public spending.

Chairman PROXMIRE. I am talking about a real GNP of 9 percent. We are very likely to get that. But we got that in 1958 and 1959.

Mr. LEKACHMAN. Not even the Council of Economic Advisers is expecting that much. But if their forecast seemed on the route to being verified, I would still view with some joy an increase in public spending on an array of needed social programs, for which the candidates are numerous—a welfare takeover, a version of revenue-sharing, possibly. There are various places——

Chairman PROXMIRE. We will have no trouble spending the money, there is no question about that.

Mr. LEKACHMAN. You reassure me. I think the unfilled social needs, and particularly the needs of the States and the cities, are sufficiently large so that the best way to guess, it seems to me, is on the expansion of Government spending. I think there is a recovery reason for it. But even if the recovery reason turns out to be partly inaccurate, I think the country would gain.

Chairman PROXMIRE. The Urban Coalition's proposed budget, incidentally, suggests about the same level of expenditure as the administration. They suggest a full employment balance, but they suggest a $16 billion reduction in defense spending. I favor that. But I do not think there is any prospect of getting it. So you could put into effect the Urban Coalition's budget pretty much with maybe a $6 or $7 billion cut in defense spending, and get about the level of full employment deficit that you are talking about. I am still not persuaded that would be responsible economic policy.

Mr. Perry.

Mr. PERRY. In the long run I think I would agree with you, we have to make a wild guess about what full employment budget we want further out.

I would be in favor of a full employment deficit at this time. But I would very much not like to see it in areas where you cannot reverse it. I would not like to see another reduction in the personal income tax, because you are never going to get that back. And I think that is important, and does speak to your concern——

Chairman PROXMIRE. Would you favor, for example, postponing the increase in the social security tax?

Mr. PERRY. Yes, but not my first choice.

Chairman PROXMIRE. Bringing the 1972 tax reduction to 1971?

Mr. PERRY. Neither of those ranks highest in my priority. But that is the sort of thing that would be clearly temporary, and clearly address itself to the need for more push at the moment but not necessarily a year from now.

Chairman PROXMIRE. But you would favor a full employment deficit in the order of what?

Mr. PERRY. I think you could go to a budget that was $5, $6, $7 billion, maybe up to $10 billion more stimulative than at present. Now, the present budget is not in balance. We are speaking of the national income accounts basis. So we are talking about a surplus of perhaps $5 billion. And the extra push I am talking about swings us from a deficit of zero to $5 billion.

Chairman PROXMIRE. You are talking about what again?

Mr. PERRY. The national incomes budget is the one that we usually look at for this purpose.

Chairman PROXMIRE. We were told by Okun, who claimed that it was based on the administration figure, that the national incomes account budget is in surplus about $5 billion.

Mr. PERRY. Exactly; so if he went $10 billion——

Chairman PROXMIRE. And the consolidated budget is in balance.

Mr. PERRY. Right; so if you went $10 billion further than the present budget you would be going into a $5 billion deficit on the national incomes account basis. But while we need this stimulus to reduce unemployment, I would fear renewed inflation if we were not doing a lot of things that are specifically anti-inflationary at the same time. Certainly people's vision of where policy is going, on balance, would be much more favorably impressed by a strong incomes policy that it would be negatively affected if we ran a deficit in the full employment budget. And I think the impact on expectations of the incomes policy would be much stronger than the impact of a larger deficit.

Chairman PROXMIRE. You are more optimistic than I am on that.

Mr. PERRY. I am not convinced that many people know what the full employment budget is going to be.

Chairman PROXMIRE. If we took off and spent another $5, $6 or $7 billion, I just wonder about the psychological impact. Business would know about it, and I think they would communicate it to the general public.

Mr. PERRY. We just had the actual deficit for the current fiscal year estimated at $18 billion. It had been estimated at a surplus of a billion and a half when this administration first proposed it. I did not really see people going out in the streets over that. And that is the kind of number that might shake them. So I don't believe that people respond in their expectations very much to that kind of number, any more than they respond in their expectations to the money supply. No one knows what that is, not one person in a thousand could tell you.

Chairman PROXMIRE. Including one economist in a thousand?

Mr. PERRY. Not one economist in a thousand really knows what to make of it.

Chairman PROXMIRE. They sure disagree over it overwhelmingly as to what can be done. You have Mr. Laffer up there, who is a very eminent young man who has persuaded the administration to go along with his analysis that if you increase the money supply 1 percent you get an immediate automatic increase in the GNP of 1 percent.

Mr. PERRY. That analysis is absurd.

Chairman PROXMIRE. I think it is, too.

Mr. BRUNNER. You have not the slightest evidence to indicate that this work deserves less credibility than any of the other major econometric models.

Mr. PERRY. You keep saying that I do not have evidence to say things. I have seen it in detail.

Mr. BRUNNER. You have not the slightest evidence, Mr. Perry. That is your opinion.

Chairman PROXMIRE. Do you want to respond to that, that you have no evidence, Mr. Perry?

Mr. PERRY. It certainly flies in the face of (*a*) all the evidence that monetarists have assembled over the years; and (*b*) all the evidence that Keynesians have assembled over the years; and (*c*) all the evidence that commonsense would lead you to believe. There may be a further vantage point from which someone can form a different opinion, but I do not know what it is.

Chairman PROXMIRE. Mr. Brunner, I would agree that econometric models are only as good as the assumptions which you put into them. And it is a matter of judgment and assumptions and so forth, analyzing those. But if you make the assumption—and I think the assumption can be characterized in my view as absurd—that the specific increase in the money supply is going to give you without lag—and that is what he said, without lag—an increase in the gross national product precisely commensurate with the increase in the money supply—I think that what has happened in just the last few months discredits that. The Federal Reserve Board has been increasing the money supply, but because the demand for money is so weak, it has not been picked up. And the effect on the economy has been that interest rates have dropped rather rapidly, especially short-term rates, but there has not been any real stimulation to the economy.

Mr. BRUNNER. I want to amplify the point that I made. I responded to the use of the word "observe." If George Perry would say that there is little evidence for this statement that there is a very short lag, I would agree with him.

Mr. PERRY. Good. But I was speaking of the model as a whole, not just the money term.

Mr. BRUNNER. There are several aspects involved in your comments. I find no reason to differentiate as yet between Laffer's model and competing other econometric models. No evidence has been accumulated thus far which enables such judgments. Your comments also emphasize that Laffer's model implies the absence of any lag in the response of economic activity to monetary policy. If this is the case, then Laffer's model is not consistent with the evidence accumulated over the past years.

(The following supplementary note was subsequently supplied for the record by Mr. Brunner:)

This is a supplementary note written after I had an opportunity to read the paper jointly authored by Arthur Laffer and R. David Ranson. Some general comments on the Laffer-Ranson model seem appropriate in view of the surprising vehemence of the reaction expressed by the expressive use "absurd" and the astonishing column in *Newsweek* of March 8, 1971, written by Paul Samuelson. It should be noted that such reactions were remarkably absent in the case of models used to justify the tax surcharge of 1968 even if such models were quite inconsistent with major and well confirmed pieces of economic analysis. There is also no need to react in a similar vein to George Perry's interesting work on the Phillips' curve. This work thoroughly disregards the operation of inflationary anticipations on the position of the Phillips' curve. Are his equations therefore "absurd"? Surely not, but they possess a dubious analytical status in view of the evidence concerning the role of inflationary anticipations which can be extracted from a variety of inflationary experiences beyond our boundaries and the last six years. It would seem useful to urge a more balanced judgment in this matter. My plea seems particular appropriate upon reading Samuelson's wholesale substitution of analysis and evidence by ad hominem remarks. The apoplectic response to the Laffer-Ranson model is particularly mysterious as the model does not necessarily preclude the occurrence of a substantial lag in the effect of monetary impulses. The stock market variable occurs with a substantial effect in the model's GNP equation. If the effect of past monetary impulses is caught by the stock market variable, then the true lag implicit in the model is positive. The situation of the model is somewhat unclear at this stage. In conclusion we should state that the evidence and analysis in support of a positive lag is still very strong. It should also be noted however that recent work in this and other countries has shortened somewhat the length of the lag relative to the original work by Thomas Mayer, Milton Friedman, and Kareken-Solow.

Mr. PERRY. It seems to me that you agree with my evaluation. I was speaking, by the way, of the whole model, not just the coefficient on the monetary term. But you supported just what I said, that an eminent monetarist like yourself would find it as objectionable as I do.

Chairman PROXMIRE. I have a few more questions. One is just to call your attention to the fact that Mr. Brimmer did a study which put a price tag on textile quotas and measured their potential effect on the consumer price index. Surely we could make similar studies of the tradeoffs that I have been suggesting. At the same time it is very useful, and the kind of thing that people can understand right away, when they can see the impact in that way.

Mr. Perry, didn't the Labor Department recently do a study on the effective minimum wage of young people, and conclude that it was not a significant deterrent to employment?

Mr. PERRY. I am not familiar with it but I am sure that that is so if you cite it.

Chairman PROXMIRE. One reason for high teenage unemployment now as compared to the past has been the rapid growth of the number of teenagers. And of course that is self-correcting, inasmuch as they will be entering the work force presumably as time goes on. And the birth rate seems to be diminishing, I am happy to say.

Mr. PERRY. I do not know whether it is that important or not. To explain all the relative changes in employment, I think that is probably an insufficient explanation; that is, there is more to it than just the increase in their numbers.

Chairman PROXMIRE. Mr. Lekachman, council member Herbert Stein just the other day stated: "Without any grand announcement, we have now taken on a large number of ingredients of what is loosely called incomes policy."

Do you see much evidence of that, apart from the Bethlehem Steel jawboning and the Davis-Bacon Act?

Mr. LEKACHMAN. It seems to me that these steps are very moderate, to say the least, and they give no particular convincing evidence of being part of a coherent program. It is true that, for example, the suspension of the Davis-Bacon Act was something which Mr. Burns was urging in his Pepperdine College address of December 8, as I recall. And he certainly regarded it as one of the ingredients of the incomes policy in his shopping list.

Chairman PROXMIRE. That is one of his 11 points.

Mr. LEKACHMAN. Yes.

So they are doing some things certainly which are consistent with an incomes policy, but bathed in an anti-incomes policy rhetoric. We were advised, I believe, on one occasion by Attorney General Mitchell to observe what the administration does rather than what it says. Nevertheless, it is not much of an incomes policy of the President speaks in one direction and acts tentatively and moderately in another.

I hope that Mr. Stein is right, that is to say that what he is speaking of is some kind of a coherent strategy.

Chairman PROXMIRE. Tomorrow we are having Secretary of the Treasury Connally, and he has emphasized the desire of the administration and Congress to continue the wage-price control legislation—that enables the administration to freeze wages and prices. The administration has indicated that they may use that to freeze construction wages, and they may use it in other areas. So this begins to look as if they may go further than many of those who have advocated incomes policy have in mind.

Mr. LEKACHMAN. It is conceivable. And I hope that this is what the shift in the administration's position, the removal of the President's authority, signifies.

Chairman PROXMIRE. You would favor a comprehensive wage-price freeze?

Mr. LEKACHMAN. I would. I am not hedging any political possibility in this. I would, if it were possible, prefer a congressional mandate of the freeze rather than a simple continuation of the President's authority at his own discretion to impose such a freeze.

Chairman PROXMIRE. There is before our committee, the Senate Banking Committee—I introduced legislation yesterday, which we are going to presumably pass rather quickly, to extend the President's power until June. This would give us an opportunity to hold more extensive hearings as to whether we should extend it further, whether we should put limitations on it, whether we should mandate it, as you suggest. The mandating proposal is the first time I have heard that suggested, that Congress might take the bit in its teeth and require the President to put it into effect. That suggests a lack of flexibility. It seems to me it is very, very hard for Congress to say that by the time the legislation passes we are going to need wage-price controls.

Members of Congress seem to feel—and I am inclined to share that view—that the time may come when you need to put it into effect, but that it should be a last resort and we should try other things to see if they will work first, because you go very far when you freeze wages and prices. They may require additional bureaucracy to enforce the freeze.

Mr. LEKACHMAN. If I might suggest, Senator, my own pet scheme—which strikes me as politically plausible of passage as peace in the Middle East, possibly—still, I would myself favor a scheme which went something like this. A congressional mandate of a wage-price freeze with an instruction to the President to prepare a scheme of selective or other controls which would go into effect once approved by Congress.

I would assume that the pressure upon both the President and the Congress to operate expeditiously, and to make the controls as limited as possible, would result in a rather brief freeze.

Chairman PROXMIRE. Gentlemen, I want to thank you very, very much. You have been most helpful. Your statements have all been very informative. You have been highly responsive.

The committee will stand in recess until tomorrow. We meet in this room at 10 tomorrow morning to hear the Secretary of the Treasury, the Honorable John Connally.

Thank you very much.

(Whereupon, at 12 noon, the committee adjourned, to reconvene at 10 a.m., Friday, February 26, 1971.)

THE 1971 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 26, 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 Miller; and Representatives Reuss, Brown, and Blackburn.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowsky, research economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Secretary Connally, you are our cleanup man. You are the administration's last witness and the committee's last witness on the President's Economic Report.

These have been among the most comprehensive hearings on a President's Economic Report that have been held in the 23 years of the committee's existence. We have heard from a large number of administration witnesses, perhaps the largest number of administration witnesses the committee has heard possibly ever, and certainly for a long time.

The administration has been very cooperative indeed. Only one Cabinet officer, the Secretary of Defense, refused to come before the committee. And the testimony of the administration witnesses has been uniformly competent. Their responses to interrogation have been frank and full.

In our report on these hearings, we have tried for years now to make this committee as constructively critical of whatever administration has been in office as we could. This is a bipartisan committee with a Democratic majority that will have to write a report this year on a Republican administration's stewardship of the economy.

Whatever bipartisanship we may or may not have achieved in foreign policy, there has been healthy and wholesome disagreement in domestic policy, and this year there seems to be more of that healthy and wholesome disagreement or, to put it another way, criticism by Democrats of the Republican administration, than in a long time.

The economy is a big issue, maybe the big issue between the parties.

We all know that, and yet we should try, and we are going to try very hard to write a report on the President's Economic Report that will not only be fair, but will try hard to find areas of agreement. I am sure we agree on goals, and as chairman of the committee I promise to do all I can to work toward policies this committee—Democrat and Republican—can unite on.

Mr. Secretary, I have never been exactly the No. 1 Connally man in the Senate. You are not exactly my choice for Democrat of the year.

I have disagreed with you on many issues and I expect to continue to do so. But I respect your intelligence, the force of your personality. You bring a vigor, a let's-get-things-going style into this administration that is mighty welcome.

Your role on a beginning-incomes policy, from what I have heard, has been an important and decisive one in the administration and I think that already is a very significant contribution.

I wish you well in your task, your new task as Secretary of the Treasury. I am looking forward to your appearance today. You may proceed in your own way. You have a very concise statement indeed, as I told you. I think it is one of the briefest we have had, but it is a good statement. If you wish to elaborate on it in any way as you proceed, you may do so.

Secretary CONNALLY. Thank you, Mr. Chairman.

Chairman PROXMIRE. You might identify the distinguished gentleman with you.

STATEMENT OF HON. JOHN B. CONNALLY, SECRETARY OF THE TREASURY, ACCOMPANIED BY PAUL A. VOLCKER, UNDER SECRETARY FOR MONETARY AFFAIRS; AND MURRAY L. WEIDENBAUM, ASSISTANT SECRETARY FOR ECONOMIC POLICY

Secretary CONNALLY. I shall, sir.

Mr. Chairman, on my right is Mr. Paul Volcker, the distinguished Under Secretary of Treasury for Monetary Affairs; on my left Mr. Murray Weidenbaum, the Assistant Secretary of the Treasury for Economic Policy.

May I say at the outset I have been looking forward with a great deal of anticipation to appearing before this committee because of the reputation which this committee has justifiably earned in the consideration of problems facing this country.

Second, in keeping with the distinguished chairman's remarks, I hope I can be a cleanup man instead of a cleaned-up man—[laughter]—when I finish here today.

Third, may I say that whatever the chairman's past feelings about me may have been, I think you are certainly imbued with a consistency, Mr. Chairman. [Laughter.]

But whatever, I do not frankly think our differences are as great sometimes as they are made out to be. But in any event, I have nothing but great respect and admiration for you, for your dedication to your views, for your conduct of this committee, and these hearings. In these difficult times I recognize full well that I have taken on a very difficult task. I did so only with the hope really that there might be some contribution I could make. I hope I can.

Certainly, before this committee, as other committees of the Congress, I will do my best to be responsive, hoping that the members of this committee will recognize that in the time that has been allotted to me in my confirmation and my appearance, that it has been impossible for me to be fully informed on every aspect of the Treasury activities and there may be some questions that I cannot satisfactorily respond to. If I feel that I am not capable of doing so, I will so advise the chairman and other members of the committee and, if I may, with the Chair's permission, ask either Mr. Volcker or Mr. Weidenbaum to respond to them in the interest of providing information to the committee which you obviously seek and which you want and to which you are entitled.

