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# THE 1972 ECONOMIC REPORT OF THE PRESIDENT

# HEARINGS

BEFORE THE

## JOINT ECONOMIC COMMITTEE
## CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

SECOND SESSION

## PART 4

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# THE 1972 ECONOMIC REPORT OF THE PRESIDENT

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THURSDAY, FEBRUARY 24, 1972

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; and Representative Reuss.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; John R. Karlik and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and Leslie J. Bander, minority economist.

## OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

This morning the Joint Economic Committee continues its annual hearings with an examination of the troublesome question of how this country can simultaneously achieve the two vital goals of full employment and reasonable price stability.

In focusing on this question, we are in a sense anticipating a future problem. Today's urgent and immediate problem is to reduce unemployment. Everyone agrees that 6-percent unemployment is far too high and that reducing unemployment below the present level will not exacerbate inflation. We would be shortsighted in the extreme, however, to ignore the difficult questions which will face us in the future when the economy again focuses on a full-employment situation. Experience of the past 2 years as earlier periods has demonstrated that more efficiently structured labor and product markets are necessary ingredients of price stability.

If we begin now to adopt needed measures of economic reform, we may succeed over the next few years in bringing the economy to a sustainable situation of full employment without excessive inflation.

If we do not initiate and vigorously pursue these reforms, we will instead find ourselves forced to choose, as so often in the past, between too much unemployment on the one hand or too much inflation on the other.

This morning we have invited four leading economic scholars—and I include you, of course, Mr. Brinner, accompanying Mr. Eckstein—Mr. Eckstein, Mr. Gordon, and Mr. Perry, to present their views on current policy and on the steps to be taken to be sure that we will not again put the economy on a treadmill where one step forward in unemployment means a step backward in inflation.

Our first witness is Mr. Eckstein, professor of economics at Harvard University. He is accompanied by Roger Brinner, also of Harvard. Just this morning the committee released a study prepared for it by Mr. Eckstein and Mr. Brinner analyzing the relationship between inflation and unemployment in the United States over the past 15 years.

In his statement this morning, Mr. Eckstein will summarize the results of his study and offer some additional comments on the current outlook.

Following Mr. Eckstein's testimony, the next witness will be Professor Gordon of the University of California at Berkeley. Professor Gordon is best known in this committee for his work as chairman of the Gordon committee, which reviewed the employment and unemployment statistics for President Kennedy.

Mr. Gordon testified last spring at one of this committee's public hearings on the unemployment data, at which time he vigorously protested the cancellation of the Bureau of Labor Statistics press briefings.

In addition to his expertise on employment stastics, he is the author of a book published in 1967 entitled "The Goal of Full Employment" in which he argues persuasively that an unemployment rate of about 3 percent is a reasonable and achievable goal for the United States.

Our final witness is Mr. George Perry, senior fellow at the Brookings Institution. Mr. Perry is author of the book "Unemployment, Money, Wage Rates and Inflation" and of two recent Brookings papers which relate directly to our topic this morning, one entitled "Changing Labor Markets and Inflation" and the second very recent study entitled "Labor Force Structure, Potential Output and Productivity."

I might say, Mr. Perry, that the administration witness have relied heavily on your analysis.

Both Mr. Gordon and Mr. Perry have been asked to adderss their testimony to current economic policy and the prospects for moving the economy toward the prospects of noninflationary full employment.

The committee has also made Mr. Eckstein's study available to them and they will respond to it.

I will ask the witnesses to observe the 15-minute time limit on your initial presentations.

Mr. Eckstein, please proceed.

## STATEMENT OF OTTO ECKSTEIN, PROFESSOR, DEPARTMENT OF ECONOMICS, HARVARD UNIVERSITY, ACCOMPANIED BY ROGER BRINNER, TEACHING FELLOW, DEPARTMENT OF ECONOMICS, HARVARD UNIVERSITY

Mr. ECKSTEIN. Thank you, Mr. Chairman. If I may, I would like to have my collaborator summarize the main results of the study itself, and then I will comment on the implications.

Chairman PROXMIRE. Very well.

Mr. BRINNER. As a background paper for this hearing, we have prepared the study, "The Inflation Process in the United States." [1] It conclusions are summarized in the opening and concluding chapters. In this statement, we focus on a few salient points and face up to the difficult question whether the United States has to lower its sights in its employment goals.

### THE STUDY IN BRIEF

On the basis of a small-scale econometric model of wage and price levels in the American economy, our study concludes that the extraordinarily poor combination of inflation and unemployment of the last few years is mainly attributable to the buildup of inflationary expectations entering into wage claims rather than any change in the structure of the economy itself.

When consumer prices rise only moderately, wage claims reflect no more than half of recent price increases. But as the rate of inflations exceeds 2.5 percent for 2 years or more, wages gradually reflect the inflation rate fully and quickly. Thus, once this state is reached, a 1-percent increase of consumer prices produces an extra 1-percent increase in wages.

Since prices, in turn, fully reflect changes in unit labor costs, the wage-price mechanism becomes explosive and the Phillips curve becomes vertical. This process is illustrated for the decade of the 1960's in the attached figure which is reproduced from study. The figure shows how the rather flat shortrun Phillips curve gradually deteriorated. In the mid-1960's, when the unemployment rate became quite low, the economy initially lived on borrowed time: price expectations were still far short of fully reflecting the actual inflation. But by the end of the 1960's, the shortrun Phillips curves had drifted far up and to the right, confronting policymakers with intolerable choices. The abandonment of incomes policy also speeded up the drift of the curves.

(The figure referred to above follows:)

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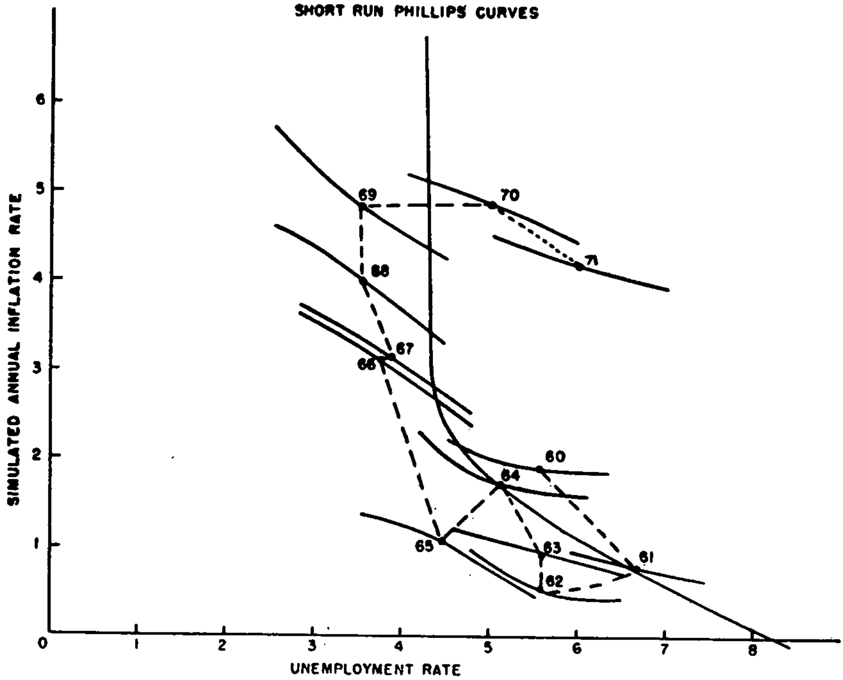
[1] Otto Eckstein and Roger Brinner, "The Inflation Process in the United States," Joint Economic Committee, U.S. Congress, February 1972, 46 pp.

[From a study entitled "The Inflation Process in the United States," p. 33, prepared for the use of the Joint Economic Committee, Congress of the United States, by Otto Eckstein and Roger Brinner, Feb. 22, 1972]

FIGURE II
SHORT RUN PHILLIPS CURVES




Mr. BRINNER. The figure also shows the longrun Phillips curve AB. It shows the relationship between unemployment and inflation that would develop if the particular unemployment rate were retained steadily until all the leads and lags had completed their effects.

While the shortrun Phillips curves will rarely be identical with the longrun Phillips curves because of the actual variations of the economy, the longrun curve shows the tendency toward which the system is headed. It also indicates the longrun choices that are open to policy. The diagram shows that the longrun Phillips curve becomes almost vertical as the unemployment rate moves from 4.5 percent down to 4 percent.

If there had been no wage-price control program, it would have taken several years to take the extraordinary inflation expectations out of the system and to return to the neighborhood of the longrun Phillips curve.

According to our simulation exercises, if unemployment has been pushed up to 7 percent and maintained at that level, normal market forces would have brought the system back to normalcy by 1974. A 6-percent unemployment rate would have accomplished the job by 1975. Had the economy followed a more realistic path of expansion, but without controls, the system would have returned to the area of explosive wage-price behavior.

The model was also used to analyze the feasibility of the wage and price targets of the phase II program. These studies are summarized in table 9 of the study.

(The table referred to above follows:)

[From a study entitled "The Inflation Process in the United States," p. 35, prepared for the use of the Joint Economic Committee, Congress of the United States, by Otto Eckstein and Roger Brinner, Feb. 22, 1972]

TABLE 9.—PHASE II STUDIES

| | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|
| I. Basic forecast (path C): | | | | | |
| Unemployment rate | 6.0 | 5.7 | 5.0 | 4.5 | 4.5 |
| Wage change | 6.45 | 5.89 | 5.76 | 5.74 | 5.63 |
| Price change | 4.38 | 3.55 | 3.48 | 3.25 | 3.15 |
| II. Controlled wage level: | | | | | |
| Wage change | 5.62 | 5.50 | 5.45 | 5.32 | 5.25 |
| Price change | 4.08 | 2.78 | 2.84 | 2.84 | 2.76 |
| Free wage path given the price results | 6.43 | 5.63 | 5.42 | 5.32 | 5.25 |
| Difference between controlled and free wage paths | .81 | .13 | −.03 | 0 | 0 |
| Accumulated wage stress | .81 | .94 | .91 | .91 | .91 |
| III. Controlled price level: | | | | | |
| Wage change | 6.41 | 5.48 | 5.14 | 4.92 | 4.92 |
| Price change | 3.76 | 2.50 | 2.57 | 2.45 | 2.40 |
| Free price path given the wage results | 4.36 | 3.40 | 3.00 | 2.85 | 2.74 |
| Difference between controlled and free price paths | .60 | .90 | .43 | .40 | .34 |
| Accumulated price stress | .60 | 1.50 | 1.93 | 2.33 | 2.67 |

Mr. BRINNER. If wages alone are controlled to reach the 5.5-percent target, the accompanying price behavior would create wage pressures that would probably break the program. The gap between the wages that would normally develop and the ceiling rate would become too great.

Similarly, if prices alone were controlled to follow the 2.5-percent target, with wages allowed to go free, it would create such a stress on the price guidelines that they would not survive. The studies indicate that the wage-price program can only succeed if wages and prices are brought into consistency with each other; that is, if both are brought within their targets.

The study emphasizes the price expectations or inflation severity factor at the expense of the competing theory, the deterioration of the structure of the labor force. Our study obtains the strongest statistical explanation of wage changes when it combines the severity factor with the national unemployment rate—without correction for mix by age, sex, or race, even without correction for new hires or quits or any of the labor market factors that have ben advanced.

This is not to say that the structure of the labor force has not changed, but that this set of factors is not the cause of the severity of the inflation. Indeed, we find that the longrun Phillips curve has not changed significantly in the last 18 years.[1]

[1] Subsequent to the completion of this paper, we have had the opportunity to run some additional forecast tests of competing models, one containing the price expectations factor, the other containing the structural labor market theory. Using data through 1969, our model using the inflation severity factor and the national unemployment rate predicts the rate of wage increase for 1970 to be 6.39 percent, still somewhat less than the actual experiencing of 6.67 percent. A model omitting the inflation severity factor but using the structure of the labor force idea underpredicted wage change more, projecting a rate of 5.98 percent. A combined model, using both inflation severity and a corrected unemployment rate, projects a rate of wage increase of 6.37 percent. Additional forecasts run through September 1971, produced the same sort of results. The actual wage index rose 6.45 percent, our model projected 6.24 percent, the structural unemployment model projects 5.67 percent, the combined model, 5.99 percent. Using equations fitted through 1970 and projecting the 1-year interval ending in the third quarter of 1971, the same pattern of results emerges. Compared to an actual of 6.45 percent, our model projects a gain of 6.42 percent, the structural unemployment model projects 6.02 percent, the combined model 6.18 percent.

## DO WE NEED TO LOWER OUR EMPLOYMENT TARGET?

Our analysis of the inflation process implies that the Phillips curve has not deteriorated. The inflation severity variable puts the wage equations back on their feet: once this factor is recognized there is no discernible change in the structure of the wage-price mechanism. The recent poor performance should be explained by the particular circumstances of the last 1960's excess demand caused by the war created a process of deteriorating price expectations that took several years to become completely visible; the abandonment of income policy at the very instant when the wage-price spiral was reaching the explosive stage.

Three major questions remain to be answered, however:

1. What factors have served to offset the deterioration of the Phillips curve that might be produced by the changing mix of the working-age population?
2. Why is the longrun Phillips curve no better than it is; that is, why does the wage-price process begin to "go critical" when the unemployment rate approaches 4 percent?
3. How could the "critical" unemployment rate be improved?

## OFFSETS TO THE CHANGING MIX OF THE LABOR FORCE

The average level of education of the labor force has risen during the postwar period. Tables 1 and 2 shows the enormous changes. The percentage of workers who had less than an eighth-grade education or less has fallen from 49.6 percent in 1940 and 36.4 percent in 1952 to 15.2 percent today.

(Table 1, referred to above, follows:)

TABLE 1.—EDUCATIONAL ATTAINMENTS OF POPULATION, 18 TO 64 YEARS OLD

| | Years of school completed— | | | | |
|---|---|---|---|---|---|
| | 8 years or less | 9 to 11 years | 12 years | 1 or more years of college | All 12 years or more |
| March 1971 | 15.2 | 16.8 | 40.2 | 27.8 | 68.0 |
| March 1964 | 23.4 | 19.4 | 35.4 | 21.9 | 57.3 |
| March 1957 | 31.6 | 19.8 | 30.5 | 18.0 | 48.5 |
| October 1952 | 36.4 | 19.1 | 27.8 | 16.6 | 44.4 |
| April 1940 | 49.6 | 18.4 | 19.7 | 12.2 | 41.9 |

Source: U.S. Department of Labor, BLS, Educational Attainment of Workers, March 1971, p. A-7.

Mr. BRINNER. The percentage with education beyond high school has risen from 16.6 percent in 1952 to 27.8 percent in 1971. Unemployment falls sharply with educational attainment. In particular, the rates drop sharply with high school completion. The share of the labor force that lacks the high school diploma has fallen from over 52 percent in 1957 to 32 percent in 1971.

(Table 2, referred to above, follows:)

TABLE 2.—UNEMPLOYMENT VERSUS EDUCATIONAL ATTAINMENT, MARCH 1971

| Years of school completed | Percent of labor force unemployed | | |
|---|---|---|---|
| | 18 years old and over | 18 and 19 years | 20 to 24 years |
| Less than 5 years | 6.4 | | |
| 5 to 7 years | 7.7 | | 16.1 |
| 8 years | 6.4 | 32.4 | 13.9 |
| 9 to 11 years | 8.7 | 20.3 | 18.8 |
| 12 years | 5.5 | 13.3 | 9.8 |
| 1 to 3 years of college | 5.6 | 13.7 | 9.8 |
| 4 years of college or more | 2.3 | | 5.4 |

Source: Ibid., p. A-17.

Mr. BRINNER. The Economic Report of January 1966 reports an analysis which standardizes unemployment rates by education. The increase of education between 1957 and 1965 lowers a standardized unemployment rate by 0.4 points. The improvement between 1965 and 1972 would reduce a standardized unemployment rate by another 0.3–0.4 points. The total benefit of more education should have lowered the target unemployment rate by an amount at least equal to the impact of the changed age-sex-race mix.

THE ROLE OF MANPOWER PROGRAMS

Manpower programs were enacted mainly in the 1960's. While they can be criticized on grounds of efficiency and performance, there is no doubt that they have a significant impact on reported unemployment rates.

Federal manpower outlays, defined to include manpower training and employment services and vocational education, have risen from a budget outlay of $250 million in 1963 to $3.849 billion in the current fiscal year and a proposed outlay of $4.486 billion in fiscal 1973.

The number of individuals in work and training programs has risen from 135,000 in 1964 to 1,183,000 in 1969. It is scheduled to rise to 1,496,000 in 1973. This is almost 2 percent of the labor force, and a much larger fraction of inexperienced workers.

These programs cut the reported unemployment rate in several ways. First, some of the individuals in these programs are considered to be in the labor force and employed. Other individuals are considered to be in a training status and are, therefore, not included in the labor force.

Without the programs, they might well be among the unemployed.

Finally, some beneficiaries of manpower programs are in private industry under various special programs. These individuals are also counted as employed. The Neighborhood Youth Corps alone, with more than 600,000 youngsters in its summer programs, directly reduces the teenage unemployment rate.

These are only the mechanical relations between the programs and the unemployment rate. The massive human investment surely is changing the productivity of these workers and making them more attractive for hiring. For any given set of macroeconomic conditions, the probability of their being employed should be higher.

Since we are dealing with the targets of macroeconomic policy, we must make allowance for the impact of the manpower programs on numerous individuals. The factor taken in isolation should make us raise our employment target.

## PROGRESS TOWARD EQUAL EMPLOYMENT OPPORTUNITY

Congress has enacted significant legislation to promote equal employment opportunity. The 1960's saw a revolution in the hiring attitudes of employers toward nonwhite workers.

The legislation and the improved attitudes cannot quickly undo 200 years of history and it will be a number of years before the black labor force is equally equipped with quality education, training and on-the-job skills. In the current employment statistics improvements in the structure of unemployment are only visible for nonwhite women. For black men, the ratio of their unemployment rate to the white rate is little changed.

Hiring attitudes toward women generally are only now in early stages of improvement. As we look ahead, few would doubt that the next 20 years will see a major closing of the gap in the employment opportunities open to women and to men. This factor also should allow us to raise our employment.

## WHY IS THE CRITICAL UNEMPLOYMENT RATE AS HIGH AS 4 TO 4.5 PERCENT?

Having argued for the stability of the long-run Phillips curve, it remains to explain why the curve is no better. The causes of this inadequacy of our economic structure can be classified into two categories: First, the inevitable frictional elements in labor markets do grow larger with the number of young workers.

Frictional factors might also raise unemployment if there are particularly short shifts in the composition in the demand for workers, such as the shift associated with the major decline in defense spending of recent years. In the case of prices in product markets, the classical theory of the competitive economy would argue that adjustment should come smoothly and symmetrically, so that even the shifts in demand should not be the source of additional price pressures. Once frictions and imperfect information are introduced, it is possible to reason one's way to a modest inflationary bias in a rapidly changing economy even under competitive conditions.

The other set of causes—in my judgment the dominant set—are the monopoly elements in product and labor markets. On the price side, our equations show labor costs passed on fully, a result consistent with both monopolistic or competitive conditions.

But the pass-on is relatively insensitive to variations in supply and demand. The pass-on is virtually complete even when utilization rates of industrial capacity are low. On the wage side, scholars still disagree whether unionization generally raises wage levels. But there can be little doubt that for some highly skilled workers supply is deliberately kept rather short, assuring the workers able to obtain the skills wages far above wages generally prevailing in the economy.

There is also the special problem of unions who have the ability to paralyze transportation and other essential services. In the recent inflation, the impact of wage increases in a few such highly publicized, high-skill occupations, had a major impact on the movements of industrial wages generally.

### HOW CAN THE CRITICAL UNEMPLOYMENT RATE BE LOWERED?

We are in the midst of a wage-price control program designed to move the shortrun Phillips curve back toward the longrun tradeoffs. While our energies are absorbed in this effort, there is little serious consideration of structural changes that would shift the longrun curve itself for the better.

A program to shift the longrun Phillips curve might well have these elements:

1. Keep the frontiers open—competition from other advanced countries is the single most effective check against monopoly power in a number of industries. Every quota, whether formal or informal, in industry or agriculture, moves us further away from our longrun full employment targets.
2. A more vigorous antitrust policy which uses price and profit behavior as criteria in the choice of cases and as an important form of evidence in the judicial resolution.
3. A combination of tax incentives and quotas for employers to stimulate the employment of the disadvantaged.
4. Efficiency in Government resource use to keep the strain on physical and tax resources to the minimum needed to meet our public goals.
5. A set of fiscal and monetary demand management policies geared to the longrun rather than the shortrun Phillips curves and aiming at employemnt targets that are sustainable over the longrun.
6. Fiscal and monetary policies designed to achieve a smoother and more balanced growth of demand and leaving the economy free from the destabilizing jolts of frequent swings in fiscal and monetary stimulus and restraint.

Chairman PROXMIRE. Can you give us a minute or 2 on how you made this study, the basis of the study, why you think the study is valid?

Mr. BRINNER. We used statistics of the past 16 years to estimate the relationships that determine wage and price inflation and then built a small model which we simulated to find exactly what had changed the economy and what had not. By using standard statistical tests we have a good deal of confidence in our results. The novel feature that introduces this inflationary severity factor is an unusual price variable entered into the wage simulation equation.

Chairman PROXMIRE. Thank you.

Mr. ECKSTEIN. Mr. Chairman, Mr. Brinner has presented our overall results. The notions that are incorporated in our model, of course, have been understood for a long time and we did not invent the general concept of expectations.

But it does appear as we look at the historical record of recent years that the expectations element did become important and that wage claims became totally at odds with any kind of usual market effect.

It is the severity of the recent experience which put us in the situation in which we found ourselves last August. Once we put this expectations factor into the equation, you then can explain the record, and, therefore, can reassert that there is a longrun Phillips curve which has not gone through any dramatic changes.

But having done that, of course, you still have to ask yourself: How is this possible? We know that the mix of the labor force changed, there are more workers, more women.

The factor alone would indeed deteriorate the tradeoff. Every time there is high unemployment there is a structural school to explain it, and the arguments advanced change rather little. Indeed, I find much of what the second part of our statement does can also be found in the Economic Report of the early 1960's.

But there are three additional factors that are fairly transparent. First of all, the labor force is better educated and it is well known that not only do the young workers suffering more unemployment but higher educated people suffer less unemployment.

Table 1 of the oral statement shows that the number of people with 8 years education or less has virtually disappeared. It declined from about 50 percent before World War II to 15 percent today, for all ages. If you look at the same figures for new entrants, they would be even more dramatic. The number of people who have completed high school, which as you can see from table 2 of the oral statements, is the critical point determining you are likely to suffer unemployment in your working career or not, has risen from 42 to 68 percent.

Chairman PROXMIRE. How many years are in that change from 42 to 68 percent?

Mr. ECKSTEIN. From 1940 to 1971. But the change from 1964 to 1971 is from 57 to 68 percent. So there is a very major change even in the last few years.

The high school diploma is really becoming the standard. Again, you consider that it is 68 percent of all workers. So the percentage of new workers must be in excess of 80, and maybe in excess of 85. So all. these young workers who suffer these terrible unemployment rates are not high school dropouts by a large shot. For the most part, they are high school graduates.

So there is the improved education factor which by itself would have lowered the reachable unemployment target by 0.4 of a point.

If we recalculated that from 1965 to 1971 it would be another 0.3 or 0.4 or some number of that magnitude. That is factor one, better education.

The second factor in the manpower programs. You can be critical of the manpower programs in one way or another. Nonetheless, there is no doubt that they do affect the unemployment rates. The outlays for manpower programs have risen from a quarter of a billion dollars in 1963 to $3.8 billion in the current year, and it is to go to $4.5 billion by fiscal 1973.

The number of people in the programs has risen from virtually none in 1960 to 135,000 in 1964, to 1.5 million in 1973. So almost 2 percent of the labor force are somehow in these programs. These programs affect the unemployment rate in various ways. Some individuals are considered to be in the labor force and employed. For example, a disadvantaged worker in the JOBS program who gets a job with a big company is now employed. Others are considered to be in training. Many of those kids in the summertime, the 600,000 Neighborhood Youth Corps kids, are not in the labor force but are in a training status. Others in other parts may be employed.

In any event, in this large and particularly vulnerable group the probability of being unemployed has been significantly reduced. This changes the unemployment target by some 0.1 of a point.

Finally, you have the equal employment opportunity advances. In the early 1960's you really were at the beginning of the change in hiring attitudes towards blacks.

Today, every large company has a major program to employ blacks. There has been legislation and change in attitudes. Of course, that does not undo 200 years of history, but it certainly is a phenomenon in our economy now of sufficient size so that it has a measurable impact on the attainable unemployment rates.

In the case of women, the womens lib movement is more recent and the changed hiring attitudes are very recent. They probably don't affect the targets yet, but we know as we look ahead 5, 10, or 20 years that much of the gap between the employment opportunities for men and women will certainly be closed.

Well, then, having attempted to reconcile why the Phillips curve might not have changed still leaves us with the problem that it never really was any good. If we say that the best attainable is 4 to 4.5 percent—and we literally don't try to pin it down to the exact tenth, because the methods would not allow us to attempt to do that, but it is somewhere in that range—why has it never been better and why isn't it better now, and what can be done about it?

There are, again, two kinds of theories that explain this inadequate Phillips curve. Keeping in mind that the black unemployment rate is twice the white and the teenage rate is three or four times the average, 4 to 4.5 percent is not a very good social target. We used to think we could get it down to 3. So it really is a kind of retreat. While one set of factors is to change mix in the labor force, the other set of factors is monopoly: monopoly in the product market, monopoly in the labor market. So far really very light quantitative work has been done to attempt to identify the really relevant weights of these two factors. My own judgment, based on my own experiences in the Government, and just observation of the economy, is that I would place a greater weight on the monopoly factor than I would on the changing structure of the labor market. These are things that made me think that way:

First of all, our findings are pretty evident that all of the labor cost is passed forward into prices even when demand is far less than excessive. Indeed, the impact of demand changes on prices is extremely modest and only in a rather extreme condition.

On the price side the costs are just passed on too easily.

On the wage side, where was the real trouble in this current inflation? The really disturbing element is in the construction trades, among public employees, in certain highly organized skills where supply was kept low, where supply is controlled essentially by the workers in those trades.

The trouble is no longer in the labor market as a whole. It is the west coast dockworkers, the miners, the people for whom our emergency disputes machinery is inadequate, people who simply possess the real market power.

What could be done to lower the unemployment rate? The answer in terms of the monopoly factor is pretty obvious, but let me draw on some other things in our study to indicate some of the things that could be done.

First of all, we do find that the longrun tradeoff is better if the economy is stable. So the first recommendation that we would make is that policy attempt to get a more stable level. For example, a full employment budget that swings from a significant surplus to an $8 billion deficit is not the kind of fiscal policy that lets you get to the best possible inflation and unemployment tradeoff.

Similarly, on the money side we probably would be better off if the money supply grew somewhat more smoothly than it has. It is just to get there in a more stable way.

Secondly, policy, itself, in its day-to-day operation has a major impact on the tradeoff. If the Secretary of Agriculture every 4 years tries to pump up farm incomes you are going to upset agricultural prices. There is no way out of that.

If people were concerned with farm incomes every year there would be an average better performance on food prices which, in turn, of course, affect wage claims.

Then beyond that, of course, you have the long list that we all have of structural changes recommended for the economy. They are included in Mr. Brinner's statement. The most important of them I would say at this time in practical terms is to keep the frontiers open to trade because after all if you look at the last 20 years that is the major positive development, to make the economy more competitive.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Eckstein.

Please proceed, Mr. Gordon.

## STATEMENT OF R. A. GORDON, PROFESSOR, DEPARTMENT OF ECONOMICS, UNIVERSITY OF CALIFORNIA, BERKELEY

Mr. GORDON. I take it that this morning's hearings are to be concerned with the continuing high level of unemployment in the United States and with the worsened tradeoff between unemployment and inflation which presumably now faces this country. Much of the recent public debate about these important issues centers around the extent to which changes in the composition of the American labor force make it now more difficult to achieve a national unemployment rate of 4 percent, without an unacceptable rate of inflation, than was the case a decade or more ago.

In this connection I might remind this committee that it was in fact just 10 years ago, in the January 1962 Economic Report of the President, that the figure of 4 percent was first put forward officially as an "interim" goal by President Kennedy's Council of Economic

Advisers—previous administrations had avoided proposing a specific number as a guide to policy. The goal of 4 percent was to be considered only an interim one, pending adoption of an eventually lower figure. Now we hear statements from the administration about an "interim" goal of 4.5 to 5 percent, until enlarged manpower programs and other policies again make possible the achievement of a lower figure.

The national unemployment rate reached its post-Korean low of 3.3 percent, seasonally adjusted, in February 1969, and continued at a level of about 3.5 percent through the remainder of that year. Beginning in January 1970, unemployment rose steadily to a peak of 6.1 percent in December, and the rate has stubbornly remained at about 6 percent since then, despite the fact that real GNP and employment have been rising since the fourth quarter of 1970. As unemployment continued at a high level without much abatement in the rate of inflation, at least until the new economic policy was introduced last August, there began to be increasingly frequent references to the growing importance of structural unemployment. What different observers mean by "structural" unemployment is not always clear, but all agree that the more important is this component of total unemployment, the more difficult is it to reduce unemployment through the use of an expansionary monetary and fiscal policy without generating an unacceptable rate of inflation. In technical jargon, increasing structural unemployment shifts the Phillips curve upward.

Recent and current discussions about structural unemployment remind me that similar issues were raised a decade or more ago. After the recession in 1957–58, the annual average unemployment rate did not fall below 5 percent until 1965. It became popular to talk about structural unemployment, and some argued that structural factors would make it impossible to bring the unemployment rate down to 4 percent through an expansion of aggregate demand without generating an unacceptable rate of inflation.

Then the argument was that the composition of demand for labor had been changing in ways that made obsolete the limited skills of may blue-collar workers with less than a high school education. Because of automation, other technological changes, and the shift in demand from commodities to services, it was argued, the occupational mix was shifting toward white-collar jobs and toward jobs requiring more education.

And, it was argued or implied, occupational mobility was limited, so that unemployed unskilled and semiskilled blue-collar workers could not be put to work without a massive investment in manpower programs—programs which, at the time, hardly existed at all.

We know the outcome of that debate. The unemployed were reabsorbed in the long expansion of 1961–65, and a 4-percent unemployment rate was reached in December 1965, just as the beginning of the Vietnam buildup was touching off a new inflationary spiral.

As we look back at the years 1961–65, the degree of inflation that accompanied this decline in unemployment seems very modest indeed.

Today, the discussion of structural unemployment takes a different turn. Now the emphasis is on changes in the composition of the supply of labor, not on changes in the composition of demand. It is the changing age-sex composition of the labor force that is causing the trouble and shifting the Phillips curve to the right.

Perhaps suprisingly, one hears little or nothing in this context about the high unemployment rates among the increased urban populations of blacks and Spanish-speaking Americans. (An exception is the group of younger economists who have propounded a "dual labor market" theory of the incidence of unemployment.)

Thus, the argument about the effect of increasing structural unemployment in worsening the inflation-unemployment trade-off has taken a new twist. It is no longer the changing composition of the demand for labor; automation as the bogey man is out. The new troublemakers are women and teenagers. Their share of the labor force has increased; and, with their differentially higher unemployment rates, it is now more difficult than before to bring the unemployment rate down to 4 percent.

This is not the end of the argument so far as the effect on the trade off is concerned. After all, we can push down those female and teenage unemployment rates if we try, even with the instruments of macroeconomic policy.

The trouble, to turn the table around, is with the supply of prime-age males. The supply of men age 25–55 has been growing relatively slowly, and with the accelerated inflow of women and teenagers into the labor force, prime-age males have been becoming a steadily smaller fraction of the labor supply. And as a result, their unemployment rates have been declining relative to the national rate.

In 1969, when the national rate was 3.5 percent, the unemployment rate for males in each 10-year age group from 25 up was significantly less than during the Korean boom, when the national rate fell to 2.9 percent.

In 1970, with an annual average unemployment rate of 4.9 percent, unemployment rates for males age 35 and above were lower than they were in 1956, when the unemployment rate was 4.1 percent.

And, in Phillips curve fashion, these very low unemployment rates for prime-age males (who, among other things, make up the bulk of our labor unions) increase the upward pressure on wages, which then spills over into other sectors of the labor market where unemployment rates are higher.

The administration seems to have seized on these trends. They are emphasized in the report of the Council of Economic Advisers in the new economic report of the President; they were reiterated, with the help of additional tables, in Herbert Stein's recent presentation to this committee; and they were emphasized again when Secretary Connally appeared before you last week. The inference is that, to quote a public statement by Secretary Connally some 8 months ago, the full employment goal of 4 percent is a "myth."

Today, the administration's position is more or less this: avoid all numbers if we possibly can; if we can't, a realistic goal for the medium-term future is something like 4.5 to 5 percent.

The argument that the changed age-sex composition of the labor force has made the 4 percent goal more difficult to achieve than a decade or more ago is now widely accepted, not only by the administration but by many economists.

A recent study by George Perry, who is here today, points toward that conclusion and has been widely cited. I am on record as having reached the same conclusion.

On the other hand, some economists believe that they can explain the worsened trade off between unemployment and inflation without taking into account the changing demographic composition of the labor force. One of them is here today. Otto Eckstein and Roger Brinner have just completed a study for the Joint Economic Committee in which they attempt to explain the combination of high unemployment and rapid inflation primarily in terms of the recent behavior of prices.

According to them there is some crucial rate of inflation, which, if exceeded, generates an accelerating rise in prices. They believe that that crucial rate is about 2.5 percent per year, which is generated by an unemployment rate of about 4.5 percent.

In effect, Professor Eckstein and his collaborator are "accelerationists," like Milton Friedman and Edmund Phelps, for unemployment rates of 4.5 percent or below. They are "Phillips curve" men for unemployment rates above this figure. Their solution to the problem that they pose is twofold. First, maintain a stable economy at close to the "natural rate." Then seek to lower the natural rate by a series of structural reforms that range from a permanent incomes policy to employment quotas for minorities and the removal of restrictions on entry into skilled occupations. I shall have more to say about this study a bit later.

I want to return now to how the full employment goal has been viewed by the present administration. It was just 2 years ago, in the February 1970 Economic Report of the President, that the Council of Economic Advisers suggested that full employment might be taken as corresponding to an unemployment rate of only 3.8 percent. This was clearly outdoing their predecessors in previous administrations.

The CEA put forward this suggestion when it projected potential output through 1975, defining potential output as that which "the economy would be capable of producing when operating at an unemployment rate of about 3.8 percent.

Things changed rapidly after that. We moved into a recession; the optimistic official forecasts for 1971 quickly proved to be wrong; and unemployment failed to decline significantly from the uncomfortably high figure that it had reached by the end of 1970.

By mid-1971, Secretary Connally had declared that the 4-percent goal was a "myth."

More recently, Messrs. Stein and Solomon of the CEA have more cautiously suggested that full employment must be taken to correspond to an unemployment rate higher than 4 percent—perhaps as high as five percent—at least so far as what can be achieved through macroeconomic policy without risking an unacceptable rate of inflation.

And still more recently, we have been told to forget about the icing and look at the cake. Or as Secretary Hodgson put it, concentrate on the doughnut (the amount of employment, which is increasing) and don't worry about the hole of unemployment. Secretary Hodgson's analogy was apt. Unemployment is indeed a hole in the lives of some 5 million Americans who cannot find jobs.

To continue with my culinary analogy, the administration, like most of us, like to have its cake and eat it, too. Today, we are told, 4 percent is an impossible full-employment goal. But, oddly, four percent still is the basis for calculating the full employment budget.

However horrendous the projected budget deficit may seem to his conservative supporters, the President can assure them that, with present tax rates and planned expenditures, the budget would be balanced at an unemployment rate of 4 percent. But we have already been told that 4 percent is an unrealistic goal for full employment.

This inconsistency was brought out in the hearings that this committee held last year on current labor market developments. I simply want to emphasize that if we accept the administration's revised notions of what unemployment rate corresponds to full employment, then the "full employment budget" is badly out of balance.

In this connection, may I also be permitted to express my bewilderment over the assignment recently given to a Presidential task force under the leadership of Secretary Connally to "conduct a study of the present status of employment and unemployment in the United States."[1]

The charge to this task force has been discussed in the hearings before this committee and reported in the press, as has the study by a top Treasury economist which again challenges our ability to maintain a full employment goal of 4 percent.

In a period of approximately 1 month the task force is to do nothing less than:

1. Provide a technical evaluation of the methods used in compiling our statistics on employment and unemployment.
2. Study the detailed characteristics of the employed and unemployed.
3. Find out what we know about job vacancies and about the relationship between vacancies and unemployment.
4. Evaluate our manpower programs and also the disincentives to work created by minimum wage legislation and income maintenance programs.
5. Recommend policies to cope with the current situation.

This is a tall order, even if the task force had a year or more for the job and were able to mobilize all the technical help it could get inside and outside Government. I am particularly interested in the charge to evaluate our statistics on employment and unemployment.

In 1961–62, a Presidential committee composed entirely of nongovernment economists and statisticians worked for some 8 months, with all the help they could get from inside and outside the Federal Government, to evaluate the official statistics on employment and unemployment and to make recommendations for improving these data.

I think it is fair to say that the recommendations of this committee, of which I had the honor to be chairman, led to significant improvement and expansion of the data over the ensuing decade.

I suggested to the Commissioner of Labor Statistics a year or more ago that it might perhaps be useful, 10 years later, to take stock of

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[1] See memorandum on "Task Force Study of Employment and Unemployment," beginning on p. 375, pt. 2, these hearings.

progress since our report and to see what further possible improvements now need to be explored.

This is apparently now to be done—in approximately 1 month by a group which is given a half-dozen other difficult research assignments to complete in the same short time.

May I express my skepticism that any significant contribution to our knowledge will come out of this almost amusingly frantic effort? It would not be amusing if it resulted in any political interference in the collection, preparation, and release of the basic data.

I turn now to the reasons for the worsening of the tradeoff between unemployment and inflation which has presumably occurred in recent years.

For the purposes of present discussion, current explanations can be divided into two groups, and we have a proponent of each type here this morning. One type of explanation emphasizes structural changes that have altered the tradeoff, particularly changes in the composition of the labor force, especially with respect to age and sex.

George Perry's recent work is currently perhaps the most widely cited example of this position, and this interpretation is increasingly being emphasized by the administration.

The other position minimizes the influence of structural changes and in effect says that we have unacceptable rates of both inflation and unemployment today because we had too much inflation yesterday.

In this view, the rate of increase in wages depends essentially on unemployment and on price expectations, the latter depending particularly on how prices have behaved in the recent past. Other variables are relatively unimportant, although they are not completely ignored. This seems to be the position of Messrs. Eckstein and Brinner in their paper for this committee.

In extreme form, this is also the pure accelerationist position. We let aggregate demand get too high and the unemployment rate too low in 1966–69. This generated a set of inflationary price expectations that is causing wages to continue to rise rapidly despite a now higher level of unemployment. If we keep unemployment high enough long enough, inflationary price expectations will diminish, and it will again be safe to reduce the unemployment rate—but only as far as the natural rate.

This position—for example, as developed by Eckstein and Brinner—finds no role for changes in the age-sex composition of the labor force. The long-run Phillips curve has not shifted upward. The short-run curve has shifted because of the more rapid rise in prices in the recent past.

Recent price behavior unquestionably affects price expectations, and the latter affect wage behavior. This is recognized in all recent studies of the Phillips curve, including those which emphasize that something new has been introduced into the situation by the changed age-sex composition of the labor force. I should like now to comment briefly on the nature of this change in labor-force composition.

First of all, the problem here results much more from a change in the age than in the sex composition of the labor force I can illustrate this point in several ways. First, let us look at the sort of calculation performed by the CEA in the new Economic Report of the President, where they compute what the 1971 national unemployment rate would have been with the age-sex unemployment rates in 1956 but the 1971 age-sex composition of the labor force. Using 1971 weights raises the 1956 overall unemployment rate by 0.4 percent.

I began to perform this sort of calculation several years ago. I have not tried the experiment for the new 1971 figures, but for 1970 I get the following results. Using 1956 unemployment rates for each group and weighting by that group's share of the labor force in 1970, I find that the changed sex composition alone raised the overall rate by only 0.05 percent, or, to one decimal place, from 4.1 to 4.2 percent. In contrast, the changed age composition raised the overall rate by about an additional 0.3 percent.

Hence, of the overall increase in the national rate of 0.4 percent attributable to a change in age-sex compositon, much the larger part is due to the changed age distribution.

The problem is not so much the growing percentage of mature women in the labor force; the problem is chiefly that the labor force is growing younger. Teenagers and young adults of both sexes make up a larger fraction of total unemployment than they did 10 or 15 years ago.

Let me illustrate this in another way. Despite a significant increase since 1956 in the fraction of the labor force accounted for by women age 25–64, the share of total unemployment accounted for by this group in 1969 was very close to what it was in 1956.

In 1970–71, years of high unemployment when female rates typically rise less than those for males, their share of unemployment was less than it was in 1956.

The share of young adults, age 20–24, in total unemployment rose from 14.3 percent in 1956 to 19.7 percent in 1969 and 21.1 percent in 1970. This occurred not only because of this group's increasing share in the labor force but also because of a marked rise in the unemployment rate for young adult women relative to the national rate. In the latter half of the 1960's, the relative unemployment rate for men age 20–24 also began to rise.

The most dramatic worsening, of course, has been among teenagers, whose share of total unemployment rose from 17.4 percent in 1956 to 30.2 percent in 1969. The teenage share declined in 1970–1971, as it typically does in a recession. The rise in the share of total unemployment accounted for by teenagers results from both their increasing share of the labor force and from the rise in their unemployment rate compared to the national rate.

As pointed out earlier, there is, of course, another aspect of this changing composition of unemployment, and that has to do with what has been happening to prime-age males, age 25–64. Between 1956 and 1969, their share of the labor force fell from 55 to 48.2 percent; their unemployment rate declined from about three-quarters to less than half the national rate; and their share of total unemployment fell from about 40 percent to about 23 percent. (This last figure rose moderately in 1970–1971.)

As a number of observers have emphasized, it is this increasing scarcity of prime-age males which, from the structural side, has been worsening the inflation-unemployment trade-off. A 4 percent unemployment rate today means a much tighter labor market for prime-age males; and the resulting rapid rise in their wages spills over into other sectors. The increasing relative supply of women and teenagers has dampened this effect somewhat.

A modified Phillips curve relating the rate of wage increase for the entire private nonfarm sector to the ratio of the unemployment rate for prime-age males to the national rate clearly shifted to the left during the 1960's, although it apparently became vertical when the rate for prime-age males fell to about half the national rate.

In less technical terms, wages in the entire economy reacted somewhat less sensitively in the 1960's than earlier to the relatively low unemployment rates for prime-age males; but during 1967–1969, when the rate for this group fell to half the national rate, wage inflation accelerated.

I turn now to the new study by Eckstein and Brinner. My comments will be brief and largely nontechnical. While I subscribe to the policy suggestions that the authors make at the end of their study, I am not fully convinced by their main empirical finding—namely, that inflation becomes explosive in the United States once the unemployment rate falls below about 4.5 percent, and at this unemployment rate the Phillips curve becomes vertical.

Nor can I accept the corollary that there has been no shift in the long-run Phillips curve since the early or mid-fifties. Their chief finding rests really only on one observation, namely, our experience in the last 3 or 4 years.

They admit this themselves when they say that this 3-year episode at the end of the 1960's "can be considered only one observation of the critical process of forming inflationary expectations." One observation hardly provides the basis for such important conclusions as they draw from the available evidence.

I should also like to ask: Accepting the results of their regression analysis for the moment, just what is the critically important natural rate of unemployment. The long-run Phillips curve drawn in figures 3 and 11 seems to suggest that this rate is about 4.5 percent. Yet, in the text the authors refer to this rate at various points as being 4 percent, "near" or "approximately" 4 percent, or "in the range of 4 to 4.5" percent. The difference between 4 and 4.5 percent is not an insignificant one.

One final comment. The authors state that the "natural" rate of unemployment is determined by the structure of the labor market. Their method of analysis and their findings imply that there have been no changes in this structure over the last 15 years. My earlier comments and other evidence not presented here make it difficult for me to accept this implication.

I shall conclude with a brief comment on the policy implications of our present and recent experience with unemployment and inflation. I have already said that I agree with the Eckstein-Brinner recommendations, although I should not wait to adopt them, as they seem to suggest, until macropolicy has in the next year or two brought the unemployment rate down to close to 4.5 percent.

Their recommendations for improving the structure of labor markets are familiar: tax incentives and employment quotas to stimulate employment of the disadvantaged, breaking bottlenecks in areas of skill shortages, and making product markets more competitive. To these they add a permanent incomes policy.

I accept these suggestions. Like Eckstein and Brinner, I realize that most of these proposals will take time to implement and a longer time to have significant effects.

I might say in that connection that there is very little evidence that thus far manpower programs have moved the Phillips curve to the left.

The chief effect that I have been able to discover is that by absorbing into manpower programs people who might otherwise have been unemployed they have simply moved us farther up to the left on the Phillips curve.

Chairman PROXMIRE. Are you saying that the only effect is that——

Mr. GORDON. I said the chief effect.

Chairman PROXMIRE (continuing). People who would otherwise be unemployed are instead in training?

Mr. GORDON. Yes. They are withdrawn from the labor supply.

Chairman PROXMIRE. But you say there is no evidence that they increase——

Mr. GORDON. The evidence that graduates of manpower programs have shifted the Phillips curve down is so far nonexistent as far as data are concerned, and at least my tentative conclusion thus far is they have had only a very slight effect in shifting it down and this has been offset by moving up on the curve.

Therefore, I would like to add an additional proposal, which is now under consideration in the Congress. That is a major addition to our now quite inadequate program of public service employment.

Public service jobs at the State and local level can be created quickly; they can be tailored to the needs of the unemployed; and if the program is large enough they can have a significant effect on the unemployment rate in a relatively short period. And, despite the dour comparisons by some administration spokesmen to WPA leaf raking, they can help to meet important public needs that are now not being met.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Gordon.

Please proceed, Mr. Perry.

## STATEMENT OF GEORGE L. PERRY, SENIOR FELLOW, THE BROOKINGS INSTITUTION[1]

Mr. PERRY. My remarks on the present economic policies are divided into three sections: agreements, doubts, and concerns. Let me start with agreements.

This year, in contrast to last, there is much to applaud and agree with in the economic report of the Council of Economic Advisers.

First, I applaud the sharp reversal in economic policies initiated last summer. On the domestic front, the direct attack on inflation and the move toward fiscal stimulus were long overdue and the delay was costly.

[1] The views expressed are my own and are not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

What has been done is not ideal, but at least we have finally taken the first step back toward high employment and reasonable price stability.

Second, I have no real disagreement with the $98 billion GNP advance forecast for 1972. It is near the high end of the range of private forecasts. And the weakness that has continued in retail sales thus far this winter further suggests that the Government forecast is more likely to prove high than low. But it certainly lies within the reasonable range of possible outcomes.

Senator PEARSON. Mr. Chairman, may I interrupt for a moment? I have to leave by 11 o'clock and I would like to ask two questions.

Chairman PROXMIRE. Do you mind, Mr. Perry?

Mr. PERRY. Go right ahead.

Senator PEARSON. What I wanted to ask the members of the panel this morning in relation to the predictions of unemployment is whether or not—and this is a little bit aside——

Mr. PERRY. I cannot hear the question.

Senator PEARSON. I said I wanted to ask a question related to the dimensions of unemployment but it was a little bit aside from inflation vis-a-vis unemployment. That is whether or not you think the Government can effectively create some sort of program dealing with economic conversion, whether it be the closing down of the military installation or whether it be the scrapping of some sort of a weapons system, or whether it be change in the space program or the abandonment of the SST.

It is feasible that the Government can do a great deal more than it has done so that it can accommodate changes from war to peace, so it can accommodate the changes in technology that exist today, particularly with reference to weapons systems?

Mr. GORDON. I think it can. If at the time of the defense cutbacks in the late 1960's, a good deal of that money had been shifted into nondefense social types of expenditures by the Government, instead of being dissipated in tax cuts, I think it would have had a significant effect on unemployment.

Further, as I suggest at the conclusion of my statement, I favor a very substantial increase in public service employment. If we had had authorized and appropriations made for a large-scale public service employment program, with some flexibility as to where the money was sent, guided by local unemployment rates, the unemployment rate in Seattle would not be what it is today.

Senator PEARSON. The only other question——

Chairman PROXMIRE. Did you wish a comment from the others?

Senator PEARSON. Yes.

Mr. ECKSTEIN. Well, first, I think it is really rather late now to be preoccupied with the conversion program because conversion is largely done. The decline in military spending really began in 1969. The Armed Services are almost down to their new lower level. The layoffs in military are largely done, and there is now probably some increase in these industries.

Therefore, it is almost a historical question: was our effort adequate to deal with the Vietnam veteran and the aerospace worker? I suppose most would conclude that the program was inadequate.

The unemployment rates of Vietnam veterans remain very high. We relied on general measures, with the exception of the emergency employment program which did employ some good many veterans recently.

The program question is whether the Employment Service, itself, our main mechanism for funneling people from one job to another, is adequate. At the moment, even after all of these many study groups, task forces and so on, in the Employment Service, its main job still seems to be to somehow justify the dispensing of the unemployment insurance claims. Its focus on the American labor market is very limited. The range of jobs referred to them is a small fraction of all jobs. Companies rely in a minor way for minor jobs on the service. Compared to other countries our effort is rather inadequate.

It is hard to remedy, as you know. It is a State program. The administration's current drive is to make it more of a State program, which means really it will continue to serve the client groups it now has rather than to converge on a national program.

Mr. PERRY. I would like to add one thing. I agree, by and large, with the comments that have been made. The statement has sometimes been made that the defense issue is the chief cause of the high unemployment rates that we see in the country today.

I think it should be made clear that that is not so. Quite apart from the question of pockets of unemployment and whether you try to do something for specific individuals or like aerospace workers, the overall problem bears almost no connection to the defense cutback. In fact, real defense purchases declined more between 1954 and 1955 than they did in the 2-year period 1969–71.

Yet, the 1954–55 period was one of the best periods of economic expansion we have had in the postwar years. So there is no necessary connection between what we did on the defense front and today's unemployment.

Mr. BRINNER. The only comment I have to add is, of course, when you are dealing either with the aerospace workers or with Vietnam veterans there are specialized skills involved. Trying to attack the problem of job creation for them by generalized fiscal policy and tax changes cannot be expected to be as fully efficient and effective as a well-focused program.

Senator PEARSON. If the chairman will indulge me for another question, it is this, and may I say as a matter of introduction that I am from Kansas. The first question is against the background of the situation that occurred in Wichita, Kans., which is only slightly less severe at its peak unemployment than Seattle.

The other question deals with: Is it feasible, can the Government in any way adopt policies that will deal with the outmigration and the very heavy migration from the rural areas into the great metropolitan areas today?

In my State, 75 out of 105 counties lost population in the last census. The sweep in catches not only the skilled young people but the unskilled in the cities. There has been a lot of talking for a long time. I get the feeling that the Secretary of Agriculture feels like this is an inevitable development and nothing really can be done about it.

Is it feasible, in your judgment, considering the unemployment problem, to do something about this very great migration from the countryside into the metropolitan areas?

Mr. Eckstein. You certainly are dealing with a long-run historical set of forces that nothing we could think of in a market economy can be reversed altogether. Also, the very fact that agricultural productivity keeps on rising, so you really require fewer and fewer people in agriculture, you wouldn't want to stop that productivity.

I suppose the question is whether it is possible to create new and stronger industrial centers in these areas. Certainly, the costs of overcrowding and pollution, of having the whole population of the country move to a few big clumps of industries and cities are very heavy for the society and the Government.

Many of our public works programs do have incentives built in that are designed to let the more remote areas get really a minor break in the Federal share and so on. That is mainly what we have tried to do.

I don't know whether the quality of the leadership in some of these States is the match of the big ones in terms of bringing together the capital and entrepreneurship to try to get new industry.

In my own State, suffering from the aerospace conversion, is now trying to get a really strong Massachusetts effort to see whether something can be done to accelerate our development.

Chairman Proxmire. Mr. Gordon.

Mr. Gordon. I agree with Mr. Eckstein that something can be done to stimulate more movement of industry into the smaller towns in the South, the Midwest, and so on. After all, we can look at the South and say that there has been a very large industrial development program going on, and the migration out of the countryside in the South has been, granted, to northern cities, but it has also been to southern towns and cities.

You can't stop the movement of particularly younger people from the countryside. I am reminded on a visit to Yugoslavia a few years ago that this was one of their major concerns. They couldn't keep the young people down on the farm. We haven't been able to and we are not likely to be able to in the future.

Mr. Perry. I have nothing to add.

Senator Pearson. I want to apologize to you, Mr. Perry, and I thank the chairman.

Chairman Proxmire. Mr. Perry, please proceed.

Mr. Perry. Thank you.

Third, I agree with the administration's optimism about bringing inflation under control in 1972. The forecast projects only a 3¼-percent rise in the GNP deflator for the year, with the rate of inflation expected to slow to the 2- to 3-percent range by the end of the year.

I believe the phase II program can be made to work and the indicated slowdown in inflation is within reach, barring only some extraordinary bad news from uncontrollable food prices.

Even with the program succeeding, we can expect some bad price statistics in the winter months and for the first quarter of the year. These will come both from a bunching of price and wage increases after the end of the freeze period, and from the bunching of Government pay increases in the first quarter of the year.

This kind of pattern, with the worst news on prices coming right at the start of the year, specifically contrasts with the often heard view that, while we may control inflation for a short while with the new programs, by the end of the year it will be accelerating once again.

This kind of doubt must also lie behind the persistence of high-interest rates in the bond market: long rates have come down only a little despite the very substantial and extended decline that has occurred in rates at the short end of the market.

I think these doubts will prove false. There is plenty of slack everywhere in the economy, both in labor and product markets. Inflation had become habitual and an incomes policy is particularly suited to the job of changing habits. So if the Government, the Pay Board, and the Price Commission stick to their guns, I think we will be in for a pleasant surprise in our fight against inflation in 1972.

My considerable agreement with the GNP and price forecast expressed in the economic report weakens when we turn to the outlook for unemployment. The administration forecasts a decline in the unemployment rate from the 6-percent level with which we ended 1971 to around a 5-percent level at the end of 1972. I doubt anything like this improvement will be achieved with present policies.

With resources severely underutilized at present, and with the first year of above-trend growth in GNP since 1968 finally in sight, I expect the economy to experience an exceptionally good advance in productivity in 1972.

But good prospects for productivity translate into bad prospects for unemployment: 1 percent more productivity means 1 percent less labor is needed to produce the year's output. Similiarly, I expect a resumption of rapid labor force growth in 1972.

After growing by an average of 1¾ million persons a year from 1965 to 1970, the labor force grew by only 1 million in 1971 as high unemployment discouraged potential workers from looking for jobs.

In the improved 1972 economic environment, a return to earlier labor force growth rates or above would not be surprising. And a 1-percent larger labor force means 1 percent more employment is needed to achieve a given unemployment rate.

Couple these two factors with the prospects for somewhat higher average hours of work in 1972 than in 1971, and even if the administration's prediction for GNP gains were realized, I would expect no more than half the improvement in unemployment that they are forecasting. Add in the risk that the GNP advance is more likely to be smaller than predicted rather than larger, and it looks as if we are aiming at little more than a draw in the battle against unemployment this year.

If we want to aim higher, we can. There is no economic principle that dictates we have already moved expansionary policy as far and as fast as we ought to. A large NIA budget deficit of $35 billion is forecast for fiscal 1972, and administration spokesmen ask, "Who would dare do more?"

Actually, this deficit looks to be about 10 parts slack induced from the automatic stabilizing property of the budget; one part full employment deficit, representing a noticeable but not excessive fiscal push on the economy; and one part hope, representing estimates of expenditures that may never materialize.

Compared to 1971, there is some fiscal push coming in the first half of this year, represented by the swing from small surplus to small deficit in the full employment budget. This push diminishes after the first half of the year. Whether this stimulus is enough, too much, or not enough depends on a more careful analysis than these summary figures provide, on what monetary policy does and, ultimately, on where the economy is heading.

It does not depend on the size of the deficit itself, or on fears about how fast the Federal Reserve will have to expand the money supply in order to finance the deficit. To achieve the same GNP, the Fed would have to expand the money supply faster if the Government were running a smaller deficit. In short, there is room for new initiatives in this budget, although I would strongly urge that they be concentrated on expenditure programs with a maximum impact on unemployment, such as H.R. 12011 which proposes a substantial expansion of the public service employment program.

On top of this, if it appears GNP is falling short of the administration's forecast, we should be ready with additional, temporary fiscal measures to bolster the expansion.

Cutting sharply into today's unemployment deserves top priority in our domestic economic planning. I am not impressed by the pacification program of administration officials urging our attention to employment rather than unemployment statistics; ours is a growing economy after all. Today's unemployment is not the hole in the doughnut, as we are urged to believe; it is more like a hole in a roof, and that demands our attention.

My doubts about the unemployment forecast for 1972 deepen to concerns about our ultimate unemployment targets. Are we still trying to return to 4 percent unemployment or are we lowering our sights to something easy, like 5 percent? This concern may seem premature with unemployment still at 6 percent.

But there are important structural issues to be raised and solved if we are to pursue a low unemployment target, and these take time.

Furthermore, what our goal is will affect expansionary policy before long: Are we to start easing onto the brakes when we cross below 5½ percent unemployment, or are we still trying to build up steam at that point?

Finally, the way we pursue expansion is influenced by what our goal is: Do we try to solve our structural unemployment problems as part of our strategy to increase employment, or do we rely solely on conventional fiscal and monetary tools?

Attention this past year has focused on the changing composition of the labor force and unemployment. I have attached a brief table to my statement that summarizes some of the implications of this changing composition. The table gives a breakdown of unemployment rates by age-sex and racial groupings of the labor force.

The first three columns show unemployment rates in 1956, 1969 and 1971. Comparing them simply illustrates how today's unemployment problem is foremost a generalized problem of excessive unemployment in all parts of the labor force. Not only are rates for all groups substantially higher than they were in the very tight overall labor market of 1969, but they are substantially higher in all categories than in 1956, a year far enough away that it can be used for comparison and which was a relatively high employment year.

Compositional questions have little to do with the high present overall unemployment rate; it is simply the result of the extended slowdown engineered in the economy since 1968.

The compositional problem is sometimes stated as if the growing number of young workers and women in the labor force substantially changes the unemployment rate we can hope to achieve compared to what was possible in the mid-1950's. The fact is that only a small part of any deterioration in our overall unemployment experience can be ascribed to the simple increase in the proportion of these secondary workers in the labor force.

In 1971, if the different age-sex groups had exhibited the same unemployment rates they had in 1956, the presence of more workers today in the groups with relatively high 1956 unemployment rates would have raised the aggregate unemployment rate by only about 0.3 percentage point.

So this is not a compositional issue either. There would be no case for a new definition of full employment on this account.

This is also a point on which I differ with the argument presented by Eckstein and Brinner concerning the age-sex issue. It is not the larger number of people that is important. I would agree that that by itself means very little.

The underlying compositional change since 1956 that is significant is the further deterioration in unemployment rates for these groups in the labor force that already experience relatively high rates in 1956. Over the last 10 or 15 years, the weak got weaker as far as age-sex groups are concerned.

It is this relative deterioration in rates that lies behind the shift in the inflation-unemployment tradeoff that I discussed with the committee last year. And it is this relative deterioration that makes it more difficult to combine low overall unemployment with reasonable price stability today.

To respond to this part of the problem by settling for a higher overall unemployment target, such as 5 percent, is to respond by ignoring it. The last two columns in the table presents estimates of how the unemployment situation would look at present is we settle for a 5 percent overall unemployment target.

Of course, rates in all groups would be far worse than in 1969. But in comparison with 1956, the experience among different groups would vary.

Workers under 20 and in the 20- to 24-year-age groups would suffer unemployment rates 20- to 60-percent higher than in 1956. Although nonwhites would experience an improvement relative to whites since 1956, they would still suffer an average 8.4-percent unemployment rate, more than 80-percent higher than whites today and no better than their own rate in 1956.

In today's 5-percent unemployment world, both women and men in the 25- to 64-age group would have about the same unemployment rates as in 1956. From these estimates, the position of adult woman relative to men would appear to have improved since the late 1960's. But this simply reflects a different cyclical response of unemployment rates in the two groups.

Primarily because there participation in the labor force varies with the overall unemployment rate, women's unemployment rates vary proportionately less than men's. At actual 1971 unemployment rates, the ratio of the women's to men's rate had actually improved compared to 1956.

At 4-percent unemployment today, it would have worsened. And at the low unemployment rates of the late 1960's, it had worsened substantially. It happens that at 5-percent unemployment today, their rates relative to men are the same as at 4-percent unemployment 15 years ago.

The last row in the table shows my weighted unemployment rate estimates. This concept weights the unemployed from different age-sex groups in proportion to how much they would be expected to contribute to production if they had jobs. For measuring overall labor market tightness or loss of production due to unemployment, it offers a better measure than the official overall unemployment rate, which weights everyone equally in these respects. And it is superior to looking at just part of the unemployed, such as the prime-age male rate, since doing that gives no weight to other groups.

In today's hypothetical 5-percent unemployment economy, the weighted unemployment rate is not as low as it was in 1956. But it is nearer to 1956 levels than the official unemployment rate since all the additional unemployment is in the under-25-age groups which have relatively low production weights.

All this indicates the problem. It does not dictate the answer. If we just wanted to bring unemployment rates for prime-wage workers to 1956 levels, a general expansion to 5 percent overall unemployment would do it. But there is little virtue other than simplicity to such a goal; 1956 was not the millenium. And this would leave many groups substantially worse off than they were then.

It is hard to believe that we should dismiss as "normal" the deterioration in the unemployment experience of young workers, or dismiss the lack of improvement over 15 years in the unemployment experience of blacks that such a formula would represent.

The question comes down to whether we are going to deal with the problems of high unemployment groups or dismiss them.

A certain complacency about all this comes through in the Economic Report and in stories about administration thinking that reach the newspapers. One gets the feeling we are very near our unemployment goal. But this is a telescopic view of the unemployment problem: the goal seems very close because the vision is so narrow.

The losses from higher unemployment extend far beyond the experience of the unemployed themselves. Discouraged workers leave or never enter the work force; employees find themselves on shorter workweeks; productivity lags; and profits and other incomes are reduced.

Presently the GNP gap, estimated as the shortfall of actual from potential output at 4-percent unemployment, is nearly $80 billion. We would be giving up roughly $35 billion of that GNP if we settled for a 5-percent unemployment target instead. That, in turn, represents a loss of more than $10 billion in Federal revenues.

In terms of budget programs, at the same set of tax rates, Federal expenditures would have to be lower by about $15 billion in order to stabilize the economy at 5 percent rather than 4-percent unemployment.

A pursuit of ambitious goals for output and unemployment would include at least the following ingredients which are missing in whole or in part from present policy.

First, we need a stepped-up manpower program, aimed particularly at the unemployment problems of high unemployment groups. This is needed both to improve the employment experience of these groups, and in order to make a low overall unemployment rate less inflationary by reducing the dispersion of rates. This structural part of the unemployment problem is difficult, both to diagnose and to prescribe for.

But we are learning and only a stepped-up manpower effort will get the needed results. For now, I believe what we need most is a sharply expanded public service employment program, particularly if we can channel it toward younger workers.

Second, we need to evolve the present phase II effort into a continuing incomes policy that will help hold back a new inflation as unemployment is reduced. An incomes policy can improve the inflation-unemployment tradeoff and permit lower unemployment rates for all groups as well as higher output for the economy.

By contrast, the administration keeps assuring us they want to end the program as soon as the present inflation is arrested. They seem anxious to move from phase II to phase out. And phasing out the program makes sense only if we are going to settle for a high unemployment-low output target.

Third, we need to pursue expansionary fiscal and monetary policies for an extended period. We should be building up steam a year from now, not reaching for the brake.

The concerns, already in the air, that monetary policy must look ahead and not go too far even now, and that fiscal policy has gone as far as it can go, are hardly appropriate today if we still retain our goals of full employment and potential output.

(The table referred to in Mr. Perry's statement follows:)

DETAILED UNEMPLOYMENT RATES: ALTERNATIVE TIMES AND ASSUMPTIONS

| | Actual | | | | | Projection—Present labor market with 5-percent unemployment rate | |
|---|---|---|---|---|---|---|---|
| | Unemployment rates (percent) | | | Percent change | | Unemployment rates (percent) | Percent change from 1956 |
| | 1956 [1] | 1969 | 1971 | 1971/1956 | 1971/1969 | | |
| Age-sex groups: [2] | | | | | | | |
| Males (age groups): | | | | | | | |
| 16 to 19 | 8.9 | 10.3 | 15.5 | +74 | +51 | 13.0 | +45 |
| 20 to 24 | 4.6 | 3.8 | 8.4 | +83 | +121 | 7.0 | +53 |
| 25 to 64 | 2.7 | 1.6 | 3.4 | +26 | +113 | 2.7 | 0 |
| Females (age groups): | | | | | | | |
| 16 to 19 | 9.1 | 13.3 | 17.4 | +91 | +31 | 14.4 | +58 |
| 20 to 24 | 6.6 | 6.3 | 9.6 | +45 | +52 | 7.9 | +20 |
| 25 to 54 | 4.5 | 3.2 | 5.0 | +11 | +56 | 4.3 | −4 |
| Racial groups: | | | | | | | |
| White | 3.6 | 3.1 | 5.4 | +50 | +74 | 4.6 | +28 |
| Nonwhite | 8.3 | 6.4 | 9.9 | +20 | +55 | 8.4 | +1 |
| Overall unemployment rate: | | | | | | | |
| Total labor force | 3.8 | 3.4 | 5.8 | +53 | +71 | 4.8 | +26 |
| Civilian labor force | 4.0 | 3.5 | 6.0 | +50 | +71 | 5.0 | +25 |
| Weighted unemployment rate | 3.30 | 2.51 | 4.65 | +41 | +85 | 3.75 | +14 |

[1] Changes introduced in the definitions of employment and unemployment starting in 1967 distort direct comparisons from published data of individual rates before and after the change. The 1956 rates by age-sex groups and the total unemployment rates shown here are adjusted to the new definitions to make them comparable with present data. The rates by racial groups are not adjusted.

[2] Data for workers over age 65 are too erratic to analyze here and are not shown separately. They are included in the totals. Age-sex unemployment rates are based on total labor force, including the Armed Forces.

Chairman PROXMIRE. I thank all of you gentlemen. This has been most informative and helpful. One of the reasons is because there are some sharply contrasting views.

Mr. Eckstein and Mr. Brinner, would you like to respond? You were rather emphatically rebutted, or at least disputed by the other two gentlemen on the panel. Would you like to take a minute or two to respond?

Mr. ECKSTEIN. Yes. First, we don't want to overclaim our results. It is, of course, correct that the total historical record that we analyzed back to 1953 is limited. There were only two major inflations in it, in the mid-1950's and now. The inflationary element only came into play in a very small way in the mid-1950's, so we really have one major and one small observation. The ideas themselves have been around, of course, before.

I suppose where our study fits into a long series of studies by ourselves and Mr. Perry and many other scholars is that we were the first study that was done after the experience of 1970–71, and that experience simply defied explanation by anything else than the kind of analysis that we have now quantified, which other people advanced theoretically.

We are also troubled by the fact that I would have expected that the changing structure of the labor force should have had some impact, a modest impact on the inflation trade-off.

