580

THE 1972 MIDYEAR REVIEW OF THE ECONOMY

HEARINGS

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JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

SECOND SESSION

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THE 1972 MIDYEAR REVIEW OF THE ECONOMY

MONDAY, JULY 24, 1972

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

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

Present: Senators Proxmire and Javits; and Representatives Reuss and Conable.

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

This morning the Joint Economic Committee begins its 1972 midyear review of the economy. We welcome as our first witnesses Mr. Herbert Stein, Chairman of the Council of Economic Advisers, and Mr. Ezra Solomon and Mrs. Marina Whitman, members of the council.

For the first time in a long time, we are convening a hearing on the economic outlook at a time when there is some good news to discuss. The real value of the gross national product increased at an annual rate of 8.9 percent in the second quarter, and this vigorous rate of growth was accompanied by a moderation of the rate of inflation.

Mr. Stein, I know you must be grateful to this committee for providing you with a forum this morning. This hearing may not go down in history as one of the great moments of the Christian era. Nonetheless, it is the first time in the history of the Nixon administration that you have been able to come before us and report some really good news about the economy. Since this may well be the first, last, and only time when this administration will have good news to report, I intend to yield to you very shortly so that you can describe for us all the improvements which have taken place in the economy in recent months.

Before yielding, however, I want to make two points which I think are important. First, if things had not been allowed to get so bad in the first place, they could not have improved so much in the past few months. If GNP had not fallen $80 billion below its potential, it would not now be growing at a 9-percent annual rate.

If unemployment had not risen to 6 percent, we would not be hailing 5.7 percent as an improvement. If the inflation rate had not been allowed to go to 6½ percent, we would not now be so eagerly scanning each price indicator that comes along for signs of improvement.

My second point is that we still have a long, long way to go before we reach what can reasonably be regarded as a satisfactory economic situation. There are still almost 5 million unemployed, plus 2½ million working involuntary part time, plus over 800,000 discouraged workers who have given up looking for a job. I have yet to see a reliable prediction that we will get the unemployment rate down to 4 percent any time in the next 2 years. Indeed, as pointed out in the recent OECD report on the U.S. economy, it will take a sustained real growth rate of over 6 percent to bring us to the 4-percent unemployment level by mid-1975.

As I have said over and over, 4 percent unemployment is not good enough. It would be an appropriate interim target at the present time. And it happens to be the number we use to calculate what we euphemistically call "GNP potential" and the "full employment budget." As a longer term objective, we should not settle for an unemployment rate higher than 3 percent, and this committee is now undertaking studies which we hope will show that there are good possibilities for getting unemployment even lower—perhaps to 2 percent.

All our problems are not on the employment front. Inflation is still a very serious problem. Despite the control program, the wholesale price index has risen at a 5-percent rate over the past 3 months. This cannot help but mean new pressure on consumer prices in the months ahead.

We remain faced with the fundamental problem of whether, and, if so, when and how to get rid of the present price and wage controls. In considering this question, it must be borne in mind that the collective bargaining calendar will be far heavier in 1973 than it is in 1972. It must be realized, that while there is an enormous amount of slack in the economy as a whole, there may be serious inflationary supply shortages in particular markets, such as lumber, leather, and beef. It must be remembered that there have been no dramatic breakthroughs toward a more efficiently structured economy which would have less inflationary bias—there have been no major reductions in import barriers, no great improvements in our techniques for manpower training and job placement, no sweeping reforms of the Government procurement process.

The good economic news in the second quarter is important, but it has brought us only a very little way toward even our shorter run objectives for the economy. Mr. Stein, I am somewhat less optimistic than you appear to be over the economic outlook for the rest of this year and for 1973. In a little while, I want to discuss with you the prospects for the different sectors of the economy. It appears to me that housing starts may have peaked in the first quarter, that business investment is expected to flatten out in the second half, that inventory accumulation may remain rather small, and that the Government will be under pressure to hold down spending. Given these factors, the prospects for a repetition of this quarter's growth rate seem slim. It may be that this recovery is going to peak out before we get back to what most of us would regard as a satisfactory level of output and employment. These are questions I think we ought to examine this morning, as objectively and constructively as possible.

Mr. Stein, I once again apologize that we have this limit of 10 minutes, but I am sure you understand that. And other Senators and Members of the House will be coming, and we hope and expect to have a very detailed discussion. So, go right ahead.

STATEMENT OF HON. HERBERT STEIN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY EZRA SOLOMON AND MARINA v.N. WHITMAN, MEMBERS

Mr. STEIN. Thank you, Mr. Chairman, for a very generous introduction.

I believe this is the first time that this present team has appeared altogether before this committee. We are very grateful to you for having chosen this auspicious date for our appearance.

I think I will not enter into the controversy about what would have happened if somebody had done this or that in the past, partly because of the limitation you place upon our time. Of course, I share your desire to remind ourselves and everyone else that we have not yet reached the promised land. But, of course, that is a reminder which has not been necessary for several years.

I will summarize the prepared statement as far as I can, although I do not believe I can remain within the 10 minutes. After all, there are three of us. But I will summarize the prepared statement.

In addition, we have prepared a supplementary statement which we would like to enter into the record to be printed with the testimony. We would like to have the opportunity to edit it a little because it has just been finished. It is a statement of just about 109 pages.

Chairman PROXMIRE. Without objection, that supplementary statement will be printed in the record when it is finished.[1]

Mr. STEIN. We will give it to you.

Almost a year has passed since a decisive and innovative set of policies was launched last August, and three-quarters of evidence is now available on which at least an interim appraisal of those policies can be based.

The results of the policies can be summarized in a few figures.

From the second quarter of 1971 to the second quarter of 1972:

Total civilian employment has increased by 2.4 million, one of the largest four-quarter rises on record.

The rate of increase of consumer prices has declined from 4.7 percent to 2.2 percent.

The rate of unemployment has declined from 6 percent to 5.7 percent and reached 5.5 percent in June 1972.

The rate of increase of real output has risen from 3.4 percent to 8.9 percent, the highest rate since the fourth quarter of 1965.

I will pass over some historical descriptions of the policy and how we got into it which I hope our readers will observe. I pass immediately to the section of the prepared statement, where we appraise the results.

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[1] The supplementary statement, entitled "The Economy at Mid-1972," was printed separately by the U.S. Government Printing Office, together with an introduction by the President in August 1972. The published document, which is a revised and updated version of the original submission, is incorporated in the permanent files of the committee and is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

With respect to demand and output, the rate of expansion has clearly accelerated.

Between the third quarter of 1970 and the third quarter of 1971—the year preceding the new economic policy (NEP)—the real GNP rose 2.2 percent. From the third quarter of 1971 to the second quarter of 1972, real GNP has expanded at an annual rate of 7.4 percent.

The index of industrial production shows a similar pattern of improvement. From the third quarter of 1970 to the third quarter of 1971, industrial production decreased. Since the third quarter of last year, industrial production has expanded at 7.5 percent per annum.

Both measures of output have accelerated over the past 12 months: Real GNP from 2.5 percent per annum in the third quarter of 1971 to 8.9 percent per annum in the second quarter of 1972, and industrial production from −1.9 percent per annum in the third quarter to 9.5 percent per annum in the quarter just past.

When the year-over-year gain of 6 percent in real GNP was projected in January it was believed, given the pattern of GNP in 1971, and its estimated fourth-quarter level, that the pace of real growth between the end of 1971 and the end of 1972, would have to average in excess of 7 percent per annum. The rate of increase in the first half of 1972, has exceeded that. Inventory investment, which had been sluggish, is beginning to rise. Net exports, which had been declining, show signs of turning around. As of midyear, the prospects are good that a strong pace of expansion will continue and that the projection made in January will be realized.

Now, this, of course, doesn't contradict what the chairman said about the probability that the rate of increase in the remainder of the year would not be as high as the second quarter.

The rapid expansion of output has been accompanied by a rapid and steady increase in civilian employment. Between the second quarter of 1971 and the second quarter of 1972, total civilian employment has risen by 2.4 million. This is one of the largest four quarter rises on record. The rate of rise, 3.0 percent per annum, was reached only once in the 1960's, and very much higher than the increase of 0.1 percent recorded in the four quarters preceding the adoption of NEP.

Our prepared statement discusses how this evidence is confirmed by other measures of employment.