I will read my prepared statement, if I may; it is relatively short, Mr. Chairman, and then be available for questions.

Chairman PROXMIRE. All right.

Secretary CONNALLY. In appearing before this distinguished committee, I would like briefly to develop and emphasize certain basic elements in the approach of the administration toward our economic problems. The elements will provide a focus for my efforts and I believe they will command widespread support in the Congress and in the country.

First, with a sizable pool of unemployed workers and excess capacity, the main instruments of policy are properly turned toward encouraging and facilitating economic expansion. This approach is reflected in the willingness of the President to accept a deficit in the Federal budget during the current fiscal year and prospectively in fiscal 1972. It is also reflected in complementary monetary policies by the Federal Reserve.

Plainly, budgetary deficits would not be appropriate in a period of strong demand and low unemployment. Even now, with demand slack and unemployment high, it is important that we keep Federal spending within full employment revenues. The President's budget fully respects that limitation.

Moreover, I am convinced that the planned deficits, resulting essentially from the recent sluggishness of the economy, can be financed without impeding flows of funds to other uses.

Second, while seeking strong and lasting economic expansion, we must continue to deal with remaining inflationary pressures. These pressures are mostly of the "cost-push" variety, reflecting an imbalance between rising wages and other costs and productivity growth. Renewed economic expansion should, at least for a time, bring faster than average productivity increases. This will help stabilize unit costs. But, where practicable, we must also be prepared to act more directly in the interests of price stability.

As you know, the administration has been moving in a number of specific areas to reinforce the disciplines of the market.

For the longer run, the persistence and extent of inflationary pressures underscore the need to find better ways of reconciling growth with price stability. This administration dealt forcefully and effectively with the overheating and excess demand pressures that characterized the late 1960's. By those actions, the groundwork has been laid for a better price performance, provided that renewed growth remains balanced and orderly.

At the same time, we must press ahead with more specific measures that, over time, can help improve our longer-term price performance. We must not shrink from necessary actions to improve the functioning of the labor market or to reinforce competitive pressures in markets for goods and services.

Third, we must recognize that we live in an interdependent world. Our actions and our performance have an important bearing on developments abroad, and we are, of course, affected by others. Points of strain and tension in these relationships are apparent.

The plainly unsatisfactory state of our balance of payment is one of the sources of strain. We fully recognize that this position needs to be strengthened. Unchecked, the present imbalances risk eroding the stability of the international monetary system and the fabric of cooperation upon which all countries are dependent. The result would be to impede the flow of trade and investment that underlies the economic prosperity of the free world.

We also know that there are no quick or easy answers to this problem, either for the United States as a deficit country or for the surplus countries which make up the counterpart of our deficits.

What is plain is that we must carry out our own part of the responsibility for an improved structure of world payments. Most fundamentally, this requires orderly growth with price stability in the United States. Fortunately, this fundamental is consistent with our domestic policies and objectives.

During the past year, the international monetary system has functioned well despite abnormally large movements of short term funds in response to interest differentials. Our very large deficit on the official settlements basis mainly reflected outflows of banking funds, which reversed the inflows that had temporarily bolstered our position in the previous years.

Coping with large swings in short-term flows may be a price that we have to pay for maintaining relative freedom of capital movements and some independence in national monetary policies in a world of convertible currencies. These swings and flows will, of course decline to the extent that national economies can in the future move more in step with each other.

In conclusion, I am in no doubt as to the extent of the economic challenge before this country. We are embarking on a program of achieving simultaneously expansion and improved price performance. Success in those objectives will help our international financial position as well. We cannot afford to fail in this effort.

I accepted appointment as Secretary of the Treasury in the belief that we can meet these challenges and that the Treasury can play a large role in that effort. But the task is a very big one. It will engage the energies and the understanding not only of the Congress and the Executive, but of American business and labor as well. I am confident that we will not be found wanting.

Mr. Chairman, I shall be pleased now to attempt to respond to any questions.

Chairman PROXMIRE. Thank you, Mr. Secretary, thank you for a very helpful statement.

Mr. Secretary, we have had divided analyses, I should say analyses that resulted, that give divided results, different results on the economy from the administration's economic experts.

The general position of the administration as expressed by the Council of Economic Advisers, the Director of the Budget, Office of Budget and Management, has been that we will have a $1,065 billion economy in the coming year and that this will be made up of a diminution in unemployment to around 5 percent, on an average, and inflation will go down to perhaps 4½ percent.

On the other hand, we have had a different estimate from the Department of Commerce. They estimate we will have a $1,045 billion economy, and that inflation will be about, will be close to what it has been and we will have an unemployment continuing at about the present level, maybe a little improvement but not much.

The Federal Reserve Board seems to have an analysis that is close to that of the Department of Commerce.

Now with this divided opinion, division, within the administration, on which side do you come down?

Secretary CONNALLY. Well, first, I certainly do not want to start off questioning the basic premise of the chairman, but I really do not believe the Department of Commerce, as such, made a $1,045 billion estimate. I think that estimate arose out of some staff report and was not, so far as I know, the position of Secretary Stans, nor is it the position of the Commerce Department.

Chairman PROXMIRE. Well, Secretary Stans appeared before this committee, I asked him for his estimate, and he referred to Mr. Passer, who is his economic expert. Mr. Passer gave the Department of Commerce estimate on the basis of what their estimates, analysis, show and, as I recall, it was $1,045 billion.

Secretary CONNALLY. Well, be that as it may——

Chairman PROXMIRE. Secretary Stans did not contradict that. He seemed to accept it. Maybe I misunderstood him. He seemed to accept what he would feel was their Department's estimate.

Secretary CONNALLY. Be that as it may, I think the thrust of the matter simply is that the administration only has one position, and that is that it anticipates a $1,065 billion GNP in 1971.

Now, obviously there is a difference of opinion, much of it in the press, among economists throughout the country. Most economists in the prviate sector, I would say, average out in their estimates at about $1,045 billion to $1,050 billion.

Now, you asked specifically where I stand. My position is entirely and completely in support of the administration position of a $1,065 billion GNP, with my own analysis of what that means. I want to say at the outset that I think we have tended, perhaps the administration as well as the Congress, economists and everyone, to place too much emphasis on precise figures.

The $1,065 billion is in iteslf no goal. The goal is what the $1,065 billion represents. The policy of the administration basically is to attempt to revitalize this economy and, at the same time, continue to bank the fires of inflation and, simultaneously, to try to provide a basis for sufficient economic activity to employ more people, to reduce the number of unemployed from 6 percent down to a more acceptable level.

Now, those are the goals. Depending on what factors and what assumptions you make, those goals can be achieved short of, perhaps, a $1,065 billion GNP. They might also not be achieved unless you have a higher figure than $1,065 billion.

Chairman PROXMIRE. I want to get it clear whether you are talking about a goal or talking about an expectation.

As I understood the Council of Economic Advisers, and Mr. Shultz, this was their expectation. They felt the most reasonable likelihood was to have an economy that would have a $1,065 billion, the numbers are not important except the numbers, besides the economy, indicate what is going to happen to employment.

They may also indicate, depending on your assumption of what is going to happen to inflation and there, of course, is the heart of what we are trying to get at.

I think the goal of $1,065 billion, I would not quarrel with that at all, that is a fine goal. In fact, I would very much like to see us achieve that and a little more.

The question is, what is realistic, what can we achieve?

You say you feel $1,065 billion is your expectation; is that correct?

Secretary CONNALLY. Yes; I think that is the expectation of the administration. It is basically the expectation on which the budget estimates were based so it is more than a goal.

Chairman PROXMIRE. Now what troubles this committee very, very much, and it troubles the eminent economists who have appeared before us, including Mr. Burns, Mr. Samuelson, a Nobel laureate one of the most outstanding economists in the world; he was outraged and shocked that the administration estimate was arrived at this way, the allegation, I hope you can disabuse me of that they have arrived at their estimate based on the views of an economist named Laffer, a 30-year-old man, a fine young mathematical economist, who has a monetary model.

That monetary model, in the view of the economists who appeared before us, is highly simplified, the assumptions on which it is based are very, very optimistic, and that lone model, that lone prediction, seems to be the only basis the administration has for this very rosy outlook for the economy.

I hope you can correct me on this.

Secretary CONNALLY. Well, Mr. Chairman, I think that is entirely incorrect. I think to assume that the administration's expectations, predictions, budget estimates, are solely based on Mr. Laffer's model is wholly and totally incorrect.

The $1,065 billion figure basically was a Troika number. It was developed prior to the time that he even established his model.

Let me say something with respect to the distinguished economist whom you quoted a moment ago and whom you named. I have found in talking with economists, Mr. Chairman, that they, like everyone else, differ with each other to a remarkable degree. So I think you just have to pick the best advice that you can.

But I think it is fair to say that the $1,065 billion figure that is being used was the product of many people over many weeks and many months of deliberations, of calculations, and should not be attributed to Mr. Laffer alone, however competent he is.

Chairman PROXMIRE. Well, I hope that—of course, I know you are telling us the facts as you see them.

Secretary CONNALLY. Yes, sir.

Chairman PROXMIRE. But I have not seen any other analysis. When I questioned the previous witnesses, the administration witnesses, who held to this estimate, as to what it was made up of, they could not tell me until much later, until finally Mr. McCracken wrote me a letter and indicated the Council expected a very large increase in personal consumption, and some other ingredients that seem to be questionable, but there was no indication that they had made a separate kind of analysis that was based on anything other than the Laffer model.

At any rate, let me get to this point: The economists who appeared before us say that whereas you do have the full employment balance in this budget on the consolidated budget basis, they say the national income accounts basis is the best way to judge the effect of the budget on the economy.

The national income accounts is a different measure than the consolidated budget. It takes into account accruals, it takes into account other elements.

Now, using the national income accounts, Mr. Arthur Okun and other eminent economists who appeared before us said you would have a surplus, a full employment surplus, a surplus of $5 to $6 billion in that budget. This would restrain the economy and keep it from growing, that surplus would tend to do that. Also, we got the picture from Mr. McCracken that there was not much of a likelihood that the economy would be stimulated by the budget inasmuch as the full employment surplus or balance was about the same in 1971 as in 1972. In other words, there was not much change, and the change Mr. McCracken assured us, is very important.

Now, where is the stimulation coming from that is going to give us this substantial increase in economy in the coming year and in view of these criticisms by competent economists?

Secretary CONNALLY. Well, first, let me just register a mild disagreement, mild only in intensity because it is in complete disagreement with the statement that the national income accounts is the best way to present the budget.

As you know, the unified budget basis of presentation largely stems from a commission which was appointed by President Johnson——

Chairman PROXMIRE. Your predecessor was Chairman of it.

Secretary CONNALLY. Sir?

Chairman PROXMIRE. Your predecessor, former Secretary Kennedy, was Chairman of it.

Secretary CONNALLY. And distinguished Members of Congress were on it. It resulted in some confusion, particularly with respect to deficits, and so forth. But, be that as it may, I think that the submission of the budget on a unified basis is, indeed, probably the best manner of presenting the budget.

Chairman PROXMIRE. Well, now, I think you are right on the best way to present the budget. I would say that is correct. And I was an enthusiastic supporter of the consolidated budget because we have the entire picture before us but, once again, I say the economists seem to insist it is not the best way to evaluate the impact on the economy itself, a better way than the administrative budget, but they argue the NIA is a still better one.

We can disagree on that. You take one position on that and I am sure many competent economists agree with that. Anyway, it is a suggestion that the economy is unlikely to get the kind of stimulus in the view of many outstanding experts.

Let me ask you this, my time is about up: What steps have you in mind the administration might take in the event the economy does not move ahead? I am talking about fiscal steps, like possibly reducing taxes or speeding up the reduction in taxes, 1971, deferring social security taxes. Do you have anything like that as a possible shift in policy if you find the economy is not moving ahead?

Secretary CONNALLY. Not at the present time. We are obviously watching the economy constantly to see how the actuality compares with the predictions, the economic predictions of the recovery during this year of 1971.

I think there are two factors that are most critical to a stimulation of the economy.

One is the budget itself which calls for the level of spending which it does, with a consequent deficit. Badly as we hate to see a deficit, we feel that in a slack period of economic activity and high unemployment a deficit budget is justified.

That in itself and the level of spending should be a very considerable stimulant since Federal Government spending represents about 20 percent of the economic vitality of the Nation.

Secondly, there is no question but what this budget and the expected recovery this year rests to a considerable extent upon the monetary policies that are followed.

There is no question but that this budget anticipates that there will be an ample supply of money available.

These two things are really the cornerstone on which this recovery is anticipated.

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

Congressman Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman.

Let me say you and I, Mr. Secretary, are sharing a first-time experience. This is my first week on this committee and I am enjoying it a great deal. You appeared before our committee in the House earlier this week, and I found your testimony there as frank and candid and as informative as it has been here today.

Mr. Secretary, I have a very distinct feeling that some in our country are trying to put you and the administration on the horns of a dilemma. They are trying to say, on the one hand, that the projected gross national product is much too high and, therefore, we will run a greater deficit in what is projected based on the gross national product.

Naturally, if the gross national product is far less than $1,065 billion, our revenues are going to be less and, therefore, the projected fiscal situation will be more—there will be a far greater deficit than what we project at the present time.

The same people who are making such predictions are deploring the fact that we are not predicting or working toward a greater surplus.

Now, do you not think that there is a little inconsistency in this position. The people who want us to have a greater deficit than what we are projecting should be applauding the high gross national product estimate on the basis that it will result in a greater deficit.

Secretary CONNALLY. Congressman, I have two observations to make in response.

No. 1, I think it is fair to say, and we would be less than candid if we did not admit it, we are on the horns of a dilemma already. I do not know who put us there and obviously there are some who want to keep us there, no question about that.

We are on the horns of a dilemma because, on the one hand, we are trying to still the impetus of inflation that has plagued this country for the last several years, trying to slow the rate of inflation. At the same time we are trying to stimulate the economy in order to create more jobs to reduce the number of unemployed. This is a difficult position to be in. There is not any question about it. It is going to take forbearance; it is going to take patience, as well as intelligence and wisdom, to try to bring it about.

Now the other observation I have to make is simply, I do not want the record to reflect that I necessarily agree with your statement that if we do not reach the $1,065 billion that we will necessarily have much larger deficits. That could well happen. A lot depends on the manner of recovery. Obviously the extent of it is important. The manner of it is also important.

You can make certain assumptions, that you can have a recovery, a stimulation of the economy, but if you assume you have it all in real growth, that you have no inflation whatsoever, this results in much higher profits, therefore much higher tax receipts, so we might indeed have a gross national product of less than $1,065 billion and yet have increased revenues depending upon the mix that results.

Now, I am not saying that is going to happen. I am saying it can happen. But I wanted to enter that just mild disclaimer.

Representative BLACKBURN. In other words, you feel that we could have the increase in gross national product due, to some extent, to increase in productivity?

Secretary CONNALLY. That is correct.

Representative BLACKBURN. Which would mean greater profits?

Secretary CONNALLY. Correct.

Representative BLACKBURN. And therefore the revenue loss by reason of the lesser figure of gross national product would not be as great?

Secretary CONNALLY. I think it is fair to say that in recovery periods we can expect to have better productivity than we have had in the last several years. Productivity has been extremely low in this country for the last 2 or 3 years.

I can be corrected, but it is running in the range of about 1 percent productivity growth, that is all; some years less than that, about seven-tenths of 1 percent, I believe the year before last. But history shows that in almost every single recovery period you do get an increase in the productivity growth.

Representative BLACKBURN. Do any of your economists have any figures to indicate whether or not there is a change in productivity on the way at the present time?

Secretary CONNALLY. Well, I do not think we have the figures, only in terms of what we anticipate and expect to gain in terms of the $1,065 billion. That figure is based on about a 9-percent growth rate. About 5 percent of it is anticipated will be in real growth, and about 4 percent in inflation.

Representative BLACKBURN. Well now, how much monetary growth do you feel that we should hope for if we are going to have a 4-percent inflation, which appears to be probable, and we are hoping for a 5-percent growth, and how much monetary growth would you personally like to see?

Secretary CONNALLY. Well, I am not sure that I want to put a figure on it. I would simply answer that, and I am not trying to be evasive nor beg the question. We are obviously going to have to have an ample supply of money if we are going to have the recovery that we anticipate, and I think we will have it.

There is no question but that in appearances before the various committees, to some extent I was chacterized as being somewhat at variance with Mr. Burns because of things I said, I believe, before your committee with respect to the fact that I did not think the 1.1-percent growth in the supply of money in January was going to permit us to reach our goals.

I went further and said that I did not think the average of about 3 percent that has obtained since September was going to permit us to do so. But these situations change.

Now at the rate we are running in February, it is probably going to go far in excess of the 1.1 percent in January. I do not know yet, but you cannot look at any one week because the changes are so volatile. We have to look at it over a period of time.