The next steps in this kind of work are to go back to longer periods, before World War II, the Korean war, and so on. As you look ahead, I expect that somebody will manage to combine this element which now looks so obviously large. It is just so obvious that the inflation is so bad because it has gone on so long.

We don't want to say that we know for certain that the Phillips curve has not changed by one fraction of a tenth of a point. But it is evident now that we are benefiting hindsight, that you can explain the good record of the mid-1960's, and that you can explain the bad record now.

Chairman PROXMIRE. One of the difficulties with your analysis is that the other side has some hard, tough figures. They can show that the unemployment among teenagers is very high and they can show precisely how this has contributed three-tenths of a percent to the adverse trade off between unemployment and inflation.

The Phillips curve would have seemed to have moved on this factor alone, just because of the increased number of young people, from 4.1 to 4.4, something like that, given a certain level of inflation.

Your reliance on expectations is such a vague, unmeasurable, indefinite kind of reliance. On the other hand, I do think that this is a very useful contribution, which Arthur Okun made, too, but you talked about it in detail, in talking about the new work force of women and young people is better educated. They have had more manpower training. There is less discrimination.

Certainly with all the discrimination that we have, which is still vicious, it is far less than it was 10 or 15 years ago. It is hard to see under those circumstances why it should be worse, but it seems that it is.

Mr. BRINNER. I think one thing we ought to clear up is that although the unemployment rates may be more dispersed, there is no reason to conclude from this that the accompanying inflation for any given aggregate unemployment rate would be higher.

For example, if you look at the subsectors of the labor market, whether by age, sex, whatever, and if they all exhibit the same kind of relationship between the tightness of their unemployment rate and the rate of wage inflation, if now the groups that have the traditionally low unemployment, high wage pressure characteristics (the prime-wage males) have decreased in proportion of the labor force, then their weight has decreased as well and, therefore, their impact on the total inflation for any given unemployment rate is diminished.

So you really can't look at the dispersion to prove from that that higher inflation results.

The other point relates to the question of whether we are looking at just one observation or more than one. It really requires two responses. One is the set of forecasts that we made using models embodying the severity factor and models embodying the labor force compositional changes. Models that used just the severity factor and the aggregate unemployment rate forecast better, whether using data up to 1969 and forecast through 1970 and 1971, or updating the models with 1970 data and predicting the inflation through phase II.

If you combine the models with the data we now have available, adding the labor force compositional changes or elements to reflect them, does not inprove the forecasts. As a matter of fact, you get a worse forecast because the coefficient estimates of our severity factor and other items are tarnished.

And then the last point is that we have in the study on page 41 a figure 13 which shows what this long-run Phillips curve looks like under alternative specifications of our severity index.

You can note that whether we say severe inflation results from 1½, 2 or 2½ percent inflation within the basic context of these Phillips curve models, the long-run tradeoff is not substantially altered. That is the left-hand panel in this diagram. Use of these lower values clearly rebutts the "one observation" argument.

I may say that this critical level is 3.8 or 4.2, but certainly no one who uses statistics claims that they can precisely identify to the nearest tenth what unemployment rate at a critical level is.

Chairman PROXMIRE. I think you have obviously done some very fine and helpful analysis. But what I am getting at is what is the reason for this? Mr. Eckstein spoke on one element which may explain it. Because we have a labor union structure which he implied provides a monopolistic power perhaps is a better explanation, to some extent, of this situation than just the factor of more women.

The fact is, the important element is, that union membership by and large consists of those between 25 and 65. The young people are not in the unions yet as they come out of school. Women are not in the unions to the same extent as they are not organized. Therefore, the jobs at least in this sector would seem to be protected for the people in these age groups. Maybe this is one reason for it.

What other explanation can you give to be convincing in view of the very remarkable record you can show, far better education and certainly less discrimination?

Mr. ECKSTEIN. It is really a question of the public's awareness of the inflation. We always fight the last battle in economics and we were busy fighting inflation when it had stopped in the late 1960's.

Chairman PROXMIRE. How does the public react? They react through unions to negotiate for higher wages and there is a ripple effect in the unorganized sector. What else is the public reaction?

Mr. ECKSTEIN. The general pattern of wage increases, organized or unorganized, after some considerable delay, finally does fully reflect the cost of living. In 1970 and 1971, and probably in 1969, also, whatever an employer paid to his ordinary worker, organized or unorganzied, both the employer and the employee were aware of the increase in the cost of living running 5 or 6 percent.

The first 5 or 6 percent of a wage increase is not considered an inflationary increase. It is not only any increased escalation in the contract, but by that time people understand that a nominal increase of a few percent is not really an increase at all.

There is one other element which may explain why there is a discontinuity to it, why at low levels people do not pay attention. It is possible, many people feel, that the first 1 percent on the prices is not even an increase, since we don't know how to measure quality and all the other uncertainties, it is well possible that a 1 percent is not an increase.

As you get to the 2 percent, it is still small. But when you get to 3, 4 and 5, the housewife complains. Everybody experiences the inflation. It takes time. That is really the critical element which we have quantified here in a certain crude way.

Chairman PROXMIRE. There is no question they feel it more and they complain about it more. I get that from my constituents. But what do they do? How is this translated into additional inflation?

Mr. ECKSTEIN. In the willingness of employers to give larger increases and the fact that at some point a pattern emerges. The number emerges from the highly publicized negotiations and that is why you have to focus on an occasional extreme case.

But the number is experienced in every way and becomes a component in the conversation between every employer and employee.

Chairman PROXMIRE. Mr. Gordon, are you persuaded at all by that?

Mr. GORDON. I have been looking at the table on page 7 in Mr. Eckstein's and Mr. Brinner's study. The timing relationship between the rate of increase in average compensation for the whole labor force and for negotiated contracts is rather interesting. They comment briefly on it. I wish they would comment in more detail.

Chairman PROXMIRE. Is that page 6?

Mr. GORDON. Page 7. This is the study, the printed pamphlet. Between 1965 and 1968, when we moved down to and then below 4 percent and stayed there on an annual basis through 1969, as in past strong upswings and tight labor markets, nonunion wages went up faster than union wages. Union wages lagged because of previous settlements of multiyear contracts.

Then in 1969, union wages began to increase faster, very substantially faster, than other wages. After all, remember that the average compensation includes union contracts, also. This has continued to be true right up through the 9 months of 1971, their last figure.

I tried some regression analysis myself on what I though was a very bright hypothesis, but I couldn't get any statistically significant coefficients, maybe because I didn't know how to do it. But I have had a hypothesis for several years now that not only the previous rate of inflation but how long labor markets remain tight—just how long they remain tight—is a significant factor.

It isn't very often commented on, but the period from 1966 through 1969, a period of 4 years, in each year of which the average annual unemployment rate was less than 4 percent, was the longest peacetime period in American history for which we have figures that the unemployment rate remained that low that long. It remained that low or lower longer during World War II when we had price and wage controls.

But leaving out World War II, 1966–69 is the longest period in our history, using the figures going back only to the turn of the century. That is the longest period in the 20th century at which the unemployment rate has remained that low that long.

Of course, as that builds up, with price increases which become wage increases, which is the Eckstein-Brinner channel, especially, or whether because the mere fact that labor markets are tight changes attitudes and expectations of workers, their officials, and makes it easier for employers to give in because they have tight product markets facing them and can always pass it on, I don't know.

But I do think that there is something about the cumulative effects of a long period of tight markets that is important also, as well as what happened in the 2 preceding years.

Chairman PROXMIRE. My time is up. I just observe that this is I think, a good, sound conclusion, but it is a very gloomy one. It means that we can never expect to have unemployment at a reasonably low level for very long unless we have price controls, wage controls, or some emphatic and effective income policy.

Mr. Perry, would you like to comment?

Mr. PERRY. I would like to comment on a couple of the things that have been said.

On the question of dispersion, I am afraid you have to forgive us. We are full of technical issues here, and disagreements come up from one economic result versus another. It is true that the simple fact of increasing dispersion does not by itself tell you whether labor markets have become more or less inflationary. It is the particular way in which dispersion has increased in this case that leads to this conclusion. There is a large body of statistical evidence on this question of shifting the Phillips curve. So let me leave that.

I do not comment on the inflation kicker that this paper has introduced, a concept that leads to an accelerationist verdict about our inflation-employment trade-off.

I agree entirely that you can't explain the present inflation, 1971, without reference to something more than the current state of labor markets, and, in particular, without reference to something that says that the long period of inflation we were in gave us a long hangover. This stubbornness of inflation arises because of long-term contracts in the union sector, because of comparability boards in almost every large city that, in effect, set a going wage for a large range of occupations, and because in an environment which has been inflationary for a long time, there is pressure to be a good employer and grant more than you would have in an environment that had no inflationary history.

In this sense I agree with the spirit of what the paper was trying to do. But there is one important conclusion, stemming from their particular statistical construction, that I disagree with. In trying to explain this subborness of today's inflation, they introduce the inflation kicker into their statistical model. It becomes very nearly a dummy variable for these years since this is the only episode that the inflation kicker can really dig into. And in "explaining" all the perpetuation of the current inflation, this variable takes on a big estimated coefficient, which read literally, tells you every time you get to point X, inflation will accelerate. What I believe it should be telling us is that every time we have had a long inflation, it will persist long after its initial causes—over tight markets—have vanished.

This is how I interpret this period, and it is quite different from the accelerationist verdict of this paper. I have written on this and called it habitual inflation. It arises from the sources I have just discussed. While it doesn't imply the accelerationist verdict, it does imply that you would have taken an awful long time to slow down the present inflation if you just let high unemployment do the job.

Though 1971 gets explained either way, the implications for how to run the world are quite different. The implications, if you accept my habitual inflation verdict, is that you badly needed an incomes policy. There is no better way to change habits than for the Government to get into the incomes policy business. And looking ahead, we can push to low unemployment rates if we reduce the disparities in unemployment rates that now exist. On the other hand, if we have an accelerationist world ahead, then we have to be very careful about how to approach lower unemployment.

So while there is a lot of agreement that the recent inflation had a very special character, and that it was wedded in the long history of inflation we had been through, these two interpretations of that experience have quite different implications about how to deal with it and what it implies for the future conduct of policy.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Gentlemen, there is before the Senate and the House legislation to set up jobs now in public service employment at the State and local level, federally funded, for 500,000 people. I think you are all familiar with it.

May I ask you whether you support such legislation?

Mr. PERRY. Yes, I do. I would be happy to write you my support of it and also to testify in behalf of it today.

Mr. GORDON. I think I have stated that in a letter to you which has been printed in the Congressional Record.

Representative REUSS. Mr. Eckstein.

Mr. ECKSTEIN. I endorse such legislation but I do hope the jobs will not be spread so thin as they were in the initial stage of this program. I know in our own area it has taken the coordination of four towns, the officials thereof, to apply for half a dozen jobs.

Representative REUSS. Of course, there weren't any jobs to speak of. The idea is to start out with 500,000 to prevent spreading them too thinly.

It is reassuring to hear this, having just heard your econometrical differences on the Phillips curve. I am moved to paraphrase Alexander

Pope: "With forms of Phillips curves let men contest, whate'er will get the jobless jobs is best."

Mr. GORDON. May I add to my comment, Mr. Chairman?

In my letter to Congressman Reuss I expressed one strong criticism of this proposal. It is about 40 percent of what it ought to be.

Representative REUSS. Perhaps we should talk about that a minute. As I said, the bill would set up 500,000 new public service jobs immediately. I welcome the views of you professionals on my simplistic arithmetic about it all. There are 5 million-plus unemployed by current measurements, so you employ in the first instance 500,000 for service employees.

I would think that by any kind of a multiplier, conservatively employed you should get 2-to-1 additional jobs. You should get 1 million jobs in addition to the 500,000 jobs, making the goods and services that the 500,000 people formerly unemployed and except for such income as they might have had from unemployment compensation or welfare without income, you get them making $7,000 a year. I would look for a 2-to-1, 1-million-job multiplier.

Then I would look for an accelerator on those 1.5 million total jobs in capital goods formation at about the normal rate of about 10 percent. That would be another 150,000 or 200,000 jobs.

Then I would hope that the present almost 8 percent propensity to save of the 80 million who have jobs would come down a bit because there would be a somewhat cheerier outlook. I would hope to find perhaps a couple of hundred thousand new jobs because of the greater propensity to spend of those who already have incomes. All told, this brings the number of new jobs to over 2 million and the unemployment rate down to the 3 or 4 percent range.

That is why, Mr. Gordon, I put the rather modest 500,000 jobs now labeled since that is five times what anybody around here wants to do. I thought that was a way to get a start.

Seriously, is my arithmetic unusually cockeyed, or could we expect some kind of multiplier?

Mr. GORDON. I couldn't have been better in the classroom myself on bringing in the effects of the multiplier. I will reply to you in several parts.

First, proposing a significantly larger program, as I gather Senator Cranston intends to introduce, I didn't have in mind that that would be completely inflexible. If we put 1 million to work in the next 6 to 9 months or whatever, I didn't have in mind that we would necessarily keep that as a minimum. They would be absorbed in private jobs as the multiplier effects of public service employment were felt.

Second, I do question your estimate on the impact on private investment because I think most of the public service jobs, particularly if there are only 500,000, would not lead in the short term to any significant impact on private investment.

Representative REUSS. I was thinking, of course, sir, not of private investment to be generated by, say the work that a hospital assistant or orderly does, but when he spends his $7,000 a year I would think that that ought to produce the same ratio between total spending and new capital investment that it traditionally has. Traditionally, we seem to spend about 10 percent of GNP on plant and equipment.

Mr. GORDON. Times aren't typical, looking back at the longer run, and I remind you of what the official capacity utilization figures seem to suggest at the moment.

Representative REUSS. Would anybody else like to comment or to take issue with the rough arithmetic that I have been indulging in?

Mr. BRINNER. I would like to go to your point about the consumer spending, and the high savings rate now. I hope that will be reduced, whether by a program such as yours or another program.

But I think it should be noted that one item, one policy measure, that is limiting the reductions in saving that might have taken place, is the higher withholding schedules that have taken effect. These have severely reduced any tax reductions that the individual would feel.

I don't know whether the curve would be to go back to the old schedules and have individuals making large payments a year from April. but certainly some adjustment would help.

Representative REUSS. Did you want to add something?

Mr. ECKSTEIN. No.

Representative REUSS. You mention the propensity to save, which currently bothers all the experts. Nobody seems to know why it is, but suddenly American consumers who used to save 6 percent of their spendable income now save 8 percent, rounding off the figure.

I have an eerie suspicion about that on which I would like to do some dredging with you gentlemen. Could it be that in the last 3 or 4 years the income shares of American families have gotten out of whack? There have been some interesting studies of the way things were in the year 1967, the last year for which we have figures. Those figures weren't terribly reassuring. They show that really no progress has been made in greater quality in the last 20 years. They show, for instance, that the top 1 percent of American families gets 6.8 percent of the income and the bottom 20 percent of American families gets less than half, 3.2 percent. This, in 1967.

Since 1967, you have had inflation, unemployment and tremendous distortions of the tax structure in favor of people at the top and against people at the bottom by income tax forgiveness at the Federal level, increases in payroll taxes at the Federal level, sales taxes at the State level, and property taxes at the local level.

My question is: Could it not be that maybe the reason you are getting this 8-percent savings rate is because income shares have shifted, and while those at the bottom are still spending everything they can get their hands on, those at the top are increasing in number and percentage, and they are already eating 2,800 calories a day, they can't eat any more; they already have all the neckties they need, and so on.

Hence, our income shares are shifting. I would like your views on this. Is this any unworthy thought on my part? Has anybody done any work on this? I know Brookings has done a great deal but nothing very recent.

Mr. PERRY. There are two issues here. One is what tax changes have occurred and, in fact, how much change we have had in income distribution. I think not much.

The other is what effect on consumption you can expect from changes in distribution that do occur. This always seems like such a relevant question; yet the fact is economists can never find a conclusive answer. At least, that is my experience with it. Intuition tells you different effects on consumption ought to show up in the data. But I am not aware of any work that shows it.

Mr. ECKSTEIN. In collaboration with Mr. Green we recently have completed a study attempting to explain why the savings rate is so high. What we did was we tried to analyze the media into which these savings went. Our theory had been that perhaps it was the growth of pension funds or life insurance reserves, something of that sort, which turned out to be incorrect. It turned out that the extra savings have gone into savings accounts. The influx into savings accounts in 1971 was equal to 10 percent of the disposable income of the American public, a number twice of what it had ever been before. Not all is from new savings. Some represents the sale of Government bonds and stocks and putting the money into savings accounts instead.

The only conclusion we could reach is that it must have been the middle and upper income groups that have the enormous amounts of savings. Of course, the fact that the stock market has not had anything too exciting in the past 4 or 5 years probably also means that the savings is a little higher, because people are not spending their capital gains.

Representative REUSS. Do we know who owns these savings accounts?

Mr. ECKSTEIN. There are figures.

Representative REUSS. Are they fat cats, or lean?

Mr. ECKSTEIN. In doing this work, we excluded the large certificates of deposits of companies. These are individual savings accounts of the sort that pay 4, 4½, and 5 percent, less sophisticated. We found two possibilities of why the savings have been so high. The first is inflation and unemployment. We know that unemployment frightens people out of spending.

Second, inflation, according to the people who study this psychologically, they maintain that high inflation is a bad time to buy.

The other possibility is that it really does represent some change in attitude, that people simply are under less pressure to keep their durables very new. There has been some change in values in society.

Representative REUSS. Partly due to the ecology movement, and partly due to people getting into a higher income bracket?

Mr. ECKSTEIN. Without being under the same pressure to spend whatever increase they made. The income distribution factor, of course, is beneath the surface there, too. As you point out, it refuses to change and, of course, the tax changes. There actually has been tax relief at the low end of the scale, also, or at least there was a little earlier.

Representative REUSS. This is a study?

Mr. ECKSTEIN. It is a study we have completed. We would be happy to supply it for the record of the hearing.

Representative REUSS. Mr. Chairman, I would like to have that.

Chairman PROXMIRE. Yes, indeed, we would like to have it.

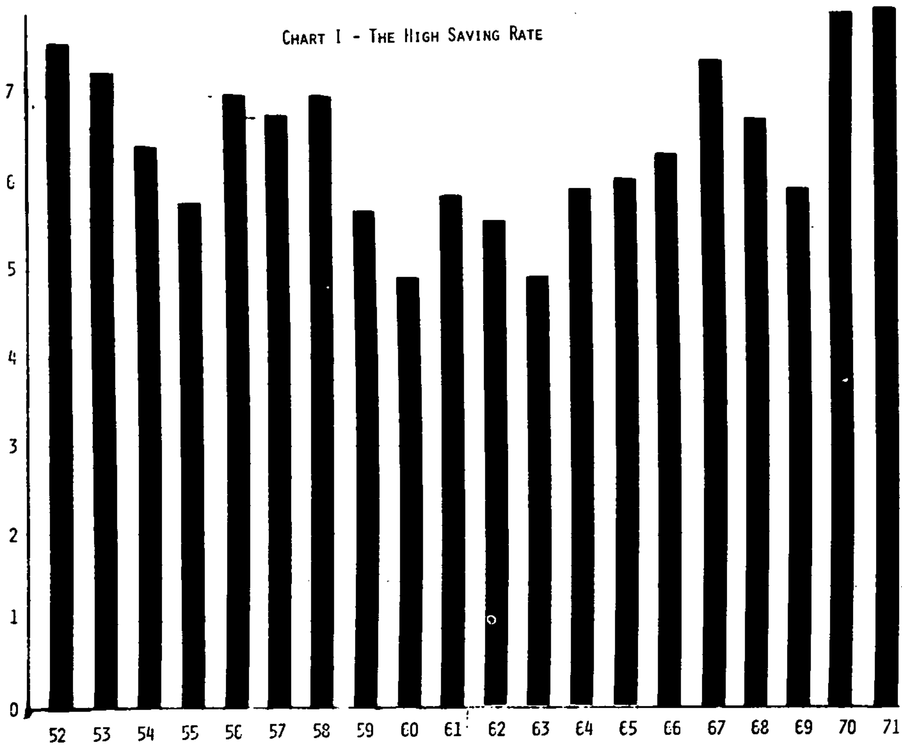
(The following information was subsequently supplied for the record:)

AN ANALYSIS OF THE SAVING RATE FEBRUARY 17, 1972
by Otto Eckstein and Edward Green

The personal saving rate in 1970 and 1971 was near 8 percent, an extraordinary rate by historical standards and a real puzzle. Several hypotheses about the causes can be advanced:

1. A growth of contractual saving;
2. Unemployment and inflation discouraging spending;
3. Demographic factors;
4. High interest rates, or;
5. Changes in psychology and a less materialistic value system of society.

Chart I shows the saving rate from 1952 to 1971.



An analysis of household sector savings based on Flow of Funds data shows no evidence that the high saving rate is permanent or that there has been a major structural shift in consumer saving behavior. The large savings in the Flow of Funds are in the discretionary accounts such as time and savings accounts and corporate bonds. They are not in the contractual savings accounts such as insurance and pension reserves. Therefore, the causes must lie among the last four factors.

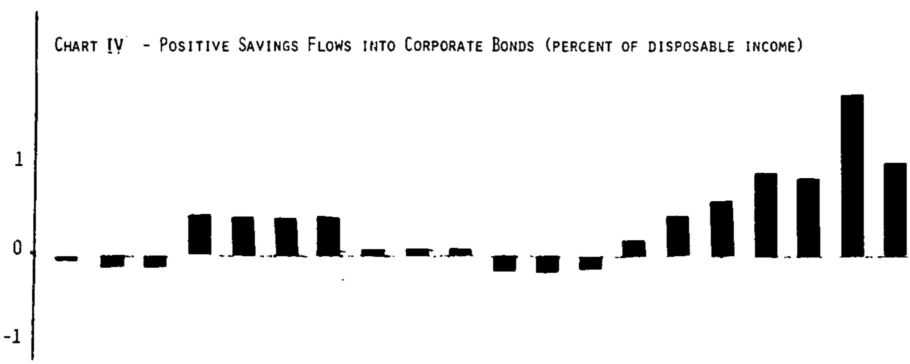
Flow of Funds and Contractual Saving

Table 1 summarizes the flows put by households into financial assets, tangible assets and debt. The flows are expressed as percents of personal disposable income to make them directly comparable to the personal saving rate. The saving rate in the national income accounts is approximately equal to the sum of the household flows into financial and net tangible assets less the increase in household debt. The deviations between financial and NIA saving probably have economic meaning. The financial saving rate is substantially higher than the NIA in years when the economy "felt" weaker than the NIA accounts showed. The "true" answer seems to lie somewhere between the two measures. (See Table 1, page 2a.)

The year 1971 had an amazingly high flow into time and saving accounts equal to 10.1% of disposable income. Some of this flow is not saving and represents switches from U. S. Government securities (which were down 2.8%) and the small reductions of mutual fund holdings. Chart II shows the flows into saving deposits; Chart III shows the flows into Government securities.

The flow from the household sector into corporate bonds was 1.1% in 1971, the fourth year of major direct household investment in this medium. The high rates of return offered on bonds have led to the public's discovery of this vehicle.

CHART IV - POSITIVE SAVINGS FLOWS INTO CORPORATE BONDS (PERCENT OF DISPOSABLE INCOME)



# Table I - Household Sector Saving

## Flows into Financial Assets, Tangible Assets, and Debt

(as a percent of personal disposable income)

| | 52 | 53 | 54 | 55 | 56 | 57 | 58 | 59 | 60 | 61 | 62 | 63 | 64 | 65 | 66 | 67 | 68 | 69 | 70 | 71 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Currency & Demand | .9 | .3 | .6 | .2 | .4 | -.4 | .5 | .6 | -.4 | .3 | .7 | 1.4 | 1.4 | 1.5 | .6 | 1.7 | 1.9 | .9 | .7 | 1.4 |
| Time and Saving | 3.2 | 3.2 | 3.6 | 3.2 | 3.2 | 3.9 | 4.4 | 3.4 | 3.6 | 4.8 | 6.1 | 5.7 | 5.5 | 5.6 | 3.7 | 6.2 | 4.8 | 2.1 | 4.7 | 10.1 |
| U.S. Government Securities | -.1 | .1 | -.5 | .9 | .4 | .0 | -.8 | 1.5 | -.2 | -.2 | .0 | .9 | .5 | .5 | 1.4 | .2 | .9 | 2.1 | .0 | -2.8 |
| State & Local Securities | .4 | .9 | .9 | 1.2 | .8 | .6 | .3 | .9 | 1.0 | .4 | .2 | .2 | .5 | .5 | .4 | -.2 | .1 | .2 | -.2 | .3 |
| Corporate & Other Bonds | -.0 | -.1 | -.1 | .4 | .3 | .3 | .3 | .1 | .1 | .1 | -.2 | -.2 | -.1 | .2 | .4 | .7 | .9 | .9 | 1.8 | 1.1 |
| Investment Co. Shares | .2 | .2 | .2 | .3 | .4 | .4 | .5 | .5 | .4 | .5 | .5 | .3 | .4 | .7 | .7 | .5 | .8 | .9 | .4 | -.0 |
| Other Preferred & Common Stock | .5 | .2 | .1 | .1 | .3 | .1 | .0 | -.3 | -.5 | -.4 | -.0 | -1.0 | -.4 | -1.1 | -.9 | -1.2 | -2.1 | -1.5 | -.7 | -.9 |
| Insurance Reserves | 1.2 | 1.2 | 1.0 | 1.0 | 1.2 | .9 | .9 | .9 | .9 | .9 | 1.0 | 1.0 | 1.0 | 1.0 | .9 | .9 | .8 | .8 | .8 | .7 |
| Pension Reserves | 2.0 | 2.0 | 2.0 | 2.0 | 2.1 | 2.2 | 2.2 | 2.5 | 2.4 | 2.4 | 2.4 | 2.4 | 2.5 | 2.6 | 2.6 | 2.6 | 2.6 | 2.4 | 2.7 | 3.1 |
| Net Investment Non-Farm Homes | 5.4 | 5.3 | 5.3 | 6.4 | 5.6 | 4.5 | 4.0 | 4.9 | 4.1 | 3.3 | 3.3 | 3.1 | 2.9 | 2.5 | 2.2 | 1.7 | 2.2 | 2.0 | 1.4 | 2.0 |
| Non-Corporate | .2 | .2 | -.5 | -.7 | -.2 | -.4 | .2 | -1.4 | -.9 | -.8 | -.5 | -.5 | -.7 | -.4 | -.8 | -.7 | -.4 | -.6 | -.3 | -.9 |
| Increase in Debt Mtges.(home) | 2.7 | 3.0 | 3.4 | 4.4 | 3.8 | 2.8 | 2.8 | 3.7 | 3.1 | 3.0 | 3.3 | 3.7 | 3.7 | 3.2 | 2.4 | 1.9 | 2.5 | 2.6 | 1.8 | 2.8 |
| Consumer Credit | 2.0 | 1.5 | .4 | 2.3 | 1.2 | .9 | .5 | 1.9 | 1.3 | .5 | 1.5 | 2.0 | 2.0 | 2.1 | 1.4 | .8 | 1.9 | 1.5 | .6 | 1.2 |
| Other | .6 | .6 | 1.0 | .8 | .6 | .5 | 1.1 | .9 | .7 | 1.1 | .6 | 1.1 | .8 | 1.0 | .8 | 1.6 | 1.5 | .8 | .6 | 1.3 |
| Saving=Financial and Net Investmt.-Increase in debt | 8.6 | 7.3 | 7.6 | 7.5 | 8.8 | 8.0 | 8.1 | 7.1 | 5.4 | 6.0 | 8.1 | 6.5 | 6.9 | 7.1 | 6.6 | 7.9 | 6.6 | 5.3 | 8.1 | 8.8 |
| Saving Rate (NIA) | 7.6 | 7.3 | 6.4 | 5.7 | 7.0 | 6.7 | 7.0 | 5.7 | 4.9 | 5.8 | 5.6 | 4.9 | 6.0 | 6.0 | 6.4 | 7.4 | 6.7 | 6.0 | 7.9 | 8.0 |
| Residual | 1.0 | .0 | 1.2 | 1.8 | 1.8 | 1.3 | 1.1 | 1.4 | .5 | .2 | 2.5 | 1.6 | .9 | 1.1 | .2 | .5 | -.1 | -.7 | .2 | .8 |

Source: Flow of Funds, Federal Reserve Board

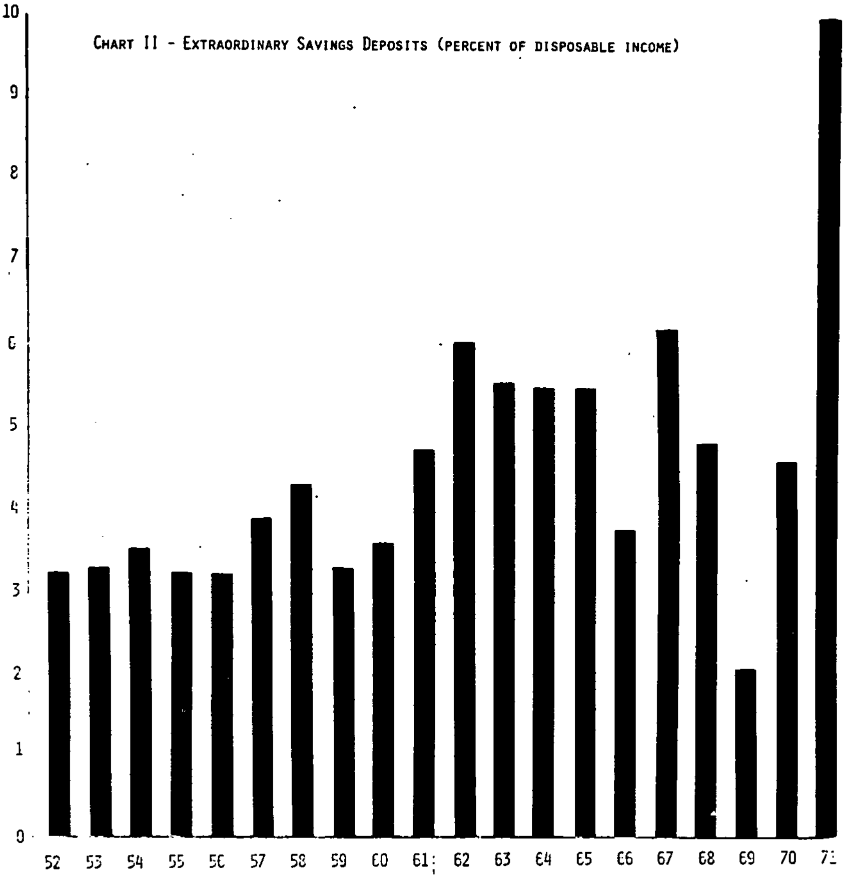
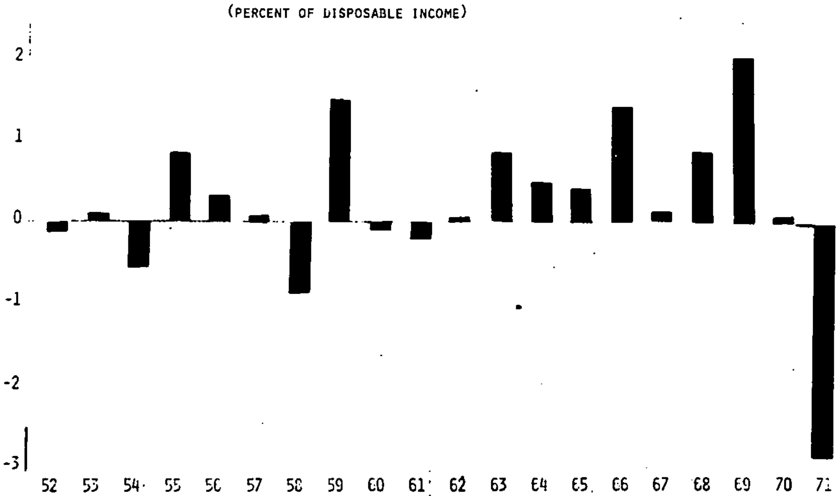
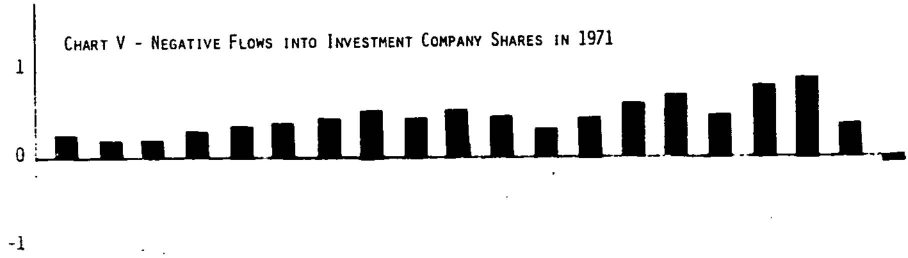


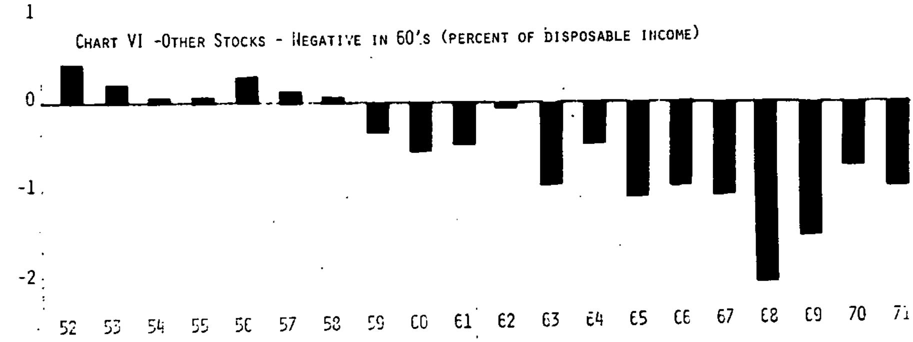

CHART II - EXTRAORDINARY SAVINGS DEPOSITS (PERCENT OF DISPOSABLE INCOME)

CHART III - EXTRAORDINARY FLOW OUT OF U.S. GOVERNMENT SECURITIES (PERCENT OF DISPOSABLE INCOME)



Mutual funds (investment company shares) showed their first post war outflow in 1971 as consumers were briefly disenchanted with the stock market. Directly held preferred and common stock had been showing net outflows since 1959 .




The growth in insurance reserves as a proportion of disposable income has been decreasing over time as insurance companies have become more efficient and have been able to spread risk as more people are insured. The public also seems to be buying more term insurance which produces few reserves. Pension reserve growth has long been increasing as a percent of disposable income as a result, in part, of the inclusion of pensions in more labor contracts. Combining these two factors shows that there has been no increase in the proportion of disposable income going into financial contractual saving.

Chart VII - Flows into Pension Reserves have been Growing (percent of disposable income)

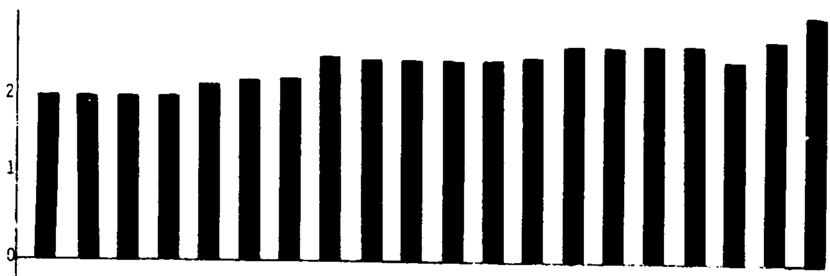
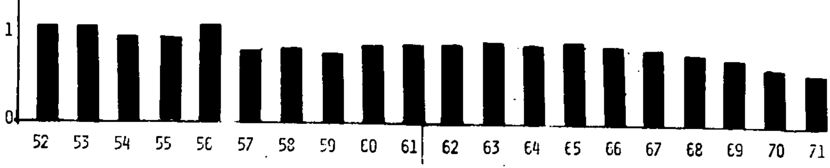
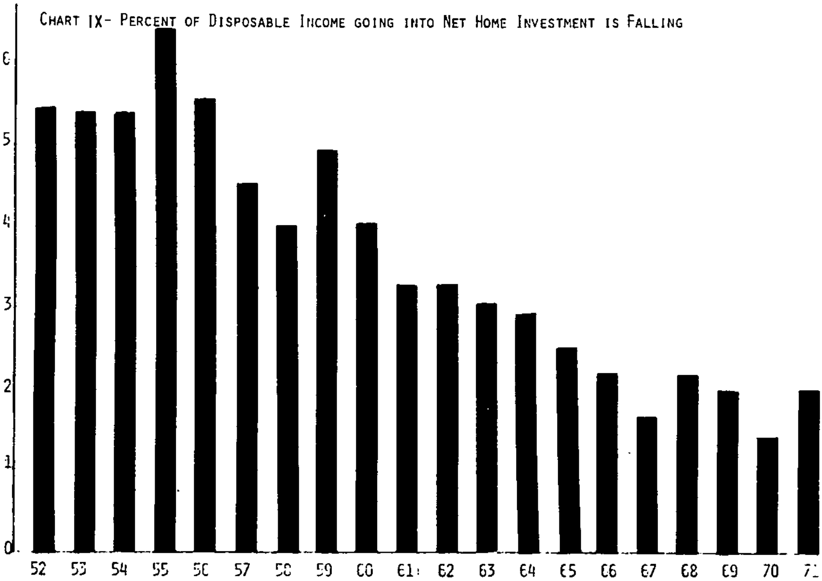



Chart VIII - Flows into Insurance Reserves have been Shrinking (percent of disposable income)




Net investment in homes as a percent of disposable income has almost halved since 1952. Housing investment as a whole has taken a shrinking share of the consumer dollar. The switch to apartments has meant that this investment is now performed by sectors other than households.

Chart IX- Percent of Disposable Income going into Net Home Investment is Falling



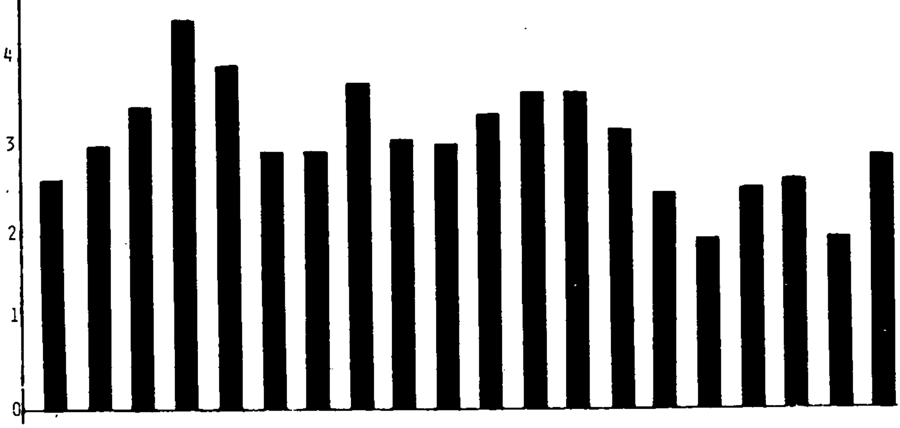
Net investment in non-corporate business has been negative since 1954 as small family enterprises gradually disappear in the industrial state.

Table 2. Net Investment Non-Corporate Business

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 52 | 53 | 54 | 55 | 56 | 57 | 58 | 59 |
| Non-Corporate | 0.2 | 0.2 | -.5 | -.7 | -.2 | -.4 | 0.2 | -1.4 |
| | 60 | 61 | 62 | 63 | 64 | 65 | 66 | 67 |
| Non-Corporate | -.9 | -.8 | -.5 | -.5 | -.7 | -.4 | -.8 | -.7 |
| | 68 | 69 | 70 | 71 | | | | |
| Non-Corporate | -.4 | -.6 | -.3 | -.9 | | | | |

Turning to the debt side, mortgage growth represented dissaving equal to 2.8% of disposable income in 1971; this rate is low in comparison to the high rate of housing starts. This flow can be expected to increase in 1972 as houses are completed and sold; it may help to lower the saving rate on an NIA basis. (This flow is mirrored as spending for consumption of housing services in the NIA accounts.)

CHART X - THE 1971 INCREASE IN DEBT FOR HOME MORTGAGES WAS NOT HIGH



## Other Factors in High Saving: Unemployment and Inflation

The Flow of Funds analysis shows little direct evidence of a structural shift toward a permanent high saving rate. However, the DRI forecast shows a saving rate near 8% throughout 1972 and 1973. Among the factors contributing to this rate are a continuing inflation at a rate of over 3% per year and a continuing high unemployment rate which drops to only 5% at the end of 1973.

In order to investigate the impact of these factors on the saving rate, two alternative DRI Model simulations were run. The first simulation holds the inflation rate of the implicit price deflator for GNP to 2% in 1972 and 2.1% in 1973 as compared to 3.1% in 1972 and 3.3% in 1973 in CONTROL 1/31. No other changes were made, though the effects of the price change on the economy were allowed to work themselves out. As a result, the saving rate is lowered by .2% by the end of 1972 and by .6% by the end of 1973. The second simulation arbitrarily holds the unemployment rate at 4% throughout 1972 and 1973, again without other imposed changes. As a result, the saving rate is more than 1% lower in 1972 and is .6% lower in 1973 than in the CONTROL solution. Table 3 summarizes the results of these simulations.

Table 3. Alternatives Show Lower Saving Rates

| | 1972 | | | 1973 | | |
|---|---|---|---|---|---|---|
| | Control 1/31 | Stable Prices | 4% Unemp | Control 1/31 | Stable Prices | 4% Unemp |
| Saving Rate | 8.3 | 8.2 | 7.3 | 7.9 | 7.5 | 7.3 |
| Real Growth Rate | 5.9 | 6.9 | 7.2 | 5.9 | 7.1 | 4.7 |
| Gross Natl Prod | 1143 | 1140 | 1160 | 1251 | 1248 | 1264 |
| Inflation Rate | 3.1 | 2.0 | 3.4 | 3.3 | 2.1 | 4.2 |
| Profits Before Tax | 95 | 91 | 100.5 | 105 | 108 | 106.5 |
| Unemployment Rate | 5.8 | 5.5 | 4.0 | 5.2 | 4.6 | 4.0 |

## Interest Rates and the Stock Market

In economic theory saving is usually related positively to interest rates, but econometric support for this relationship remains nonexistent. DRI has not yet re-examined the evidence. High interest rates yielding high rates of return may induce less spending by discouraging credit purchases and encouraging more saving than would otherwise occur.

Poor performance of the stock market yielding lower wealth leads to lower discretionary durables consumption. The stock market factor has direct impact in the DRI Model on luxury durables (other durables); but the effect is not large enough to substantially lower the saving rate for reasonable growth rates in the stock market index.

## Demographic Factors

It is well-known that young families are the main borrowers in the economy while families in the two decades before retirement are the main savers. Therefore, changes in the age composition of the population should lead to changes in the saving rate. At this time, the demographic factors should be producing low rather than high saving rates. This can be seen from Table 4 which shows that the percent of total population in the borrowing age group is relatively large and increasing.

Table 4. Borrowing Age Population is Growing Again (Percent of total population age 20-24)

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Year | 52 | 53 | 54 | 55 | 56 | 57 | 58 | 59 | 60 | 61 | 62 | 63 |
| Percent | 37 | 36 | 35 | 35 | 34 | 34 | 33 | 33 | 32 | 32 | 32 | 31 |
| Year | 64 | 65 | 66 | 67 | 68 | 69 | 70 | 71 | 72 | 73 | 74 | 75 |
| Percent | 31 | 31 | 31 | 31 | 32 | 32 | 32 | 32 | 33 | 33 | 33 | 34 |

Note: Forecasts are Series D, U. S. Bureau of Census, current population reports, Series page 25, No. 470, November 1971.

## Conclusion

The saving rate is high, not because of contractual saving or demography. It is the other hypotheses that survive: high unemployment and inflation, high interest rates, or a shift in basic values and psychology. Whether any or all of these factors are temporary or permanent remains to be seen.

Representative REUSS. Wouldn't you all agree that if more income could be put into the hands of the 20 percent lowest income families in the United States—I would prefer to do it by a jobs program rather than by a welfare program—if this happened, you would find, would you not, that this high savings rate overall, which so bothers everybody, would go down? Isn't that bound to be true? The propensity to spend would be admirable, and that would bring down the 8 percent quite markedly.

What do you think?

Mr. PERRY. The proposal certainly stands on its own merits. Whether you would notice it in a savings rate, whether it would be more than a decimal point or two is the question I earlier suggested we don't have a conclusive answer to.

Representative REUSS. We live by decimals, when you translate it into GNP. It would be very important.

Mr. PERRY. Yes, whatever effect would occur should be in that direction. I think there is no question that we should prefer public jobs to welfare. I find it strange that we have been so reluctant to embrace that very obvious proposition. And, of course, the real net costs of a job program are much smaller than the apparent budgetary costs.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PROXMIRE. Along that same line, we have been just on the verge of feeling that there will be a breakthrough, that we will reduce that savings level. I remember a couple of years ago when it got up to 7 percent, predictions were that it would go down to 6. It had even been cranked into some of the forecasts.

One of the interesting figures is that in Japan their savings rate is about 20 percent. There is no reason why it can't go up here. It may be 9 percent next year, or 10. Certainly, some of our tax policies seem to encourage and emphasize investment rather than consumption. Mr. Bernstein, I understand, made that point the other day. So we haven't been working in any explicit way to encourage getting this down. People talk about it but nobody seems to do anything about it.

I would like to ask about another modification of the Reuss suggestion. I enthusiastically favor his 500,000 jobs program and am happy to support it. I think there is a much more effective way of overcoming this because so much of it is psychological.

The President is right now in China getting the attention of the world. On August 15, he went on television with a tremendously exciting economic program that had all of our attention. Supposing when he comes back he gets on television and says that the one remaining, big economic problem about which we have done very little is employment. In order to overcome this, he is going to propose not only that we accept the Reuss proposal but that every month until unemployment gets below 5 percent, the Government serve as employer of last resort and hire 100,000 people in addition to the 500,000, and just keep it going until it is achieved.

With this kind of determination by the Federal Government which only the President can dramatize, would you think that this sort of a program, of placing a clear priority on reducing unemployment, the kind that we placed on the space program or the highway program or national defense, for that matter, would engender the kind of confidence we need, or would it be so inflationary as to be overdoing it?

Mr. ECKSTEIN. He would have to make clear, of course, that he planned to continue this program well past election.

Chairman PROXMIRE. Of course, he couldn't continue it very much past election, I don't think—well, I don't know. But this would be his policy as long as he is in office, until unemployment gets below 5 percent. Maybe it could be lower, but take that.

Mr. ECKSTEIN. I suppose the other side of it is he would also have to accompany that proposal with a more visible administration support to phase II than it has so far received.

Chairman PROXMIRE. One of the purposes of phase II, as I understood it, was so that we could have more stimulative policies.

Mr. ECKSTEIN. And these things would have to go hand-in-hand. In phase II, the public boards are doing as good a job as they can, given the extent of support that they have. Of course, the President would have to spell out the measures that he would actually use, public employment, whatever else. It obviously would be a great boon to the economy and we would move forward.

Chairman PROXMIRE. Mr. Gordon or Mr. Perry.

Mr. GORDON. I have already made it clear that I favor even larger public service employment programs than Congressman Reuss has proposed. I am not sure I understand the virtue of the precise 100,000 a month figure.

Chairman PROXMIRE. Of course, there isn't any statistical or intellectual virtue in it. It seems to me there is a psychological virtue in having the Federal Government say, "This is our policy. We are going to get unemployment below 5 percent." Maybe some other formula is better. But in order to do it, so that the people can understand, the Government is going to continuously work as an employer of last resort with unemployment this high, and this is the way they are going to do it.

Mr. GORDON. I would prefer, perhaps out of stubbornness, a program that would be something as follows: The President asks Congress to authorize and then appropriate the funds for public service employment programs up to 1 million persons, let's say, at the discretion of the President, with something mandatory to indicate that he must spend the money and put the people to work, until the unemployment rate falls to a certain figure.

If that means that you start out hiring at the rate of 200,000 or 300,000 a month and then by the end of a certain number of months the unemployment rate is down below whatever your trigger figure is, then you stop.

Chairman PROXMIRE. That is fine. I had the same thing in mind. I didn't mean to be rigid.

Mr. PERRY. I guess I would have one reservation. Other things being equal, I would prefer that people be employed in their most productive occupation. I think if you have a public employment program which comes on too fast, is too encompassing, you run some risk of interfering with the growth of employment in the private sector. I am sure there is something in between that is the right strategy.

Chairman PROXMIRE. How could you enfeeble the growth of employment in the private sector by this kind of a program? Wouldn't this help increase the aggregate demand?

Mr. PERRY. It would certainly have the expansionary effect.

Chairman PROXMIRE. What would be the negative effect, providing you have an effective phase II?

Mr. PERRY. The process of people changing jobs and looking for jobs is going on all the time. If you have such a strong program, and I am not sure I sense just the strength of the program you are proposing, you might interfere with that process.

Chairman PROXMIRE. As I tried to indicate, it would only go to a point where you get unemployment down to a certain level. No. 2, another element, would be to recognize the fact that you bring out so well, that the problem is the unemployment of a certain group, particularly. We would have to try and key this to young people, blacks, Mexican Americans and others who are in great difficulty.

Mr. PERRY. I think that is very important. The more you can really have a priority system, a program aimed in the first instance at people who have trouble finding jobs elsewhere, the more favorable it would be.

Mr. BRINNER. In trying to estimate the direct effects, rather than the total indirect and direct multiplier effects, of a certain number of jobs, whether it be 500,000 or 1 million, on the aggregate unemployment, you have to keep in mind that by providing these jobs we are going to draw into the officially dedicated labor force and the aggregate unemployment rate will not be reduced as significantly as if we had just given 500,000 of the currently officially unemployed some jobs.

So when we are evaluating this program, after it has been enacted as we hope it will be, we must not be too harsh on it if it doesn't seem to have the effect that we might have expected initially.

Chairman PROXMIRE. There are several very important policy areas raised in Mr. Eckstein's study which I would like to get you gentlemen to comment on. First, the study argues that there is a certain critical level of unemployment below which inflation rather suddenly becomes a much more serious problem. This is estimated at between 4 and 4.5 percent given the present structure of the economy.

Do you agree there is a particular level of unemployment which is critical? If so, would you agree this level is somewhere around 4 or 4.5 percent?

Mr. Gordon, you commented on that briefly. Would you elaborate?

Mr. GORDON. There may be a level. If there is, I don't know what it is. I am not convinced it is some precise point between 4 and 4.5 percent on the basis of the Eckstein-Brinner study. We had unemployment in the 1920's, going back a long time, around 4 percent and prices trended downward. Many things were different then, of course.

Chairman PROXMIRE. Unemployment in the period 1953–57 averaged around 4.3 percent.

Mr. GORDON. In 1955–57, it averaged between 4.1 and 4.3, averaging 4.2. Then if you look, preferably with a strong pair of glasses, you can see the slight contribution that past inflation made to the inflation rate in the Eckstein-Brinner study.

Mr. PERRY. I don't agree that we have a very well defined sharp point and that going beyond that is an accelerating of inflation, that we dare not move there. I think that estimating such a result does arise because of the particular way that this study went about identifying what happened in the last couple of years, and I think it is misleading to give the impression that there is this very sharp point which you dare not go beyond.

If you accept the view that what we have had is this habitual inflation lately and it is more a matter of something that won't slow down rather than something that will run away from you, then I don't think you get the same conclusion.

I think you can press the labor market, getting more inflation for your trouble as you do press it harder and harder, but there is not a precipice over which we are about to fall at some point.

Furthermore, the extent to which you run into the problem of inflation at all is going to depend on the mixture of unemployment as we get there. That is the other point on which I disagree. It is not one abrupt point which is equally inflationary, equally a trigger point for runaway inflation, regardless of what sort of mix of unemployment we have in the labor market, regardless of whether we get there with one market tight and another market very loose or a better combination. We really have to address ourselves to that question.

Chairman PROXMIRE. What is your view on how and when phase II should be disbanded? Do you think a permanent income policy is necessary to continue at acceptable levels of inflation and unemployment?

Mr. PERRY. Yes.

Chairman PROXMIRE. Do you favor a 2-year continuation of phase II?

Mr. PERRY. I am in favor of a continuing income policy, one that, whatever you call it, would evolve from the thing quickly thrown together last fall.

Chairman PROXMIRE. To be more precise, how long would you continue phase II, and what kind of an income policy would you favor?

Mr. PERRY. I would like to alter phase II right now.

Chairman PROXMIRE. Right now if you could change it, how would you change it?

Mr. PERRY. I would change it to permit it to concentrate on the parts of the economy where a great deal of market power exists—on the large labor unions and concentrated industries and on a few selected other problem areas such as construction. This would concentrate the limited bureaucratic resources available in those areas where I think an income policy can be most useful, and would get away from trying to monitor prices as extensively as the present Commission does.

Chairman PROXMIRE. I have been saying the same thing up here, but I am concerned about how you can work this out from a practical standpoint. If you go to the labor people, you say, "You are the ones on which we have to zero in on fixing, limiting wage increases," and you go to the big companies and you say, "You are the ones where we have the problem as far as administering higher prices are concerned."

Mr. PERRY. You have to give them a guarantee on the rest of it, and you have to give them a kickback, if you like, if you don't deliver on the guarantee. The reason this policy is sensible is that if you control parts of the economy, the rest is competitive enough not to bother you.

Chairman PROXMIRE. That is interesting. Give them a guarantee?

You would say that in the event other wages rise more that they would be given at least equivalent treatment?

Mr. PERRY. I would think there would be nothing wrong with having a wage rule for a large contract and in addition a cost of living kicker should things elsewhere in the economy run away in such a way that that wasn't the right wage settlement to have made in the first place.

Chairman PROXMIRE. You would shift right now to a policy in which you would concentrate on the large labor unions and the large companies that have the capacity to administer prices?

Mr. PERRY. Yes. I think the Pay Board already is concentrating most of its efforts there by the nature of its operation. The Price Commission, on the other hand, is scattered all over the place and cannot concentrate where it should.

Chairman PROXMIRE. I think it is an effective fact that is against the law, or at least it is worked out so that it is complicated and difficult, for an employer to give more than a 5.5-percent wage increase. Employers just love to cooperate with that. So the government has a built-in enforcement mechanism. Once you knock that out you have a new ball game.

Mr. PERRY. I think you should have a rule for everybody. That is, there should be guidelines and moral suasion throughout the economy; but you just can't hope to have and don't need the bureaucratic enforcement over the whole economy. The reason the present 5.5-percent guideline is so effective is precisely because the inflation we have gotten into is habitual, we are on a treadmill, and someone can blow a whistle and say the game should slow down.

It has not been surprising, but certainly a pleasant result, that in fact wages everywhere have slowed down. I think that tells us something about the nature of the inflation we were in. In overly tight markets you wouldn't get that same cooperation because employers would naturally be trying to bid for the labor they needed and would be willing to exceed the wage standard if they had to.

Chairman PROXMIRE. Mr. Gordon, let me get into another area. In 1967 you published a book entitled "The Goal of Full Employment" in which after examining the composition of the labor force you reached the following conclusion:

> Our informed guess is that with the help of expanded, more effective manpower policy, and possibly some small help from guideposts, it should be possible to come close to an aggregate full employment goal corresponding to a national unemployment rate of about 3 percent.

Did you modify that conclusion any way based upon subsequent changes in the economy? Do you consider that overly optimistic?

Mr. GORDON. I think I finished that manuscript at the end of 1966, and I did not have the experience of 1967–71, which might have led me to modify those conclusions somewhat. I would certainly now add the contribution of the public service employment program. I am now more pessimistic about the results visible thus far, of manpower programs, than I was then.

I would put it this way: I still think from all the evidence I can find, from BLS and elsewhere, that minimum frictional unemployment in the United States, plus what I would call that part of structural unemployment I have no hope we would ever get rid of, comes to something like perhaps a fraction over 3 percent.

I do not take into account the cumulative effect over a number of years of accelerated inflation. While I am not the accelerationist even at 4 percent that Mr. Eckstein apparently is, no student who believes in a nonvertical Phillips curve ignores the effect of the behavior of the price level in the past.

If you have had several years of rapid inflation, that is a powerful influence tending to push wages up in the future. As long as the figures available to us seem to suggest that what is commonly accepted as frictional unemployment is less than 3 percent, and then if you are willing, as I am, to be moderately hopeful that we can significantly reduce the degree of racial discrimination and tend significantly to equalize employment opportunities and housing opportunities, we ought to be able substantially to reduce what is loosely referred to as structural unemployment, which is partly what is involved in this talk about the changing age-sex composition of the labor force.

I would favor an incomes policy, and I think 2 years is a minimum for it. I think I would go along with Mr. Perry in saying it is probably safe to concentrate on the large firms and the large unions. To that I would make a very important qualification, that my definition of large employers and large firms would include the construction industry.

Chairman PROXMIRE. Health services, too?

Mr. GORDON. I don't see the union pressure from health services.

Chairman PROXMIRE. But you have scarcities of doctors, nurses and so forth.

Mr. GORDON. Quite. I am all in favor of regulating medical prices. As a substantial consumer of those services, I am somewhat prejudiced.

I would also favor a pay board with stiffer backbones, particularly with respect to some of the wage settlements.

I went back to the very early history of the wage board and I have the impression that they have been stiff only slightly in the 4 months they have been operating. I would stick to the proposition that some day we ought to and can get the unemployment rate down to less than 4 percent, but it will take a much bigger, more intensive effort than we have thus far attempted.

Chairman PROXMIRE. Mr. Eckstein, I would like to have you comment on a paper prepared by the Secretary of the Treasury.

He states:

> In 1972, assuming a labor force increase of around one and a half million, the unemployment rate may be lowered to 5 percent. But that unemployment rate might represent the maximum benefit from cyclical expansion without unleashing unwanted inflationary reproductions.

Later:

> Over the next few years a 4-percent unemployment rate as a National goal is not feasible without significant inflation. This might apply even if some new fundamental approaches in manpower training now in sight were tried.[1]

Mr. ECKSTEIN. Let me comment on each of the parts of that statement. First, by 1972 the labor force is likely to grow by more than a million and a half because the population rose rapidly and in a re-

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[1] See article entitled "The Unemployed: Who, Where, and Why," beginning on p. 376, pt. 2, these hearings.

covery phase the people go back to work. Therefore, the unemployment projection growing out of that is likely to be too optimistic.

On the 5-percent question, my feeling is that if this country really has to set its target as 5 percent being the best we can do, it represents a bankruptcy policy.

Our study does not say that 4.5 percent or any specific number is the ultimate possible target that we can reach. What we say is that with the average structure that we have had in the last 15 years, that is the kind of figure that seems the best that we can attain.

In that period we have suffered from highly unstable demand policies in several administrations. We have suffered from a general accommodation by the political process to various producer groups which has served to raise prices in many ways. We have had government procurement practices which have wasted resources. We have invested large sums in very low return civilian areas.

If there is no room in the structure that is politically realistic, then indeed the Secretary's final statement is correct.

It is dubious that we can manage a 4 percent effectively if everything is different. But it is the job of Government to take everything as different. It is a question of the leadership applied on behalf of this social goal, and that is improving the structure and improving the price stability as well as other goals.

Chairman PROXMIRE. Mr. Perry, I would like to challenge your thesis on some other angles. Certainly your facts are correct. There is no question that the proportion of young people and women have increased in the last 15 years. On the average, they work fewer hours per week and at lower wages than adult men.

If I understand your study correctly, you use the wage rate as the measure of productivity of work. I recognize this is standard economic theory. However, we had testimony yesterday, from Mrs. Kreps, a fine economist, that men on the average earn about one-third more than women doing the same job. This is after correction of the data for differences in years of training and work experience.

Doesn't this fact introduce large error into any comparison of the relative productivity of male and female workers that uses relative wages as the measure of the productivity? Shouldn't I turn your conclusion around and argue that if I can hire a woman to do the same job as a man and pay her only 75 perecnt of the man's wages, this should be anti-inflationary? Socially that is reprehensible, but I don't see why it is inflationary. Mrs. Kreps also pointed out that women are overeducated for the jobs they hold. She pointed out that the jobs that they can get after college education are about equivalent to what men get after high school education.

Doesn't this mean high productivity relative to wages and isn't it anti-inflationary?

Mr. PERRY. I agree it would be anti-inflationary if you could start switching jobs from employed to unemployed at the present time. I am not sure that that, by itself, recommends the policy.

Chairman PROXMIRE. How about the simple fact that you have a situation now where one of the explanations for the relatively high unemployment is that there are so many more women in the work force and more women are unemployed? If those people can be hired, in view of the fact that they work for less, that element, at least, would be counterinflationary.

Mr. PERRY. I don't know to what extent they literally do the same work. I would have thought that much of the discrimination comes because of the nature of the job that they are given. To the extent that is true, the employer may be making a big mistake.

To the extent that they were literally doing the same job, it certainly would be anti-inflationary to hire the lower priced worker. Where that is really the case, it would reduce costs of production.

Chairman PROXMIRE. She said the change in the age and sex composition is only one of the changes that have taken place in the last 15 years. Mr. Okun last week and Mr. Eckstein this morning both pointed out there has been a significant improvement in education. Mr. Okun took the 1957 labor force groups by the difference in education and weighted them against the groups today. He found this would reduce the overall unemployment rate by about one-half of 1 percent.

I know this fact by itself does not conclusively prove anything but it does suggest there has been anti-inflationary as well as inflationary changes in the labor force.

It should also be pointed out there have been major changes in the structure of job units. There are relatively more service jobs and fewer manufacturing jobs. I don't know whether this makes inflation by education larger or smaller, but it should be examined. Shouldn't we be examining all the changes in the structure of the job market and not just one of them?

Mr. PERRY. Yes.

Chairman PROXMIRE. Are we?

Mr. PERRY. We do not have a good handle on the other aspects of this problem, and certainly we should know more about it. But I should stress again that it isn't the fact of an increasing number of young workers, but the fact of their deteriorating upemployment experience that matter so much.

Chairman PROXMIRE. Deteriorating relative to employment experience?

Mr. PERRY. Deteriorating relative to the prime age males.

Chairman PROXMIRE. It seems to me the only thing they don't have is the seniority. The older are in jobs that are protected.

Mr. PERRY. In the face of all we have said, the manpower training and improved education, the result is still this increasing dispersion of unemployment among age-sex groups. This goes in the face of all these factors like education that might have been expected to yield improvements. It is the final result that commands my attention, not the reasoning as to why we did or didn't get there.

If you had asked me in 1960 what would happen to the dispersion of rates in 1970, I would have predicted you would narrow the dispersion. There were many reasons for us to expect this. Education would be one thing. Tight labor markets another. But it did not happen.

Chairman PROXMIRE. You say the weak get weaker, but the weak actually are better trained; there is less discrimination. I think we are moving quite rapidly, though not rapidly enough to suit us. But yet the weak are getting weaker?

Mr. PERRY. This is a situation which should have improved, but hasn't.

Chairman PROXMIRE. I make a habit in Wisconsin of going to plant gates and shaking hands of people going to work. There are a number of very large institutions in our State where you never saw a black face. You don't see that any more. Many, many more blacks are coming in. We only have a 10-percent population of blacks in Milwaukee, small compared to most cities of that size, but they are far more widely employed than ever before.

I think we can make far more progress in the next few years, especially in view of what the Senate did the day before yesterday.

Mr. GORDON. I have a number of things to say bearing on your dialog with Mr. Perry, if I may.

First of all, I think you place too much emphasis on the higher education of workers. This has been matched to a significant degree by higher educational requirements by employers. The high school diploma has become virtually a sine qua non for a good job, even for a semiskilled blue collar job. Therefore, it isn't just that a much larger fraction of our labor force has completed high school, but it is that far more than previously employers are demanding that.

Here you have a ratchet effect. The better educated our work force, the more stringent are the standards of the employers.

Secondly, let me emphasize again something I tried to make clear in my statement. We ought to stop talking about the effect that adult women have had on the unemployment rate because for age groups from 25 up there has been no increase in the share of total unemployment accounted for by these more mature women since 1956, and their relative unemployment rate, that is, their rate relative to the national rate, has not risen.

In 1970–71, in fact, their share of total unemployment and their relative unemployment rates were less than they were in 1956.

Third, with respect to the effect that women may have had on the Phillips curve, let me mention again something I just barely passed over. I did what I found to be a rather fascinating chart of the Phillips-curve type in which I put on the vertical axis the wage increase for the private, nonagricultural work force, and then instead of an unemployment rate on the horizontal axis I put the ratio of the prime age male rate to the national rate.

There was a clear shift in that "Phillips curve" in the 1960's, to the left, and becoming more horizontal down to a relative unemployment rate of about 0.5. That is, relative tightness for prime age males relative to the total labor force seemed to cause less wage inflation up to about 1968 than it did in the 1950's.

I attribute that in part to the effect of the growth and relative importance of the young people in the labor force.

The next thing I wanted to mention is that I would urge this committee to keep its eyes on the rest of the 1970's, and think about what is going to happen to the age-sex composition of the labor force during the decade ahead. The share of the labor force made up of teenagers is not going to rise. It is going to decline slightly.

The share made up of men and women age 20 to 24 is going to increase somewhat. It has already been increasing, but the big jump, and this is the point I want to emphasize, in the share of the labor force between 1970 and 1980 is going to be among both men and women in the age group 25 to 34.

We had better start worrying about that part of the prime age male adult section of the labor force.

Chairman PROXMIRE. That is really the prime employment age.

Mr. GORDON. Not in terms of an effect on wages, I think. With seniority systems built into our working rules, with the wage——

Chairman PROXMIRE. It seems to me they don't have the handicap that those of us who are over 40.

Mr. GORDON. I am not prepared to predict what the effect of that particular change in the age composition is going to be on the Phillips curve. I just bring it to the attention of this committee, that there is going to be relatively a very large increase in the work force made up of men and women in the age group of 25 to 34.

Chairman PROXMIRE. Wouldn't this be the best trained?

Mr. GORDON. Yes. Education in the labor force in inversely related to age for perfectly understandable reasons. The younger groups in the labor force have a better education. They are the ones who finished high school, and their fathers did not.

Then if I may comment on another point that has been brought up, I have examined a number of other dimensions of the labor force. I have studied dispersion of unemployment rates not only by age and sex but by occupation, education, industry, and geographically. An interesting thing which ought to make us scratch our heads a bit is that the occupational dispersion of unemployment rates has behaved the reverse of the dispersion for age and sex. It has declined in the last 15 years. It declined quite significantly between 1956 and the middle 1960's and has remained at its new low level more or less since then but not rising significantly.

Finally, and I come back to a point which you made, there has been some improvement in the nonwhite—white relationship. Relative unemployment rates for blacks and other minority groups have fallen very modestly relative to white rates, particularly in the last 4 or 5 years, although there has been a discouraging rise in the last few months.

I thought these footnotes might be of help.

Chairman PROXMIRE. I have just a couple of quick questions I would like to ask about this: Yesterday we had three distinguished economists discuss with us the severe employment handicaps of women, blacks and Mexican Americans. They said they couldn't see anything in the programs that have been proposed by the administration or that are pending in Congress that will improve this in the next year except perhaps the action taken by the Senate this past week on discrimination. They don't think that will help except as a long-term change.

Would you agree with that?

Mr. ECKSTEIN. I am not sure I canvassed every proposal that has been made. It seems like a rather harsh statement.

Chairman PROXMIRE. Can you think of anything that would help?

Mr. ECKSTEIN. We did pass the equal employment opportunity legislation yesterday. I trust the administration will sign it.

Chairman PROXMIRE. I said that. But I said this is something that will take a while on the basis of similar past legislation. We had legislation that was even more far-reaching in 1964. As Mr. Gordon has just finished indicating, this has been a very modest improvement, with deterioration in the past few months.