Despite the big increase in employment since the third quarter the overall unemployment rate remained remarkably steady through all four quarters of 1971, at around the 6-percent level. The rate has declined to 5.7 percent in the second quarter of 1972, and the most recent measure, for June, is 5.5 percent.

The decline of the unemployment rate has been retarded by exceptional growth of the civilian labor force. Between the second quarter of 1971 and the second quarter of 1972, the civilian-labor force expanded by 2.3 million. This exceptional increase was a result of two extraordinary factors.

One was the increase in the participation rate; that is, the proportion of the population in the labor force. The second was the reduction in the Armed Forces which resulted in a very large increase in the civilian labor force. The size of the Armed Forces are reduced by about 425,000 in the past year.

In the period ahead, both of the extraordinary factors in the growth of the civilian labor force are expected to abate. Future increases in the total labor force will presumably return to a more normal relationship with the future increases in the working age population. More importantly, the Armed Forces have now been reduced to about the level scheduled for fiscal year 1973. Continued growth of civilian employment at the pace we have had in the recent past will therefore reduce the number of persons unemployed at a much faster rate. Although expectable variation may yet temporarily raise the figure above the 5.5 percent experienced in June, we believe that the unemployment rate will fall to the neighborhood of 5 percent by yearend.

As we expected, the rate of productivity increase has risen with the rapid expansion of real output. Output per man-hour in the private nonfarm economy showed almost no improvement between the fourth quarter of 1968 and the fourth quarter of 1970. Productivity began to rise again in 1971. We estimate that productivity has risen by about 4 percent since the second quarter of last year. (The increase was 4.3 percent, according to official figures subsequently released.)

In spite of very large nominal increases in wage rates, the real spendable weekly wages for the average production worker did not improve at all between 1965 and 1970—the longest stretch of no improvement since 1947, when this statistical series begins. Indeed real spendable weekly wages declined somewhat over this 5-year period.

In 1971, real spendable weekly wages began to rise and the pace of rise has quickened over the past four quarters, helped by a rise in weekly hours of work and a net cut in tax-rates. For the average production worker in the private nonfarm economy the increase over a year ago is 4.0 percent, compared with an average annual increase of 1.3 percent from 1960–68.

The decline in real spendable weekly wages, prior to 1970, was accompanied by a decline in corporate profits per unit of output. The rise in spendable wages in 1971 and the first half of 1972, has been accompanied by a rise in corporate profits.

Before August 15, 1971, we had no American experience with comprehensive wage and price controls in peacetime. We had not had experience either with any very forceful and detailed incomes policy. The intense public discussion of such policies which preceded the President's announcement of the freeze was based on foreign experience, wartime experience, the U.S. guidepost experience, a priori reasoning, hopes, fears, and intuition.

We have now had almost a year of experience with price and wage controls. This is not a long enough period from which to draw certain and universal conclusions. Still it is possible to form a judgment about what has happened so far and to appraise the future with more evidence than we had last August.

Four main observations can be made about the experience with the controls so far:

1. The rate of inflation has been much lower during the period of the controls than it was earlier. If we compare the annual rate of increase during the control period (August 1971 to June 1972) with the increase during 1971, before the freeze, we see a decline of about 30 percent in the rate of increase of consumer prices, a decline of about 30 percent in the rate of increase of wholesale prices, a decline of about

40 percent in the rate of increase of industrial wholesale prices and a decline of about 20 percent in the rate of increase of hourly earnings. While a number of causes combined to bring about that result, the price and wage control system undoubtedly contributed to it.

2. The price and wage control system has been consistent with the rapid rise of production, employment, and productivity already described and probably contributed to that rise.

3. During the period of the control system the gains from increasing productivity and production have been widely shared among workers and owners of capital. The controls seem to be reasonably fair.

4. The control system has not required a large bureaucracy or imposed burdensome costs of compliance on businesses and individuals subject to it.

I point out in our prepared statement that there were a number of favorable aspects of the situation in which the control system operated which contributed to its success.

We believe that the combination of the price-wage control system with other anti-inflationary policies will lead to continued reduction of the rate of price increase in the months ahead. By that I don't mean a reduction from the 0.1 that we had in the CPI in June, but a reduction from slightly below the 3 percent rate of the entire control period to date.

To achieve this goal will require firmness in the application of the controls, responsibility in avoiding excessive fiscal and monetary expansion, willingness to devote other instruments of government to the task, and cooperation of labor, business, and the public. We believe that these conditions will be present.

The realinement of exchange rates established under the Smithsonian Agreement of December 1971 provided the basis for a fundamental improvement in the U.S. payments position.

For various reasons, the results of the realinement were expected to be slow in coming. But we now believe that there are a number of factors operating to reverse the deterioration in the U.S. trade balance.

First, we will get the effect of the realinement of exchange rates.

Second, we will get the competitive advantage stemming from the fact that our prices are rising less rapidly than those in Europe and Japan.

And third, we expect a resurgence of demand in some of our major partner countries, notably Germany and Japan.

Some evidence of these forces is suggested in the preliminary second quarter figures for net exports of goods and services (on the GNP basis). In value terms the deficit on goods and services, which had increased from an annual rate of $2.1 billion in the fourth quarter of 1971 to $4.6 billion in the first quarter of 1972, widened slightly further in the second quarter to $4.9 billion. But in real terms (1958 dollars) this deficit, which had grown from $1.8 billion in the fourth quarter to $3.3 billion in the first, shrank to $2.4 billion in the second quarter preliminary figures.

Moreover, we now have some evidence that the substantial outflows of speculative funds which took place during the currency crisis of 1971 began to be reversed about mid-March. Between then and mid-June, the balance on official reserve transactions, which had been in substantial deficit, improved markedly.

In the latter part of June the pound sterling came under heavy speculative pressure. On June 23 the British Government allowed the pound to float. As a result of this action, heavy speculation erupted against the U.S. dollar and for a time European central banks purchased large amounts of dollars. Very recently, the United States also intervened in the exchange markets, purchasing a limited amount of dollars with foreign currencies. As the Treasury said: "The action reflects the willingness of the United States to intervene in the exchange markets upon occasion when it feels it is desirable to help deal with speculative forces."

We are now in the course of a vigorous economic expansion. Production and employment are rising strongly. Unemployment is declining. The rate of inflation has been reduced. Our international economic position is improving.

These favorable trends will almost certainly continue throughout the year. There will surely be fluctuations in the pace of improvement. In some months there will be reversals. Just how far we will have progressed by year-end is not assured. But about the general improving trend there is probably widespread agreement.

It is necessary now to be looking at the problems beyond 1972—to 1973 and thereafter. Policy actions considered now will have their main effects in this later period, and it is to this later period that the main options and problems relate.

On the domestic scene the major general problem is to keep a steady expansion going, driving the unemployment rate down while achieving reasonable price stability with much less reliance and wage controls that we now have. We do not believe that the option of retaining tight controls while pumping up excess demand and thereby achieving price stability and very low unemployment is a viable one. Neither is it a new option. Instead it is the classical siren song which has lured many anti-inflation efforts to disaster.

We have no fixed scenario for the termination or alteration of the price and wage control system. We have indicated our determination to continue it and adapt it as is necessary and useful. But we believe that the main force operating to restrain inflation today is the state of demand relative to capacity. We also believe that we must prepare ourselves to rely even more in the future on prudent policies to control demand, rather than on wage and price controls.

The key is to maintain a steady growth of demand but to prevent an explosion of demand. And one key to that, certainly essential and probably the most important thing, is to keep the budget from exploding.

We have an expansive fiscal policy now, as the situation requires. While we have kept expenditures close to the amount that would be balanced by the revenues at full employment, we have run deficits in the neighborhood of $25 billion in each of the past 2 fiscal years. The President's proposed budget for fiscal 1973 would also have been balanced under full-employment conditions. This balance has been strained by a number of developments so far this year, but the President is determined to prevent significant departure from full-employment blance, by seeking offsets to budget overruns. It is also his policy to achieve balance in the full-employment budget for fiscal year 1974. We recognize how difficult that will be, but we are convinced it is possible. Achieving that goal will of course be much easier if the goal is effectively shared by the Congress.