I am not going to put a precise dollar amount or percentage on what I think should be the exact amount of money supply. I am going to simply say again that I am not going to be in juxtaposition to Mr. Burns. He is a man for whom I have very great personal admiration. By any standards he is one of the most distinguished economists in the country. He has been in and out of government for many, many years. I think he is one of the most learned men in or out of government in this country in his field. His goals are no different from the goals that the rest of us have. I am of the view that he is not going to permit any repressive actions of the Federal Reserve Board to thwart the recovery which is so essential to this country.

Representative BLACKBURN. Now, what indicator would you use to show that monetary policy is either too loose or too tight? If an increase in interest rates occurred, would this be a sign to you that perhaps we should change our monetary policy?

Secretary CONNALLY. Obviously, the supply of money has been increasing, the availability of it is certainly there. The interest rates have gone down. To give you an example, a little over a year ago short-term Treasury bills were carrying a tag of about 8 percent. They are now about 3.64 on short-term bills. There has been an enormous decline particularly in short-term interest rates. Now it has also affected long-term interest rates but not to the same extent.

Representative BLACKBURN. Does this lead you to believe we should remove the 4¼-percent ceiling on Treasury notes? What effect would this have in financing the debt?

Secretary CONNALLY. Well, we asked the Congress for removal of the four and a quarter percent climitation on long-term Government bonds. We did so for a number of reasons. The basic reason we asked for it was simply we think it is good business in debt management to have the authority when circumstances are such that the issuance of long-term Government bonds is advisable. The ceiling of four and a quarter percent was imposed in 1918, and has not been changed since that time.

The Ways and Means Committee of the House indicated they were not going to remove the ceiling, but they propose to give us a $10 billion exemption from the operation of the limitation.

Representative BLACKBURN. Would this tend to save the Treasury money?

Secretary CONNALLY. Sir?

Representative BLACKBURN. Would this tend to save the Treasury money?

Secretary CONNALLY. In my opinion, it certainly will. You have to look at the overall question of debt management. In the early part of the 1960's, because you had a relatively stable economy with very little inflation in it. the Treasury Department was able to issue long-term bonds even with the ceiling in existence. It was the issuance of those bonds that has kept the debt manageable, because beginning in 1965 your interest rates were such that we could not issue long-term bonds and none have been issued since 1965.

In 1965, the average maturity of the outstanding obligations of the Treasury was 5 years and 9 months. At the end of January 1971, that average maturity had decreased to 3 years and 4 months. So this means that we are turning over this enormous debt at the rate of approximately a hundred billion dollars a year. This creates counterproblems. So, it is in trying to get ourselves out of this position—of trying to manage this enormous debt within a short time frame—that we asked for the lifting of the interest ceiling.

Representative BLACKBURN. Mr. Chairman, my time has expired. I would like to submit a question though to have answered later, I am going to have to leave.

Chairman PROXMIRE. All right.

Representative BLACKBURN. Mr. Secretary, in view of your testimony that we are still fighting cost-push inflation, would you have prepared an answer for the record, on whether or not you think we should have some revision in our antitrust laws as they relate to business and labor?

Thank you, Mr. Secretary.

Secretary CONNALLY. Thank you.

(The following was subsequently supplied for the record:)

A subcommittee of the Domestic Council is presently reviewing the Administration's antitrust policy to determine whether there should be any change in that policy or in the antitrust laws themselves. As a member of that subcommittee, I am currently considering whether inflation could be significantly curbed by altering the Administration's antitrust policy or by amending the antitrust laws. To date, I have not reached any conclusion as to whether some revision of our antitrust laws as they relate to business and labor would materially help to reduce inflation.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

On behalf of the Democratic side I want to welcome you, Secretary Connally. You are a Democrat.

Secretary CONNALLY. Thank you.

Representative REUSS. Under Secretary Volcker served under the Democrats, Assistant Secretary Weidenbaum votes Republican, but he frequently thinks Democratic. [Laughter.]

Chairman PROXMIRE. The kiss of death. [Laughter.]

Representative REUSS. I wrote you, Mr. Secretary, about tax loopholes 2 or 3 weeks ago, I believe it was on February 2, referring to my proposal for tax reform, round 2—a legislative package which would raise $6 billion a year by plugging the following loopholes. Oil and gas percentage depletion and intangible drilling expense; capital gains on property transferred on death; a unified gift and estate tax, eliminate payment of estate taxes by redemption of Government bonds at par; tax generation skipping trusts; increase capital gains holding period to 1 year; terminate capital gains treatment for stock option; and tax interest on State and local bonds, with a compensating subsidy to States and localities. All of those are well-known loopholes, and most of them have been the subject of Treasury recommendations in the past.

Do you support or oppose this legislative loophole-plugging package?

Secretary CONNALLY. Well, I hope, Mr. Reuss, you will forgive me if I cannot just say yes or no, I do or I do not.

Representative REUSS. I did write you because I did not want to take you by surprise, but anyway, it is a big package.

Secretary CONNALLY. Yes.

Representative REUSS. And I will be grateful for just, if you want, a yes or no.

Secretary CONNALLY. I do not want to give you a yes or no. I will be delighted to respond to any one of them, to the extent that you will permit me to do so.

Representative REUSS. Yes.

Secretary CONNALLY. I am not sure I can give you a complete or satisfactory answer.

Representative REUSS. Right. There are in all 10, the first three have to do with oil, gas, and minerals and they are, respectively: (1) Eliminate percentage of depletion in case of excessive cost of oil, gas, and other minerals; (2) eliminate the deduction for intangible oil and gas drilling expenses; (3) eliminate depletion on foreign-based oil wells.

Secretary CONNALLY. Let me basically approach it this way: With respect to extractive minerals we should start off by recalling, as I know you do, that in the Tax Reform Act of 1969 percentage depletion was dropped 5½ points, 22 percent from 27½ percent, the first time it has been decreased since it was enacted in 1926; and that a number of other substantive changes were made with respect to the tax on extractive minerals. The ABC transactions and the carved-out production payments were eliminated, all oil and gas operations were made subject to the minimum tax on tax preferences, and some adjustments were made in foreign tax credits. The result was that additional taxes in the range of $700 million were imposed on the oil and gas industry in the Tax Reform Act of 1969.

Now, I do not at the present time view our situation with respect to basic fuel supplies in this country as warranting any additional changes. So, to that extent, I would disagree with your recommendation that we again go into this problem and make substantial changes in the tax structure.

I think, Mr. Reuss, more properly perhaps, we should be concerning ourselves, and I mean this quite seriously, about our basic fuel supply, because I think we are at the point of, just at the threshold of an energy crisis in this country. I do not think there is any question about it.

Now, we have to be quite candid in recognizing that we no longer have the capacity to supply the fossil fuels to completely satisfy the needs of this Nation, and, particularly, we are now unable to assist any of our friends in Western Europe, in the free world. We have seen this brought into clear focus recently in the negotiations that are being carried on by the OPEC countries with the major international oil companies. They just met in Teheran, and they are now continuing negotiations with other countries in North Africa, particularly Libya. There is not any question in my mind but that the OPEC countries, and this includes all of the nations of the Arab world as well as Venezuela, are determined that they are going to take a very strong hand in the future management of the production of fossil fuels from their countries, and that certainly is understandable. But when you consider that Western Europe has to have those fuels, when you consider that Japan has to have those fuels, when you consider that we cannot any longer meet our needs and supply theirs, I think we ought to start turning our attention not to discouraging further development and exploration for fuels in this country but rather toward taking steps to encourage every type of development of energy.

Representative REUSS. The fourth proposition has to do with the present loophole exempting capital gains taxes on property transferred at death. Do you have a feeling about that?

Secretary CONNALLY. Mr. Reuss, I know I do not want to be presumptious enough to suggest that the words that you used——

Representative REUSS. Legal method of tax avoidance, let us say that. Good.

Secretary CONNALLY. But I was going to register a mild objection to the word "loophole."

Representative REUSS. You are quite right.

Secretary CONNALLY. Because this is a matter that Congress has acted on. Again, there are wide differences of opinion about it. I am not sure that I have a very strong position on that particular point. There are very smart tax lawyers who argue both ways. It is a very complicated thing. Although it sounds relatively simple, it is not at all.

Representative REUSS. You do not agree with the proposal of the Treasury Department of December 1968 entitled "Tax Reform Studies and Proposals," in which it was suggested that this method of tax avoidance be done away with?

Secretary CONNALLY. No; I would not say that I would agree with it. I do not think that was a Treasury proposal. I think that was a staff proposal which was never adopted by the Treasury Department nor by the administration.

Representative REUSS. And you do not agree with it?

Secretary CONNALLY. No, sir.

Representative REUSS. No. 5, a proposal to unify gift and estate taxes into a single transfer tax. That also was a recommendation of the Treasury staff in December 1968.

Secretary CONNALLY. Well, here again, Mr. Reuss, you get into, you know, highly technical tax considerations. On the one hand, if you combine them, on the face of it, it will make things fairly simple. On the other hand, it seems to me, that if you combine them you destroy the incentive really for people to give money during their lifetime. I suppose this gets back to a basic question of whether or not you think people who, by whatever means, acquire any material wealth should keep it until they die or whether or not you want to have a tax policy in this country that encourages those who have wealth to give to young people before their death.

I personally adhere to the latter philosophy. I think that we ought to encourage gifts by people, as we traditionally have, and as the present laws provide, so that parents can give their children or their kinfolk or whomever money in order to hasten their productive participation in this country.

Representative REUSS. No. 6 of my proposals is to eliminate the payment of estate taxes by redemption of Government bonds at par. That is the avoidance or loophole whereby an elderly gentleman can go out and buy U.S. bonds at 68, and then when he dies a couple of weeks later, his estate can turn them in at a hundred. The average taxpayer would just love to be able to buy 68-cent dollars to pay his Federal tax bill, I really think this loophole is somewhat of a gyp.

Secretary CONNALLY. We do not issue these bonds any more. There are still some outstanding. Perhaps Under Secretary Volcker would care to elaborate on it.

Representative REUSS. Maybe you agree with this one. All I would do would be to prohibit the further issuance of these loophole bonanzas.

Secretary CONNALLY. Under Secretary Volcker says by law if we issued long-term bonds we probably would have to issue some of this type. We have not done so simply because we have issued no bonds at all.

Representative REUSS. That is one reason I am opposing your "Let us issue $10 billion in long-term bonds proposal," because I sense, and now you have confirmed it to me, that you intend to use this as a further opportunity to churn out bonanzas for wealthy taxpayers.

Secretary CONNALLY. No, no. It is part of the law. We would not do it for that purpose. We obviously are going to follow the law with respect to the issuance of the bonds.

Representative REUSS. Yes, but the law, unless you plug the loophole, permits you to issue these bonds which, I think, are an outrage. But, anyway, I have your answer on that.

Secretary CONNALLY. Yes, sir.

(The following was subsequently supplied for the record:)

THE SECRETARY OF THE TREASURY,
Washington, March 8, 1971.

HON. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed is the material requested by Representative Reuss during my testimony of February 26 before the Joint Economic Committee.

There was also a colloquy between Representative Reuss and me with respect to Representative Reuss' proposal to prohibit further issuance of Treasury securities which can be redeemed at par in payment of estate taxes.

The Treasury Department has joined Mr. Reuss in this proposal, and I would appreciate it if the record of those hearings would indicate our support.

Sincerely yours,

JOHN B. CONNALLY.

Representative REUSS. Number 7, tax generation—skipping trusts. There, again, that is recommended in the Treasury's December 1968 proposals. How do you feel on that one?

Secretary CONNALLY. Well, here again, you get to a very fundamental question of whether or not you want to continue the present custom that prevails in this country whereby a man can leave a life estate to a son and remainder to his grandson, and I see nothing wrong with that.

Representative REUSS. Number 8, increase capital gains holding period to 1 year.

Secretary CONNALLY. Well, this was considered in the Tax Reform Act of 1969. The House passed the Tax Reform Act with that provision in it, but the Senate knocked it out. I certainly would not be for such a change at this particular point in time. I see no real justification for it and, at a time when we are trying to stimulate the economy I think this would be a very deep depressant, and I would not recommend it.

Representative REUSS. Number 9, terminate capital gains treatment for stock options.

Secretary CONNALLY. This, I think, was also, Mr. Reuss, a part of the Tax Reform Act of 1969 to a limited extent. The act increased the tax on long-term capital gains and provided a 50-percent maximum tax rate an earned income thereby narrowing the difference in tax rates applicable to these two types of income. Also, the bargain element of the stock option at the time of exercise is treated as a preference under the minimum tax. I doubt we would get any revenue from the change you propose because we would have to give the employer a deduction if the bargain element were to be taxed to the employee as ordinary income.

Representative REUSS. Number 10, and the last in my legislative package, is to tax the interest on State and local bonds, with a compensating subsidy to States and localities. This again, to refresh your recollection, was done in the House version.

Secretary CONNALLY. Right.

Representative REUSS. But in the 1969 act it was dropped in conference. How do you stand on that?

Secretary CONNALLY. There is a good argument—at least the statements are made and I accept them at face value—that the Federal Government, because of the revenue that it could obtain if State and local bonds bore interest that were taxable, would recover more than the subsidy would cost. But I would oppose doing away with the tax exempt status of State and local bonds and replacing it by Federal subsidies as a matter of policy. I just do not think that State and local governments ought to be dependent on the Federal Government for any more resources. As a matter of fact, I would go the other way, I strongly recommend revenue-sharing so that there is greater freedom on the part of State and local governments to manage their own affairs.

Representative REUSS. Thank you for the very forthright answers you have given on the 10 points in my legislative package. I do not think it would be an exaggeration to say that, in your view, the Reuss loophole-plugging package is an idea whose time has not yet quite come. [Laughter.]

Secretary CONNALLY. Well, I would simply say, Mr. Reuss, that I do not think it is universally accepted.

Representative REUSS. I am disappointed to hear the rather hard-line attitude of the Treasury, because in this time of a really alarming upcoming Federal deficit in the budget, at a low level of employment and in a stagnating economy, and in view of the continued taxpayers' revolt in this country—the feeling on the taxpayers' part that it is unfair that these avenues of escape still exist—I do think it very much in the national interest to adopt a loophole-plugging program just as soon as possible. But we cannot agree on everything.

Secretary CONNALLY. Mr. Reuss, no, sir.

Representative REUSS. And we agreed happily on so many other things the other day.

I would ask, Mr. Secretary, that you file with the committee, if you would, the Treasury's latest figures on those high-income taxpayers, you might group them from $250,000 up in annual income, who entirely escape Federal income tax by reason of tax loopholes. There were a number of those a couple of years ago, which the general public got quite exercised about, and I would like to know to what extent that still persists.

Secretary CONNALLY. I will check to see, Mr. Reuss. I do not know whether any list has been filed since I have been there but I will do the best I can.

Representative REUSS. Do the best you can, not just since you have been there, but in the last year or two.

Secretary CONNALLY. I doubt, in view of the minimum tax and tax preferences provision of the Tax Reform Act of 1969, that there would be any who do not have to pay tax.

(The following was subsequently supplied for the record:)

In 1968, the latest year for which full statistical data is available, 222 persons with "adjusted gross income" of $200,000 or more reported no tax due. Preliminary data indicate that 301 persons with adjusted gross income of $200,000 or more will report no tax due for 1969.

Of course, the major provisions of the Tax Reform Act of 1969 did not become effective until 1970 and the tax returns for 1970 are not due until April 15, 1971.

Representative REUSS. Unfortunately, loopholes were left as to tax-exempt bond interest and some other things, so I fear that if the public knew what was going on it would become even more upset.

Thank you, Mr. Chairman.

Chairman PROXMIRE. You spoke, Mr. Secretary, about the estimate of $1,065 billion being a Troika estimate, that is of the Council of Economic Advisers, the Office of Budget and Management, and the Treasury. There must have been a range of possible gross national product levels. Was a $1,065 billion right in the middle?

Secretary CONNALLY. No; I do not think it was in the middle. I think it was on the high side. I think the range ran from roughly $1,040 billion—I do not say this necessarily was in the Troika—it ran from $1,040 billion to $1,075 billion depending on what basic assumptions you make and what credence you wanted to give to a 7 percent rate of recovery. For many years, most economists in the country have underestimated the extent of the recovery by a considerable margin.

There were a lot of factors that went into it. I think the $1,065 billion was admittedly, perhaps, on the high side of the average.

Chairman PROXMIRE. Were you a member of the Troika when this was——

Secretary CONNALLY No, sir.

Chairman PROXMIRE. This was before you became Secretary of the Treasury?

Secretary CONNALLY. Yes, sir, basically.

Chairman PROXMIRE. You are positive that there was a specific meeting at which this figure was agreed upon?

Secretary CONNALLY. I cannot cite you chapter and verse, no, sir, but there is no question——

Chairman PROXMIRE. You tell me it was a Troika decision?

Secretary CONNALLY. Yes, sir; it was but I do not recall what date there was a meeting or what hour. There is no question but what Secretary Kennedy, Mr. McCracken, and Mr. Shultz were all involved in this, not once, but a number of times.