Mr. ECKSTEIN. I think I would be grateful if the administration enforced with some vigor the legislation which has been passed in the last 5 years.

Mr. GORDON. I can't speak, as Mr. Eckstein said, for every piece of legislation that has been passed and signed by the President. I would say the recent actions of the administration have been of a sort to worsen the dispersion of unemployment rates by race. The weakening of the administration attitudes on housing and the apparent weakening of its attitudes on school segregation, which, unfortunately seem to be shared by a substantial element of the Congress, point in that direction.

Mr. PERRY. I think it is something that will take time. I can't think of any way to solve it in a year's time.

Chairman PROXMIRE. I would like to finally depart from the main topic this morning long enough to ask each of you for your forecast of the unemployment rate at the end of the year.

Mr. Perry, I take your statement to mean that unemployment will be at 5.5 percent at the end of the year and maybe at the 6-percent level. Is that right?

Mr. PERRY. I would say the rate is more likely to be above 5.5 than below it.

Mr. GORDON. If you will give me a large enough standard error, about 5.5.

Mr. ECKSTEIN. Our current forecast for the fourth quarter is 5.5 percent.

Chairman PROXMIRE. We have at last found something we can pretty much agree on. Gentlemen, I want to thank you very much. You have been a most stimulating and helpful panel.

The committee will stand in recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 10 a.m., Friday, February 25, 1972.)

# THE 1972 ECONOMIC REPORT OF THE PRESIDENT

**FRIDAY, FEBRUARY 25, 1972**

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: Senator Proxmire and Representative Reuss.

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. Jasinowski, research economists; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and Leslie J. Bander, minority economist.

## OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Today we hear once more from three distinguished economists whom we have invited to discuss one of the major problems still facing our economy, how to control inflationary pressure. We hope to cover a great deal of ground covering their views on the likelihood of success of phase II, its probable life cycle, and where we should go after phase II is phased out.

One of our witnesses made the suggestion that the controls should immediately be limited to large corporations only. That was yesterday, one of the witnesses we had yesterday. I personally was against the promulgation of sweeping wage and price controls and for a system of voluntary constraints and also for limiting the wage and price controls in the second phase II to large corporations and large labor unions.

I am sure we will get into a discussion of this later. The whole question of equity in the present wage-price control system is a knotty one. Indeed, it is because I believe inequities will increase and spread if mandatory controls become unworkable. Although the chief focus of today's hearing will be on inflation control, I do hope witnesses will give us their evaluation of the overall economic outlook for 1972.

Our first witness today is Prof. Gardner Ackley, professor of economics at Michigan. He has appeared many times before this committee. He was a member of the Council of Economic Advisers from 1962 to 1968 and as we all know, was Chairman of the Council of Economic

Advisers from 1954 to 1968. He served as Ambassador to Italy in early 1968 and 1969. He is the author of a book on inflation has had experience with the problem of administering price controls.

Mr. Ackley, I want to especially commend you, and this is without any implied criticism of our two other witnesses today, who I am sure have excellent statements, but I did have a chance, which I haven't had usually with witnesses who have appeared before this committee, to study and read your prepared statement because you thoughtfully provided it for us well in advance. Yours is the only prepared statement which I have had a chance to read and consider carefully because you provided us with your views even before the normal point requested by the committee.

We realize when we ask expert private witnesses to appear with little if any compensation that this is an imposition on them. On the other hand, we feel strongly only if we have advance notice of what witnesses will say will the Congress and the public be best appraised of the import.

Your prepared statement is the best I have ever seen and presented to the Congress. Your points are made concisely, fairly, with devastating conclusiveness that makes it hard to single out any one for special attention.

First, however, I do note your calling for a return to fine tuning by the present administration, after it having roundly denounced this approach by its predecessors. This complaint should be doubled in brass for those formerly purist economists such as George Shultz, and Herb Stein, the Chairman of the Council of Economic Advisers.

Second, the complete irresponsibility of the administration short-run fiscal policy; third, the fundamental objections to the phase II approach action by the Nixon administration; and fourth, your doubts as to the decisionmaking process used by administrators in phase II.

Mr. Ackley will be followed by Professor Harberger of the University of Chicago. He is a long-standing student of Government policy in the economic area. He is one of the most profound defenders of the free market system and has researched in depth inflationary processes in Latin America.

Our roundup witness will be Professor Baumol of Princeton, another great friend. He has devoted most of his working life to the academic and also has made many fine contributions to the understanding of public policy, particularly in welfare and urban economics.

Please confine your oral testimony to about 15 minutes, if you will.

Mr. Ackley, please proceed.

## STATEMENT OF GARDNER ACKLEY, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. Ackley. Thank you, Mr. Chairman. You have asked me to make a brief oral statement but invited me to submit a longer one for the record.

Chairman Proxmire. Your entire prepared statement will be printed in full in the record.

Mr. Ackley. The prepared statement you have is marked preliminary version and I do intend to make some minor changes, but I will supply those to the staff.

In this shorter oral statement now, I intend to confine my remarks entirely to inflation policy, although as you noted, my longer statement does include some comments on fiscal and monetary policy.

My present estimate of the extent of inflation in 1972 is, I think, very much like others you have heard. My own GNP forecast reflects a rise in the GNP deflator of about 3.2 percent for the year as a whole. However, it is my guess that by year-end consumer prices will probably be rising at the rate of 3½ to 4 percent.

Even this would represent quite an improvement, of course, from the nearly 6-percent inflation rate of a year ago. Although some slowing down of inflation surely would have occurred by now without wage-price controls, I think most of the rather definite slowing down that has occurred since last August is attributable to those controls, and they are still having some effect in slowing down price increases and probably will during the rest of 1972.

Of course, the real key to price changes in the year ahead, as in any other year, is the rate of increase in hourly compensation—wages and fringe benefits. The freeze was clearly effective in stopping almost any increase in pay rates for three months. Yet it is still difficult to conclude that, as of today, there is a significant number of workers whose pay is lower than it would have been in the absence both of the freeze and of the Pay Board.

Preliminary BLS data show that the average increase embodied in new wage settlements reached in both the third and fourth quarters of 1971 were just as large as in earlier quarters. Given the aerospace and longshore settlements, it seems unlikely that the record in the current quarter will look much better. Of course, the coal, the railroad, the aerospace, the longshore settlements can be thought of as constituting the tail end of the last wage round, and once these laggards are through the gate, we are told, from here on it will look very different.

Surely, the basic standards that the Pay Board has set for the new contracts that should be negotiated from here on out, and its declared intention, at least, to have a look at the terms of all deferred increases under earlier contracts in excess of 7 percent could very well accomplish a substantial reduction in the rate of pay and benefit increases this year. But the Board's standards leave a lot of room for future exceptions and I think we will just have to wait and see.

I confess to having a great deal of sympathy for the difficulties faced by the public members of the Pay Board. Their votes on most issues are the crucial ones. They have to weigh the requirements of effective stabilization policy against threats to the very survival of the Board that might arise either from a walkout by some of its members or from what could turn out to be a politically intolerable strike against one of the Board's decisions. Since I do believe it important that the Pay Board survive, I am somewhat reluctant to second guess its decisions, appalling as some of them seem to be. If the Board should collapse, it would not only doom current efforts to curb inflation, but I think it would be an exceedingly serious portent of and precedent for our future ability to solve longer run problems of inflation control.

The Board's job has not been made any easier by occasional deliberate or perhaps thoughtless efforts of political figures and government officials of both parties to exploit for political advantage the tensions that are inevitably raised by this most delicate and demanding effort of wage control. Attempts to discredit the motives or the intelligence of representatives on either side, beginning even before the Board was formally constituted, certainly don't help.

In this place, I have to say that Members of Congress, too, have sometimes made the Board's task more difficult by talk and also by legislation. Provisions of the Economic Stabilization Act Amendments of 1971, especially those dealing with fringe benefits, are surely mischievous for successful wage control. Just how mischievous we learned only yesterday. If history is any guide at all, the Congress is likely to write in some equally mischievous amendments dealing with price controls, once these controls should begin to bite. One would hope, I think, that election year pressures for further political intervention can be resisted, although I am not sure that they will be.

I can only hope that the mere fact that the Board continues to survive the various threats to its existence will gradually build up its own confidence and the confidence of those subject to its regulations in its continuing ability to survive, even as it exercises progressively more rigorously its stabilization responsibilities.

The only specific criticism that I would here make of the Board has been to me its incredible unwillingness or inability to bring the Construction Industry Stabilization Committee into some kind of line. The approvals granted by this committee have continued further to widen the already gaping margin between construction pay and all other wages, creating problems of overall wage stability not just this year but I think for many years to come.

Price controls are administratively infinitely more complex than wage controls. But politically they are probably far simpler.

Well, simpler, perhaps—but not exactly simple politically, either.

At the very beginning of phase II, the administration made what I considered was an essentially political decision about price controls, and one which I think has already begun to boomerang. The decision was that there should be the appearance of price controls nearly across the board, presumably mainly in order to make labor less restive about accepting wage controls. But the phase II price controls at retail, for rents and for personal services were planned to be and are essentially nominal. The real effort was supposed to be concentrated on the prices charged by giant firms, the so-called tier I companies, most of them operating at preretail levels, whose price increases would require advance approval from the Price Commission.

There were several troubles with this strategy. The first was that the plans involved only a tiny staff to administer the price controls, really not enough to do a decent job even for the tier I companies. But the Commission found, as I predicted, that even though the controls over retail prices, rents, and personal services were to be only cosmetic, it took a tremendous amount of staff time and effort just to keep up the facade of control.

The second problem was that after a while people began to see that the controls over the prices that make up what obviously to them is the most important part of their living costs, that is, retail prices, rents, and personal services, were essentially meaningless. Now they are beginning to suspect that the whole price control or price-wage control effort is a fraud.

What should have been done, in my judgment, was to have been honest about it, explaining that the inflation problem we face today is not like that we have faced during previous control periods when demand for practically everything exceeded our ability to produce it. Today's inflation is a cost-push inflation and it arises basically from the wage policies of strong unions and pricing policies of big business, and especially the interaction between these two.

This cost-push inflation does not originate at the retail counter, nor in setting rents, nor in pricing personal services. These prices reflect the effects of the cost-push inflation. But to the extent that the sources of that inflation can be controlled, so will be its reflection in these prices even though they are not controlled directly. Indeed, they could not in any case be effectively controlled without a vast bureaucracy, and a truly heavy administrative burden on the millions of individual retailers, suppliers of personal services, and landlords.

That is why I have argued from the beginning that phase II ought to exempt all retail sales, personal services, and rents from price controls, along with a number of the less important and more competitive manufacturing industries, while trying to do a tough although equitable job for big business and basic materials.

It doesn't seem to me to be doing that now. According to a recent release more than two-thirds of all the tier I companies have already received price increases approvals averaging 3.1 percent for the affected products and 1.6 percent when spread over the total sales of the affected firms. One doesn't have to assume that all the remaining tier I companies will receive similar approvals, nor is it necessary to realize that many of the first two-thirds will come back for second helpings, and for price increases on products not covered the first time to regard this record as quite disappointing. Moreover, we can be sure that the large price increases that have already been approved for basic materials will soon begin to generate further price increase applications for products incorporating these materials. Given the record to date, it is easy for me to image that the tier I companies could receive price increases this year averaging well in excess of three percent.

Well, is 3 percent so bad? We know that uncontrolled food prices are and will be increasingly substantially. The Department of Agriculture now says by 4 percent. Service prices, where productivity gains are small, surely have to rise with or without controls, perhaps by as much as 4 percent.

Moreover, the long lag in the adjustment of such prices as rents, utilities, transportation rates, and tuitions to rising costs insures that there will be a further significant rise in prices of these important components of the price indexes.

If the average increase of all prices this year were to be held to 3 percent, one would have to expect that the prices of the tier 1 manufacturing companies, which are concentrated in industries with above average productivity gains, should rise very little on the average. Instead, they appear to be contributing significantly to a continuing inflation at a rate substantially above 3 percent. Why?

First of all, I can't believe that the current staff of 500—or perhaps it is now 680, according to the Wall Street Journal the other day—with all the attention that it has to give to retail prices and rents, utility rates and other things, can possibly be giving adequately critical review to the exceedingly complex reports, or what I think ought to be exceedingly complex reports, that are filed by hundreds of giant companies justifying price increases for hundreds of thousands of products.

Experience under previous price controls clearly establishes that even the largest and best managed companies don't find it at all difficult, when they are submitting data to a price control agency, to resolve every doubtful statistical and accounting question, and there are a great many of these, in a way that supports a larger price increase than the applicable price control standard intended to permit. It would be strange if they did otherwise.

Moreover, the Commission's particular standard for price increases, permitting, as it does, a pass-through of the per unit increase in all costs, has to rely on arbitrary accounting and statistical procedures and conventions that are inevitably biased, even when applied in perfectly good faith, toward an overstatement of cost increases and the overlooking of cost reductions. This is especially so during a period when the volume of production and sales will be rapidly expanding. It is not easy to explain nor always even to understand why this has to be so. But my own experience with formula price controls in both OPA and OPS, and I believe the general experience of those agencies, was that cost pass-through formulas invariably have this effect, even when the reports or applications are scrupulously audited by the agency's own accountants.

The statements of the Price Commission and the Council of Economic Advisers (in the Economic Report) rely far too heavily, it seems to me, on the overriding profits standard to handle these problems. The overriding standard is that price increases must not permit the ratio of profits to sales to exceed that realized in the best two of the firm's last 3 fiscal years.

Unfortunately, whether today's price increase will cause this profits standard to be exceeded ordinarily can't be known until considerably more than a year has elapsed. The relationship between any given price increase and a subsequent increase in overall earnings above the standard could rarely if ever, I believe, be established with sufficient precision to support retroactive penalties for deliberate violation of price regulations. And very few firms must regard it as likely that there will still be price controls more than a year from now that might require embarrassing price rollbacks. I have no major objection to the Price Commission's profits standard, but it simply is not effiective as now applied.

There is a brief paragraph on page 93 of the Economic Report which hints that these problems may be receiving attention by the Price Commission. I certainly hope so.

In the meantime, let me venture three modest suggestions: One, the Commission ought to stop trying to give overnight or at least very prompt service on price increase applications. It should review them as carefully and thoroughly as its limited staff will permit, and demand justification and documentation where appropriate. Surprisingly few approvals of price increases appear to have been for less than the amounts requested. As an old price controller, I can't believe that even a cursory review would not turn up many more cases of obvious overestimates of cost increases, the use of clearly pessimistic assumptions regarding productivity and sales volume, many conceptually inappropriate measures of cost factors—such as those related to transferred materials, discounts and allowances, and the pricing of inventories—and even instances of complete misunderstanding of the regulations.

Two, instead of regarding its job as merely that of mechanically applying standards regardless of where this may lead, the Commission, in my judgment, should be exercising some active judgment, persuasion, and possibly even a little arm twisting in an effort to delay or certainly to minimize increases that it approves in prices of strategic materials that affect the basic level of industrial costs or large items of consumer expenditures. I am personally appalled at the size of the increases the Commission has given for price increases for steel, aluminum, and other industrial materials and products. I even have the impression that some of these increases were larger than the companies had expected to receive approval for.

Three, there may well be appropriate cases for the use of product-wide or industry-wide regulations based on the Commission's own studies and projections of costs, productivity, and sales volume. If it were not burdened by the compulsion to maintain and administer some useless controls, I think it could undertake this activity and thereby assure tighter application of its own standards.

I have commented on phase II controls, Mr. Chairman, mainly on their own terms, that is, accepting the presumption that the general design for phase II is correct.

However, if you should recall my testimony of last August 31, you will remember my urging that phase II should basically comprise a period of transition, as brief a period as possible, toward longer term arrangements quite different from the system we now have. These longer term arrangements would be designed to deal on a continuing basis with what I see as the endemic inflationary problem of our society, a perennial creeping inflation, intermittently threatening acceleration to a walk or a trot.

In my judgment, this longer term system must be flexible and basically voluntary, although some last-resort means of legal compulsion probably ought to be available to deal with specific and flagrant cases of violations of the standards of the program.

Devising and carrying out that kind of a program is an even more difficult challenge than that of making a fully compulsory system work. I sincerely hope that serious and organized planning is going on for a phase III of this general sort. The administration has been less sharply insistent in recent months than it had been earlier that its objective was simply to restore completely free markets in which businesses and unions could set prices and wages as they please, with no reference to the public interest. Paul McCracken, my University of Michigan colleague, made clear at the time he left the Government his personal belief that such an outcome was now an unreasonable expectation. I haven't seen any official statement clearly accepting or rejecting this point of view.

Perhaps it is unreasonable to expect that prior to the elections the administration will either begin to move toward such a more permanent and more flexible system, or even to make clear its intention in this respect if it were to continue in office. So I assume that the stabilization program will probably continue to operate in much the same way it has been in the months ahead. But I would sincerely hope that no actions would be taken prior to the election which were inconsistent with the possibility that either a re-elected or newly elected administration might subsequently wish to transform the present system of compulsory controls into a more flexible and mainly voluntary and, I hope, viable, continuing system of incomes policy.

I would again emphasize, however, the necessity for the leaders of both parties and in the private sector to devote much hard thought and imaginative insight to the design of this kind of longer term program and of the machinery to administer it. I would even suggest that this committee might do an important service by commissioning some studies and/or scheduling some hearings on these matters during the remaining months prior to November.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Ackley follows:)

PREPARED STATEMENT OF GARDNER ACKLEY

In his letter inviting me to testify today, the Chairman indicated that my principal topic should be price-incomes policy and the outlook for controlling inflation. He said, however, that the Committee would also welcome my views on appropriate fiscal and monetary policies for 1972. This statement is confined to these two matters. Let me first say a few words about fiscal and monetary policies.

FISCAL AND MONETARY POLICY

The subsequent less formal statements of Administration officials have been somewhat more frank than were the *Budget* and the *Economic Report* in describing the Administration's fiscal policy for 1972. While maintaining a facade of budgetary respectability, the plan in fact seems to be to balloon every form of Federal spending this year in an effort to provide a powerful fiscal stimulus to economic expansion and a reduction of unemployment. The plan clearly involves a substantial full-employment deficit during calendar 1972, and the Chairman of the Council of Economic Advisers has boasted that "even the Democrats" couldn't or wouldn't push fiscal stimulus any further than this.

Since I have contended for several years that we have needed a much more expansionary fiscal policy than the Administration was willing to contemplate, and have strongly insisted that at times a full-employment deficit is entirely appropriate, please don't expect me to criticize this further step in the Administration's conversion to the merits of a stimulative fiscal policy, and to its "fine tuning" (which is what the Administration's partisans used to call it when proposed or practiced by others). I am only sorry that the conversion has taken so long. But please forgive me if I also recall that, only six months ago, the Administration was still preaching the dangers and wickedness of a full-employment deficit; and that on August 15, the President called for a $4.7 billion *reduction* of Federal spending during the current fiscal year. "Tax cuts to stimulate employment must be matched by spending cuts to restrain inflation", he said.

The whole sorry record of this Administration's economic policy has been one of proclaiming laudable targets for employment and GNP, which it claimed that it wished and expected to achieve, but of practicing a fiscal strategy which that it wished and expected to achieve, but of practicing a fiscal strategy which effectively prevented the achievement of those targets.

Now, however, the Administration seems determined to "pour it on"—at least for the next six or nine months—in the hope of getting the unemployment rate to 5% by year end. "If this doesn't work, said Director Shultz, "the fiscal policy boys will have to go back to their drawing boards." Well, let me tell him that the "fiscal policy boys" know that there are considerable lags between decision and result. Opening the spigot in Washington does not instantaneously create production and jobs in the 50 states. It is, administratively, difficult enough to expand Federal outlays suddenly and rapidly. But even when Washington gets moving, increased contracts, purchase orders, and progress payments do not in themselves constitute increased production or require enlarged employment; increased grants to State and local governments do not instantaneously expand State and local governments payrolls and purchases. And the "multiplier effects" of actual increases in government outlays take even longer to be felt.

I share the Administration's desire that the unemployment rate should reach 5% or less by the end of 1972. But if my assessment of the strength of private demand is anywhere near correct, the Administration should have started "pouring it on" last summer, or even earlier, if it expected to achieve this goal. Reliance on an oversimplified version of fiscal policy economics may prove quite as disappointing to the Administration as did its earler reliance on a naive monetarism.

Although I am obviously not a monetarist, I know that monetary policy does "matter". Given my view of the economic outlook, the appropriate monetary policy is one which will keep long-term interest rates in 1972 no higher than they are now—whether that may mean for the rate of growth of $M_1$. $M_2$, or $M_3$.

## PHASE II CONTROLS AND THEIR COVERAGE

Now let me turn to inflation control. The *Economic Report* shows that the August 15 freeze clearly "worked", as my testimony to this Committee on August 31 predicted would be the case—to the expressed surprise of its Chairman. A short freeze is easy and should always work; it is the 'Phase II" which follows that is difficult, and the effectiveness of which may come into question.

The Administration made one basic decision about Phase II with which I fully agree, namely, that it should be a *limited* control system. But this decision was mainly framed in terms of personnel. The President said that he was determined to avoid a vast "price-control bureaucracy"—such as those which administered the World-War-II and Korean-War controls—apparently on the ground that the existence of these bureaucracies insured that regulations would be complex, detailed, and therefore burdensome and guaranteed the perpetuation of controls after their need had disappeared. I disagree with both of these judgments as applied either to the World-War-II or Korean controls. Complex regulations and their associated bureaucracy were necessary in the earlier control programs in order to provide, at the same time, (a) comprehensive and effective price controls, along with (b) the *minimum possible burden* of distortions, inequities, and administrative complexity for those controlled. And the large bureaucracies did not delay the prompt elimination of the earlier controls—an elimination that surely was much too prompt in 1946.

*If* we did not pretend that we now needed and had effective controls nearly across the board, then the current Price Commission staff of 500 might conceivably be adequate to administer Phase II price controls. But we are pretending that we need and have effective and nearly comprehensive controls. Either the pretense or the staff limitation—or perhaps both—will soon have to be abandoned. From my testimony on August 31 you can judge that I prefer to give up the pretense of comprehensive controls.

At that time, and frequently since then, I have urged the prompt termination of all or nearly all compulsory controls over retail prices, rents, most personal services, and at pre-retail levels for a broad range of less important manufactured and processed goods, where effective competition prevails. I have argued, and firmly believe, that compulsory controls in these areas

(a) are quite unnecessary under current and foreseeable economic conditions;

(b) are almost entirely ineffective in their present form; and nevertheless

(c) create administrative problems which require far too much of the time and effort of the small price control staff to permit a good job to be done where it is necessary for controls to do a good job—namely, in restraining the cost-push inflation which arises from the actions of big business and powerful unions.

Moreover, these unnecessary controls impose a considerable administrative burden on those subject to them; here and there, quite at random, they impose individual hardships. I would not hesitate to impose these costs if the controls served an important function; but they seem to me quite intolerable when in fact the controls serve no such function.

What is the reason for the meaningless facade, for example, of required price posting in retail stores? The substantive regulations require merely that retailers preserve their customary markups over their acquisition costs. Anyone with any knowledge of retailing knows that, over-all, customary markups will be preserved in today's economy—and would be, even in a substantially more buoyant economy—without any substantive price control regulations or any required posting of prices.

Please understand me. I am not saying that rents, retail prices, and the prices of personal services or of goods manufactured by competitive industries would not rise in the absence of controls. I am only saying that they would rise no more than they will rise under the kind of controls that a staff of 500—or even 5000—can administer, or should try to administer, in the kind of economy we will have in 1972 and 1973. These are simply not the areas where cost-push inflation originates. Prices in these areas reflect the *effects* of cost push inflation. But if the sources of that inflation are controlled, so will be its reflection in these prices.

The *Economic Report* justifies the decision in favor of nearly comprehensive controls in such terms as "to preserve the psychological benefits realized by the freeze", or to "reassure the public that the process of stemming inflation would be as widely and evenly distributed as possible." My own view is that the public's increasing discovery that current retail price controls and rent controls are essentially meaningless has already begun to generate the belief that the entire price-wage control effort is a fraud. This belief will progressively undermine the public understanding and support that are absolutely essential for the success of the vitally necessary program to control cost-push inflation. In the short-run, an elaborate public-relations game may appear to advance the national interest; in the only slightly longer run, the real requirement, and, indeed the only hope, is to tell people the truth.

## PRICE CONTROLS FOR BIG BUSINESS AND BASIC MATERIALS

What about the price controls that *are* important—which I believe are essentially those over "Tier I" firms, although with possible additions and exclusions to make the list of those subject to the controls include essentially big business and basic materials?

First of all, I cannot believe that the current staff of 500—with all the attention that is devoted to the problems of rents, retail pricing, utility rates, and other things—can possibly give adequately critical review to the exceedingly complex reports (or what sure *ought* to be exceedingly complex reports) filed by many hundreds of giant companies, justifying price increases for hundreds of thousands of separate products. Experience under previous price controls clearly establishes that even the largest and best-managed companies do not find it at all difficult in submitting data to the price control agency to resolve every doubtful statistical and accounting question—and a vast number of such questions do arise—in a way which supports a larger price increase than the applicable price control standard intends to permit. It would be strange if they did otherwise.

Moreover, the Commission's particular standard for price increases, permitting as it does a per-unit pass-through of the increase in all costs, has to rely on arbitrary accounting and statistical procedures that are inevitably biased—even when applied in perfect good faith—toward an overstatement of cost increases and the overlooking of cost reductions. This is especially so during a period when the volume of production and sales is and will be rapidly expanding. It is not easy to explain, or always even fully to understand, why this must be so. But my own experience with formula price controls in both OPA and OPS—and I believe the general experience of those agencies—is that cost-pass-through formulas invariably had this effect, even when applications or reports were scrupulously audited by these agencies' own accountants and statisticians.

The statements of both the Price Commission and the Council of Economic Advisers (in the *Economic Report*) rely far too heavily, it seems to me, on the overriding profits standard to handle these problems. (The overriding standard is that price increases must not permit the ratio of overall profits to sales to exceed that realized in the best two of the firm's last three fiscal years.) Unfortunately, whether today's price increases will cause this profits standard to be exceeded ordinarily cannot really be known until considerably more than a year has elapsed. The relationship between any given increase in price ceilings and a subsequent increase of overall earnings above the standard could rarely, if ever, I believe, be established with sufficient precision to support retroactive penalties for deliberate violation of the price regulations; and very few firms must regard it as likely that there will still be price controls more than a year from now that might require embarrassing price rollbacks. I have no objection to the profits standard. But it is simply not effective as now applied.

A brief paragraph on p. 93 of the *Economic Report* hints that these problems may be receiving attention by the Price Commission. I surely hope so.

According to a recent release, more than ⅔ of all Tier I firms have already received price increase approvals, averaging 3.1% for the affected products, and 1.6% when spread over the total sales of the affected firms. Increases have been denied in the case of only about 5% of the applications received. One need not assume that all of the remaining Tier I firms will receive similar approvals, nor recognize that many of the first ⅔ will come back for second helpings, and for price increases for others of their products, to regard this record as quite disappointing. Moreover, we can be sure that the price increases already approved for basic materials will soon begin to generate further price increases for products incorporating these materials. Given the record to date, it is easy to imagine that Tier I firms could receive price increases this year averaging well in excess of 3%. It could be still more, if wage controls do not succeed in holding the average increase in hourly compensation this year reasonably close to 5½%.

We know that uncontrolled food prices are and will be increasing considerably; that service prices, where productivity gains are small, must surely rise—with or without controls; and that the long lag in the adjustment of such things as rents, utility and transportation rates, tuitions, and government fees to the rise of costs insures a significant further rise in these important components of the price indexes. If the average increase of all prices this year were to be held to 2½ or even 3%, one would expect that prices of Tier I manufacturing firms—concentrated in industries with above-average productivity gains—ought to rise very little on the average. Instead, they appear to be contributing significantly to continuing inflation at a rate substantially above 3% this year.

What ought to be done about it? Without more detailed knowledge of how the Price Commission is applying its standards in Tier I cases, it is hard to make specific suggestions. I may add that this is the most reticent price control administration we have ever had. Past price controls operated mainly through separate product or industry regulations, and the authorizing legislation required that each such regulation be accompanied by a "Statement of Considerations". These Statements were detailed and illuminating. Past control authorities were required to have advisory committees, to which detailed explanations and justifications of proposed actions were given. They issued detailed and informative Quarterly Reports. This one operates behind an impenetrable veil. Still, I can venture a few suggestions.

1. The Commission should stop trying to give overnight service on price-increase applications. It should review them as carefully and thoroughly as its limited staff will permit, and demand justifications and documentation where appropriate. Surprisingly few approvals of price increases appear to have been for less than the amounts requested. As an old price controller, I cannot believe that even a cursory review would not turn up many more cases of obvious over-estimates of cost increases, use of clearly pessimistic assumptions regarding productivity or sales volume, many conceptually inappropriate measurements of cost factors (such as those relating to transferred materials, discounts and allowances, inventory accounting, and a host of other items), and even of complete misunderstanding of the regulations.

2. Instead of regarding its job as merely that of mechanically applying its standards, regardless of where this may lead, the Commission should be exercising some active judgment, persuasion, and possibly even a little arm-twisting in an effort to delay or minimize the increases it approves in prices of strategic materials that affect the basic level of industrial costs, or large items of consumer expenditure. I am personally appalled by the size of the approvals the Commission has given for price increases for steel, aluminum, and other basic industrial materials and products.

3. There may well be appropriate cases for the use of product-wide or industry-wide regulations, based on the Commission's own studies and projections of costs, productivity and sales volume. If it were not burdened by the compulsion to maintain and administer some useless controls, it could undertake this activity, and thereby assure tighter applications of its standards.

WAGE CONTROLS

What is the prospect for wage controls? Let me first say that I have the greatest sympathy for the problems faced by the public members of the Pay Board, and I surely would not wish by my criticisms to make their problems more difficult than they inherently are. I believe it important that the Pay Board hold together: not merely to deal with current problems, but as portent of and precedent for our ability to solve longer-run problems of inflation control.

Keeping labor and management representatives pulling in harness has not been made easier by the deliberate or thoughtless efforts of political figures and government officials of both parties to exploit for political advantage the tensions inevitably raised by this most delicate and demanding effort. Attempts to discredit the motives or intelligence of representatives on either side, beginning even before the Board was formally constituted, did not help. In this place, I have to say that Members of the Congress, too, have sometimes made the Board's task more difficult, not only by talk but by legislation. Provisions of the Economic Stabilization Act Amendments of 1971, especially those dealing with fringe benefits, were surely extremely mischievous for successful wage control. (If history is any guide at all, the Congress is likely to write in some equally mischievous amendments dealing with price controls, once these controls should begin to bite.) I surely hope that election-year pressures for further political intervention can be resisted on all sides!

Given the basic dilemma which must face the public members of the Board—the need to weigh the requirements of effective stabilization policy against possible threats to the very survival of the Board that might arise either from a walkout of some of its members or from what might be a socially, politically, or economically intolerable strike against its decisions—it is difficult for an outsider to second guess the Board's decisions, as appalling as some of them may and do seem. One can only hope that the Board's survival in the face of these threats will gradually build up its own confidence, and that of those subject to its regulations in its continued ability to survive—even as it exercises, progressively more rigorously, its stabilization responsibilities.

One can, perhaps, fairly criticize what appear to have been dreadful staff and administrative arrangements at the Pay Board. I cannot believe that these impediments to the Board's successful operation were unavoidable. One understands, however, that these arrangements are now finally beginning to shape up.

The only other specific criticism I will make of the Board has been its to me incredible unwillingness or inability to bring the Construction Industry Stabilization Committee into line. The approvals granted by this Committee have continued further to widen the already gaping margin between construction pay and all other wages, creating problems for overall wage stability not just this year but for many years to come.

The *Economic Report* argues that, despite the many exceptions to its own basic standards which the Pay Board has felt itself forced to grant, there is a good chance that the average advance of wage rates may be held to the neighborhood of 5½% during 1972. The *Report* clearly admits, however, that there are many routes whereby the average pay increase in 1972 could some substantially to exceed 5½%. And there are still other routes that the *Report* did not mention—in particular, the pressures that will arise to abandon the 5½% basic standard, once the advance in the Consumer Price Index threatens to return to the 3½ to 4½% range later this year, as it easily could. But should the basic 5½% standard be breached, or should, through other means, the average increase in hourly wage and fringe benefit costs in 1972 rise appreciably about 6%, I fear that the entire stabilization program—including the freeze—would have to be judged not merely a waste and a failure, but worse, because of the portents it would carry for our future efforts to restrain inflation.

SUPPORTING ACTION

I believe that every action, on the part of the Federal Government, State and local governments and agencies, and of all private persons and organizations, ought fully to support the efforts of the Pay Board and Price Commission to achieve effective stabilization of the price level in the months ahead.

I do not mean to confine this to moral support. In particular, the wage policies of governments at every level have often not been consistent with the Pay Board's policies. Federal farm policies and import restraints generally remain quite inconsistent with our anti-inflationary objectives. If we really mean business about stopping inflation, governments—and the Federal Government in particular—should be using every available instrument to lower or stabilize particular prices, and to bring the rate of wage increase into a range consistent with the reasonable stability of prices. I do not see evidence of this determination in the day to day activities of the Federal Government.

PHASE III

I have commented on the Phase II controls mainly on their own terms—that is, accepting the presumption that the general design for Phase II is correct. However, if you should recall my testimony of last August 31, you will remember my urging that Phase II should basically comprise a period of transition—as brief a period as possible—toward longer-term arrangements quite different from the system we now have. These longer-term arrangements would be designed to deal on a continuing basis with what I see as the endemic inflationary problem of our society—a perennial creeping inflation, intermittently threatening acceleration to a walk or trot. In my judgment, this longer-term system must be flexible and basically "voluntary", although some last-resort means of legal compulsion must be available to deal with specific cases of flagrant and significant flouting of the program. Devising and carrying out such a program is an even more difficult challenge than that of making a fully compulsory system work.

I sincerely hope that serious and organized planning is going on for a Phase III of this general kind. The Administration has been less sharply insistent in recent months than it had been earlier that its objective was simply to restore completely free markets, in which businesses and unions could set prices and wages as they pleased, with no reference to the public interest. The former Chairman of the Council of Economic Advisers, my University of Michigan colleague, Paul McCracken, made clear at the time he left the Government his personal belief that such an outcome was an unreasonable expectation; but I have seen no official statement either clearly accepting or clearly disputing this point of view.

Perhaps it is unreasonable to expect that, prior to the elections, the Administration will either begin to move toward such a more permanent and more flexible system of incomes policy, or even to make clear its intentions in this respect were it to continue in office. Thus, I assume that the stabilization program will operate in much the same way as it has been during the months ahead. But I would sincerely hope that no actions would be taken prior to the election which were inconsistent with the possibility that either a re-elected or a new Administration might subsequently which to transform the present system of compulsory controls into a more flexible and mainly voluntary continuing system of incomes policy.

I would again emphasize, however, the necessity for the leaders in both parties to devote much hard thought and imaginative insight to the design of such longer-term policies, and of the machinery to administer them. I would even suggest that this Committee might do an important service by commissioning some studies and/or scheduling some hearings on these matters during the remaining months prior to November.

Chairman PROXMIRE. May I say this last suggestion is one we take very seriously. I do intend to ask both the Price Commission and the Wage Board to come before this committee next month. I think some of the questions which I raise, which frankly have not been raised by Members of Congress to the best of my knowledge, as sharply and as clearly as you do this morning, should be asked of the Price Commission and Wage Board. I am sure they will be.

Mr. Harberger, go right ahead, sir.

## STATEMENT OF ARNOLD C. HARBERGER, PROFESSOR, DEPARTMENT OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. HARBERGER. Thank you, Mr. Chairman.

Mr. Chairman, there are two points from which I enter this debate. The first is a long study of inflation in Latin America, and the second is that I was a member of a bipartisan task force on inflation that prepared a report on this subject in the period between President Nixon's election and his inauguration.

Drawing on my Latin American experience, I must state my long and continuing belief that in the United States the public mind has grossly exaggerated the dangers and harms that inflation brings. No one observing the economic performance of Brazil in the last 3 or 4 years, where they have had real economic growth at 9 and even more than 10 percent per year—they have had nontraditional exports, that is, those other than coffee and cotton and things like that, growing at more than 50 percent a year; their foreign exchange reserves are now at $1.5 billion, an all-time high for that country, and very large in relation to its economic size—nobody who looks at that can believe that inflation in and of itself dooms a country to an inadequate economic performance.

In Brazil and other countries, many of the injustices that are usually linked to inflation have been avoided. Savers are adequately protected against it with interest rates high enough to cover the inflation, and those engaged in the export trade, who are often penalized under inflation, as production costs rise while world prices remain constant, are protected in Brazil by a policy that keeps the exchange rate moving along with internal prices and costs.

The package of policies that I have just described—interest rates that reflect the inflation, indexed bonds and other obligations, steady adjustment of the exchange rate to the inflation, and so forth—is one that I have urged for the inflationary countries of Latin America for more than a decade.

It was first applied by the Frei government in Chile, starting in early 1965, followed by Colombia in 1967, and Brazil in early 1968. Very recently Argentina has gotten into the game.

In all these cases it proved successful, in the sense of producing satisfactory real economic growth, unusually good export performance, and a minimum of distortion or dislocation of productive activities and of resource allocation in the internal economy.

And contrary to many people's prior fears, these policies—of making it easier to live with inflation by minimizing its distortons, inequities and other costs—did not in any way add fuel to the inflationary fires.

Quite the opposite, in each case their adoption was followed by a reduction in the inflation rate—in Chile from more than 40 to less than 20 percent in 2 years—after which a spate of fiscal irresponsibility broke the back of the stabilization effort—in Brazil from 30 to 25 to 20 percent, and in Colombia very gradually from around 10 to around 7 percent over a 3-year period.

I think one should take for granted that economic success in the real side of the economy isn't itself prejudiced seriously by inflation rates much larger than we have seen.

I now turn to some reminiscences concerning the inflation task force. It would be presumptuous indeed to say that this task force "wrote" the Nixon administration's game plan on price stabilization, but it is also certain that there are few if any significant discrepancies between the task force's diagnosis of the problem and its recommended strategies on the one hand, and the corresponding diagnosis and strategies stated by the Council of Economic Advisers during the first 2 years of the Nixon administration. The task force and the Nixon Councils of 1969 and 1970 agree, in particular, on the following propositions:

1. Inflation by itself is no permanent solution to a problem of potential unemployment. Put in another way, there is no significant permanent trade-off between inflation and unemployment.

If a 4 percent rate of measured unemployment represents the minimum rate that can be achieved on a sustainable basis without inflation when people are operating on the expectation of zero inflation, 4 percent (or something very close to it) is also the minimum rate that can be achieved and sustained when people are expecting a 6 percent rate of inflation, and that is what the monetary and fiscal authorities give them.

The same would go if the people expected a 10 or 15 percent rate of inflation, and those expectations were validated by the monetary and fiscal authorities. The general idea that the minimum sustainable rate of unemployment is not itself very different for different rates of inflation is sometimes summarized in the economic literature under the concept of the "natural rate of unemployment" (4 percent in my example and in the opinion of most U.S. experts).

Both the task force and the Council accepted the general idea of a natural rate of unemployment, though neither believed that the natural rate was immutable. Both felt that while this rate could not be influenced significantly by changing the rate of inflation, it could be influenced by measures to improve the functioning of the labor market through such things as better job information, increased retraining facilities, and a lower minimum wage for teenage workers, and both groups so recommended. (Parenthetically, the Latin-American experience gives ample evidence that the mere existence of inflation does not buy a country's way out of the unemployment problem: Argentina and Brazil have on occasions suffered severe employment crises, and Chile milder ones, at rates of inflation in excess of 30 and even 50 percent.)

2. Though there is no long-term tradeoff between inflation and unemployment, such a tradeoff generally exists in the short run. In general, some reduction in unemployment can be bought by generating in the economy an inflation rate that is higher than what people expect, that is, by genearting a 5-percent inflation when people expect 3 percent. But this is only a short-term phenomenon because people readjust their expectations on the basis of experience.

When they come to expect 5 percent, one is back to the natural unemployment rate again, and to put some extra zip into the economy at that point the authorities would have to generate a 7- or 8-percent inflation rate. And the extra zip would once again be eroded as people came to expect this higher rate to continue.

Sadly, all this has its implications, in reverse, for the problem of achieving stability when an inflation is already underway that has been incorporated into people's expectations.

To get them to expect less inflation, that is, to reduce their expectations from 6 percent to 4 percent, one has to give them a basis for that change in their ideas. This, in general, entails exposing them to a lower rate than they expect, and that is likely to mean the opposite kind of tradeoff between inflation and unemployment—that is, less inflation, and an unemployment rate above the natural rate. Neither the task force nor the Council wanted it to be that way, but both felt that the short-run tradeoff just described was a fact that had to be lived with, one based on the best available theoretical studies and empirical evidence concerning our economy.

Thus, it was reluctantly accepted that a price, in terms of greater-than-normal unemployment, would have to be paid in the process of winding down the inflation.

3. Though it appeared inevitable that stabilization could only be achieved at a price in terms of unemployment, both the task force and the Council went to great lengths to find the strategy that would minimize this price.

Both groups concluded that the social and economic costs of a gradual winding down of the inflation over a period of 2 or 3 years would be significantly less than those that would follow from the "shock treatment" of jarring economic expectations loose by abruptly slamming on the monetary and fiscal brakes hard, come what may.

A little extra unemployment—perhaps one-half percent to 1 percent—for a period of 3 years, jogging down the inflation rate gradually from 6 to 5 to 4 to 3 percent, was a far lower price than the perhaps 5 or 6 percent extra unemployment that would induce people to revise their expectations downward from 6 to 3 percent, all in a single year.

4. Both voluntary guidelines and mandatory controls were to be avoided. It was naive to believe that truly voluntary guidelines, that is, guidelines set with no stated or implied sanctions whatever against violators, would have any significant effect. Similarly, to the extent that guidelines under previous administrations had had a measurable effect, most of this resulted from the threat—implied if not openly stated—of retaliation against violators through the use of any of a multitude of "persuaders" over which the administration had discretionary power.

Both the task force and, I believe, the Council, felt this type of arbitrary use of administrative power offensive; in addition, it was grossly inequitable. Selected industries felt the full weight of administrative pressure, while many others, with higher price rises than those selected, felt none at all.

Mandatory controls on prices and wages were judged to be unnecessary if appropriate monetary and fiscal policies were pursued, downright pernicious in their absence, and cumbersome and costly to the economy in any event.

They had no place whatever as an instrument of longrun policy, and in the short run any hypothetical benefits they might produce in the area of inflation control would be small, and would be likely outweighed by their costs in other dimensions.

So much for the background. Let me now turn to almost everybody's question, "What went wrong with the Nixon game plan?" My answer may startle you, however, for I am not sure that the game plan was wrong in any fundamental respect.

I still believe that there is no longrun tradeoff, and that there is a shortrun tradeoff between inflation and unemployment.

I still believe that a price in terms of added unemployment must be paid for the winding down of an inflation.

And I still strongly oppose "voluntary" guidelines, and am skeptical even in the best of cases about the wisdom of imposing mandatory controls even temporarily.

In short, I am not prepared to follow the Council of Economic Advisers in its abrupt turnaround of August 15, 1971, even though I must recognize that from President Nixon's own point of view, that turnaround was a masterful political stroke.

He responded to a felt need on the part of our society, with labor—thinking of price controls—and business—thinking of wage controls—all clamoring for them, and in the process made noncontroversial what otherwise would have been an important campaign issue.

Perhaps this is the point at which to insert another parenthetical comment, relevant to my judgment above, concerning how people look at wage and price controls. It is no accident that the polls taken just after August 15 showed workers approximately 75 percent in favor of the freeze and about 25 percent against it—assuming wage increases are approximately evenly distributed throughout the year, about 25 percent of workers were frozen out of the increases they had coming, while the remaining 75 percent could sit back and enjoy the price freeze.

At the same time, I cannot in good conscience assert that either the phase I freeze or the phase II controls constituted a gross calamity for the American economy.

In the first place, it is conceivable, as the Council asserts, that the imposition of controls may improve in some degree the tradeoff between inflation and unemployment. Expectations about future price increases, which it should be evident from my earlier analysis are a crucial variable in any stabilization effort, do not respond only to observed changes in the inflation rate. Latin American experience is conclusive in this regard. When a man takes power in whose intentions and capacity to reduce the rate of inflation the public really believes, as was the case when Alessandri was elected President of Chile in 1958, and when Krieger Vasena became Minister of Finance in Argentina in 1966, that fact in itself can induce a change in the public's inflationary expectation.

By the same token, if the public's reaction to phase II is to really believe that this year's inflation rate will be 3 rather than 6 percent, that fact in itself will contribute to the achievement of the administration's stated aim.

This is the position that the present Council has taken, and while I cannot allege that it is totally beyond the range of possibility, I would assign it only a very small probability.

In the second place the present control mechanisms have been designed by people who are fully aware of the pitfalls that await any full-blown and rigid price and wage control system. Both the designers and administrators of the present system have tried and continue to try to keep to a minimum the amount of interference with the natural operation of the price mechanism in guiding the allocation of the Nation's resources in the production of goods and services. Herbert Stein, Ezra Solomon, Arnold Weber, and Jackson Grayson, in particular, are economists of high professional stature with a demonstrated appreciation of the critical role of the price mechanism in our economic process.

I am confident that they will do their utmost to avoid the gross errors into which many price control schemes have stumbled, the worst of which is trying to repeal, by administrative fiat, the law of supply and demand.

Yet, while I issue no cry of impending doom concerning the present control system, and while I retain a high professional regard for its authors and administrators, I am still skeptical concerning its results.

I am convinced, in particular, that the great bulk—probably two-thirds—of our labor force lies outside the net of effective administration of controls, and the same is probably true of the prices of more than half the goods and services that make up our gross national product.

The movements of these wages and prices will be mainly governed, as in the past, by the interplay between existing inflationary expectations on the one hand and the general stance of our monetary and fiscal policies on the other.

The Price Commission and the Pay Board will surely have some modest influence in restraining increases of those prices and wages that do fall within their administrative net, but it is hard to see how this influence can be more than marginal.

The guidelines that have been set are already reasonably generous, and the very sensitivity of their administrators to the potential harm that more rigid controls would wreak insures that there will be a fair number of exceptions on the upward side—of which we have already seen a few. Indeed, according to Professor Ackley's testimony, I would say more than a few.

On the other side, we must recognize the subtle but very real influence of controls to actually increase prices and wages. The landlord who would be willing to rent a vacant apartment for $150 a month in the absence of controls may hold out for $160 or $170 if he fears that future increases will be denied or arbitrarily limited.

Workers who might in normal circumstances be willing to settle for a 2-percent raise this year may fight for a 5.5- or 6-percent raise to establish a higher base for future controlled increments.

And it is hard for me to imagine that anyone who has been to a supermarket recently can avoid the conclusion that there has been some significant juggling upward of the summer 1971 prices on which the controls are supposedly based.

When the partial effective reach of the controls—which in my view is a fact of life that must be accepted, for trying to alter it would only make things worse—the likelihood—and probably the necessity and wisdom—of numerous upside exceptions, and the perverse incentive toward preemptive wage and price increases that otherwise would not occur are all taken into account, it is hard to avoid the conclusion that the influence of the control mechanisms on the rate of inflation in this country will be at best slight.

And when one weighs this possible slight gain against the cumbersomeness of even this control machinery, and the economic cost—not disastrous but still inevitably present—that it entails, one can fairly wonder whether the whole exercise is worth the effort.

There remains the task of trying to diagnose more clearly our present situation and to distill in some way the lessons of the past 3 years' experience. Here I am afraid that I have no pat answers to offer but only a couple of, perhaps, sobering observations.

First, the apparent tradeoff between inflation and unemployment has been much more unfavorable than most of us—certainly the task force and the Council—expected. This can well be a new fact of life to which we must adapt our policies. And it gives rise to the gnawing question, what would it have cost us, and how much would we have benefited in terms of greater output and employment—if the game plan had been to hold to, say, a steady 6-percent inflation without trying to press it down?

This would have required an earlier and even more forceful effort to free up international exchange rates—which, by the way, in my opinion was the only real plus in the August 15 package—but if it would have yielded even a semblance of the prosperity that Brazil has been able to achieve with a steady, almost institutionalized rate of inflation, it may well have been eminently worthwhile.

The issue here is whether the shortrun costs of getting from a 6- to a 3-percent inflation might not outweigh the longrun gains.

Second, recent events give rise to the equally gnawing question of whether the so-called natural rate of unemployment may not have risen above the 4-percent figure that everybody cites.

On the one hand our labor force composition has shifted toward a somewhat higher proportion of those groups (particularly married women and the young) with traditionally higher unemployment rates, and with greater volatility between labor-force and non-labor-force status.

This latter volatility means, by the way, that the fact of not being employed does not entail, for these groups, the same degree of hardship that we normally have in mind (usually thinking of the principal breadwinner of a family) when we speak of the costs of unemployment.

On the other hand, even when it comes to the principal income earner of a family, the costs of being unemployed seem to be somewhat less than they used to be.

Taxi companies in Chicago and major cities still advertise for drivers, promising incomes from $125 to $150 a week, and sheer honesty requires us to recognize that many of the unemployed are capable of occupying such a post.

This gives rise to the questions of why, with 6 percent overall unemployment, we have not had an oversupply of taxi drivers, and other similarly accessible occupations that undoubtedly exist?

It is noteworthy, also, that in the 1970 census, unemployed males were asked what was the minimum weekly wage which they would accept. The responses, for adult males in the South Side ghetto area of Chicago, averaged $107, and for teenagers, $88 per week.

In asking these questions I do not want to imply that the problem of unemployment may be a nonproblem, but only that its nature and the costs involved may be substantially different from the image about them that we carry in our minds, inherited in many cases from the very different world of the 1930's. Rather, and without venturing to prejudge the answers. I personally feel that the serious investigation of the issues that these questions raise should have high priority at the present time, and that the results of such investigation will play a profoundly positive role in guiding the future course of policy in the area of employment, inflation, and stabilization.

Without seriously confronting these problems, we may be just talking in sort of a dream world.

Thank you very much.

Chairman PROXMIRE. Thank you, Mr. Harberger.

Please proceed, Professor Baumol.

## STATEMENT OF WILLIAM J. BAUMOL, PROFESSOR, DEPARTMENT OF ECONOMICS, PRINCETON UNIVERSITY

Mr. BAUMOL. In dealing with the issue, we must recognize that it is not a matter of inflation alone. What helps to render it intractable is the simultaneous presence of "mild" inflation and "mild" unemployment. The most noteworthy and critical observation that I can offer in this respect is the almost universal failure of policy to deal effectively with this issue.

Various versions of what is called "incomes policy" have been tried in many Western countries, in almost all cases without notable success. As a consequence, I am rather surprised at the remarkable lack of modesty of my fellow economists in an area in which they have a great deal to be modest about.

I am surprised at their willingness to offer relatively unqualified policy prescriptions suggesting that all would be well if monetary supply were increased by $x$ percent a year or such and such were done in relation to trade union negotiations, or something of that sort.

I do feel that our profession has much to offer on many policy issues, and I certainly do not want to sell our advice short. But in this area, what it has to offer is still highly tentative and imperfect, and I would certainly urge my colleagues to reflect this in their utterances and urge the public to take this into account in their evaluation of those utterances.

Wage and price controls in particular, it seems to me, must be regarded with considerable skepticism despite the fact that there are some economists who have gone quite far in endorsing them. Certainly, it is quite clear that universal wage and price controls are virtually unenforceable without enormous and cumbersome administrative machinery. And even then it is virtually impossible to enforce them without imposing very great inequities and major inefficiencies on the economy.

By major inefficiencies I do not mean just the small departures from theoretical norms which economists who like to play with models of perfect competition are likely to cite to us. I mean here systematic departures from a viable balance between prices in major sectors of the economy.

I cite, for example, the case of the service sector which, because of its limited opportunities to increase its productivity, must be expected to increase in its relative costs perhaps 2 to 6 percent per year compounded, an estimate which is confirmed by virtually every service sector that I have had the opportunity to study.

If, in fact, prices are not permitted to reflect those differentials, there is the very real danger that major portions of the service sector may effectively be strangled. But such differentials which, over a very short period of time may become large indeed, are very difficult to determine administratively because it is not true that one can pick a fixed differential and say that is appropriate for all service activities. One must be able to decide case by case, firm by firm, or service by service what is the appropriate differential in price, and this is where any attempt at an efficient and viable sort of control operation breaks down.

Even were it possible for such differentials to be determined, they might not be viable politically because the pertinent agency would then be forced to face the general public and, in effect, endorse rises, for example, in medical costs and automobile insurance much more rapid say, than those in the costs of electricity or telephone service, because otherwise private enterprise will no longer be able to offer those services.

Certainly, current price and wage controls seem to be falling into all of these difficulties. They have not attempted to provide the machinery that really can impose effective controls. They really have not adopted some sort of systematic procedures that can undertake to provide intelligent and carefully designed differentials between sectors of the economy. In all of this, they seem to have contributed significantly to business uncertainty that has impeded the progress of recovery.

Price and wage controls are also dangerous because they tend to undermine the rewards and, hence, the motivation for efficiency. This seems to me a luxury that our economy can ill-afford, given the threat of foreign competition and the problems of maintaining growth in our per capita incomes.

Certainly, the motivations for efficiency in our economy seem recently to have had few enough defenders. The free market system provides this motivation by generous rewards to those who prove their efficiency and merciless penalties upon those who do not.

Yet we find ourselves faced with the proposal that we use as a precedent for others the scandalous subsidies designed to save a firm such as Lockheed from bearing the penalties of its management's past performance. What better way can there be to undermine the economy's ability to perform effectively?

So far my remarks have largely avoided any attempt to formulate a program to deal with the problem of inflation. This was, of course, deliberate, a reflection of our limited understanding of the problem. But let me close with an attempt at a few more affirmative comments, some of them representing the obverse of points I have already made:

1. In seeking to avoid a troubled period of simultaneous inflation and unemployment incomes policy is not the only relevant instrument. On the contrary, a great deal can be accomplished by making certain that present and future expansionary monetary and fiscal measures are not pushed too far too fast.

2. In any attempt at a trade off between inflation and unemployment it is a mistake to consider the two to be equally serious problems. An economy can gradually adapt its contractual relationships and can learn in other ways to offset some of the most serious consequences of rising prices. On the other hand, the chronic misery and wastes of unemployment and its tendency to fall with disproportionate severity

on the population groups that are already at an economic disadvantage mean that a rise in joblessness is a very high price to pay for an increase in price stability.

3. Whenever possible, we should stimulate competitive pressures that can restrict the freedom to undertake inflationary price and wage rises and which can force more efficiency on our economy. Competition may still be the instrument that is most effective in dealing with cost-push problems.

4. With all this, some sort of incomes policy may yet be unavoidable. But given its indifferent record it may be far more appropriate to seek to design measures from which we can hope to learn what really does work than to undertake by sheer guesswork to arrive at a program that is effective where none has really worked very well before. The policy which is optimal from the point of view of learning is, obviously, not necessarily the one that is most effective in controlling inflation, but where our understanding of the tools is so limited no better choice may be open to us.

Thank you.

(The prepared statement by Mr. Baumol follows:)

### Prepared Statement of William J. Baumol

The recent period of simultaneous unemployment and inflation has failed to produce much of a display of modesty by my professional colleagues, though it showed clearly that we have much to be modest about. The plain fact of the matter is that we simply have not learned any effective remedy for a simultaneous onslaught of a relatively mild unemployment and a relatively mild inflation. In recent years western governments have tried out a remarkable variety of incomes policy, the approach to the matter that is so widely recommended, and in no case does the success of the program seem to have been particularly dazzling. Yet economists continue to assert with little qualification that the government should have been doing so and so to the supply of money or such and such to the budget or something else to wage negotiations or pricing processes as though these were tried and true remedies known for their effectiveness and reliability.

The fact is that like cancer, "mild" unemployment coupled with inflation is a very serious disease, but it is usually only in private that we seem to be willing to admit that we have as yet found no cure for the economic illness. More deplorable than the likelihood that this stance may in the long run contribute little to the reputation of our profession is the possibility that it may impede the search for effective measures.

The wage and price controls that we have adopted as the instrument of our incomes policy are, of course, the most direct way of going about the matter but that need not make them the most effective. Indeed it seems to be that if they work at all it will be because they have somehow led the public to believe that they are going to work, thereby decreasing somewhat the pressures for rapid rises in prices and wages in the course of the wage and price setting process. If this symbolic act does indeed manage to change the expectations of the public then, at least for a while, the expectations of decelerating inflation may become a self-fulfilling prophesy.

However, even this is by no means certain. The limited information we have received about policy measures planned for the future seem to have contributed substantially to uncertainty in the business community and may well have helped to produce the disappointing rate of recovery. In the longer run price and wage controls inevitably run into problems far more serious. Without enormously complex administrative machinery it becomes impossible to enforce them with any degree of uniformity. Having started out with a substantial body of exempted sectors, the exemptions have grown rapidly and predictably, for every exemption produces its own inequities and increases the pressures for the next. If the prices of food products continue to mount can one really expect labor to acquiesce quietly to wage restrictions; and where liberal wage settlements are permitted can the prices of manufactured goods be held back very long?

On the other hand, even if machinery adequate for general enforcement of wage and price controls were really available it is at least arguable that a protracted bout of price regulation would itself have serious consequences for the economy. The fact is that even if prices are stable overall relative prices must change and change substantially with the passage of time if intolerable economic distortions are to be avoided. In saying this I am not referring to minor misallocations resulting from some shift in fashion and the resulting frustrations of the modified preferences. It is the balance among major sectors that is at issue.

Perhaps the most noteworthy case in point is the allocation of our labor force between the services and manufacturing. Because of the nature of their technology—the fact that capital equipment plays a relatively small role in their supply process—it has, predictably, proved difficult to obtain increases in productivity in the services anything like what the flow of innovation has achieved in the manufacturing sector of the economy. In the latter wage increases we have been offset by productivity gains while in the service sector every wage rise has largely gone into increasing costs. It must be emphasized that the difference in productivity gains is not a reflection of superior management or more efficient labor in manufacturing, but stems from the very nature of the product of the service sector—the fact that it offers little scope for assistance from capital equipment.

The implication of all this is that balance between the two sectors has required a differential growth in their costs and prices. The costs of education, medical attention, automotive insurance, the performing arts etc., have over the postwar period risen at an average rate perhaps 2 to 6 percent per year more rapidly than costs in the economy as a whole. These differentials have in many cases grown enormously in magnitude with the passage of the decades. Now any system of price controls which does not permit these differentials to continue will threaten to strangle the service sector which now employs so enormous a proportion to our labor force. On the other hand any government agency that attempts to calculate the appropriate differentials, item by item, undertakes an impossible administartive task. That is the dilemma on whose horns we are impaled. To be feasible price controls must be based on some simple and understandable rule of thumb procedure that can readily be applied to everyone impartially and automatically; but the very simplicity of the rule of thumb must before very long impose intolerable strains on the economy.

Wage controls may at first glance seem a more obvious and satisfactory way to go about the matter but these, too, lead to serious problems. The political strains imposed by wage controls and the inequities they introduce are obvious enough, and these in turn bring in other problems. One cannot expect to maintain a system of wage restraints without some parallel restriction of profits. But any system of profit ceilings with which I am acquainted has serious and perverse implications for efficiency and incentives. For example, a simple restriction of profits to $x$ percent or a heavy tax on all profits above that level, leaves unaffected the inefficient firms whose earnings would be below $x$ percent in any event, i.e., it fails to penalize the very firms whose contributions to the economy is most questionable.

The fact is that continued efficiency of our economy, its ability to continue to provide rapidly rising living standards and to compete internationally, requires that we keep up every possible pressure making for efficiency. The secret of the success of the free market economy as a producer of commodities has been its merciless penalization of the inefficient and its rewards to the efficient. Yet today we are offered all sorts of measures designed to blunt these pressures or to undermine them altogether. International trade policy threatens to produce a new protectionism that enables those of our domestic producers who are least efficient to avoid the threat of the most efficient of their foreign competitors, and the scandalous subsidies designed to shore up Lockheed are proposed as a model for a more general program to protect weak managements from reaping the rewards of their incompetence. I cannot over-emphasize the dangers of such actions for the future of our economy and the real costs our consumers may consequently have to bear.

So far my remarks have largely avoided any attempt to formulate a program to deal with the problem of inflation. This was, of course, deliberate, a reflection of our limited understanding of the problem. But let me close with an attempt at a few more affirmative comments, some of them representing the obverse of points I have already made:

1. In seeking to avoid a troubled period of simultaneous inflation and unemployment incomes policy is not the only relevant instrument. On the contrary,

a great deal can be accomplished by making certain that present and future expansionary monetary and fiscal measures are not pushed too far too fast.

2. In any attempt at a trade off between inflation and unemployment it is a mistake to consider the two to be equally serious problems. An economy can gradually adapt its contractual relationships and can learn in other ways to offset some of the most serious consequences of rising prices. On the other hand, the chronic misery and wastes of unemployment and its tendency to fall with disproportionate severity on the population groups that are already at an economic disadvantage mean that a raise in joblessness is a very high price to pay for an increase in price stability.

3. Wherever possible, we should stimulate competitive pressures that can restrict the freedom to undertake inflationary price and wage rises and which can force more efficiency on our economy. Competition may still be the instrument that is most effective in dealing with cost-push problems.

4. With all this, some sort of incomes policy may yet be unavoidable. But given its indifferent record it may be far more appropriate to seek to design measures from which we can hope to learn what really does work than to undertake by sheer guesswork to arrive at a program that is effective where none has really worked very well before. The policy which is optimal from the point of view of learning is, obviously, not necessarily the one that is most effective in controlling inflation, but where our understanding of the tools is so limited no better choice may be open to us.

Chairman PROXMIRE. Thank you, gentlemen.

All of you seem to be critical in one way or another of the present method adopted to control prices.

Mr. Ackley, you said that Members of Congress made the board's job more difficult by talk and legislation. You were referring to the Wage Board.

Mr. ACKLEY. Yes.

Chairman PROXMIRE. Can you give us examples of that, what Members of Congress and what did they say?

Mr. ACKLEY. I didn't bring along a docket quoting speeches by Members of Congress about questions before the Wage Board or questions relating to the Wage Board's responsibilities. But I am quite aware in my capacity as a careful newspaper reader that there have been remarks critical of the Board's efforts to maintain even modest minimum standards with respect to wage increases.

Chairman PROXMIRE. I am conscious of criticism by Members of Congress of the action by the Board in allowing the enormous increase for the coal miners, criticism of the Board in allowing a big increase in the railroad industry, and very harsh criticism. But I don't think that is what you had in mind.

Mr. ACKLEY. No, I did not. I expect I am properly challenged to produce evidence or withdraw the statement. If you wish, I would be glad to try to produce some evidence or withdraw the statement.

Chairman PROXMIRE. Maybe there is a quieter sentiment expressed privately that you know about, but the criticism has been right along your line, that we need more backbone; they have to be tougher. It is hard to do it, but they have to crack down on wage increases or the whole effect of this apparatus isn't going to work.

Mr. ACKLEY. That is what I like to hear.

Chairman PROXMIRE. Mr. Harberger, you present a most refreshing kind of approach. It is certainly different than anybody else's. I must say I can't buy it, maybe because it is so shocking. Your idea that in South America Brazil has done very well with 20-percent inflation, and it was much higher than that before, that they have had this enormous growth, there is at least the implication that if we relaxed a little bit about inflation, and concentrated more on the economic growth and on reducing unemployment, and so forth, perhaps forgot about controls, that we might have a better setup.

What haunts many of us, I suppose, is something that may not be as relevant, is the German experience, for example, in the 1920's, and the fact that the developing countries are so different in so many ways than this very complicated, relatively ultra modern economy that we have.

Mr. HARBERGER. Mr. Chairman, I showed my statement to a couple of younger colleagues, including Bob Gordon who testified before this committee last July, and they came after me saying, "Why didn't you go all out in that direction? Why did you hold back as much as you did?"

Chairman PROXMIRE. When you say "go all out"——

Mr. HARBERGER. I thought that what I was saying was shocking enough the way it was. I am glad you confirm my judgment. I don't want to give at all the impression that inflation in and of itself is good. I don't think anything I said in my statement implied that. In fact, I think the inflation of the kind in Brazil, perking along with everything sort of right, does have some economic costs which I think can best be expressed by thinking in terms of a slide rule where a little black line all of a sudden gets to be about a half-inch wide.

Chairman PROXMIRE. You were suggesting some ways of overcoming the worst aspects of inflation. The first thing you think about is someone who has worked all his life and has a small savings which disappears. You say it isn't necessary. In Brazil, they put it into bonds adjusted in relationship to the cost of living, interest that adjusts in relation to the cost of living, social security the same way.

Mr. HARBERGER. All of those things are entailed in a generally escalated inflation, with these kinds of protections for savers, exporters and so forth.

Chairman PROXMIRE. The remarkable conclusion you made is on the basis of the record in South America; this is not inconsistent with reducing the rate of inflation. You point out that in each of these countries the rate of inflation came down in spite of what many critics would argue would make it uncontrollable.

Mr. HARBERGER. Exactly. This confirms, I think, the basic proposition that it is the monetary and fiscal methods that will determine what your rate of inflation is going to be. To have an economy that is adaptable, as the Brazilian one is, to inflation rates, whether large or small, does not itself make the inflation rate large.

Chairman PROXMIRE. Mr. Baumol.

Mr. BAUMOL. I am very sympathetic to Mr. Harberger's views, and, I, too, am not shocked by them. But even if one regards them as unacceptable politically now, and, in effect, one can't really do something with them in their most naked form, I think they have very serious implications that one can act upon.

For example, the fact is that we are likely to have some degree of inflation that will leave many people uncomfortable over the foreseeable future. Yet many regulations we have now impede any efforts to reduce the pain of that inflation. Insurance companies find difficulties in obtaining permission to offer policies with variable annuities. There are ceilings on various types of savings accounts which prevent the savers from being compensated for the rate of inflation.

Throughout our economy we find all sorts of institutionalized inflationary penalties falling on the people we worry about most. So even if we take just the modest view that inflation is certainly less serious than a major increase in unemployment, and that therefore we are going to have to live with some degree of inflation, surely the moral of the experience that Mr. Harberger cites is that we ought to start taking away some of the impediments to the reduction of the pain of inflation.

Chairman PROXMIRE. I have thought, and I think many others do, that the most disastrous, the saddest, aspect of economic failure is unemployment. Unemployment is something that you cannot possibly reclaim. You can't buy it back. If a man loses a day's work or a week's work or a year's work, that is it. He is through.

Life is finite. Our working period is limited. That is an enormous waste.

You said there was perhaps nothing wrong with the Nixon game plan. Egad! How about the economic discomfort index? Have we ever had a situation where a game plan has gone off the track more in terms of the level of unemployment, the level of inflation, the combination? This seems by itself to be a disaster at the time he acted.

Mr. HARBERGER. Let me state my interpretation of the game plan.

The game plan was to reduce inflation slowly rather than rapidly by accepting a minimum of unemployment over what would be the 4-percent norm.

Chairman PROXMIRE. That is not the way they told this committee. When Mr. McCracken came before this committee, and when Mr. Shultz came before this committee, in 1969, their game plan was not to increase unemployment at all. They wanted to hold down unemployment. At that time it was much less than 4 percent. It was around 3.5 or 3.6. It was to hold that. Meanwhile, they felt that prices would adjust.

I don't think they ever have admitted that their game plan was to permit unemployment to increase. Maybe politically they can't say so, but privately they did. I doubt they would ever feel they should go above 4.5, let alone above 5 and then go to 6 and stay there for more than a year.