We would like to warn against too ready acceptance of the idea that our impending budget problems can be solved by increasing taxes. Probably the greatest delusion is to think that the problems can be solved by increasing taxes on other people—and particularly on a few other people—and most particularly on people who are not paying their fair share. The President has said that the administration would propose a program of tax reform before the year is out. One of the objectives we seek in developing such a program is to increase the equity of the tax system. However, when we consider the differences of opinion that exist about what equity is, when we consider the possible inequities of suddenly changing long-established practices, and when we consider the past record of Congress in these matters—it is not prudent to count on a large or swift increase in revenue from closing "loopholes" affecting small fractions of the population.

A warning is also in order when we turn to the possibility of meeting our budget problem by raising taxes generally. The pressures for higher spending are great. But the public resistance to higher taxes is also great, and understandably so. Failure to control spending may make a tax increase necessary without making it probable. It would be better to face the expenditure problem now than to count on successfully facing the tax problem later.

On the international side, the Smithsonian Agreement was a major achievement. It embodied a multilateral approach to the solution of international monetary problems, taking into account the interests of both surplus and deficit countries. Since then, a number of events have affected the development of the international monetary system within the Smithsonian framework. Among them are the narrower exchange rate band agreed upon among EC member and applicant countries in April as a first step toward monetary union; the alteration in the Smithsonian pattern of exchange rates caused by the float of the pound sterling; and the spread of exchange-control measures by countries attemping to insulate themselves against large inflows of foreign funds.

The pressure of these events reinforces the need to begin work on comprehensive negotiation for the long-term modernization of the international monetary system. The United States has taken the lead in an international movement toward discussion of the needed reforms. Our prepared statement discusses a number of institutional matters in which the United States has taken the lead and on which progress has been made to establish machinery which will begin work on the revision of the international monetary system.

The goal of a liberal and equitable world order implies, on the monetary side, a system which facilitates payments adjustment without resort to policies detrimental to the achievement of domestic economic goals or to the efficient allocation of resources. One feature of such a system would be that exchange rates adjust more smoothly and readily to exchange economic circumstances than they did in the past. On the trade side, our goal implies that the multilateral negotiations expected to begin in 1973 should be comprehensive, encompassing agriculture as well as industrial trade and nontariff as well as tariff barriers. At the same time, a workable trade agreement will need to include a safeguard system that gives temporary protection to economically sensitive industries, as well as provision for domestic adjustment programs to assist the effective reallocation of resources which would otherwise require permanent protection.

A number of steps have been taken in the past year which will pave the way for expanded economic contacts between the United States and the Communist countries as well. A series of recent high-level discussions on commercial issues, highlighted by the President's visits to Peking and Moscow, have demonstrated a serious desire on both sides for such expanded trade. One immediate result of these discussions was the Soviet Union's agreement to purchase $750 million of U.S. grains over the next 3 years making her the second largest buyer of U.S. grains after Japan. Agreements on the part of the President to establish commercial commissions with the Soviet Union and Poland to negotiate agreements on a variety of commercial issues and the relaxation of a number of restrictions on U.S. trade with the Peoples Republic of China should lay the groundwork for expanded mutually beneficial commercial relationships with these countries.

The problems we face, both at home and in our international economic relations, are difficult. We express concern in order to invite cooperation, not to indicate despair. On the contrary, we have made encouraging progress. More important, the Government of the United States has shown a high order of responsibility, innovativeness, and activism in dealing with its problems. This, and the great strength of the American economy, are the fundamental bases of confidence.

(The prepared statement of Mr. Stein, Mr. Solomon, and Mrs. Whitman follows:)

Prepared Statement of Hon. Herbert Stein, Ezra Solomon, and Marina v.N. Whitman

Mr. Chairman and Members, we are pleased to be here to present our mid-year review of the U.S. economy. The review this July is more than usually important. Almost a year has passed since a decisive and innovative set of policies was launched last August and three quarters of evidence are now available on which at least an interim appraisal of those policies can be based.

The results of the policies can be summarized in a few figures.

From the second quarter of 1971 to the second quarter of 1972:

Total civilian employment has increased by 2.4 million, one of the largest four-quarter rises on record.

The rate of increase of consumer prices has declined from 4.7 percent to 2.2 percent.

The rate of unemployment has declined from 6.0 percent to 5.7 percent and reached 5.5 percent in June 1972.

The rate of increase of real output has risen from 3.4 percent to 8.9 percent, the highest rate since the fourth quarter of 1965.

THE POLICY AND ITS OBJECTIVES

The history of the policy which led to these results can be briefly summarized. Steps to deal with inflation were initiated in the third quarter of 1968. With the passage of the Revenue and Expenditure Control Act fiscal policy turned from being sharply expensive to moderately restrictive. This turn of policy was facilitated by the end of the long and sharp rise in defense expenditures and in the size of the armed forces, which was followed by cutbacks beginning in mid-1969. The shift of fiscal policy was accompanied by a tightening of monetary policy. As a result of these measures the pressures of excess demand was reduced, and by the end of 1969 eliminated.

The end of excess demand was followed slowly by a reduction of the inflation rate. The rise of consumer prices had reached a 6.9 percent rate early in 1969 and average 6.1 percent during that whole year.

In 1970 it still averaged 5.5 percent. By 1970 demand pull was clearly no longer a major factor in the behavior of prices. The long experience with rising prices and the long exposure of each of the major factors of production to static or declining real incomes, especially in the face of extremely large increases in nominal income flows, was leading, quite understandably to vigorous attempts by labor and business to catch up or keep up by raising wages or prices. In the case of labor, wage demands were being determined more by the push of living costs and by the drive to reestablish customary relations than by the pull of demand for labor, and in the case of businesses, prices were reacting to wage and other production costs rather than to demand conditions.

The set of policies adopted on August 15 had three principal components. These were: actions to shift the economy on to a path of much more rapid expansion of output and employment; to restrain inflationary behavior and expectations, first by a freeze on prices and wages followed by more flexible controls; and to suspend convertibility of the dollar in order to bring about a realignment of its external value large enough to offset the rapid increase in prices and costs that had taken place after 1965. These polices were followed up by the Revenue Act of 1971 and the expansive Budget submitted in January, by Phase II controls and by the Smithsonian Agreement.

The turn in policy had both short-run and long-run objectives. Our expectations for these objectives were stated candidly in the 1972 report.

(1) The short run objectives were to stimulate a much more rapid expansion of demand, and at the same time to make sure that expansion led to increases in real output and employment rather than to increases in prices.

The expectation for 1972 relative to 1971 was that aggregate demand would rise by $100 billion, that real output would rise 6 percent and that the price increase, measured by the GNP price deflator, would abate to about 3¼ percent. For consumer prices the target was for an abatement by year end, to an inflationary rate below 3 percent per annum. Civilian employment was expected to rise strongly and this was expected to bring the unemployment rate down to the neighborhood of 5 percent by year end.

(2) The longer run objective was to restore a state of affairs in which reasonable price stability can be maintained without controls. This was to be achieved by eliminating the pressure for higher money wages and prices left over from six years of inflationary experience by providng in its place the conditions for large and genuine increases in real wages and real profits. The rapid rise in output was expected to promote a rapid increase in man hour productivity, which we regard as the only sure basis for a rapid increase in real wages and real profits.

(3) Suspension of convertibility was to provide the freedom to expand rapidly and the basis for a realignment of exchange rates and readjustment of trade policies which in turn would help to convert a growing imbalance between exports and imports into a balanced position.

APPRAISAL

How has the economy responded to the policy shift of last August? As far as aggregate demand and aggregate output are concerned the rate of expansion has clearly accelerated.

Demand and Output

Between the third quarter of 1970 and the third quarter of 1971—the year preceding the New Economic Policy (NEP)—real GNP rose 2.2 percent. From the third quarter of 1971 to the second quarter of 1972 real GNP has expanded at an annual rate of 7.4 percent.

The index of industrial production shows a similar pattern of improvement. From the third quarter of 1970 to the third quarter of 1971 industrial production decreased. Since the third quarter of last year, the industrial production has expanded at 7.5 percent per annum.

Both measures of output have accelerated over the past 12 months: Real GNP from 2.5 percent per annum in the third quarter of 1971 to 8.9 percent per annum in the second quarter of 1972, and industrial production from —1.9 percent per annum in the third quarter to 9.4 percent per annum in the quarter just past.

When the year-over-year gain of 6 percent in real GNP was projected in January it was believed, given the pattern of GNP in 1971 and its estimated fourth quarter level, that the pace of real growth between the end of 1971 and the end of 1972 would have to average in excess of 7 percent per annum. The rate of increase in the first half of 1972 has exceeded that. Inventory investment, which had been sluggish, is beginning to rise. Net exports, which had been declining, show signs of turning around. As of mid-year, the prospects are good that a strong pace of expansion will continue and that the projection made in January will be realized.