Chairman PROXMIRE. What estimate did you make about monetary policy, or were made I should say, because you were not a member of the Troika?

Secretary CONNALLY. No, sir; I was not.

Chairman PROXMIRE. Do you know from what you heard about it, what estimates were made about monetary policy, the outlook for the future?

Secretary CONNALLY. That there had to be an ample supply of money available.

Chairman PROXMIRE. What did that mean? Did you have any figure for the increase in the money supply?

Secretary CONNALLY. I do not have a figure and I do not think if I knew, I would want to repeat it because I do not think anyone knows. The figure has been so kicked around that I do not want to attribute it to anybody. I do not know who used it. They were talking generally in terms of 6 percent, but I would not use that figure. I do not think it is important. I think you have to look at the overall question of not only the M-1 figures but your M-2 figures.

Now, I said a moment ago that the money supply increased by 1.1 percent in January. I was talking about the M-1 figures. If you used the M-2 figures, the increase would be about 14 percent. If you knock out the large CD's, it is still 12 percent on this modified M-2 basis. Those moneys include the moneys that are in time deposits.

Chairman PROXMIRE. But there was no specific assumption about what kind of monetary expansion we should have whether M-1, M-2 or M-3 reserves or whatnot. It was just an estimate with a vague so-called ample money supply that would probably get you to a $1,065 billion gross national product average in 1971.

Secretary CONNALLY. Mr Chairman, so far as I know, there was not. I assumed if there were, that Mr. McCracken would have listed that as one of the ingredients in the reasons he gave to this committee, and I do not know whether he did.

Chairman PROXMIRE. Was the $1,040 billion estimate, that was not the Treasury estimate, was it?

Secretary CONNALLY. No, sir. I do not think that was the Treasury's estimate. [Laughter.]

Chairman PROXMIRE. Because you say a range from $1,040 billion to $1,075 billion.

Secretary CONNALLY. Mr. Chairman, when I was using the range of $1,040 billion to $1,075 billion I was talking about the general range of forecasts by economists. I was not talking about the troika or the Treasury staff range.

Chairman PROXMIRE. I had asked you about the possibility of using tax policy to stimulate the economy in the event the economy was not moving rapidly enough, and you said you made no decision to defer some social security taxes and moving the 1972 tax reductions into 1971. Could you give us any notion on how you feel about an investment tax credit as a stimulus for the economy? There has been a lot of talk about that. We know there has been a slowdown in business investment in plant and equipment. I wonder whether now the business investments tax credit has been ruled out.

Secretary CONNALLY. No, I would not say any of these matters have been ruled out. I think it is too early to make the affirmative decision to support any of them. By the same token, I certainly do not want to say that we rule out any possibilities.

Chairman PROXMIRE. Repealing the excises, is that a possibility, too?

Secretary CONNALLY. Of what, sir?

Chairman PROXMIRE. Repealing the excise taxes.

Secretary CONNALLY. I doubt that that would be the approach that would be taken, but again, I would not want to rule out any possibility.

Chairman PROXMIRE. The huge jump in wholesale price index which we heard about yesterday, fantastic increase, and the biggest 2-month increase in many a month, I guess many a year, of course, was shocking but, there was specific reason for the increase last month, I recognize, particularly in the price of beef and I assume that is not going to be repeated, nevertheless this does suggest to us that inflation is still very much with us, still a very serious problem, and I am still not clear on what the administration's policy is with respect to getting it under control.

On the one hand, they seem to condemn controls or even guidelines. On the other hand, you did ask for an extension of the standby authority on wages and prices, and I put in a bill yesterday to do it. We are going to have hearings before our banking committee shortly about that and before my subcommittee on that.

Right after the administration asked for that it seemed to backtrack from the construction wage issue by not providing for a freeze or a guideline there, but simply for repeal of the Davis-Bacon Act, which seems to be a relatively mild, and some people say, an ineffective expedient.

Are you going to invoke controls, Mr. Secretary, any real prospect that you might?

Secretary CONNALLY. Not in the foreseeable future. May I take exception to the statement that we asked for these controls. It probably is more accurate to say that we acquiesced in them. We did not resist them. The administration last year did oppose them but Congress passed them.

Chairman PROXMIRE. I disagree with some members of this committee on my side of the aisle. I am not for price controls now and I think this is an interesting statement of yours. I might be persuaded to drop my bill that I have just introduced. I think we might say we will not have wage-price controls and not give the President that authority. We had Mr. Burns and others say that this could be a dictatorial kind of authority. If we gave it we should give it for a very short period of time.

Secretary CONNALLY. Yes.

Chairman PROXMIRE. And I think if you have the attitude that it is something you do not care much about maybe we ought to forget it.

Secretary CONNALLY. Well, in my testimony with respect to this, Mr. Chairman, I think I made it abundantly clear that even though we would have the authority, we would not use it unless we came back to the Congress for further specific authority to do so.

Chairman PROXMIRE. Then, you never had in mind to use it in the construction industry. You were not going to put in a freeze and you were not considering the use of that?

Secretary CONNALLY. Let me make clear what I am talking about is general wage-price controls. The answer to your question with respect to the construction industry was, yes, in the limited area for a limited time, it might be considered differently than it would be on a general basis.

Chairman PROXMIRE. Well, you see that legislation that we were considering renewing is the basis, as I understand it, for your being able to use it in the construction industry.

Secretary CONNALLY. That is correct.

Chairman PROXMIRE. So, if we do not put it into effect you will not be able to use it with respect to construction, transportation, or any other industry that is likely to have an inflationary settlement?

Secretary CONNALLY. That is correct.

Chairman PROXMIRE. Then, you would want it?

Secretary CONNALLY. We acquiesced in the passage of it with the understanding that on the general issue of imposition of wage and price controls, it would not be done without coming back to the Congress for again securing a very clear mandate.

Chairman PROXMIRE. But on a limited basis you might very well put it into effect?

Secretary CONNALLY. It is possible. That option was available.

Chairman PROXMIRE. And was not used, that is right.

Secretary CONNALLY. Was not used.

Chairman PROXMIRE. Again, it is very important for me to understand this because I think that some of us in the Congress may not be willing to go ahead with it if you just say, "Well, we acquiesce in it but we are not particularly interested in having this power", because you do not even think you will probably put it into effect on a limited basis.

Secretary CONNALLY. Well, obviously, Mr. Chairman, I think any administration wants as much flexibility as it can get with respect to any of its problems, so I do not want to be in a position of just saying to you that you ought to preclude us from taking certain actions. I tried to be frank and candid about it in simply saying, even though the administration has the power, it does not generally look with favor upon the imposition of wage and price controls or even a wage stabilization board.

Chairman PROXMIRE. I understand, Mr. Secretary. You are an intelligent man and a decisive man and I have got great respect for you in these respects.

Do you feel that you might need an authority to use price and wage controls on a limited basis or not. If you do feel you might need it perhaps we should put it in, we should pass it. If you do not feel you should need it then I think there is good argument we should not pass it. I do not believe in forcing something on the President he does not want, that he is indifferent to.

Secretary CONNALLY. I do not think we need it at this point. I doubt that we will use it. But I am not going to say that we are just going to turn our backs on it, no. If the Congress wants to delegate that authority to the President we are certainly going to accept it.

Chairman PROXMIRE. You are more passive than I thought you were.

Let me ask you, Mr. Secretary, about your position on guidelines. The administration finally spoke out and did some jawboning with respect to steel. Bethlehem proposed, as you know, a sharp increase in steel prices, the President spoke out, I thought with real force, and he got some results. I was disappointed he was not able to get better results, but he did get some results. Nevertheless, we now have a situation where the President has indicated he may speak out under some rare circumstances but there is no guideline, no comprehensive indication, no suggestion to labor or industry as to what kind of a policy the administration is aiming at. There is, I think, a feeling that labor and management would probably get away with very substantial price increases before this President is going to blow the whistle. Would we not be better served by a definite policy we knew about in advance so that everybody would know what the rules were?

Secretary CONNALLY. Well, on the face of it, Mr. Chairman, it sounds as if my answer should be in the affirmative.

But as a practical matter, my answer will certainly be modified to this extent. I think you can assume or the country should know, as a matter of fact that, No. 1, the President does not believe in mandatory wage and price controls. No. 2, he does believe in the free play of bargaining within the market. No. 3, he does not believe that wage and price controls or a wage stabilization board or guidelines will work, not for any extended period of time, at all. It did not work here in the sixties, it has not worked in Canada. It has not worked in Great Britain. There is no recent experience anywhere in the world that I have heard about that would lead one to believe that it was a satisfactory answer.

No. 4, I think it should become clear to everyone, industry and labor alike, that he is going to start expressing himself in a very forceful manner with respect to increases in prices that he thinks are not justified under the circumstances and increases in wages that he thinks are out of line with what is happening in the country.

Chairman PROXMIRE. This is good news, the President is now going to jawbone then, I take it, very clearly when he thinks wages and prices are out of line; he is going to say so and going to say so emphatically. I think it is most important because he is the one Federal official, the one person in the nation, who can be listened to and get national attention and can focus public attention in these matters. I think it is very good news.

Let me ask you just one more question, my time is just about up.

We have had economists on both sides of this. Frankly, most of the private economists who have appeared have favored an income policy and, as you know, the Chairman of the Federal Reserve did too, and by income policy I mean guidelines and I mean some kind of a wage-price review board, that kind of thing. You do not. Those who did not favor this kind of policy, however, had another alternative. Their alternative was to hold prices down by a supply policy, particularly with respect to imports. They feel more steel imports, oil imports and others should presently be admitted. You have already spoken to some extent on oil. but I still cannot get through my head how we can justify opposition to the free flow of Canadian oil into this country in view of the fact that Canadian oil is security safe, in view of the fact that the one justification we have heard over and over again for oil import quotas is national defense. They are at least as secure as Alaskan oil, they are more secure than offshore oil, why could we not have oil from Canada come into this country? It would greatly help our state and it would not threaten the domestic economy in oil.

Secretary CONNALLY. Mr. Chairman, the President, as a result of the increase in gasoline prices did increase the quota by 200,000 barrels a day on the importation of crude oil.

Chairman PROXMIRE. Why do we have to have any limitation on the importation from Canada? It was a very light increase, really. It is a lot of oil but percentagewise it is not.

Secretary CONNALLY. Basically, the limitation was, as I understand it, a restriction on the inportation from Canada. It was closely watched because we were receiving into this country Canadian crude and Canadians, in turn, were supplanting their own crude with Venezuelan crude. They were shipping us their crude and then meeting their own needs by the importation of Venezuelan crude, which was obviously getting around the quota program.

Chairman PROXMIRE. Even Venezuelan crude is from the standpoint of national defense, safe. We have relatively dominant control of the oceans in this Hemisphere. I agree with you we should not ever get in position of relying on Middle Eastern oil, but from the national standpoint the hemispheric oil in this Hemisphere ought to remain free.

My main point is I just do not see any real anti-inflation policy in this administration other than a fiscal and monetary policy which now, as you say, has to be expansive, there is no indication of a coherent income policy, either on the supply side or the wage-price guidelines side.

Secretary CONNALLY. Well, I thought I just pointed out that there is not an incomes policy in terms of establishment of a wage-price board because I tried to point out the President does not believe it will work.

Second, he is opposed to imposition of mandatory wage and price controls, because he does not think the country would stand for it and he does not think it is justified.

Third, he should have made it abundantly clear in his actions with respect to gasoline prices, his actions with respect to steel prices, his actions with respect to construction wages, he should have made it clear to the people in the country, both labor and management and industry, that he is concerned about what they are doing and he is going to continue to be concerned.

Chairman PROXMIRE. Senator Miller.

Senator MILLER. Thank you, Mr. Chairman.

Mr. Secretary, a recent study by a Harvard. economist, Dale Jorgensen, shows a recent liberalization of the business depreciation schedule will in the long run have the effect of decreasing unemployment by one-tenth of 1 percent. I have heard other estimates that the depreciation changes will have a very minimal effect upon the unemployment picture, certainly in the short run and probably in the long run.

Now, what else can we do taxwise, that might give us a better impact on unemployment. The investment tax credit has been alluded to. I find some support for investment tax credit among some of the business community, but they went through the on again and off again, on again, off again, treatment of the investment tax credit, and there is a great amount of concern over the fact that, as I recall, some 60 percent of the total tax savings from the investment tax credit went to the benefit of some 250 major corporations throughout the United States, so that the smaller businesses and farmers received what might be called the crumbs of investment tax credit.

I am wondering if there is not something else we can do. For example, if legislation were to be introduced calculated to provide an incentive with respect to growth income, the purpose being to encourage businesses to grow and, of course, to provide more jobs, would you have your people over there give it a good hard look, because I am afraid that we are just playing with the fringes on the depreciation liberalization, certainly if Mr. Jorgensen's estimate is pretty nearly accurate.

Secretary CONNALLY. We certainly will look at it.

Senator MILLER. I think we need some suggestions from the Treasury Department going beyond the depreciation changes which you did not need legislative authority to put into effect, and the investment tax credit is talked about. But I can see where putting it back in to a limited extent, with a limitation which would enable small businesses and small farmers to receive some benefit on this but without letting 250 major corporations pick up the lion's share of it, would have a good response.

But there is quite a budgetary impact by the investment tax credit even if you have a limitation on it. We went all through this in the Finance Committee a couple of years ago, but there ought to be some way of doing more, taxwise, than changing depreciation allowances so that one-tenth of 1 percent relief in unemployment will be the fall-out effect.

Secretary CONNALLY. Well, Senator, I have two observations to make. First, I do not question the impact of the depreciation change. You are a distinguished tax lawyer, you know full well that there were many reasons, even more paramount really than its impact on the economy, for the change in depreciation schedule.

Secondly, from your observations and from your questions it appears that you assume that present policies are not going to work. We are not yet prepared to make that assumption. If the administration becomes convinced that these policies will not work, I do not think we will have any hesitancy in coming back before you with whatever ideas we might have, including tax reductions or investment tax credit.

Senator MILLER. Please understand, I did not wish to imply that I do not expect the President's policies not to work, and I certainly think everyone hopes they will work. But in the testimony we received from Arthur Burns, Mr. Burns, and also some statements made in response to questions of the Council of Economic Advisers, I think we all understand that there are many premises and assumptions contained in the forecasts, and if, as Paul McCracken admitted, some of those assumptions go by the boards, if the assumptions of reasonable stability in the international scene and on the domestic scene is frustrated by long costly strikes or loss of exports in major export sectors, then all bets are off.

Secretary CONNALLY. That is correct.

Senator MILLER. And it seems to me that the tax angle has a great potential, and that it ought to be looked into very carefully even assuming that the President's programs are going to take effect. I think we need as many arms in our arsenal to fight the unemployment problem and the inflation problem as we can get.

You have some very distinguished tax people and economists over in your Department, and I think that we would like to at least informally talk with some of them. I do not suggest that they send legislative proposals down, but I think we would be very receptive not only on this committee, but on the Finance Committee to have some informal visits about some of the possibilities.

Secretary CONNALLY. Senator, we would be delighted any time, obviously at your convenience. We talk about these problems all the time. We have come to no conclusions. We have no present recommendations to make to the President or to the Congress, but I would not want you to think that we do not even consider the possibilities. We do, and we would be delighted to discuss them with you, any of us at any time.

Senator MILLER. Well, thank you.

Now the other night I was at a meeting and a statement was made by one of the speakers that we ought to have import controls against imports coming into this country where the reason they were coming in and competing effectively against our own domestic goods was because of wage rates by the exporting country to the United States, which were far below a reasonable level.

I suppose there are some cases where this can be shown to be the fact. I understand there are many other things involved besides wage differentials with respect to export competition and import competition, but what would be the attitude of the Treasury Department, on doing a survey, especially with respect to our major trading partners, to determine the degree to which their increase of exports to the United States or their competition against exports from the United States in international markets is effectuated through the wage differential.

Secretary CONNALLY. Well, Senator, we certainly recognize that this is a problem but if you will not, and I do not propose that you go this far, if you will not import anything where wages are lower than ours you would not import from any place in the world.

Senator MILLER. I am not suggesting that, but I am talking about a case where there are other differentials in the overall costs of products, but the wage differential is the decisive one and it is abnormally low, let us put it that way.

Secretary CONNALLY. All right, sir. Let me give you some comparative figures between 1968 and 1969 in various countries around the world which I would like, Mr. Chairman, if I may, to insert into the record at this point.

Chairman PROXMIRE. Without objection, it will be inserted at this point in the record.