Mr. HARBERGER. My interpretation of the game plan was that 4.5 was sort of the figure that people kind of hoped would be the limit. What I feel is that the reality of the situation may be such that in order to get inflationary expectations down from 6 to 5 percent, you have to go up to 8 percent unemployment.

That is not a problem of plan. It is sort of a problem of a fact of life that one has to face. Our inflationary anticipations have proved, I think, as a surprise to everybody, to be almost totally intractable. This has led me and many other people to say maybe it would have been better just to accept a steady 6-percent inflation and rebuild our institutions in order to live with the fact, as distinct from what happened.

But if you are going to reduce inflation, I don't think you are going to talk it down. The monetary and fiscal efforts that were made certainly were aimed in the direction of pushing it down.

Chairman PROXMIRE. My time is about up. but let me say if you are as negative as you and Professor Baumol seem to be on price and wage controls, and you had the 2½ years of experience under the fiscal and monetary policy that wasn't working, I just don't see how you could come to any conclusion other than it was a failure, period. It was not working and you had to move at that point to something else. Or continue with the approach of saying it takes 8 percent unemployment, 10 percent unemployment, and that is it; we will be tough. Of course, it is tough on the unemployed. But that seemed to be the only alternative.

Mr. HARBERGER. I would say live with 6 percent inflation.

Chairman PROXMIRE. Live with 6 percent inflation.

Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Mr. Harberger, you brought up some interesting case studies in Latin America. One of them that you mentioned is Colombia, where in 1967 Colombia followed the recommendation of you and others to accept a mild rate of inflation and try to run their economy that way.

You point out that it was quite successful. That policy was accepted by Colombia, was it not, over the protests of the International Monetary Fund, the World Bank and all the other respectable authorities?

Mr. HARBERGER. Let's start from the beginning. In all of these cases it wasn't the country making an inflation. The inflation was already there. The policies that we suggested were only policies to keep flexibility within the economy during the inflationary process. There are many, many cases in which, for example, a country would have a 40 percent inflation a year and would hang on to an exchange rate at 10 pesos to the dollar for 2 years running. Now suppose you are in the export industry and your costs are going up 50 percent a year and the prices you can sell for in the world market stay the same. You really have your throat cut by that kind of a thing. But with a flexible policy that keeps the exchange rate going up along with domestic prices and costs, and the exporter is left kind of immune to the inflation process.

It is similar with regard to savers. Inflation can erode savings, but if you have the mechanism of readjustability, and sufficient high interest rates, savers are also protected.

The policies that I and others have advocated, of keeping exchange rates moving and having what we call interest rates positive in real terms, were fully supported by the Fund.

Representative REUSS. Let me turn from Colombia to Chicago, particularly the interesting point you made in your prepared statement where you suggest that maybe the unemployed are less willing to take available jobs today than may have been true in the past.

You specifically say:

> Taxi companies in Chicago and other major cities still advertise for drivers promising incomes from $125 to $150 a week and sheer honesty requires us to recognize that many of the unemployed are capable of occupying such a post. This gives rise to the question of why with 6 percent overall unemployment we have not had an oversupply of taxi drivers and other similiarly accessible occupations that undoubtedly exist.

I have a couple of questions. Of course, Chicago, fortunately, has an unemployment rate of 4 percent rather than 6 percent. That makes a lot of difference, does it not?

Mr. HARBERGER. I imagine it must make some. But I have seen in my travels around—and I look at the want ads whenever I pick up a paper—that they are always looking for taxi drivers. It isn't just Chicago, but I readily concede that Seattle could be a different case. I would certainly concede that.

Representative REUSS. It is also true, is it not, that in Chicago, being a taxi driver involves some extra hazards by reason of the construction of the el, the overhead rapid transit system with its posts every few feet and the necessity to zigzag around them?

Mr. HARBERGER. I think that the more serious hazard is the problem of being held up.

Representative REUSS. I was going to come to that. Particularly on your side of town, the University of Chicago side of town, cab driving is a hazardous occupation because of the likelihood of being mugged or held up.

Mr. HARBERGER. There are certainly a lot of North Side cabdrivers who, when they take me home, turn right around and deadhead downtown. I don't want to deny that.

Representative REUSS. I wanted to call your attention, too, to the most recent statistics on job vacancies in manufacturing as of last October. I think that is about the most recent period which we have figures on.

There were 90,000 vacancies in manufacturing, nationwide, and 1,200,000 unemployed manufacturing workers. That is 13 workers looking for each job. Two years before, in October 1969, there were about 242,000 job vacancies in manufacturing and 722, 000 unemployed workers. That was only three workers looking for every one job. There is some significance in that comparison, isn't there, on this question of to what extent, if at all, our unemployment problem is just because people don't want to take available jobs?

Mr. HARBERGER. I think this is an interesting point to bring up sort of an alternate interpretation to the sort of thing that Professor Ackley was referred to. We should recognize in the first place that less than a quarter of the labor force is involved in manufacturing in the United States, and not all of the manufacturing labor force are members of strong unions.

When you get strong unions pushing up wages to high levels, what happens is that the employers naturally try to find ways of economizing on this expensive labor. I would say that the exercise of monopolistic power by strong manufacturing unions is going to lead progresssively to a shrinking of that sector relative to the rest.

The more natural outlet for people who are unemployed will be the other 75 to 80 percent of the economy where wages are more competitively determined and where opportunities for absorption exist more readily.

Representative REUSS. Let me turn now to another subject which none of you particularly were asked to cover and didn't, the subject of governmental revenues since 1969.

I am told that the revenue yield of individual income taxes declined from about $22 billion and corporate income tax by some $6 billion a year from 1969 to 1971. Meanwhile, payroll taxes at the Federal level and State sales taxes, local property taxes, have all gone up. Of course, the Federal Government faces a very pronounced revenue shortage.

The administration is talking about—at least this is one thing that one hears about—introducing a value-added tax. I would welcome any observations any of you gentlemen may have about the revenue priorities of the administration and what alterations of those priorities any of you may think desirable.

Mr. Ackley.

Mr. Ackley. I would be strongly opposed to a value-added tax. It seems to me if additional revenues are needed, given a budget which recognizes proper priorities, there are better alternative sources that are readily available.

My first preference would be for tax reform, to close many of the loopholes, the methods by which taxes are lower for some people than others with the same income. As I believe a study which was submitted to this committee earlier suggested, a truly comprehensive reform of the corporate and individual income tax could yield something over $70 billion at current income levels and tax rates. That would be a pretty radical reform; but there are certainly large opportunities in that area.

If reform is not available, I would still greatly prefer an increase in the rates of the personal and corporate income tax, for a number of reasons which I think are well known.

As you suggest, the rate structure of both of those taxes has been eroded by tax rate reductions. If we merely went back to the tax rates that existed in 1963, we would have—I have forgotten—some $40 billion of extra revenues at current income levels. I would certainly prefer higher rates for the personal and corporate income tax to a value-added tax.

Representative Reuss. Mr. Harberger.

Mr. Harberger. I am in a sort of bind here. I have been a long-term advocate of the value-added tax, long before the present spate of its popularity came about. I always disassociated the value-added tax from the issue of progressivity. As an old public finance man, I have always felt and I still feel that progressivity is a characteristic of the system and not of an individual tax. It doesn't really matter that under a particular label rich people are paying a smaller proportion than the poor if under all labels taken together they end up paying the appropriately larger proportion than the poor. I have thought that if value-added tax were to be introduced at a given time, its introduction should be compensated by such adjustments to personnel income tax as to make the overall progressivity of the system what would be desired.

Representative Reuss. You describe yourself, then, as an almost ferocious progressivist on the income tax in order to overcome the regressive mix of the value-added tax?

Mr. Harberger. The value-added tax is approximately proportioned. The advantages of the value-added tax—and I am not at all thinking of the trade off between property taxation and value-added taxation being talked about now—its conceptual advantages are strong.

In the first place, it is the least distorting of all taxes as far as relative incentives to production and whatnot are concerned.

In the second place, it has a very broad base at a very low rate which gets you a lot of revenue.

In the third place, whenever you get into an emergency situation, where instantaneously you need more money, this tax can provide it. Indeed, I would judge that with a value-added tax, in 3 months you turn up the ticker for $10 billion without any trouble.

People would fill in their forms as usual and they would calculate their valued added the same way, but would apply a different rate. Take the Korean war excises. They came in as an emergency measure. Everyone agrees they were a terrible package of taxes. They had no true economic justification, and it took us 10 years to get rid of them. Had we had a value-added tax in effect at the time of the Korean war, it would be a matter of putting it up a percent or a percent and a half, and we would have gotten as much yield from that as from the whole messy package.

Mr. BAUMOL. I agree with Mr. Harberger in principle. Since I don't at the moment envisage the likelihood that he would get the increase in progressivity that would be needed to offset the regressivity introduced by a value-added tax, I must say that I will go down the line with Mr. Ackley's comments.

I would like to just add two other points. One is that the closing of the loopholes themselves besides bringing in additional revenues will, of course, contribute greatly to effective progressivity of the system. By increasing the effective progressivity I should emphasize that it will not only help matters on revenues today, but will help to increase revenues cumulatively over the future. That is to say, in an economy with inflation, nothing serves more effectively to meet the fiscal needs of a community than a progressive income tax system. Sweden, for example, has been spectacularly successful in financing the rising costs of its public services simply because of its high rate of inflation, and the fact that it had so highly progressive a tax system. That occurred because even people with constant real earnings were constantly reclassified into higher brackets.

They were automatically providing the revenues that were needed to meet the rising costs of public services, and without going through the painful political process of having to modify tax rates.

I would therefore advocate progressivity not only because I believe in it strongly as an issue of equity, but also because I see it as really the one device that is capable of preventing the deterioration of the public services to which our entire economy has been subject in recent years. My only worry about this whole issue, in particular the issue of closing of loopholes, is that I fear the way the political process is going to work out, and that, as happened last time, instead of tax reform things just get messier than they were.

Representative REUSS. Yes, that is up to us. They are beyond your control. But you certainly make a good point.

You have said close loopholes for equity, close loopholes to increase the revenues, close loopholes to increase progressivity and thus avoid a situation where there isn't enough purchasing power to take the product off the market. Isn't there a fourth reason to close, if not all loopholes, at least a good many of them? Don't many existing loopholes distort economic decisions and thus hurt jobs in this country?

I will give you a couple of examples. One huge loophole is the exemption of any tax whatever on capital gains realized only at death.

That, of course, causes stockholders to stay locked into particular securities when in a freer security market, if they didn't have a disincentive to get rid of that particular stock, they would be selling the stock in the old buggy whip company and buying stock and thus transferring capital to a high-technology new company. That loophole causes capital immobility.

Another loophole is the tax exempt bond loophole. It produces a remarkably thin market for municipal bonds. They will be selling them to the very wealthy taxpayers. If there were an additional option open to the municipalities, to keep their tax exempt privilege if they want it but also have the power to sell taxpaying bonds and receive from the Treasury a check for the difference in interest rates, then you would have a much broader market and a better flow of capital to our hard-pressed localities.

A third case is our tax laws on foreign earnings of U.S. corporate subsidiaries which postpone any income tax on income made abroad but not repatriated. That gives, in my judgment, an unfair incentive to export jobs from this country. I think our tax laws ought to be neutral on that.

Wouldn't you agree that many, many loopholes are pernicious in terms of our economic goals at home and ought to be done in for that additional reason?

Mr. BAUMOL. I certainly agree strongly with the general statement, that there are very serious distortions—disincentive effects that result from the loopholes. I would like to offer comments on a couple of the examples you gave.

I am chairman of the economic policy council of the State of New Jersey. When Governor Hughes was contemplating the problems that would be raised by tax reform, I urged him strongly to break from the other Governors and support the notion of exemption of municipal bonds. He said that he was convinced by the arguments but he faced a very great practical difficulty, which I think we must be sympathetic.

I said, "Would it not be desirable to ask in exchange some sort of Federal revenues which would have no strings attached and which would come with much less cost to society?"

He said, "Unfortunately, any time we give up a source of revenue and get something in exchange, we have no guarantee that it will remain without strings attached or that the present Congress can commit a future Congress, whereas the tax exemption feature does give us something which we can depend on."

I am not suggesting that his argument should be treated as the final say in the matter, but it is certainly a very real issue and one which must be faced up to.

Representative REUSS. If I could interrupt you, we have since, I think, reduced the swelling on former Governor Hughes' position, because our current loophole-plugging proposal is not to ask States and municipalities to give up their tax-exempt bond privilege. They would be allowed to retain that. They would simply be given another attractive option of a tax-paid bond with a Federal subsidy on it. I would hope that some day your advice would be taken.

Mr. BAUMOL. Thank you.

Can I just comment on one other point?

I think I may not have made sufficiently clear my grounds for advocating the closing of the loopholes. This relates to what I said earlier about the service industries. The fact is that in the United States, as in other Western countries, one of the problems that we face in financing education and financing libraries, police protection and many other sorts of public services, is that the nature of these things permits very little in the way of increases in productivity and they must compete in cost with the manufacturing sector of the economy.

As a result, the costs in these sectors have risen somewhere between 2 and 6 percent a year compounded faster than those in the rest of the economy. This means that in order to keep financing these services at the level and quality that most of us would advocate, we must have revenues coming in at a rate faster than the rise in GNP because these costs are going up more rapidly than those in the rest of the economy. What I have asserted, and I think most economists would agree with, is that progressivity in the tax system along with a built-in inflation in the economy will, in fact, help to yield those additional revenues that are needed to keep up the quality of the services provided by the public sector of the economy.

Representative REUSS. Thank you.

Chairman PROXMIRE. I would like to make a statement on what you gentlemen just said and then ask a question. You don't have to respond to the statement.

No. 1, you have a Proxmire amendment on State and local bonds which has the support of the Governors, overwhelmingly, the mayors. the Investment Bankers Association, which would provide as an alternative taxable State and local bonds with a 33⅓ percent subsidy from the Federal Government.

At the present time, the Federal Government loses 42 percent, because this is the tax bracket in which investors in State and local bonds are, it would save the Federal Government a potential $1 billion a year.

It greatly improves the opportunity for State and local bonds to sell because it broadens their market. This is the reason, of course, why we have these groups that are now for it. I think with that kind of support we have a good chance of getting it passed.

No. 2, on the value added tax, I hope you gentlemen have a chance to read one of the editorials in The Washington Post this morning. It is excellent, because it points out that the property tax, too, can be made more progressive, which Wisconsin has just done. It was made more progressive by providing exemptions for low-income persons. Some 10 States have followed our State's example.

Furthermore, you can eliminate the discrimination in the property tax by making it statewide. There is no reason why this cannot be done to meet many of the objections that we now have, from the fact that the property tax as now administered results in inferior education for people who live in districts where the residents are poor, where they don't have industry.

But with all respect, Mr. Harberger, I don't see how you can possibly disassociate any tax from progressivity. It seems to me this is the No. 1 criterion of VAT.

If you sat here in the Congress I think you would recognize what is going to happen if we get a value-added tax, with all of the principles that you can argue on it. We will have a less progressive income tax, not a more progressive income tax.

We will have less reliance on the income tax; we won't need it as much. On the value-added tax, you make a wonderful point that I hadn't thought of before. When you want money in a hurry, you won't have a surtax on the income tax, but a 1.5 percent increase in the value-added tax, which is highly inflationary, which is very regressive.

For these reasons, I hope we can stop it. We are going to have hearings before this committee on the value-added tax in depth. I invite you to make whatever statement you would like to make in connection with those hearings.

We would like very much to hear from you on the subject.

Let me ask you this, Mr. Ackley: Your statement is a splendid assessment of our present control program but it is also very discouraging. I understood you to say, though I didn't see it in your text, that the control program is responsible for most of the restraint on the rise in prices. Is that correct?

Mr. ACKLEY. I think most of the slowing down of the rate of inflation which we have observed since last summer has to be attributed to the control program, yes.

Chairman PROXMIRE. That seems to contradict a lot of the other things you say. We have a situation now, and I have just gotten the figures on the wholesale price index, which shows that in the last 2 months they have increased at a rate of better than 6 percent, the annual rate, for the last 2 months.

It doesn't indicate a very effective program. Of course, the freeze worked briefly. We all expected that, that it would work for a short time.

But then it seems that since then it is not working very well. You pointed out in your analysis that if you can't get a beter performance from your big companies that are in manufacturing than you have been getting, it would seem that the phase II program was going to be a failure.

Mr. ACKLEY. I would certainly agree that the great bulk of what slowing down there has been is attributable to the freeze and to the time lag it takes after the freeze to get the prices moving up again. I would expect that by, let's say, the end of the year, the rate of price increase, under present performance of the control authorities, will be about what it would have been if we had had no freeze and phase II. But the price level will be substantially lower because we will have had this substantial period in which the rate of increase was slowed down.

Chairman PROXMIRE. Then you have a rather profound implication that I think we may have missed. You believe that the phase II program carries with it an even greater danger simply than its current failure to bring down the inflation rate.

The serious danger is that if we experience a major failure with incomes policy, we will be reluctant to try again. If phase II doesn't succeed more than it currently appears to be doing we will be throwing away our hope of combining full employment with price stability in the years to come.

Is this the meaning of your prepared statement?

Mr. Ackley. I think maybe you have made it a little stronger than I had intended it to be. I am particularly seriously worried, however, about the prospects in the Pay Board, because it seems to me that any kind of incomes policy has to rest upon some kind of a social compact between labor and business, in which each gives up something in return for the other giving up something. And the Pay Board, in a sense, is the arena in which we see a present striving toward some social compact of this kind. I think that its breakdown in dispute and disarray would be a serious portent for our future ability to get these two back in harness, working together in the interest of price stability. That is what I mean.

If this should happen, I still do not believe we should throw up our hands and say there was no further hope.

Chairman Proxmire. It would be harder to get a future Congress or future administration to act on something if it failed.

I would like Mr. Baumol and Mr. Harberger to comment on another element. On page 24 of the Council's economic report is the following:

> The price-wage controls were meant to be emergency expedients required in the particular historical context but expected to fade away, leaving no permanent change in the system except the eradication of inflation.

Mr. Ackley, I think, has taken sharp exception to that statement.

He feels there must be a careful and deliberate move from phase II to permanent incomes policy. In other words, we need a change in the system, a change that will improve our ability to achieve full employment.

Mr. Harberger, would you comment on it? Would you be satisfied to see phase II fade away without phase III?

Mr. Harberger. Since I have very little faith that phase II will do any good at all and certainly probably will in the net amount to a net cost, I would be certainly happy to see it fade away.

When you get to the longer term problem, it seems to me, I can see something corresponding to the Antitrust Act, that kind of thing, working on monopolistic wages. My reaction when people talk about pushing up prices and things like that is to ask, what about the construction trades? What about the plumbers and the carpenters? They have been monopolized, locally, usually, usually with some sort of municipal backing by regulations of various kinds.

It seems to me that it is scandalous to have somebody installing a faucet and earning $15 an hour when there are plenty of people fully capable of installing that faucet that are ready, able and willing to do it for $3.50 or $4 an hour.

I don't think that that kind of gross exploitation of monopoly power is justifiable for any group. That goes equally for an industry group or a labor group.

But I disassociate totally the problem of monopoly from the problem of inflation. Monopoly makes these wages high relative to the others, while inflation is a ballooning of prices in general.

Chairman Proxmire. We need structural changes in the competitiveness in both the labor and industry markets. We can agree on that. We can agree on the manpower programs as a means of training people.

I am talking, however, about an incomes policy of the kind that Mr. Ackley proposed, wage-price guidelines, something of this kind. I think you or Mr. Baumol indicated it had been tried in other countries without success.

Is there some way that we can adopt this? It was tried in this country I think with considerable success over 3 or 4 years. Mr. Ackley was one of the principal architects or the principal architect, along with Mr. Heller.

Mr. HARBERGER. I had a debate with Art Okun one time on this subject, and Art cited a set of industries that had been subject to guidelines pressure and showed that during the period when the pressure was on them their prices rose less than the other industries.

Then when the guidelines came off their prices went up faster than the other industries.

I pointed out two things. One was let's make it clear that during the period when the guidelines were imposed on industries A, B and C, that all the rest of the industries really were having their prices go up faster. Doesn't that fact itself reflect the inequity of the application of the guidelines?

The guidelines industries were forced to have price increases lower than those of the rest of the economy.

Chairman PROXMIRE. It relates to your problem of competitiveness. In particular industries you simply do not have effective price competition. You don't have it in steel, you don't have it in automobiles, you don't have it in many other areas where you have an oligopoly, where you have an opportunity for a few units to really establish and fix one way or another their prices. You certainly don't have effective competition in labor markets.

Under these circumstances, if you are going to have some kind of reasonable trade-off, you can't expect to have antitrust action that will do this, though many wish they could. But you will not get it. Let's be realistic about it. If you are not going to get it, isn't there some substitute such as having forceful and effective Presidential jawboning and standards that are established and very close work with labor union leaders and industry leaders so they constantly understand precisely what we are working at and appreciate that they are being treated fairly?

Under those circumstances, why wouldn't it be possible to work like this? I understand the construction labor leaders recognize they are on a treadmill they can't get off of. They are embarrassed. They realize they are working their people out of jobs by some of these enormous increases.

If there is some mechanism, some institutional adjustment to this, that is what I am talking about. It is not that there are a great many industries but there are enough. Steel is such a bellwether.

Further, there is a ripple effect. You have a wage increase in one big union and that is likely to be translated across the board elsewhere. What is the matter with hitting it head-on?

Mr. HARBERGER. In economics I am kind of a fundamentalist in the sense that I really don't think that if a big industry got a wage increase that was totally out of line, that it would be transmitted to the rest of the economy and thus create havoc—I simply don't think it would be transmitted.

Chairman PROXMIRE. There are some. We have had experience with this so often, with this kind of thing. You said that some of the catch-up has been as a result of the fact that in other industries they were held. I think the construction settlements have undobtedly had some kind of a transmittal effect; the Teamster settlement that was made 3 or 4 years ago undoubtedly has had a highly inflationary effect.

If some other union is doing well, why shouldn't they? They don't want to take a back seat. So this example is very important to them.

For an employer, he has to look at it the same way. He sees other industries that are providing very high settlements and he is much more inclined under those circumstances, even though the economic situation might not lead him to do that, to go along with big, even inflationary, wage increases.

Mr. HARBERGER. I was at a conference in England last year where people from the United Kingdom and the United States got together for a long weekend of discussion on the problem of incomes policy. We had there not only the exheads but also several of the key members of the British Incomes Policy Board which had been disbanded. It had been tried and hadn't worked well.

We entered the halls about 50–50 for and against the idea of an incomes policy approach. After 3 long days of discussion we ended up still just about 50–50 with nobody having very much changed his mind.

I am a pessimist about incomes policy. I don't think it has worked. I think scenarios can be written, as the one you just stated, Mr. Chairman, that make it look potentially good.

Chairman PROXMIRE. Anyway, you think phase II probably should end and that is it?

Mr. HARBERGER. Yes.

Chairman PROXMIRE. Except for working in specific areas like construction and so forth to overcome obvious imbalances between the power of the union and the power of the management.

Mr. Baumol.

Mr. BAUMOL. I find myself in the middle again, by virtue of the fact that I am so impressed by my own ignorance on the subject.

I believe it would be desirable not simply to end phase II. I think, much as I consider the problem of unemployment more serious than that of inflation, given our institutional arrangements, I think inflation is a very painful experience and we ought to try and do something about it without increasing unemployment.

On the other hand, aside from saying that we ought to act boldly and with determination and in the American way, I don't really have much more to contribute at this point.

The point I am making is that I am less pessimistic than Mr. Harberger. I think we will learn with the passage of time what does work. But that is quite different from pretending that we know now what is going to work.

Chairman PROXMIRE. Do you think the wage-price guidelines in 1962–66 were failures or successes?

Mr. BAUMOL. I think they were modest and temporary successes. I remember having a session on the subject with Mr. Ackley.

Chairman PROXMIRE. The price increases were very limited.

Mr. BAUMOL. Yes; but I think partly accidental and for other reasons that they were stable. I think Mr. Ackley and his group acted just as well as they could have, given our limited state of knowledge. I have defended him before and I would do so again.

But I would certainly not defend him to the extent of saying that he was able to take a situation whose inflationary potential was enormous and that he was able to translate it into one of great stability. I don't believe that, and I don't think he does.

Chairman PROXMIRE. I will call on Mr. Ackley to respond, but before I do that I will point out that during this period we had a steady, regular drop in unemployment, and we did hold down the rise in the cost of living remarkably well, especially in view of what has happened in the past 3 or 4 years.

Mr. Ackley.

Mr. ACKLEY. I hope my position isn't misunderstood as being one that suggests that all we have to do to solve the inflation problem is to have an incomes policy. I am firmly on record over and over again that this is one of a large number of things we ought to be trying to do to deal with this long-term inflationary condition in our economy.

I was appalled a little earlier when perhaps you trapped Mr. Harberger into responding that the choice was really between finding ways to protect the victims of inflation or having wage and price controls.

It seems to me that there are so many things in addition that we can do. We shouldn't accept the idea that the tradeoff between unemployment and inflation is 6 percent unemployment in order to get 2- or 3-percent inflation.

There are a lot of things we can do to be changing that tradeoff. There are all kinds of institutional changes we ought to be trying to make in our society, to improve competition, remove rigidities, after Government policies which directly raise wages and prices.

There is another part of that package that I think we ought to be working on, and that is incomes policy. I think it would make a useful contribution, perhaps a modest one, but a necessary part of the total package. It seems important that we make it work. That is the extent of my enthusiasm about an incomes policy. It is not an enthusiasim which says you can solve all the problems of inflation that way.

Chairman PROXMIRE. Do you have a timetable, Mr. Ackley, for ending phase II?

Mr. ACKLEY. As I said earlier, my view is that phase II ought to be a transition period as short as possible toward a much less comprehensive and compulsory system.

Chairman PROXMIRE. Is it realistic for us to expect it to be dropped before the election?

Mr. ACKLEY. I don't know. Earlier I had predicted that the administration would end phase II on September 15 by simply declaring we had won victory.

Chairman PROXMIRE. The George Aiken approach in Vietnam.

Mr. ACKLEY. Yes; I think it depends on the extent to which the public support for price and wage controls continues to erode. I think we have all observed that when there are no wage and price controls the public is all for having them, but once we have them public support quickly begins to disappear. It has already happened.

It is very possible, in my view, that by September 15 or sooner wage and price controls will be considered a liability by the administration and they will be dumped.

Chairman PROXMIRE. I take it that all of you gentlemen, though Mr. Baumol said it explicitly, that unemployment is the more serious problem than inflation?

Mr. HARBERGER. Yes.

Mr. ACKLEY. Far more serious. I agree with Mr. Harberger that we frequently exaggerate the cost of inflation. The true cost is not properly represented in most popular discussions.

Chairman PROXMIRE. And the cost of getting it down always seems to go to the person at the bottom of the totem pole, the poor. They are the ones who have to suffer when you follow a policy of letting unemployment increase.

Well, gentlemen, thank you very, very much. This is a fine panel and you have presented very stimulative and responsive answers.

The committee will stand in recess until Monday, at 10 o'clock in the morning, when Mr. Woodcock, the president of the United Automobile Workers, will be our witness.

(Whereupon, at 2:15 p.m., the committee recessed, to reconvene at 10 a.m., Monday, February 28, 1972.)

# THE 1972 ECONOMIC REPORT OF THE PRESIDENT

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**MONDAY, FEBRUARY 28, 1972**

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 Percy.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; Lucy A. Falcone, research economist; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and Leslie J. Bander, minority economist.

## OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

In my 11 years on the Joint Economic Committee, I have always found the UAW to be among the most steadfast supporters of the objectives of the Full Employment Act. They have always stood ready to assist in providing testimony and giving us the benefit of their opinion and supplying information whenever asked. I cannot think of one instance where a committee request has not evoked quick response from them.

Our witness today, Mr. Leonard Woodcock, president of that union, exemplifies this public-spirited attitude. In his tenure as president, he has given us much wise counsel, and I cannot think of many instances where I have been inclined to disagree seriously with him. Mr. Woodcock, we have been looking forward eagerly to hearing from you today. Obviously, the problems of our economy are in the forefront of public concern at the present time, and I know of no one who is better qualified to speak for American labor than you.

I notice that you have a very comprehensive prepared statement which will be placed in its entirety into the record. It is a most helpful prepared statement. I had a chance to study it over the weekend. I understand that you will summarize it in your oral testimony so as to provide the maximum amount of time for discussion of the many issues that concern us both.

Senator Percy, do you wish to make a statement?

Senator PERCY. Mr. Chairman, I have no opening statement, other than to say I once again welcome Leonard Woodcock. I was asked recently—and I think you might be interested in knowing—at a very large business meeting why do I seem to get along so well with the UAW? The question implied that as long as I got along with the UAW so well, that then, automatically, it meant I should not be getting along well with the business community.

I said: "The only way I can explain it is that I find they are humanists and they are on the right side of so many issues that I simply could not possibly aline myself against them on these issues."

So, I feel very much as the chairman does. So many of these issues are not management-labor issues. I think this has been the great foresight of UAW. Through the years it has addressed itself to what is good for the Nation. I certainly commend you, Mr. Woodcock, for your leadership in this area. And in my own region, in the Illinois-Iowa region of the UAW, Mr. Robert Johnston and his colleagues have distinguished themselves for their leadership in working with us on many, many problems in that region.

Though I may disagree with you on certain phases of your testimony, it is highly provocative, I am not a spokesman for the administration, but if it needs a questioning voice occasionally it will find it in some of the criticisms you have levied. I find your prepared statement very thought-provoking and stimulating and it is of great service to the committee and the Congress to have such a careful and thorough analysis of the economic message of the President as you have provided to us this morning. Thank you.

Chairman PROXMIRE. Go right ahead.

## STATEMENT OF LEONARD WOODCOCK, PRESIDENT, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW), ACCOMPANIED BY JACK BEIDLER, LEGISLATIVE DIRECTOR

Mr. WOODCOCK. Thank you, Mr. Chairman and Senator Percy.

It was a little over a year ago, I appeared before this committee and said at that time we have a Government headed by an administration which follows a most erratic economic policy. Unfortunately, that statement was only too prophetic. The forecasts the administration made a year ago were far off the mark in direction of overstatement, so much so that one distinguished economist has been led to describe the 1971 economic report as "A disaster for economic science."

If the forecast for this year is equally off the mark, then, indeed, we are facing a troubled future.

In his 1971 Economic Report, the President promised that 1971 would be a better year than 1970. Yet, on the whole, it has been the weakest recovery period for any recession period since before World War II, so much so that the Federal Reserve Board headed a summary of economic events last year as "1971: A Year of Reluctant Recovery."

In that year, the gross national product grew by only 2.7 percent, compared with an average of 6.9 percent in the first recovery year after the last three recessions.

There are some striking similarities between the recent recession and that of 1960–61, but, of course, the major difference was that the recession through which we have just come, hopefully just come, was an engineered recession.

The official unemployment figures, as the committee well knows, understate the problem. If we add together the full-time unemployed, which is the official figure, plus the time lost by workers who want and need full-time jobs and can find only part-time work, plus adjustment for changes made in 1965 and 1967 in the method of counting which tends to disregard some workers actually unemployed, plus some 700,000 discouraged unemployed who have given up looking for jobs they know are not there, we find the actual unemployment rate for January, 1972, is not 5.9 percent but is closer to 7.9 percent, or a total equivalent of 6.8 million full-time jobs that are lacking.

And, of course, the hardest hit are the poor, the black, and the young.

I need not emphasize to this committee that compensation of production workers has been falling behind that of other groups. Between 1968 and 1970, considering only the median earnings of male civilian full-time workers, the real earnings of salaried managers and officials, adjusted for price changes, rose by 5.9 percent. Those of craftsmen rose by 4.2 percent, and laborers by 3.3 percent, and of operatives by only 1.2 percent. Among all manufacturing workers, the average buying power in 1967 dollars, of the average after-tax paycheck of a worker with three dependents in 1971 at $102.42 was just 1 cent higher than the $102.41 figure for 1965.

The BLS Monthly Labor Review for January proved the point that we in UAW had been saying, that the cost of living escalator formula was essentially counterinflationary, because out of 6.7 million workers scheduled to receive deferred wage increases this year, 3.6 million workers covered by escalators will receive an estimated average increase of 6.3 perecnt, while 3.1 million workers not covered by escalators, where the negotiators had to guess at the extent of the inflation to come, accounted for an average increase of 8.1 percent.

On the question of poverty, I do not need to underscore that we are unfortunately again, after a generation, moving backwards. In 1970, there were 5.2 million families, or 25.5 million persons, 13 percent of our total population, below the poverty level. Between 1969 and 1970, the number of poor persons actually increased by 1.2 million, or 5.1 percent. This is the first time this has happened since the 1930's.

In contrast to the lack of progress made by industrial workers and the poor, business and its owners are doing very well indeed. Between 1970 and 1971, labor costs per unit of production rose by only 3.4 percent. Within the same period, unit nonlabor costs—profits, depreciation, interest, rents, and indirect taxes—rose by 6.6 percent, or nearly twice as much.

Profits in particular have gone up far more than most published figures indicate. This is because the rules of depreciation have been continually relaxed more and more, so that actual profits have been hidden in accelerated depreciation charges.

Allowing for these changes, 1971 profits will be higher than those for 1969 or 1970 and will probably exceed even the previous record year of 1968.

Department of Commerce technicians have shown that in 1970 nearly $11 billion, or one-fifth of total depreciation for that year in nonfinancial corporations, was attributable to acceleration of depreciation rates and the shortening of the life span of capital equipment over which depreciation could be taken.

We had previously, before the Congress acted at the request of the administration, opposed the investment incentive credit and said that with 26 percent of capacity idle, such investment as does take place will be probably mostly for purposes of modernization to replace existing plant and equipment with more efficient facilities.

I might say that my own city of Detroit is now plagued with plant closings and plant movings being financed by the 7 percent tax credit and, indeed, this has stranded thousands of workers in the city of Detroit with lengths of service running up to 25 and 27 years.

Now, the defenders of the credit, of course, argue it will help increase productivity. But unless markets expand, higher productivity means that fewer workers are required to satisfy the demand for the products of industry.

The Economic Report forecasts that real gross national product will grow 6 percent between 1971 and 1972, and estimates that the unemployment rate should decline from the 6 percent level of December 1971, to the neighborhood of 5 percent by the end of 1972. Most economists are consistently predicting, however, that we are going to see a rate on the higher side of 5.3 percent by December, the end of this year.

Programs for manpower training and public service employment constitute one of the instruments to which the Economic Report refers with great frequency as a means of reducing unemployment. But an examination of the 1973 budget shows that the expenditures proposed for manpower training services will not be enough; 1971-to-1972 outlays for these services increased by $512 million, but the new budget will show an increase of only $396 million, or an increase of 30 percent less than the increase that was requested last year.

Chairman PROXMIRE. What page are you on now, Mr. Woodcock?

Mr. WOODCOCK. This is a summary of my own I extracted from the 93-page prepared statement. I find it difficult to break the tradition of lengthy statements. I want to emphasize, however, Mr. Chairman, we are seven pages less than last year.

Chairman PROXMIRE. Yours is a great tradition. For many, many years the UAW has done this, and I think it has been very helpful.

It is a good idea to have a good long solid prepared statement, especially if you can summarize it as effectively as you can do in this short period of time.

Mr. WOODCOCK. I would now like to address myself, Mr. Chairman, to the question of what is a tolerable level of unemployment. We are very concerned that the increasing discussion of 5 percent now is your measure of what, in fact, is full employment.

We edged up from two to three and then to four and now apparently are edging to five.

Yet, since 1947, we had average rates of unemployment below 4 percent in 9 years, or more than one-third of the time. In 4 other years, the rate was 4.5 percent or less.

And to accept the notion that because women are a greater proportion of the work force and teenagers who are a greater proportion of the population and, obviously, of the work force, that because this is the fact we have to discount that and have a lesser goal for what is full employment, is, in our opinion, wholly outrageous.

I would like to point out, too, that in fiscal 1972 individuals will get 37 percent of the $5.4 billion in tax relief, and business gets the rest, or 63 percent.

In fiscal 1973, the individuals' share will fall to 31 percent, and much of that will go to the wealthy.

By 1974, the rising benefits of the reinstated 7-percent investment tax credit will shift the balance much more sharply in favor of business. This will reinforce a tendency for corporations to pay a declining share of the cost of running the country.

In fiscal 1965, corporate taxes made up over 34 percent of Federal income taxes.

It is estimated that in fiscal 1973, their contribution will be about 27 percent, in spite of the fact that these estimates assume improved economic conditions and a substantial increase in profits.

It is calculated that the relief for business generated by new accelerated depreciation and the investment tax credit alone, not counting the DISC tax windfall, will rise to an average of roughly $9 billion per year for 1975 and thereafter.

With regard to DISC's, it has been estimated that more than half of the tax savings from this new loophole will go to the 100 largest U.S. corporations.

We would hope that Congress would undertake a thorough ongoing revision of existing tax laws to spread the burden more equitably, close loopholes and broaden the tax base. Some of the eroding features of the present individual income tax which benefit only the wealthy are the special taxation of realized capital gains and of gains transferred by gift or bequest, the tax exemption for interest from State and local government bonds, the oil depletion allowance, and the maximum tax rate on earned income.

The additional yield that could be collected in 1972 under a more equitable income tax has been estimated at $16.2 billion.

The time certainly has come to take a good hard look at the highly regressive social security tax. Every worker on a payroll pays the same rate, up to the earnings ceiling, regardless of his total earnings. This means that a worker with earnings of $9,000 or less pays 5.2 percent of it in social security taxes, while a person with earnings of $25,000 or more would pay 1.6 percent of his earnings or less for social security.

When the social security tax was instituted, 96.9 percent of all wage or salaried workers were earning no more than the maximum on which the flat rate was levied. In 1969, only 73.4 percent of employees had incomes below $7,800. In order to include approximately 95 percent of employees below the maximum, such maximums would have had to be $15,000 in 1970.

In fact, while much has been said—and not enough done—about the need for removing the poor from the income tax rolls, very little attention has been paid to removing the much heavier payroll tax burden of the poor.

In 1969, Joseph Pechman estimated that the Federal income tax bill of the families and the individuals who were officially classified as poor was $200 million a year, as compared with the $1.5 billion they paid in payroll taxes. The poor should be exempted from paying this tax as soon as possible.

To further increase the progressivity of the social security tax, we propose two additional changes: (1) The ceiling on earnings on which the tax is payable should be raised to $15,000, restoring the original principle of the tax, so it would then cover the total earnings of approximately 95 percent of wage and salaried people; (2) the Federal Government should contribute an amount equal to that paid by the employers and the employees, respectively.

Now, we have got to get our economy moving again. This is the key to the whole question of productivity about which we hear so much today. A strong increase in public service employment is the most immediate necessity. We urge immediate support for the measure to amend the Emergency Employment Act of 1971 to produce 500,000 public service jobs directly.

As part of a broader manpower policy, we encourage the development of training and upgrading of disadvantaged workers, federally sponsored in-school work-study programs for teenagers plus adequate vocational counseling, and expansion and upgrading of the public employment service is placement and counseling activities, both for workers and employers.

For the longer term, we propose a civilian equivalent of NASA to tackle some of our major problems whose impact is nationwide. For example, a civilian NASA could be given the task of coordinating all forms of passenger transportation, both within and between our cities, by developing new concepts in mass transit. It could also undertake the mammoth task of producing new housing required to meet our present and future needs.

The battle against pollution, if it is to become successful, must be fought on this same large scale. In this effort, I might say we reject the administration's proposal to meet the problem by a scale of charges or taxes on industries which pollute as, probably, an antipollution tax would quickly develop into a license to pollute.

Congress should immediately authorize increasing the amount which the administration has asked for the new Occupational, Safety and Health Act, to $150 million. Even that falls far short of what is needed, but it would provide an inspection staff of 3,000—training funds sufficient to meet the growing needs of both management and union personnel, and the kind of research money needed to carryout the Government's responsibilities under the law.

Our present patchwork system of State workmen's compensation laws also require complete revamping.

Federal standards should provide at least 75 percent of the total wage lost, whether disability is temporary or permanent, and survivors should be paid for the full period of dependency or widowhood.

Federal minimum standards for State unemployment compensation systems should guarantee workers adequate benefits for at least a year of unemployment.

We should establish a Federal fund, financed through a small tax on contributions, to reinsure private employer pension funds, so that workers will have a financial assurance that the benefits supposedly guaranteed them under the plans will, in any case, be paid.

The minimum wage, we believe, should be increased to at least $2.50 per hour. We reject vigorously the administration's proposal to reduce the minimum wage for teenagers, which would be used by unscrupulous employers as a vehicle to replace adult skilled or semi-skilled workers with young boys and girls at a reduced wage.

We oppose strongly the Cost-of-Living Council's decision to exempt only wages under $1.90 per hour from wage control; 5.5 percent of the so-called guideline would come for such workers to 10 cents per hour. We think this is a gross denial of the congressional intent.

Work should be spread more evenly in times of high unemployment by restoring the premium pay for overtime work to a level which will encourage employers to add to their work force in times of increased demand rather than schedule overtime for those already employed. Because of the substantial increase in fringe benefits which tend to increase with employment but not with the number of hours worked, overtime at 50 percent premium is still less costly than increased employment. We have established that for the auto industry—and I am sure it is equally true for most other basic industries—the overtime premium must now be at least 100 percent to give the employer any significant incentive to increase his work force rather than schedule overtime. We will be happy to supply to the staff the calculations on which we base this assertion.

Chairman PROXMIRE. Would you do that, provide that for the record?

Mr. WOODCOCK. Yes, sir; we will, sir.[1]

We support the Family Assistance Plan, although, quite obviously, the income guarantee and the basic proposal of $2,400 is grossly inadequate. It is only 58 percent of the 1971 estimated poverty threshold of $4,139. By the time FAP is implemented, that will have moved up to $4,400.

We believe families without children and unrelated individuals must be covered.

We believe the work and training test requirements should be abolished.

We believe the federally financed part of the new welfare system should be federally administered.

We are, of course, supporters of the Health Security Program embodied in S. 3, H.R. 22, and we think the President was absolutely right in July, 1969, when he said that our health care system is approaching the border of disaster.

The question is: Who will pay for all of these things about which we speak in our statement?

Well, first, in large part, they will pay for themselves. A nation never made itself poor by producing more wealth. Putting the unemployed back to work will mean more earnings and thus a wider tax base

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[1] Material to be supplied for the record was not available at time of printing the hearings.

for Federal, State and local revenues. In addition, at full employment, some $8 billion in welfare and other transfer payments could be saved.

The program of tax reform should continue in the direction of making our tax system more progressive, through the closing of tax loopholes which will increase the revenues to the Federal Government substantially.

We favor reforms of the local property tax system so that large corporations, as well as expensive country clubs, would bear their full share of property taxes.

Much could still be saved by paring more fat off the Pentagon, by closing down the unnecessary military bases that retiring Deputy Secretary Packard instanced at a point, and we certainly do not understand why we still need to maintain outside of Vietnam 2,270 military bases overseas, which we had with piston-engine aircraft, in this day of jet airlift capability where we can move tens of thousands of troops anywhere within the world in a matter of hours.

We believe, too, that the proposal we have long supported that the administered pricing system of American industry should be brought into the full light of day is the best answer to the major problem of inflation. We would hope the Congress could get away from the mandatory—failing—control system which we now have and replace it with a voluntary price-wage review board which is embodied in the bill introduced into the House of Representatives by Representative Reuss.

We think, too, inflationary pressures can be suppressed by eliminating special protections given particular industries. For example, by limiting oil imports, the Government has imposed $5 billion a year in extra cost on the American consumer.

I would like to emphasize the closing part of our statement. We need to keep our statistics clean and we compliment the chairman of this committee for his endeavors in this regard, because so much of the credibility and the faith of our collective bargaining system depends upon the acceptance of those statistics. If it should ever become a matter of belief that those statistics were being used for political advantage and political purpose, we would do a grave disservice to our entire collective bargaining system. And I would hope that in assessing the economic health of this country, which is measured in this way, that if this interference is in fact going on, that this committee should make a special investigation of this matter.

I would like to thank you, Mr. Chairman, for this opportunity to place in the record our comprehensive prepared statement and for this opportunity given me to summarize it as briefly as I could.

(The prepared statement of Mr. Woodcock follows:)

PREPARED STATEMENT OF LEONARD WOODCOCK

Mr. Chairman, when I had the privilege of appearing before this Committee a little more than a year ago to comment on the problems facing the economy, I remarked that "we have a government headed by an Administration which follows a most erratic economic policy."

Looking back, I think most of you will agree with me that that was a rather prophetic understatement.

Unfortunately, the Administration's economic forecasts of that time were equally far off the mark in the direction of overstatement—so much so that one distinguished economist has been led to describe the 1971 Economic Report as "a disaster for economic science."

If the Administration's economic forecast for 1972 goes equally awry—and I have no great confidence that it will not—then we are indeed faced with another rough and rocky year ahead of us.

In his 1971 Economic Report to the Congress the President said:

"1970 was the year in which we paid for the excesses of 1966, 1967, and 1968, when Federal spendingf went $40 billion beyond full employment revenues. But we are nearing the end of these payments, and 1971 will be a better year, leading to a good year in 1972—and to a new steadiness of expansion in the years beyond.

"We are facing the greatest economic test of the postwar era. It is a test of our ability to root out inflation without consigning our free economy to the stagnation of unemployment. We will pass that test."

He also declared:

"The basis conditions to bring about a simultaneous reduction of unemployment and inflation are coming into being. We are going to continue to slow down the rate of inflation in the middle of an orderly expansion. And we are going to do it by relying upon free markets and strengthening them, not by suppressing them. Free prices and wages are the heart of our economic system; we should not stop them from working even to cure an inflationary fever. I do not intend to impose wage and price controls which would substitute new, growing and more vexatious problems for the problems of inflation. Neither do I intend to rely upon an elaborate facade that seems to be wage and price control but is not."

We all know what was done in 1971.

Again, in his Economic Report this year, the President stated:

"Nineteen hundred and seventy-one was in many ways a good economic year. Total employment, total output, output per person, real hourly earnings, and real income after tax per person all reached new highs."

WE CANNOT JUDGE MERELY BY AGGREGATES

But we cannot judge the economy of a growing country merely by looking at aggregates. Of course total employment grew. Since the civilian labor force grew by 1.4 million between 1970 and 1971 (annual averages) employment had to grow, or unemployment would have reached staggering proportions. Unfortunately, while employment did grow, it grew less than the labor force by some 900,000, with the result that unemployment grew even faster than employment. Total output also grew, but not enough either in terms of providing jobs or meeting the needs of the people. Essentially the same thing could be said about the other economic indicators referred to in the President's Report. For example, Gross National Product expressed in dollars of constant buying power grew by 2.7 percent, a disappointing performance for the first year of a recovery period. In the last three recessions previous to the 1970 recession, real GNP grew by an average of 6.9 percent from the trough year to the next year.

FRB TAKES MORE CONSERVATIVE VIEW

A much more conservative view than the President's about the record for 1971 was that expressed by the Federal Reserve Board in its January 1972 *Bulletin*. Under the heading, "1971: A Year of Reluctant Recovery" it said in part:

"The year 1971 had started with a strong upsurge in GNP. However, this gain reflected in large measure a rebound in automobile sales following the end of a strike at a major auto company. Growth in GNP decelerated in the second quarter despite substantial fiscal stimulus and continued rapid growth in the monetary aggregates. Although consumer outlays maintained a moderate pace of growth and residential construction activity recorded substantial gains, several factors tended to act as a drag on recovery in this period: Real outlays for business fixed investment remained depressed—despite some recovery in profits—reflecting substantial underutilization of capacity; spending by the Federal Government for goods and services edged downward as outlays for defense were cut further; and net inventory investment remained modest, despite the stockpiling of steel in anticipation of a possible strike in August. Moreover, a serious further deterioration in U.S. foreign trade accounts wiped out the positive balance of net exports after the first quarter. As a result, industrial production grew very slowly, not even reaching its pre-auto-strike level; employment gains remained modest; and the unemployment rate held around a discouraging 6 per cent level."

This sombre but frank description of the developments of 1971, obviously made without any feeling of necessity to match economic analysis to the political requirements of an election year, gives little support to the extravagant claims of the Administration.

### ECONOMIC PERFORMANCE IN 1971

In its analysis of the past year's economic activity, the Report tells us:

"The year 1971 was one of limited recovery in demand and production. During 1969 the Administration had actively sought to slow down the economy in order to control inflation. . . ."

We see some striking similarities between the last recession and the immediately previous recession. Back in 1960, at a time when the country was just emerging from the worst postwar recession, the Administration plunged the economy into another economic landslide through its outdated and inept fiscal policy. In its eagerness to wipe out the Budget deficit, the federal government cut expenditures at a time when receipts were rising, thereby causing a disastrous turnaround in the fiscal balance. Between the fourth quarter of 1958 and the first quarter of 1960, the fiscal balance swung from a deficit of $11.5 billion to a surplus of $7.2 billion. In other words, within the short period of 15 months, overall demand was reduced by $19 billion, thus bringing about the 1960/61 recession.

In fiscal 1969, the same fiscal policy was put into effect. Taxes were raised and expenditures were reduced. Between the second quarter of 1968 and the second quarter of 1969, a fiscal deficit of $11.1 billion was turned into a surplus of $10.7 billion.

As the Report admits:

" . . . Those efforts had their major impact at the end of 1969 and early 1970, when the rise in demand slowed considerably and output dipped, . . ."

In effect, overall demand was cut by approximately $22 billion in one year and real GNP dropped 0.6 percent between 1969 and 1970.

The fiscal policies undertaken in 1960 and 1969 were very similar, and led to comparable results. The essential difference is that the Eisenhower Administration blundered into the 1960–61 recession, while the 1970 recession was part of a deliberate plan to end inflation by slowing down the economy at the recognized cost of rising unemployment. Another difference lies in the magnitude of the reduction in demand; $3.8 billion per quarter in 1960/61 compared with $5.5 billion per quarter in 1969/70. In spite of this, in 1960 the downswing started in the quarter immediately subsequent to the quarter in which the federal surplus reached a peak. In 1969, the downturn began only two quarters after the federal surplus reached a peak.

### WITH ONE FOOT ON THE BRAKE, THE OTHER ON THE GAS PEDAL

The delay in the 1969/70 downturn was a consequence of the ongoing expansion in nonresidential fixed investment. Between the second and third quarters of 1969, nonresidential fixed investment was the only component of final sales which showed a substantial increase in real terms. Business was taking advantage of the investment tax credit still in effect, but scheduled to be abolished. When the credit was finally eliminated, the sharp increases in real investment during the second and third quarters of 1969 had already contributed very substantially to the inflationary pressure. At the same time, these expenditures added to idle capacity and made the recovery more difficult once the downswing was on its way.

### THE GAME PLAN DOES NOT WORK

The deflationary fiscal policy was supposed to combat inflation. Instead, it succeeded in bringing about the recession while the price level continued to rise (see Table 1). Just before the plan was launched, between 1967 and 1968, real GNP increased 4.7 percent while the price level increased 4.0 percent. Between 1969 and 1970, real GNP dropped 0.6 percent and the price level increased 5.5 percent.

### THE PLAN IS CHANGED

By the end of 1970, unemployment had risen from 3.6 percent in December 1969 to 6.2 percent in December 1970. An increase of this order of magnitude had not occurred for 21 years, since December 1948. As a result, the 1971 Economic Report of the President promised an expansionary public economic policy, and the CEA set goals of $1,065 billion for the GNP in 1971 and of 4½ percent for the unemployment rate by mid-1972. The 1971 Report was careful, however, to avoid expressing its output goal in terms of real growth, which is the only meaningful way of setting such goals. We are encouraged to see that the 1972 Report does not suffer from the same lack of realism. Now that the 1971 statistics are in our hands, it is obvious that the goals for last year were not achieved. GNP totaled $1,047 billion for 1971 as a whole and prices, as measured by the implicit price deflator, rose 4.6 percent, indicating a real GNP growth of only 2.7 percent.

TABLE 1.—CHANGE IN REAL GNP AND CHANGE IN THE PRICE LEVEL 1967–71

| Year | Real GNP | | Implicit price deflator | |
|---|---|---|---|---|
| | 1958 (billions) | Percentage change | 1958=100 | Percentage change |
| 1967 | $675.2 | | 117.6 | |
| 1968 | 706.6 | 4.7 | 122.3 | 4.0 |
| 1969 | 724.7 | 2.5 | 128.2 | 4.8 |
| 1970 | 720.0 | −.6 | 135.3 | 5.5 |
| 1971 [1] | 739.4 | +2.7 | 141.6 | 4.6 |

[1] Preliminary.

Source: Department of Commerce.

There is no ambiguity concerning the goal of 4½ percent unemployment. The overall unemployment rate amounted to 6.2 percent in December 1970 and 6.0 percent in December 1971. There was no significant decline during the whole year; the rate fluctuated within a very narrow margin of 6 percent, averaging 5.9 percent for the year, the highest since 1961. Given that no progress was made in reducing unemployment during the past 12 months, there is no reason to believe that the rate will drop by 1½ percentage points in the next five or six months. The Administration has acknowledged that: the 1972 Report of the CEA now forecasts:

"With output rising at a rate of something like 6 percent a year, employment will rise strongly. This implies a fall in the unemployment rate to the neighborhood of 5 percent by yearend. . . ."

Later in this testimony we will give the reasons why we believe the 5 percent goal will not be achieved either.

### THIS IS THE WEAKEST BUSINESS UPSWING ON RECORD

The Administration's goals, as stated in last year's Economic Report, were based on the assumption that its fiscal and monetary policy would lead to an above average business upswing. On the contrary, and in accordance with our predictions and those of many other economists, there was not enough expansionary power in its policies, and the current recovery has turned out to be the weakest since before World War II. Table 2 compares the behavior of four critical indicators in the last four recovery periods. The figures can be summarized as follows: Four quarters after the trough, real GNP has risen one third less than during the previous three expansions (5 percent as compared to 7.6–9.2 percent). Industrial production, 13 months after the trough, has not yet reached the level attained in the peak of November 1969.

TABLE 2.—REAL GNP, INDUSTRIAL PRODUCTION, CAPACITY UTILIZATION, AND UNEMPLOYMENT IN PAST AND PRESENT BUSINESS UPSWINGS, 1953–71 [1]

| Recovery period | Preceding peak | Trough | 4 quarters after trough: Level | Change compared to—: Trough | Change compared to—: Previous peak |
|---|---|---|---|---|---|
| 1954–55 | (2) | (3) | | | |
| GNP (billions of 1958 dollars) | 413.7 | 407.2 | 442.1 | 8.6 | 6.9 |
| Industrial production (index, 1967=100) | 56.8 | 51.4 | [4] 59.3 | 15.4 | 4.4 |
| Capacity utilization, manufacturing (percent) | 95.1 | 82.7 | 91.1 | [5] 8.4 | [4] −4.0 |
| Unemployment rate (percent) | 2.7 | 6.0 | 4.1 | [5] −1.9 | [5] 1.4 |
| 1958–59 | (6) | (7) | | | |
| GNP (billions of 1958 dollars) | 455.2 | 439.5 | 479.9 | 9.2 | 5.4 |
| Industrial production (index, 1967=100) | 62.5 | 54.6 | [4] 67.0 | 22.7 | 7.2 |
| Capacity utilization, manufacturing (percent) | 84.0 | 71.2 | 84.9 | [5] 13.7 | [5] .9 |
| Unemployment rate (percent) | 4.2 | 7.4 | 5.1 | [5] −2.3 | [5] .9 |
| 1961–62 | (8) | (9) | | | |
| GNP (billions of 1958 dollars) | 489.7 | 482.6 | 519.5 | 7.6 | 6.1 |
| Industrial production (index, 1967=100) | 67.0 | 62.9 | [4] 71.7 | 14.0 | 70 |
| Capacity utilization, manufacturing (percent) | 82.0 | 74.5 | 82.0 | [5] 7.5 | [5] 0 |
| Unemployment rate (percent) | 5.2 | 6.8 | 5.6 | [5] −1.2 | [5] .4 |
| 1970–71 | (10) | (11) | | | |
| GNP (billions of 1958 dollars) | 725.2 | 715.9 | [12] 751.3 | 4.9 | 3.6 |
| Industrial production (index, 1967=100) | 110.3 | 102.6 | [4] 107.6 | 4.9 | −2.5 |
| Capacity utilization, manufacturing (percent) | 84.3 | 74.1 | 74.0 | [5] −.1 | [5] −10.3 |
| Unemployment rate (percent) | 3.6 | 5.9 | 6.0 | [5] .1 | [5] 2.4 |

[1] All data are seasonally adjusted.
[2] July 1953.
[3] August 1954.
[4] 13 months later.
[5] Percentage point difference; note in unemployment figures, an negative sign means lower unemployment, i.e., a positive performance.
[6] July 1957.
[7] April 1958.
[8] May 1960.
[9] February 1961.
[10] November 1969.
[11] November 1970.
[12] Revised.

Source: U.S. Department of Commerce.

As we have said, excess capacity is much greater than during any previous cycle. The rate of capacity utilization, four quarters after the trough, is still as low as it was at the trough. This did not happen in any of the previous postwar cycles. Moreover, compared to the preceding peak, the operating rate four quarters after the trough was twice as weak as during the worst previous postwar business cycle—down over 10 percentage points as compared to 4 percentage points. But the weakness of the current recovery—and the hardship it implies for millions of people—is reflected most clearly in the unemployment figures. *In fact, as far as unemployment is concerned, there has been no recovery at all. Fourteen months after the trough, unemployment is higher than at the trough.* Never before have so many people lived in a prolonged recession that is officially called a recovery. Even during the slowest expansion, between February 1961 and February 1962, the unemployment level dropped by 1.4 percentage points.

UNEMPLOYMENT IN 1971

The recession has not ended for the five million people who are unemployed. The average official rate of unemployment in 1971 was higher than in any year since 1961. Our country is just one-tenth of a percentage point away from the undistinguished honor of being one huge labor market with "substantial and persistent" unemployment. The Labor Department identifies labor market areas as having substantial and persistent unemployment if the area's unemployment rate is 6 percent or more for a year. Over the last year our country has had an average unemployment rate of 5.9 percent.

However, as this Committee learned from witnesses of the Bureau of Labor Statistics last August, this figure is actually far too low to represent total unemployment. BLS technicians conceded that the full-time unemployment rate would be running at about 6.3 to 6.5 percent today—and the same would be true of the 1971 average—if certain changes had not been made in the way BLS counted unemployment some four to six years ago. We estimate that the rate would be 6.6 percent (see Table 3). In addition to the 5.1 million officially unemployed in January 1972, we should count 742,000 discouraged persons in the fourth quarter of 1971 who, according to BLS, desired to work but were not actively seeking work because experience had convinced them that because of age, lack of skill, high unemployment in their communities or for other reasons there were no jobs for them. Another 2.4 million people work part-time, but would work full-time if full-time work was available, and their lost time represented the equivalent of 0.5 percent of the labor force in January.

TABLE 3.—UNEMPLOYMENT IN JANUARY 1972 (SEASONALLY ADJUSTED)

[In percent]

| | Current official figure | Corrected figure |
|---|---|---|
| Full-time unemployment rate[2] | 5.9 | 6.6 |
| Total labor force time lost[3] | 6.4 | 7.1 |
| Number of full-time unemployed (million) | 5.1 | 5.7 |
| Full-time equivalent of labor force time lost[4] (million) | 5.7 | 6.1 |
| "Discouraged unemployed"[5] (million) | .7 | .7 |
| Total equivalent of full-time unemployment (million) | | 6.8 |

[1] Corrected to take account of participants in certain manpower programs who prior to 1965 were counted as unemployed, and corrected to account for further definitional changes in 1967. Professor Killingsworth, in testimony before the Joint Economic Committee in August 1971, estimated that these changes in definition have reduced the official unemployment rate by at least 0.7 percent.

[2] Unemployment as a percentage of the civilian labor force.

[3] Total labor force time lost covers the lost working time of persons who are seeking a part-time job or a full-time job or who are involuntarily holding a part-time job for economic reasons, even though they want a full-time job.

[4] The lost working time of persons who are seeking a part-time job or who involuntarily hold a part-time job is expressed as the equivalent of a number of fully employed workers.

[5] 4th quarter 1971; workers who are unemployed but have either withdrawn from or not entered the labor market because they think that no jobs are available for them.

Source: Bureau of Labor Statistics.

Altogether, as Table 3 shows, and assuming that the number of "discouraged unemployed" in January 1972 was not significantly different from the average for fourth quarter 1972, the total shortfall of employment in January was the equivalent of 6.8 million full-time jobs, or 7.9 percent of the adjusted labor force.

Some areas, of course, have suffered far more seriously than others. As of January 1972 there were 54 major labor market areas with "official" full-time unemployment rates of 6 percent or more, and of these, nine had rates of 9 percent or more (including three with rates of 12 percent or more).

High unemployment has brought hardship to millions. Among the hardest hit are the poor, the black and the young. In the third quarter of 1971, unemployment among the urban poor was 10.4 percent. Poor urban blacks experienced unemployment of 14.1 percent, and poor urban teenagers experienced a devastating unemployment rate of 26.0 percent. When figures for the fourth quarter are released, we deeply regret that they will be the last figures on unemployment among the urban poor for a long time. In a move that is becoming all too familiar with this Administration, statistics on urban poverty neighborhoods have been discontinued until possibly 1973. One cannot help but suspect the timing of this decision.

For black workers, the unemployment rate was 10.6 percent in January, exactly twice the 5.3 percent rate of white workers, and up 1.1 percentage points since January 1971. During the same period, the number of workers who have been unemployed for 27 weeks and over increased by 100,000; their total now stands at 562,000.

COMPENSATION AND WAGES

Since 1966 workers have been forced to seek increases in money wages at rates in excess of productivity gains to protect their living standards against further erosion by inflation. On various occasions I have had the opportunity of demonstrating from official data, before this and other Committees of the Congress, the undeniable fact that wages increases have not been the cause of the periodic inflations from which our economy has suffered, but rather their result. In one inflation after another, prices have begun to rise while labor costs per unit of production were either stable or actually falling. In some cases unit labor cost have failed to rise for months after the price inflation had gotten underway—usually accompanied by an inflation of profits also, since with labor costs falling and prices rising, an increase in profits is virtually inevitable. Finally, however, workers who have found the buyng power of their paychecks repeatedly eroded by rising living costs have at last been forced to demand compensating wage increases.

Nor have I hesitated to admit that the wage increases demanded have at times exceeded the amount justified by price increases which have already taken place—even when allowance is also made for that portion of the wage increase justified by productivity advanced. That is to say, once inflation has seriously set in, there may well come a time when unit labor costs will show a total rise from the prior period of stability even greater than the rise of prices.

The reason is perfectly simple. When unions and employers bargain simply on the basis of their *expectations* of what the future will bring, both sides are almost certain to assume that the inflation will continue, and probably at an accelerating pace. Workers, naturally, will demand wage increases to match those expectations, and employers will find it difficult to resist the justice of their demands. The result, of course, is that the very expectation of accelerating inflation sets in motion forces which tend to produce exactly what is expected. That is one of the reasons why inflation is so difficult to control once it has got a firm grip on the economy.

THE COST-OF-LIVING FORMULA IS NONINFLATIONARY

That is also one of the reasons why we have always insisted that the cost-of-living escalator formula first negotiated almost a quarter of a century ago between the UAW and General Motors Corporation, which has since spread through most of the auto industry and into other industries also, is basically noninflationary—because if higher prices result in the need for compensating wage increases, the wage increases do not take place until *after* prices have actually risen. There is no question of raising wages in expectation of price increases yet to come. In fact, the balance has at times been too much the other way, as in the period 1967 to 1970, for example, when, as the result of an experiment which we in the UAW intend never to repeat, there was a gap not of months but of years between the price increases and a major part of the wage increases required to compensate for them.

The reason for my having raised this question at this time is not just to restate an abstract theory of wage and price behavior, but because recent data prove that the UAW formula is not only correct in theory but effective in practice.

In the *Monthly Labor Review* for January 1972, an article by Michael E. Sparrough and Lena W. Bolton entitled, "Calendar of Wage Increases and Negotiations for 1972" points out some pertinent facts.

Due to the accident of timing of contract expirations, there will be a relatively light collective bargaining schedule this year, but a greater than average number of deferred wage increases under existing agreements. The number of workers covered by cost-of-living escalators will be at an all-time high.

Based on BLS analyses of 2,022 contracts covering 9.4 million workers, some 6.7 million workers will receive deferred wage increases this year.

For the 3.6 million workers covered by escalators, the average scheduled increase is 4.5 percent, plus whatever is produced by the escalator. (For most UAW members the scheduled increase, or "improvement factor" is 3.0 percent.) On the authors' assumption of a 3 percent rise in the CPI, the resulting increase for the group covered by escalators would average 6.3 percent. (I presume this is based on the fact that all escalators do not compensate fully for CPI increases. Even if they did so, the average increase for groups covered by escalators would be only about 7.6 percent.)

By contrast, the average increase already scheduled for the 3.1 million workers without escalators is 8.1 percent, significantly higher than that anticipated for the group with escalators.

It may seem strange for a trade union leader to be hailing a formula which gives the affected workers the prospect of a smaller wage increase than those not covered by such a formula. But what the workers covered by escalators may lose this year in cents-per-hour, is made up for them by the assurance that their modest scheduled wage gains are protected against erosion by *any* increase in the Consumer Price Index. And as partakers in the benefits of a stable economy, they and all other consumers will be protected by the knowledge that their escalator protection cannot produce one-tenth of one percent rise in the CPI, because it does not come into effect until *after and unless* the CPI has already risen.

On the topic of compensation and wages, the Report asserts:

"Increases in average hourly compensation in the private nonfarm sector accelerated sharply from late 1965 until 1968, then leveled off at an average annual rate of increase of about 7 percent until the freeze was instituted in August 1971."

In spite of the workers' efforts to protect their living standards against erosion by inflation, it was only in mid-1971 that the average production worker with three dependents was bringing home a paycheck with as much purchasing power as his paycheck of October 1965. On this matter, the Bureau of Labor Statistics, in its February release on Productivity, Wages and Prices, explains:

"The rise in average hourly earnings of workers in the private nonfarm economy slackened steadily after the first quarter of last year. Nevertheless, because of gains in weekly hours of work and a slowing uptrend in prices, the purchasing power of weekly earnings rose almost as much in the fourth quarter as in the first."

Earnings of some occupational groups, except professionals, managerial employees and service workers, have increased much more rapidly. The median earnings of male civilian, year-round, full-time workers by occupation for 1968 and 1970 were as shown on Table 4. (No data are available for 1971.)

As the table shows, operatives and kindred workers, the group most likely to be associated with strong labor unions, experienced the smallest percentage increase in income of any occupational group shown. But the snail's pace of real progress among this occupational group from 1968 to 1970 can be seen even more clearly in the last column of the table, when the percentage change in earnings is adjusted by the change in the CPI. The real progress of operatives and kindred workers was 1.2 percent, well below the long-term trend of productivity growth.

TABLE 4.—MEDIAN EARNINGS OF MALE CIVILIAN YEAR-ROUND FULL-TIME WORKERS, 1968–70

| Occupation of longest job | 1968 | 1970 | Percentage change: Current dollars | Percentage change: Adjusted by CPI [1] |
|---|---|---|---|---|
| Professional, technical, and kindred workers (salaried) | $10,243 | $11,937 | 16.5 | 4.4 |
| Managers and officials (salaried) | 10,661 | 12,597 | 18.2 | 5.9 |
| Clerical and kindred workers | 7,324 | 8,652 | 18.1 | 5.8 |
| Craftsmen, foremen, and kindred workers | 7,958 | 9,253 | 16.3 | 4.2 |
| Operatives and kindred workers | 6,773 | 7,644 | 12.9 | 1.2 |
| Service workers, except private household | 5,898 | 6,964 | 18.1 | 5.8 |
| Laborers, except farm and mine | 5,606 | 6,462 | 15.3 | 3.3 |

[1] The increase in the CPI from 1968 to 1970 was 11.6 percent.