Employment

The rapid expansion of output has been accompanied by a rapid and steady increase in civilian employment. Between the second quarter of 1971 and the second quarter of 1972 total civilian employment has risen by 2.4 million. This is one of the largest four quarter rises on record. The rate of rise, 3.0 percent per annum, is higher than the biggest increases recorded in the 1960's, and very much higher than the increase of 0.1 percent recorded in the four quarters preceding the adoption of NEP.

Employment as measured by nonagricultural payrolls has also risen over the past year but the expansion in this measure began one quarter later, and has accelerated faster than the household survey series. From the third quarter of 1971 to the second quarter of 1972 payroll employment rose by 1.8 million, or at an annual rate of 3.4 percent.

Unemployment

Despite the big increase in employment since the third quarter the overall unemployment rate remained remarkably steady through all four quarters of 1971 at around the 6.0 percent level. The rate has declined to 5.7 percent in the second quarter of 1972 and the most recent measure, for June is 5.5 percent.

The decline of the unemployment rate has been retarded by exceptional growth of the civilian labor force. Between the second quarter of 1971 and the second quarter of 1972 the civilian-labor force expanded by 2.3 million. This unprecedented increase was a result of two extraordinary factors. Because of increased participation, the total labor force increased by 1.9 million persons, or by about 81 percent of the total increase in the 16 and over population. Such an increase is typical only during periods of rapid increase in the demand for labor. In addition the size of the armed forces was reduced by about 425,000. The result was a very large increase in the civilian labor force—twice as large as the average annual increase from 1960 to 1968. Because of this factor, the increase of 2.4 million in civilian employment reduced the number of persons unemployed by less than 100,000 between the second quarter of 1971 and the second quarter of 1972.

In the period ahead, both of the extraordinary factors in the growth of the civilian labor force are expected to abate. Future increases in the total labor force will presumably return to a more normal relationship with the future increases in the working age population. More importantly, the armed forces have now been reduced to about the level scheduled for FY 1973. Continued growth of civilian employment at the pace we have had in the recent past will therefore reduce the number of persons unemployed at a much faster rate. Although expectable variation may yet temporarily raise the figure above the 5.5 percent experienced in June, we believe that the unemployment rate will fall to the neighbohood of 5 percent by year end.

Productivity

As we expected, the rate of productivity increases has risen with the rapid expansion of real output. Output per man-hour in the private nonfarm economy showed virtually no improvement between the fourth quater of 1968 and the fourth quarter of 1970. Productivity began to rise again in 1971. We estimate that productivity has risen by about 4 percent since the second quarter of last year.

The improvement in productivity is a key element in the present policy because it is a necessary condition for real wages to rise and a durable offset to price pressures.

Real spendable weekly earnings

In spite of very large nominal increases in wage rates, the real spendable weekly wages for the average production worker did not improve at all between 1965 and 1970—the longest stretch of no improvement since 1947 when this statistical series begins. Indeed real spendable weekly wages declined somewhat over this five year period.

In 1971 real spendable weekly wages began to rise and the pace of rise has quickened over the past four quarters, helped by a rise in weekly hours of work and a net cut in tax-rates. For the average production worker in the private nonfarm economy the increase over a year ago is 4.1 percent, compared with an average annual increase of 1.3 percent from 1960–1966.

The decline in real spendable weekly wages prior to 1970 was accompanied by a decline in corporate profits per unit of output. The rise in spendable wages in 1971 and the first half of 1972 has been accompanied by a rise in corporate profits.

The Price and Wage Control System

Before August 15, 1971 we had no American experience with comprehensive wage and price controls in peacetime. We had not had experience either with any very forceful and detailed incomes policy. The intense public discussion of such policies which preceded the President's announcement of the freeze was based on foreign experience, wartime experience, the U.S. guidepost experience, a prior reasoning, hopes, fears and institution.

We have now had almost a year of experience with price and wage controls. This is not a long enough period from which to draw certain and universal conclusions. Still it is possible to form a judgment about what has happened so far and to appraise the future with more evidence than we had last August.

Four main observations can be made about the experience with the controls so far:

1. The rate of inflation has been much lower during the period of the controls than it was earlier. If we compare the annual rate of increase during the control period (August 1971 to June 1972) with the increase during 1971 before the freeze, we see a decline of about 30 percent in the rate of increase of consumer prices, a decline of about 30 percent in the rate of increase of wholesale prices, a decline of about 40 percent in the rate of increase of industrial wholesale prices and a decline of about 20 percent in the rate of increase of hourly earnings. While a number of causes combined to bring about that result, the price and wage control system undoubtedly contributed to it.

2. The price and wage control system has been consistent with the rapid rise of production, employment, and productivity already described and probably contributed to that rise.

3. During the period of the control system the gains from increasing productivity and production have been widely shared among workers and owners of capital. The controls seem to be reasonably fair.

4. The control system has not required a large bureaucracy or imposed burdensome costs of compliance on businesses and individuals subject to it.

These positive results of the control system have been achieved under favorable circumstances. Before the system was launched, the Administration had demonstrated its determination to follow anti-inflationary fiscal and monetary policies, and the rate of inflation had already declined from its peak. The economy has been operating below its potential and situations of excess-demand at existing prices and wages have been uncommon. The rise of output and of productivity during the past year permitted widespread gains of real income and moderated the struggle over income shares. Frustration with long-continued inflation had stimulated support for the stabilization program among all sectors of the Nation. The decision to start the program with a comprehensive freeze highlighted the urgency of the problem and the need to suspend business as usual and politics as usual if the problem was to be met.

Of course, the program also had some special difficulties to contend with. It was initiated when profit margins were exceptionally low, so that there was little room for cost absorption. We were going through a low point in the meat production cycle, which would push up prices of that critical product. The rise in prices abroad and the reduction in the exchange value of the dollar tended to raise prices of imports. Nevertheless the conditions on balance were extraordinarily favorable, more favorable than can be expected in the long run.

We believe that the combination of the price-wage control system with other anti-inflationary policies will lead to continued reduction of the rate of price increase in the months ahead. To achieve this goal will require firmness in the application of the controls, responsibility in avoiding excessive fiscal and monetary expansion, willingness to devote other instruments of government to the task, and cooperation of labor, business and the public. We believe that these conditions will be present.

International Trade and Payment

The realignment of exchange rates established under the Smithsonian Agreement of December 1971 provided the basis for a fundamental improvement in the U.S. payments position. But a turnaround involving major economic adjustments could not happen instantly. Moreover, in the short run, the dollar devaluation would actually have a perverse impact, causing a further deteriora tion in the U.S. trade balance. This is because a devaluation had the immediate effect of raising the prices and thus the nominal value of imports, while the response of real trade flows to relative price shifts, increasing the volume of exports and decreasing the volume of imports, occurs only with a lag. In addition, divergent cyclical trends in the United States and our major customer countries had a negative impact on our trade balance; rapid expansion here stimulated and demand for imports, while varying degrees of economic slack in several of our major partner countries slowed the demand for our exports. As a result of these various pressures, the U.S. merchandise trade balance deteriorated in the first quarter of 1972. At quarterly rates the decline was almost $200 million; the total deficit on current and long-term capital account increased by $1.4 billion in the first quarter of 1972 to $3.2 billion.

There are a number of factors now operating, however to reverse the deterioration in the U.S. trade balance. These include: the effect of the Smithsonian realignment of exchange rates on real trade flows, stimulating exports and retarding imports; the competitive advantages stemming from the fact that wholesale and consumer prices are rising less rapidly here than in Europe and Japan, and a resurgence of demand in some of our major partner countries, notably Germany and Japan. Some evidence of these forces is suggested in the preliminary second quarter figures for net exports of goods and services (on the GNP basis). In value terms the deficit on goods and services, which had increased from an annual rate of $2.1 billion in the fourth quarter of 1971 to $4.6 billion in the first quarter of 1972, widened slightly further in the second quarter to $4.9 billion. But in real terms (1958 dollars) this deficit, which had grown from $1.8 billion in the fourth quarter to $3.3 billion in the first, shrank to $2.4 billion in the second quarter preliminary figures.