(The information referred to follows:)

HOURLY EARNINGS OF WAGE EARNERS IN MANUFACTURING INDUSTRY, VARIOUS COUNTRIES, 1968 AND 1969 [1]

[In U.S. dollars]

	1968	1969	Absolute increase	Percentage increase
Belgium	1.07	1.17	.10	9.34
France	.92	.99	.07	7.60
West Germany	1.20	1.34	.14	11.66
Italy	.71	.78	.07	9.85
Netherlands	1.04	1.15	.11	10.57
Sweden	1.91	2.09	.18	9.42
United Kingdom	1.04	1.14	.10	9.61
Japan	.67	.80	.13	19.40
Canada	2.39	2.58	.19	7.94
United States	3.01	3.19	.18	5.98

[1] 1970 data not yet available. Data are averages for calendar year, adjusted for e change rate changes.

Source: Department of Labor, Bureau of Labor Statistics.

Secretary CONNALLY. But for purposes of discussion, I would like to give you comparative figures. Belgium, for instance—these are hourly earnings of wage earners in manufacturing industries.

Senator MILLER. For what year?

Secretary CONNALLY. 1969, which is the last year we have reliable figures, these are in terms of U.S. dollars, Belgium is a $1.17, France is 99 cents, West Germany is a $1.34, Italy 78 cents, these are all 1969 figures. The Netherlands a $1.10, Japan 80 cents, Canada $2.58, United States $3.19. Those are the averages. Now, relatively speaking, they have not changed much between 1968 and 1969. When we get the 1970 figures we will certainly analyze them. But with wages being a substantial portion of the cost of most commodities, it is obvious that with these differentials Japan, for instance, 80 cents, that is their hourly earnings of their wage earners, average, and ours is $3.19, well, you have a tremendous difference.

We are going to have to use a higher degree of technology in order to compete. Now, that is the truth of the matter.

We have to be more imaginative, we have to be more innovative, we have to get our productivity up and our unit costs down or you cannot compete with cost differentials like this.

Senator MILLER. This is so. But you talk to some business people and they will tell you that their technology is about as good as they can get it and the technology of some countries like Japan in steel production, is just as good as ours.

Secretary CONNALLY. It is.

Senator MILLER. And, of course, you can take into account the cost of shipping from Japan and other countries over to the United States, and still the competition comes in and the next thing you know you have a loss of jobs.

Secretary CONNALLY. That is correct.

Senator MILLER. And that is basically what we are talking about and, of course, there is the old cliche that you have to import in order to export and nobody that I know of in his right mind would deny that principle, but when we look back at 1964, and find that our favorable trade balance of exports over imports was $7½ billion, and then by 1968 it had disappeared, and Senator Long will tell you that it was in the red about $2½ billion because of the difference in valuing exports versus imports, talking into account in one case cost, insurance, freight and not doing so in the other then, of course, we begin to get alarmed.

Now, we had a very sharp upturn last year. As I understand, we got back to a $2.7 billion favorable trade balance, and we are delighted about that and we hope that it will continue. But there are some very hard decisions that are going to have to be made on these wage differentials, I think, and I am not suggesting that because there is a wage rate of 80 cents in Japan, and a wage rate of $5 in the United States, therefore, Japan should be excluded from our markets. But I do think there needs to be a sophisticated study of those areas where there are wage differentials that are decisive, and where the wage in the country concerned is below, let us say, what in that country would be regarded as a reasonable wage.

And also I would like to ask this. Would it be possible for you to show us with respect to these wage rates in the major trading partner countries for 1969 and what they looked like in 1968?

Secretary CONNALLY. Yes, sir.

Senator MILLER. And what they looked like in the United States in 1968 versus 1969.

Secretary CONNALLY. Yes, sir; I have those figures and they will be inserted in the record.

(The information referred to follows:)

TABLE 1.—COMPENSATION PER HOUR WORKED IN MANUFACTURING INDUSTRY, ADJUSTED FOR COMPARABILITY, 1968–69 [1]

[In U.S. dollars]

	1968	1969	Absolute increase	Percentage increase
Belgium	1.59	1.74	.15	9.43
France	1.44	1.55	.11	7.63
West Germany	1.64	1.84	.20	12.19
Italy	1.24	1.37	.13	10.48
Netherlands	1.52	1.68	.16	10.52
Sweden	2.52	2.76	.24	9.52
United Kingdom	1.19	1.30	.11	9.24
Japan	.75	.90	.15	20.00
Canada	2.82	2.04	.22	7.80
United States	3.67	3.89	.22	5.99

[1] 1970 data not available. Adjustments to achieve comparability are made to take account of differences between countries in such elements of labor cost as certain bonuses, employer's social insurance contributions, and other nonwage payments. Data are averages for calendar year, adjusted for exchange rate changes.

Source: Department of Labor, Bureau of Labor Statistics.

TABLE 2.—ANNUAL RATE OF INCREASE OF PRICES IN MAJOR OECD COUNTRIES [1]

	1958–68 average	1969	1970
United States	2.1	4.7	5¼
Canada	2.5	4.7	4
Japan	4.5	4.5	5¾
France	4.0	6.9	5½
Germany	2.8	3.5	7
Italy	3.5	4.1	6¼
United Kingdom	3.1	5.1	6
Total of above, excluding United States	3.7	4.8	6

[1] GNP/GDP deflator.

Source: OECD, Economic Outlook, December 1970.

TABLE 3.—ANNUAL RATE OF INCREASE OF CONSUMER PRICE INDEX IN MAJOR OECD COUNTRIES

[Percentage change]

	1968–69	1969–70
United States	5.4	[1] 5.9
Canada	4.5	[1] 3.6
Japan	5.2	[1] 7.6
France	6.4	[1] 5.7
Germany	2.7	[1] 3.9
Italy	2.6	[2] 4.9
United Kingdom	5.5	[1] 6.2

[1] January–November.
[2] January–October.

Source: OECD Main Economic Indicators, various issues.

Senator MILLER. As I understand, these wages rates in these other countries as well as in our own country, have a tendency to increase about at the same pace as the increase in inflation, and I remember a few years ago Secretary Fowler told us that we did not have to worry too much about our own inflation because the inflation in some of the other countries was higher than ours.

At the time I did not have a response but I did a little research a few months later and I found that because of the low base of these competitor nations in the wage area, because of that low base, they could stand a higher, much higher, rate of inflation than we could with our high wage base, and that even though we had a lower rate of inflation, the cost per hour of wages was getting higher and higher relative to our competitor countries, and we are going further behind in our competitive position.

If you have some, if you can have some input on that point I think it would be helpful to the committee.

Secretary CONNALLY. We shall.

I can give you some 1968 figures now.

Senator MILLER. I think if you will supply it for the record that will be all right.[1]

Secretary CONNALLY. Fine, sir.

Senator Miller. I think we need to look at the rate of inflation and, if what I suggest is true, how the United States is falling further and further behind in this wage differential because of the inflation and the higher wage base that we have.

Secretary CONNALLY. We will be delighted to do that, sir.

Senator MILLER. Thank you.

I would like to ask Mr. Volcker this question. We had a proposal before the Congress last year that I recall was an authorization for $1 billion for the IDB that was in the international financial institutions bill, and this was dropped as I recall, and there was a, more or less a compromise, which seems to me authorized a hundred million dollars or something like that.

Mr. VOLCKER. That is correct.

Senator MILLER. Now, I presume that the Department will be sending back over for the Congress consideration this portion of the bill that was not acted on favorably?

Mr. VOLCKER. I think you assume correctly, Senator.

Senator MILLER. I have been reading about a hassle over in the House, in, I think the Foreign Affairs Committee, with respect to a recent loan made to Chile by the IDB. Are you familiar with that?

Mr. VOLCKER. I am familiar with two recent loans to Chile by the IDB, yes. I am not familiar with the House discussion.

Senator MILLER. Well, as I read the newspapers, there was criticism on the part of some members of the committee to the effect that this loan had been made to the Allende government in Chile and I would like to find out, first of all, to what extent does our representation on the IDB give us a veto over loans made by IDB?

Mr. VOLCKER. We have a minority of the weighted voting power in the IDB. The loans in Chile, the only recent authorizations that I know of, have been to two universities.

Senator MILLER. Well, I do not remember what the loan was for, it seems to me it was around $12 million.

Mr. VOLCKER. I do not remember the precise amount, but there was consideration of one or two university loans. They were not to the Government but to universities.

Senator MILLER. But if the IDB management decides they want to make a loan to any countries, they have the voting power to do so regardless of the position of the United States?

Mr. VOLCKER. Well, the management does not. The loans are authorized by the Executive Board.

[1] See table 1 on p. 607.

Senator MILLER. I understand that, yes.

Mr. VOLCKER. In which the United States has a large weight but not a majority.

Senator MILLER. What is our weight?

Mr. VOLCKER. As I recall it, 42 percent in that institution.

Senator MILLER. Would you say that that would be an effective weight, has it been that way, have there been any loans made by IDB that were approved by the overall Board but that were voted against by our representative on the Board?

Mr. VOLCKER. I would have to check the entire history on that. I am not aware of any time we actually voted no at this point, but I would want to certainly check the facts on that.

(The following was subsequently supplied for the record:)

The United States Executive Director has not formally voted against any IDB loan approved by the Executive Board. In November 1969 he abstained on a $9 million ordinary capital loan to Peru for electric power due to uncertain economic conditions in the country at that time.

Senator MILLER. Now, as I recall, one reason for the $1 billion authorization was because that fitted in with a negotiated agreement at Punta del Este between the United States and the other members of the IDB in which they agreed they would increase the amount of their contributions to the IDB over what they had been, although frankly, we still put in the lion's share. Is that so?

Mr. VOLCKER. Precisely.

This billion-dollar authorization was for the Fund for Special Operations, the soft loan window of the IDB, which operates somewhat differently than the regular funds of the IDB, and we provide a larger proportion of the funds. But as part of this agreement, the Latin Americans agreed to substantially step up their relative contribution.

Senator MILLER. Well, one thing that troubled me was that here we are with a serious budget deficit in this country, with unemployment, and with many people criticizing the amount of foreign aid programs that we have, granted many of them tend to look at the foreign aid bill and voice their criticism, but we all understand that the foreign aid bill is just one part of our overall foreign aid program, and these international banking institutions such as the World Bank, the Asian Development Bank, and the IDB represent another very important aspect of our foreign aid program.

But I would like to find out why is it necessary for us to authorize $1 billion at this time, especially when the appropriations within that are not going to be carried out for years and years. Why could we not meet our commitments in connection with the negotiations at Punta del Este by authorizing a hundred million dollars this year, if that was the program for the contributions, and then authorizing another hundred million dollars next year or authorizing year by year, all the time keeping watch to see whether the IDB is going to function according to what we hope and expect?

Mr. VOLCKER. Well, the practice in these international lending institutions, not only the Inter-American Development Bank, but the World Bank and its sister institutions and the Asian Development Bank, has been to negotiate at intervals a package designed to support the operations of that institution over a period of time in the thought that this lends a certain stability and confidence in their own planning process and permits orderly operations over a period of time.

It provides a focus for legislative consideration in the United States and other countries against this kind of long-term background.

It is true the funds would actually not be disbursed for a good number of years, but these institutions properly and prudently operate on the basis they do not want to go out and make loan commitments—involving a planning process, a long investigatory process, a process of feasibility studies, and all the rest—unless they are confident they are going to have the money in the bank when the loan has to be disbursed.

So, they, understandably and, I think, desirably should have the commitment of funds so they can begin their planning and investigation and commitment process with the understanding that the actual budgetary drain on us will not develop for a number of years.

Senator MILLER. Will you be able to furnish this committee the picture of the developments of the loans, the actual disbursements, and the schedules over the next 5 years under that program?

Mr. VOLCKER. I am sure we can.

Senator MILLER. It is rather complicated, but I think you have some people over there who could work that up for us.

Mr. VOLCKER. When you say the next 5 years, my only hesitancy is when you get 5 years ahead one makes certain assumptions and projections, and the certainty of those assumptions and projections decreases the further out you go.

Senator MILLER. Just do the best you can, but you mentioned the planning of the organization——

Mr. VOLCKER. Quite right.

Senator MILLER (continuing). And how it fits with what they decided at Punta del Este.

Mr. VOLCKER. We can provide you, I think, with that kind of information.

Senator MILLER. Thank you very much.

Thank you, Mr. Chairman.

(The following was subsequently supplied for the record:)

The understandings reached among IDB member countries at Punta Del Este in April 1970 were designed to cover loanable resource requirements for the years 1971–1975 for Ordinary Capital operations and for the years 1971–1973 for the Fund for Special Operations. The Congress has already authorized the amounts relating to Ordinary Capital operations, and appropriations for these purposes will be sought in the normal course.

As for the Fund for Special Operations, the Punta Del Este understandings foresaw loan operations rising from the actual 1969 level of roughly $400 million in all currencies to levels of $650 million or more in 1972 and 1973. Since 1970 availabilities appeared adequate for planned 1970 lending and for a reasonable carryover into 1971, it was concluded that 1971 FSO contributions could be limited to $150 milion, of which the U.S. share would be $100 million. After prospective 1971 lending operations, however, the picture alters drastically. The amounts expected to be carried over into 1972 would represent less than two months' lending for that year. Even with the full levels of 1972 contributions (including the $450 million from the United States), the end-1972 level of availabilities would represent less than one-third of a year's lending requirements for 1973. Essentially the same situation would prevail at the end of 1973 on the basis of full implementation of the Punta Del Este understandings. The following table summarizes this situation:

[In millions of dollars]

	1970	1971 estimate	1972 estimate	1973 estimate
Commitments	440	560	650	700
Probable maximum end-year availabilities	468	100	180	225

It can safely be concluded that failure to provide the levels of funding planned at Punta Del Este would result in a complete alteration of the rhythm and pattern of IDB operations through the Fund for Special Operations, and would, in fact, constitute a unilateral U.S. rejection of the fundamental understandings arrived at, at that time.

Chairman PROXMIRE. May I ask you, Mr. Secretary, how in your judgment, the economy is coming along in the first quarter. We have had two-thirds roughly, of the first quarter has passed, we have had statistics, of course, on unemployment, and many other economic indices. What is your judgment as to the likelihood of achieving the expectation of the administration of that substantial recovery in view of what we have experienced so far?

Secretary CONNALLY. Well, I am not at this point certainly overly optimistic about it. We have not seen enough, in my judgment, to be conclusive one way or the other. But I have not seen enough elements of recovery that are sufficiently strong to lead me to relax very much about it, very frankly.

Chairman PROXMIRE. Well, I appreciate that frank answer.

The day before yesterday we had an eminent forecaster, Otto Eckstein, who revised his forecast on the basis of the performance in the first quarter, revised it from $1,047 billion to $1,045 billion and this seems to me to be a realistic kind of an action in view of, as I understand it, we should have with the recovery from the auto strike which, of course, depressed artificially the last quarter of 1970, we should have about a $35 billion increase in the first quarter if we are going to get a $1,065 billion GNP for the year, and we are not getting that. We are getting far below that.

Furthermore, we were told by the economists who appeared that in the last half of this calendar year the national income accounts will be in substantial surplus, and even the consolidated budget will be in surplus, although they will be in deficit in the first half of 1972. So that this is another reason why we are apprehensive about getting the kind of recovery that we would like to get.

Secretary CONNALLY. Well, let me say I believe this economist to whom you referred, and if I am incorrect——

Chairman PROXMIRE. He is a former member of the Council of Economic Advisers.

Secretary CONNALLY. I think his prediction the month before was $1,045 billion. He increased it to $1,047 billion and then decreased it to $1,045 billion again. I think it is really too early to tell whether you are going to make these projections or not. Actually to get to $1,065 billion for this year we are going to have to have a very, very strong second half of the year. There is no question about that.

Chairman PROXMIRE. And the budget tends to be a little restraining during the sencond half of the year, at least not as expansionary in the second half as in the first half or in the first half of 1972.

Secretary CONNALLY. Well——

Chairman PROXMIRE. That is why some of us feel that you might keep an open mind on the possibility of somewhat more expansionary fiscal policy.

Secretary CONNALLY. We certainly will. We will certainly keep it open, fiscal as well as monetary policy.

Chairman PROXMIRE. You express very well your concern about balance of payments and, of course, this is a central responsibility as Secretary of the Treasury, and I am glad that you are concerned with it. You say that the principal concern we should have in this respect is that we have to keep inflation under control, and I think that certainly is one element.

But, as I said before, I do not see a clear, coherent emphatic anti-inflationary policy, kind of a catch-as-catch-can incomes policy here and there, a determination to drive the economy ahead which, I hope you will persist in and continue, but no incomes policy to cope with inflation.

What concerned me here is this: We may be in serious danger with respect to balance of payments in the near future. People in Wall Street and others have warned us, for this reason. We have had rapidly falling interest rates, and you showed that they were dramatically falling in the last very short period for Treasury bills. They were almost in half, as you say, from 8 percent down to 3½, nearly eight down to 3½.

Now, if this continues it just has to mean that capital will leave this country and invest abroad where the differential rates, of course, would encourage them to go abroad.

Anybody with any brains who wants to make a good return, the best return on his capital, and that is what investors are supposed to do, is not going to invest where the return is low, and obviously it is lower here now than it was a few months ago and there has not been a similar drop in interest rates abroad.