Note: The Census Bureau also publishes data on self-employed proprietors and farmers, and on salesworkers, but since these groups encompass such a broad range of earning levels, comparisions of median earnings over time are not apt to be meaningful as a measure of income changes. We have also excluded self-employed professional, technical, and kindred workers as their hours worked are apt to decrease in a recessionary period.

Source: Bureau of the Census.

Among manufacturing workers as a whole, no progress in the buying power of average weekly paychecks has taken place at all in the past six years, as data taken from one of the statistical tables attached to the CEA Report indicate. The figures are shown in Table 5.

TABLE 5.—AVERAGE WEEKLY SPENDABLE EARNINGS (1967 DOLLARS)[1] IN MANUFACTURING INDUSTRIES, 1965–71

| Year | Worker with no dependents | Worker with 3 dependents |
|---|---|---|
| 1965 | $94.26 | $102.41 |
| 1966 | 94.21 | 102.31 |
| 1967 | 93.28 | 101.26 |
| 1968 | 93.76 | 102.45 |
| 1969 | 92.81 | 101.49 |
| 1970 | 91.68 | 99.66 |
| 1971 [2] | 94.78 | 102.42 |

[1] Average gross weekly earnings, less social security and income taxes, divided by the Consumer Price Index.
[2] Preliminary.

Source: Bureau of Labor Statistics.

In 1971, the buying power of the weekly paycheck of the average manufacturing worker with three dependents was just one cent higher than in 1965.

During the same period, output per man-hour of the average manufacturing worker increased by 13.5 percent, according to the same source.

WORKERS GIVE UP SOME BENEFITS SO AS NOT TO LOSE JOBS

On the matter of wage rate increases in major collective bargaining agreements in manufacturing, the Report tells us:

"Collective bargaining agreements in manufacturing provided larger wage increases in 1971 than in 1970, with average first-year wage increases accelerating from 8.1 percent in 1970 to 10.7 percent in the first 9 months of 1971. Since 1965, average wage increases have been larger in nonmanufacturing industries than in manufacturing. Efforts of manufacturing workers to reverse this pattern, to regain old wage differentials, and to obtain gains more nearly like those in the transportation and construction industries were partly responsible for the acceleration in manufacturing."

As we have just seen, operatives and kindred workers were getting the smaller increases. However, unless one reads the fine print footnotes to tables, what the reader may well overlook is that the data relate only to manufacturing establishments in which a decision was made to *increase* wages. Only last month the *Wage Street Journal* (January 26, 1972) reported on a number of situations with which we in the union movement are only too well acquainted.

Across the country, at large and small companies, workers are agreeing to forego raises and benefits in an effort to preserve their jobs in a sagging economy. While statistics are not available on the number of cases in which labor has chosen jobs over money recently. Professor Bernard D. Meltzer, a labor expert at the University of Chicago, was quoted as saying he is "certainly under the impression that the incidence of such situations today is much greater than a year ago or five years ago."

Similar situations, says the *Wall Street Journal*, face workers in "scores of companies in many industries." Among those to which it specifically refers are companies in such important industries as rubber, electrical appliances, office equipment, printing and brewing.

NEGLECT OF THE POVERTY PROBLEM

There is one major omission in this year's Economic Report, an omission which it shares with the Reports presented in 1970 and 1971. That is a failure either to discuss the problem of poverty in our nation, or to provide data by which the extent of poverty can be measured even by the highly conservative official yardsticks. In fact, as in last year's Report, the goal of abolishing poverty is not even mentioned. It is as though the Administration had fallen back upon the hope that if nobody would say anything about poverty, the problem would somehow go away.

Unfortunately, the available data do not support that hope. In 1970, there were 5.2 million families, or 25.5 million persons (13 percent of the population) below the poverty level.

Between 1969 and 1970, the number of poor persons actually increased by 1.2 million, or 5.1 percent. This is the first time since the 1930s there has been a significant increase in the poverty population.

Some of the poorest groups have experienced no improvement at all in the last five years.

TABLE 6.—WHERE POVERTY HAS NOT LESSENED AT ALL

[In millions]

| | 1965 | 1970 |
|---|---|---|
| Families with female heads (all family members) | 7.5 | 7.6 |
| Unrelated individuals: | | |
| Males | 1.3 | 1.4 |
| Females | 3.6 | 3.6 |

Source: Bureau of the Census.

The poverty thresholds—or low-income thresholds, as the Administration has euphemistically started calling them—have been adjusted through the years for changes in the Consumer Price Index. But poverty is a relative concept. Table 7, which compares such thresholds with the median income of families, shows a widening gap.

TABLE 7.—THE WIDENING GAP THAT ISOLATES THE POOR FROM THE NATION'S PROGRESS

| | 1959 | 1970 |
|---|---|---|
| Poverty threshold for a nonfarm family of 4 | $2,973 | $3,968 |
| Median income of families of 4 in the United States | 6,070 | 11,176 |
| Poverty threshold as a proportion of median income (percent) | 49 | 35 |

Source: Bureau of the Census.

A nonfarm family of four receiving 50 percent of the median income or less was considered poor in 1959. In 1970, the same family—at 50 percent of median income—lies $1,600 above the poverty level and is not even counted among the near-poor. This latter group, defined as having earnings between 100 percent and 125 percent of their respective low-income threshold, comprised a total of 10.2 million persons in 1970. In all, there are 35.7 million people living in poverty or near-poverty in the U.S. The anti-poverty measures applied thus far have not been nearly adequate.

## THE FAMILY ASSISTANCE PLAN

By definition, poverty is a lack of sufficient income or assets to finance a socially accepted standard of living. The proposed Family Assistance Plan (FAP), although inadequate in many respects, does give recognition in principle to this fact and provides a first step toward what could become major welfare reforms. It provides for a federally financed income guarantee, extends cash transfers to the working poor and appears to take some steps toward federal administration of public assistance.

This can be an important step forward. In 1970, according to the Census Bureau, about 36 percent of the poor people in the U.S. were members of families with a male head who worked in that year; and about 52 percent of the members of poor families with a working head were poor despite the fact that the breadwinner held a full-time, year-round job.

However, there are several ways in which FAP, as passed by the House on June 22, 1971, must be improved:

(a) The payments proposed in the bill are inadequate. In 1970 it would have taken approximately $11.4 billion (according to the Bureau of the Census) to raise the incomes of all poor families and unrelated individuals above the poverty line. None of the estimates of budgetary allocation of the FAP bill before Congress came even close to that figure.

The income guarantee for a family of four is $2,400, if the family had less than $720 in annual earnings. This is only 58 percent of the 1971 estimated poverty threshold of $4,139; by the time FAP is implemented, the threshold will exceed $4,400.

Each dollar earned in excess of $720 would result in a 67 cents reduction in FAP benefits. If the family comes close to the estimated 1974 poverty threshold (as close as $4,320), payments are reduced to zero.

The inadequacy of the benefits is revealed by the fact that, as of July 1971, eighteen states are currently guaranteeing more than $2,400 per year to four-person families which qualify for ADC.

(b) The goal of reducing poverty must be enhanced by inclusion of families without children, and unrelated individuals.

(c) The work and training test requirements should be abolished. It is useful to bring a variety of manpower services to the attention of low-income people. But we do not accept the provision which would arbitrarily deny payments to individuals who feel they cannot participate in a training program or take a job. There may be many good reasons for this, such as those of mothers of large families, or with ill or handicapped children, or because work offered is really sweated labor. We must not allow low-wage employers to hire FAP recipients at below-market wages just because the work requirement has pushed these recipients into the labor market.

We believe that most people prefer work to welfare, and will work if they can, as long as they are fairly paid.

(d) The federally financed part of the new welfare system should be federally administered. This would ensure uniformity of benefit levels and eligibility practices across states. Experience with ADC has indicated that uniform federal rules administered by state and local agencies become not so uniform in application.

There are, of course, many other weapons than the Family Assistance Plan needed in the war on poverty. Some of them are especially directed to the poverty problem, others attack problems which affect many more of our people, but which bear particularly heavily on the poor. We shall deal with these matters when we come to discuss the UAW's general proposals for improving the state of our nation.

### NONLABOR UNIT COSTS ARE GOING UP

In contrast to the lack of progress made by workers and the poor, business and its owners are doing very well indeed. To show the role of business in the present state of the economy, we must look back at what has happened in the past five or six years.

After four years of continued strong increases, the growth of real GNP started slowing down in 1966. From an annual rate of 6.4 percent from 1964 to 1966, the increase was only an annual 3.6 percent from 1966 to 1968. Productivity growth slowed down accordingly. At the same time, in 1965 prices started going up sharply even while unit labor costs were still falling, but by 1966 compensation per man hour began to rise more rapidly as workers strove to protect their purchasing power. Unit labor costs increased considerably. From 1970 to 1971, the picture is altogether different, as Table 8 shows. Productivity increased 3.4 percent, a rate of growth significantly above the recent trend. This was primarily a result of cost cutting on the part of employers; capacity utilization and real growth are still very low. At the same time, compensation per man-hour rose very little more than in recent years, which resulted in a marked slackening of the rise in labor costs per unit of output. The implicit price deflator, however, was still rising at a rapid 4.5 percent, and unit nonlabor payments (i.e., the sum of profits, depreciation interest, rental income and indirect taxes) soared at a *6.6 percent* rate, away above its 1957–1970 trend of 2.0 percent.

TABLE 8.—CHANGES IN COMPENSATION, PRODUCTIVITY, AND COSTS IN THE PRIVATE NONFARM ECONOMY, AT ANNUAL RATES, 1966–68 AND 1970–71

| Item | Percentage change | |
|---|---|---|
| | 1966 to 1968 | 1970 to 1971 [1] |
| Compensation per man-hour | 6.5 | 6.9 |
| Output per man-hour | 2.2 | 3.4 |
| Unit labor costs | 4.1 | 3.4 |
| Unit nonlabor payments [2] | 2.2 | 6.6 |
| Implicit price deflator | 3.4 | 4.5 |
| Real compensation per man-hour [3] | 2.8 | 2.5 |
| GNP (constant dollars) | 3.6 | 2.7 |

[1] Preliminary.
[2] Nonlabor payments include profits, depreciation, interest, rental income, and indirect taxes.
[3] Compensation per man-hour adjusted for changes in the Consumer Price Index.

Source: Bureau of Labor Statistics.

THE MYTH OF LOW PROFITS

The spectacular rise in nonlabor unit costs was reflected in the strong recovery of corporate profits. Profits underwent a cyclical decline in 1969–70 but recovered strongly in 1971 and will do even better in 1972.

The true extent of their recovery has been masked by last year's attempt of the Treasury Department to unilaterally amend the rules for computing depreciation. It is not generally known that these changes, which permit corporations to shift substantial amounts out of profits and into "capital consumption" for income tax purposes, were immediately reflected in the Department of Commerce statistics on profits for the first three quarters of 1971, even before Congress had had an opportunity to act on them.

Subsequently, Congress approved the Asset Depreciation Range (ADR) System, but rejected the modification of the first year depreciation rule. Commerce has revised the 1971 figures to reflect this action, but a poorly publicized revision can hardly counter the misimpressions which were formed during the crucial days of 1971. Moreover, the ADR rule change distorts even these figures downward.

To cut through the confusion about profits, Table 9 shows three sets of figures: (1) the originally published figures, which were Commerce Department revisions of the incoming data to reflect the ADR and first year depreciation rule changes; (2) the recently published revisions of those figures which remove the impact of the first year depreciation rule change but retain ADR; and (3) the unpublished figures which are comparable to past profit figures in that they reflect neither rule change.

TABLE 9.—CORPORATE PROFITS BEFORE TAXES, SHOWING NECESSARY REVISIONS

[Seasonally adjusted annual rates, billions of dollars]

| 1971 | Original Department of figures (1) | Revised Department of figures (2) | Profits further revised to remove effect of ADR (3) |
|---|---|---|---|
| 1st quarter | $79.8 | $83.0 | $83.3 |
| 2d quarter | 83.8 | 86.9 | 87.6 |
| 3d quarter | 82.9 | 85.8 | 86.9 |

Source: Department of Commerce.

The difference between column (1), which shows the figures as the Commerce Department first published them, and column (3), which shows the figures on a basis comparable with past years, is $3.5 billion for the first quarter, $3.8 billion for the second quarter and $4.0 billion for the third quarter.

Shorn of the 1971 rule changes, 1971 corporate profits will exceed $86 billion. This will put 1971 higher than not just 1970 ($75.4 billion) but 1969 ($84.2 billion) also. Only 1968 ($87.6 billion) will be higher, and only because of other depreciation rule changes made in past years.

The history of the tax treatment of depreciation has been a continual shortening of the time span over which businesses must stretch depreciation charges, and an acceleration of the rates at which depreciation may be charged during the early life of an investment. On any individual investment the acceleration of depreciation (thereby reducing profits) is offset by reduced depreciation later on (thereby increasing profits). But for the aggregate of investment this does not occur because of continual increases in the stock of capital investment. Rather, there has been a steady increase in the annual shift from aggregate profits to aggregate depreciation.

Department of Commerce technicians have made several studies of the effect of the liberalized rules on depreciation and profits, the latest appearing in the January 1972 issue of *Survey of Current Business* and covering the year 1970. It shows that for nonfinancial corporations, fully $10.7 billion or one-fifth of total depreciation for 1970 is attributable to acceleration of rates and shortening of service life spans.

This compares with $8.7 billion two years earlier and $4.9 billion ten years earlier. In other words, to achieve comparability with 1960 requires increasing reported 1968 profits by $3.8 billion and increasing 1970 profits by $5.8 billion.

It is useful to consider how profits in the 1971 recovery would have compared with profits in the 1968 boom had it not been for this shift from profits to capital consumption. The amount so shifted increased by $0.9 billion from 1968 to 1969 and by $1.1 billion from 1969 to 1970. The measure of the incomparability of 1971 to 1968 is thus $2 billion plus the 1970–71 shift plus ADR ($0.9 billion), or perhaps $4 billion in all. Since the CEA's preliminary estimate of 1971 profit is $85.2 billion or only $2.4 billion less than 1968, clearly on a basis comparable with the past year 1971 established a new all-time high in corporate profits.

Recovery from the recession has been less than boisterous by nearly every measure except corporate profits. With most economists both in and out of government agreeing that corporate profits will rise by another 15 percent or more in 1972, perhaps the Committee can now understand our skepticism about the claim of low corporate profitability and our deep concern about the lack of restraint on profits.

THE OUTLOOK FOR 1972

In its appraisal of the extent of economic progress it expects in 1972, the Administration is now repeating almost exactly the optimistic line of a year ago. As expressed in the Report:

"The U.S. economy will expand substantially in 1972. All major components of domestic demand will increase and the aggregate demand for goods and services will rise by about $100 billion to around $1,145 billion. This is an increase of 9½ percent over the level of GNP in 1971. The real increase will be around 6 percent while the implied increase in the GNP price deflator is around 3¼ percent. This is compatible with the interim objective of an inflation rate of 2 to 3 percent by the end of 1972."

The first reason that the Report cites for those expectations is that in the fourth quarter of 1971, real output had already begun to rise more rapidly than in the two preceding quarters. In effect, real GNP rose then at an annual rate of 5.8 percent, considerably faster than the sluggish 2.8 percent and 3.2 percent increases of earlier quarters. All sectors of demand rose, except for a decline in net exports. But not all sectors rose with the same strength; among the strongest were personal consumption expenditures in durable goods, fixed investment in residential structures and government purchases of goods and services. The removal of the excise tax and application of the price freeze induced a sharp rise in auto sales; some of this rise was at the expense of subsequent sales, the Report admits.

Indeed, as the Commerce Department reported at the beginning of February, consumers have scaled back their plans to purchase cars and major appliances. This is in contrast to the results of the previous survey, taken in October, according to which car-buying plans were unusually strong. As of the first week of January, consumer plans to buy new cars in the next six months fell to 98.8 percent of the 1967 average, from 103.4 percent in the October survey.

## CONSUMER CONFIDENCE IS NOT HIGH

The Economic Advisers to the President are optimistic about the development of personal consumption expenditures in 1972. They explain their optimism in the Report:

"There is already evidence that consumer confidence has improved since last summer. The expectation is that it will improve further as employment increases and the rates of unemployment and inflation decline. . . ."

We take particular issue with the last sentence of the above statement, and similar assertions interspersed throughout the Report. It is not inflation that holds consumer spending down. On the contrary if families have inflationary expectations and at the same time expectations of steady employment, they will tend to buy more rather than less. As the economists of the University of Michigan's Survey Research Center have explained:

"There has been a significant improvement in how upper income families evaluate past changes in their financial situation. Consumers have been saving at a high rate over a prolonged period and have accumulated substantial liquid assets. Under these circumstances, when people feel a need to buy something, or when a special occasion comes along, they will not deny themselves even if sentiment is low. Therefore, a sizable number of consumers are shopping for bargains to put under the Christmas tree.

"The increase in sales will be temporary, however, as many consumers are buying in advance of expected price increases. . . . *Fully 26 percent of all respondents in the October-November survey gave expected future price increases as a reason why now is a good time to buy large household items.* To some extent, current demand for cars and other major discretionary items is borrowing from future demand." [Emphasis added]

This, by the way, confirms our contention that the good performance of GNP in the fourth quarter of 1971 is not the clear sign of a strong recovery that the Report would have us believe.

Instead of inflation, it is the very real danger of layoffs and prolonged unemployment which makes consumers save for rainy weather. Thus, reports like that of the January 1972 Gallup Poll, which found that 41 percent of those surveyed thought that there will be more people out of work in their communities in the next six months, and another 26 percent expect that at best unemployment will not fall, convince us that workers' unemployment expectations will weigh very heavily against any boom in consumer spending.

A similar finding was reported by the University of Michigan's Survey Research Center. Their index of consumer sentiment stood at 82.2 percent of the February 1966 based in the October-November 1971 survey, a little under the 82.4 percent August-September index. They also noted that consumer sentiment is greatly affected by expectations about unemployment and that considerably more people believed unemployment would increase in 1972 than believed it would decrease.

## RESIDENTIAL CONSTRUCTION

Although the current housing boom is still going strong, and the same Commerce Department survey finds a rise in the number of people planning to buy a house in the next six months, a recent *Wall Street Jounral* survey among participants at the meeting of the National Association of Home Builders found a majority of members forecasting a fading of the building boom in the second half of this year. This would be due to rises in the mortgage interest rates starting next fall, and to a trim in the government subsidies for low- and moderate-income housing. As the economy picks up even moderately, pressures on mortgage funds will increase. On the other hand, government assistance for low and moderate cost housing is scheduled to decrease in fiscal 1973, from 583,000 units to 511,000. The latter figure could get as low as 350,000. HUD Secretary George Romney warned the Home Builders Association, unless some weaknesses in the program, such as graft, corruption and kickbacks, are corrected.

One of the signs of overbuilding is the vacancy rate in total rental housing. After hitting a low of 4.8 percent in the last quarter of 1970 the rate has been at 5.3 percent for the last two quarters. We are not as confident as the Administration is that residential construction, which has traditionally helped the country pull out of a recession, is going to outdo its first year expansion performance by 7 percent, or 145,000 units.

BUSINESS FIXED INVESTMENT

Business fixed investment is expected to rise 9.1 percent in 1972. This would be a substantial increase from the meager 2.2 percent that capital outlays increased from 1970 to 1971. In manufacturing, the anticipated increase is 4.0 percent over the very low levels of 1971, when outlays actually fell 5.4 percent from 1970, and would still be less than in that recession year.

Table 10 shows capital outlays in manufacturing and nonmanufacturing—deflated by the implicit price deflator for nonresidential fixed investment—and capacity utilization, one and two years after the trough year. The last recession is the only postwar recession when capital outlays in constant dollars actually decreased one year after the trough year. In manufacturing, the decrease amounted to 10 percent of 1970 investment, while anticipations are for a very low 1.6 percent increase with respect to 1971. Even if the current forecast for business investment in 1972 is fulfilled, the increase in capital outlays in real terms will be the lowest of either first or second year recovery periods following the last four recessions.

TABLE 10.—CAPACITY UTILIZATION AND BUSINESS INVESTMENT IN NEW PLANT AND EQUIPMENT IN PAST AND PRESENT EXPANSIONS, 1954–72

| Recovery period | Trough year | 1 year after trough year: Level | 1 year after trough year: Change with respect to trough year (percent) | 2 years after trough year: Level | 2 years after trough year: Change with respect to previous year (percent) |
|---|---|---|---|---|---|
| 1954–56: | 1954 | 1955 | | 1956 | |
| Capacity utilization, manufacturing (percent) | 83.5 | 90 | [1] 6.5 | 87.7 | [1] −2.3 |
| Capital outlays, all industries [2] | 31.64 | 33.10 | 4.6 | 37.97 | 14.7 |
| Manufacturing | 13.02 | 13.19 | 1.3 | 16.18 | 22.7 |
| Nonmanufacturing | 18.62 | 19.91 | 6.9 | 21.79 | 9.4 |
| 1958–60: | 1958 | 1959 | | 1960 | |
| Capacity utilization, manufacturing (percent) | 74 | 81.5 | [1] 7.5 | 80.6 | [1] −.9 |
| Capital outlays, all industries [2] | 30.55 | 31.84 | 4.3 | 34.67 | 8.9 |
| Manufacturing | 11.43 | 11.81 | 3.3 | 14.07 | 19.1 |
| Nonmanufacturing | 19.09 | 20.04 | 5.0 | 20.60 | 2.8 |
| 1961–63: | 1961 | 1962 | | 1963 | |
| Capacity utilization, manufacturing (percent) | 78.6 | 82.2 | [1] 3.6 | 83.3 | [1] 1.1 |
| Capital outlays, all industries [2] | 33.24 | 35.84 | 7.8 | 37.53 | 4.7 |
| Manufacturing | 13.23 | 14.10 | 6.6 | 15.01 | 6.5 |
| Nonmanufacturing | 20.01 | 21.74 | 8.6 | 22.52 | 3.6 |
| 1970–72: | 1970 | 1971 | | 1972 | |
| Capacity utilization, manufacturing (percent) | 78.2 | 74.5 | [1] −3.7 | | |
| Capital outlays, all industries [2] | 61.32 | [3] 59.38 | −3.2 | 63.30 | 6.6 |
| Manufacturing | 24.58 | [3] 22.02 | −10.4 | 22.37 | 1.6 |
| Nonmanufacturing | 36.74 | [3] 37.36 | 1.7 | 40.93 | 9.6 |

Note: Estimates for 1972 are based on plans for capital expenditures reported by business in late November and December 1971. The Administration's forecast that the GNP implicit price deflator will be 3.25 percent higher in 1972 than in 1971 has been taken into account.

[1] Percentage point difference.
[2] Capital outlays in billions of 1958 dollars.
[3] Preliminary.

Sources: Department of Commerce; Securities and Exchange Commission.

MISPLACED CONFIDENCE IN THE INVESTMENT TAX CREDIT

Whatever confidence the Administration has as to business stepping up its investment, it attributes such increased spending to the new investment tax credit and the accelerated depreciation write-off incentives.

While described as 'incentives," these tax cuts are in reality windfalls. The investment tax credit, for example, is available for investment that would have been made in any event as well as for any—inevitably relatively small—

amount of additional investment that might be attributable to it. (In fact, the credit is available even to a firm that responds to the "incentive" by *reducing* the amounts of its investment below previous levels.) Thus, in the unlikely event that the credit stimulates an investment increase of as much as 10 percent, more than 90 percent (100 divided by 110) of the credit will represent tax revenues wasted in paying businesses for investments made for reasons that have absolutely nothing to do with the credit.

As to the Administration's hopes that a large part of our unemployment problems will be solved by the investment tax credit, the *New York Times* (September 20, 1971) had this to say:

"President Nixon's proposed tax credit of 10 percent on business investments in new machinery and equipment appears more likely to increase corporate profits than to create additional jobs for unemployed workers next year.

"And although the tax credit has been almost universally welcomed by business leaders, it probably will not have a major effect on capital spending plans for 1972, particularly during the first half of the year, according to a *New York Times* survey.

"Most companies said they will replace machinery and equipment at about the same rate they had planned before last month's announcement of the proposed tax credit.

"The program that was billed by President Nixon as one that will create more jobs for Americans may do precisely that in the long run.

"EFFECT IS ASSESSED

"But for the next six months to a year at least, its impact will be more strongly felt on corporate profit-and-loss statements, industrialists and economists asserted.

"Few new jobs will be created quickly through plant expansion or in the industries supplying new machinery, the survey indicated. Most businesses, however, will reap extra profits if the tax credit is passed, because it applies to equipment already ordered and to machinery that would have been ordered even if the tax credit had not been announced."

We believe such investment as will be made, with 26 percent of capacity idle, will be for purposes of modernization, i.e., to replace existing plant and equipment with more efficient facilities. In fact, the defenders of the credit argue that it will help to increase productivity. But unless markets expand, higher productivity means that fewer workers are required to satisfy demand for the products of industry. Thus, unless accompanied by measures designed to boost demand sharply, the investment tax credit, to the limited extent that it may tend to increase investment, will become a job destruction rather than a job development measure.

What industry lacks today is not machinery but customers, and the investment credit could make the latter even scarcer.

UNEMPLOYMENT IN 1972

As we all know, the Economic Report forecasts that real GNP will grow 6 percent between 1971 and 1972, and estimates that the unemployment rate should decline from the 6 percent level of December 1971 to the neighborhood of 5 percent by the end of 1972. In this expectation, the economic advisers to the President stand almost alone. Most economists are consistently predicting that we are going to see a rate on the higher side of 5.3 percent by December 1972. George Perry, of the Brookings Institution, for example, has recently worked on a revised estimation of the relationship between the GNP gap (the gap between actual and potential GNP) and the unemployment rate, analogous to Okun's law. According to his conclusions, if real GNP growth proceeds at a 6.0 percent rate after the end of 1971, unemployment is projected to average 5.8 percent for all of 1972 and reach 5.5 percent only by the end of 1972.

The Report goes on to say:

"Reduction of the unemployment rate in 1972 is a primary objective of this year's economic policy. It is to this end that the Government is pursuing a highly expansive fiscal policy."

One of the instruments of such fiscal policy is the tax package that has been handed out to business. We have referred to its doubtful impact on jobs in another part of this testimony. Programs for manpower training and public service employment constitute another instrument to which the Economic Report refers with great frequency.

Upon examination of the 1973 Budget, it is clear that the expenditures proposed for manpower training services will not be enough. From fiscal 1971 to fiscal 1972, outlays for these services increased by $512 million. From 1972 to 1973, the Administration is asking for a $396 million increase, or almost 30 percent less than the increase that was requested in January 1972.

Skill training efforts other than veterans' programs would remain essentially level, with an actual decline in estimated per capita outlays. Veterans' programs account for $66 million of the total increase in outlays for skill training programs, although no expansion is expected in the number of new enrollees.

Work support programs other than emergency assistance would get $758 million, up 13 percent from fiscal 1972. Most of the increase would go to Neighborhood Youth Corps in-school and summer, although a drop in the number of new enrollees is expected.

Labor market services are supposed to step up their spending 12 percent after an increase of 14 percent from fiscal 1971 to fiscal 1972. Part of these outlays are assigned to a special placement program, boastfully called in the Budget "a nationwide program of computerized job banks to match job seekers with job opportunities." In fact, as reported by the *Wall Street Journal* (January 25, 1972) :

". . . Most of the job banks now set up in nearly 100 cities simply turn out daily listings of openings. 'The matching is done by eyeball,' an insider admits."

The other component of federal manpower policy is the emergency employment assistance program, designed to temporarily subsidize most of the cost of adding new employees to state and local government payrolls. It was first vetoed by the President in December 1970 in its original form, after funds amounting to $2.5 billion had been assigned by Congress. The compromise bill finally signed by the Executive authorized up to $1 billion or an equivalent of 128,000 positions by the end of fiscal 1972; but by the Report's own admission, only about 75,000 had been filled at year's end. In an economy where over five million workers are unemployed, such figures are meager indeed; only one unemployed worker in every 70 has been helped to find a job.

The Report also tells us of the hardships of those communities heavily dependent on defense-related activities brought about by the realignment of defense expenditures. We in the UAW know of these hardships probably better than anybody else. Many thousands of our members in the aerospace industry have lost their jobs. In December 1971, total employment in the industry was estimated at 931,000 workers. This represented a 35 percent decline from March 1968, when total employment peaked at 1,431,000 workers.

The Inter Agency Economic Adjustment Committee, in the meantime, is claiming to have aided 44 communities in 22 states in the transition from a defense-based local economy to a balanced local economy. That seems like a painfully slow response to a rise in unemployment that has left 54 major labor areas and over 800 smaller areas in a condition such that unemployment in these areas is equal to 6 percent or more of its work force. The Report fails to put the problem of these communities in its proper perspective; decreases in military personnel and defense employment were part of the Administration's program to gear down the war, and it was its inescapable responsibility to do this in a way carefully planned to minimize the economic and social dislocations involved.

In summary, the picture as it stands now is highly dismaying. It is impossible to believe that the manpower policies proposed by the Administration are nearly extensive enough to cope with as high an unemployment rate as our economy is now suffering and will continue to suffer.

## WHAT IS A TOLERABLE LEVEL OF UNEMPLOYMENT?

There has been increasing talk from Administration sources of a retreat to a target higher than 4 percent for "full employment." For example, Treasury Secretary John Connally was reported by the *Wall Street Journal* (January 21, 1972) as "scoffing that the concept of 4 percent unemployment as a peacetime norm is a mere 'myth'."

The Report does not go this far, but it states:

". . . This highly uncertain estimate [of what represents full employment] became solidified over the ensuing years as a result of repetition, even though the 4 percent rate was seldom achieved."

On the contrary, since 1947 we had average rates of unemployment below 4 percent in nine years or more than one-third of the time. In four other years, the rate was 4.5 percent or less.

In order to make their point about the difficulty of attaining full employment in a dynamic economy, the Report emphasizes the increasing proportion in the labor force of females and of males under 24, who presumably suffer more "transitional unemployment." But a change in the structure of the labor force does not warrant a change in our full-employment goals; women who more and more frequently are heads of households and young men and teenagers who need jobs need them as much as older men and they should have an equal opportunity of employment.

The Administration is completely inconsistent. Under its Family Assistance Plan it would force mothers and young people into the labor force. But when they fail to find jobs, it would dismiss their unemployment as of questionable significance.

### ERODING MINIMUM WAGE PROTECTION

With respect to teenage unemployment, the Report suggests:

". . . The rising levels and expanded coverage of the minimum wage since the middle fifties may have been a factor in the upward drift of the teenage unemployment rate. For this reason the Administration has urged the provision of a lower minimum wage for teenagers to prevent any further narrowing of job opportunities."

The Administration's solution is unacceptable. A lowering of the minimum wage for those 16 to 19 years old would most probably lead to the displacement of adults from unskilled and semi-skilled jobs, since teenagers could be hired at a lower rate.

### FISCAL AND MONETARY POLICY

Government purchases of goods and services rose considerably in the fourth quarter of 1971, but the increase was mainly due to an increase in military pay in November, designed to facilitate the building of an all-volunteer armed service.

During the first quarter of 1972 there will be a federal pay increase, and; according to the Report, additional increases in purchases, which are scheduled to rise by an unstated percentage. On a National Income Accounts basis, the projected deficit for calendar 1972 is $36 billion compared to $23 billion in calendar 1971. Thus, by the well-known measure of an increasing deficit, fiscal policy is stimulative. However, it is certainly not stimulative enough, as reflected by its goals. The Administration is forecasting a rate of unemployment of 5.0 percent by year-end. Most economists agree that this is an extremely optimistic forecast; but it is also an extremely inadequate one.

Part of the fiscal impact on the economy is supposed to come through the Administration's new Revenue Sharing proposals. We have already stated our disagreement with the concept of revenue sharing and urge Congress to strengthen the system of categorical grants instead of approving the President's proposals.

The Administration expects considerable stimulus from tax cuts in 1972. We shall discuss next our disagreement with the Revenue Act of 1971 and the inequitable distribution of the tax cuts.

### WHO WILL GAIN FROM THIS YEAR'S BUDGET PROPOSALS?

Not only is the Administration's proposed Budget inadequate to get the economy back on the road toward full employment, but it will increase the many distortions which already exist in favor of large corporations and wealthy families as against small business and families with low and moderate incomes.

The composition of budget receipts fully reveals to us the inequities of the Accelerated Depreciation Range provisions and the Revenue Act of 1971, which legislated upon the Administration's proposals of August 1971.

TABLE 11.—EFFECT OF THE REVENUE ACT OF 1971 ON INCOME TAX RECEIPTS

[In billions of dollars]

| | Fiscal years | |
|---|---|---|
| | 1972 | 1973 |
| Increased exemptions | −$1.7 | −$1.2 |
| Increased deductions | −1.0 | −1.4 |
| Correction of withholding schedules | +.7 | +.1 |
| Job development credit | −2.5 | −3.6 |
| Accelerated depreciation | −.9 | −1.9 |
| DISC | (1) | −.1 |
| Total | −5.4 | −8.1 |

1 Less than $50,000,000.
Source: The Budget of the U.S. Government, fiscal 1973.

In fiscal 1972, individuals will get 37 percent of the $5.4 billion tax relief, and business will get the rest. In fiscal 1973, the individuals' share will fall to 31 percent, and much of that will go to the wealthy. By 1974, the rising benefits of the reinstated 7 percent investment tax credit will shift the balance much more sharply in favor of business. This will reinforce a tendency for corporations to pay a declining share of the cost of running the country. In fiscal 1965, corporate taxes made up over 34 percent of federal income taxes. It is estimated that in fiscal 1973 their contribution will be about 27 percent, in spite of the fact that these estimates assume improved economic conditions and a substantial increase in profits.

Furthermore, while the ADR giveaway and the investment tax credit are new and indefinite bonuses to corporations, the increases in personal exemptions and standard deductions are merely speedups in reductions due under the Tax Reform Act of 1969. For a family of four with $10,000 income, the cuts from 1971 to 1972 will amount to $95, or a reduction of 9.5 percent, if the short form is used. There is no further tax reduction now scheduled to take place from 1972 to 1973, or thereafter. In contrast, it is estimated that tax giveaways to business will amount to $3.4 billion in fiscal 1972, $5.6 billion in fiscal 1973, and $6.8 billion in fiscal 1974.

These cuts are equal to 8½ percent, 14 percent and 17 percent, respectively, of the profits taxes paid by corporations in 1968, the all-time record high year for corporate profits. (Taking into account the fact that part of the tax giveaways involved go to unincorporated businesses, the aggregate tax savings to corporations will be slightly below those percentages.) As we have said before, tax relief for business does not end in fiscal 1974; it is calculated that the relief for business generated by ADR and Job Development Credit alone (i.e., not counting the Domestic International Sales Corporation tax windfall) will rise to an average of roughly $9 billion per year for 1975 and thereafter. Although it is difficult at this time to estimate the future dollar value of DISCs to corporate business, it has been estimated that more than half of the tax savings from this new loophole will go to the 100 largest U.S. corporations.

### TAX REFORM IS NEEDED

The acceleration of depreciation write-off, the investment credit, and DISC simply create new loopholes in the tax structure. The benefits, in the main, will flow to the largest and most powerful corporations. General Motors, for example, obtained $297 million in investment tax credits in the period 1962–70, though the corporation admits that such "incentives" do not affect investment programs, which are planned for years ahead. GM's recent chairman, James Roche, said specifically:

> ". . . the investment tax credit is intended to stimulate spending, especially by some smaller companies and those in weak financial condition. It should be understood that most companies of any size determine their purchases of equipment by the needs of the business and not by any short-term tax advantages."

From the standpoint of what the "incentive" accomplished, that was $297 million of public revenues washed down the drain—a sheer waste of monies that could have been put to good use for urgent public purposes.

The new depreciation system permits corporations to reduce their taxes by charging depreciation at a rate 20 percent higher than was previously permitted. It represents a wasteful dissipation of tax revenues for the benefit of corporations and their stockholders. In addition, under the prior law, a business taxpayer could be called upon to demonstrate to the IRS that his depreciation write-offs had some relationship to reality. If the firm failed this test, the IRS would disallow the excess depreciation deductions. Under the new aw, however, the reserve ratio test goes by the board and the businessman is assured that the depreciation deductions he claims will never be questioned.

INVESTMENT TAX CREDIT SHOULD BE LIMITED

These recent trends toward building more inequities into the federal tax structure should be reversed. Although most of the damage has already been done b ythe Revenue Act of 1971, we ask of Congress that some modifications be introduced into the law with regard to the investment tax credit, as follows:

(a) The credit should be established on an incremental basis. This would mean that the credit would be available only for investment in excess of (i) the dollar amount of investment in excess of the average during a stated base period, or (ii) the amount of investment in excess of the average ratio of investment to sales in a similar base period, or (iii) the amount of investment in excess of the depreciation taken for tax purposes in the same year. This approach at least would make the incentive to increase investment more nearly commensurate with the revenue loss.

(b) It has been asserted by spokesmen for several business firms in addition to GM, quoted in such reputable publications as the *Wall Street Journal* and the *New York Times*, that the investment plans of large corporations are not affected by the credit. Given this fact, the credit should be either (i) limited to corporations below a specified size, or (ii) if applied to all corporations, limited to a maximum amount related to the legitimate needs of small firms.

(c) Half of the credit should be set aside temporarily in a government trust fund to cushion adjustment for workers who might be displaced as a result of investment for "modernization" purposes. The money involved would be held in the reserve for 5 years, during which period it would be used to "make up" wages and fringe benefits to adversely affected workers. The amount required to set aside would be reduced for companies that had established other sound programs to pay such benefits. Monies remaining at the end of five years would revert to the company involved. Thus, the firm would have an incentive to plan carefully to minimize dislocation of its workers. If the firm's reserve proved inadequate to pay the specified benefits, the deficiency would be made up by the Treasury. (The National Commission on Technology, Automation and Economic Progress, popularly known as the "Automation Commission," commended a similar proposal for study by the Treasury, the Council of Economic Advisers and other appropriate agencies.)

INDIVIDUAL TAX CUTS NOT NEW BENEFITS

As we mentioned before, one of the most glaring inadequacies of the Revenue Act of 1971 is that the tax cuts for the great majority of individuals are not new or added benefits. Aside from the low-income allowance, the principal relief for individuals represents merely a speedier application of provisions enacted in 1969 to go into effect on 1972 income. A thorough-going revision of existing tax laws should be undertaken to spread the burden more equitably, close loopholes and broaden the tax base. Some of the eroding features of the present individual income tax which benefit only the wealthy are the special taxation of realized capital gains and of gains transferred by gift or bequest; the tax exemption for interest from state and local government bonds; the oil depletion allowance; and the maximum tax rate on earned income. Table 12, derived from materials supplied to the Committee by Joseph Pechman and Benjamin Okner, shows the additional yield that would be obtained from this modified income tax at 1972 income levels, using the 1972 tax rates and exemptions and a flat $1,3000 standard deduction.

TABLE 12.—COMPARISON BETWEEN ADJUSTED GROSS INCOME, TAXABLE INCOME, AND TAX LIABILITY UNDER PRESENT LAW AND UNDER A MODIFIED INCOME TAX, 1972 INCOME LEVELS

[Amounts in billions of dollars]

| Item | Adjusted gross income | Taxable income | Tax liability |
|---|---|---|---|
| Present law, plus elimination of maximum tax rate on earned income | $776.1 | $478.2 | $103.0 |
| Plus: | | | |
| ½ realized capital gains | 17.1 | 16.5 | 9.3 |
| Constructive realization of gain on gifts and bequests | 10.4 | 9.5 | 4.4 |
| Tax-exempt state and local bond interest | 1.9 | 1.9 | 1.2 |
| Other preference income [2] | 1.2 | 1.1 | .6 |
| Dividend exclusion | 2.2 | 1.9 | .7 |
| Equals: Modified income tax | 809.0 | 509.2 | 119.1 |

[1] Revenue Act of 1971 applied to 1972 incomes. Effect of maximum tax is $1,000,000,000.
[2] Excess of percentage over cost depletion and accelerated over straight line depreciation.

Note: Totals may not add due to rounding.

Source: "Individual Income Tax Erosion By Income Classes," Joseph Pechman and Benjamin Okner, JEC, compendium of papers on the economics of Federal Subsidy Programs, Jan. 14, 1972, p. 21.

The additional yield that would be collected in 1972 under such a modified income tax is estimated at $16.2 billion. This is a measure of the subsidies that are being paid to favored groups in the population, almost all of them in the high and very high income brackets ($25,000 or more). This is six times the annual amount of tax relief individuals will get in fiscal 1972 and 1973. The additional revenues gained by ending such giveaways might be put to good use in many areas of public spending, or they could be used to subsidize low-income groups through reductions in their tax rates and direct payments to those too poor to pay any income tax.

## SOCIAL SECURITY TAX REFORMS NEEDED

Finally, we believe that the time has come to take a good hard look at the highly regressive Social Security tax. Every worker on a payroll pays the same rate, up to the earnings ceiling, regardless of his total earnings. Table 13 shows how the effective tax rate goes down as earnings go up.

TABLE 13.—EFFECTIVE SOCIAL SECURITY TAX RATE OF ALL WAGE AND SALARY WORKERS, BY EARNINGS BRACKET

| | Wage of salary earners, 14-years old and over | | |
|---|---|---|---|
| Wage or salary income brackets (1969) | Number (thousands) | Percent of total | Effective social security tax rate, percent |
| $1 to $7,799 (or loss) | 64,520 | 73.4 | 5.2 |
| $7,800 to $9,999 | 10,110 | 11.5 | 5.2–4.1 |
| $10,000 to $14,999 | 9,580 | 10.9 | 41.–2.7 |
| $15,000 to $24,999 | 2,990 | 3.4 | 1.7–1.6 |
| $25,000 and over | 615 | .7 | 1.6 |
| Total | 87,905 | 100.0 | |

Note: Totals may not add because of rounding.

Source: Bureau of the Census. Social Security Administration.

When the Social Security tax was instituted, the picture was far different: 96.9 percent of all wage or salary workers were then earning as much as or less than the maximum on which the flat rate was levied. The table tells us that in 1969, 73.4 percent of all earners had incomes below $7,800. In order to include approximately 95 percent of workers below the maximum, such maximum would have had to be $15,000 in 1970.

In fact, while much has been said—and not enough done—about the need for removing the poor from the income tax rolls, very little attention has been paid to removing the much heavier payroll tax burden of the poor. In 1969, Joseph Pechman estimated that the federal income tax bill of the families and individuals who were officially classified as poor was $200 million a year, as compared with the $1.5 billion they paid in payroll taxes. The poor should be exempted from paying this tax as soon as possible. The principle of the low-income allowance, one of the very few progressive features of the 1971 Revenue Act, should be carried over into the payroll tax.

The following table indicates the regressivity of the payroll tax by showing the tax liabilities of both the income and the Social Security tax of a married couple with two children at different income levels. By comparing 1962 with 1971, it also places a table published in the 1973 Budget in its proper perspective. The Budget table purports to show how individual income taxes have been cut substantially over the years. However, the text neglects to point out that, merely because of inflation, in the last nine years, families would have moved into a higher income bracket and would now be paying a higher marginal rate. Our table shows that a family with a $3,000 wage income in 1962 paid 2.2 percent of their income in federal income taxes and 3.1 percent in Social Security tax, for a total of 5.3 percent of their income in both taxes combined. Nine years later, assuming only a rise in income sufficient to offset inflation, their wage income was $4,020, of which federal income tax took 1.0 percent, but Social Security tax took 5.2 percent and the two combined took 6.2 percent, a higher percentage than in 1962. For families with incomes of $5,000 or more in 1962, the result of federal income tax cuts has been a standoff in percentage terms.

TABLE 14.—INCOME AND SOCIAL SECURITY TAXES OF A MARRIED COUPLE WITH 2 CHILDREN, 1962 AND 1971

| | 1962 | | | 1971 | | | |
|---|---|---|---|---|---|---|---|
| Wage income | Income tax | Social security tax | Combined Federal taxes | Wage income [1] | Income tax | Social security tax | Combined Federal taxes |
| $3,000 | $65 | $94 | $159 | $4,020 | $39 | $209 | $248 |
| $5,000 | 420 | 150 | 570 | 6,690 | 438 | 348 | 786 |
| $7,500 | 877 | 150 | 1,027 | 10,040 | 1,007 | 406 | 1,413 |
| $10,000 | 1,372 | 150 | 1,522 | 13,390 | 1,666 | 406 | 2,072 |
| $15,000 | 2,486 | 150 | 2,636 | 20,080 | 3,230 | 406 | 3,636 |
| $25,000 | 5,318 | 150 | 5,468 | 33,470 | 7,595 | 406 | 8,001 |
| TAXES AS PERCENT OF INCOME | | | | | | | |
| $3,000 | 2.2 | 3.1 | 5.3 | $4,020 | 1.0 | 5.2 | 6.2 |
| $5,000 | 8.4 | 3.0 | 11.4 | 6,690 | 6.5 | 5.2 | 11.7 |
| $7,500 | 11.7 | 2.0 | 13.7 | 10,040 | 10.0 | 4.0 | 14.1 |
| $10,000 | 13.7 | 1.5 | 15.2 | 13,390 | 12.4 | 3.0 | 15.5 |
| $15,000 | 16.6 | 1.0 | 17.6 | 20,080 | 16.1 | 2.0 | 18.1 |
| $25,000 | 21.2 | .6 | 21.9 | 33,470 | 22.7 | 1.2 | 23.9 |

[1] 1971 income with same buying power as equivalent 1962 income shown on this line.

Source: Social Security Administration; Internal Revenue Service.

In order to increase further the progressivity of the Social Security tax, we propose two additional changes. First, the ceiling of earnings on which the tax is payable should be raised to $15,000, which would restore the original principle of the tax, that it should cover the total earnings of approximately 95 percent of the people. Second, the federal government should contribute an amount equal to that paid by employers and employees respectively, so that each of the latter two groups would contribute one-third of the cost, and general revenues the remaining third. This would make possible the very substantial improvements in Social Security benefits which are needed to bring them up to adequate levels, without the necessity of raising the basic contribution rate.

*The Value-Added Tax (VAT)*

The value-added tax was being forcefully advertised by the Administration until a few weeks ago, and was then suddenly dropped for the present at least, but is still obviously under serious consideration. It is a sales tax on consumer goods collected by producers and distributors at each stage of production or distribution. The tax collected from the consumer is computed by applying the full tax rate to the full sales price. From this, the producer or distributor is permitted to deduct the amount of VAT which he, in turn, had to pay to his suppliers for the raw materials and business services which were used in the production of his output.

With regard to its impact on the consumer, the VAT is no different than a retail tales tax. The consumer bears the full final burden. This means that the VAT in its original form is not only highly regressive, but also highly inflationary, since it has the simple effect of a straight increase in consumer-aid prices. In order to make the VAT more palatable, the Administration proposed to introduce a system of income tax credits or rebates aimed at lessening the tax's burden on lower-income people. If properly done, that would admittedly make of VAT a fairer instrument of fiscal policy. There are other features of VAT which worry us considerably, however, among them its invisibility.

One of the political advantages of any form of sales tax is that it can, if desired, be completely hidden from the consumer, as is the national sales tax in Canada, by imposing it at some level of the distribution process earlier than the sale to the final consumer, so that the tax simply disappears within the price charged by the retailer. In addition, even if the sales tax is openly added as such to the retailer's price, the fact that it is paid out in relatively small amounts with each purchase makes it much less visible than, for example, the income tax. There, even though the use of a withholding principle may spread actual payments out over the year, the necessity of making out an annual income tax return brings very sharply and perhaps painfully to the taxpayer's mind the amount of tax that is being levied upon him.

But what is politically attractive is not necessarily sound social policy. After all, we do live in a democracy in which the ultimate decisions, or at least the choice of those who are to make ultimate decisions, is supposed to rest with the people. Such decisions and the choice of who is to make them can really represent the will of the people only if the people are as fully informed as possible, and one of the essential pieces of information to which they are entitled is the cost entailed by the decisions that are made.

To state a specific case, the Economic Report indicates that the present inflation had its roots in the expansion of the war in Vietnam about 1965. As indicated elsewhere, we in the UAW do not agree that that was the sole cause of the inflation. However, no one can deny that the decision not only to expand the war in Vietnam, but also to finance it in large part by increased government borrowing rather than by meeting the full cost through increased taxation, was an important factor contributing to the present inflation. This was a fact of which only a relatively small proportion of the American people were aware, and even for economists it was obscured in part by the fact that the still unacceptably high rate of unemployment in 1965 did require an expansionary fiscal and monetary policy. But, if a large part of the cost of the war had been paid through an increase in the most apparent of taxes, that is, the personal and corporate income tax, two socially desirable results would almost certainly have followed. First, the danger of inflation would have been much less, and if some inflation nevertheless did take place because of the structural rigidities of the administered price system, it would have been easier for economists to have traced the cause to its root. Second, if the people had been made painfully aware through increased income tax payments of what the war was costing in money as well as in lives and the waste of resources which could and should have been put to better use, the probability is very high, almost to the point of certainty, that popular revulsion against the war in Vietnam would have developed much earlier than it did, and either this Administration or its predecessor would have been forced to start gearing down the war and seeking some other solution to the problem in Southeast Asia at a much earlier date.

WHAT MUST BE DONE

What must we do to solve the problems which today beset us? Above all, we must get forward movement again into an economy which went into recession in 1970 and in 1971, to quote Arthur Okun, "looked like an economy stuck in the mud."

The first step toward getting the economy out of the mud and onto firmer ground is a substantial reduction in unemployment. Economic arguments apart, this should be a primary concern for human reasons, because unemployment is demeaning to the unemployed. But on purely economic grounds, unemployment is too wasteful to be tolerated. Our nation is depriving itself of the wealth which idle hands and idle machines could be producing.

### MORE PUBLIC EMPLOYMENT ESSENTIAL

Since the private economy is clearly unable to provide the millions of additional jobs we need, and even substantially expansionary government policies will take some time to get the private economy into motion, a strong increase in public service employment is the most immediate necessity. The Emergency Employment Act of 1971, which provided for a maximum of less than 130,000 public service jobs by the end of 1971 and actually filled only about 75,000, is totally inadequate to the task. Instead, we urge immediate support for the measure to amend that Act, introduced last December by Congressman Henry S. Ruess and Senator Walter F. Mondale, and intended to produce 500,000 public service jobs directly.

As Mr. Reuss has pointed out, there will be a multiplier effect, since the four or five billion dollars which he proposes be appropriated for the "Jobs-Now" program will be quickly spent by the newly employed and their families. This will create new demand for consumer goods which will create more jobs in the private sector, at the same time increasing the rate of utilization of plant capacity and providing the most effective stimulus possible for increased private investment.

I am pleased to see that already the "Jobs-Now" program has much broader support than that of its two main sponsors and numerous co-sponsors in both the House and the Senate. As Congressman Reuss has already indicated for the record, it has the support of such well-known and respected economists as Professors James Tobin of Yale University, a former member of the Council of Economic Advisers, R. A. Gordon of the University of California at Berkeley, Sar A. Levitan, director of the Center for Manpower Policy Studies at George Washington University, Robert M. Solow of the Massachusetts Institute of Technology, V. Lewis Bassie, director of the Bureau of Economic and Business Research at the University of Illinois, Otto Eckstein of Harvard University, also a former member of the CEA, and a host of others. I am pleased and privileged to add to this galaxy of stars the million and a half members of the UAW, who in a Special Convention last November also endorsed the principle of the "Jobs-Now" program as "the quickest way to provide useful and needed work for the jobless, to sustain their self-respect and to generate consumer purchasing power needed to sustain the economy."

### MUCH MORE FISCAL STIMULATION NEEDED

In order to get our economy under a full head of steam as soon as possible, however, as well as to meet our too-long-neglected social needs, many more programs are needed, some of which will not involve significant added costs, some of which will actually save the government money, but which in total will provide more fiscal stimulation than the Administration's present Budget proposes.

We are not particularly impressed with the concept of the full-employment budget as a yardstick for fiscal policy. But even the concept is not properly implemented in the present Budget, because it fails to take into account some $8 billion of savings through reduced government expenditures on welfare and other transfer payments at full employment. When we add to that the fact that the policy goals represented by the proposed Budget, both in reducing unemployment and in meeting the pressing needs of the states, the cities and the people everywhere are totally unacceptable, it follows clearly that in our view the extent of fiscal stimulus presented in the Budget is entirely inadequate.

### RENEW THE WAR ON POVERTY

No man or woman amongst us should feel free to hold high his head with pride in his country so long as we permit so many millions of families and individuals to remain submerged in poverty. We in the UAW have been urging drastic measures to combat poverty for many years now. The general outline of what must be done was succinctly expressed by our 1970 Constitutional Convention, which declared:

"The conquest of poverty, as the UAW has pointed out repeatedly, requires jobs for all who are able and willing to work, wages sufficiently high to provide decent living standards for all who are at work, and adequate, assured incomes for all who are unable to work. In practical terms, these requirements involve an effective national full-employment policy, comprehensive coverage under minimum wage legislation with the minimums fixed at adequate levels, and legislation—including increases in minimum benefits under the various social insurance programs—to assure a guaranteed minimum annual income above the poverty line for those unable to earn their own way because of age, disability or family responsibilities. To these must be added access without financial barriers to high-quality medical care—for health care costs can impoverish even families with comfortably high incomes—and subsidized good housing in good neighborhoods—for without subsidies decent housing is beyond the reach of those at the lower end of the income scale."

Many of these programs, of course, will benefit not just the poor alone, but our entire nation. For example, based on the relation of civilian employment to GNP in 1971, every percentage point by which we lower the unemployment rate not only puts some 800,000 people back to work, but it adds over $10 billion to the wealth our economy creates. This is an understated figure, for it does not take into account that increased employment not only means more people working, but higher productivity for those who work.

### A CIVILIAN NASA TO MEET SOCIAL NEEDS

In addition to those industries which have not been expanding as they should to provide new jobs, defense industries in particular have experienced a sharp decline in employment. To use an example which is particularly familiar to us in the UAW, total employment in the aerospace industry has declined by 500,000, from a peak of 1,431,000 in March 1968 to an estimated 931,000 in December 1971. Many of these workers, together with many of the other unemployed and those still to be released from military service, have special skills or the ability, with some retraining, to develop skills which could be used in a civilian equivalent of NASA to tackle some of our major problems whose impact is nationwide.

The necessity for a national organization, in which government and private enterprise cooperate in meeting a national problem, has been recognized in the establishment of AMTRAK to provide nation-wide passenger rail service. If AMTRAK fails, as some contend it may, the fault will not be in the principle adopted, but in the fact that its application to passenger rail traffic alone was too narrow. A civilian NASA could be given the task of coordinating all forms of passenger transportation, both within and between our cities. Thus, it could be given the responsibility of developing new concepts in mass transit, not within a vacuum, but in close relationship to the services available through more traditional forms of transportation by air, road and rail.

And if, as the CEA Report indicates, our present systems of surface freight transportation are not operating as efficiently or as economically as they should, a similar program of coordination of the various systems could also be undertaken there.

### HOUSING

In the same way, a civilian-type NASA could undertake the mammoth task of producing the new housing required to meet our present and future needs. In 1968 the Congress declared that 26 million housing units must be provided by 1978; so far as we have provided only about 5 million of them, leaving 21 million units still to be built. To produce them, and especially to produce good homes at a cost that families with low or even moderate incomes can afford, we will have to reform the housing industry. We must develop new designs, new materials, new construction methods, and new ways of assembling and utilizing land without paying toll to land speculators.

In addition, a civilian NASA could explore the possibilities for this country of a "New Cities" program, such as that successfully undertaken in Britain, where whole new communities have been developed from scratch. Based on consideration of the total needs of those who are to live in them, the location of industrial areas, homes, schools, shopping areas, recreation and transportation would all be planned with the goal of providing a better community than is possible through present unplanned methods. Obviously, although again it could cooperate closely with private enterprises, both those now in existence and new ones which would develop, the undertaking of such a venture would require federal government initiative at the start such as a civilian NASA could provide.

POLLUTION

The battle against pollution, if it is to become successful, must be fought on the same large scale, crossing not only state boundaries but even national boundaries, as in the case of the present U.S.-Canadian International Joint Commission. It only makes sense, for example, that water pollution be attacked on a regional basis, each region comprising an entire watershed, such as that of the Great Lakes and the St. Lawrence, the Mississippi, the Hudson etc., although in the case of some of our largest drainage basins subdivision into subregional areas might be desirable.

Air pollution, on the other hand, might require a quite different approach, perhaps related to the direction of the prevailing winds or to other factors still unexplored.

An interesting suggestion has been made to meet the dangers both of accidental radiation and of "heat pollution" from nuclear power plants. That is that study be given to their location in thinly inhabited areas around cold waters such as Lake Huron and Lake Superior, where as the Canadian experience with such a plant on Lake Huron has shown, increasing the water temperature has actually improved the growth of fish and other marine life.

In the effort to clean up our waters, land and air, we reject the Administration's 1972 proposal to meet the problem by a scale of charges or taxes on industries which pollute, just as we rejected the similar "property rights" approach of 1971. This proposal neglects entirely that industry represents only one source of pollution; agriculture and city wastes are also sources of major importance. In any case, we know of no way in which the costs, especially the human costs, of pollution can be measured and set against the costs of reducing or eliminating it. All too probably an "antipollution tax" would quickly develop into a "license to pollute."

At the same time, in considering the costs of a successful war on pollution, which by some estimates may reach astronomical figures, we must remember that the economic costs of pollution itself can also be astronomical, ranging from the wiping out of commercial fisheries and the destruction of recreational areas on which millions of people depend for a living, to the corrosive effects of sulphur oxides and other pollutants on everything from automobiles to the very homes we live in.

POLLUTION, HEALTH AND SAFETY IN THE WORKING PLACE

Along with the battle against pollution in the community, we might fight also against pollution in the working place. We welcome the news that the Department of Labor is planning to crack down more heavily on employers who permit toxic substances to pollute the air in their plants, but we urge that more attention also be given to such problems as sound pollution, which has permanently endangered or destroyed the hearing of thousands of workers, and the general neglect of cleanliness which makes many jobs unnecessarily disagreeable and even hazardous.

We have long awaited an increase in the attention paid to occupational safety and health, but not nearly enough is being done. Congress should immediately authorize tripling the $50 million which the Administration has asked for the new Occupational Safety and Health Act to $150 million. Even that falls far short of what is needed, but it would provide an inspection staff of 3,000, training funds sufficient to meet the growing needs of both management and union personnel, and the kind of research money needed to carry out the government's responsibilities under the law.

WORKMEN'S COMPENSATION NEEDS REVAMPING

Our present patchwork system of state workmen's compensation laws also requires complete revamping. Since I testified at some length on this matter before the National Commission on State Workmen's Compensation Laws just a few weeks ago, I shall not repeat myself again here. Suffice it to say the present out-dated system is neither prompt, equitable nor adequate to meet the needs of today's workers and their families. It should be replaced by universal coverage under standards set by a federal Workmen's Compensation Commission. Benefits should provide for at least 75 percent of total wage loss, whether disability is temporary or permanent, and survivors should be paid for the full period of dependency or widowhood. Full provision should be made for both medical and vocational rehabilitation. Workmen's Compensation should be taken out of the hands of private insurance companies and benefits should be paid from state Workmen's Compensation Funds.

Other jurisdictions have made all these improvements and more. We should no longer permit ourselves to lag behind.

### OTHER WORKER PROTECTIONS NEEDED

Still other hazards face workers and their families to which they are entitled to protection.

We in the UAW have many times raised the issue of adequate federal minimum standards for state unemployment compensation systems. Such standards should guarantee workers adequate benefits for at least a year of unemployment to maintain themselves and their families in dignity and decency. They should outlaw the demeaning "search for work" requirements, at least at times and places when job opportunities are virtually nonexistent; with an adequate computerized employment service, a worker should need only to register with the service and be prepared to accept suitable work when it is found to be available.

A federal fund, financed through a small tax on contributions, should be established to reinsure private employer pension funds, so that if the employer goes out of business or otherwise discontinues the plan, workers will have a financial assurance that the benefits supposedly guaranteed them under the plan will actually be paid.

The minimum wage should be increased to at least $2.50 per hour, still barely enough to keep an average family above the poverty line. We reject vigorously the Administration's proposal to reduce the minimum wage for teenagers, which would be used by unscrupulous employers as a vehicle to replace adult skilled or semi-skilled workers with young boys and girls at a reduced wage.

We oppose vigorously the Cost of Living Council's decision to exempt only wages under $1.90 per hour from wage controls. This could mean that a worker earning $1.90 and restricted to a 5.5 percent increase would receive only 10 cents more for a total of $2.00 per hour—which, if he worked a full 2,080 hours per year, would give him earnings of only $4,160, less than that required to keep an average family out of poverty.

I also repeat again the plea that has been made many times, to spread work more evenly in times of high unemployment by restoring the premium pay for overtime work to a level which will enable the penalty to perform the function for which it was originally intended—to encourage employers to add to their work force in times of increased demand, rather than schedule overtime for those already employed. Because of the substantial increase, both through legislation and collective bargaining, in fringe benefits which tend to increase in cost with the number of workers employed, but not with the number of man-hours worked by any given work force, the present 50 percent premium is no longer adequate for that purpose. Overtime is still less costly than increased employment. UAW technicians have established that for the auto industry—and I am sure it is equally true for most other major industries—the premium must now be at least 100 percent to give the employer any significant incentive to increase his work force rather than schedule overtime. I shall not burden the Committee with their rather technical analysis at this time, but I shall be happy to supply the figures on request.

### MANPOWER TRAINING

After many years of experience in trying to deal with the problems of large-scale unemployment, I think few people would disagree today that one component of a full employment program must be more federal manpower training. Earlier in this statement we have indicated where we felt the present training programs fall short, and the obvious corollary is that we propose they be expanded.

We have also indicated how a civilian NASA-type organization could help increase the supply of workers with the special skills required for organizing the conversion from defense production or military service to meeting our social needs at home. The projects indicated would also provide a demand for semiskilled or even unskilled workers that could very easily match the supply.

Two other groups particularly attract our concern. One consists of the workers, like those in the Appalachian coal towns, whose only source of work, the only thing they know how to do, has run out and there are no more jobs for them. Some of them can be helped by bringing new industries to their communities which require skills they can learn. Others can be better helped through assistance in relocation, plus the necessary training for other jobs. Such assistance, of course, must be complemented by job-creating programs; there is nothing more likely to push a man or woman under for the last time than to move to a new home, train for a new job—and then find no job available.

The second group is that of the dropouts, found mostly in the central cities. Some are young people who for a variety of reasons, economic, family, psychological or just because the school has failed them, have dropped out of school, and after finding it impossible to get steady, rewarding employment, have dropped out of the labor market. Others are perhaps their older brothers and sisters, especially among the racial minorities, who have also dropped out because they find themselves left at the end of the employment line, and the line nowadays is always too long for them to reach the hiring gate. One of the heartbreaking consequences of the growth in unemployment is that through the cooperation of some forward-looking employers we had just begun to find jobs for these men and women who could not meet the standard requirements for hiring. Many of them, after considerable personal effort, had just begun to learn the hard discipline of the working-place, such obvious disciplines as punctuality and regular attendance on the job, when the layoffs began and they, as the last hired, were the first to be laid off again.

This emphasizes the fact that only in an economy of rapidly expanding employment can such manpower measures be effective. Given such a turnaround in the economy, we urge that vigorous measures be taken again, through work-study programs, expanded opportunities for vocational education and special arrangements with forward-looking employers to enable these dropouts from the economy—and all too often from society as a whole—to find their place in our nation's forward progress.

## NATIONAL HEALTH SECURITY

Despite 30 years of effort through negotiated group insurance programs, and the involvement of 1,800 different insurers, private insurance has failed to provide a major mechanism for financing and delivering health care for all our people. The industry has done a good job in getting across the need for protection and in selling beginning coverages for those who can afford them—but the job has outgrown them. Only one-third of Americans' health care expenditures are paid by insurance. Thirty-million people have no private coverage whatsoever; 36 million have no hospital insurance; 39 million have no surgical insurance and over 100 million have no coverage of basic physicians' office or home care visits.

Skyrocketing costs have gotten completely out of hand: compared to 15 years ago, the cost of health insurance for the average automobile worker is up 500 percent, and the coverage he has, although improved, is still limited in scope. Unions like our own find it increasingly costly to make substantial improvements in negotiated health care benefits: in our new contracts we find we must give up a portion of anticipated new wage increases simply to pay for the continuation of previously bargained benefits.

For years the organized medical profession has taken the lead in assuring us that we have the best health care in the world. Yet Americans last year spent $63 billion for health care that was thorough for very few, half-sufficient for millions more and totally missing for millions of others. There is ample evidence that the nation's health today is worse than it was 15 or 20 years ago, compared with other industrial nations.

Pouring additional funds into private insurance programs, as the Administration proposes through its own health plan, will add to overall waste and inefficiency and subsidize the present misguided nonsystem. Moreover, the National

Health Insurance Act is a plan with no comprehensive benefits, less benefits indeed than auto workers have in their present collective bargaining agreements. And the poor and near-poor are in most instances provided with fewer benefits than they have in the present fragmented Medicaid program.

As an alternative, the UAW among others, urges the enactment by Congress of the Health Security Program, which would deal simultaneously with the problems of health manpower shortages, spiraling costs, and lack of health care organization for the delivery of services.

The entire range of personal health services would be covered, including care for the prevention and early detection of disease, the treatment of illness, and rehabilitation.

Financing for the National Health Insurance Plan would be through a Health Security trust fund similar to the Social Security trust fund: 35 percent would come from a 3.5 percent tax on employer payrolls; 25 percent from a 2.1 percent tax on individual incomes up to $15,000; and the remaining 40 percent would come from federal general revenues.

### DRUG ABUSE AND ALCOHOLISM

The UAW is deeply concerned over the serious and growing problems of drug abuse, narcotics addiction and alcoholism in our society. We believe the spread of these "illnesses" is a reflection of the alienation of many, particularly the young, from our society; it is a reaction to the tensions and pressures of the harsh, real world, feelings of inadequacy and social conflicts which come from a value system which gives higher priority to material achievement than to people; it is an unhappy attempt to find "fantasy" solutions to gnawing personal and family problems; it is often a reflection of the dissatisfactions with the school, the home and the work place.

We urge federal, state, and local governments to intensify their efforts to develop new knowledge of the causes and methods of treatment of drug addiction and alcoholism and to augment support for the pitifully limited treatment resources now available. Accordingly, we welcome the call for an increase of $55 million in obligations for drug abuse programs in the 1973 Budget, and hope that it will continue to be an increasing effort.

### WELFARE REFORM

The UAW has consistently supported constructive efforts to reform public welfare programs. Present welfare allowances are woefully inadequate. Moreover, the variation in standards and administration from state to state lead to gross inequities among recipients.

The UAW supported the principle of basic reform in public welfare programs as embodied in the proposal initially made by the Nixon Administration, although we had a number of improvements to suggest. Regrettably, as the bill finally was passed by the House as HR 1, it became less welfare reform and more "punish the poor."

A fresh start has been made to provide minimum national welfare standards in the Amendments to HR 1 introduced by Senators Ribicoff and Hartke. They provide sound first steps for minimum incomes, constructive provisions to assist the poor to obtain education and training, and omit punitive, nonproductive requirements that welfare recipients must work. Fewer than 10 percent of persons receiving welfare aid are actually or potentially employable.