The substantial outflows of speculative funds which took place during the currency crisis of 1971 began to be reversed about mid-March. Between then and mid-June, the balance on official reserve transactions, which had been in substantial deficit, improved markedly.

In the latter part of June the pound sterling came under heavy speculative pressure. On June 23 the British Government allowed the pound to float. As a result of this action, heavy speculation erupted against the U.S. dollar and for a time European central banks purchased large amounts of dollars. Very recently, the United States also intervened in the exchange markets, purchasing a limited amount of dollars with foreign currencies. As the Treasury said: "The action reflects the willingness of the United States to intervene in the exchange markets upon occasion when it feels it is desirable to help deal with speculative forces."

PROBLEMS AND POLICY FOR THE FUTURE

We are now in the course of a vigorous economic expansion. Production and employment are rising strongly. Unemployment is declining. The rate of inflation has been reduced. Our international economic position is improving.

These favorable trends will almost certainly continue throughout the year. There will surely be fluctuations in the pace of improvement. In some months there will be reversals. Just how far we will have progressed by year-end is not assured. But about the general improving trend there is probably widespread agreement.

It is necessary now to be looking at the problems beyond 1972—to 1973 and thereafter. Policy actions considered now will have their main effects in this later period, and it is to this later period that the main options and problems relate.

On the domestic scene the major general problem is to keep a steady expansion going, driving the unemployment rate down while achieving reasonable price stability with much less reliance on price and wage controls that we now have. We do not believe that the option of retaining tight controls while pumping up excess demand and thereby achieving price stability and very low unemployment is a viable one. Neither is it a new option. Instead it is the classical siren song which has lured many anti-inflation efforts to disaster.

We have no fixed scenario for the termination or alteration of the price and wage control system. We have indicated our determination to continue it and adapt it as is necessary and useful. But we believe that the main force operating to restrain inflation today is the state of demand relative to capacity. We also believe that we must prepare ourselves to rely even more in the future on prudent policies to control demand, rather than on wage and price controls.

The key is to maintain a steady growth of demand but to prevent an explosion of demand. And one key to that, certainly essential and probably the most important thing, is to keep the budget from exploding.

We have an expansive fiscal policy now, as the situation requires. While we have kept expenditures close to the amount that would be balanced by the revenues at full employment, we have run deficits in the neighborhood of $25 billion in each of the past two fiscal years. The President's proposed budget for fiscal 1973 would also have been balanced under full-employment conditions. This balance has been strained by a number of developments so far this year, but the President is determined to prevent significant departure from full-employment balance by seeking offsets to budget over-runs. It is also his policy to achieve balance in the full-employment budget for FY 1974. We recognize how difficult that will be, but we are convinced it is possible. Achieving that goal will of course be much easier if the goal is effectively shared by the Congress.

We would like to warn against too ready acceptance of the idea that our impending budegt problems can be solved by increasing taxes. Probably the greatest delusion is to think that the problems can be solved by increasing taxes on other people—and particularly on a few other people—and most particularly on people who are not paying their fair share. The President has said that the Administration would propose a program of tax reform before the year is out. One of the objectives we seek in developing such a program is to increase the equity of the tax system. However, when we consider the differences of opinion that exist about what equity is, when we consider the possible inequities of suddenly changing long-established practices, and when we consider the past record of Congress in these matters—it is not prudent to count on a large or swift increase in revenue from closing "loopholes" affecting small fractions of the population.

A warning is also in order when we turn to the possibility of meeting our problem by raising taxes generally. The pressures for higher spending are great. But the public resistance to higher taxes is also great, and understandably so. Faliure to control spending may make a tax increase necessary without making it probable. It would be beter to face the expenditure problem now than to count on successfully facing the tax problem later.

On the international side, the Smithsonian Agreement was a major achievement. It embodied a multilateral approach to the solution of international monetary problems, taking into account the interests of both surplus and deficit countries. Since then, a number of events have affected the development of the international monetary system within the Smithsonian framework. Among them are: the narrower exchange rate band agreed upon among EC member and applicant countries in April as a first step toward monetary union; the alteration in the Smithsonian pattern of exchange rates caused by the float of the pound sterling; and the spread of exchange-control measures by countries attempting to insulate themselves against large inflows of foreign funds.

The pressure of these events reinforces the need to begin work on comprehensive negotiation for the long-term modernization of the international monetary system. The United States has taken the lead in an international movement towards discussion of the needed reforms. As the forum for these negotiations, a committee of 20 ministers and their deputies, based on the present representation on the Board of Directors of the International Monetary Fund, is expected to be formally established at the IMF meeting in September. The new body is expected to consider, in addition to international monetary reforms, the relationships beween these proposed reforms and international arrangements involving trade, capital flows, international investment, and development assistance. The broad mandate of this new group reflects the view that the establishment of an international economic system in which each country is assured fair access to world markets and in which market-directed international transactions can make their contribution to economic growth and well-being requires complementary reforms on the trade and the monetary side, since there are strong links between the efficient functioning of the international trading system and the stability of the international monetary system.

The goal of a liberal and equitable world order implies, on the monetary side, a system which facilitates payments adjustment without resort to policies detrimental to the achievement of domestic economic goals or to the efficient allocation of resources. One feature of such a system would be that exchange rates adjust more smoothly and readily to changing economic circumstances than they did in the past. On the trade side, our goal implies that the multilateral negotiations expected to begin in 1973 should be comprehensive, encompassing agriculture as well as industrial trade and non-tariffs as well as tariff barriers. At the same time, a workable trade agreement will need to include a safeguard system that gives temporary protection to economically sensitive industries, as well as provision for domestic adjustment programs to assist the effective reallocation of resources which would otherwise require permanent protection.

A number of steps have been taken in the past year which will pave the way for expanded economic contacts between the United States and the Communist countries as well. A series of recent high level discussions on commercial issues, highlighted by the President's visits to Peking and Moscow, have demonstrated a serious desire on both sides for much expanded trade. One immediate result of these discussions was the Soviet Union's agreement to purchase $750 million of U.S. grains over the next three years, making her the second largest buyer of U.S. grains after Japan. Agreements on the part of the President to establish commercial commissions with the Soviet Union and Poland to negotiate agreements on a variety of commercial issues and the relaxation of a number of restrictions on U.S. trade with the Peoples Republic of China should lay the groundwork for expanded mutually beneficial commercial relationships with these countries.

The problems we face, both at home and in our international economic relations, are difficult. We express concern in order to invite cooperation, not to indicate despair. On the contrary, we have made encouraging progress. More important, the Government of the United States has shown a high order of responsibility, innovativeness, and activism in dealing with its problems. This, and the great strength of the American economy, are the fundamental bases of confidence.

Chairman PROXMIRE. Thank you, Mr. Chairman, for the comprehensive and helpful analysis of the economic outlook at midterm.

Last January, the administration recommended a budget policy which implied a sharp increase in expenditures before the end of fiscal 1972. This was to lead to a full employment deficit for fiscal year 1972 of about $8 billion. This was justified on the grounds that the economy was sluggish and needed strong fiscal stimulus. In fiscal year 1973, the full employment budget was to be restored to balance according to your January plan.

It now appears that your January budget estimates were extremely inaccurate. The actual deficit in fiscal year 1972 was probably $23 billion, rather than the $39 billion you projected. You were about $16 billion off. The full employment deficit was also correspondingly smaller than you projected. Yet the economy is behaving very much as you forecast. It is puzzling that your budget forecast could be so bad and your GNP forecast so good. I can think of several possible explanations: (1) Fiscal policy is irrelevant; (2) your understanding of how fiscal policy affects the economy is not very good; or (3) you knew very well that there would be no $39 billion deficit, but you wanted to start with a large number so that later you could talk about reducing the deficit.

Is one of these the correct explanation, or is there some other reason why you were so wrong on fiscal policy without being similarly in error on your GNP forecast?

Mr. STEIN. Well, Mr. Chairman, if we have a choice between being right in managing the GNP and being right in managing the budget deficit, I would much prefer to be right in managing the GNP. However, there are several factors involved here——

Chairman PROXMIRE. You are saying that the administration has more control over the GNP than it has over the budget, are you?

Mr. STEIN. We have more interest in it.

Chairman PROXMIRE. We all have more interest in it. Were you just lucky?

Go ahead.

Mr. STEIN. Well, that helps.