So, what can you do to protect us against this kind of deterioration in our balance of payments; that is, the flight of capital abroad with our interest rates down and perhaps falling lower and foreign interest rates not falling?

Secretary CONNALLY. Well, not a whole lot unless you want to go to completely regulated business, and the truth about it is that we have already had a large capital outflow as U.S. banks reduced their liabilities to their foreign branches. That is why we had last year an official settlements deficit of almost $10 billion—well $9.8 billion including our allocation of special drawing rights over $10 billion, if you excluded them. To a large extent this deficit reflects these financial outflows. On merchandise trade, we had a surplus.

Now, we have some restraints, but they are not completely rigid. The Federal Reserve has some restraints on their banking institutions on the outflow of capital; the Commerce Department has restraints with respect to direct investments overseas; Treasury has restraints on purchases of foreign securities through the interest equalization tax, but these obviously are not sufficient to prevent all capital outflows.

Now, we offset some of it recently in the last 2 or 3 weeks, when we had an Eximbank borrowing operation.

Chairman PROXMIRE. What has been the outflow, do you have the figures on that?

Secretary CONNALLY. No, sir; I do not have them on the tip of my tongue, at any rate.

(The following was subsequently supplied for the record:)

The total outflow of private U.S. and foreign capital in 1970 was close to $9 billion.

Chairman PROXMIRE. At any rate, the main thrust of my questioning— and I hope we will get that for the record if we can—but the main thrust of my questioning is that there might be a temptation for the administration to try to solve our balance-of-payments problem to some extent by working with the Federal Reserve to stop the drop in interest rates or to maybe even adopt polices that would reverse the fall in interest rates and have them go up. I think you would agree with me—I hope you would agree with me—that would torpedo the domestic recovery which ought to take first priority.

Secretary CONNALLY. Mr. Chairman, you are correct, we cannot have it both ways. We are going to lose some money that follows the short-term advantages, whether it is here or overseas, and we have already lost some of this capital that seeks the best interest wherever it is. We have had an outflow of capital because of this interest differential. But this is not to say that we ought to try to drive interest rates back up in this country to prevent that outflow of capital, because we get right back into the problem that we are trying to correct.

Chairman PROXMIRE. We did have an interest equalization tax, as I recall.

Secretary CONNALLY. That is right.

Chairman PROXMIRE. There were lots of objection to it, that it was a real interference with freedom of capital movement, which all of us would like to see as we would like to see freedom of trade and freedom of controls in our own prices and wages, but it did seek to have some effect.

How useful could this be as a way in the short term?

Secretary CONNALLY. We have asked for an extension of the interest equalization tax. It is presently three-quarters of 1 percent. Under the act that is now in existence, it expires March 31 of this year. The President has the authority to change it from zero up to 1½ percent and it is some restraint. But, frankly, the best restraint we can have is to have domestic prosperity. This is what would be best so that we have an effective utilization of capital at home where it will mean more to those who have to keep their money here and plow it into this economy rather than send it over just because they can make a percentage point or a point and a half of interest difference.

Chairman PROXMIRE. The process of getting there is what concerns me.

Secretary CONNALLY. That is right.

Chairman PROXMIRE. We are going to have to hold our interest rates down.

Secretary CONNALLY. That is correct.

Chairman PROXMIRE. We have to be very careful with a policy we would like to adopt with respect to inflation because if we adopt it, of course, as you said, it slows down the recovery.

Secretary CONNALLY. We are just living in difficult times, Mr. Chairman. If you look back over the past decade, and I do not want to try to throw brickbats at anybody, it is the last thing we ought to be doing at this point, but in the early part of the sixties, when we had a relatively stable economy, we had very little inflation.

Now beginning in the latter part of 1960's,—1967, 1968,1969,—this inflation began to go up to where, when this administration came in, they had a raging inflation on their hands.

Chairman PROXMIRE. I recall that; I am sorry, I was going to say apropos that because you said that very well and I think I know what you are driving at. Yesterday on the floor of the Senate I made a speech on the effect of food prices on inflation, and Senator Fulbright interrupted me and said:

You are talking about trivial, relatively unimportant things. The real cause of inflation is the Vietnam war. As long as we have the Vietnam war we are going to have it. One way we can slow down this inflation is to get out of the Vietnam war.

Now, I think there is something to that Fulbright view, and I think undoubtedly the buildup during the Vietnam war caused this inflation, we have already slowed down the Vietnam war some, but I think there is great wisdom to Senator Fulbright's position as long as we are in it and going into Laos and we are in a position where, as the President said the other day, we have to be prepared for staying in a long time, he is resisting any limit on getting out, any time limit, I just wonder if this inflation problem can really be brought under effective control.

Secretary CONNALLY. Well, Senator, I have a couple of observations I would like to make. I do not suppose this is the appropriate place to get into any prolonged discussion about the effects of the Vietnam war. Obviously, it contributes something to our negative balance of payments. But I think it is only fair to say that the President, from the time before he took office and since he has taken office, has consistently said that he is winding this war down, and I think in truth and in fact he has done so, notwithstanding the move into Cambodia and into Laos.

Now, I do not think, if you had the Vietnam war completely out of the way, that you would solve the balance-of-payments problems. I just do not believe that.

Chairman PROXMIRE. I am talking about inflation and you are talking about balance of payments; you are shifting our ground.

Secretary CONNALLY. It will not have much effect on inflation. If you look at what has happened in recent times, national defense in 1969, I think it was, had a budget in excess of $81 billion.

Chairman PROXMIRE. In the coming year they will have just about the same budget.

Secretary CONNALLY. Sir?

Chairman PROXMIRE. Just about the same budget. The obligational authority they are going to ask for is about $80 billion.

Secretary CONNALLY. On a comparable basis the budget this year will be $77.5 billion.

Chairman PROXMIRE. That is outlay.

Secretary CONNALLY. Sir?

Chairman PROXMIRE. That is outlay, but the obligational authority will be about the same.

Secretary CONNALLY. I am sorry?

Chairman PROXMIRE. But defense spending, this has not changed very much. The President has adopted wise policies, I think, in getting us out of Vietnam, it has been better than it was in previous administrations and maybe it is unfair but I think Senator Fulbright's position in addition to the far more important foreign policy aspects and human aspects in this, there is a very serious economic effect of the continuous struggle in Vietnam. It is costing us about $13 billion we would not be spending if we were not there, that is the differential in costs. That alone has some effect on prices in this country and, as you say, it has some effect on balance of payments, although it is perhaps not the only one, I think it is certainly a major one.

Secretary CONNALLY. Now, our problem in balance of payments involves the analysis of transactions with every country with whom we do business. Part of the flight of capital from this country has been due to the fact that there has been a high degree of prosperity in Europe, for instance. That situation may change. It can change fairly radically because certainly in 1969 we were absorbing much of the capital in Europe with the interest rates that obtained here. Yet we have had a dramatic turn around in a year's time beginning about the middle of last year.

So, I must confess to the fact that we are just living in tough economic times. We are going to have to keep a balanced program, in my judgment. We are going to have to take a very reasoned view of the things we can do, without overreacting, and yet take enough of a positive stand to help solve the problems both of controlling inflation and reducing unemployment, and stimulating this economy.

Chairman PROXMIRE. Now, you indicated that the Treasury bills had dropped sharply and, of course, you are right and they are most sensitive but I would point out to you that, although mortgage rates have dropped they have gone on the order of from 9 percent to 8 percent, they are still very, very high by any kind of comparison and they have not dropped very much and it is going to take a continued effort on our part to get mortgage rates down and, I think, all of us would have to recognize if there is going to be any real stimulation in the economy in the coming year it is not going to come from business investment in plant and equipment, it is not going to come from inventories, it is going to have to come from housing, that is the big spending item that has to improve and that depends very, very greatly on what happens to mortgage rates as I think we just have to conclude.

Secretary CONNALLY. I could not agree more, Mr. Chairman. I think it is significant to have at this point the figures for January 1970; housing starts in thousands of units were 1,059,000. In January 1971, it was 1,700,000, so the housing starts have increased approximately 640,000 in January 1971 over January 1970.

But I hasten to add that I could not agree more, we have to bring the mortgage rates down, that we cannot afford to go back to a mortgage rate that is in excess of what exists now.

As a matter of fact, I would like to see the rates even lower than they are.

Chairman PROXMIRE. And that figure you gave on housing, you are talking about a deep depression level of housing, and now, I think a serious recession level of 1.7 million. I was the author of the amendment to the 1968 Housing Act that called for a goal of 26 million housing starts in the next 10 years, from 1968 on. We should have better than a 1.7, 1.8, 1.9. I think we ought to have 2.1, 2.2, or 2.3 million housing starts this year if we are going to get that kind of stimulus, and I notice the Council, when we got the breakdown of how the economy was going to grow, they predicted a 38-percent increase of housing starts that will just have to take an easy monetary policy.

Secretary CONNALLY. I would agree but there are two factors that impinge on our ability to do it. I would not question the housing goals particularly, but we do not want to increase starts to the point where we again get inflationary prices in lumber and materials which cause us some trouble here just a very few short months ago. Furthermore, we do not want to depress the available labor supply where we get more inflation in the construction industry which is where we are having the most trouble of all major sectors in the economy.

Chairman PROXMIRE. Well, we have the available construction industry labor supply. We had 13-percent unemployment. We now have 11 percent and I think you recognize it is the unbalance between very powerful unions, national unions, and relatively weak management, and the ability on the part of management to pass on whatever the unions get in a wage settlement.

Secretary CONNALLY. That is part of it.

Chairman PROXMIRE. I think the administration is wise to try to move in this area, although in my view, they have not moved very decisively.

I yield to Senator Miller.

Senator MILLER. Apropos of Senator Proxmire's request for information on funds from the United States going to overseas investments, I am wondering whether that flow might be less than what we expect, because I would see where the money going into Treasury bills would be discouraged from going into Treasury bills, but would be encouraged to go into these mortgages, into the mortgage money market. So, I am wondering if just because we have had a drop in Treasury bills, if it necessarily follows that we have had a mass exodus of funds overseas.

Secretary CONNALLY. No.

Senator MILLER. If you could amplify the information Senator Proxmire asked for by perhaps showing us where the flow might have gone if it did not go overseas, where it went into the United States, I think it would be helpful to us.

Secretary CONNALLY. All right, sir. Do you want to comment on that, Paul?

Mr. VOLCKER. I would just like to make one comment at this point on this question. The most sensitive and volatile element in the capital flows has been the amount of bank borrowing abroad and particularly in the Eurodollar market and that was the part built up so sharply in 1968 and 1969. That is the part that was repaid so rapidly in the course of the past year and, of course, as that is repaid—and that is the most sensitive element—there is less to flow out through that particular avenue in the future.

Now, money can go out through a lot of different avenues, and we can provide you with more detailed figures. But the big switch in the situation has been this bank behavior in the past year.

Senator MILLER. If you had a drop of Treasury bill investments and discouragement of funds going into the Treasury bills but that money has gone into the mortgage money market, of course, that would be helpful to us on the domestic scene.

Mr. VOLCKER. Yes and, of course, it does. Mortgage buying institutions are now pretty well awash with money and are very eagerly out looking for mortgage investment. And some of that money with which they are awash is money which individuals had put into Treasury bills a year or more ago and are now placing back into the savings institutions. That is a very helpful way of getting that money into the domestic economy.

Senator MILLER. If they are awash with it why have not the mortgage interest rates come down?

Mr. VOLCKER. Mortgage rates have begun to come down quite rapidly, but they came from very high levels and they are traditionally sticky, as you know. It is only in recent months that the rates have begun to come down quite precipitously. That is reflected perhaps in the FHA ceiling rate which was formerly under strong pressure at 8½ percent, and has now come down to 7 percent, to take one example.

Chairman PROXMIRE. The mortgage rates are still, the indicators tell us, are averaging 8 percent, although the FHA is seven.

Mr. VOLCKER. There are a lot of different mortgages and many conventional rates would be averaging in that range but would be moving lower.

Chairman PROXMIRE. Mr. Secretary, one other question. I notice the Council's estimate is the housing starts are not going to increase during this year much above the January level. There has been this very substantial increase in January, but I think, as I said, it is still a very low level in relation to our needs. At any rate, is the administration's expectation that housing from now on is not going to continue to increase as it has, largely because of the fear of rising costs of construction and the effect that this might have on rising construction costs? I got that from your earlier answer that you were afraid this would drive up the cost of lumber.

Secretary CONNALLY. That was not the official position at all. I was merely making that comment. The administration has taken no position.

Chairman PROXMIRE. I do think in some of those areas the administration policy can have far more effect than other policies in holding prices down. Certainly, the Federal Reserve holds down the cost of money. I know the administration last year tried to hold down the cost of lumber and I think some of the other costs——

Secretary CONNALLY. I think the problem, as Secretary Romney says, you have to have a market for these houses. Land costs are still extremely high and there certainly is no disposition on the part of this administration to discourage or retard the additional housing starts in any way, shape, or form. On the contrary, we want to encourage more of it if we can.

Chairman PROXMIRE. This is why getting the mortgage rate down further is so important. Secretary Romney has told us that 80 percent of the American people today cannot afford to buy a new home; 80 percent, this is a shocking figure. You have to have an income of about $12,000 a year to afford a new home today.

Secretary CONNALLY. I have said, Mr. Chairman, and I want to repeat again, that part of our administration's philosophy is a monetary policy that makes ample money available. I have just said to you that even though mortgage rates have come down I personally do not think they have come down enough. Even though the prime rate to prime borrowers is down, I would like to see it go lower. We have no argument.

Chairman PROXMIRE. My time is up.

I might say Congressman Brown and I were in New York last night on the Cavett Show. We debated the supersonic transport.

Secretary CONNALLY. Who won?

Chairman PROXMIRE. Well, of course, Congressman Brown has good reason to feel he won and I have the same good reason to feel I did.

Representative BROWN. I might say, Mr. Secretary, it is a continuing debate and I might observe that the other two guests were people who are on the show, "The Odd Couple."

Chairman PROXMIRE. So, they had two odd couples. That will be on tonight, incidentally, 11:30 on ABC. We come on at 12:15.

Representative BROWN. I do not think either one of us get residuals, nothing was mentioned, a little chopstick. That was not the point.

Mr. Secretary, your statement has in it—and I would like to put together two or three ideas here and pursue a thought with you, if I may—this line, "At the same time we must press ahead with more specific measures that, over time, can help improve our longer-term price performance", in terms of inflation and "we must not shrink from these actions to improve the functioning of the labor market or to reinforce competitive pressures in markets for goods and services".

Foreign sales, "Unchecked, the present imbalances risk eroding the stability of the international monetary system and the fabric of cooperation upon which all countries lean on," and so forth.

Secretary Stans, when he was before us, indicated that the area of our most significant success in terms of balance of trade is in the technology-intensive areas of production in this country. Agricultural products, we have a small positive balance. In raw materials we have a low or rather a bad imbalance, and in manufactured products not technology-intensive, we are even worse off.

I would like to predicate my question for your response in the area that agricultural products, I am sorry, raw materials tend to be more—tend to involve more labor than do the technology-intensive products because technology-intensive would infer, I think, there was large machinery involvement, and that manufacturing products not technology-intensive might have more labor as a percentage of their costs than technology-intensive production; and then say or suggest that perhaps this recommends two or three specific policies both with reference to international trade and with reference to our domestic price level on costs, and that is that we must take some action at the Federal level to control the structure of labor costs, to take care of that part of the problem in those areas where we are doing very poorly, raw materials and non-technology-intensive products; but beyond that perhaps this recommends a policy in terms of incentives or taxation policy which would encourage us to do even better in the manufactured products that are technology-intensive and that this might recommend some kind of an investment tax credit so that we can be sure to maintain at least our advantage in that area of manufactured products that are technology-intensive.

If you want to comment on that, let us see if we are in agreement or disagreement and go from there.

Secretary CONNALLY. Well, I have several comments with respect to the points you raised. Number 1, with respect to agricultural commodities your figures and premise are absolutely correct. Part of our problem is the fact that the European Common Market, for instance, has imposed a restrictive variable levy system against the import into that area of American agricultural products, and we are constantly striving to reduce its adverse impact on our exports.

Representative BROWN. Let me just ask you about the quid pro quo for the manufactured products that are not technology-intensive, apparently they or somebody is doing fairly well in distributing to us such products, and I assume this is the textile area and some others, shoes.

Secretary CONNALLY. I think this is normal. In a highly industrialized nation such as this, I think you can expect raw materials to come in. In every country the first thing they try to do is to become self-sufficient in foodstuffs, so obviously, we are under pressure with respect to foodstuffs. Then as they become industrialized they begin to manufacture the nontechnology intensive items. In a highly industrialized society it stands to reason that most of our favorable balance of trade will come from technology-intensive manufactured items, for several reasons. First, because we are always on the frontier of developing new ideas and new products, and new commodities and, secondly, we are without substantial competition in some of these areas. So——

Representative BROWN. Let me just observe with reference to agricultural products, Secretary Hardin has been before us and I have asked the Secretary to give us some figures to verify a premise which I hold in this area that so far as our technology in agriculture is concerned in the ability of one man in agriculture to produce large quantities of food that we have perhaps gotten very close to an irreducible minimum of efficiency there.