We shall continue to work for minimum national standards for welfare income, including prohibition of sweat shop wages and employment. President Nixon's veto of the carefully worked out program for a nationwide network of child care centers was a cynical repundiation of his own commitments of two years earlier. We shall continue to work with Congress to provide these needed facilities for the millions of American women who work and for their children who frequently do not have available decent facilities for their daytime care.

The requirement for maximum feasible participation of the poor in anti-poverty programs should be restored and made a reality. Wherever possible, anti-poverty jobs for which they can qualify should be given to the poor themselves.

Skilled social work and counselling services should be made available by the federal government through neighborhood centers, the schools and other local facilities readily accessible to the poor and others who may need such services.

Federal support of social work education should be expanded to increase the supply of skilled personnel, and qualified persons from low-income families and minority groups should be given special encouragement and assistance to undertake such education.

WHO WILL PAY?

The question arises, of course, who will pay for these ambitious programs, and how, without causing inflation?

There are several answers. First, in considerable part they will pay for themselves. A nation never made itself poor by producing more wealth. Putting the unemployed back to work will mean more earnings, and thus a wider tax base for federal, state and local revenues.

In addition, Nancy L. Teeters in a study for the Brookings Institution has estimated that at full employment the country would save some $8 billion in welfare and other transfer payments which would no longer be required.

Replacing slums with good homes in good neighborhoods will cut down on many local costs, such as those for crime prevention, fire protection, etc.

Much more can also be raised through continuing to close tax loopholes. The Tax Reform Act of 1969 only made a beginning. As noted earlier, at least $16 billion could be saved through closing those remaining tax loopholes which favor the wealthy almost exclusively.

In addition, as we have indicated, the program of tax reform should continue in the direction of making our tax system more progressive.

We favor reforms of the local property system which also have been proposed in Congress, so that large corporations, as well as such retreats of the wealthy as expensive country clubs would bear their full share of property taxes.

We beleieve that much could still be saved by paring more fat off the Pentagon. We support the proposal that if the Administration proposes a military budget of more than, say, $60 billion, it should be required to present also an alternative budget based on $60 billion in military spending, together with recommendations for programs to alleviate the hardships caused to defense workers by cutbacks in military spending.

Such an approach, incidentally, would also lead to more, not less employment. BLS data indicate that for every billion dollars spent in primarily defense-oriented industries, some 79,000 jobs are created, while for every billion of 1958 dollars spent in such industries as contract construction, which would be a major beneficiary of new peacetime programs, some 103,000 new jobs are created.

Still more fat could be pared by closing down unnecessary military bases at home and overseas. On his resignation as Deputy Secretary of Defense last December, for example, David Packard revealed to the press that one of the frustrations of his job had been the impossibility of cutting down unnecessary military bases in the U.S., many of which were maintained largely for political reasons. In addition, as of two years ago, we were maintaining 2,270 bases overseas (not including Vietnam), many of which seem more important for the propping up of military dictatorships in foreign lands than for the defense of this country. To close them down would not only save us large sums of money, and help rectify our imbalance of foreign payments, but would be one method of indicating our willingness to take direct steps toward ending the Cold War.

If rising inflation does nevertheless become a threat, we believe in attacking it where it is. We in the UAW believe we have demonstrated frequently enough that a major source of inflation must be traced to the administered price system which allows many huge corporations to insulate themselves to a considerable degree from the normal competitive forces of the market place. In doing so, they provide an economic "umbrella" for other firms which virtually destroys price competition in whole industries, and often replaces it with other forms of competition, such as excessive advertising, which add to costs rather than reducing them.

To meet this form of price-profit inflation, we have long advocated the establishment of a Price-Wage Review Board which would require major corporations and major unions, where necessary, in administered price industries to open up the books and reveal all the pertinent facts in public hearings before prices could be raised. We believe this would be far more effective than the present system of so-called price controls which is steadily being eroded. A most revealing report on the growing inadequacy of the price control program is to be found in the February 19 issue of the *National Journal*, which I recommend for perusal by every member of this Committee.

Still other inflationary pressures can be suppressed by eliminating the special protections given particular industries. S. David Freeman, for example, until last year director of the energy policy staff at the White House, just recently told this Committee that by limiting oil imports the government has imposed $5 billion a year in extra costs on the American consumer and encouraged oil companies to "skim the cream" off domestic oil reserves.

I do not believe that a country with as much natural and man-made wealth as the United States must suffer the alternatives of inflation or economic stagnation which prevents us from creating the wealth we require to meet our people's needs. The task may not be easy, but I hope I have suggested some useful methods by which it may be approached.

KEEP OUR STATISTICS CLEAN

I cannot conclude without making some reference to a most unhappy and unwise trend which I see developing in the field of government statistical information. One of the great strengths of the American economy is that businessmen, unions, farmers, professional economists and all other interested parties have usually had confidence that U.S. official government statistics were as fully reliable as they could be within sometimes limited resources. UAW technicians may have at times quarreled with technical methodologies, and we may have wished that more data could be made available, but we have always been confident that our statistical agencies were permitted to do their job as best they saw it, without partisan political interference.

Recently, however, there has been what some of us have felt to be a trend toward interference with the Bureau of Labor Statistics in particular, in the direction of limiting its action both in the gathering of data which might prove embarrassing to the Administration, and of interpreting them for the press and the public.

One current threat is that continued updating of the City Worker's Family Budget, which measures the needs of an average family, will be replaced by a new budget which will rather measure what is actually spent. This is a retrograde step, because the Family Budget has for years been used as a yardstick to measure actual needs, and often bears little relationship to how much families are actually able to spend in an effort to meet their needs. The planned change, incidentally, has been unanimously rejected by the Labor Research Advisory Council to BLS.

A second deletion which has already been mentioned is the suspension of surveys of unemployment rates in poverty neighborhoods. The value of these surveys in assessing the needs of the poor goes without saying.

In addition, there have recently been changes in the internal staff of BLS which have had the result of downgrading those sections of the Bureau which deal with analysis of data, especially with respect to unemployment, and the removal to other jobs of technical specialists who had great professional competence in these areas.

Some time earlier it was reported that BLS technicians would no longer hold monthly briefings with the press following release of data on employment, unemployment, prices and related matters, where the significance of the data could be explained. It is greatly to the credit of Senator Proxmire that he immediately responded by requesting BLS to hold such monthly briefings under his sponsorship.

In January last the very distinguished economist, Gardiner C. Means, wrote an article for the *Washington Post*, analyzing the increases in employment figures with which Administration spokesmen have been trying to take the public's mind off the intolerably high rate of unemployment. Mr. Means suggested that much of the increase was because many who had no regular jobs had undertaken various forms of self-employment, from selling encyclopedias door-to-door to casual labor such as snow shoveling and grass cutting, and were thus classified as employed although actually seriously under-employed. BLS Commissioner Geoffrey Moore replied to the article, but admitted that he could not explain the discrepancy of more than 700,000 between the increase in the number of persons reported as employed, and the actual increase in the number of payroll jobs.

Shortly after, a secret document from the Treasury, brought to public attention by Senator Proxmire, which suggested that the "full employment" goal of

4 percent unemployment should be raised to a higher level, has been accompanied by a questioning of unemployment and employment data by Treasury Secretary John B. Connally, and followed by the appointment of a special committee to make a "crash study" of the question. Not one person from BLS, which gathers and prepares the statistics, is included on the special committee. Concerning the original document, the *Wall Street Journal* of February 18 reports:

"Of 1971's average 4,993,000 unemployed persons, Mr. Liebling [Herman I. Liebling, a top Treasury economic forecaster and author of the original document] finds, 48% were below the age of 25 years. That's a segment of the population on which Mr. Nixon isn't believed to be counting much for reelection, anyway."

Mr. Chairman, if the statistics by which the economic health of this country are measured are going to be affected by the make-up of the groups on which this or any future Administration may be counting for reelection, then they become virtually useless. I urge this Committee to make a special investigation of this matter.

Chairman PROXMIRE. I want to thank you, Mr. Woodcock, very much.

I have a couple of quick reactions to your statement.

One is the one you touched on, but I think it would be helpful if you could possibly give us more precise analysis of it.

You admit that this would cost a great deal:

Increasing social security, as I understand it, by providing the Federal Government would match the amount that is now contributed by the employer and the employee.

Providing for a family assistance program that would be much higher than the one that the House has proposed, which costs $5 billion; and I take it your proposal would cost several times more than that if it is going to meet the standards which you suggest.

A health care program that would be the kind of comprehensive program that the UAW has advocated for a long time. You suggest that part of this would be taken care of by more employment—presumably unemployment down from 6 percent to 4 percent to 3 percent. Obviously, if it gets down to 4 percent you barely balance the budget, because we have full employment defined at 4-percent deficits now.

You suggest a tax reform which would raise such funds.

You suggest closing some military bases which would be, certainly, helpful.

But, all in all, it would seem to me that you may fall considerably short here, although I think the generalality which you give us, that we usually do not improverish our country by building our wealth, may well be correct.

Is there a possibility you could cost this out and then indicate where the money is likely to come from?

Could you do that?

I do not mean for us this morning; I mean for the record.[1]

Mr. WOODCOCK. Well, in the statement, for example, the military budget, anything beyond $60 billion would have to be justified, item by item. It is my own personal belief that for many, many years, in effect, the Pentagon was held unaccountable. It has never been under the pressure of the gun of having to adjust things. And I know, in my own union, when we went deeply into the red, we found ways of effecting economies because we had to, which we would not have done had we not been under the gun and in substantial deficit.

[1] Material to be supplied for the record was not available at time of printing the hearings.

The Pentagon has never been subject to those pressures.

I share the belief there are billions of dollars there that could be recovered, saved, without in one way affecting the security of our Nation. I am not now talking about new weapons systems. On those things, I am not an expert.

Chairman PROXMIRE. Needless to say, Mr. Woodcock, it is music to my ears. You know I have been hitting that beat for a long time.

But you say $60 billion. We are now at present proposing $81.5 billion. Perhaps there is a $20 billion saving there. But these programs—your shopping list—have a cost of at least $100 billion, it would seem to me, when you include the health care, a very large increase in welfare payments, all of the other ingredients that go into it. Again, I am not asking you to give me that analysis now, because I think it would be more helpful if you had a chance to look at it and give it to us at your leisure.

I may have misunderstood what you said, but, frankly, I have been advocating, with as much vigor as I know how, an antipollution tax. I have done that because it seemed to work. It was tried in West Germany, and it worked. It cleaned up the Ruhr River. There is no river on the face of the earth which should be more polluted than the Ruhr River. Saginaw, Mich.—They had a very serious pollution problem in Saginaw. They clamped an antipollution tax on, and in months they cleaned it up by more than 50 percent. Springfield, Mo.; Cincinnati, Ohio—the same thing. There is no reason why the antipollution tax should not be an incentive for cleanup, and I can't for the life of me see how it could be anything else.

I thought you said that the antipollution tax would develop into a license to pollute.

The principal conservation organizations took that view of my proposal the year before last. Now, they are all supporting it. They recognize that this should be an effective way of coping with pollution and imposing the burden of pollution where it should be—on those who use the products that are polluting. This where the incentives would have to fall.

Mr. WOODCOCK. If that is to be done, Senator, it has to be wedded to the others who are responsible, the public bodies, and so on, that would have at least as great and sometimes a greater impact upon the pollution in the atmosphere and the waters.

Chairman PROXMIRE. I agree wholeheartedly with that. Yes; it, indeed, does. It has to be tied in with the fact, as you say, that municipalities and other bodies perhaps are responsible for 50 percent.

Mr. WOODCOCK. And, of course, whether or not it becomes a license to pollute would relate directly to whether or not the tax was sufficient as against the cost effectiveness of the programs to avoid the tax. If the tax was relatively low, then it would become a license to pollute because they would cheerfully pay the tax and do nothing about decreasing pollution.

Chairman PROXMIRE. Yes; but the difficulty now is, when a firm is charged with pollution it hires a public relations firm, its lawyers go to work with the courts, and in case after case they have been able to go on year after year increasing their pollution. The present strategy was analyzed by the GAO in a report a year or so ago. They found the areas where the Federal Government spent the most money to prevent pollution, they have a more serious pollution problem than ever. It is partly because there is no clear understanding and a calculable economic disincentive to pollute. If you add a tax it is one way you increase your profits, you cut your pollution. The amount of oxygen demand you put into the water is reduced and your profits go up because your tax is cut. That is what I was getting at.

Mr. Woodcock, I have gone through your entire prepared statement.

It is a good one, as I say, and it is a long one. I am shocked at your avoidance of comment on phase II. You are in a remarkably strong position to understand it, not only as the head of one of the really great unions but also as a member of the Pay Board.

Are you satisfied with the way things have been going?

Mr. Woodcock. No: I am not. More than a year ago, when the Congress was considering the first Economic Stabilization Act, I testified against it. I spoke privately to key persons against it. I am on public record as beliveing the first Economic Stabilization Act was put into place as a political ploy and not because it was believed to be good for the country, which I think is the wrong way to legislate.

The major step having been taken on the 15th of August, it was obvious we had to have a phase II. I am concerned about the ineptness of the handling of the control, the class bias that is in there.

When, for example, in tier III, where there are 10 million enterprises, they are rigidly held to 5.5 percent on wage and economic benefits or they must report them, but on prices they can do what they will, being prepared to justify them if, in fact, caught in a spot check. The spot checks are being done at the rate of 10,000 per week, which means 10 million enterprises will be finally covered in 20 years.

Such a class bias, I think, does not go well to the equitable continuance of the controls we have. I do not say this with any joy, because I think in the period we now are in that controls should be equitably accepted and that there should be a cooperative relationship to make them function well. But the way they are being handled, I do not think they could, and the fact is, the slogan seems to be "Delay is the name of the game." The objective is not good, because it just piles up the inequity and means we will come very quickly to the point where the whole thing will fall of its own weight.

Chairman Proxmire. The area that has been most vigorously criticized—maybe it is unfair, maybe it is not adequate—but it has been the Pay Board. Frankly, it has been the fact there have been large pay settlements provided—coal, railroads, some other areas. I suppose the dockworkers may well be another. With a guideline of 5.5 percent—which may or may not be adequate, but with a guideline of 5.5 percent and with a settlement of 16 percent or 15 percent or 12 percent or more, perhaps, in the dockworkers' case, how can we have an effective anti-inflation program and provide exceptions of that kind?

Mr. Woodcock. Well, first of all, the Nation generally believes that the total problems of inflation is labor-cost push, which is not, of course, the fact. Labor-cost push did not create the inflation; it became a part of the problems along the way, and when we get a percentage guideline, it does not make much sense at all.

You take 5.5 percent on $2 an hour is 11 cents an hour; 5.5 percent on $8 an hour is 44 cents, and we are spreading the gap between the lowest and the highest, which is not good for our economic health. There certainly should be some figure which is allowable, let's say 5.5 percent of the average wage, which is in the neighborhood of $3.50. Then 5.5 percent of that, anything up to that, should be allowable, so we can get at the low pocket that creates practical problems.

The notion of establishing a guideline which becomes suddenly magical and mystical—we argued about 5.5 percent—5.5 percent is the product of an ongoing 3-percent productivity factor plus the objective of a 2.5-percent inflationary rate by the end of 1972. Hence, 5.5. We argue that it should be more than that. You say if the objective is 2 to 3, take the higher end of that. Take a somewhat higher figure so we can move down toward it, and we were told it has to be 5.5 because there will be so much above 5.5. But when the 5.5 gets in place, then it suddenly becomes the upper limit. You cannot take as complex and delicate an economy as that in this country in peacetime and hope to have that work. It just will not do.

What will happen when the Pay Board attempts to strike down the dockworkers' agreement?

The one on the east coast is higher than the one on the west coast, but it was helped put in place by a high official of this Government. These are very practical problems.

Chairman PROXMIRE. I was one of three Senators who voted against the Senate bill requiring compulsory arbitration in that case. One of the reasons I did is because I have a very deep feeling that collective bargaining is something we ought to make big sacrifices for—I mean the whole country. I think it is worth big economic losses at times to preserve collective bargaining. I think it is worth strikes. I do not think the strike is the world's worst thing. I think you have to accept strikes once in a while in a free society. You do not have them in Russia.

If we are going to have an effective anti-inflation program and mean business about it, then you can't say "Well, if the Pay Board insists on a noninflationary or mildly inflationary settlement, we can have a strike and the utilities then would not have the coal." It seems to me that is the kind of price you have to be willing to pay if you are going to have, as I say, freedom—freedom in labor negotiations, and if you are going to have any kind of discipline in holding down the cost of living.

It is easier for me to say it as a Senator who is not on the Pay Board. You are right in the line of fire. You are also a union leader. You are in the toughest spot of all, you and the people on the Pay Board—and the management side. Both of you groups are in a very tough position. I just feel very strongly about not dismissing the notion of a strike, and once we come to that, saying we cannot permit them to strike, why not?

Mr. WOODCOCK. I think I can approach these problems with a clear conscience. I had not been president of my own union very long when I went to the automobile negotiations, and hanging over us was the Teamsters' settlement where a very unique thing had happened. They made a national agreement ratified by the membership, reopened after the Chicago strike settlement which was a separate matter, increased its terms by 40 percent, provided wage increases of $1.85 over 39 months, plus 16 cents in cost of living, 8 cents in each of 2 years. And the members of my union were saying "If the Teamsters can do that, you can do that."

It was with a little trepidation, I will be frank to say, that I said to our local leaderships that it was wrong to do that: fighting for big increases in years 2 and 3 with ongoing contracts to anticipate inflation guarantees, unfortunately, the continuance of that inflation. We should be satisfied with a moderate increase in line with productivity, provided that that is protected by a cost-of-living clause. And, in fact, our cost-of-living clause only gives us 75 percent protection and not 100 percent protection because of the arithmetic of the calculation.

When that was done in auto and ag implement, it was largely followed in can, aluminum, steel, copper, and so on.

I believe that we were on the right track before the big freeze in August. I do not think the big move was needed in August, but I do not blame the President for doing it, because the Democratic leadership of this Congress was playing games with him and laid the basis for saying "Well, if things go wrong, he had the weapon which he did not use." And he did use it.

As one responsible American, I want to try to make that work the best it can for the good of my country.

Chairman PROXMIRE. That is a very good answer. I will be back.

Senator Percy.

Senator PERCY. Mr. Woodcock, one of the areas you have commented on, the value-added tax, is certainly going to be one of the most hotly debated issues involving tax policies of this year and next year.

You are uniquely qualified to comment on it, and I do agree right off that it is a far more regressive tax than our progressive income tax. It imposes a heavier load on the wage earner, particularly on the elderly who consume virtually all of their income as against higher income people who invest a great deal of theirs.

In Michigan, as I understand it, you had a value-added tax for a period of time, and it was abandoned. Is there any comment you can make on this experience in Michigan and whether the Michigan experience has any applicability to a national value-added tax?

Mr. WOODCOCK. I cannot, offhand, Senator; no.

Senator PERCY. I think we have a problem, though, that we have to face up to. The Federal Government has got to raise revenue for many of the programs that you espouse and support. Your welfare reform proposal is going to cost more money, not less. If we invest in people, as I think we should, health care is going to cost a great deal more. Certainly, the manpower programs that many of us support are going to cost more money. These programs just take into account the fact the job skill has to be changed much more frequently by a worker today to keep his job than ever before.

And environmental protection is going to cost more.

We can only get these added revenues from one of two places: cuts in existing programs or new sources of revenue.

Would you care to comment on any new sources of revenue you see or on cuts that can be made in the present level of expenditure?

Mr. WOODCOCK. In our prepared statement, we, of course, go to the question of the budget of the Pentagon. I underscore again that I am not necessarily talking about new weapons systems; I am just not competent to determine whether this or that weapons-system is needed.

It seems to me quite obvious that the way the budget has grown over the years, the comments made by Mr. Packard upon his resignation, would indicate there is gross waste in that budget. We hazard a figure of what is about $60 billion. Obviously, that is a high-sounding figure. There are certainly billions of dollars that can be recovered there.

We can be more precise about the closing of loopholes, some of which, I admit, would be very difficult to close.

But there would be an additional $16.2 billion in revenue there.

And the fact that the economy will be sharpened in its recovery will, in itself, of course, generate new tax revenues.

We believe with these ways we can find the money to do what is needed, as well as bringing the budget back into balance.

Senator PERCY. An idea was offered several years ago by the administration proposing a tax on leaded gasoline which would then make it more expensive to burn gasoline which contaminated the air. I have never seen a piece of legislation sent up on that. Have you taken any position on that, or do you have any advice as to whether that would be necessary?

The administration proposed at that time a level of taxation of 2 cents a gallon which might raise $1.3 billion.

Mr. WOODCOCK. Well, I must confess, again, I am not an expert on the economics of the petroleum industry, but I am old enough to remember when I paid more money to get lead in my gasoline, and I am paying more money to take the lead out of my gasoline. Somewhere I get lost along the way.

Whether it be through taxation or by flat prohibition to the point the automobiles on the market can function on nonleaded gasoline, obviously, some way has to be found, and if it is through taxation which can do the job, we support that.

Senator PERCY. One area where I have had my sharpest disagreement with the economists of labor unions has been in the incentives required for modernizing American industry. I have been very concerned that our plant and equipment is getting older and obsolete in this country as against other nations. This has been confirmed by visits that I have made to plants in this country and abroad through the years.

Statistically, last year was the first time this country dropped out of first place, down to fourth place, in the installation of new equipment. We are now behind the Soviet Union, Japan and Germany.

I just do not see how a nation can compete if it does not continue modernization. If we have much higher cost in labor and still less efficient machinery going into our plant and equipment with plants getting older, I do not see how we can really compete in the long run.

It is for this reason I did support the investment tax credit and new Treasury depreciation schedules. You indicate that you are in favor of ending the investment tax credits.

It is my belief, strongly, that the only way to create new jobs is to get new markets. There are plenty of markets. It is just that we are losing them abroad, and more and more foreign countries are taking over our domestic markets. How can we reconcile this difference?

What steps can I take to better understand labor's position?

I have invited their economists to consult with me at any time. At the hearings at the Treasury Department on ADR, I had no one call on me to give me the hard data that showed me why we are so far apart on this one issue. You, yourself, have been very progressive in the automobile industry in working with the companies to see they do keep modern and keep up to date and not resist new machinery and equipment going in, which I think is to your great credit.

But there has to be some things done. The adjustment assistance, for example. We talked to our people about that. It sounds good, but when it is in being it does not mean anything. And if we had, in fact, an effective adjustment assistance program so that companies and workers affected by these things could be helped along to the point where they again became properly self-sustaining, that would make it possible to continue to have a free-trade position.

But we, unfortunately, have relatively, the worst kind of a social security system of any of the developed nations. And when you have, for example, in the bearings industry where we have had overnight, thousands of our people dislocated by imports and they have no place to go, it is very difficult for me to say:

> Well, a free-trade position, basically, is good for our country—the question is not what may be good for the country but what about me right now. I have worked for this company for 22 years; I am 52 years old. What do I do?

And, of course, some say:

> Why don't you fight as hard for me as leaders of other unions are fighting for their people in support of Hartke-Burke?

And we have to find some kind of answers.

I met, for example, with a rather powerful group representing the Japanese Government. I said to them that it would seem to me the Japanese automobile industry would be well served if they began to assemble in the United States the cars for which they have a proven market over here. It would only be 12 percent of the total labor content, but it would begin to defuse this problem. It would be done not in the governmental sense but in the private sense. I am going to Japan in October, and I hope to get the opportunity to make this point to the Japanese manufacturers because they have to make moves, too, to get some sense of security to American workers or we are going to have a protectionist tide that would be, in the long run, I think, bad for the country.

Senator PERCY. I will just conclude at this point. I will send this part of your testimony to Peter Peterson, who is deeply interested. I think you will find in our new Secretary of Commerce a man dedicated to the principle of freer trade by consistently maintaining employment levels in this country. He has said:

Mr. WOODSTOCK. Of course, our concern with the tax is that it does not do the job it is designed to do. We have quoted again in this prepared statement General Motors Corp.'s Mr. Roche who said:

> The existence or non-existence of the tax will have nothing to do with General Motors' investment plans.

It seems to me that the investment credit should be allowed either on proof that this is an investment that would not otherwise have been made, which will merit the cut, or to companies of a certain smaller size or whatever. It has to be geared to a social end rather than just a broadaxe approach to the matter.

Senator PERCY. I agree that to the extent that a higher credit is given to equipment that is going to be purchased anyway, this could be considered in the nature of a windfall. But it also provides additional capital to buy new machinery and equipment and, I hope, provides incentive for the future. I tend to associate myself with a paragraph in the New York Times article you have enclosed and quoted in your prepared statement:

The program that was billed by President Nixon as one that will create more jobs for Americans may do precisely that in the long run.

I have always thought this would be no short-term stepladder. It takes a long time to make those decisions, to get the equipment ordered and installed, and so forth. I tend to think this is going to be a very important tool for job creating and increasing productivity in the future. I think it is going to be a longer term game than perhaps the administration did feel it was to be.

I would very much like your impression of the Hartke-Burke bill. Has the UAW taken a position on this? What do you think of this approach of protecting—possibly in the short run—maybe in the short run—but I do not think in the long run it would—American jobs by going highly "protectionist" as that bill would have us do?

Mr. WOODCOCK. Our union has had a traditional free-trade position. We have not changed that position, but, obviously, we have increasing concern. We have a convention coming up at the end of April, and we are trying, through discussion, to determine what should be our policy.

Again, I am old enough to remember the devastating consequences of Hawley-Smoot in 1931, in putting a fence around the United States, not solving the U.S. problems, and not only worsening our own but making the whole world's problems worse.

In our own company, we never made a decision to manufacture a product abroad until we could see by so doing it was to expand our markets abroad and would enable us to get more import licenses into that country of goods manufactured here so that we could guarantee our workers that by going abroad we would increase our employment in this country. The statistics through the years have borne out the wisdom of that policy. Never go abroad, until we can see it would really do us good at home, in providing the funds, the mechanism for doing it and doing it with the bargaining we did, say with Japan when we started out there.

So, I think your philosophy would be very consistent with his approach to this kind of problem. We find it very sympathetic in bargaining to find ways to accomplish more employment. I wish we had been able to find ways like that in the electronics industry in Chicago which is just devastated.

As I went through the unemployment offices as I told the chairman earlier—I talked to workers in the electronics industry. For 20 to 25 years we had an electronics industry and suddenly we do not have the industry left in Chicago of any consequence. It is all in the Far East now. We have not found the answer to that.

Mr. WOODCOCK. If I may, Mr. Chairman, there are things, of course, on which we are on record. On the question of capital export, and so on, which is now done in a purely private fashion, there should be some showing that it is in fact in the national interest, and then things must be done to protect those who are affected by it. But, obviously, movement overseas is not entirely negative, just as the Bell and Howell example you gave. I was in Peoria a couple of weeks ago and the Caterpillar management recalled that since they moved in with Mitsubishi in Japan the American Caterpillar exports have moved up from an averaged of $2 million to currently $48 million a year. This sort of thing we have to know and understand and not shut our eyes to.

Senator PERCY. I put Bill Blackie's case history in the Congressional Record recently, as a shining example of what can be done if you go abroad in the right way.

Thank you.

Chairman PROXMIRE. I was interested to hear you say, Mr. Woodcock—because you are completely honest as well as a thoughtful person, not given to statements that you feel you cannot support—and I was surprised to hear you say that you thought this was not a cost-push or wage-push inflation. Your prepared statement bears out your position, of course. You say that expectations are at the heart of the inflation, and at the same time the expectations, you admit, do enter into negotiations between labor and management which result in increases in wages and prices that are perhaps inflationary. But, as I understand it, you feel this can be somewhat reduced by protecting against an anticipated inflation, by encouraging cost-of-living settlements. Is that correct?

In other words, instead of having some of the huge settlements which are based apparently on expectation of big inflation, you have a settlement based on productivity and then leave the inflationary aspect to whatever does develop, and that is reflected in the actual increase in pay as the cost of living increases. Is that correct?

Mr. WOODCOCK. That is correct.

Let me make myself clear, Mr. Chairman. I said that the labor-cost push did not begin this inflation, it began with the escalation of the war in Vietnam, the primary factor in 1965, unfortunately unaccompanied by the necessary taxing measures that should have been taken in 1966. The guns-and-butter policy did not work. It produced inflation. Labor, then fighting to make up for its lost ground, became part of the problem—no question about it. Labor-cost push beginning in late 1966 became part of the total problem, but not the only problem.

The gross deficit in the Federal budget is inflationary.

The pumping up of the money supply that will inevitably take place this year as the economy is nudged up again, partly for political reasons, will be substantially inflationary, and just to overcome it by trying to restrain workers' incomes will only serve one purpose, and that is to channel more of the national income into profits and into the pockets of those who are essentially well off.

Chairman PROXMIRE. We had a distinguished economist, Mr. Harberger of Chicago, testify on Friday. He had a great deal of experience in advising and working with South American governments that encounter inflation. He suggested that we might adopt this principle which you have applied to wage settlements for many other things such as social security, for example, variable interest rates, so when people put the amount they save into a savings account, they would be protected. The Government bonds, so as the cost of living goes up, the value of the bonds would increase, the interest you would receive would increase; the social security benefits would increase, taking the real cutting edge—at least much of it—out of inflation.

Now, he said that has been tried in South American countries, and, in spite of the warning by many that this would be inflationary, it has not resulted that way at all. He gave us statistics that showed, while the inflation is still high by our standards, it is much less than it was 2 or 3 years ago, in spite of the fact they have insulated their economies to some extent by this kind of procedure.

Do you think this would be a principle that could be applied to savings, social security, and other sources of income in addition to wages?

Mr. Woodcock. I think it certainly could be applied to social security. However, I have a little concern in that regard, that if that were done, then, social security levels would be left entirely to rise only with the cost of living.

Chairman Proxmire. I have been concerned with that.

Of course, we have done much better than the cost of living.

I would agree with you that this kind of protection might be helpful if it is a supplement and not a definitive determination of social security.

Now, I would like very much to get your evaluation of the Price Commission.

We are going to ask the Price Commission to come before this committee this coming month.

Mr. Grayson. We want Judge Boldt to come before us, too.

We have gotten a lot of criticism from some of the witnesses who appeared before the committee, especially as to the Price Commission, frankly. Mr. Ackley was very precise in analyzing some of the things they had permitted. I am still very concerned about the secrecy with which they operate. They have had only one public hearing, and that was with respect to public utilities, nothing else. We would like very much to see what we can do about opening up a greater understanding of how this Price Commission and the Wage Board and the Cost of Living Council, for that matter, operate.

Could you give us your impressions on the operations of the Price Commission and where you think they could be improved?

Mr. Woodstock. Well, I can say, as a generality, I am not very happy with it, but that does not say very much. I suppose, in regard to the secrecy, that here we go to the question of productivity which is a key to their willingness to allow prices to move in any direction. Of course, productivity, as far as the bulk of American industry is concerned, is one of the most closest guarded secrets that they have. I think they find themselves in a very difficult position relative to that.

My problem is when you say, "What is your criticism," and so on?

For a while the Price Commission was getting editorial plaudits, they were doing a good job and the Pay Board was doing a rotten job. There was one newspaper in which I remember reading an editorial praising the Price Commission and kicking the Pay Board around, and also in that same issue there was just a little item that showed that their advertising rates had been allowed to increase by 4.7 percent by the Price Commission of whom they were so laudatory.

I think it would be hard to revise the statistics, no matter how you do it, it is arbitrary, but one way of highlighting it, making the public more conscious, would have been to continue the press conferences that were held by the technicians who explained this kind of thing.

What we have now is a release, in which the Bureau of Labor Statistics doesn't say very much, and has some tables and then you have a public interpretation by the Secretary of Labor, who is a political appointee, an administration man.

And any administration is going to put the best possible light on the statistics, and that is it.

We do not give the press a chance to meet in a conference with the real experts who put this together, and who are nonpartisan, nonpolitical, and who seem to me are much more likely to give the press, and therefore the public, a clearer and more comprehensive picture of this kind of thing.

Mr. WOODCOCK. Well, I certainly agree the discontinuation of the press conferences was a very bad thing from the policy point of view. And I applaud you, sir, for trying to make a substitute for that, but there can be no substitute for the Government itself, the Government, that piece of the Government that is responsible, being directly responsive to the people through the press.

It is the only medium we have, and to substitute for that information by press handout is not good enough. It is not democratic.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. I have been very much interested, Mr. Woodstock, in following the automobile industry closely this last year, as a hopeful sign for the future. I think the economy is going to depend very much more on the automobile than housing. Certainly this year.

I have been looking at the question of overtime carefully because of the statements made by some of the automotive manufacturers which I really deplore, that they intended when auto production increased to increase the amount of overtime, rather than new hires.

And I joined with a number of Senators in bringing this to the administration's and the President's attention, to be a factor we ought to look at. The automobile industry was a leader in hiring the hardcore unemployed. They were laid off when there had to be layoffs.

We certainly want to try to hire those people back, as much as possible.

In looking at the amount of overtime put in, January to June of 1971 was 4 hours per week; August, 2.6; September, 3.2. I do not have figures for the late fall. Do you happen to know whether overtime actually was increasing during those periods or decreasing, or was about the same as it had been previously?

Chairman PROXMIRE. Let me follow that up a little bit. How do we phase out of phase II, and move into phase III? They have already knocked out small firms, retail firms that gross $100,000 or less, would you think this is the way to do it, or is there some other better way to accomplish that end?

I would agree with you we ought to get out of this as fast as we can, but is is a question of how you do it, about permitting inflationary forces to move in again.

Mr. WOODCOCK. Well, having taken phase I, now being in phase II, you can't even yet say "Well, tomorrow the thing is off." Because that would produce new uncertainties on top of present uncertainties.

But we continue to believe that the basic long-run answer is the kind of wage-price review board we have been advocating now for 14 or 15 years, covering the administered pricing section of the economy which takes in most of the big companies, 100 or so, we estimate, and put them under the spotlight of public opinion on their price movements. I think we would see some very salutary things happen in our economy.

Chairman PROXMIRE. You think we could move to that rather quickly?

Mr. WOODCOCK. I think we could; yes.

Chairman PROXMIRE. I would like to see that, too. I certainly favor our doing it and I think you are right, this is where most of the inflationary problem lies, in the very large sectors of our economy.

I am also impressed with table 3 in your prepared statement. Instead of the current official figure of unemployment of 5.1 million, you put it at 6.8 million. This is a tremendous difference.

I assume you do not attribute this to any connivance by technicians?

Mr. WOODCOCK. No.

Chairman PROXMIRE. Why shouldn't these facts be made public regularly, or what is the reason for this?

Mr. WOODCOCK. Well, obviously, the question of those who hold part-time jobs but who need in fact full-time jobs is an estimate, and those who have dropped out because they are discouraged and no longer looking for work as a number of 700,000, again is an estimate.

We think it is pretty close to the fact. The fact that someone drops out of the market and gets by somehow does not lessen the fact that that individual very much needs a job. And because the large proportion of those happen to be women and teenagers out of work and out of school, certainly does not diminish the fact that as a special objective they have to be included in any full employment objective this Nation should have.

Chairman PROXMIRE. You are saying those who dropped out of the labor force and those who are working part time who would like to work full time and they are counted as fully employed, these factors are overlooked in the 5.1 million unemployed.

Mr. WOODCOCK. In the automobile industry?

Senator PERCY. Yes.

Mr. WOODCOCK. I do not have them off the top of my head.

Senator PERCY. Do you feel that there has been a tendency to put in overtime, rather than hire new people? Has the repeal of the excise tax and the added incentives that were given to the automotive field to stimulate production and sales, actually increased employment? Do you have any indications that overtime is being resorted to rather than hiring additional workers?

Mr. Woodcock. Of course, at the beginning of the model period overtime has been the general practice, because of the question of working out the bugs, as we term it. With the lessening of the style changes, that becomes less of a problem, for example, in the fall of 1971.

Of course, Mr. Iacocca and Mr. Cole of Ford and General Motors, respectively, are on the public record as saying flatly, if we get an increase in production, we will do it through overtime.

The unfortunate thing is the time and a half, which our contracts call for as well as the law. It is cheaper to work overtime than it is to bring somebody on to work, let us say, 13 weeks, but not beyond 26 weeks.

Senator Percy. Well, I realize that as a former manufacturer, the tendency is to always put in more overtime. But, of course, our problem is to get unemployment down. And if we cannot get it down and we cannot hire new people in the automotive industry, where we have given a real incentive and real boost at a loss of tax revenue then I would be concerned.

I would very much appreciate your union keeping an eye on this because of your own social concern of getting reduced unemployment and because of the high level of unemployment realtively speaking in Michigan, as to whether or not too much overtime is being resorted to and whether or not this does not indicate to the automobile industry a lack of confidence in the future.

Maybe the present high sales are just a temporary thing. I would hope we have provided a stimulus that would long sustain.

Actually, new hires in 1971 seems to be lower than previous averages, The average, 1966 to 1970, was 2.3 new hires per 100 workers. It was 1.1 percent in July; 1.7 in August; 1.2 in September; and I again do not have other figures. But if you have more current figures in your economics department, I would certainly appreciate having them.

Mr. Woodcock. We will check.

Senator Percy. I would like to watch this with you in a most kindly way along with the industry to encourage them to hire new people in every way we possibly can. If it is a lack of training funds, we certainly ought to see you get training funds.

But that industry is a bellwether industry for so much else, and if we can't make progress in new hires there, I would be concerned if we could in other industries.

I would like to turn to the debate on unemployment as to what is a proper level. I do so because of the recent studies that have been released indicating that 4 percent is no longer a norm, that 4.5 percent is closer to it. This is a terribly important point and I draw no conclusion at all that if 4.5 percent is the norm, then we ought to be having a full employment budget at 4.5 percent, not 4 percent. If we continue to budget at 4 percent, but feel 4.5 percent is more realistic, we will have permanent deficits as long as we can see. Even in periods when emnloyment is higher.

Can you provide any further data on evaluating what is normal?

And I go back to your own statement in your prepared statement, in which you say:

Since 1947 we had average rates of unemployment below 4 percent in 9 years or more than one-third of the time.

If we take those years and examine them carefully, we achieved unemployment rates below 4 percent in 1966 to 1969, which is, of course, a period of heavy expenditures for Vietnam. We did in 1951 to 1953, which was during the Korean war. And in 2 years before 1950, namely, 1947 and 1948. The years of unemployment rate between 4 percent and 4.5 percent were from 1955 to 1957 and 1965, which was the beginning of the Vietnam buildup. Putting that all together, there has been no year in the last 20 years, other than a war or a war buildup year, which saw an unemployment rate below 4.5.

Since we're talking about peacetime goals, and hopefully have a decade of peace ahead of us, or a generation of peace, these statistics worry me. I just do not know what the accurate figure should be.

As a legislator, it makes a whale of a difference to us, as to what we look upon as normal peacetime unemployment. We do know in the figures you have so aptly given, the impact is harsh on blacks today, and the figures you give, 10 to 11 percent overall and in the region of St. Louis, the 5-county region, among young blacks it is over 25 percent, and that is just unconscionable. We can't tolerate levels of that kind. Your help in providing that data, as to what is a really normal unemployment level would be extremely helpful to us.

If you have any further comments on that, I would very much appreciate them.

Mr. WOODCOCK. Of course, this ties in, we all know, with the hoped-for absence of inflation. I still remember Sumner Slichter who said "Creeping inflation is endemic with our system. And as between having millions of our people condemned to be outside society and having my own income and assets somewhat eroded by a degree of inflation, I would sooner see them part of our society and have my own assets somewhat diminished." That is really what we are saying.

Senator PERCY. Well, I think it is something we are going to watch very carefully and should we come across information you might not have, we will certainly send it along to you for analysis.

But we are going to need joint guidance, I think, here.

In your prepared statement you very frankly indicate that you would not hestitate to admit wage increases demanded have at times exceeded the amount justified by price increases which have already taken place.

I have made the statement that I do not feel very strongly that the day of demanding more and being willing to give less should be over if there is to be a real competitive position that American labor and management can take in creating new world markets and expanding our output here. I haven't found labor, organized labor, disagreeing with that. I found a cynicism by business that labor would ever take that attitude. But in your own area of increasing productivity, can the UAW be helpful in stimulating the creation of productivity councils such as we operated so effectively during World War II? Both the chairman and I sponsored legislation of Senator Javits to create productivity councils. We have about $10 million available now for this purpose.

Can the UAW help take a leadership position? I find a reluctance by business to get started on it, because they think labor is not going to cooperate. They have been so used to fighting labor, they just cannot believe labor is going to be on the same side of the table with them.

I have always found labor in this regard very progressive and anxious to work toward a national goal and work on the same side of the table when we have a common interest with management.

Mr. Woodcock. We would be happy to cooperate with that. As far as our biggest companies with which we deal are concerned, they do not seem to have too much interest. That is our prerogative, they tell us. Of course, when I hear discussion about wage increases may be permissible if tied into the trading away of improper work rules, we are in the unfortunate position of not having any improper work rules to trade off. So we find ourselves in an increasingly difficult position.

But we would be happy to cooperate in that if the industry has a desire to.

Senator Percy. There is one other area I feel is vitally necessary. I was quite interested in talking recently with Sylvia Porter about productivity, to find that she is a sophisticated economist with a readership of 42 million, or her column at least has that potential, but that she was unaware of the fact that the law now provides in the so-called Percy Amendment for a total exemption from wage controls by the Pay Board for any wage increases that are granted as a result of increased productivity.

She and others thought right away, does that mean speedup of work? And on the floor of the Senate, I specifically excluded any of that kind of activity so that it would remove from the worker the feeling this is just a pressure to drive him to produce more which in the end might reduce employment.

The Pay Board has just this last week increased or issued the guidelines for this particular so-called Percy Amendment, which I am happy to say our chairman was the principal cosponsor. Can the UAW get the word out and help get the word out that we are not in any way trying to limit wage increases but that we want to pay people more?

That is the way to stimulate an economy, to create more consumerism.

What we cannot stand is wage increases totally unrelated to productivity increases that force prices up which make wage increases meaningless.

Can the UAW use its powerful communication of sources to somehow promulgate these guidelines which are very simple, very direct, and help us get business going so that labor and business can work cooperatively toward ways of getting wages up in a way that will not force prices up?

Mr. Woodcock. We would be happy to cooperate there, too, Senator.

Of course, from the social point of view, in those industries that are able to operate above the productivity line, rather than the workers in those industries getting higher wages by virtue of that fact, they really should reduce their prices so the total society shares in that benefit, and not simply those who happen to be working in that enterprise. That is the whole principle behind the UAW wage theory, that we limit productivity increases, wage increases to the national or social productivity in the belief that when productivity exceeds that—and I think in most of the companies in which we do business that is the fact—that should be reflected in lower prices, so that the total society is the beneficiary.

Senator PERCY. I think in the Price Commission we have a man who we will be questioning subsequently in these hearings. But I am impressed with the fact he is determined to bring excess prices down. That is about the only mechanism I guess we have got for getting at it, but I agree with the philosophy of it certainly.

Senator PROXMIRE. Mr. Woodcock, I might follow up what Senator Percy has said about the unemployment rate that we can achieve without unacceptable inflation. The figures show in 1955, unemployment was 4.4 percent, a peace year; 1956, 4.1 percent, a peacetime year; 1957, 4.3 percent, a peacetime year; average inflation for those 3 years, 2 percent.

Since that time education levels have increased. It should be easier to employ the people, many of the people who are unemployed, because they are better educated now than they were 15 years ago.

Mr. Okun pointed out that since 1957 education levels have increased so much that we should be able, our tradeoff ought to be less than it was then.

In other words, we ought to get unemployment down lower with the same degree of inflation.

Discrimination, another element which structurally prevented us from achieving a reasonable level of unemployment, is certainly less than it was before. We have a long way to go. We all hope the bill that passed the Senate last week is going to become law. That is going to help.

But certainly I think anybody who goes to a plant today, as you and I have done so often and you know so much about the people, not only UAW has had the policy so many years, other unions and nonunion shops are required not to discriminate as much as they did in the past. That helps.

Manpower training, 20 times as great as it was in 1957. All of these elements are the kind of structural improvements people are talking about. It seems the notion we cannot get unemployment below 4.5 percent or 5 percent just does not make sense.

It is true there are more women. But the women are better educated than the men were. It is true there were more blacks but the blacks are better educated than the white married men were.

After all, when it is argued we have had unemployment because we have more females in the work force or more blacks on the work force, the important element is whether these people have a skill, anything they can sell, anything they can use. It seems they do have more of a skill, are better able to be employed than they were then.

What is your comment on that situation?

Mr. WOODCOCK. Well, I agree with all of the things you have said, Mr. Chairman. We cannot have a viable democratic society if we have, as an accepted part of our total program, the notion that millions of our people are not part of that society. It will just tear the guts out of this country.

And to accept a high level of unemployment as something that is part and parcel of our total position is to go against the grain of everything in which we believe. When people need to work, this society has got to be in a position to give them the work they need.

Chairman PROXMIRE. Do you see anything at all in the structure of our society now, or the nature of our technology, which makes it harder to get unemployment down than it was 10 or 15 or 20 years ago, without a high rate of inflation?

Mr. WOODCOCK. I think the whole notion of structural unemployment has been overdone. The fact that even if it is during war-induced periods, that we are then able to put them to work, shows that structural unemployment can be met, because if there were in fact structural unemployment, it would stay in place whether you have a war-induced economy or not. Because by its very nature, we are by statistics covering up our shortcomings.

Senator PROXMIRE. I find your table 2 in your prepared statement fascinating. Let me go over it with you.

Compared with either cyclical troughs or prior peaks, the performance four quarters to the recovery, our most recent experience is the worst.

No. 1, the gain in real GNP is least.

No. 2, the gain in industrial production is least. In fact, in the case of industrial production we are still below the previous peak, whereas in other recessions we had by a year after the low point substantially exceeded the previous peak.

No. 3, the recovery in rate of utilization of manufacturing capacity is nonexistent in the most recent cycle, and we are still 10 percent below capacity utilization when we were at the last cyclical peak.

The unemployment rate, No. 4, at the recovery phase of the present cycle is far higher than that in the three previous cycles.

Would this be a fair summary or reading of the statistics?

Mr. WOODCOCK. Yes; it would.

Chairman PROXMIRE. As I understand the administration's position, it claims we should not expect as rapid recovery as in past cycles because the recession was not so great. What is your response to that?

Mr. WOODCOCK. Well, the recession wasn't so great in the sense of falling to a point, but it was great in terms of its length. Of course, it was an engineered recession, which was another unique quality it had. But that does not affect the fact that our recovery has not been very substantial. I think, in large part, this is because of the uncertainty.

The uncertainty, unfortunately, is being intensified by the control mechanisms that are operative. There has been a certain loss of faith in our future.

I had a somewhat contradictory experience, speaking along with the chairman of one of America's biggest corporations, before the New York Economic Club.

He was speaking, in effect, for permanent economic control. I was speaking, in effect, for a free market economy. It seemed to me our roles were somewhat mixed up.

But there seems to be a loss of faith in the viability of our system by men who are in key positions of power. I am not speaking now of Government. I am speaking about private industry.

Chairman PROXMIRE. That is fascinating. The management's position has been for controls and the labor position is for free market in the case you give, in the debate.

Mr. WOODCOCK. It wasn't a debate. We just happened to share the platform at this dinner meeting.

Chairman PROXMIRE. You point out the administration in early 1971 forecast a 4.5-percent unemployment in mid-1972 and it may get down to 5 percent by the end of 1972. You argue with that. You say it would not get down to that level for a long time if we follow present policies.

At this point I would like you to highlight what is wrong with the administration's forecast for unemployment in 1972.

Mr. WOODCOCK. Well, by the time that has already passed, it is quite obvious that they are not going to meet their prediction. And the weight of the evidence, as far as those who are in the business are predicting, which I note is on the high side, as we say is 5.3 percent. That will be by the end of the year. The average for the year will be considerably above 5.5.

Chairman PROXMIRE. I take it that you do not expect sustained housing investment this year. Part of this is due to overbuilding, but I take it part is also due to rising mortgage rates later this year.

Mr. WOODCOCK. Right. Mortgage rates and also the fact that we do not have a proper land use policy in the Federal or in the States.

Chairman PROXMIRE. It is interesting that rising mortgage rates is something the Federal Reserve Board, I think, recognizes, the undesirability of high long-term rates. The Fed has been under criticism. It is kind of amusing. They have been under criticism for driving short-term rates too low, that is from people who say this has resulted in more of this Nation's money flowing out when we need it to come in because of the balance of payments.

I think they could adopt policies which would be much more constructive, especially with respect to housing. We proposed those policies again and again. I have offered legislation to enable the Fed, for example, to buy housing obligations as other central banks do in other nations. At any rate, you feel on the basis of the analysis of you and your economists the mortage rates are likely to rise and it is going to limit the prospects of continued high level of housing construction at the end of the year?

Mr. WOODCOCK. That is the advice I get; yes, sir.

Chairman PROXMIRE. Do you think we could avoid that by a different kind of monetary policy that would favor keeping long-term rates low?

Mr. WOODCOCK. I don't see why that isn't possible. Other countries do it in a successful way. There is no reason why we can't.

Chairman PROXMIRE. Is it true that you feel a lag in consumer spending is not due to consumer price expectations but the fear of unemployment? I think you say that in your prepared statement.

Mr. WOODCOCK. Fear of unemployment, and that being part and parcel of the jumble of uncertainty in the fear.

Chairman PROXMIRE. That is one of the major reasons why the administration's forecast is likely to be off?

Mr. WOODCOCK. I think so.

Chairman PROXMIRE. I note in your prepared statement that you dispute the claim repeatedly made by the administration that profits have been squeezed in the most recent period.

You say reported profits have been held down because profits have been shifted to costs—capital consumption allowances.

Would you supply for the record how corporate profits would compare in the last several years had there been no change in capital consumption allowances from 1967 through 1972?

Also, would you supply for the record how this compares with the experience of other income shares?

Mr. WOODCOCK. Yes; we will, sir.[1]

Chairman PROXMIRE. I agree the House-passed family assistance plan ought to be improved. You argue the payments are inadequate. Would you favor a provision which involved $11.4 billion to raise all poor family incomes to or above the poverty line?

Mr. WOODCOCK. Let me say in response to that, Mr. Chairman, I am most hopeful that the principle at least will be established, and the arithmetic can be thought out later. But, obviously, the amount now proposed is woefully inadequate. It was when it was proposed. It is even more inadequate now. I can think of no better way to spend that money than in this way.

There will be other savings, administrative savings, and so on, when we move to a sensible way of helping those who are outside our economic system.

Chairman PROXMIRE. Isn't the cost of this program likely to depend very heavily on the status of our economy? For example, if we have a low level of unemployment, if the working poor can find jobs at which they can earn a pretty good income then, obviously, the cost of the program diminishes. If we have a high level of unemployment, then your cost is going to balloon.

So one way of keeping this cost down and at the same time permitting more reasonable allowances is to make sure you have an economy that is really functioning on all eight cylinders.

Mr. WOODCOCK. That is correct. Of course, if we have a high level of unemployment, the costs are going to be there in some fashion, anyway. They may not be as visible as they would be if we had a sensible Federal system.

Chairman PROXMIRE. Right now the costs are borne overwhelmingly by the poor, themselves, in inadequate shelter, food, inadequate opportunities to live a good life.

Mr. WOODCOCK. And it may be old fashioned, but I think it is a major factor in our unemployment.

Chairman PROXMIRE. I couldn't agree with you more on that.

In your prepared statement you note an increasing frequency of cases where workers are forced to give up pay increases in order to keep jobs. Perhaps this is just what the present administration was aiming at. Do you know of similar situations where business held down or reduced prices to maintain their markets?

Mr. WOODCOCK. In my home town of Detroit, we have had quite a wave of demanded wage cuts for staying in that market. And the workers have had to decide as between the wage benefit and the security of a job.

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[1] Material to be supplied for the record was not available at time of printing the hearings.

Chairman PROXMIRE. Do you see any policy here? Do you think this is a governmental policy?

Mr. WOODCOCK. No, I don't think so.

Chairman PROXMIRE. Is this an economic fact of life?

Mr. WOODCOCK. I think it is a consequence of the economics.

Chairman PROXMIRE. Do I read you correctly in your prepared statement that it looks as if wage increases in 1972 will be in the 6- to 8-percent range?

Mr. WOODCOCK. This is in existing contracts?

Chairman PROXMIRE. Yes, sir.

Mr. WOODCOCK. Well, of course, for those who have cost of living clauses, it will depend upon the degree to which inflation is in fact motivated. But it could well be in that range, yes.

Chairman PROXMIRE. Well, now, say increases averaged 6.8 percent, I believe, in 1971. One argument is if they are around 7 percent this year, they might have a more inflationary impact on the prices in 1972 than we had in 1971, on the assumption that productivity is the same. And productivity is unlikely to be higher in the second year of recovery, so this would mean it would be hard to make much progress in fighting inflation, under those circumstances, wouldn't it?

Mr. WOODCOCK. I think as a generality, the productivity of the second year of recovery tends to be less than in the first. But in this sluggish recovery, I think the reverse would be true. I think productivity will rise more sharply in the second year than in the first year, if we identify last year as the first year of recovery.

Chairman PROXMIRE. On the assumption you do have 6.8 percent wage increase and the assumption, make any assumption you want to about inflation and about local taxes, and other elements of it, would you estimate that this would provide any increase in real take-home pay?

Mr. WOODCOCK. There has been some slight increase in real take-home pay on an average. I would think that would be retained, hopefully, in this period.

Chairman PROXMIRE. I note in table 5 of your prepared statement which says that real spendable earnings in manufacturing have not increased one iota since 1965. That seems appalling to me. Why is that so?

Mr. WOODCOCK. I just said that last year there was some small increase, but that overcame in effect the net decrease in the period 1965 to 1970. There had been a net decrease.

Chairman PROXMIRE. One of the economists appearing before this committee argued because there are more members of the family working now than before, because whereas a few years ago it was rarer for a wife to work or for children to work, that actual family income, real income, has increased even though individual pay has been eroded by inflation and local tax increases.

Is this possible?

Mr. WOODCOCK. Well, I don't know how these statistics vary over the years. I understand the average wage earner per family is 1.7. The average family is somewhat less than four, according to the

Census Bureau. But I do know from my own members, who are in the upper bracket as far as industrial workers are concerned, that if there are children in the family the wife has to have some kind of a job if they are going to have a decent standard of living.

Chairman PROXMIRE. Just one other question in this connection. To what do you attribute this pickup in the last year? Apparently, for the period from 1965 to 1970, when there was no pickup, I mean where there was no improvement in real take-home pay. Now there has been, you say. Why?

Mr. WOODCOCK. In the first part of the 5 years when there was in effect a net decrease, wages relative to rises in prices were not moving up nearly as fast and there was a sharp decrease at that point.

And in the last year there has been, in the last 18 months, there has been in effect a recovering of that ground and inflation was, of course, moderated even before the freeze of August 15. It was still up at a very high rate but it was less than it had been.

These two things together made for the recovery of the ground, putting us back where we were relatively in the position of 1965.

Now, that, of course, is an average. As Mr. Heller said, a man with one foot on a hot stove and the other foot in the icebox, on the average is comfortable.

Chairman PROXMIRE. That is a good analogy.

Senator Percy.

Senator PERCY. Just a few more questions. There has been some considerable discussion and proposals of double time for overtime. Would you give us your views on that, Mr. Woodcock?

Mr. WOODCOCK. We believe it is necessary to restore the deterrent effect of the overtime rate which was the original purpose of the Fair Labor Standards Act in the mid-1930's. It was not to give more money to the workers. It was to give an incentive for the employer to put new people on when he had more work to do, rather than working those who were on his payroll more time.

Time and a half is no longer a deterrent, certainly in our industry, and we will press vigorously in our contract to repair that deficiency. But I would hope we would also do it through amendments to the Fair Labor Standards Act.

Senator PERCY. Under the title "Neglect of the Poverty Problem" in your prepared statement, you talk about the failure to address ourselves to this problem adequately. I am particularly concerned with poverty among the elderly. It is the only group in America where poverty is increasing every year, getting worse, not better, and where the prospects and hopes appear to be so dim due to people living so much longer, inadequacy of retirement income, high cost of living, and little recourse that they can have. A very small proportion of our resources are going to help the elderly.

I have introduced a very comprehensive and I presume in many respects a very expensive program for the elderly, just two challenge us to raise our sights. Some aspects of it are fully supported by others. I presume you support 100 percent payment to widows under social security rather than 82.5 percent that is now paid.

Have you taken a position on providing prescription drugs to people under medicare? This is a costly venture, but do you support that?

Mr. WOODCOCK. We support that, although under our private program we make that available through the employers. But we think it should be available on a general basis to those in our Nation who fall in that category.

Senator PERCY. Our distinguished chairman is a member of the Banking Committee that I served on for 4 years. I find it is harder to fight when you are not on the committee than when you are on the committee. I have long wanted to see an Assistant Secretary of Housing, an additional position created. I would have liked it statutorily for the elderly, but I would be quite satisfied if they created an additional slot and designated him as exclusively concerned with the problems of the elderly.

That includes not just public housing or public financed housing, but the problem of how do they continue to pay their real estate taxes when they are not educating children and so forth.

We are going to report out a bill. I understand it does not make provision for it. I intend to fight for it on the floor of the Senate. Would the UAW feel this upgrading of the problem of the housing for the elderly to an assistant secretary level and having one man deeply concerned with it be a desirable thing?

Mr. WOODCOCK. Yes, we would. I might say with regard to this general problem of the elderly, I would hope that when Mr. Mills talks about a 20-percent rather than a 5-percent increase in social security benefits, that is weighted toward the low end of the scale; because this is where the concentration of poverty is, those who get woefuly inadequate amounts from social security.

Senator PERCY. You do support the cost of living escalator for social security recipients?

Mr. WOODCOCK. We do, with the caution that it not be frozen from then on. That is all the Congress has to address itself to. If in fact our economy rose and there is a productivity factor, those on social security are entitled to share in that increase.

Senator PERCY. That is right.

Mr. WOODCOCK. Not simply keep even.

Senator PERCY. Right. It would be not a replacement for that.

Does the UAW support feeding programs? We were struggling a year ago to keep a $1.7 million experimental program—feeding for the elderly—alive. It would have provided at least one hot meal in experimental centers across the country, 5 days a week. We now overwhelmingly have voted for $100 million to provide this on a more permanent basis across the country.

Do you support this legislation on funding for it?

Mr. WOODCOCK. Yes, we do.

Senator PERCY. And full funding for it, I presume.

Another area of filling a need which I find is very great among the elderly is some place they can go. I suppose this is why they gravitate to States that cater to the elderly, such as California and Florida. But we need community centers for the elderly and construction funds, just as we need day care center construction money. I think we need construction money for community centers for the elderly, where they can go, where they can be with people their own age, where they can be in some central place where services can be provided. Transportation alone is one of the hardest things. They lose their driver's license.

We are failing in mass transportation and public transportation in big cities and small cities. The elderly are immobile. I don't know whether you have addressed yourself to this problem. It is going to take a lot of money, but is this an area of priority you feel the UAW would support?

Mr. WOODCOCK. Most definitely. And in a private way, where we can do this ourselves, we have, as part of the local union, or separately where we have substantial members, we have retiree centers where we give counseling and other aid, sometimes in connection with the United Fund. But it is really a godsend to the people that have such a source.

Senator PERCY. Lastly, although it does not cost the Federal Government anything, thank heaven, but can't we provide the same thing for elderly people that we have for youth and military personnel—reduced fares, on any mass transit that has Federal funding or is in interstate commerce. This would be for buses, railroads, and trains, provided it is on a non-rush-hour basis. That is something the UAW could actively support. We are having trouble getting it before the Commerce Committee.

Mr. WOODCOCK. We support that and we have done it repeatedly locally. It makes economic sense, too.

Of course, that ties into the whole problem of the mass transit system which this Nation desperately needs.

Senator PERCY. I would like to thank both of you, Mr. Woodcock and Mr. Beidler. We have not put you to work today, Mr. Beidler, but thank you very much for being here. It is very valuable testimony.

I would like to call the Chair's attention to an article from the Chicago Tribune that came out last Sunday, two days after my deadline on the article I was submitting to the Tribune on the subject of busing. I would like to commend Mr. Woodcock for his byline article. I am pleased that the Tribune carried it promptly as it did with the big headline "Busing Wrong Issue, Wrong Time."

It is very perceptive, unemotional approach to a highly inflammatory and emotional issue, and certainly you are subjected to just as much criticism for taking a progressive viewpoint, an enlightened viewpoint as a politician is. You are in a sense holding public office within your own union. I just commend you for speaking out at a time when the rhetoric is just filling the airways and the enlightenment is very little with all of that rhetoric.

The demagoguery and bigotry on this particular issue exceeds anything I have seen for a long time. To have some clear thought on this issue at this time is exceptionally important to the general electorate and certainly those in public office who have to go to the floor of the Senate and vote on the busing issue tomorrow.

I wish to thank your union for the very, very progressive position you take on humanitarian issues which go on way beyond the wage and hour and pay conditions for members of your particular union, but are for the good of the country and for all America.

Mr. WOODCOCK. I was unaware it appeared in the Chicago Tribune. The piece was written for a Knight newspaper and a shortened version appeared in the New York Times.

Senator PERCY. Yes. I see the Knight Newspaper Service is credited down at the bottom of it. I would like to put it in the Congressional

Record, and I will properly credit the Knight News Service, Jack Knight, for having you do this.

Mr. Woodcock. I might say my election comes up before yours, sir. Mine comes up in April.

Chairman Proxmire. He is in the same spot as you fellows are.

Senator Percy. We have a primary in March in Illinois and I am absolutely flabbergasted that I have no primary opponent. A year ago it looked like there would be 20 people fighting to run against me.

Chairman Proxmire. In view of your liberal record in your conservative party, it is amazing.

Senator Percy. We prefer to call it a progressive record in a party we trust will always have hope for enlightenment.

Chairman Proxmire. For your moderate record. "How's that?

I want to thank you very, very much, President Woodcock. You have been most responsive and helpful. Your answers are among the best we ever get up here because you come to the point, you never ramble on. You are most helpful to us. Thank you for your fine statement.

Jack Beidler, we are delighted to see you. Mr. Woodcock's good right arm in Washington.

The committee will stand in recess until 10 o'clock tomorrow morning.

We will hear from three distinguished economists. Congressman Henry Reuss will chair the meeting.

(Whereupon, at 12 noon, the committee recessed, to reconvene at 10 a.m., Tuesday, February 29, 1972.)

# THE 1972 ECONOMIC REPORT OF THE PRESIDENT

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TUESDAY, FEBRUARY 29, 1972

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, Representative Henry S. Reuss (member of the committee) presiding.

Also present: Loughlin F. McHugh, senior economist; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone, research economist; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and Leslie J. Bander, minority economist.

## OPENING STATEMENT OF REPRESENTATIVE REUSS

Representative REUSS. Good morning.

The annual hearings of the Joint Economic Committee will be in order for further survey of the economic situation in 1972.

These annual hearings tend usually to be quite specific in their nature. Our mandate demands that we address ourselves to the specific requirements of short-term economic policy. It is important that we follow our mandate.

It is important, for example, that we evaluate whether present economic policies will bring the unemployment rate down to the 3- to 4-percent level, where it ought to be or whether it is more likely the unemployment rate which has been hovering at the 5½- to 6-percent rate where it is now.

It is important to examine the changes in the size of the full employment budget deficit from one-half year to the next.

It is important to ask whether a further increase in the already high social security tax rate is desirable fiscal policy.

Important as these specific short-term questions are, we would narrow our perspective by unduly preoccupying ourselves with them. It is difficult to know whether the policy decisions dictated by our short-term needs are also moving us toward the larger objectives of social and economic justice to which most of us, at least, give lip service.

This morning we have asked our panel to evaluate current economic policy in terms of the contribution it may be making toward ultimate social objectives. Our panel members are three distinguished economists with strong opinions about our social objectives and the inadequacy of current policies to move us toward these objectives. We invited these gentlemen in the hope of obtaining fresh perspectives on the issues to



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which this committee devotes so much attention. Having read your prepared statements, I know we will not be disappointed.

Our first witness this morning will be Mr. Douglas Dowd, professor of economics at Cornell University, and at the moment visiting professor of San Jose State College in California. Mr. Dowd is well-known to students of economics for his splendid biography of Thorstein Veblen as well as for his research into the concentration of economic power and for his outspoken views on the current social order.

We will then hear from Barry Bluestone, instructor in economics and senior research associate, Social Welfare Research Institute, at Boston College. He is noted for the research that he has done in the fields of poverty and income distribution. He is an active member of the Union for Radical Political Economics. The Joint Economic Committee has a good record over the years of providing a forum for various points of view. We have, however, been somewhat remiss heretofore in availing ourselves of the excellent new work being done by the members of the Union for Radical Political Economics. I hope this morning's hearing can begin at least to address the balance.

The final witness will be Howard Sherman, professor of economics at the University of California, at Riverside. He is noted for his research into corporate profits and also for his studies of Marxism. I will leave it for him to explain whether he is an advocate as well as a student of Marxism. The people on which Mr. Sherman will base his testimony this morning is a joint effort with Assistant Professor E. K. Hunt, also of the University of California at Riverside.

Gentleman, I have your prepared statements, which, under the rule and without objection, will be placed in full in the record if abbreviated or summarized. I would now like to ask each one of you in the order I have given to either proceed to read your prepared statement, to summarize it, go outside it, or proceed any way you like.

Mr. Dowd, please proceed.

## STATEMENT OF DOUGLAS F. DOWD, PROFESSOR OF ECONOMICS, CORNELL UNIVERSITY, AND VISITING PROFESSOR, SAN JOSE STATE COLLEGE, SAN JOSE, CALIF.

Mr. Dowd. I think I will choose to read my statement, Mr. Reuss, since it is relatively brief.

A society is what its social priorities have been, given what nature, time, and circumstance permit. The quantitative levels and qualitative patterns of its production, consumption, and trade, and of its income and wealth, provide the simplest measures of what its priorities have been. Even more illuminating, if also subtler and more complex, are the social and political relationships in the society, and between it and other societies. Taken together, these sum up how much effort of what kinds have and have not been made over time by (especially) those with power in the society.

Thus, when we observe, more than a century after the Emancipation Proclamation, that black (among other nonwhite) Americans must still engage themselves in a desperate struggle to achieve social, political and economic justice—a struggle which, despite superficial achievements shows signs neither of abating nor of ending in justice—we must conclude that the resources of the society have not been placed behind this struggle; that social priorities have lain elsewhere. Putting it less gently, we may conclude that much in the way of power and resources must have been used to hold back progress in that struggle, in a land rich both in its resources and in its proclaimed devotion to equality. The same may be said of the existence of poverty in America. It can be argued that today a lower percentage of Americans are poor than, say, half a century ago; but in absolute terms there are now more Americans in poverty than earlier. That disgrace is connected, of course, to the disgrace of racism; but it is more than that, for two-thirds of the poor are white.

If there is an at least partial economic basis and solution for racism and poverty, their persistence becomes obscene when it is set against the spectacular increases in American income and wealth in recent decades—decades also of spectacular increases in speeches, essays, proposals, and legislation evidently designed to rid American society of those blights. For the objective reality of that same period mixed half-hearted efforts with downright obstruction; as is still so.

What are we to conclude from all that? One conclusion suggests itself; whatever disadvantages may accrue to those directly and indirectly afflicted by the existence of racism and poverty in America, there must be in addition those who consciously or unconsciously benefit from that set of conditions—and who effectively resist and obstruct the social changes required to eliminate those conditions.