A major element in the shift between the original estimate and the present estimate for fiscal 1972, as you know, was the unexpected amount of overwithholding of income tax in the first half of calendar 1972. I think we have to say that we do not yet know precisely, and perhaps never will know precisely, what the amount of overwithholding was. But apparently it was quite a large number, and accounted for substantially the difference between the full-employment deficit earlier estimated and the deficit we probably have had.

Now, the question is, why did the failure to get the originally projected full employment deficit under these circumstances not have a seriously depressing effect on the economy? And this raises a question, I think, about which economists would have to admit that they are uncertain.

That is: What is the effect on consumer behavior of a change in the amount withheld from their incomes as tax if the underlying liability is not thereby affected? That is, the question is raised whether consumers, insofar as they react to their after tax income, react to their income after their true liabilities or to their income after the amount of withholding.

The evidence would seem to suggest that at least in this period the consumers responded to their true incomes, that is, to their incomes after their true tax liabilities, and not to their incomes after the amount that had been execessively withheld.

Another factor in the difference between the original estimate and the current estimate is that the original estimate for 1972 included among the budget outlays about two and a half or two and a quarter billion dollars of retroactive payment of revenue sharing which we projected would be enacted and effective before June 30, 1972. But we didn't think that the retroactive enactment of revenue sharing, assuming that it occurred, say, on the 29th of June, was going to have a big effect on the economy in the first half of 1972. The thing is, of course, that one mustn't make too mechanical deductions from the budget figures.

And, of course, the third point that must be made aside from the failure to enact the retroactive revenue sharing, is that the expenditure estimates for fiscal year 1972 are quite close to the mark, I believe.

The other factor is that some elements in the private sector were stronger during the first half of this year than we expected.

I would reject the notion that we had exaggerated the expected size of the deficit.

Chairman PROXMIRE. You see, that is so hard to understand. You say that some elments in the private sector were stronger than you expected, but you projected the GNP pretty much on the nose.

And yet you come out with a gross error in your estimate of the budget. I recall a bigger error than to estimate a $39 billion deficit and come up with a $23 billion deficit.

Mr. STEIN. I haven't researched the record——

Chairman PROXMIRE. Let me ask you this, because this is prospective rather than past. I understand that you are now worried that the money you didn't spend in fiscal 1972 as you say will "slopover" into 1973, I believe that is your phrase.

So, I would like your judgment as to the appropriate fiscal policy in fiscal 1973, that is the present year, the present fiscal year. Should the budget be in full employment balance in fiscal year 1973 or should it be in deficit?

Mr. STEIN. We would like to see the budget in full employment balance in fiscal 1973. As you know, we proposed a firm expenditure ceiling for fiscal 1973 initially at $246.3 billion. The failure of Congress to enact the retroactive portion of revenue sharing in fiscal 1972 probably makes a $246.3 billion budget ceiling an unrealistic figure. We are now eager to obtain from Congress a firm expenditure ceiling of $250 billion.

Chairman PROXMIRE. This sounds to me, Mr. Stein, as if you placed a higher priority on combating inflation, and you are still convinced that the way to combat inflation is to slow the economy rather than reducing unemployment.

With unemployment at 5.7 percent in the second quarter you simply call for a balanced full employment budget—I don't see how that provides necessary fiscal stimulus, is there any likelihood that in this quarter we will get any reduction in unemployment?

Mr. STEIN. We have just demonstrated, Senator, that the behavior of the economy is not exclusively dominated by fiscal policy.

Chairman PROXMIRE. But it is one of the few things that the Government can use to do something about the situation.

Mr. STEIN. As we look ahead to fiscal 1973 with the prospect of a budget in full employment balance, we see a continued vigorous expansion at a rate which will continue to reduce the unemployment rate, but will not blow the economy out of the water.

The big problem now is not should we stop and reverse the expansion, the question now is, shall we try to continue a steady and strong but not explosive expansion. And our position is that getting as close as we can to full employment balance in fiscal 1973 is consistent with continued strong expansion.

As a matter of fact, we will have had a very close to full employment balance in fiscal 1972, and yet that was a year in which we did have very strong expansion.

Chairman PROXMIRE. We certainly didn't have much of an improvement in unemployment. It stayed very close to the 6 percent level. It went down to 5.5 percent in June, and we had testimony before this committee last Friday which indicated that we should accept that with the greatest caution, it may only be a temporary, probably was only a temporary improvement. At any rate, unemployment was between 5.7 and 5.8 percent in the second quarter, and we seem to have a long way to go. You talk about getting unemployment down to the neighborhood of 5 percent by the end of the year. How much of a tolerance do you have in that neighborhood? Do you mean, give or take two-tenths of 1 percent?

Mr. STEIN. Well, if I had intended to be more precise I would have stated it in numerical terms. But our belief is that the number will be lower than the 5.5 percent that we had in June. It would not be sensible for me to try to predict a number to the decimal place for December——

Chairman PROXMIRE. Let me ask you, what should be our unemployment target for 1973?

Mr. STEIN. We believe the target should be to continue a reduction below the rate which we will have at the end of 1972. And we think that that continued reduction will take us below 5 percent. But we have not formulated an answer to that question, nor do we think it is necessary at this point. We now see that the economy is making quite commendable progress in increasing employment, reducing unemployment, and simultaneously reducing the rate of inflation.

If this turns out as we go through the remainder of the year to be a persistent pattern, then our goal in 1973 can be correspondingly more ambitious than if we run again into a serious conflict between expansion and inflation.

Chairman PROXMIRE. Mr. Stein, I plead with you as the Chief Economic Official of this administration to recognize that while this administration has made some commendable progress in economic growth in recent months and in combating inflation, that your most serious weakness by far is in the area of unemployment. And it is not very reassuring that you say that you hope to get unemployment somewhere down below 5 percent in the coming year, and to hear what seems to be—and I am not sure it is indifference, but what seems to be a much lower priority for doing something about the nearly 5 million people who are out of work than to meet some of the other very important objectives that you have to meet.

Mr. STEIN. Well, Mr. Chairman, we think we are facing a very critical point in the economic policy of this country. We have at great pain and suffering, or at least at considerable pain and suffering, made really substantial progress in reducing the rate of inflation. We have discovered that it is very easy to generate inflation, and it is a very slow process and a very difficult process to reduce it.

We think that we have an obligation to be responsible about this, and to be careful that we do not revive the forces of inflation. We are as eager as anyone to reduce unemployment, and we are gratified to see that it is being reduced. I do not accept the view that the decline to 5.5 percent in June was some statistical abberation. But we do have the responsibility of balancing these two objectives, and I think it would not be of service to pretend that we don't.

Chairman PROXMIRE. Let me make one other point in connection with this. In addition to the very heavy unemployment that we have, with 5 million people out of work, we are operating at only 76 percent of capacity. With these unused resources it seems to me that all the objectives that President Nixon and our presidential nominee, Senator McGovern, seek are very difficult and very expensive unless we can utilize our resources more fully.

This is true of any kind of a welfare program far more expensive, and I mean many times more expensive, with nearly 6 percent unemployment than with much lower unemployment. This is true of the kind of revenues that the Federal Government is going to receive. This is true of getting the kind of improvement in trade with other countries, the kind of relaxation on the part of the unions and the part of the companies that are concerned with foreign competition.

All of those things, it seems to me, depend so very heavily on breaking this unemployment barrier. It seems to me that this is something that we should concentrate a great deal more attention and far higher priority on.

Mr. STEIN. I really don't think you should be giving me this lecture, because we have produced in the private economy an enormous increase in employment, and an enormous increase in output, and an enormous reduction in unutilized potential of the economy.

And we expect that the policy on which we are embarked will continue to do that. The only point I am making is that the rate of expansion of demand can be too large as well as too small, and we have an obligation to avoid both of these dangers.

Chairman PROXMIRE. I appreciate that.

What concerns me is the fact that we now have more than 2 million people more out of work than when President Nixon took office. This has been one signal, conspicuous failure of the administration and the failure of our economy, and it should not be partisan, but in this election year we cannot avoid it.

The fact that we have almost twice as many people out of work in June 1972 than in January 1969, is a terribly serious problem, I think the most serious problem in the economy.

Senator Javits.

Senator JAVITS. Chairman Stein, I am very interested in your statement on taxes. You say in the prepared statement: "We would like to warn against too ready acceptance of the idea that our impending budget problems can be solved by increasing taxes."

And then you go on to say that obviously you are not going to raise very much money by closing loopholes affecting small factions of the population.