Secretary CONNALLY. No question about it.

Representative BROWN. Whereas, many other countries still have considerable give to get to a more technologically advanced state in their agriculture.

Secretary CONNALLY. You are absolutely right.

Representative BROWN. So, in the future that does not promise to be an area where we can keep all that far ahead. We are bound to be caught up on it a little and there is not in those unit labor costs in agriculture, there is not much advantage in putting pressure on the labor market. As a matter of fact, in this country it is going the other way because you are organizing labor in agriculture around the United States, which will make agricultural products more expensive whether they are bought here in this country or sold abroad, so we have a problem where we are not going to do a lot more in agriculture in the future.

Secretary CONNALLY. Right.

Representative BROWN. But with reference to labor policy in this country it would seem to me that the area of labor cost impacts most heavily in the manufactured products, both technology-intensive and non-technology-intensive, and to an extent, perhaps, in the raw materials development area. Could you comment on that?

Secretary CONNALLY. Yes, sir; and well, I will insert in the record, Congressman, some figures on relative hourly wage earnings in countries around the world both in 1968 and 1969.[1] The 1970 figures are not yet available but it will show very clearly the disparity and the problem that we have, and I will also introduce along in that same place in the record, the rate of inflation compared in many of these same countries,[2] and there is no question but what labor is going to have to recognize that we operate in the world market, just as industry must know it, and that they are going to have to be competitive, if not competitive in terms of actual dollars or earnings per hour then competitive in increased productivity.

[1] See table 1 on p. 607.
[2] See tables 2 and 3 on p. 607.

Now, and beyond that, I think that one other point I would like to make in connection with your remarks, there is no question but that if you analyze the whole balance-of-trade mechanism of this country, we show a favorable balance-of-trade really in only one category of any significance and that is in the area of technology-intensive manufactured items. Now these are basically the products of research.

The Government must look, and this Congress must ultimately look, carefully at the decrease of research money, whether it was in defense or whether it was in NASA or whether it was in space or whether it is SST or whatever, you are going to have to analyze that constantly and the administration as well as the Congress, is going to have to make up its mind where this technology came from, what was the genesis of it. The genesis of it is in the laboratories, and who supports these laboratories? Basically, the Federal Government has been doing it to an increasing degree until recently. Much of the research money has now been cut out and I think there is a question whether this is a very wise procedure to follow in a long run.

Representative BROWN. You have gotten into an area that I would very much like to pursue. I do not want to miss a point and I want to skip it quickly, I feel, but I do not know whether you concur or not, we need this advanced depreciation allowance and perhaps even this tax credit because not only must labor become more efficient in terms of their organization and operation but also I think industry has an obligation to become more efficient and to invest money in the improvement of their manufacturing facilities. Of course, that has been something that has been a little scary in the last couple of years because we have had much lower liquidity on the part of the industry in this country that has been usual over our history and we have also had much higher interest rates and, therefore, it becomes more expensive and more difficult for industry to borrow for capital improvements that do increase productivity.

If we are to maintain our lead in the technology-intensive areas to close the gap, and in the non-technology-intensive materials area, and close the gap in the raw materials area we must become more efficient in capital and labor and I think this is the time to increase capital investments toward that improvement. Would you concur?

Secretary CONNALLY. Basically, I would. Basically, we are trying to do that with the fiscal and monetary policies that are now being followed in this country by this administration.

Now, this investment tax credit has been imposed twice and removed twice. You all know better than I, but I doubt if the Congress would look with a great deal of favor on it. Frankly, I think it is a little bit too early for us to recommend or to ask for it at this point. I have considerable faith in the policies that this administration now has in mind to solve this problem of investment.

One of the things we have to constantly keep in mind is the anticipation of any fueling of inflation, You have to anticipate it because there is nobody who wants inflation. When it grew so drastically in 1967 and 1968 and over into 1969, nobody wanted it, but actually, the seed had been planted a couple of years before, and it suddenly got out of hand.

Now, as we move toward expanding this economy we have to, at the same time, be sure that we do not reach the point where we are going to create the problems all over again that we have painfully tried to cure the last couple of years.

Representative BROWN. I would accept that and I would accept this codicil to it. I think that you have had with the sharp drop in interest rates and the increased ease, therefore, of borrowing the possibility that industry would be encouraged to make its improvement in plant and equipment and efficiency, and that perhaps we do not immediately need the investment tax credit, but it is certainly a weapon that might be given some consideration in the future.

Secretary CONNALLY. No question about it.

Representative BROWN. Let me go on to this technology-intensive area because, as the Senator said, we debated the SST last night and I happen to believe we must observe some political restraints here, too. The balance-of-trade aspects of the SST are significant, I think. The Senator and I had some disagreement on this. But this is an example, I suggest, of the question of where we are going to put some of our Federal investments. Is it going to be in research, is it going to be in development of new products and new technologies, whereby we can improve our balance-of-trade status or, in fact, the question of priorities, do we invest it all in social improvements, which may or may not have a long run benefit in the area of our ability to pay in 1980 and 1990 for the cost of the social advances that we hope to make in this country.

I would like for you to take a long look down the road and see how we balance this question of money in subsidizing housing now versus money in, to take a specific example in, improving technology of improvement of housing now.

Secretary CONNALLY. We certainly will take a look at it but the only answer I can give to your question is that you cannot do all of any one thing. You cannot put all your money into nonproductive areas, and you cannot put all of it into research and development. You have to have, as best you can, in a free society, a balanced economy. Obviously, you will put some of the money into welfare payments or whatever other social programs you wish to talk about, and there are social programs that have some hope for future building in the field of——

Representative BROWN. Certainly an investment in education would fall in that area. I would think—in education——

Secretary CONNALLY. Education, manpower training with respect to environment. There is a lot of money that could be put into the research areas of environment. All the research money does not have to go into hardware, so to speak, for the military. It can be in the field of environment.

Representative BROWN. Any investment, not any investment but a good portion of investments in the military goes to a nonproductive item, unless there is some spinoff.

Secretary CONNALLY. That is correct.

Representative BROWN. The same thing might be said of the space program unless there is a spinoff that would be the benefit, but certainly an investment that would give us better trade balances would be beneficial, would it not?

Secretary CONNALLY. Yes, sir.

Representative BROWN. My time is up, Mr. Secretary.

Chairman PROXMIRE. Senator Miller.

Senator MILLER. Mr. Secretary, you have recommended that the ceiling on long-term Government bonds, the ceiling rate of interest, be repealed.

Secretary CONNALLY. Yes, sir.

Senator MILLER. Two questions on that. One, if this were done would this have a good influence in preventing money running out of the United States overseas and, therefore, relieving our balance-of-payments deficit to some extent?

Secretary CONNALLY. I think a limited, at best a limited, impact. Do you disagree with that?

Mr. VOLCKER. I think the impact would be limited, as the Secretary suggests, and largely indirect in the sense of demonstrating to foreigners that the deficit is responsibly financed and not in a way that is going to build up inflationary problems at sometime in the future.

Senator MILLER. I am thinking in terms of the money because Senator Proxmire indicated his concern that money, which is not going to go into Treasury bills, at 3½ or 4 percent, will go overseas and give us a balance-of-payments aggravation problem.

Now, if your long-term securities can be marketed at 6-percent instead of 4½ or 5, would not that mean that there would be less likelihood of that money going overseas and more likelihood or a great deal of likelihood that it would be put into long-term securities?

Mr. VOLCKER. I do not think the direct effect would be very important, Senator Miller. Many of these people who are sensitive to these international differentials will not want to put their money in longer term securities. They want their money in highly liquid form and they are looking for a 6-month or 3-month or 2-week investment. They can buy longer term securities at higher rates now, and the mere fact that the Treasury makes an issue available itself—they are available in the market now to a limited extent—I do not think it would have a major direct impact on the shorter term flows.

Senator MILLER. Of course, the higher the interest rate went up on the long-term securities the more reason there would be for the money to stay at home.

Mr. VOLCKER. But we would not expect this authority to push long-term interest rates up.

Senator MILLER. I am sure you would not do that deliberately but would not that be the result of opening up the advantage to invest here in the United States rather than going overseas?

Mr. VOLCKER. I think we testified we want to do this carefully so it does not have any important impact on the general interest rate structure in this country.

Senator MILLER. I was going to ask you the question of what is your answer to those who do not want to remove the ceiling, who say if you did remove the ceiling it would have a tendency to keep mortgage money at a high interest rate, therefore, discouraging home building and so on.

Mr. VOLCKER. I think the basic answer to that, Senator, is that analysis of what has happened in the past suggests that the presence of the interest rate ceiling which has forced a lot of short-term borrowings at particular times, has had a very adverse impact on the flow of money into the mortgage market and, therefore, into housing. You will find that people who have a direct interest in the housing market are uniformly supporting this effort to remove the ceiling because they have seen the adverse impact that forced financing in the short-term area can have on the mortgage market and on the housing market.

Senator MILLER. I am glad to get that answer because generally, at least as carried in the press, the basis for the recommendation to remove that interest ceiling limitation has been that Treasury is all disturbed about the disproportion of short-term borrowing in its portfolio and it wants to have a longer-term portfolio and not get into these crunches which I know you personally are involved with all the time. But if there is another aspect of it such as you just outlined, I think that ought to be publicized, too.

Mr. VOLCKER. That is a very key aspect and we would like to publicize it as much as we can.

Senator MILLER. Now, I though my colleague, Congressman Brown, was going to get into this but he did not. Maybe it is not what he had in mind. I do not want to commit heresy, but really, you tickle my fancy with what you had to say about these technologically-intensive businesses, and I would like to ask this question: What would be your reaction, and I think you might have your people study it, to what we could call selective investment tax credit, selective based upon, for example, whether there is a technologically-intensive business and then, perhaps, give them the investment tax credit in full if all of their volume of business goes overseas, and if only half of their volume of business goes overseas and half stays at home then give them half of this investment tax credit so we have a real spur to those businesses that are going to be in the export trade and it gives them some basis for competition with their trading partners overseas who are getting through the value added tax systems overseas, getting a tax rebate.

Secretary CONNALLY. Senator, the Administration last year recommended to the Congress what is known as the "DISC" proposal, which is calculated to do precisely what you recommend. The Congress did not approve it. Labor opposed it, why, I will never know, because it, to me, is a very logical extension of an intelligent government policy to assist American business, create jobs for American labor to compete with foreign companies that do have the tax advantages that are inherently a part of the value-added tax as imposed by their countries. In this budget there are $200 million to start this particular proposal.

I think it is as sound a proposal as I have heard advanced and I regret the Congress did not favorably act on it.

Senator MILLER. Mr. Secretary, I am very familiar with the DISC proposal and I made a speech in favor of it one time.

Secretary CONNALLY. Yes, sir, I know you did.

Senator MILLER. It was killed in the Senate Finance Committee, I think probably on the basis of a mixture. While there were some dissenters who were concerned about the fact that the AFL-CIO had indicated that this could result in a terrific bonanza, which I frankly could not see, there were others who were somewhat concerned that it did not do enough of a job.

I must say that if I was a business, technologically-intensive business, owner in this country, and I could be offered the DISC proposal which would merely defer my tax bill I could factor out the interest savings by having the money all right and that would have some attraction, but if I could have an investment tax credit which would be an actual cut in my tax bill I think I would opt for the tax cut.

One of the drawbacks of this proposal was that it merely amounted to a tax deferral rather than a tax cut. There is great concern that that did not do the job of helping us meet the competition of countries where they actually cut the tax if not eliminate it, and I think that this matter of a selective investment tax credit calculated along the lines of helping our exporting companies, and if we do a job on it that means more jobs for people, merits looking into.

Anyhow, would you have your people take a look at it?

Secretary CONNALLY. Yes; we certainly will. I want to just comment that here at some point you get into the problem at least of subsidizing exports which is in violation of our international agreement but we will certainly look into it.

Senator MILLER. On that point, let me say there was great restiveness in the Senate Finance Committee over that aspect. That probably was the third reason for not acting favorably on this. We are deeply disturbed—I think most of us in the Congress are deeply disturbed—by what appears to be a tendency by some of our foreign trading partners to violate the spirit—if not the letter—of GATT to suit their purposes and we have got something going right now with respect to this agreement covering North African countries and Common Market countries on citrus.

Secretary CONNALLY. That is correct.

Senator MILLER. But we think there is a little too much semantics in the GATT rule covering what can be rebated and the delineation between what are called direct taxes and indirect taxes and we are rather disturbed about it. I do believe that we can do something with respect to this problem that DISC would not have done—not that DISC did not have some beneficial features to it—but I think we are going to have to go much further than that, and this selective investment tax credit with respect to exports might be one area to look into.

I had not thought of it before. I do not know whether you had that in mind, Congressman Brown, or not but I appreciated your raising this point because it appealed to me.

Secretary CONNALLY. We will certainly look into it.

Senator MILLER. I am through.

Chairman PROXMIRE. Congressman Brown. We have both finished, so Congressman Brown, you have the floor.

Representative BROWN. I might go on and push to the next point that, unfortunately, I did not have time to get to. This point picks it up and that is this is certainly better than exporting the jobs. I would rather export the materials than the jobs, and what we are faced with, I think, as Secretary Romney, and I believe his testimony has fallen together pretty well with that we have had from the members of the Cabinet, that many technology-intensive businesses and many other businesses in this country are finding it more economic for them to invest in plants abroad from the labor standpoint perhaps, from the cost of plant standpoint perhaps, but more economic to invest abroad and sell to other markets abroad or even to sell back into this country than they are to invest in the United States in plant and labor, and so forth.

Now, the result of that is, simply put, we are exporting jobs and the ability of individual Americans to pay their taxes and, as a matter of fact, we are converting individual Americans from system supporters to those who must live off the system and the welfare case is taken as an extreme; specifically obviously in such instances obviously he is worse off, specifically labor which still has jobs left in this country may be better off because they can buy some of the material that is now produced abroad and have a somewhat lower price than they would have if they were produced here. Nevertheless, in the long run the whole country is worse off because we are not producing the goods and materials and being paid in the world market effectively for them to support the kind of social investments that we hope to be making in this country in the future.

Let me just ask, Mr. Secretary, if you disagree with any of this, I would be glad to take that exception but I would like to observe on the question of the flight of capital that the person who owns the capital may, in fact, do just as well and better by investing abroad than he would if that were invested here, His profit potential may be that much greater, and the same thing applies to investing in plants and productive capacity, I assume, as applies to investing in the money market abroad.

If the investor is going to make a higher rate of interest abroad, he plays in that rather heady atmosphere, he is likely to do just that. If he is in position to invest even though he may be a small stockholder in a large company and not know he is investing abroad his money may very well be invested abroad for him to make profit on the productive capacity.

What kind of policies would you or do you have under consideration or are you using or do you think might be considered for curing that problem of the flight of capital and the loss of jobs and the loss of markets in this country?

Secretary CONNALLY. Well, I think—and I am going to ask Mr. Volcker to also respond to this if it is agreeable with you, sir—my comments are simply these. When you talk about the flight of capital or at least the context in which we have been discussing it largely this morning, we are talking about a highly volatile capital that basically does not go overseas for long-term investment. It is a short-term, 90-day, 6-month type.

Representative BROWN. People who play the money market.

Secretary CONNALLY. These are people who play the money market and these are the ones who are having the tremendous volatile effect on our official settlements and balance of payments, where they just follow the interest rates.

Representative BROWN. But I am looking down the road further than that. I think it has been fairly thoroughly explored. I want to look a decade ahead to what we may face in terms of the investment in productive capacity abroad by American firms because we are facing that to an increasing degree.

Secretary CONNALLY. Well, we obviously have no substantial controls at the present time. I do not think it would be the policy of this administration to try to have rigid controls with respect to American capital going overseas. We have discussed earlier the programs which are part of Treasury, Commerce, and the Federal Reserve System; the interest equalization tax, foreign investment controls under Commerce and the banking regulations that the Reserve System administers. They, I think, tend to discourage the export of capital to a limited extent and, perhaps, that is all we ought to do at the present time.

Representative BROWN. Get capital necessary for these productive capabilities, what does it mean down the road for American labor, American capital, to try to separate capitalists and labor? Our system does not do that, fortunately, as much as a lot of other systems which are not as sophisticated, developed in as sophisticated a way as ours is. What does that mean for American labor in the future? Is labor likely to be more hurt than capital?

Secretary CONNALLY. Sure; because it is not as mobile.

Representative BROWN. It seems to me that is clearly the case.

Secretary CONNALLY. Labor is not as mobile as capital so they can be hurt more. This is the problem that both industry and labor have in this country. If we have domestic prosperity here, if we have adequate profits as well as adequate wages, I do not think we have any problem in competing with the rest of the world, not at all.