So it is with that whole list of what we call problems in America today: Who gains and who loses from a dangerously inadequate medical, health, and drug situation in America? Who gains and who loses from the deepening urban crisis—a crisis at once of housing, of transportation, of pollution, of crime, of unemployment, of health, of education, of fiscal and social bankruptcy? Who gains and who loses from the steady growth of militarism not only in our foreign policies but also at home, as conveyed by the code words "law and order"? Who gains and who loses from the terrifying achievement of institutionalized secrecy in government?

Other such questions could be asked; and to all of them the answer must be: Some few gain, while the multitude pays, and loses; and what has been loved as America is poisoned. Is it poisoned beyond cure?

What was loved as America was replete with promises, as it was with assumed and admired realities. As a very young man, I—like so many of the young today—took it for granted that the Government of the United States was designed by the people to serve the people. Education and experience taught me, as in recent years it has more swiftly taught the young (and many of their parents) that the validity of that most attractive generalization requires an ugly modification: The government of the U.S. functions like one designed by those with power to serve those with power—power derived from control over key elements of the economy, the military, and government itself (with satrap power for those at the top of agriculture, labor, the media, medicine, and education).

Those who have and exercise that power today congratulate themselves and each other because the schools and the streets are, by comparison with earlier years, quiet. The explanation for that quiet is less comforting, and not least for the Congress. Behind the innumerable demonstrations of the past decade lay a sweet (if worried) belief in the promises of America, a belief that public opposition to pervasive and acknowledged wrongs—racism, the Indochinese war, poverty, malfunctioning schools—would somehow lead those with power to move with the otherwise powerless to right what was wrong. Of that sweet belief, all that now remains is incredulity, a shamefaced and angry recognition of what now is seen as Candide-like naivete.

There was an orchestrated set of responses to the rising protests, of course. But it was a response that, saying, "yes we agree," set about finding ways to manipulate rather than to represent the public. What had been almost casual deceit became systematic, until now we are becoming accustomed to expect our information on basic policy decisions will come not from the government but (if at all) from those who are defying the government, often at high risk to themselves. A government that does not trust the people is one that senses it is going against the wishes—and the interests—of the people; and its task becomes more complicated than simply denying information to its people. It must move further, into judicial repression and shortly toward physical repression—of which the Kent State killings and subsequent judicial fiascos are only the best-known examples. And what takes place at the Federal level inexorably finds its mirror on the State and local levels—where, in an age of resounding rhetoric about the need for progressive social change, we find police chiefs as mayors, open racists and reactionaries as Governors.

So, those who counted on a responsive government were right; but the response has been perverse, and the consequence is that the numbers who have given up on their government grow daily. These one-time believers in America are now scornful and sullen. They divide into those who move steadily to the right and steadily to the left, both having given up on what was once taken to be the American way. Those who move to the right see the need for another America, one in which force is required to keep those down who are already down; while those who move to the left see the need, too, for another America, where a radical transformation is required to allow freedom, well-being, and equality not just for those at the bottom of the society, but for those better off in income terms, but not by any means well off in human terms. I identify with the latter group, but I can well understand what has moved the others to the point where they are willing to trade away common decency for status, security, and stability. Neither group would exist if the social priorities of the past had been shaped to serve the people as a whole, rather than the powerful few.

Those with whom I identify are radical both in perspective and in hopes—if also quiet in practice, just now. They see government, and those whom its policies truly represent, as immovable, except to make a bad situation worse. If and when they vote, their votes will be against, not for. They believe as little that the electoral system is a way of changing society for the better, as they do that buying white instead of colored Kleenex—or not using it at all—will reduce water pollution. Given the performance of government in recent years, can it be denied that the electoral process is a sham? And whose responsibility is that, if not (at least in part) those who have been elected?

What subtle arguments will be dared still to convey to the tens of millions of disillusioned, angry, and informed people why, 8 years after an election won overwhelmingly by the "peace candidate", the war in Indochina grinds on; grinds on 4 years after the maelstrom in Chicago—a maelstrom produced by the continuation of the war and the insistence upon doing so; grinds on still, with the President still seeking what neither can nor should be obtained: a government in South Vietnam approved by the United States, created by us and indifferent to the slaughter and disruption of its own people, and one that everybody—not least Presidents Nixon and Thieu—knows would fall overnight were American military support simply to stop. What even subtler arguments can be developed to all those Americans who, now wishing to see an end to the war (if for diverse reasons), know also that the Americanization of Vietnam has meant the deterioration of America, and that both processes go on and on, although there is no dispute about the deadly effects of either. Is there anyone in this Congress who does not know that both the Vietnamese and the Americans would have been enormously better off if our involvement had ended before it began? Or better ended in 1963 than in 1968, or in 1968 than in 1972, or better ended today than tomorrow? What would have been better for both had it happened continues to become worse for both because it has not. Nor, considering the pervasive and insidious consequences of that war on American society—its economy included—can there be any sane discussion of social priorities in this country until it totally abandons that priority which tortures us as it has destroyed tens of thousands of Americans and hundred of thousands of Vietnamese, Laotians, and Cambodians.

The well of America had to be polluted for us ever to have involved ourselves in Vietnam; and that involvement has now poisoned the well. America can be renewed, but only if there is a decisive reversal of our priorities, only if we pay as much honest attention and devote as many precious resources to human needs and growth as we have to military wants and destruction.

A simple test is in the offing, and it will take place in the Congress of the United States: In a year when, as so often in the past, all speak of peace, the President has asked for an expansion of the military budget—when what is needed is a sharp contraction in that budget and a program for large-scale social reconstruction at home. There cannot be many who doubt that the President will get at least what he asks for in military dollars, by an overwhelming vote in this Congress. The lack of courage and conviction that will be represented in that vote—as in the long failure of the Congress to bring the war to an end—is both a manifestation and a consequence of the priorities of this society. If Congress will not use its power for needed change in the society, it is requiring that the people find other means of doing so. To fulfill that requirement will not be easy for the people or the society; but it seems the only way to create an America worthy of its name.

Thank you.

Representative REUSS. Thank you very much, Dr. Dowd.

We will withhold questions until we have heard from the rest of the panel.

Mr. Bluestone, please proceed.

## STATEMENT OF BARRY BLUESTONE, PROFESSOR, DEPARTMENT OF ECONOMICS, BOSTON COLLEGE

Mr. BLUESTONE. I would like to read from part of my prepared statement and also comment on it.

Representative REUSS. Good. If you proceed that way, and if you can, give us some idea of what page you are on from time to time.

Mr. BLUESTONE. Fine. I will use the introduction and then I am going to read the section beginning with the heading "The 1973 Federal Budget and Economic Report of the President."

Some years ago a congressional committee requested testimony on the urban crisis. Dozens of experts appeared before the committee giving detailed accounts of the problems facing the cities. One expert concentrated on the age and size of sewer pipes, another on the narrowness of city streets, and so forth. Each indicated what they thought to be one of the pressing problems of the city and the solution necessary to ease the crisis. Among the final witnesses was Lewis Mumford, one of America's foremost urbanologists. In his testimony, Mumford asserted that the urban problem could never be solved by simply aggregating all of the solutions each expert had suggested. Rather, he indicated that the problem with American cities is that they are fundamentally unlivable. Urban areas had grown up in such an unplanned and anarchic fashion that to renovate the cities would be impossible. The only real solution to the urban crisis, he noted, was to build new cities from scratch and slowly destroy the old ones.

Today, in discussing current economic priorities in light of the Economic Report of the President, I feel very much the way Mr. Mumford felt in discussing the cities. Numerous witnesses have appeared before this committee to express their opinions on present economic problems. Generally they have commented on the desirability and feasibility of individual administration policies and have attempted to evaluate the success potential of these programs.

Rather than do the same and discuss how particular policies can be marginally altered to ameliorate current economic crises, I will try to indicate why the underlying structure of the economy is fundamentally unsound and why major changes in economic priorities are necessary before anything significant can be done about the causes of our most important domestic economic problems. My focus will be restricted to the two tendencies which pose the greatest difficulty for capitalist economies: (1) The tendency toward an increasing unequal distribution of income; and (2) the tendency toward an ever worsening trade-off between inflation and unemployment.

Many witnesses, I would have hoped, would have come to this committee and explained not only what the moral consequences of the Vietnam war have been, but also would have told us something about the economic consequences of that war. I am going to try and raise that issue today and try to make it as clear as I can. I will try and say something about the American economy and how it is structured and show why the immoral actions that we have initiated as a country have also made our domestic economic problem intolerable.

Basically, our economy is based on a system of private investment decision where individual owners of capital makes decisions as to what will be invested and where. Generally, there is a tendency toward reinvesting in the highest profit activity and there is less investment in less profitable activities.

The result is that over a period of time, we have a system which generates what might be called uneven development. We see this uneven development in the industry structure in America. We have developed a dual economic structure; a high profit, highly monopolized, and capital intensive sector on the one hand and a low profit, competitive and capital poor sector on the other. One set of industries generates relatively higher wages, the other generates poverty.

We see uneven development, however, not only in the industry structure but in the structure of investment in our own people. We have a school system still based on local property taxes to a great extent, which generates many more resources for the rich than for the poor. We develop, therefor, an economy which is dual in both the industry structure and in the structure of the work force.

The implications of a dual economy are two: One is that over time, if we just had the private economy operation, we would see an ever-widening income distribution, an income distribution which is more unequal over time. You would have an increasing dichotomization between the rich and the poor. In addition to this, we would also see, and we have seen, a tendency toward a worsening tradeoff between inflation and unemployment. In the terminology of the economist, we would see the "Phillips" curve moving further and further away from the origin. The uneven development generates inflationary pressures in the high-wage, high-profit sector, while at the same time generating a tendency toward unemployment in the other sector. What is interesting about this is that according to a dual economic structure model, we would precisely predict the inflation and unemployment forces that we now have. This is the legacy of uneven development. It can only be changed by moving away from an economy which is based on private investment motives.

What is the role of the Government? The Government plays two roles. And it plays both sides of the fence. On one side it exacerbates uneven development through its expenditure policies, through its tax policies, and through its investment and subsidy policies. You can think of the Government as one consumer with a very skewed consumption pattern, mostly in defense and to a lesser extent in highways. Its expenditure policy, of course, will be beneficial to a small set of industries (a limited but very important set of industries) while it will starve other sectors of the economy. What has happened in the last generation is that Government expenditure policy has, in almost all respects, reinforced the dual economy in the private sector.

Tax policy performs the same role. The corporation income tax, with its depreciation allowances, its investment tax credits and so forth disproportionately benefits the high-profit sector and disproportionately harms the sector in which many of the working poor are located. Investment and subsidy programs in the past have done precisely the same. During World War II, the Federal Government created $45 billion worth of capital which went directly into the private sector. In the recent past we are doing the same thing with subsidies to such companies as Lockheed Aircraft.

That is the way the Government exacerbates uneven development. However, it also has had an effect on offsetting the tendency toward uneven development, partly through fiscal and monetary policy dealing with the inflation-unemployment problem, to a much greater extent through welfare programs, and to some extent through manpower programs, and through progressive taxation. We would expect that the Government would find it politically necessary to try to offset the tendency toward a dual economy—an economy marked by great affluence for a small segment of the population and great poverty for others—in order to maintain some degree of political stability. We find that the Government has been able to offset temporarily the tendency toward greater and greater disparities of income. While, it has not been able to move in the direction of making the income distribution any more equal, at least it has been able to offset the tendency in the opposite direction. We know that since Workd War II the distribution of income has remained fairly constant. Page 1 of the Wall Street Journal yesterday morning mentioned these statistics.

We know that the poorest one-fifth of all families perennially receive approximately 5 percent of the total income after account is taken of taxes and welfare transfers. On the other hand, the richest fifth are left with a little more than 40 percent year after year, while the wealthiest 5 percent have normally received between 14 and 17 percent of total after-tax and transfer income.

Those are very interesting constants. We have seen this distribution at least since World War II, and some statistics point out that this same basic distribution of income has been with us since the beginning of the 20th century. The wealth distribution, by the way, has really not changed since the American Civil War.

If we want to evaluate the current budget, what we really want to know is whether the offsetting tendency will be greater or less than the tendency toward reinforcing uneven development. I would like to turn to the 1973 Federal budget and evaluate it in this light. I will begin with the heading entitled "The 1973 Federal Budget and the Economic Report of the President" of my prepared statement.

The economic priorities engendered in Federal budgets since World War II have generally been responsible for promoting the growth of the dual economy and the problems inherent in such an economic structure. During this period an overwhelming proportion of Federal budget expenditures were devoted to what is called national defense. These expenditures went disproportionately to one sector of the economy leaving other sectors relatively undernourished. This no doubt reinforced the tendency toward uneven development between sectors, ratified the propensity toward an unequal income distribution, and aggravated the unsatisfactory trade-off between inflation and unemployment. The 1973 Federal budget must be analyzed in light of this experience in order to judge its effect on these problems.

We can look at a defense expenditure as a percent of the total Federal budget and compare what has happened over time. We note in 1965, 52.5 percent of total Federal outlays went to the Department of Defense. In 1970, it fell slightly to 51.5 percent, and in 1971, to 47.5 percent. The 1972 estimate is 42.7 percent, while the 1973 budget estimate is 42.0 percent.

In terms of total national security, the relevant figures are about 79.8 percent in 1965, falling to something in the neighborhood of 64 percent in 1972, and 63.5 percent in fiscal 1973. Between 1965 and 1972, there was some progress in the direction of reducing the percentage share of defense expenditures and increasing the percentage share of nondefense programs. This should in the long run improve the structure of the economy and ease some of the pressure in the dichotomization process.

Yet the 1973 budget fails to continue this policy of making significant cuts in the relative impact of the defense budget on the economy. Instead, the administration proposes a $6.3 billion increase in budget authority for national defense and a 16-percent increase in strategic military programs over fiscal 1972. In addition the budget calls for an increase of $838 million in new spending authority for military research and development, $3.6 billion for new naval shipbuilding, and substantial increases in military assistance to the domestic armed forces of the Theiu regime in South Vietnam. All of these new expenditures, and especially those for military hardware, portend a renewed tendency toward uneven development. To the extent the new budget authority is passed to allow the development and deployment of ABM, MIRV, and the B-1 bomber, the process of uneven development will continue unabated reflecting the tendency during the 1950's and 1960's.

What must be remembered is that as long as the No. 1 economic priority remains with the Department of Defense, the price paid by society will be more substantial than just higher taxes. Distributional problems and stabilization crises are built into the American economy through privatized investment decisions. Unbalanced public expenditure policies only serve to aggravate this trend.

At the same time that the defense sector is being given more funds, the budgets for other sectors of the economy are not being expanded at a rapid enough rate to forestall further uneven development. In some cases net new Federal funding for programs will actually fall from 1972 levels. In the area of agriculture and rural development, total funds will be cut from $7.35 billion to $6.89 in 1973. In the crucial area of natural resources and the environment, the budget for new net outlays is cut nearly in half from $4.37 billion to $2.45 billion. And in the area of commerce and transportation, there is a slight budget reduction from $11.87 billion to $11.55 billion. All of these budget cuts will contribute to the inflation-unemployment problem.

Increases in community development and human resources are also inadequate. The administration has recognized the problems existing in housing and in education and manpower. Yet in the 1973 budget these priority items are allowed only moderate expenditure increases. Community development and housing receives only $800 million in new budget authority while human resources funding has been increased to only $11.28 billion from $10.14 billion in 1972.

Again the price paid by society for these unbalanced priorities will be greater than just the cost of doing without a cleaner environment, better urban transit, more adequate housing, and more education. The priorities themselves structure the overall economy in such a way as to create the problems we have discussed at length in this testimony. More investment in strategic bombers and less in housing, more battleships and less in education allocate physical and human resources so as to reinforce the tendency toward uneven development between regions of the country and sectors of the labor force. This is especially true in the area of human resources. The failure of the Federal Government to compensate for unequal educational opportunity directly contributes to the strikingly unequal distribution of income in the United States.

There are other facets of the 1972–73 Nixon economic program which deserve attention. The investment tax credit of 1972, like its predecessor in the early sixties, will tend to accelerate the pace of uneven development. The industries which are already more profitable will take greater advantage of this biased incentive. Industries and firms with poorer credit ratings and inadequate retained earnings will find it difficult to take advantage of the program. Overtime, capital-intensity will diverge even further between sectors of the economy creating the inherent problems noted often in this analysis.

There are three programs in the Nixon budget which will tend to offset the tendency toward dichotomization of the economy and a greater inequality in family income. Increases in social security benefits by 5 percent in 1973, the deployment of funds under the Emergency Employment Act of 1971, and the proposed family assistance plan will all have a direct counterbalancing effect on uneven development. Yet in all three cases the program will at best only stabilize the present unequal income distribution. All three are seriously underfunded to such an extent that there will be no inroads made against inequality. Social security will still leave millions of older citizens desperately poor. With unemployment in excess of 6 percent nationally and as high as 9 percent in some urban areas the transitional public service jobs created by the Emergency Employment Act are too few and too late. Finally, the Nixon formula for the family assistance plan will hardly keep pace with the disequalizing income trend in the economy. The $2,400 national minimum Federal income standard is much too low to assure a stable income distribution for very long, and the high-unemployment rates created by the dichotomization process assure that the work incentive cannot function.

All in all the 1973 Federal budget is a great disappointment from the perspective of restructuring the economy. It reverses an important trend in defense expenditures. It fails to adequately expand Federal investment in disadvantaged sectors of the economy. It fails to provide enough education and manpower funds to offset the secular deterioration in human capital between rich and poor. Finally, the new welfare program is woefully inadequate to offset the continuing thrust of an economy which proceeds through uneven development.

The 1973 budget will consequently do little to solve the basic social problems in our cities and rural areas. Much worse, however, is that, on balance, the priorities set by the budget will do nothing to ameliorate the income distribution problem or reverse the worsening tradeoff between inflation and unemployment. At best the income distribution will not further deteriorate. At best inflation will be reduced by fiat through continued direct control of private sector wages and prices. But the massive gap between rich and poor will continue to exist and little will be done to reduce unemployment which does not at the same time impose a great strain on prices. All of this is the legacy of uneven development. It is the extremely high price most of us pay when a complex economy is run according to the plutocratic needs of private capital.

Before closing my testimony I must make a plea on behalf of new research. In the past we have failed to deal with the pressing problems of the American economy. To a great extent this is because we have studied the wrong problems. We have built intricate models to predict growth in gross national product. But we have failed to study the distribution of benefits from that growth. We have performed thousands of statistical manipulations on labor force characteristics to predict effects on the wage distribution. But we have failed to completely comprehend the overriding impact of racial and sexual discrimination on the structure of the labor market. We have studied how to optimize marginal tax rates on welfare recipients so as to increase work incentives. But we have failed to fully understand that a 33-percent unemployment rate for ghetto teenagers and young adults nullifies the inducement to work. In short, we have failed to study the social and political economic environment within which the economy operates.

What is needed is now and far-reaching political economic research which investigates the structure of the economy and the institution which make it work. In addition to national studies, we need more regional studies. We need to study the effect of Government spending on the pretax and transfer distribution of income. We need to understand how Government imposed effective tax rates affect the growth potential in different regions, different industries, and different sectors of the labor force. Finally, and most importantly, we need to know in detail how and how much overreliance on private investment decision tends to promote uneven development which imposes such hardship on so large a part of society.

Thank you.

Representative Reuss. Thank you, Mr. Bluestone.

(The prepared statement of Mr. Bluestone follows:)

## Prepared Statement of Barry Bluestone

Some years ago a congressional committee requested testimony on the urban crisis. Dozens of experts appeared before the committee giving detailed accounts of the problems facing the cities. One expert concentrated on the age and size of sewer pipes, another on the narrowness of city streets and so forth. Each indicated what they thought to be one of the pressing problems of the city and the solution necessary to ease the crisis. Among the final witnesses was Lewis Mumford, one of Ameria's foremost urbanologists. In his testimony, Mumford asserted that the urban problem would never be solved by simply aggregating all of the solutions each expert had suggested. Rather he indicated that the problem with American cities is that they are fundamentally unlivable. Urban areas had grown up in such an unplanned and anarchic fashion that to renovate the cities would be impossible. The only real solution to the urban crisis, he noted, was to build new cities from scratch and slowly destroy the old ones.

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Rather than do the same and discuss how particular policies can be marginally altered to ameliorate current economic crises, I will try to indicate why the underlying structure of the economy is fundamentally unsound and why major changes in economic priorities are necessary before anything significant can be done about the causes of our most important domestic economic problems. My focus will be restricted to the two tendencies which pose the greatest difficulty for capitalist economies: (1) the tendency toward an increasing unequal distribution of income; (2) the tendency toward an ever worsening trade-off between inflation and unemployment.

The main thrust of my testimony will be to ascertain how the Government reinforces or offsets these natural propensities. I will include in my testimony a brief analyses of the fiscal year 1973 Federal budget and attempt to reveal its probable effect on the long-run prospects for the economy.

THE DYNAMICS OF OUR ECONOMY

The key to the dynamics of the American economy lies in what has been called the law of uneven development. Those who control capital resources in the economy will tend over time to reinvest in those particular product lines, machinery, and workers which promise the highest return on dollar investment. Conversely, investment will tend to decline in segments of the economy where potential expected profit is relatively low. In the static theory of normal economics, diminishing returns to any single investment supposedly militates against a long-run dichotomy between sectors of the economy or between individuals or classes in society. Theoretically after some point, increased investment in one industry will tend to become less and less profitable and capital holders will begin to shift their surplus savings to other sectors of the economy. Expanded investment dollars will shift from the auto industry to the textile industry, for instance, or from the education of white middle-class youth to black children in the ghetto.

In an era of concentrated capital resources, however, the simple dynamics of profit maximization does not produce this result. Rather a "secular deterioration" evolves between nations, between industries, and between social classes. There is an inherent tendency in the economy toward a dichotimization between the haves and the have-nots.

This occurs for two reasons. First, investment in a dynamic economy tends not only to increase the capital-intensity of the product or factor of production in question, but also changes the quality of the factor so as to make further investments technologically profitable. Capital investment in a given product, for instance, often increases the market value of the product thereby signaling the profitability of renewed investment. Higher past profits are also used for research and development which further expands the market for these goods. Profits also allow expanded advertising which reinforces this tendency. On the other hand, new capital, products, or people which originally fail to meet the test of the market seldom receive additional investment and consequently become doomed to deterioration. A lack of funds for research and development and advertising due to a lack of profits operates to the relative disadvantage of these segments of the economy.

The second reason for a dichotimization within society derives from the potential redistributive effect of any given private investment. While it may be true that continued investment runs into diminishing marginal returns, owners of private capital will tend to link profitability and distribution criteria in reinvestment decisions. Private investors will tend to reinvest their capital in areas which promise the highest relative return only if such investment does not tend to alter the long-run income distribution in such a way as to reduce their own relative standing. Owners of capital have both a psychological and political stake in an unequal distribution of income and consequently often measure their success not by the absolute amount of their accumulation, but by the relative surplus they accumulate compared with others. Private individuals will thus tend to invest in their "own" rather than contribute to the economic viability of competing individuals or groups. Rarely will the maximization of private returns constrained by this distributional objective coincide with the maximization of total social return. The outcome is uneven development where the rich become wealthier and the poor relatively more impoverished. It is important to realize that this is not an aberation in the private sector of the American economy, but precisely its traditional and necessary nature.

The most discussed case of "secular deterioration" or uneven development is found in the realm of international trade between developed and underdeveloped countries. Many economists have for a number of years argued that international trade patterns have led to the enrichment of the developed world and the impoverishment of the nations of Latin America, Africa, and non-Communist Asia. The eminent Swedish economist Gunnar Myrdal has termed this process "circular causation with cumulative effect."

What plagues trade between nations, however, is evident within the American economy itself. The tendency toward uneven development can be seen clearly in the development of industries in the United States. In tracing wage histories since World War II, one finds that the wage differential between "high-wage" and "low-wage" industries has increased secularly. In 1947 the set of industries with lowest wages paid straight-time hourly rates which averaged 75 percent of the average wages prevailing in the highest wage industries in the Nation. Regardless of slight cyclical variation in wage increases during the ensuing period, the wage ratio between these two sets of industries fell to 60 percent by 1966. The low wage industries granted smaller wage increases (in percentage as well as absolute terms) in all but 4 years during the two-decade period.[1]

Econometric evidence indicates that no matter the level of unemployment or the state of the economy, the secular deterioration of wage rates between industries cannot be reversed. Reinvestment in the more capital-intensive, monopolized, and more profitable industries follows precisely from the profit maximization rule. Conversely, relatively less investment is undertaken in the less profitable industries. Over time the capital intensity of the two sets of industries dichotomizes, productivity levels dichotomize, and finally wage terms deteriorate.

The result in this instance has been the creation of an extensive working poor population. In 1968 over 10 million workers—one in five private nonsupervisory employees—earned less than $1.60 an hour in the United States.[2] The working poor make up well over half the poor in the nation according to Department of Commerce figures.[3] Naturally they are concentrated in those industries which have been disadvantaged in relative capital-intensity, concentration, profits, and wage levels. Since the economic status of those no longer in the labor force—the aged and the disabled, for instance—depends to such an extent on previous labor force status, the secular deterioration between industries affects the nonworking poor as well as those currently low-paid.

But uneven development is not restricted to industrial dichotomization alone. The same pattern of secular deterioration is clearly evident in the investment decisions regarding the schooling, training, and health of the Nation. Reinvestment is normally undertaken in those children in whom already significant investments have been made. Socialization in the home is obviously biased in favor of the wealthy who can afford educational playthings, home libraries, and summer vacations for their children. The unequal distribution of educational resources in the home is then mirrored in the school system to a great extent due to the local nature of school finance. Studies of schooling ranging from preschool programs to higher education have shown that the distribution of educational resources is severely biased in favor of the more wealthy. Numerous studies have proven the degree to which educational investment is dichotomized between city and suburb, between white schools and black, and between vocational and college preparatory programs. Beyond high school, the dichotomization continues as college and university resources are distributed overwhelmingly on the basis of social class and race. In this way the socialization process is structured so that it perpetuates social class divisions from one generation to the next.[4] From

[1] These results are found in an unpublished paper by the author entitled "The Secular Deterioration of Wage Terms Among Industries in the United States (1947–1966), Fall, 1968.

[2] Manpower Report of the President, April 1968, table 5, p. 27.

[3] Current Population Reports: Consumer Income, "Income in 1968 of Families and Persons in the United States," p–60, No. 66, Dec. 23, 1969, table 24 (U.S. Bureau of the Census).

[4] See Sam Bowles, "Unequal Education and the Reproduction of the Social Division of Labor," Review of Radical Political Economics, Vol. 3, No. 4 Fall-Winter 1971.

preschool to college, the children of the wealthy continue to receive new investment while the children of the poor are pushed out of the education stream at an early point in their lives. At birth the rich and poor begin with nearly equal abilities, but with time the educational reinvestment process assures uneven development and unequal opportunity between the two. An economic system based on private investment decisions thus tends to produce a dual economy both in the structure of industries and in the structure of the labor force.

The dual nature of the economy not only has implications for the distribution of income, but tends to promote the structural imbalances which lead to inflation-unemployment crises. Reinvestment in the sectors which already have extensive investment tends to create an inflationary demand for skilled labor specific to these capital-intensive industries. In the other sector of the economy, chronic "underinvestment" creates a surplus of labor with large scale layoffs and high unemployment. The secular deterioration in "human capital" investment adds to this problem by creating a small "over"-skilled and over-specialized elite while at the same time failing to prepare a large part of the population for the job structure which evolves through uneven development. This creates bottlenecks and inflationary pressures in one part of the economy while fostering unemployment in another. While there are no doubt additional causes for the present inflation-unemployment problem, the dual economy which follows from overreliance on privatized investment decisions plays a major role in creating the crisis.

### THE ROLE OF GOVERNMENT IN THE AMERICAN ECONOMY

Up to this point the discussion has dealt with the economy as though Government played an insignificant role. Yet, obviously with Federal, State, and local governments responsible for nearly one-third of annual gross expenditures, focusing on the private economy alone severely misrepresents the dynamics of the American economic system. Government has come to play a complex and crucial part in the dynamics of the dual economy. Its part must be understood to fully comprehend the present state and future prospects of the economy.

In a number of ways, the Federal Government implicitly reinforces the tendency toward uneven development through its expenditure, investment, and tax policies. Merely as consumer, for instance, it exerts a powerful influence over the distribution of profits and growth potential among industries. Indirectly this affects the distribution of wages among workers and their families. Thus, while the overall effect of Government policy is felt "macroeconomically" through fiscal and monetary policy, the extension of the public sector is increasingly felt at the "microeconomic" level. Individual industries and sectors of the labor force are directly affected by Government policy. These microeconomic pressures were felt well before the imposition of direct wage and price controls and still play the dominant role in the public structuring of private economic markets.

In terms of direct Federal purchases from the private sector in 1970, $82.2 billion or 78 percent of a budgeted total of $105.6 billion was earmarked for the Defense Department.[5] This 78 percent was heavily concentrated in a small number of highly specialized and regionally concentrated industries, notably in aerospace, electronics, ordnance, and transportation equipment. To a great extent, these industries have higher profits and pay higher wages precisely because of Government intervention in the marketplace. The addition to an industry's total product demand due to Government purchases can determine the direction an industry goes in the process of uneven development. In my own research I find that, after controlling for other factors, a 25 percent point difference in Government expenditures by industry results in a difference of $0.22 per hour in industry wage rates for equivalent labor. Table 1 indicates the lowest wage industries in the Nation. None of these are noted for large defense contracts. Within this list only hospital services are significantly affected by Government demand. Low wages in retail trade, personal services, and nondurable manufacturing are a function, in part, of the defense bias in public purchasing policy.

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[5] Budget of the U.S. Government, 1970, Special Analyses, A, p. 15.

TABLE 1.—PERIPHERAL INDUSTRIES IN THE UNITED STATES. AVERAGE WAGE RATES AND THE PERCENTAGE OF WORKERS, BY INDUSTRY, EMPLOYED AT WAGE RATES BELOW $1.60

[In 1966 dollar equivalents]

| Industry | Average hourly earnings (for all workers in industry) | Percent below $1.60 per hour |
|---|---|---|
| Southern sawmills and planing mills | $1.25 | 88.2 |
| Nursing homes and related facilities | 1.19 | 86.3 |
| Work clothing | 1.24 | 77.1 |
| Children's hosiery mills | 1.33 | 76.9 |
| Men's and boys' shirts | 1.26 | 75.5 |
| Laundries and cleaning services | 1.26 | 75.4 |
| Men's hosiery mills | 1.37 | 71.7 |
| Synthetic textiles | 1.57 | 55.5 |
| Cigar manufacturing | 1.39 | 55.4 |
| Cotton textiles | 1.53 | 54.5 |
| Wood household furniture | 1.57 | 50.8 |
| Footwear | 1.64 | 49.3 |
| Women's hosiery mills | 1.55 | 50.0 |
| Fertilizer manufacture | 1.67 | 41.7 |
| Hospitals | 1.86 | 41.2 |
| Candy and other confectionery | 1.87 | 34.2 |
| Brick and structural clay tile | 1.91 | 33.9 |
| Wool textiles | 1.59 | 32.7 |
| Structural clay products | 2.08 | 20.8 |
| Miscellaneous plastic products | $1.95 | 19.9 |
| Men's and boys' suits and coats | 2.12 | 19.5 |
| Textile dyeing and finishing | 1.96 | 16.7 |
| **RETAIL TRADE** | | |
| Limited-price variety stores | 1.31 | 87.9 |
| Eating and drinking places | 1.14 | 79.4 |
| Hotels and motels | 1.17 | 76.1 |
| Drug and proprietory stores | 1.56 | 71.3 |
| Gasoline service stations | 1.52 | 66.7 |
| Apparel and accessory stores | 1.70 | 59.7 |
| Department stores | 1.75 | 59.6 |
| Miscellaneous retail stores | 1.75 | 58.0 |
| Retail food stores | 1.91 | 47.6 |
| Building equipment and hardware dealers | 1.98 | 39.4 |
| Furniture, furnishings, and appliances | 2.10 | 38.4 |
| Motor vehicle dealers | 2.40 | 28.7 |

Source: Industry wage surveys, Bureau of Labor Statistics, Department of Labor (1961–66).

In hearings before this committee in 1967 Prof. Wassily Leontief and Prof. Andre Daniere estimated the interindustry employment effort of a deescalation of the Vietnam war.[6] According to their calculations, using the 1958 Input-Output Matrix of the U.S. economy, a $19-billion reduction in Vietnam spending with a reduction in taxer or increased nondefense spending would have resulted in increased employment in the disadvantaged sectors of the economy. Employment would have risen by 3.8 percent in the food industry, 3.8 percent in leather goods, 3.7 percent in livestock, 3.7 percent in apparel, 3.4 percent in medical and educational services, 3.2 percent in retail trade, 3 percent in fabrics and yarns, and 3 percent in personal repair services. Some employment losses would have naturally occurred in a number of defense industries including ordnance, aircraft, and electrical apparatus. While the employment gains may not have led immediately to wage gains in the disadvantaged sector, increased demand in this sector could have had a significant long run effect on the earnings of the working poor relative to other members of the labor force. The effect on the inflation-unemployment tradeoff would have been salutary as well.

The distribution of effective corporate income taxes, structured through depreciation and depletion allowances, investment tax credits, and intangible expense writeoffs also benefits the more concentrated and powerful industries to the detriment of others. Through extensive manipulation of the tax base, the effective tax for some industries is as little as one-third the rate paid by other industries. Relatively low tax rates in the oil and steel industries, and in metal can and paper and cement production, for example, partially explain the relatively higher profits and higher wage rates prevailing in these industries.

A study of the effect of the corporate income tax on interindustry wage differentials finds that the 1964 tax cut was responsible for a significant part of

[6] Andre Daniere, appendix to the statement of Prof. Wassily Leontief on the Economic Effect of Vietnam Spending (hearings before the Joint Economic Committee, 90th Cong., 1st sess., Apr. 24, 25, 26, 1967), vol. 1, p. 247.

differential wage gains during the early sixties.[7] Industries in which the percentage tax cut was double the mean tax reduction in all industries showed overall wage gains which were 20–25 percent greater than the average. In this way Federal tax policies influence the size of interindustry profits and wages. Reinforcement of uneven development in the private sector is the consequence. Indirectly this leads to the inflationary pressures found in one sector of the economy and serves to exacerbate the surplus labor problems found in others. Unequal tax treatment as well as unequal expenditure between industries ratifies the secular deterioraton in the income distribution through a dichotomization of capital intensity, concentration, profits, and finally wages.

In addition to tax and expenditure policy, the Federal Government uses direct investment and subsidization in such a way as to further contribute to the uneven development of the economic structure. During World War II one sector of the private economy benefited from the distribution of over $45 billion to Government-financed capital investment.[8] The Federal Government built plants and outfitted them with machinery for private defense contractors. Much of this investment was amortized over a short 5-year period thus creating a continuing capital subsidy for these industries. Again the beneficiaries were those industries which have come to be associated with relatively higher profits, more reinvestment, and higher wages. The industries in table 1 as well as others in the disadvantaged sector of the economy gained little from the World War II policy.

In the post-World War II era direct Government investment in the private sector declined, yet it is still noticeable in some sectors of the economy. The $250 million guaranteed loan to Lockheed Aircraft is the latest and most striking example of this policy. Joint private-public projects such as COMSAT, no matter their intrinsic value, tend to reinforce uneven development as well.

There is one other aspect of Government policy that deserves note before moving on. Government spending tends to respond to public pressure in a "stop-go" fashion. Both real and imagined needs build up in the economy before they are satisfied by Government programs. Finally when any given problem reaches crisis proportions, the Government spigot is turned on and the flow of resources is released in a grand swell. This is particularly true of national defense crises. Following Sputnik the Federal Government responded with swollen NASA budgets which distorted the economy. The fear of "missile gaps" has led to similar distortions, as did the unexpected Vietnam buildup in 1965–66. When the so-called "crisis" has been weathered, the Federal spigot is often dramatically shut off, creating the "boom-bust" pattern often noted in Government-impacted industries. This pattern of crisis reaction is partially responsible for the current inflation-unemployment problem. A lack of longrun planning and long-term budgeting, along with a certain degree of national security paranoia, creates a crisis mentality and the economic problems which go along with it. The sheer size of government spending has exacerbated this problem manyfold.

What should be clear from the foregoing analysis is that the Government has grown to such proportion that it now directly affects individual industries and individual segments of the labor force even when this is not the explicit motivation behind a given expenditure, tax, or investment policy. The "microeconomic" effects of government programs in many ways have eclipsed the impact of "macroeconomic" policy. In general, defense spending, corporate income tax policy, and Government investment in the private sector have tended to ratify the inherent tendencies within the private economy.

## ECONOMIC INSTABILITY, INCOME REDISTRIBUTION, AND GOVERNMENT INTERVENTION

The uneven development of the American economy leads to three problems; inflation, unemployment, and a highly unequal distribution of income. To counter the first two, the Federal Government has generally relied on fiscal and monetary policy to even out the ups and downs of the business cycle. Over time, however, the process of uneven development has created a dual economic structure which is less and less amenable to macroeconomic pressure. A single overall macroeconomic policy cannot solve both the problems of inflation created in one sector

[7] The figures on elasticity of wages with respect to tax rates were derived from unpublished work of the author. These are preliminary estimates and should be interpreted with caution.

[8] Robert J. Gordon, "$45 Billion of United States Private Investment Has Been Mislaid," American Economic Review, vol. 59, No. 3 (June 1969).

of the economy and the problems of unemployment emanating from another. The sheer fact of having created a dual economy, reinforced through Government policy, has generally led to the growing obsolescence of the Keynesian economic stabilization machinery. Given the structure of the economy, offsetting macroeconomic policy has become necessary in an attempt to simultaneously solve the problems of inflation and unemployment. The development of the dual economy made inevitable the wage and price controls now in effect. The success of the new policy is still very much in doubt and is clouded by the fact that the process of uneven development has proceeded a long way.

The Government has been somewhat more successful in offsetting the inherent tendency toward a more unequal distribution of income. The trend toward greater economic disparity between industries and individuals would necessarily continue if it were not for the fact that the Government has found it socially necessary to attempt to offset the powerful forces toward dichotomization of the economy and a more unequal income distribution.

Historically the Federal Government has relied on three devices to accomplish this difficult task. One is the progressive income tax. While the tax system is generally proportional, taking an equal percentage of income from all families, a slight measure of progressivity exists between the very poor and the very rich. This tends to somewhat offset the effects of uneven development. A second device has been welfare. For those who have borne the worst ravages of the secular deterioration, the government provides subsidies. These too tend to reduce the economic effect of uneven development. Manpower programs, directed at the secular deterioration of "human capital" investment, complements other government policies used to offset the tendency toward dichotomization of the income distribution. Through subsidization of institutional and on-the-job training as well as remedial education, the government has attempted to increase the marketability of "disadvantaged" sectors of the workforce.

The temporary "success" of these programs can be seen in the aggregate income distribution statistics which clearly indicate that the distribution of after tax and transfer income has remained approximately constant at least since World War II and possibly since the turn of the century. The poorest one-fifth of all families perenially receive approximately 5 percent of total income after account is taken of taxes and welfare transfers. The richest fifth are left with a little more than 40 percent year after year while the wealthiest 5 percent have normally received between 14 percent and 17 percent of total after tax and transfer income.[9] The degree of stability in the income distribution is reflected in the wealth distribution, which while extremely unequal by any definition, has remained equally unequal since the American Civil War.[10] Thus the Federal Government has been able to almost exactly counterbalance the private and public forces leading to an even more unequal distribution of income.

What is most crucial to realize, however, is that this distributional stability has only been achieved through increasingly massive Government programs. The forces leading to uneven development are extremely powerful and constant. To keep the income distribution fixed over time requires the State to run ever faster to remain precisely in the same place. This is overwhelmingly indicated by statistics on both manpower programs and welfare. Between 1961 and 1970 the total outlay on manpower and human resource development programs at the Federal level grew from $184 million to over $2.6 billion a year. Total Federal aid to the poor through income security programs. commodity and service programs (incuding housing, health, food, and compensatory basic education), manpower policy, and economic and community development grew nearly threefold in this period from $9.7 billion to $27.8 billion.[11] The welfare picture is even more illuminating. In the ten year period ending in 1967 the AFDC caseload doubled from 2.5 million to 5 million families. In the following four years, the caseload doubled once again and the total AFDC cash outlay tripled. In the one year ending in April 1971, the caseload had increased again by nearly 25 percent and the cost had skyrocketed by more than 36 percent.[12] At this

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[9] For further statistics see Frank Ackerman, Howard Birnbaum, James Wetzler and Andrew Zimbalist, "Income Distribution in the United States," Review of Radical Political Economics, vol. 3, No. 3, Summer 1971.

[10] Lee Soltow (ed.), Six Papers on the Size Distribution of Wealth and Income (New York: National Bureau of Economic Research, 1969) p. xii.

[11] Budget of the U.S. Government, 1970, Special Analyses K and M.

[12] Public Assistance Statistics, National Center for Social Statistics, U.S. Department of Health, Education, and Welfare, Report A-2, November 1970.

rate the caseload will double in less than three years once again and the costs will double in approximately two.

Yet these increasingly massive inputs of training and subsidy have only been sufficient to offset the growing tendency toward greater disparity between the wealthy and the poor. The income distribution has not become more equal even in the face of these equalizing transfers. Obviously, if the dynamic effect of uneven development continues to unfold over time reinforced by public expenditure, tax, and investment policies, the government will be forced to constantly expand the public transfer economy in order to counterbalance the income distribution effect in the private sector. Simultaneously, the government will be forced to rely increasingly on specific wage and price controls in order to offset the inherent tendency toward a worsening trade-off between inflation and unemployment. An advanced economic system which continues to rely on private investment decision and reinforces these decisions through public policy is faced with ever mounting problems in the areas of inflation, unemployment, and income distribution. To rectify these problems requires that the Federal Government recognize the microeconomic effects of its priorities and take appropriate action to redirect large-scale investment toward the underdeveloped sectors of the economy. Massive infusions of capital are necessary in the industries, regions, and people which have been systematically denied private and public investment funds in the past.

### THE 1973 FEDERAL BUDGET AND THE ECONOMIC REPORT OF THE PRESIDENT

The economic priorities engendered in Federal budgets since World War II have generally been responsible for promoting the growth of the dual economy and the problems inherent in such an economic structure. During this period an overwhelming proportion of Federal budget expenditures were devoted to national defense. These expenditures went disproportionately to one sector of the economy leaving other sectors relatively undernourished. This no doubt reinforced the tendency toward uneven development between sectors, ratified the propensity toward an unequal incme distribution, and aggravated the unsatisfactory trade-off between inflation and unemployment. The 1973 Federal budget must be analyzed in light of this experience in order to judge its effect on these problems.

Table 2 indicates the percentage of total Federal funds devoted to the Department of Defense and to national security. This latter category includes all defense outlays plus expenditures on international affairs, space research and technology, veterans benefits, and interest on the national debt due to past wars.

TABLE 2.—PERCENTAGE OF FEDERAL FUNDS EXPENDED ON NATIONAL DEFENSE

| | 1965 | 1970 | 1971 | 1972 estimate | 1973 estimate |
|---|---|---|---|---|---|
| Department of Defense | 52.5 | 51.5 | 47.5 | 42.7 | 42.0 |
| Total national security | 79.8 | 73.2 | 69.5 | 64.0 | 63.5 |

Source: 1973 Fiscal Year U.S. Budget in Brief, published by the Office of Management and Budget January 1972.

Clearly between 1965 and 1972, there was some progress in the direction of reducing the percentage share of defense expenditures and increasing the percentage share of nondefense programs. This should in the long run improve the structure of the economy and ease some of the pressure in the dichotomization process.

Yet the 1973 budget fails to continue this policy of making significant cuts in the relative impact of the Defense budget on the economy. Instead, the administration proposes a $6.3 billion increase in budget authority for national defense and a 16-percent increase in strategic military programs over fiscal 1972. In addition the budget calls for an increase of $838 million in new spending authority for military research and development, $3.6 billion for new naval shipbuilding, and substantial increases in military assistance to the domestic armed forces of the Thieu regime in South Vietnam. All of these new expenditures, and especially those for military hardware, portend a renewed tendency toward uneven development. To the extent that new budget authority is passed to allow the development and deployment of ABM, MIRV, and the B-1 bomber, the process of uneven development will continue unabated reflecting the tendency during the fifties and sixties.

What must be remembered is that as long as the No. 1 economic priority remains with the Department of Defense, the price paid by society will be more substantial than just higher taxes. Distributional problems and stabilization crises are built into the American economy through privatized investment decisions. Unbalanced public expenditure policies only serve to aggravate this trend.

At the same time that the Defense sector is being given more funds, the budgets for other sectors of the economy are not being expanded at a rapid enough rate to forestall further uneven development. In some cases net new Federal funding for programs will actually fall from 1972 levels. In the area of agriculture and rural development, total funds will be cut from $7.35 billion to $6.89 billion in 1973. In the crucial area of natural resources and the environment, the budget for new net outlays is cut nearly in half from $4.37 billion to $2.45 billion. And in the area of commerce and transportation, there is a slight budget reduction from $11.87 billion to $11.55 billion. All of these budget cuts will contribute to the inflation-unemployment problem.

Increases in community development and human resources are also inadequate. The administration has recognized the problems existing in housing and in education and manpower. Yet in the 1973 budget these "priority" items are allowed only moderate expenditure increases. Community development and housing receives only $800 million in new budget authority while human resource funding has been increased to only $11.28 billion from $10.14 billion in 1972.

Again the price paid by society for these unbalanced priorities will be greater than just the cost of doing without a cleaner environment, better urban transit, more adequate housing, and more education. The priorities themselves structure the overall economy in such a way as to create the problems we have discussed at length in this testimony. More investment in strategic bombers and less in housing, more in battleships and less in education allocate physical and human resources so as to reinforce the tendency toward uneven development between regions of the country and sectors of the labor force. This is especially true in the area of human resources. The failure of the Federal Government to compensate for unequal educational opportunity directly contributes to the strikingly unequal distribution of income in the United States.

There are other facets of the 1972–73 Nixon economic program which deserve attention. The investment tax credit of 1972, like its predecessor in the early sixties, will tend to accelerate the pace of uneven development. The industries which are already more profitable will take greater advantage of this biased incentive. Industries and firms with poorer credit ratings and inadequate retained earnings will find it difficult to take advantage of the program. Overtime, capital-intensity will diverge even further between sectors of the economy creating the inherent problems noted often in this analysis.

There are three programs in the Nixon budget which will tend to offset the tendency toward dichotomization of the economy and a greater inequality in family income. Increases in social security benefits by 5 percent in 1973, the deployment of funds under the Emergency Employment Act of 1971, and the proposed family assistance plan will all have a direct counterbalancing effect on uneven development. Yet in all three cases the programs will at best only stabilize the present unequal distribution. All three are seriously underfunded to such an extent that there will be no inroads made against inequality. Social Security will still leave millions of older citizens desperately poor. With unempoyment in excess of 6 percent nationally and as high as 9 percent in some urban areas the transitional public service jobs created by the Emergency Employment Act are too few and too late. Finally the Nixon formula for the family assistance plan will hardly keep pace with the disequalizing income trend in the economy. The $2,400 national minimum Federal income standard is much too low to assure a stable income distribution for very long, and the high unemployment rates created by the dichotomization process assure that the work incentives cannot function.

## CONCLUSION

All in all the 1973 Federal budget is a great disappointment from the perspective of restructuring the economy. It reverses an important trend in defense expenditures. It fails to adequately expand Federal investment in disadvantaged sectors of the economy. It fails to provide enough education and manpower funds to offset the secular deterioration in human capital between rich and poor.

Finally, its new welfare program is woefully inadequate to offset the continuing thrust of an economy which proceeds through uneven development.

The 1973 budget will consequently do little to solve the basic social problems in our cities and rural areas. Much worse, however, is that, on balance, the priorities set by the budget will do nothing to ameliorate the income distribution problem or reverse the worsening trade-off between inflation and unemployment. At best the income distribution will not further deteriorate. At best inflation will be reduced by fiat through continued direct control of private sector wages and prices. But the massive gap between rich and poor will continue to exist and little will be done to reduce unemployment which does not at the same time impose a great strain on prices. All of this is the legacy of uneven development. It is the extremely high price most of us play when a complex economy is run according to the plutocratic needs of private capital.

POSTSCRIPT

Before closing my testimony I must make a plea on behalf of new research. In the past we have failed to deal with the pressing problems of the American economy. To a great extent this is because we have studied the wrong problems. We have built intricate models to predict growth in gross national product. But we have failed to study the distribution of benefits from that growth. We have performed thousands of statistical manipulations on labor force characteristics to predict effects on the wage distribution. But we have failed to completely comprehend the overriding impact of racial and sexual discrimination on the structure of the labor market. We have studied how to optimize marginal tax rates on welfare recipients so as to increase work incentives. But we have failed to fully understand that a 33 percent unemployment rate for ghetto teenagers and young adults nullifies the inducement to work. In short, we have failed to study the social and political economic environment within which the economy operates.

What is needed is new and far-reaching political economic research which investigates the structure of the economy and the institutions which make it work. In addition to national studies, we need more regional studies. We need to study the effect of Government spending on the pretax and transfer distribution of income. We need to understand how Government imposed effective tax rates affect the growth potential in different regions, different industries, and different sectors of the labor force. Finally, we need to know in detail how and how much overreliance on private investment decision tends to promote uneven development which imposes such hardship on so large a part of society.

Representative REUSS. Mr. Sherman, please proceed.

## STATEMENT OF HOWARD SHERMAN, PROFESSOR, DEPARTMENT OF ECONOMICS, UNIVERSITY OF CALIFORNIA AT RIVERSIDE

Mr. SHERMAN. I will summarize the prepared statement, concentrating primarily on the domestic side, since my coauthor, assistant Professor Hunt, is more the expert on the international side.

The administration, it seems to me, favors the monopoly corporation. This is not a piece of detective work by myself, this was rather the stated position of the administration. President Nixon says "all Americans will benefit from more profits." Vice President Agnew says that "rising corporate profits are good for the average man and are needed more than ever by the poor."

On the contrary, I would argue that the last thing the poor person needs is more monopoly profits. It seems to me the monopoly corporations cause certain of the evils of the United States. No. 1, that they push down the real wages, which thereby start poverty. No. 2, that they are primarily responsible for the phenomenon of unemployment and inflation in our present economy. And No. 3. that they support militarism, thereby contributing, I believe, to many of the underlying factors that caused our international monetary crisis.

First of all, why do we have unemployment and inflation in the United States today? Let me make three introductory remarks here.

First, I would note that this is really unprecedented in American history. We have no previous case, to my knowledge, of rapidly rising prices at the same time as we have a very significant large-scale unemployment.

Second, I would note that it is impossible in the orthodox Keynesian economics, which so many of us were brought up on, and which has now finally become fashionable even in Government circles. In Keynesian economics, one would certainly assume that unemployment is caused by too little demand. But one also assumes that inflation is caused by too much demand, so it would not seem that we could have both at once.

The third introductory point concerns the present reality. President Nixon says in his economic report: "1971 was in many ways a good economic year." But the data in his report show, it seems to me, the opposite. First, there was much unemployment, especially among minorities and youth and women in the United States; second, there was declining production in both 1970 and 1971, in the aggregate for the whole year; and, third, that there was rising prices in both years. As I said before, that combination has not occurred previously in our history, in any significant amount, certainly not for a 2-year period.

Now, when we come to unemployment, I think the usual kind of reason advanced still applies, mainly, a lack of demand for goods. If you go to the reason for the lack of demand, then you have to look at the fact that wages have not kept pace with the increase of the national product. Wages certainly are the largest component of consumer demand and the fact they do not increase rapidly enough certainly leads to the kind of crisis where you cannot sell the goods that have been produced.

In fact, in every major expansion in our history, the share of profits tends to rise and the share of wages falls. That is certainly true even if you simply take the Department of Commerce data.

On the other hand, of course, what you get into is the problem that since wages are rising more slowly than profits, and since profittakers have a much more lower propensity to consume, you then get a shift in the whole propensity to consume. To put it in words of plain English, the shift from wages over to profit means that the average consumption compared to national income goes down.

On the other side, if you take up the question of inflation, as I said, the Keynesian view of it has always been what is called by economists, demand-pull. Pull simply meaning that you have aggregate demand greater than the supply. However, that explanation does not go if there is unemployment. One cannot believe there is an excess of aggregate demand when you have 5 or 6 percent unemployment at least. Therefore, most economists come to the conclusion that inflation must be cost-push.

Now, what on earth does the word "cost-push" mean here? There are two views, I think, of what it means. One is the conservative view, that cost-push basically means wage-push. It means that wages are rising rapidly and this causes the inflation. However, the evidence is quite contrary. As I said, historically, if you look, you find in most major expansions that wages have not risen more rapidly; in fact, they have risen much less rapidly than profits.

In the 1960 to 1971 period, again according to the President's economic report, you find that wages and salaries rose by 59 percent, but that profit and interest rose by 83 percent. Therefore, I believe on the whole, that the wage-push theory is really an ideology. It is an ideological pretext for price increases by the large corporations; and it is an ideology used as a pretext for strict control of wages and very loose control of prices by the Nixon administration.

The second point of view as to the meaning of cost-push, the radical point of view, I believe, is that it is largely a profit push. It is a profit push because of the degree of monopoly power over prices. We have had in the past 20 years a very significant and considerable increase in economic concentration, even though it was already high before that.

In 1950, the 200 largest manufacturing firms had 49 percent of all the assets. By 1967, they are up to something like 59 percent. That is a very large increase in that kind of period.

The phenomenon of monopoly pricing power was, I think, first looked at most significantly before this very same committee. The Joint Economic Committee in 1959 heard testimony by Professor Lanzillotti and his testimony, I think, is one of the first that really very clearly states some of the problems. He pointed out that, in the 1940 recession, all prices fell, as was normal for recessions up to that point. Competitive prices fell by about 8 percent, but monopoly prices in the monopoly sector fell by only 2 percent. Certainly, as with all of this data, one can argue about the exact facts, but I think there is no question as to the general direction.

With the 1953 and 1957 recessions we found a new phenomenon. Competitive prices did fall slightly in both of those recessions, but for the first time, in a large sector of the economy, the highly concentrated sector controlled by monopoly, the prices actually rose. And, again, if you take the most recent recession of 1970–71, I think you find the competitive prices were constant and slightly rising, while monopoly prices rose quite rapidly So this is the major problem area.

In fact, in 1971, just from a preliminary looking at the data, I find that competitive profit rates fell, but monopoly profit rates tended to rise pretty much.

So the Nixon new economic policy follows from this. It has been one of helping to keep wages down, but letting prices rise a great deal more. And, of course, there is no lid on profits. To me, this makes for more unemployment since you are preventing consumer demands from rising, at the same time that it keeps the inflation going by feeding corporate power.

On the other hand, the Nixon administration's answer to unemployment has been twofold. The first was the tax credit for the major corporations, which certainly may do something for their profit rates but seems very unlikely to do anything for unemployment. Since we have something like 25 percent of machinery idle at the present time, then one cannot expect business to go ahead and order or invest in more machinery under those circumstances, even if it is made somewhat more profitable for them.

Second, having recognized the other possibilities do not work, I think then you come to the point Professor Bluestone emphasized, that there has been one major increase in the budget designed to help overcome unemployment; and that has been military spending. Military spending clearly is the one type of spending that both big business and the Nixon administration are quite happy to increase. Military spending and such foreign adventures as Vietnam, it seems to me, are favored by the monopoly corporations for two very good reasons.

In the first place, in the military sector, as pointed out by the studies by Senator Proxmire, you find that there have been very high profit rates in the military sector, much higher than the civilian sector, and that these profits are highly concentrated. They had mostly gone to the top 100 corporations.

Second, in the foreign investment sector you find the same thing. Some of my work and that of others has shown that the profit rate in the foreign investment sector, particularly in the underdeveloped countries, is at least double or more that of the domestic profit rate. It is no longer really a minor point, it is a very major amount of corporate investment. Something like 15 percent of all corporate investment over the last 10- or 15-year period has been from international investment.

Furthermore, again, you find it is highly concentrated. In fact, concentration in the foreign field among American corporations is much more than it is in the domestic area.

So in both of these areas, connected with military spending and with protection of foreign investment, you find certainly that the large corporations have a very major stake in it. That, of course, is very different than the stake of the American people. Thus the economists say, in a cost-benefit analysis, you find the benefit from our military spending and military ventures goes to the monopoly corporations. The cost goes to all of us. The cost is measured in terms of inflation, in terms of higher taxes, in terms of death and wounded.

And just a word on the international monetary crisis. It seems to me that much of the problem is simply that we have a great deal more overseas spending than even the United States can afford. Up until last year, it certainly was not due to an excess of imports over exports, nor was it due, I think, even to private investment. Private investment tends to have a greater flow of profit inflow than even the investment outflow. But the crises was due to our military spending abroad and it continues to be due to that. So that you cannot have an equilibrium balance of payments without having considerable reduction in military spending. And, of course, we are going the opposite way.

I come finally to proposing a solution which seems to me the only type of solution that a radical can really propose in the long run. The long run solution, I would argue, is to nationalize the thousand largest corporations. If you do so, the economy then becomes one that is manageable, that it is possible to do things we want to do with it. If you like, you could control the board of directors of each of those thousand. You could elect the board of directors, perhaps 60 percent by decision of the Joint Economic Committee and 40 percent by the workers in those enterprises. Then you would have something that would allow you to put in plenty of investment in those areas, reducing unemployment. You could control the prices directly to control inflation, while you remove the major support of military spending. You also reduce the workers' alienation in those areas.

That is all of my testimony, except I would add an answer to the chairman's question. The chairman asked the question about my use of Marxism. I might say, like Professors Dowd and Bluestone, I am a member of the Union for Radical Political Economics—U.R.P.E. is at 2503 Student Activities Building, University of Michigan, Ann Arbor, Mich, 48104. I just returned a book called, "Radical Political Economy" New York; Basic Books, 1972. My identification would be with the word "radical left" I think.

In this sense, I suppose I am a follower of Marx, that is, in the sense that he was one of our first great radical economists. But then I am also a follower of Thorston Veblen or Eugene Debs or Tom Payne or any of the other American radicals. I would even say that in the sense that I follow strongly his attacks on the military profit rate, I am a follower of Senator Proxmire. Or if you take his many studies of economic concentration, I am a Wright Patmanite, I suppose, in that sense.

Thank you.

Representative REUSS. Thank you very much, Mr. Sherman.

(The joint prepared statement of Messrs. Sherman and Hunt follows:)

JOINT PREPARED STATEMENT OF HOWARD SHERMAN AND E. K. HUNT

THE NEW ECONOMIC POLICY "ALL AMERICANS WILL BENEFIT FROM MORE PROFITS"

Nixon's New Economic Policy (NEP) is based on his philosophy that "all Americans will benefit from more profit." (TV speech, Oct. 7, 1971.) It reminds one of Charley Wilson's philosophy that "what's good for General Motors is good for the country." To understand this policy, we shall examine how more profits are related to unemployment, inflation, and low wages. Internationally, we shall examine how the drive for more profits leads to foreign investment, foreign wars military spending, and international monetary crises. We shall then try to explain the paradox of an honest, mildmannered, clean-living American President—champion of private enterprise—committing the venal sin of imposition of bureaucratic controls on the economy during peacetime.

MORE PROFITS AND INFLATION

Most inflations in American history have been during wars. Prices rose rapidly and profit rates were very high during the Revolutionary War, the Civil War, and first and second World Wars. These inflations are of the classic demand-pull type. In each case, the Government demand for military goods was unlimited. With a restricted amount of goods available and an unlimited demand, prices will naturally rise rapidly. Keynesian theory (in the language of the elementary textbooks) thus states that inflation is caused by excess demand when the supply is already as high as full employment will produce.

The inflation of the last few years, however, has obviously been a different kind of animal. We have had only a "limited" war in Vietnam, which has merely created enough demand to keep us out of a major depression. The American economy, however, has been far from full employment, but has still had inflation.

The data in the President's Economic Report[1] reflects this situation, though the President himself, like Pangloss, tells us that this is the best of all possible

[1] Economic Report of the President for 1972 (Washington, D.C.: U.S. Government Printing Office, January 1972).

worlds. Mr. Nixon says: "Nineteen hundred and seventy-one was in many ways a good economic year.[2] But the industrial production index declined from 110.7 in 1969 to 106.7 in 1970 to 106.5 in 1971 (the last time we had 2 full years of decline was in the reconversion period of 1945–46, and before that in the great depression of 1931–32).[3] Moreover, unemployment (in the vastly understated official figures) rose from 3.5 percent in 1969 to 4.9 percent in 1970 and 5.9 percent in 1971—with nonwhite unemployment at 9.9 percent, and youth (16–19 years) unemployment at 16.9 percent in 1971.[4] Since female unemployment is also higher than average; if you are young, black, and female, then jobs are impossible to find. At the same time, the consumer price index continued to rise: 100.0 (1967), 104.2 (1968), 109.8 (1969), 116.3 (1970), to 121.3 (1971).[5] So in this "good economic year" production fell, unemployment rose, and inflation continued (and the U.S. balance of trade was unfavorable).

If inflation is not demand-pull—since we are far below full-employment—then what is it? Most economists would agree that it is a cost-push inflation. There is bitter disagreement, though, on the meaning of that term. Conservatives believe the main rising cost is wages, and talk about wage-push inflation. Radicals believe the main rising "cost" is profits and talk about profit-push inflation.

The conservatives allege that labor shortages and strong unions push up wages, this forces entrepreneurs to raise prices, and a cost-push inflation spiral thus begins. It is true that back in the 19th century in the early stages of U.S. industrial development, there may have been some shortages of workers during the railway booms. These shortages temporarily caused wage increases and made immigration necessary to get more cheap labor. Since that time, however, the peacetime U.S. economy has been characterized by labor surplus and unemployment. Moreover, unions have always been better at defending wages from cuts than in getting higher wages to keep up with price rises. As Keynes put it, workers have a "money illusion" so higher money wages will usually satisfy them, even when price rises are holding down their real wages.

As a result, in almost all U.S. expansion periods, prices and profits have risen much faster than wages.[6] From 1960 to 1971, for example, incomes from unincorporated businesses, corporate profits, rents and interest rose by 83% while wages and salaries rose by only 59%. Moreover, while income from ownership (profits, rents and interests), remained at record highs throughout the period from 1965 to 1971, the average real income, or spending power, of a worker with three dependents failed to increase at all during those years of rapid inflation.[7] The conservative theory is therefore only hogwash, useful to bolster the arguments of big business. Wage increases have only been a *pretext* for previously decided price increases; the cost-push theory of inflation has been used as a weapon against labor to hold down real wages and increase profits. Nixon follows this grand tradition.

The radical view of inflation is quite different. In our view, it is monopoly power that is responsible for rising prices in the face of unemployment. To make the point, some background facts of economic life are important.

The U.S. economy still has millions of very small enterprises but a few hundred corporate giants hold most of the wealth and do most of the production. In manufacturing, the top 200 firms held "only" 49 percent of all assets in 1950, but held 59 percent of all assets by 1967! Among all corporations in all sectors, just 958 firms held 53 percent of the assets; while the smallest 60 percent of corporations held only 1.5 percent of the assets.[8] The millions of nonincorporated businesses held altogether less than 1 percent. In each individual industry, output is dominated by 3 or 4 giants—the technical term for these few is "oligopoly," but we will use the popular term "monopoly" beause they do tend to act exactly like one monopoly firm. Finally, each of the top 3 or 5 firms in an industry is now often held by a conglomerate that also holds one of the giants in several other industries.

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[2] Ibid., p. 3.
[3] Ibid., p. 235.
[4] Ibid., p. 223.
[5] Ibid., p. 247. Maybe Mr. Nixon considered it a "good economic year" because corporate profits rose from $75 billion in 1970 to $85 billion in 1971, Ibid., p. 209.
[6] Plentiful data and further discussion of this point are presented in Howard Sherman, Radical Political Economy (New York: Basic Books, 1972), pp. 86–87.
[7] These data are from the Economic Report of the President for 1972, op. cit. pp. 209 and 233.
[8] Sherman, Radical Political Economy, op. cit., pp. 99–101.

Even more concentrated than assets are profits. Over the long run (1931 to 1961, excluding the war years 1940 to 1947) the smallest class of corporations, under $50,000 assets, made a negative rate of profit on investment, —7.1 percent. Each larger asset class made a higher rate of profit. Those corporations over $50 million made a long-run profit rate of 10.4 percent.[9] The same is true when we classify industries according to the degree of economic concentration. The highly concentrated industries, such as automobiles or tobacco, have enormously high profit rates; while the more competitive areas, such as textiles or apparel, have very low-profit rates. Finally, we find that the small corporations in the competitive industries have very unstable profit rates, going negative in mild recession; whereas the monopolies maintain their rate of profit come hell or high water.

How does this happen? Part of the answer is that in a depression (and this means most of the time, now that we are in an era of chronic stagnation) the small firms are forced to operate below the minimum technologically necessary scale of production, so they have higher costs per unit. This is true "cost-push", but operates only for the small firms, who have no power to raise prices, and therefore must suffer lower prices. If Nixon had talked only about small business profits being too low, he might have had a point.

The second reason for the higher profits and greater stability of the monopoly corporations, however, is their price-fixing power. Not only do they charge the consumers high prices, but their power as buyer also allows them to pay low prices to small businesses and small farmers, and to pay low wages. It is important to note, however, that the gentlemen who run the monopolies do not always push their prices as high as possible or keep their wages as low as possible. They have vast reserves and can afford (as small business cannot) to take a long view of profit maximization. The wise corporate manager keeps his prices below the maximum possible during the expansion upswing, while he increases his slice of the market, both through his "reasonable" prices and massive advertising.

When the crunch comes as costs rise and consumer demand is limited (by limited wages), the small firm can only watch its profit margin decline, since its prices are set by the competitive market. Not so the large oligopoly or monopoly firm. Since it had intentionally set its price a little below what the market would take, it may now use up part of the slack to raise its prices. Of course, wage increases are given as the excuse, even though they are merely a belated response to earlier price and profit rises. Higher wage costs would have no direct effect on prices if it were not that monopoly power (in technical jargon, the oligopolistic structure of industry) allows the giant firms freedom of price fixing within wide limits.

This is not an imaginary phenomenon. It used to be—in the good old days—that prices fell in a depression. That is no longer the case. The shape of coming events was shown by Robert Lanzillotti in hearings of the Joint Economic Committee of Congress (in 1959).[10] He showed that in the 1948 recession, prices in the more competitive industries did fall by 8 percent, but fell by only 2 percent in the more concentrated industries. In the recessions of 1953 and 1957, there was something new: even the more competitive prices fell only slightly, while monopoly prices continued to rise during the recessions. This is the phenomenon that we find causing such havoc in the 1968 to 1971 period. Prices of the monopoly corporations continue to rise rapidly even in the face of unemployment.

We might also mention, that in the good old days, small business usually gained back some of its relative position during prosperities. That is no longer the case. As early as the expansion from 1948 to 1953, Lanzillotti's pioneering report showed competitive prices rose by only 12 percent while monopoly prices rose 23 percent. Similarly, in the expansion from 1954 to 1957, monopoly prices rose by 16 percent, while competitive prices rose by only 4.5 percent. The same thing occurred in all the prosperity periods of the 1960's. In the whole period to the present, monopoly prices rose most rapidly, while small business prices rose less (and wages lagged far behind). The couse of these phenomena is a long-run increase in economic concentration and monopoly power.

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[9] Ibid., pp. 106–109. Also see Howard Sherman, Profits in the United States (Ithaca, N.Y.: Cornell University Press, 1968), p. 41 ff.