I agree with that, but then you say it would be better to face the expenditure problem now than to count on successfully facing the tax problem later.

Now, with the accelerating war in Vietnam, the Brookings Institution finds that you have no elbow room in the budget anyhow. Where are you going to reduce expenditures to avoid increasing taxes?

Mr. STEIN. I have the greatest respect for the Brookings Institution, but it is not the Bible. And we recognize that it is going to be very difficult. The expenditure increases that are projected by the Brookings Institution are very large expenditure increases that we have projected in our own 5-year outlook in the Budget and the Economic Report. They do constitute an enormous problem before the country.

But these expenditure increases are not given by the Constitution. Most of them are not even given by substantive legislation; that is, they are subject to control.

Some of them are not. But there is a good deal of control left in the Congress and the administration if they operate cooperatively.

I think it is entirely too loose an expression to say, as many people are now saying, that the budget is out of control. The budget is under control by the Congress and by the President.

The Brookings Institution also made the point, which I think more and more people are coming to agree with, that a great many of the programs on which we have been spending rapidly increasing amounts of money in the last 10 years are not paying off. They are not yielding the results we thought they were going to yield. We had a war against poverty, and it did not make nearly the progress that was expected in reducing poverty. We have had enormous programs for improving education, and the contribution of those programs to the improvement of education is not so easy to show. We have enormous programs for doing things about manpower, structural difficulties, training, relocation, and so on. All these things need to be reexamined in a hardboiled way in answer to the question, are they really paying off? Not just are they named on bills which indicate that some great result is to be achieved, but whether from the experience we have had, are they going to pay off?

Now, this is going to be very difficult. We are engaged in an effort to review these programs. But, of course, the first place to start before you ask where are we going to cut what is already in the budget, is with the things which have not yet been enacted. To the extent bills representing billions of dollars are floating around Congress and are enacted, in a few years some member of the committee will say, here we have this expensive water bill and that expensive something else which commit us for the next 10 years. One thing is to stop now before we are committed to paying for the bills.

Senator JAVITS. Those bills to which you are referring we will insist are not in the budget. The budget is already subject to the argument that it is out of control.

Right now, as I understand it, some 70 percent of your budget is fixed and uncontrollable, and is not subject to this kind of volition. And yet with the Vietnam war going on and the President asking you for more billions for defense expenditure, I would like to know myself, specifically, where are we going to cut. I believe, Mr. Stein, that in an election year is the very time to be frank with the people as to what they face.

As for myself, I find it extremely difficult to see how we are going to get by without asking the people to face the issue of some broader tasks than reaching the few loopholes or the few rich ones, that isn't going to produce enough dough.

Would you be good enough to comment on that?

Mr. STEIN. I regard the idea of the broader general tax that is going to yield us tens of billions of dollars as a thing which is much easier to say than it is to say that we will cut tens of billions of dollars out of the budget. But I think the tax is much less likely to be enacted. I have been around here for quite a long time, and I have also studied quite a bit of history of the Government's fiscal policy. I know that there has not been any general increase of taxes in peacetime since 1932. And I keep reminding people that was not a very happy experience. So, I think that Congress is going to be very reluctant to make a general tax increase.

And for that reason alone I think it is incumbent on us to be very frugal about the budget.

Now, it is true that the fiscal 1973 picture is not out of reach. We have proposed a ceiling of $250 billion. With the President's budget and with some things that are floating around, we are up to about $253 billion. We would undertake to live within that $250 billion if Congress would enact a ceiling which applied equally to Congress and to the administration. The fiscal 1974 problem is just beginning. The President has sent out ceiling letters to the agencies which are based on the proposition that we are going to get the fiscal 1974 budget into balance at full employment, if we are not constantly confronted with pending proposals which are tied to measures which we cannot do without. If we can have some reasonable cooperation, we can do it.

Senator JAVITS. Mr. Stein, would it be asking too much to ask you to give us specifically for the record an analysis of how you would implement facing the expenditure problem now rather than counting on successfully facing the tax problem later?

Exactly what do you urge, or what do you believe the Congress can or should cut?

Mr. STEIN. I am afraid it would be asking too much of me.

Senator JAVITS. You say it would be asking too much?

Mr. STEIN. Yes. This is a question which can only be answered on behalf of the administration as a whole. As I have indicated, we have presented a budget for fiscal 1973 which is very close to meeting the targets for balance that we have set forth. We are in the process of developing a budget for fiscal 1974 which will be balanced. And this means that we are going through a serious study of everything that is on the books. It would be presumptious and premature for me to submit a list of my preferences.

Senator JAVITS. Mr. Stein, I find it a little bit contradictory to say that the duty of the Chairman of the Council and the Council itself is not to tell us where they believe the cuts can be made, because that is policy. And yet you just 3 minutes ago said that as a matter of policy you are not going to tell the country whether it does or doesn't need a broader tax program to raise a lot of money, because you don't believe that the Congress will enact it.

That certainly is policy, even more than the first question.

Now, what is the job of the Council? Is it to advise us what we ought to do without regard to politics? Are you in charge of politics, too?

Mr. STEIN. No. The politics I share with a number of other people.

Senator JAVITS. That may be too bad.

Mr. STEIN. No, I am not giving you a political answer when I talk about policy. The question of whether one should cut program A or program B involves policy considerations which are far beyond the scope of the Council of Economic Advisers, however broadly that scope might be defined. This is a matter that in the end the President will determine. The general advice that we ought to aim at getting the full-employment budget in balance is within our province to offer to you, as we have offered it to the President, and the President agrees with that.

As for whether you should raise taxes or not, I am not saying that you should not raise taxes, I am saying that you should not behave on the expenditure side as if you were going to raise taxes and then discover that you are not.

Senator JAVITS. As a matter of fact, Mr. Stein, isn't our situation, as much as I join with the Chair and my other colleagues that in great measure the administration is entitled to whatever credit it gets for being in charge, that things have materially improved, but from everything you tell us and from everything we see, we are facing a very grim situation come the next fiscal year. We are simply trying to wear a suit which is too small for us. And all I am urging is that you tell us—because I have the greatest respect for the expertise of this Council—what we ought to do, and leave to us the decision as to whether we have the political courage to do it. But at least tell us that we ought to do it.

Mr. STEIN. Well, for fiscal 1973 we have submitted to you a budget. This is our view of what ought to be done. For fiscal 1974, we will submit to you a budget which is our view of what should be done. And that is where we stand.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you.

And welcome Chairman Stein and your associates. It is a pleasure to participate in your tour of happiness here today.

I notice that you attribute your success—and I quote from your first paragraph—to the "decisive and innovative set of policies that was launched last August."

Now, as I read the hristory, for two and a half years the Democrats in Congress were very critical of the inflation at home and neglect of the dollar abroad, and made some very specific proposals: A wage-price freeze at home and closing of the gold window and the devaluation of the dollar abroad. Legislative proposals were forwarded to carry those out. Those proposals were pretty much opposed by the administration until August 15, when they were adopted. And as you said in the prepared statement, they worked like a charm. My question is, Are you prepared to show your gratitude by campaigning for a Democratic Congress this fall?

Mr. STEIN. Well, Mr. Reuss, I don't campaign for anyone.

Representative REUSS. You won't campaign against the Democratic nominees?

Mr. STEIN. I am not campaigning at all.

Representative REUSS. I was very interested in Senator Javits' questions about the 1972 budget. You speak of the budget that was submitted, one that contained a $25 billion deficit, as a budget that was in full-employment balance for 1973.

What was your unemployment figure when you are talking about full employment?

Mr. STEIN. Four percent.

Representative REUSS. Four percent. I, also, was interested in the article of Mr. Rowen in the Post in which he set forth the budget according to Goldman-Sachs. This budget shows a deficit including the programs that the President has signed, or approved, that will increase that $25 billion deficit by at least another $8 or $10 billion.

I request that entire article be printed in the record.

Chairman PROXMIRE. Without objection, it will be placed in the record at this point.

(The article follows:)

[From the Washington Post, July 23, 1972]

BUDGET DRIFTING OUT OF CONTROL, NIXON ORDERS CUTBACK FOR 1974

(By Hobart Rowen)

You're going to hear an awful lot about budget deficits in the next few days.

To be specific about it, the top brass of the Nixon administration, accompanied by Federal Reserve Chairman Arthur F. Burns, are preparing to go before the Joint Economic Committee to confess that the deficit for fiscal 1973—which began July 1—will be well in excess of $30 billions.