Representative BROWN. Not with our technological development.

Secretary CONNALLY. That is it. But if you get to the point where you do not have sufficient profits or sufficient inducements for money to either invest here or grow here and provide the jobs, then we are in trouble.

Representative BROWN. Or to starve off by conscious Federal policy, whether congressionally inspired or inspired by the executive branch, the technological development in this country you are literally committing suicide, are you not?

Secretary CONNALLY. You are in trouble, that is correct. I could not agree with you more.

Representative BROWN. It seems to me this has not been looked at either by the press or the economists. We seem to be looking at the short term all the time between what we do today or tomorrow and not what we do the week after next when we may be hinged in some of these technological areas.

Secretary CONNALLY. In 1972 over 1971 I think we do have an increase of nearly a billion and a half dollars in obligations for research and development, between $16 billion and $17 billion, in that range. The 1972 estimates are $16.7 billion, up from $15.6 billion, so it is up $1,200 million.

Representative BROWN. You made the comment that you applied this to military. I would not apply this to military, although quite a great deal of our technological research that has been directly funded in a federally direct sense has been in that and the spinoff of a lot of military has had industrial applications which has been applied to industrial products in this society of ours. But where are we heading, Mr. Secretary, if we cannot encourage it by public policy through public agencies like the Defense Department and the other activities?

Secretary CONNALLY. NASA, atomic energy, environmental control, all of them play a part.

Representative BROWN. All of these other fields, then where do we go in terms of encouraging it in the private sector of our society? How do we get that job done or are we going to cut down on the technological development by Federal policy in both areas? And is that wise and I would assume you would agree it is not wise.

Secretary CONNALLY. I think you are leading me into deep water here in discussing a subject I am not particularly competent to discuss. But I think the inevitable result of the Government R. & D. programs, which for the most part are in the field of science, whether it is in the National Iustitutes of Health or the Defense Department or in NASA or wherever, is a type of research that contributes enormously to the private sector, when done in the field of applied research. They take the applied research for use in developing new products. So, in my judgment, it has a direct relationship of enormous proportions.

Representative BROWN. I guess what concerns me, Mr. Secretary, is that you suggested in technology, when I did not particularly have it in my mind, the relationship between technology and military. I think the military in this country is only slightly less popular than smallpox and I think that drags technology into the picture of also being something that is negative, that technology people seem to have the black hats in our society.

Secretary CONNALLY. I agree.

Representative BROWN. And I am concerned about that. I think political capital has been made of this fact by demagogs in our society, and I think that technology frankly, is getting a bad rap in this whole operation, because it tends to be technology against the environment on occasion, and I think that is unfortunate. It tends to be technology meaning the military against social benefits, and I think that is unfortunate because it seems to me that if you look at the trade balances, if you look at the advantages of jobs in this country, and jobs hopefully make us less in need of welfare care for the average American, I think, who would like to have a job of his own rather than be on welfare or get some public job provided for him; if you look at that situation, it seems to me, we may, in effect, be killing the goose that lays the golden egg when we strike out at technology. Is that a fair assumption or not? As a member of this team that is hopefully going to direct us for the next couple of years and where we are headed in our approaches to—I am not going to ask you to bless the tax credit. We may have a difference just on that, but I will end with this question.

Secretary CONNALLY. Well, Mr. Brown, let me say certainly I would agree with part of your statement and that is much of our research and development has been tied to the military and the military today wear black hats. I do not think they should. I think this is wrong. I think we tend to take too narrow a view of many of our programs. We do not consider all of the aspects, and I am talking about the people generally now, I am not talking about the Congress. We tend to want to seek the easy, simple answers to problems and I do not know any easy, simple answers to most of the prolems that this country faces.

So, I happen to feel that when we talk about many of these things, and let us take the military again, the Defense Department, I carry no particular brief for them at this moment in time, although I think they have been much maligned. But it is significant that this budget anticipates a reduction of 17,500 people in the defense sector at a time when we are trying to increase employment. It is significant that the problems of the whole aerospace industry are tied to the reduction of long-range programs which are currently largely tied to the military. If we have tremendous unemployment problems in California and Washington States—we have a 13-percent unemployment in California and higher than that in the Seattle area—it is directly related to policies affecting the military. These things have a cumulative effect and I frankly cannot make simple answers to some of the propositions.

Representative BROWN. Well, I am not intending, Mr. Secretary, that you should defend the military. I am really asking that you defend the technological development that our society has been built on and the need for technological development in the environmental area, in the medical area, in the area of education, and also perhaps in some of the industrial areas that help us pay for the areas of social technological study that we need so desperately in this society to improve not only the quality of life but the quality of man in our future.

Thank you, Mr. Secretary.

Chairman PROXMIRE. Thank you, Mr. Secretary. I would just like to conclude by saying, I do not know what demagogs Congressman Brown could have been talking about. Frankly, I am all for technology, I am all for a strong military force and I think the people who serve in the military force deserve our admiration, our respect, it is often a tough cruel job and they have been overwhelmingly fine people, but I think that it is a healthy thing and a wholesome thing at long last we are taking a critical look both at technology and at our military spending; we should have done this years ago and we did not do it. In past years we have allowed a military appropriation bill of $50, $60 billion dollars or more to pass in 2 hours. A long speech, no questions, nobody would go into detail analyzing whether we needed all of it or not. Now, we are beginning to question it and I think that is good and I would agree with you that I do think Members of Congress and I think this was the sense of your reply to Congressman Brown, you think Members of Congress have been responsible in questioning the budget. They may disagree very vigorously.

Secretary CONNALLY. Sure.

Chairman PROXMIRE. But they have every right and every duty to question it; technology, too. For the first time we are asking questions about whether we should pay not only a price in terms of money but price in terms of the possible deterioration of the environment by technology. I think it is a perfectly proper, desirable question, we should have asked it years ago. It is time we asked it but I think Congressman Brown is right in saying we can overdo it. The technology is our only hope for improving our standard of living.

I talked earlier about your being our cleanup man because you are our last witness. You have done a great job, most responsive, intelligent and effective, and when I say a cleanup man not cleaned up as you say, but you are batting No. 4 in the batting average, a real power hitter.

Thank you very much, Mr. Secretary. And I am delighted that the Treasury is in such good strong hands.

Secretary CONNALLY. Mr. Chairman, you are very kind and very gracious. I assure you it is a great privilege for us to be here this morning. We look forward to every opportunity to appear, when you feel our views or opinions will contribute to the deliberations of the work of this Congress for which I have profound respect and admiration.

Chairman PROXMIRE. Thank you very much.

The record will be kept open for 2 weeks. The committee stands adjourned.

(Whereupon, at 12:40 p.m., the committee was adjourned.)

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

RESPONSE OF HON. JOHN B. CONNALLY TO ADDITIONAL WRITTEN QUESTIONS POSED BY REPRESENTATIVE REUSS

Question 1. In the light of the extraordinary $10 billion official settlements payments deficit in 1970, to what extent should the United States actively try to diminish net foreign expenditures through deflation, capital export controls, and similar measures? On the other hand, to what extent should we expect other countries to implement the actions they can take—such as liberalizing import restrictions or revaluing exchange rates—to curtail undesirable surpluses with the United States?

Answer. The large size of the official settlements deficit in 1970 was associated with very large repayments of short-term borrowings abroad by United States banks. These repayments were associated with the continuation of relatively tight credit conditions in Europe, and especially in the Federal Republic of Germany, as compared with the easing of money market rates in the United States. The deficit on recorded current and long-term capital transactions was running at an annual rate of $3.3 billion a year in the first three quarters of 1970.

Reduction in this underlying deficit is not a simple or easy task. The best environment to facilitate such an improvement is a domestic economy which avoids both deflation and inflation, and achieves stable real growth. Insufficient real growth tends to be associated with a weakening capital account in the balance of payments, while inflationary overheating has an adverse effect on our trade position.

While it is the Administration's desire to phase out the restraints now applied to exportation of capital by Americans, progress in strengthening the balance of payments has permitted only modest relaxation of these restraints. An extension of the Interest Equalization Tax is being recommended to the Congress, to provide continuation of the present flexible authority.

The Domestic International Sales Corporation is aimed at giving our exporters tax treatment more nearly comparable to that extended to earnings on direct investment abroad. This should help to strengthen our current account position and thus provide more scope for relaxation of capital restraints.

Foreign countries can adopt various policies to reduce their current and long-term capital surpluses, which correspond to out deficit, and thus help to correct the imbalances in the world payments structure. As regards the capital accounts, they can offset their export surpluses with public aid to developing countries, and by encouraging private long-term capital investment in deficit countries. As regards the current accounts, liberalization of import restrictions is an obvious first step among the alternatives which could reduce surpluses.

Question 2. The recent decline in U.S. short-term interest rates below levels in Europe and the imposition of reserve requirements on liabilities to foreigners led in 1970 to a major reflux of short-term capital from the United States to Europe. Of course, this return flow would not have occurred in such large dimensions if Regulation Q had not induced banks to initially seek funds in the Euro-dollar market during late 1968 and 1969.

Do you think that in the future it would be desirable to avoid any such massive accumulation and subsequent decline in short-term liabilities to foreigners? If so, what new policies or departures from former practices would you recommend to ensure against a repetition of these events?

Answer. Large international movements of foreign private funds into and out of U.S. banks took place in 1968, 1969 and 1970. In the first two years the flow was towards the United States, as credit conditions here were tighter than in many European countries, and U.S. banks borrowed from their foreign branches. During 1970 there were large repayments of such borrowings, stimulated by tighter money in Europe. As a result, the official settlements balance of the United States was in surplus by $4.3 billion in the first two years, and in deficit by about $10.7 billion in 1970 (excluding SDR allocations).

While retention of Regulation Q ceilings on large Certificates of Deposit by the Federal Reserve system, during a period of credit tightness in 1968 and 1969, focused demand on the Euro-dollar markets, the demand for funds on the part of these banks, even in the absence of Regulation Q, would have impinged on the world market for short-term funds to some degree in any event. Nor can we overlook the fact that competition for funds would have had a greater adverse impact on other domestic financial institutions in the absence of Regulation Q. The reflow in 1970 was essentially due to changed monetary circumstances in various countries and not to the imposition of reserve requirements on foreign borrowings of U.S. banks, which were applied to marginal increases in borrowings above specified levels.

While in an ideal world it might be desirable to avoid such large swings in short-term funds, in the real world such flows may be a consequence of the need to utilize monetary policies of different degrees of tightness in different countries simultaneously, because countries are at different phases of cyclical developments. The experience of 1968 to 1970 has made it evident that very large amounts of banking funds can move into any major country where credit supplies are tighter than they are in other monetary centers. The realization of this fact has led to discussion of the problem among international monetary officials, with a view to ascertaining whether present techniques and procedures can be further developed to provide more scope for independent monetary policies in individual countries while retaining the advantages of interconvertibility of major currencies.

Question 3. The recent report of the Council of Economic Advisers states "It is envisaged that SDRs will eventually supplant dollars as the major source of reserve growth." However, special drawing rights are unlikely to become the chief source of new reserves if the United States continues to run deficits with foreign official institutions of the dimensions that occurred in 1970. Do you believe the United States should pursue policies that will encourage the replacement of the dollar by SDRs as the chief source of additional reserves?

Should we, for example, suggest that the interest rate paid on SDRs be increased to make them a more attractive reserve asset and a better alternative to the dollar?

Answer. Special Drawing Rights are intended to provide for an adequate rate of growth in world reserves. Their long-term future is related to the development in our own balance of payments on official settlements, and the trend of the dollar holdings of foreign monetary authorities, as well as to the growth in other reserve assets. Reducing our deficits will probably make it easier to negotiate future increases in Special Drawing Rights, and such a reduction is an objective of policy in any case.

The question of interest rates paid on SDRs is only one aspect, and generally not a major one, in the policies of foreign monetary authorities in determining the composition of their reserves. At present the Special Drawing Rights pay interest at 1½ percent, while gold reserves earn no interest at all for their holders. As the Special Drawing Rights have a gold value guarantee, the United States view has been that the need for a higher interest rate on SDRs has not been established. During the past year, interest rates on dollar reserves have declined markedly, and the differential between the return on dollars and on SDRs has narrowed from 5 to 6 percent at the end of February 1970 to about 2 percent at the end of February 1971.

Question 4. In December 1968, the Executive persuaded European and Japanese steel producers to voluntarily restrict their exports to the United States. From 1960 through the end of 1968, wholesale prices for iron and steel products increased 5.5 percent. But from December 1968 through November 1970, wholesale prices for these products rose 13.8 percent, more than twice the amount in the previous nine years. In the light of these facts and the recent 6.8 percent rise in the price of structural shapes, will the Administration oppose renewal of this voluntary arrangement when it expires?

Answer. It is true that the price of iron and steel products rose rapidly in the last two years. These price increases, which were in excess of the increase of the entire wholesale price index for the same period, are of great concern to the Administration in its fight against inflation. Dr. Houthakker, of the Council of Economic Advisers, is presently chairing a subcommittee to study the question of steel, with particular regard to the stance the Administration should take with respect to renewal of the voluntary agreements after December 1971. Price behavior in the domestic market is one important consideration which Dr. Houthakker will use to formulate a recommendation to the Cabinet Committee on Economic Policy.

Question 5. In discussing movements in the consumer price index during 1970, the Council of Economic Advisers say in their report (p. 54), "an acceleration of price increases was also evident in apparel, where demand has not been strong and where competitive markets are the rule." Apparel prices to consumers rose at an annual rate of 2.9 percent in the first half of 1970 and 5 percent in the second half. Given this unacceptable rate of inflation, how can the Administration advocate the implementation of additional restrictions on textile and apparel imports? Why hasn't the question of textile imports been submitted to the Tariff Commission?

Answer. The question of textile imports has been the subject of extensive study within the executive branch, and the Tariff Commission in January 1968 issued a comprehensive report on textiles and apparel. A further investigation by the Tariff Commission would not, therefore, seem warranted. The facts are already well known.

This Administration has sought to limit the rise of textile imports while continuing to advocate a liberal trade policy. The case of textiles is unique, partially because of the enormous importance of the domestic industry. One out of every eight workers in manufacturing is employed in the textile industry. Furthermore, it is a major employer of minority workers, of women and of the under-skilled. In the recent past, the United States trade balance in textiles has deteriorated rapidly, leading to a sharp decline in employment.

One key factor in this deterioration is maintenance by other countries of extensive restrictions on textile and apparel imports from the same countries now shipping so heavily to the U.S. Our market has been open while others have been open while others have been closed and the impact has been considerable.

Restrictions on textile imports, whether imposed by legislation or arrived at through negotiation, should include sufficient flexibility to allow the President to relieve any inflationary pressures that might otherwise build up. The provision of the Trade Bill considered by the last Congress, which would have established textile quotas, contained such flexibility.

I would point out that the rate of inflation in cotton textiles in the past several years has been substantially below the over-all rate even though the importation of cotton textiles has been regulated since 1968 by a series of bilateral agreements.

Question 6. The scheme for the establishment of Domestic International Sales Corporation (DISC) that the Administration advanced last year would defer taxes on export earnings and under some conditions could become a tax exemption for exporters. Given the critical education, health, and medical needs of our population and also considering the financial bind that State and local governments are struggling against, would you explain why we should be subsidizing exports with tax deferrals or tax expenditures?

Answer. The DISC proposal is a measure to place export production in the U.S. on the same tax footing as production abroad by foreign subsidiaries of U.S. firms, and thus correct the present anti-export bias in our tax laws. In this way, we will make export activity more attractive to U.S. industry.

The need for more rapid export growth seems clear-cut, when we consider that last year, despite a favorable cyclical pattern—with the U.S. economy deflating while the economies of our major trading partners were extremely buoyant—our trade surplus was only $2.2 billion (balance of payments basis), or less than half of the $5.4 billion average in the years 1961–65. This trade surplus, though it was larger than in 1968 or 1969, was still far from adequate to offset payments resulting from government expenditures abroad and direct investment and other capital outflows.

In consequence, a goal of this Administration—the orderly relaxation, and ultimate removal, of our program of restraint on capital outflows—has had to be retarded. A stronger current account, spearheaded by rising export proceeds, would be the best and surest way to expedite removal of controls on capital outflows. We see the DISC proposal as helping to improve our export performance.

Question 7. The Administration has committed itself repeatedly to the removal of controls over capital exports. You have a target for GNP in 1971; do you have a similar target date for the abolition of capital export restrictions?

Answer. A target date has not been established for the abolition of restraints on capital exports. Instead the procedure is to review the international payments and monetary situation periodically to determine the degree of relaxation of the existing restraints which appears prudent and reasonable. The pace of relaxation is related to the developments in the balance of payments, but not in a rigid and arithmetical way. Thus there has been some trimming of the restrictions both for 1970 and 1971, despite the continuing difficulties in our balance of payments position.

Setting a target for the abolition of restrictions would not be wise in view of the many variables that affect the balance of payments, not only developments in the United States but policies and rates of growth in the rest of the world.

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