[10] Robert K. Lanzillotti in hearings before the Joint Economic Committee of Congress, Employment, Growth, and Price Levels (Washington, D.C.: U.S. Government Printing Office, 1959), p. 2238. Discussed fully in Sherman, Radical Political Economy, op. cit., pp. 114–116.

### SOLUTIONS TO PROFIT-PUSH INFLATION AND UNEMPLOYMENT

As always, the right-wing anachronisms, such as Milton Friedman, stick to the line that government need only stop interfering with business and everything will be fine. In this era of problems such as profit-push inflation and chronic unemployment, almost nobody accepts that solution. The most modern instruments acceptable to right-wing economists are the mild monetary measures, but these have proven totally inadequate to meet major crises ever since the thirties.

The usual liberal Keynesian solution for unemployment was to increase aggregate demand (by more Government spending or lower taxes); while their solution for inflation was to reduce aggregate demand (by less spending or more taxes). Under the present conditions of insufficient aggregate demand and unemployment, combined with profit-push inflation, these solutions are also inadequate. A small increase in demand, usually by military production or by cutting corporate taxes, does not necessarily stimulate output and employment; but is used by the dominant large corporations as a means of further raising prices for higher profits. A small decrease in demand, usually by cutting welfare spending or raising taxes, does not necessarily reduce most prices; but only leads to more unemployment.

The most daring liberal economists, such as John Galbraith and Paul Samuelson, have recognized this new situation for some time. Since aggregate measures will no longer work, they advocate some form of direct control on individual prices and wages. Their dream seems to be that full employment could be reached by more Government welfare spending, while direct controls would hold down inflation. They neglected several things, particularly the political reality. Yet their arguemnts did convince the Democratic Congress; at least, the feeling was created that standby wage-price control would be an excellent political ploy. The Democrats could claim that they had passed legislation for a daring solution, but that the President was too conservative and unwilling to use it.

We all know that the President did decide to use this power given him by the liberal economists operating through the liberals in Congress. He has not used the power in the way that the liberals dreamed, but in a way that was quite predictable. Nixon's new economic policy gives tax credits to big business, freezes welfare spending, carefully restricts wages, but lets most prices increase, and has "voluntary" controls on profits. The dream has become a nightmare. The system of controls would seem to combine all the worst features of capitalism and centralized socialism. It is a directed economy in the interests of the military-industrial complex; a kind of extensive peacetime direction seen before only in fascist economies.

We do not merely label, but will show here that the following features will result from the program: (1) As Friedman argues, controls will prevent efficient operation of the market, will lead to a vast bureaucracy, and tend toward corruption and repression; (2) As many liberals argue, the program does damn little for the unemployed; (3) As Samuelson argues, the program is pro-business and will shift the distribution of income from wages toward profits; (4) Internationally, it is designed to protect American investments and dominance in many other countries, to maintain the present U.S.-oriented system of international finance, and to continue vast military spending here and abroad. Radicals thus agree with both the conservative and liberal criticisms of the program. We argue that it adds up to the worst of all possible worlds, and that this dilemma will exist so long as the capitalist system continues. We believe it predictable that the controls would always be fixed in this way by a big business dominated administration (a liberal Democratic President might change their shape a little, but not much).

### MORE PROFITS AND INEFFICIENCY

The conservatives such as Milton Friedman[11] are horrified at the violation of the First Commandment of laissez-faire economics: Thou shalt not interfere with the market process of setting wages and prices. They have always argued that if prices are not set by competition in the market, then resources including capital and labor cannot be efficiently allocated.

If the Government arbitrarily sets wages and prices, then how can a businessman rationally calculate what to produce or what technology to use? More pre-

[11] Milton Friedman, Newsweek (Aug. 30, 1971).

cisely, if a businessman does follow the arbitrary prices set by government, he will not produce what consumers desire nor will he produce it in the cheapest possible way. Indeed, the monopolies would probably put less money and effort into production improvement (since prices are fixed), and more into corrupting administrators to raise prices (as they presently do in military procurement). Perhaps "corruption" is the wrong word; those who administrate the price controls mostly favor business demands because they are mostly pro-business by training and background—just as the present regulatory agencies always are. Thus government controls on wages and prices doom a capitalist economy to inefficiency—and will create an enormous, inefficient, and possibly repressive bureaucracy.

MORE PROFITS AND LESS WAGES

We noted Nixon's philosophy that "all Americans will benefit from profits." This seems strange when we have demonstrated that the inflation he was supposed to control was mainly based on monopoly profit-push. It is not so strange when you understand the old trickle-down theory. At the National Governor's Conference in 1971, Spiro Agnew must have been thinking of the trickle-down theory when he said: "Rising corporate profits are good for the average man and are needed more than ever by the poor."

What do the poor get from corporate profits? Well, if there are more corporate profits, then the profit recipients can afford more shoeshine boys to keep their shoes clean. Thus the profits trickle down to the shoeshine boys. A more modern and sophisticated form has it that more corporate profits mean more investment, and this means more employment (an argument examined in the next section).

Nixon's NEP has a wage board with representatives of labor, business, and the "public." The "public" representatives, however, have proven to be even more anti-labor than the business representatives! And the "labor representatives are the leaders of big unions, protecting only their own interests, and not those of all labor. Nixon's NEP price board is even more interesting; it has only "public" representatives, meaning pro-big-business. Nixon's NEP controls on profits and interest are none-existent, since he boasts that they are "voluntary." In general, therefore, the Nixon NEP has resulted in rising corporate profits, but has made workers' wages a falling share of national product.

Before leaving this topic, we must note that corporate profits were very high in the mid-1960's, yet very little seems to have trickled down to workers. According to official, understated, figures for 1966, at least 14 percent or 25,000,000 Americans were living in poverty (and there has been little change up through 1971).[12] This poverty line is based on an "economy diet," infrequent purchases of clothing, and minimal housing of the slum variety. Moreover, about 60 percent of Americans fall below what the Bureau of Labor Statistics calls a "moderate but adequate city worker's family budget." Nor are businessmen and workers to be found equally among poor and rich. Of the bottom 60 percent of income receivers, whose budget was less than "adequate" by BLS standards, almost all were workers whose sole income came from wages and salaries.

On the other side, the richest 2 percent, who make more than $25,000 a year, receive about 90 percent of their income from property in the form of rent, interest, or profit. The top one-tenth of one percent of all taxpayers, with incomes over $200,000 a year, receive 23 percent of all dividends and 37 percent of all capital gains. The top two-tenth of one percent of all taxpayers own 65 percent to 71 percent of all stock.[13]

MORE PROFITS AND MORE UNEMPLOYMENT

The above data show that a few wealthy owners of giant corporations receive most of the income pie, while millions of workers each receive very, very small slices. We have also shown that Nixon's NEP will tend to make income distribution even more unequal. But if the economy is to thrive, millions and millions of cars and refrigerators and TV sets must be sold. The few rich can buy only a few, no matter how extravagant they are. The mass consumer buying must come from wages and salaries, which are the main component of consumer demand. Therefore, if wages and salaries are held down, while the share of profits rises, there is

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[12] See extensive data and discussion in Sherman, Radical Political Economy, op. cit., pp. 49–50 ff.

[13] Ibid.

insufficient consumer demand. Lack of consumer demand means that goods pile up on the shelves unsold. Naturally, if goods cannot be sold, workers are fired, and unemployment grows. Thus high profits and low wages seem to mean less consumer demand and more unemployment.

The basic element of the Nixonian NEP is the freeze on wages, with no present controls on profits and dividends. Can it be that Mr. Nixon and his administration are representing only the few big businessmen rather than the millions and millions of workingmen? Can it be that he doesn't give a damn about poverty, low wages, or unemployment?

Nixon's NEP does provide a very small amount of tax relief (in higher exemptions and deductions) that will put a few more dollars into consumer demand. The main thrust of his tax program, however, is relief for the poor suffering corporations. He (and the Democratic Congress) are giving many billions of subsidies in the form of tax credits for new investment.

It is true that total demand includes not only consumption spending, but investment in new machinery and factories. So Mr. Nixon's ghostwriters might answer that tax credits and higher profits after taxes will result in more investment in machinery and factories, and surely more workers will be employed in this work. That is true, but unfortunately it runs into a problem.

If more machines and factories are built, they have to produce something, and it has to be sold! In reality, the U.S. economy not only has "too many goods" relative to the low incomes of workers and consumers, it also has too many machines and factories for the present production level. In fact, some 27 percent of all capital goods are now lying idle. To make more machines and factories, while leaving workers' incomes too low to buy the new flood of goods (or even the present flood), is surely not the answer. In other words, a few more workers might be put to work immediately by Nixon's investment credits, but soon the problem will become worse as a result of this temporary "cure."

Unemployment involves a dilemma that cannot be solved by wage-price controls. From the viewpoint of the businessman, there is a lack of demand and high costs that make for low profit expectations, so less investment. The Nixon program would hold costs down by restricting wages and cutting corporate taxes. But this only leads to the other side of the dilemma: low wages mean less consumer demand, while more investment leads to a greater flood of (unsold) consumer goods. So the Nixon program raises immediate profit rates, but leads eventually to more economic depression and mass unemployment.

### MORE PROFITS AND MILITARY SPENDING

There is one kind of spending dear to the heart of most big businessmen; it provides super high profit rates, and yet it puts no more goods on the market to add to the unsold pile. In ancient Egypt, the main unmarketed good was the pyramid; in modern America, it is military production. Bombs and bullets are even better than pyramids for the economy; pyramids remain to dot the countryside, while bombs and bullets can be rained down on Vietnamese. Thus, military production is quickly disposed of, even though there is no market demand for it.

Remember the Nixon philosophy that "all Americans will benefit from more profits." From this point of view, military production must be the greatest benefit to all Americans. As expected the new Nixon budget proposes a $6.3 billion increase in military spending.[14]

Not only does military production have a guaranteed market, but the rate of profit is at least twice as high as for civilian industry (a point carefully documented by Senator Proxmire's investigations).[15] Of course, these profits are not distributed to all Americans, nor even to all businesses. According to the Department of Defense, between 1950 and 1967 the 100 largest contractors received two-thirds of all military contracts; and just 10 giant firms received almost one-third!

### MORE PROFITS FROM FOREIGN INVESTMENT

It is frequently argued that economic interests and the quest for profits are relatively unimportant in determining America's policies and actions in the international sphere. Typical of this view is the assertion made by Peter Passell and

[14] Executive Office of the President, The Budget in Brief for 1973 (Washington, D.C.: U.S. Government Printing Office, 1972), p. 45.
[15] See discussion and data in Sherman, Radical Political Economy, op. cit., pp. 141–145.

Leonard Ross in a recent issue of the New York Review of Books: ". . . it is important to keep in mind that international trade doesn't really matter much for the U.S. economy. Trade accounts for only 5 percent of American GNP." This type of statement, which is repeated endlessly in the writings of professional economists as well as journalists, obscures much more than it explains.

The ratio of American exports to GNP gives no notion of the importance of profits which Americans receive from foreign holdings. These profits are particularly significant for the giant multinational corporations which dominate the American economy. Between 1950 and 1970 the value of American-owned assets and investments abroad grew from $54 billion to $166 billion.[16] Thus, production abroad by American-owned capital is now estimated to be five and one-half times greater than American exports.

When we compare American exports plus sales of foreign affiliates with the domestic output of goods by farms, factories and mines, we find that the foreign market is at least 40 percent as large as the domestic market. It is not surprising that by the mid 1960's corporate profits originating in the foreign sector were nearly 25 percent of all corporate profits[17] of which 60 percent is from foreign investment. This ratio is more than double the 1950 figure. Since these profits are even more concentrated in a few giant corporations than are domestic profits, it follows that foreign profits are certainly a major consideration for the largest and most powerful of American firms.

PROFITS, DOMINANCE, AND MILITARY SPENDING

The nature of the American worldwide economic supremacy is very complex. Control is often hierarchical rather than direct. The United States stands at the top of a worldwide hierarchy of capitalist nations. The largest portion of American foreign investment goes to the countries of Western Europe and Canada (although the direct investment in underdeveloped countries is certainly significant). These countries, in turn, invest in each other as well as in underdeveloped countries. American control in Western Europe and Canada thus becomes an indirect channel by which direct economic control around the world is supplemented and strengthened.

The Canadian example particularly horrifies Europeans as an omen of their own possible future. U.S. investment is 80 percent of all foreign investment in Canada. Total foreign investment in Canada controls 60 percent of all manufacturing (including 97 percent in autos and rubber and 77 percent in chemicals and electrical apparatus), 62 percent of mining and 64 percent of the petroleum and natural gas industry.[18]

Yet Canada is a developed, industrialized capitalist country; the foreign dominance is much greater and more harmful in many underdeveloped countries. Whereas in Canada and Europe the U.S. annual capital investment far outweighs U.S. profits, in the underdeveloped countries, U.S. corporations extract more in profit and interest than their new investment each year. The effect is that the underdeveloped countries are subsidizing U.S. development at the expense of their own. In Latin America from 1950 to 1965 we invested $3.8 billion, but extracted $11.3 billion in profits. In Africa and Asia in the same period American corporations invested only $5.2 billion, while extracting $14.3 billion in profits.[19]

American economic supremacy in these countries was achieved mostly by financial strength but partly by force. To maintain this economic empire, the U.S. Government supports financially and militarily all the most reactionary governments, because only these are subservient (Thieu, Chiang Kai-chek, the Greek junta, the Duvaliers in Haiti, and numerous others). In 1969 the U.S. Government also kept 1,517,000 soldiers in 1,400 bases in 70 to 80 foreign countries.[20] This was in addition to our "police force" in Vietnam.

Thus foreign investment and military spending are closely related. During the last two decades foreign investment has brought in about 15 percent of U.S.

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[16] Federal Reserve Bulletin (April 1971), p. 280.

[17] See Harry Magdoff, "The Age of Imperialism" (New York: Monthly Review Press, 1969), p. 182.

[18] Canadian Privy Council Report of the Task Force on the Structure of Canadian Industry (Ottawa: Queen's Printer, Jan. 1968). These data are taken from various pages of the Report.

[19] Sherman, Radical Political Economy, op. cit., pp. 161–162.

[20] Ibid., p. 170.

corporate profits, while lucrative military production has contributed at least another 10 percent of corporate profits. Taken together, and including their indirect effects, these have a massive impact on the U.S. economy. Moreover, most of military and foreign profits go to the same top 100 or 200 corporate giants[21] Therefore, while most of us suffer from foreign adventures (taxes, inflation, killed and wounded), the monopoly corporations support these investments and wars because they provide their lifeblood.

MILITARY SPENDING, FOREIGN INVESTMENT, AND THE MONETARY CRISIS

This brings us to the important question that leads us to a consideration of the international consequences of Nixon's new economic policy: how has the United States financed the creation and policing of its international economic empire? In other words, from what source have we gotten the dollars to finance our foreign investments and our foreign military network?

In order to answer this question we must briefly consider the mechanism of international monetary exchange. When the United States exports commodities to, say, Germany, the German importer pays in deutschcemarks. The deutschemarks must be converted into dollars before the American exporter can be paid. If a German exporter has just sold goods of an equivalent value to an American importer, then the American would have paid in dollars—which must be converted to deutschemarks before the German exporter can be paid. It is obvious that if the value of our imports from Germany are equal to the value of our exports to Germany, then both exchanges can easily be made. In that simple case, the dollars paid by the American importer would be channeled, indirectly, back to the American exporter. Similarly the German importer would, indirectly, pay the German exporter.

In the aggregate, however, it is unusual for a country's exports and imports to happen to be equal. Under a gold standard, gold serves as an international medium of exchange with which a country balances its financial affairs with other countries. If the value of a country's imports exceeds that of its exports, it pays the difference in gold. If the value of its export is greater, it receives the difference in gold.

Over the past few centuries, however, the volume of international trade has grown much faster than the world's stock of gold. The insufficiency of gold has been remedied in two ways. First, the value of gold has persistently increased, so that a smaller amount of gold could service more trade. Second, the currency of the dominant capitalist country or countries has served as a "key currency" or a substitute for gold. Thus, the so-called international gold standard of the nineteenth century was really a sterling standard. Surpluses or deficits in balances of payments were usually settled with payments of sterling. Sterling was, of course, convertible into gold. But the British monetary authorities managed to create a worldwide confidence in sterling that made such conversions unusual.

The British export surplus, however, was usually not paid to them in gold or sterling. Instead, in the nineteenth century British trade surpluses financed her acquisition of an empire. Buying a country's land, resources and capital is, in principle, no different than importing goods. In this way a surplus of exports over imports permits a country to export capital, or to pay the costs of maintaing a standing army on foreign soil.

Since World War II, the international economy has functioned with an American dollar standard. Although the dollar was convertible into gold, the world wide acute shortage of dollars up to about 1958 made this convertibility incidental and irrelevant. During those years American export surpluses partially financed our economic aid, our foreign military expenditures and our foreign investment. The costs of establishing and maintaining an international economic empire, however, greatly exceeded the amount of financing created by the American export surpluses. The excess costs were met by paying out billions of dollars.

Because American economic dominance established the dollar as the international medium of exchanges, the recipients of these dollars held on to them. Otherwise, they would have immediately demanded that they be taken back in exchange for our exports or gold. These exports and the gold would have represented the real payments by which we purchased our economic empire. But,

[21] Ibid., pp. 144–145 and 163–165.

because the expanding volume of international trade necessitated an expanding volume of dollars (the international currency), foreigners held these dollars in bank accounts on which they generally received only the lowest nominal interest income. Much of our economic empire was acquired without making any real payment. Foreigners were forced to provide us with very cheap loans with which we acquired economic dominance over them.

Suppose there had been some method of controlling military expenditures and foreign investments within reasonable limits. In that event, there seems to be no reason why this nearly costless method of economic conquest might not have been continued indefinitely. But such control was not possible. The ethos of the cold war, the growth of the military-industrial complex, and the U.S. conflicts with national liberation movements pushed military expenditures continuously upward. Moreover, there was no way in which the volume of foreign investment could be controlled. Investments were made by individual corporations solely on the basis of projected profitability.

### THE CRISIS AND THE NIXON SOLUTION

The result was that the military expenditures abroad and U.S. foreign investments created deficits, which had to be paid by an increasing outflow of dollars. These dollars held abroad finally exceeded the amounts which foreigners were willing to hold. Foreign dollar holders began to demand gold for their excess dollar balances. In 1957 the American Treasury had $22.8 billion in gold stock; by 1971 this figure had fallen to $10.2 billion.[22] Over the 14 year period the United States was forced to finance over $12 billion of its economic expansion by paying out gold. Nevertheless, between 1950 and 1971 the increase in American "liquid liabilities to foreigners"—a measure of the amount foreigners have now forced to loan Americans—was about $45 billion.

In 1968 and again in early 1971 attempts by foreigners to convert their dollar holdings into gold or into other currencies created minor crises. Throughout the sixties it had been obvious that the size of the recurring American balance of payments deficit was too large. There appeared to be two possible courses of action: either finance a larger portion of military expenditures and foreign investment by achieving a larger surplus of exports over imports, or reduce the size of military and investment expenditures. American militarism showed no signs of abating, and repeated pleas for voluntary restrictions of foreign investment fell on ears which were deaf to anything but the prospect of more profits. It became quite clear that only a more favorable balance of trade could alleviate the situation.

In this set of circumstances it was clear that the American dollar was overvalued. A devaluation of the American dollar in relation to other currencies would make imports from foreigners more expensive for Americans. It would also make American exports cheaper for foreigners. If foreigners would permit this devaluation, it would surely increase the American export surplus.

The problem with this solution was that as of June, 1971 foreigners held $51.3 billion in American dollars. If the value of the American dollar were reduced by 10 percent, these foreigners would suddenly lose the equivalent of about $5.130 billion. This incredibly large amount of wealth would simply evaporate. Consequently, the slightest hint of an American devaluation would produce a rush of foreigners seeking to exchange their dollars for gold or other currencies. Such a rush could undoubtedly lead to the collapse of the entire international monetary mechanism.

By July of 1971 Nixon's economic advisers were aware of the fact—which was to be made public in August—that the surplus of exports over imports, with which we had financed part of our military expenditures and foreign investment year after year, had turned to a deficit of over $800 million during the second quarter of 1971. In the face of this setback, Nixon made his August 15th announcements. In order to reduce the international deficit he did three things. First, he imposed the wage-price freeze discussed above. Although this was designed largely for its domestic effects, it was also believed that it would make American exports more competitive in the international market.

Second, in blatant violation of the General Agreement on Tariffs and Trade, he imposed a 10 percent tariff surcharge. This openly aggressive attempt to export America's economic woes was rationalized by asserting that American

[22] Economic Report of the President, op. cit., p. 302.

business had been competing "with one hand tied behind her back." The "unfair edge" possessed by foreign competitors would no longer be tolerated, he argued. The implication of Nixon, Connally and other spokesmen for the new tactics, was that the United States was still the champion of free trade but was being forced to react defensively to European and Japanese trade barriers and quote restrictions.

This is simply not true. A recent State Department study showed that after the completion of the current Kennedy round of tariff reductions, the average tariff rates on industrial goods will range between 8.3 and 11 percent for the major capitalist powers including the United States. Such a narrow range hardly indicates much of an "unfair edge" for anyone. The same study shows that U.S. quota restrictions are more significant in total dollar terms than those of the other major capitalist powers. Moreover, over the last 8 years the United States has been gradually extending its quota system while the other countries have been reducing theirs.

The third feature of the Nixon plan was the severing of the direct link between the American dollar and gold. This bold stroke brought into the open a fact of which many Americans had been only vaguely aware, that there is currently a major power struggle taking place among the developed capitalist countries.

POWER, PROFITS, AND GOLD

Since the early sixties the major capitalist countries, particularly those of Western Europe, have been aware that the preeminence of the American dollar in international finance has been forcing them to finance America's international economic take-over. The power which European capitalists had acquired, during the strikingly successful economic recovery from World War II, created a situation in which European and Japanese capitalists were simply no longer willing to play a subordinate supporting role to American capitalists in the world hierarchy. So throughout the 1960's they persistently struck at the Archilles heel of the international financial structure that supported American dominance—the convertibility of American dollars into gold.

By converting dollars into gold, the foreign captialists hoped to bring sufficient pressure on the United States to force a major curtailment of American foreign investment. But this plan could work only if there were a suitable substitute for American dollars as an international medium of exchange. In the meantime, American capitalists sought to find a system of international finance in which the dollar would still be the dominant currency, but in which the vulnerability of gold convertibility could be eliminated. The answer which recommended itself to all of these capitalist powers—but for diametrically opposed reasons—was a system of "paper gold" or "special drawing rights" (SDR's) controlled by the International Monetary Fund (IMF).

SDR's are simply IOU's of the International Monetary Fund which are readily accepted as money by most trading countries. If a country accumulates an excess of another country's currency, it can exchange this currency for SDR's—the new "paper gold." International liquidity can easily be ensured because the IMF could, in principle at least, create IOU's without limit.

The major foreign capitalist powers saw this as a possible means of undercutting American economic hegemony. The IMF, they theorized, would have an upper limit on the amount of any country's currency it would hold. If American capitalists continued their profligate international spending spree, dollar holders would quickly convert their dollars into "paper gold" (SDR's) until the IMF was holding the maximum permissible level of dollar balances. At that point the United States would have lost its source of cheap financing of its economic empire and would be forced to curtail its foreign investment.

The United States, on the other hand, hopes that SDR's will simply become disguised dollars. The American government hopes to use its immense power in the IMF to ensure a situation in which dollars could be freely convertible into SDR's in whatever quantities are necessary to achieve American purposes. If this were the case, foreign holders of SDR's would still be providing American capitalists with very cheap loans. The only changes would be that the IMF would act as an intermediary for channeling the loans into American hands, and that the vulnerability of gold conversion would be eliminated. American supremacy in the capitalist world hierarchy would be assured.

In view of these conflicting motives, it is no surprise that international agreement on beginning a system of "paper gold" was achieved only after many years of intense debate and negotiation. A plan for an IMF "paper gold" was proposed by John Maynard Keynes at the Bretton Woods Conference in 1944, at which the original IMF charter was written. Opposition to Keynes' plan, particularly on the part of the United States, forced its abandonment. For 25 years thereafter the IMF functioned without the power to create international money. By the late 1950's most economists were convinced that the existing financial arrangements were dangerously unstable. Pressure to establish an "international money" increased. The need for more international money reserves was acute. In 1958 world money reserves were about 57 percent of world imports. By 1967 this figure had slipped to 36 percent.[23]

Throughout most of the sixties, representatives of the major capitalist powers doggedly attempted to negotiate a compromise agreement. The fear of an international monetary collapse spurred them to make some mutual concessions. The result was that in 1967 the Board of Governors of the IMF decided to establish a system for the issuance of SDR's. That system went into operation in January, 1970.

A most divisive issue, of course, was the quantity and allocation of the initial creation of SDR's. Even more divisive was the issue of how, when, and for whom SDR's would be expanded. A very complex voting system was devised, with each country receiving a number of votes that reflected its power in the IMF. The United States, for example, got 21.8 percent of the votes, while the United Kingdom got 10.4 percent, Germany 5.2 percent and Japan 3.2 percent.[24] It was agreed that it would require an 85 percent majority of the votes to change the quantity and allocation of the SDR's. Although this made the United States the only country with veto power, it by no means established American control over the issuance of SDR's. The United States will have to rely upon persuasion, cajolery, bribery or threats to achieve its aims in the IMF.

With this background information, one can see the desperate game of brinkmanship begun by Nixon and Connally in mid-August. The administration is determined to do two things: First, they hope to force certain major countries, particularly Germany and Japan, to increase the value of their currencies in relation to the dollar—so as to give the United States an export balance. Second, by using the fear of collapse of the international finance system, they hope to establish a system of SDR's which will permit continued low-cost financing of American deficits.

The ultimate threat which the United States can exercise is to refuse to convert foreign dollar holdings into gold or any other currency. With more than $50 billion in dollar balances outstanding this would utterly destroy the system of multilateral international finance. But this economic doomsday machine, like America's nuclear arsenal, represents devastation on such a scale that competitors realize its use would be suicidal. As a consequence America's ability to coerce in the economic sphere will undoubtedly be as limited as it is in the military sphere.

During late 1971, both Germany and Japan made some concessions to the United States. They allowed the value of their currencies to float upward slightly—altnough they are nowhere near the point where Connally was attempting to push them. Almost immediately they both began to feel the adverse effects. Germany, in particular was experiencing its highest unemployment in 30 years. Finally, the Smithsonian Agreement, reached in Washington on December 17 and 18, 1971, committed the United States to an official devaluation of the dollar from $35 per ounce of gold to $38 per ounce. Although this Agreement was widely applauded, it was not nearly adequate. No basic steps have been taken to remedy the underlying problems which originally led to the difficulties. Consequently, the free market price of gold is now (February, 1972) $48 per ounce and the solution to the impasse seems nowhere in sight.

Nixon and Connally appear to be steering a dangerous collision course because of their insistence that the remaining disequilibrium be remedied by America's major trading partners through revaluation and trade controls. Failure to resolve this conflict conceivably could lead to the collapse of the entire international payments mechanism. Still, we believe that the United States will relent before she kills the goose that lays her golden eggs. Under the circumstances, it seems that a major devaluation of the dollar or revaluation of gold is the most likely

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[23] Joseph Gold, Special Drawing Rights, Character and Use (Washington, D.C.: International Monetary Fund, 1970), p. 7.
[24] Ibid., p. 22.

short-term answer to the impasse. If the price of gold is raised substantially, it will postpone for some considerable period the desire of most Europeans to convert dollars to gold. A revaluation will not, however, completely eliminate the efforts of European capitalists to force the United States to reduce its level of foreign investments and to cut the size of its balance-of-payments deficit. The conflicts won't be gone, merely postponed.

The most skillful negotiators have been unable to resolve these conflicts over a period of years of intensive negotiations. This is, we believe, because the underlying motive in capitalist trade relations is, and must be, the acquisition of profits. A profit system inevitably leads to a hierarchy of economic power, rivalry and subjugation. Conflict is inherent in such a system, whether we look at the domestic economy of the United States or the international economy.

WHAT IS TO BE DONE?

On the domestic scene, we find that Nixon's wage-price controls and fiscal policy will only slow inflation, will certainly not end unemployment, will mean a large and inefficient bureaucracy, and will shift income from wage earners to profit makers. Internationally, his continued high military expenditure in support of U.S. investment abroad, plus attempts to coerce European capitalists into paying for it, are unlikely to succeed. It is not clear that the United States can control the new paper gold (SDR's) to the extent it needs to support high profits and military dominance in many countries. The problem is that liberal as well as conservative measures are predicated on a continuing system of maximum capitalist profits here and abroad with all that is implied by that system. Yet it is impossible to have equitable distribution, no inflation or unemployment, peace, and international stability under such a system.

We believe, therefore, that it is necessary to make some fundamental changes. Since less than 500 corporate giants control most of the U.S. economy, and since their search for maximum profits leads to most of our problems, we propose that these firms be publicly owned (that would include the largest banks as well as manufacturing enterprises and utilities). The control would be exercised partly by the workers in those enterprises and partly by our democratically elected representatives in Federal, State, and local governments.

With nobody amassing private profit from these corporations, the democratic process will not be dominated—as it now is—by corporate owners and managers. Moreover, under public control for public purposes, these enterprises can always invest enough for full employment, they can keep their prices stable, avoid pollution of the environment, and hire and promote without racial or sexual discrimination. With workers' participation in control, workers may significantly reduce the level of their alienation. Moreover, we saw that only the owners of the largest corporations benefit from military spending, dominance over, and high profit extraction from foreign countries (while the U.S. public suffers from taxes and war deaths); so publicly controlled corporations would not support huge military spending for foreign adventures. With this change, an acceptable international equilibrium might also be achieved.

Representative REUSS. Mr. Bluestone, in your prepared statement, you say: "The distribution of aftertax and transfer income has remained approximately constant, at least since World War II, and possibly since the turn of the century." You go on: "The poorest one-fifth of our families perennially receive approximately 5 percent of total income after account is taken of taxes and welfare transfers." And then you conclude by saying: "Thus, the Federal Government has been able to almost exactly counterbalance the private and public forces leading to an even more unequal distribution of income."

It may seem odd to me to cavil to a radical economist for not being radical enough, but wouldn't you agree with me, developments in the last 2 or 3 years suggest that maybe we are moving backward in the direction of inequality and that the relative progress from the 1930's is being eroded as evidence of this superradical position I am taking?

I cite the study by the Federal Reserve System, uncovered by the enterprising reporter from that radical publication, the "Wall Street Journal" which you mentioned, which as reported in the Wall Street Journal for February 28, suggests that just taking 1969 and 1970, that the lowest fifth in that 1-year period went down by a tenth of a percentage point, that the second fifth went down by three-tenths of a percentage point, that the middle fifth went down by two-tenths of a percentage point, that the fourth fifth, the next to the top fifth, stayed even, and that the highest fifth went up by six-tenths of a percentage.

Mr. BLUESTONE. Right.

Representative REUSS. One may say, well, they are just factions but they involve billions of dollars, and I am wondering if the phenomenon which has all of these establishment economists up the wall, namely, that people in the last 2 or 3 years seem to be saving about 8 percent of their spending income, rather than the more normal, traditional 6 percent. I wonder if the reason is, of at least in part, that income shares are getting out of whack, and that as the propensity to consume gets shifted upwards to higher income brackets, of course, the average goes up toward 8 percent, even though people in the lower two quintiles are very likely spending all of the income they make and then some.

I wonder, therefore, whether the tendency since 1969, to decrease the progressive income tax, to increase the regressive payroll tax at the Federal level, also the tax at the State level, property tax at the local level, coupled with increasing unemployment and inflation, has not brought about a retrogression in the income distribution pattern of the last 20 years which certainly was not getting any worse, until the last 2 years, but that seems to be getting worse now.

What about that?

Mr. BLUESTONE. I think you are absolutely right, in the last year or two things seem to have gotten worse. When we look at the 1971 statistics, we are going to find they worsened a little bit.

If you look at the data over the last 15 years or so, you will see some fluctuations. The numbers we see are in the range of those fluctuations. However, I think your point about the changes in the tax law are very well taken. My testimony here is in that sense quite conservative. I am, in effect, saying that we are doing a bit better than we actually are. I think the important point to remember is that when you have a process of uneven development or what the prominent Swedish economist, Gunnar Myrdal called circular causation with cumulative effect, you have a tendency over time for uneven development to become worse and worse, to go faster and faster. In order to keep the same distribution of income over time, the Federal Government has to do more than stand in place. It has to keep running faster and faster, like Alice in Wonderland, just to keep the income distribution constant.

I would expect if some proposal like H.R. 1, or one of its substitutes is passed, social security benefits do increase as they are supposed to, and a few of the other things go into effect, the lowest fifth, for instance, will continue to retain between 5.6 and about 5.8 percent of the total distribution of income.

But the important thing is that the Government, given the structure of the economy, constantly has to run faster and faster and faster in its redistribution mechanisms just to stay in the same fairly pitiful place where we are now. The Government has not kept pace with uneven development in the past 2 years. We have seen the distribution going against the poor in favor of the rich. What I am arguing is that the supposedly magnificent new programs in welfare, and the Emergency Employment Act, and so forth, will do nothing more than keep us where we were, let us say, in 1969. We have to go well beyond that if we are going to change the results over a long period of time.

But even more important than this, the crux of my argument is that we have to run so fast just to keep up, it is obvious we cannot do this forever. What will be necessary is a restructuring the economy, a restructuring of the underlying pretax and transfer distribution of income.

But you are absolutely right in terms of what these statistics show.

Representative REUSS. You have advocated that the United States pursue a course, as you put it, of even rather than uneven economic development. I am not quite sure I understand, so I will ask a question or two about it.

Specifically, if we consciously pursued a course of even rather than uneven development—and I put here to one side the overemphasis on the military which I happen to agree with you on—but if we made even rather than uneven development our watchword, how would the structure of industry be able to change in order to reflect technological innovation, and, second, how could the structure of industry be able to change in order to reflect the growing manufacturing capabilities of developing countries? And the desirability of adjusting to that?

Mr. BLUESTONE. Well, basically, what we have had through uneven development, of course, is an addition of more and more capital to the sectors that already have large amounts of capital. These sectors are, in fact, becoming more and more productive. They have some competition from other countries but they are remaining competitive because of productivity increases.

At the same time that we have added more and more capital to these industries, we have, in effect, kept the capital structures in other industries fairly fixed over time.

I think it might be important to see what the results would be if we balanced our economic priorities. What I mean by that, is a budget which paid more attention to our needs in education, in housing, in clothing, in foodstuffs, and so forth, as opposed to a budget which constantly takes 40 to 50 and 60 percent of Federal spending and puts it in a small set of defense industries.

In 1967, Professor Leontief and Professor Daniere estimated the interindustry employment effect of a deescalation of the Vietnam war. This was back in 1967, when we were talking about possibly deescalating the war. According to their calculations, using the 1958 input-output matrix of the U.S. economy, a $19 billion reduction in Vietnam spending with a reduction in tax or increased nondefense spending would have resulted in increased employment in the disadvantaged sectors of the economy. Employment would have risen by 3.8 percent in the food industry, 3.8 percent in leather goods, 3.7 percent in livestock, 3.7 percent in apparel, 3.4 percent in medical and educational services, 3.2 percent in retail trade, 3 percent in fabrics and yarn, and 3 percent in personal repair services.

As I pointed out in my written testimony, some employment losses would naturally have occurred in a number of defense industries, including ordnance, aircraft, and electrical apparatus. While the employment gains in other industries may not have led immediately to wage gains in the disadvantaged sector, I think it is clear that increased demand in this sector could have had a significant long-term effect on the earnings of the working poor relative to other members of the labor force. The effect on the inflation-unemployment tradeoff would have been salutary as well.

In other words I am saying that I would expect if we had another set of social priorities—social priorities which placed more emphasis on building up the health and livelihood of our people, and the people of other countries and less on destroying the livelihood of our people and destroying the lives of others—we would have an economy which was more stable in terms of unemployment and inflation. We could move the Phillips Curve in toward the origin, allowing us a much better tradeoff between inflation and unemployment, and we would at the same time make some inroads in the distribution of income.

In effect, the Government is taking away from one part of the private sector something like $80 billion and putting it into another sector of the economy. In a real sense, we have had the health industry and education industry subsidizing the defense industry in this country.

Representative REUSS. Well, insofar as what you are saying, Mr. Bluestone, is that we ought to reorder priorities away from excessive defense expenditures, aerospace and other allied things and toward health, education and welfare, the environment. I would agree and, of course, all of the Democratic presidential candidates are going around saying that, too.

Mr. BLUESTONE. This year.

Representative REUSS. This year. They may not mean it as much as you would like, but they are saying it. So I want to try to distill out of your observations, something that distinguishes you from the Democratic presidential candidates. You seem to be saying in addition to the need to reorder priorities away from defense, toward health, education, and welfare and the environment, you seem to be saying that you would shift capital investment from defense and defense-oriented industries to disadvantaged sectors.

You mentioned leather, hand-goods, and apparel. I have a couple of difficulties with that. God knows, these are depressed, disadvantaged industries but it may be because at this particular conjuncture of world events, these are things that are better under comparative advantage produced abroad, particularly in developing countries.

We may be clobbering Nigeria if we shift too much automated capital to our economy.

Mr. BLUESTONE. Not at all. There are two economic ways that we can get a shift in capital investment between industries. One way is a direct shift. We can take Federal funds and reallocate it from defense into schools, for instance. This is something which I would hope all of us would agree is necessary. This is a direct shift in investment. There is a second way, however.

In some of those industries that I have listed, for instance, in table 1 of my prepared statement, anywhere from 50 to 80 percent of the labor force is earning $1.60 or less. These are mostly in the private sector of our economy. What happens when we shift investment? Instead of spending tax money on defense expenditures, let's just for example reduce taxes and leave the consumer with more income. This is what Mr. Nixon says he would like to do, as a matter of fact. This would mean people would have more money to buy things.

Now, I have only been around this world for about 26 or 27 years, but I have yet to find anybody in my neighborhood buying an F–111, not only because it is a very poor machine but because people do not have a strong need for them. But I know people in my own neighborhood spend a lot of money on clothing and would probably in some cases want to spend more. They spend a lot of money on housing. They would in many cases like to spend more. They would like to spend a lot of money in terms of the kinds of things that consumers need. These include things like leather goods, clothing, housing, and, of course, all of the public sector goods.

What we would be doing, in effect, is shifting demand from the defense sector into the consumer goods sector. This would increase demand, both for American goods produced in our own leather goods industry and demand for leather goods produced in other countries. Nigeria does not produce many weapons, but it does produce some consumer goods that we can use.

What would happen, of course, over time, is that there would be greater demand in these industries and I think the data from the input-output matrix says it would actually be quite a satisfactory increase in many cases. This would allow somewhat greater profits in these industries and larger wage increases for the people who work in them. And out of some of the retained earnings and also out of the stronger private sector economy, you would find these industries being able now to invest somewhat more in capital equipment. This would not be the public sector giving direct funds, but like the auto industry finances almost all of their advancement out of retained earnings, the leather goods industry would be able to do it, too.

These are all the small-scale industries, but the same effect can occur in the real big ones, like health, education, and in the vital social services that we have underinvested in for such a long time. I am only saying that this kind of redirection of our economy has a salutary effect. The defense employment cuts can be absorbed. We have done all kinds of research on that and much of this research has appeared before this committee. We would be able to have not only the kind of shift we want in terms of the things we need as a people but, at the same time, we would get the kind of economic effect, both in terms of income distribution and the trade-off between inflation and unemployment which would make the economy somewhat better.

I might add, I am very pessimistic about any of this occurring. I am very pessimistic about the possibility of a short-run or even a middle-length run reduction or, extensive cut in defense expenditures. I feel very much like Professor Dowd in this respect.

This is the first time I have ever been in Washington to testify before a congressional committee. I have been here many times before marching in your streets, trying to convince you, the Senate and the House of Representatives, that the priorities you have set, and the priorities that President Kennedy, President Johnson and now President Nixon have set, are those that not only destroy the very fiber of our country and the very backbone of other countries through our bombing and our wars, but destroy the economic structure of our country as well as some underdeveloped countries in other parts of the world.

This is what is important. The budget document itself, something we should all study much more intensively, is where we find that kind of effect beginning. I hope that clarifies it somewhat.

Representative REUSS. Yes. Thank you very much.

I would now like to ask a question of all three witnesses, having to do more with the day-to-day decision that this Joint Economic Committee must make, particularly faced as it is with its duty of writing within the next few weeks a report on the economic report.

I would like to get your views on three current policy issues. I will run through the three of them and then ask, first, Mr. Dowd and Mr. Sherman and Mr. Bluestone to comment on them.

PUBLIC SERVICE EMPLOYMENT

Would a substantially expanded program of public service jobs not only be a desirable step back toward fuller employment, but also a step toward breaking down the dual economy which Mr. Bluestone has just been describing?

TAXES

Are you satisfied with the degree of progressivity in your taxes? If not, what specific steps could be taken to increase progressivity and restore the revenues we have so unfortunately given away in recent Congresses? What about income tax reform? What about social security tax reform? Would you comment on the value-added tax, for instance?

INCOME POLICY

Should we stick with the present price-wage controls for the time being, or should we get rid of them quickly? What should replace the present phase II: A more limited price income policy, a return to the free market, or something else?

Those are three current issues—public service jobs, taxes, and price-wage policy—on which we would appreciate elucidation.

Mr. DOWD. One of the things about these kind of questions and all other important economic questions is that the answers to them, I think, are very simple, and no one needs to understand economics to know the answers to them. The real problem is one of implementing those answers, and that gets to be quite complicated.

I remember about 10 to 15 years ago, a New York Times reporter, for some reason or another, was wandering the streets of New York asking various people what they thought should be done by the Government. A middle-aged black man was asked this question, what did he think the government should do.

He said, "Well, all I can say is, I know I need a job, I know my family lives in rotten housing, and we don't have adequate medical care and the schools are no good. So what I would like to see happen is for the Government to start a construction program in which I would get a job building better housing and better schools and better hospitals, and I would have a good income and help pay for all that through the taxes that I would be able to pay," and so on. This is a very simple-minded and very correct position to take.

I think when it comes to public service employment, there is no question that it would be not only wise but essential for the Federal Government to extend public service employment. The question is, Doing what? The jobs that should be offered, could be offered, would be jobs that fulfill or help to fulfill the needs that ordinary people in this country have for housing, for health, for HEW, in effect.

But they should be jobs that rebuild the society while also providing income for people doing work that is dignified and meaningful, rather than the sort of thing that went on in the 1930's, the WPA kind of fiasco.

The problem with that, as with everything else I talk about here, is the extraordinary resistance to simple and good programs. Public housing is hardly a novel idea in this country, but effective and successful public housing, providing jobs to those who need them most and would be very happy to have them, that doesn't seem to be possible. The reason it is not possible is not because it is beyond the imagination of Americans or anyone else to devise ways; it is difficult for Congress, which has to fund these programs to wiggle its way through, even if it chooses to do so, to wiggle its way through the power structure which is made up, not only of big corporations but also powerful unions, powerful in this respect, at least.

The same thing is true when you talk about taxes. There is a set of power relationships that work from all of these things that, in fact, defines not what our stated priorities will be but what our effective priorities will be. So the taxes are becoming increasingly regressive in keeping with what Mr. Bluestone has had to say about the dual economy, with which I agree completely. At a time when taxes must become more and more progressive, they are becoming more and more regressive. And the final or perhaps the final plunge into some form of combined obscenity and insanity is Mr. Nixon's value-added tax, which is an inspired way of not only soaking the poor—and they have very little left to soak—but also of worsening the American balance-of-payments and balance-of-trade situation because of what this would mean in terms of American prices, exacerbating inflation as well as unemployment at the same time.

Taxes are quite clearly not progressive enough. They don't seem from the point of view of the present administration or a good many Democratic Congressmen, to be regressive enough, because the tendency is quite clearly in the direction of more regressivity.

That tax policy, or I should say, the general fiscal policy, the pattern of expenditures and taxation in this country fits in symmetrically, harmoniously, with the whole thrust of public and private policy, which again has its origins and its liveliness in the set of power relationships in this country.

When it comes to what phase III should be, I don't really feel it makes much difference what one says phase III or anything else should be until one can specify the politics by which one would move from point 1 to point 2, and point 2 to point 3. What phase III will be will depend on what the Nixon administration and those who cooperate with it in Congress and elsewhere decide is necessary in order to maintain the well-being of those who already have power and in order to keep the system from running out of control in terms of inflation or unemployment.

The criterion will be principally the one having to do with inflation, rather than employment. This has always been the case in my life. I remember vividly an ad in the New York Times, back in, I think it was, the 1957–58 recession. Guaranty Trust Co. had an ad with a big headline: "What's Wrong With a Little Recession?" they wanted to know. There is nothing wrong with a little recession, depending on where you sit in the economy as the recession passes by you or passes through you.

Inflation, from the point of view of those who own the means of production, has always been much greater a threat than unemployment which, in fact, is a very useful salutary kind of a device to discipline the labor force and get it back into the position where it will be appropriately docile.

I really do think that the problem that has to be come to grips with by people like myself, people who are not in Congress, and who have no meaningful power, the problem is, how to devise a movement for changing this country that will not wiggle through the power structure but displace it. I see no other way for making any sense whatsoever of our needs. Although one can abstractly specify what is needed in what Marx used to call a kitchen recipe. But a kitchen recipe without cooks, without stoves, without nutrients, without a kitchen, doesn't really make an awful lot of sense.

Representative REUSS. Thank you.

Mr. Sherman, I remind you again, the public service employment, tax reform, and income policy are the three things I particularly wanted you to address yourself to.

Mr. SHERMAN. In a basic sort of way, I can only endorse Professor Dowd's remarks as certainly stating, I think, the fundamental point.

Let me come at it a few different ways. When you speak of public service employment, in the first place, certainly one is in favor of it, in general, as a policy, providing you are not talking about public service in the Armed Forces.

I would like to be very specific about this question of the resistance that one meets. For example, there is the resistance caused by the fact that if you have an increase in public service employment, it means definitely and clearly greater pressure on wages. It means that you will have somewhat higher wages and that fact by itself means you are going to get strong resistance from those that pay wages in private industry.

Let me remind the committee that we have had a nice law on the books since, I think, 1946, the Full Employment Act. And here you have a good case of very good intentions. But the intentions clearly do not seem to have any particular result. Since the Employment Act of 1946, we have had very, very considerable amounts of unemployment. I think the reason is that there are forces that can take every conceivable action to prevent Congress from actually enforcing or reinforcing that kind of law.

It calls to mind the fact we have recently had statements by establishment economists and the administration that, after all, unemployment is going to have to be over 5 percent if we are going to have a smoothly functioning economy; that means, I take it, an economy in which there is enough excess labor that you can keep wages down very considerably.

I notice that percentage figure keeps on rising. I do recall that in the Second World War we had something like maybe a half percent unemployment at one time. Ever since then, the figure that we are told is simply fictional unemployment keeps going up. The latest statements I have heard on it states that, after all, the reason we have this extraordinary level of unemployment is that some of these "marginal people" now on the market really don't belong there. There are lots of youths and lots of women, we are told, on the market. If they would only get out of the labor market then, of course, you wouldn't have that much unemployment. That is nice to know. It certainly would not help these people.

I understand, also, that the one thing that is going forward, I think it is under Congress, in fact, is a study of how to change the definitions of unemployment so as to improve the employment picture. If you change the definitions enough, I am sure that one can come up with the fact we then have only one percent unemployment. But that does not seem to me to do much towards changing the reality.

The second question you asked is concerning the progressivity of taxes. The fact is that we have vast loopholes in the taxes, as you well know, that make sure the effective tax rate actually does not rise above a particular point, and that, if you look at the total redistribution effect coming from the Federal income tax, it is minute. I think, in fact, if you looked, in addition, at all of the regressive taxes, all of the types of sales taxes and property taxes and so on, you find that one could make a very good argument that the total tax structure is actually regressive.

Again, I have no hope particularly of changing that, since as Professor Dowd pointed out, it cannot be changed unless you change the present kind of power structure. On the whole, economic ruling classes just don't go committing suicide. They go ahead to very strongly protect their own interests.

Let me come to the third point. You asked about the price-wage controls. One point I think is worth making is that it seems if I understand the politics of it, that the price-wage controls originally arose through the efforts of the liberals in Congress. And this is a case very much, I think, like, for example, the farm subsidies. Farm subsidies, if I recall my history, arose of the vast need of the rural poor, the tremendously underpaid agricultural workers. If you look at the farm subsidies, of course, in the first place you find no agricultural workers getting anything out of it directly. In fact, it has been pointed out the subsidies tend to reduce production to some extent, therefore hurt the farm workers. Not even the small farmers, of course, benefit much from farm subsidies. Basically, the large farmers get most of the benefits.

The reason I go into that is to make the point we have a somewhat similar case here. We have a law passed to some extent by the liberal forces in Congress, utilized as one would have expected by the administration (by the power structure, that is) in a way that means that the brunt of the cure for inflation is to fall on the working class. It is to fall against labor, certainly against unorganized labor. If you look at the strange composition of the Wage and Price Boards, you have this interesting phenomenon, that the public members, so-called, appointed by the President, turn out to be more anti-labor than the business members. That seems to me a very strange and revealing kind of phenomenon.

If you ask whether one can return to competition, I don't think you can easily return. Well, if one can return to pure and perfect competition (which never existed), it seems very doubtful that it would cure many of the evils of capitalism. Therefore, I think again that the only kind of way you could proceed would be for actual public ownership of the thousand major corporations, something which I also doubt is a short-run feasible political possibility.

Representative REUSS. Thank you, Mr. Sherman.

Mr. Bluestone.

Mr. BLUESTONE. I think when we look at the three problems of public service employment, taxes and price and wage controls, we must look at these in a broader context.

First of all, when we think of public service employment we should remember the discussion of this act, which was passed in 1971, and the extension of that act over time, appropriately coincides with a lot of discussion about family assistance programs and the Talmadge amendment to the Social Security Act which requires people to work who are determined employable. This is the same kind of requirement that will come out in H.R. 1.

The idea here is that we are going to set up a new welfare system, as I said before, just to try and keep the income distribution from not becoming any worse. Now we are going to put in some very stringent work requirements. It is very difficult to put in a lot of work requirements if there are no jobs. One possibility for public service employment then is to create a whole number of meaningless jobs which don't create meaningful social services, but which make the work requirements in other legislation something less than a total farce.

In my own State of Massachusetts, my research institute has just completed a study of the general relief program in our State. The legislature, in a bit of insanity, passed a law that went into effect in October, very similar to the Talmadge amendment, which required approximately 11,000 of the 29,000 general relief recipients to pick up their relief checks at their local employment offices.

We were asked to do a study of the effects of this program. One of the things that we found out, of course, was that the program itself cost something in the neighborhood of two to three times more than it actually saved in checks not picked up. More important than this, is that we interviewed approximately 600 of the 1,800 people who did not pick up their checks. We sent out a questionnaire to them and asked, "why didn't you pick up your welfare check?" We did this because the Governor and the State legislature wanted to know if the program could stop welfare cheating.

Yesterday, as I was completing my testimony, I was leafing through the replies. I found one that went like this—it wasn't filled out by the recipient; it was filled out apparently by her daughter or her neighbor. It noted that she was too ill to pick up her check, although she was deemed employable and was supposed to. "She died on November 23, 1971, no check, no hot water, no heat, of cancer of the lung."

That is what this new program did. This is what the Talmadge amendment will mean for AFDC, or the work requirements in FAP. My theory is that what will happen is that public employment will be used to say, "Well, we created these jobs, people should now fill them."

The other problem I am worried about is that public employment may lead to the case where low wage work is substituted for people who are now in State and local municipal employees unions and who are making higher wages. If we are going to have a meaningful public employment program, it must first of all be very large; and second of all, as all of the members of this panel have pointed out, it must create meaningful work, meaningful not only to the recipients of jobs, but meaningful to our society in producing those goods and services we need. Finally, it has to be a program not aimed so much to create make-work so that the work requirements have some teeth in them, but to create an environment in which we can have dignity and decency on the job.

On the question of taxes, you don't need three radicals to tell you the tax system isn't progressive. All of your liberals and most of your conservatives, will tell you that. My one suggestion would be that social security should be funded not through special payroll taxes, but, of course, should be funded out of regular income taxes so that it becomes at least proportional if not somewhat progressive. It is, of course, extremely regressive at present. It taxes the poor more than the rich.

One interesting fact pointed out by an English friend of mine is that the payroll tax especially burdens blacks. Blacks pay into the social security fund just like whites but since their incomes are lower and more of their income is taxed, they pay out larger proportions of their income in social security taxes. And yet, because of institutional racism in our society and the structure of health care and social services, a large proportion of black men die before they reach the age of receiving social security. So blacks, generally, given the terms of social security under the present tax system, are actually subsidizing white workers in this country.

Finally, on the question of price and wage controls, I think it is almost an obvious corollary of my testimony that they are inevitable. This is true given a system which develops a dual economy; given a system which tends to make for an ever worsening inflation-unemployment crisis, and given a system that Mr. Nixon would like to keep basically in private hands, and, in fact, in the hands of a very small number of people. You have to do something about that crisis and the only way you can do something about that crisis is to hold down wages. It is very clear that we not only do not have profit controls, but we don't even have price controls. We are really finding that the wage and price controls are turning out to be wage controls to hold down the wage of workers.

The other thing that I might add, though, is that government intervention at the microeconomic level, like direct wage and price controls, is nothing new. The government has been doing this for a long time, not as directly through specific wage and price controls, but by its demand priorities. When the government goes ahead and decides to invest $78.6 billion in defense and defense industries, this is direct intervention, of course in the prices, wages and profits in these industries.

One more thing we should realize, of course, is where inflation is occurring. It is precisely occurring in defense industries. When we have a 250 percent cost over-run on the F–111 or C–5A, that is a price increase. In economics, we call this inflation. It is something in the neighborhood of probably 100 times the inflation we see in the economy as a whole.

Representative REUSS. Thank you. All of this suggests a broader question which I would like to put to you.

Now, suppose somehow or other the Congress and an executive addressing themselves to the problems of our society should actually revamp our total tax laws so that they are really progressive. Suppose we drastically reorder priorities away from the military and its allied pursuits and toward health, education and welfare, the environment, and other great social goals?

Suppose the government by interposing itself as an employer of last resort at a good wage, should be able to bring employment down to a true level that represents frictional unemployment, somebody going from one good job to another good job, 2 to 3 percent, whatever it is.

Suppose by vigorous antitrust enforcement, TVA yardstick competition, opening of our gates to foreign competition, and so on, some measure of competitiveness is injected into the economy.

That is enough. Suppose that is done—I don't by this question want the judgment, political science judgment of you gentleman as to whether it is possible or likely that this will happen. Take it as a given. You three people and 436 would like to get elected to Congress and you get a President like you, and you legislate all of this.

My question: Is this going to work or is the whole system so rotten that you don't think these are sufficient to keep it together and we should go to social ownership for needs and production?

Mr. DOWD. I would like to take a crack at that, first.

Representative REUSS. Or anything else.

Mr. DOWD. The supposes that you have made remind me of the old question: If my aunt had wheels would she then be a bicycle? And there are other variations on that basic question. So that if all of these supposes you raised have the underlying supposition that the capitalist system would remain but become competitive and not destructive; not destructive of human beings in terms of the duality of the economy. But the thing that is left unanswered there is why would one want a capitalist system of that sort nowadays?

The justification for capitalism historically, whether in terms of Adam Smith or Marshall or any of the great economists who may have built up that rationale, has always been that it is the system best designed to enhance the wealth of nations through its efficient producing mechanisms. On the political side the justification has been that such an economy would enhance political democracy.

But today our needs are not really—I think this would have to be argued at length but could be argued successfully—are not really more plant efficiency, they are for somehow or other not only finding social efficiency—I would like to get away from the word efficiency—they are finding ways that require a maximum of social intelligence and commitment to make it possible for us to live at all, let alone to live decently.

I am not just speaking about the environment and air and water and so on, which God knows, are threats enough, but it is a matter of finding a way to live to overcome the tensions, the various serious tensions and hostilities and imbalances that exist in this society as between all kinds of people, not just between blacks and whites but between all levels and areas of society, and various other kinds of groupings we can imagine.

A capitalist society when it works best is a competitive society. And in my view, and I would think the other panelists would be with me, what is necessary is to build a society that is anything but competitive, in which people learn to work with each other for each other, rather than against each other for themselves. I don't think capitalism can work at its best, in the very best face you can put on it, unless it is competitive. We have seen how competition works and it has its effect not just in an economy leading to monopoly incidentally. It isn't just that competition dominates the economy, it is also that it infiltrates every aspect of our lives.

I am a teacher. I have been a teacher for 20 years. I don't have to tell everyone here who has been to school, we have competition in school. We are competitive. Men are competitive with each other outside of the job, outside of the school. Women and men are competitive with each other. The competition that is the glory of this system is the undoing of the people in it and it is the undoing of the society and the world.

I don't think that we can get to the kind of social system we need by taking the fangs out of capitalism, because when we take the fangs out of it, which is what you are proposing, if that were to happen we still have the same beast, and it is a beast the world can no longer tolerate and no longer needs. If it were ever the case, and Marx himself was one of the first to point this out and point it out eloquently, if it were ever the case that society needed a highly productive economic mechanism, capitalism in the 19th century certainly provided that function. But that is not what we need today.

We need something quite different that is a social organism rather than an economic mechanism. I would answer your question by saying, even if this were possible and you and I both know it is not, it is by far still quite undesirable and dangerous.

Representative REUSS. Before turning to our friends here, if you want to do away with the whole structure, you people would be the first to admit that the persons sought to be done away with would not take kindly to the idea and, hence, eggs would be broken in large numbers and peace-loving people that you are, I hope you crank that into your computers. I am sure you do.

Second, on the point you made, Mr. Dowd, that when I get through with my statement of the idea of patching up what we have got, there still is a lot of abrasive and disruptive competition around—how rough would that really be on a simple carpenter or whoever in the society I am describing, how rough is eager-beaver competition in price and quality between members of an atomized industry? Does that result in such a degraded life for the blue- and white-collar workers in it?

Mr. DOWD. I think it leads to a dehumanized existence. I don't think it is the kind of society that human beings can realize themselves in as human beings.

I am sure from what I know of you, I am sure you are familiar with the writings of R. H. Tawney. In his "Acquisitive Society," he made a remark apt for this particular occasion. He pointed out—perhaps more pessimistically than he had to—that he couldn't conceive of any change in social institutions that would rid man, as he put it, of his proclivity for greed and self-satisfaction, and so on. But what he could conceive of would be a society which did not encourage these qualities.

It is the essence of the capitalist society that encourages the worst in us, encourages and requires it of us for survival, for income enhancement, or even for income maintenance. It encourages our worst qualities, not just on the job but in the whole of one's life-style. It encourages the qualities which are destructive of not just the environment but of man trying to live in the environment.

This is the point not only I would make but the point that the young people today all over the world are making. They want a different society, they want a society in which the possibilities and the needs of human beings stand at the center not the needs and possibilities of production. I believe, because of the way technology is today, we need not strive after efficiency in order to have high levels of well-being. We do need, however, very much to strive deliberately after social harmony and social well-being in order to have anything we need. It is a whole reversal of priorities that simply has to be done and there is no change of capitalism in the way of defanging it that can, in any sense, approximate that.

It still leaves that same encouragement of the worst in us, which we have taken to be the best in us because that is what we have been socialized to believe. But when we fight against each other, bang-bang-bang, that is what a man does, and, unfortunately, that is what a man does. We translate that into Vietnam, which is a sporting contest so far as the way it is reported and looked at.

Representative REUSS. That is what a man does in Yugoslavia, East Germany, and other state ownership countries?

Mr. DOWD. It may be. I am speaking in and about America. I don't think that anything that is happening elsewhere can be taken as more than suggestive, suggestive of something to be avoided. suggestive of something to be sought for. But what we can do in this country comes out of the best of the American tradition. What we have to do is overcome the worst of those traditions, and in my view to do that we have to overcome capitalism as the system that encourages the worst in us.

Representative REUSS. Do you see anything on the face of the earth today which you would point to as a model—not that your failure to do so, if you cannot do so, would defeat you.

Mr. DOWD. I have had the opportunity to visit North Vietnam. That is what we would call in this country a poor country. But the human beings do not relate to each other in a poor way in that country. This is perhaps induced in large part by the long war that they have been involved in, but that is mixed with an attitude which is not just communism, it is Vietnamese and it comes out of their traditions. There is a relationship between those people which when I tried to describe it to myself and others, when I came back, the only word I could use was humanness.

There is a humanness in the way those people relate to each other. I don't know enough about other countries. I have not been to China, for example. I have not been any place, in any other Socialist country, but I do know that what I observed in North Vietnam was what is important for human beings.

In this country, one sees what exists and believes what exists is all that is possible. It is not. What is possible for the Vietnamese is possible for all human beings, in different forms, perhaps.

I grew up, I became a Socialist because I grew up as an American idealist. I did not become a Socialist for some other screwy reason. I became a Socialist because I took America seriously and looked around and saw what it was. I became a Socialist because I am an American, because I really took seriously the promises of this country. They can be realized in the American grain. But that American grain cannot be taken to mean an economic system that is fixed by the hand of God forever and that it is the only thing that satisfies the possibilities of human beings. I simply do not believe that and there is evidence to make me disbelieve it.

Mr. SHERMAN. It is especially hard to follow after Professor Dowd, because not only has he said the most fundamentally important things, but said them in a very beautiful fashion. I can add only a few aspects to his thoughts.

I have been to the Soviet Union and studied that country. It has certainly both things, some things I like, a lot of things I don't like. I think that much of what I don't like in the Soviet Union comes from its particular history. It was a very backward country when it came to socialism. It took it as a very quick means of industrializing. It took it as a quick means of overcoming a centuries' old poverty, illiteracy, and so on.

So, for the United States, I am much more hopeful. It seems to me that for us socialism can only mean a tremendous advance, because we can build both on the basis of our long-standing democratic traditions and on the basis of the high material base that we began with.

In that case, I think that we can have a socialism, certainly, which will be a humanist democratic one.

On the question of breaking eggs, that Congressman Reuss mentioned, it seems to me that we are breaking an awful lot of eggs right now, first of all on other peoples' heads. We are breaking eggs over the heads of the people in Vietnam. At Kent State the National Guard broke eggs over the students' heads. Moreover, there is the continued misery, after all, of a large portion of this, the wealthiest nation on earth with the degree of poverty that we still have. Last summer I saw the poverty in India, where you certainly don't have a socialist country, instead you have a poverty that just continues at such a high level of misery that it is hard for any of us to believe and imagine. It is misery that causes people to protest, but the people and the students do not initiate violence; it is the police and the ruling classes that initiate violence.

Coming back to your question, then, finally, when you asked the "iffy" question about whether all of those things can be done. I think to some degree you start with the assumption of a pure and perfect competitive capitalism. I would just like to make the point that that is so far from what we have today. We have in the first place, since the 1890's, a vast amount of monopoly and economic concentration. Our industries are not characterized by several hundred thousands of competitors normally. Most of them are characterized by three to eight major competitors, and they actually tend to work very well together, it turns out. If you look at our major industries, the setting of prices does not appear to be any different than what an economist would expect if you had exactly one corporation.

Second, since the beginning of the Second World War, we have had in many ways not only an economy characterized by monopoly, but certainly an economy characterized by a very large degree of Government interference, Government regulation. But it is a type of Government interference and regulation that is, of course, the opposite of anything Socialists would ever ask for.

In 1943, military spending got to be something like 40 percent of the GNP. Since then, it has gone down, but not certainly as much as one would want.

When you ask the question, it seems to imply that we have got an economy on the one hand that continues the private profit motive, which as Professor Dowd pointed out, leads to many kinds of dehumanization. On the other hand, you must be assuming vast amounts of regulations for the things you are talking about.

In that case, I have to agree with my conservative colleague, Professor Friedman, that if you have an economy with the private profit motive on the one hand, hemmed in on all possible sides by vast amounts of regulations, then I think you are going to get the worst of both economic systems. You are going to get a highly inefficient operation on the one side, because of the amounts of bureaucracy and the amounts of interference with capitalism; and, on the other side, you are going to continue to have the kind of inhuman system operating that constitutes capitalism. Particularly, as you certainly recall from all of our periods of previous controls, business then finds it much more profitable to spend their time attempting to bribe and influence Government and attempting to raise prices politically, to keep wages down politically, than to do any amount of production.

Thus, in many ways, this system of regulated capitalism creates the worst of all possible worlds.

Representative Reuss. Thank you.

Mr. Bluestone.

Mr. Bluestone. I can only make a few additions to that, many of them coming from our colleague, Mr. Friedman, again.

One of the classes I teach has been studying Mr. Friedman in detail. We have an affinity for him in many ways. We studied what pure capitalism, or pure competition would be like in our society. My undergraduates came to some conclusions.

One thing they concluded was that, by and large, if we look at the history of this country or other Western European countries, we find one thing that has always been true about competition, it is dynamically unstable. It always tends to break down. So that even if we could have moved to all of your "supposes" the tendency over time would be for that to break down again, and for monopoly elements to rise again in the economy. This would occur on both the industry side and on the labor side.

Basically and fundamentally, there is one social condition that marks men and women. This is not the desire to compete and struggle against each other but, in fact, a desire, a basic desire, for security: a basic desire to make life better for themselves and safer for themselves.

I think because of this people tend to get together. Capitalists try to get together in order to make sure they have higher profits. Workers get together for security against unemployment or an accident or ill health in the family. Because of its dynamic instability, your system would fall apart. It would not work over time. We would all of a sudden move to your system and then we would evolve very much into a system like we have today, repeating the mistakes of the past.

It is also important to realize in the system you pose, that we are not beginning at time zero. We are not starting from scratch. And this poses some major problems because to think that we can move to that kind of system, having already created a social structure and a political structure like the one we have in this country, makes it almost impossible that your system would succeed.

It seems to me that there is one thing that is going to happen and that is the kind of system Professor Dowd talked about will eventually be reached. We will evolve to that system because, fundamentally, I think this is what people need and want.

The real question, however, is the speed with which we reach that better system. We can move very slowly. We backtrack many times as you pointed out in the income distribution system, but inevitably given that we have enough time and our natural resources aren't destroyed and Mr. Nixon decides not to push the button and finish us all off, we will reach that kind of system, that stage in which people will be human beings.

The problem in my eyes involves the speed at which we move toward that system. The longer we put off moving toward a system of cooperation, rather than competition, the longer it takes us to get there, the more suffering there will be in this country and other countries. That basically means that for people like myself we have to constantly push harder and harder all of the time to try and move the system in that direction as fast as possible, in order to minimize human suffering. That means, not only should I come into these hallowed halls to give my testimony, but it means when we see the Federal budget as we have seen this year, when we see budgets for the war, when we see expenditures to kill expanded over and over again, we have to not only come here but we have to get in the streets and organize with our brothers and sisters. And it means that we have to move and push you as hard as we can.

Representative Reuss. Thank you very much, Mr. Bluestone, Mr. Dowd, and Mr. Sherman, for your thoughts and your helpfulness. We appreciate it.

The hearings of the Joint Economic Committee on the 1972 Economic Report are now concluded. I would announce that there will be a hearing in this place next Friday, March 3, to discuss the latest information on employment and unemployment. The witnesses will be from the Bureau of Labor Statistics, Mr. Geoffrey Moore, and Professor Bassie from the University of Illinois. Thank you very much.

We now stand adjourned.

(Whereupon, at 12:05 p.m., the committee was adjourned, to reconvene subject to the call of the Chair.)

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