They won't say so directly, but the fact is that the federal budget is out of control. Unless the Nixon administration finds some way of chopping it down, the fiscal 1973 deficit could in fact hit $40 billions.

Over the weekend, cabinet members were given ceilings for their departments for fiscal 1974—the year that starts July 1, 1973—and the screams to be heard in Washington on Monday will suggest how sharp a knife is being wielded by OMB Director Caspar Weinberger.

"We don't want to get into any more fiscal stimulation," Weinberger told The Washington Post. If Congress would co-operate, Weinberger says, the federal budget posture could be made a lot more respectable.

The economic case for reduced spending will be made with especial force by Burns, who will tell Congress that unless budget cuts are enforced, the nation will be faced with a tax increase of meaningful proportions.

Financial markets, Burns feels strongly, need some reasurance that the Nixon administration can bring the budget under control. Without that, Burns has told friends, international monetary markets will continue to be jittery.

But the Nixon administration's record of budget management is rather dismal. For fiscal 1971, the President forecast a $2 billion surplus, and wound up $23 billion in the red.

Then a deficit of about $12 billion was forecast for fiscal 1972, revised to $38.8 billion last January, and now appears to have shrunk to about $23 billion because of bad estimates on spending and on tax withholding.

And instead of the $25.5 billion deficit originally forecast for fiscal 1973, the number is clearly somewhere in the $30 billions, at a time when the economy is expanding. Moreover, in 1973, wage settlements are likely to be on the upswing again, adding to inflationary pressures.

Despite appeals to cabinet officers to pare their spending requests, it now appears that federal spending for fiscal 1973 will run $255 to $258 billion, or well over the administration's hoped-for ceiling of $250 billion.

Delay on revenue sharing has shifted about $2.5 billion from fiscal 1972 into fiscal 1973. New benefits for disease-stricken coal miners will add another $1 billion. The cost of the new Social Security package (benefits will be boosted 20 per cent beginning Oct. 1) will be $6.5 billion, or nearly $2.5 billion more than Nixon originally budgeted. (The benefits will be even more costly in fiscal 1974 and beyond.)

And that's not all. An analysis by Goldman, Sachs of New York shows that military spending could go $1.5 to $3 billion over the target, and that health-education spending is likely to mushroom by $1 billion (a popular heart-lung research bill alone could add $500 million).

When you add potential spending for even more liberal Social Security-medical coverage; for pollution control, flood relief, school lunch subsidies, and veterans medical care, you can see why Cap Weinberger, as a budget balancer by profession, risks a daily heart attack.

Thus, what may be in store is a boom for 1973, but one with an inflationary bust and high interest rates at the end of it.

The Nixon administration has desparately tried to avoid tax-increase talk during this election year, promising instead expenditure control. But it's easier said than done, as every man in the Office of Management and Budget knows.

What's worse, if a tax increase is needed, the political strategists know that even if they propose a value added tax, they probably couldn't get it through Congress for 2 to 3 years.

So what's left that could be made effective some time during calendar 1973? Loophole-plugging? The Nixon people insist there's not much money there. Cut the investment credit or slow accelerated depreciation? That's McGovern talk.

So if the Nixon crowd wants to reclaim the "fiscal integrity" tag, it will either have to cut the budget or propose straight increases in corporate and/or individual tax rates. Wall Street, which isn't as dumb as it sometimes likes to sound, figured it out some time back.

Representative REUSS. I note that even your expenditure limitation—and you declined to tell Senator Javits how you would get expenditures down to that figure—but even your $250 billion expenditure limitation would leave a deficit over the full employment $25 billion deficit of about another $5 or $6 billion; would it not? In other words, it would be about $30 or $31 billion.

Mr. STEIN. The full-employment deficit that we showed in the midyear budget review for fiscal 1973 was $3 billion. That was based on a $250 billion budget outlay. We are saying that we would like a budget ceiling of $250 billion, an expenditure ceiling of $250 billion. We accepted a $3 billion deficit for fiscal 1973, partly on the ground that most of that $3 billion was accounted for by the retroactive revenue-sharing payment.

Representative REUSS. Let's see what you have got in there. Did you get coal miner benefits?

Mr. STEIN. Yes, coal miner benefits. We submitted a budget of $246.3 billion. And the midyear review was $250 billion. The coal miner benefits account for $1 billion of that difference.

Representative REUSS. If you get expenditure of $250 billion and revenue estimates of $219.9 billion, that is a budget deficit of $30 billion plus.

Mr. STEIN. I don't accept the Goldman-Sachs-Rowen revenue estimates.

Representative REUSS. You are certainly entitled not to. But how does the budget according to Weinberger differ, not according to Goldman-Sachs?

Mr. STEIN. It is smaller. The estimates that were in the Sunday paper reduced the expected corporate recovery tax receipts by $2 billion for fiscal year 1973. And we see no reason to do that. Otherwise, the figures that are presented in that column are a good statement of the problem. We don't disagree with the problem. We agree that there is a danger that if we don't control some of these things, stop some of these things, there can be a larger deficit.

Some of the things that get that deficit in the tabulation are HEW appropriations well over what the President asked for, water control program expenditures well over what he asked for, and so on.

Obviously if the Congress is going to enact expenditure programs much bigger than the President asked for, we are going to have a bigger deficit.

Representative REUSS. The President himself is asking for much bigger expenditures than he first asked for, such as Vietnam, bigger by several billion: is that not so?

Mr. STEIN. Well, the exact amount of that, of course, is dependent upon developments. But the administration, as I have said many times, despite the need to increase in certain categories, is prepared to live within a $250 billion expenditure ceiling, and would like the Congress to join it.

Representative REUSS. Passing from there, in an effort to reduce the deficit, or at least to reduce or eliminate the deficit that was greater than the full employment deficit that you started with, I brought to vote in the House a couple of weeks ago a procedural measure which, if successful, would have raised $5 to $6 billion by giving House Members an opportunity to vote on two tax matters:

(1) Repealing the asset depreciation range system rapid depreciation; and

(2) Increasing the minimum income tax from 10 to 20 percent.

The administration opposed that proposal of mine, and as a result, it was defeated 203 to 180. Wasn't that a mistake? Wouldn't it have been fiscally responsible to attempt to reduce the deficit at this time? And as a practical matter, wasn't a modest exercise in loophole plugging of the kind I mention something that at least should have been brought to a vote in the House?

Mr. STEIN. You can go down this list and pick up any $5 billion on either side of the budget and say, won't it be a mistake not to have done that. Of course, the problem is not only to bring the budget into balance, but to bring it into balance in a way which is consistent with a great variety of other objectives. If we didn't have other objectives, we wouldn't have a problem.

Now, the ADR, of course, was just adopted and approved by the Congress last year. And we believe it is contributing to the revival of the economy which we are having.

About the minimum tax, I can't say anything further than that we have indicated our desire to look at the tax reform problem as a whole, and to make recommendations about it before the year is out.

Representative REUSS. On another budgetary matter, more than 60 Members of the House are cosponsoring a jobs now public service employment bill which would immediately create 500,000 jobs in the public service sector at the State and local level in order to combat the 5 million unemployed problem that Senator Proxmire talked about.

It would, however, cost on the order of $3 to $4 billion a year if such a bill is enacted.

Would you recommend that it be signed or vetoed?

Mr. STEIN. I don't think it would be wise for me to answer that now. That is something which, when the President asks me, I will tell him.

Representative REUSS. A question of international matters?

Mr. STEIN. Well, I would like to share the glory.

Representative REUSS. Or Mr. Solomon, for that matter.

In the prepared statement you refer to the Soviet Union's agreement to purchase $750 million of U.S. grain over the next 3 years. Under what credit terms is that grain being purchased? Is it a commercial transaction, or is there an Eximbank participation? And particularly what is known about the interest rate on the credit extension?

Mrs. WHITMAN. I believe, Mr. Congressman, it is a commercial transaction. The question of Eximbank credit and the Soviet Union is one of a number of issues that are currently being discussed by Secretary Peterson in Moscow. But at the moment the extension of Ex-Im credit to the Soviet Union is not permitted.

Representative REUSS. So, as far as you know this is a normal commercial transaction with an interest rate comparable to other foreign extensions of credit, which I gather is in the 6, 7, or 8 percent range?

Mrs. WHITMAN. That is correct, something over 6 percent.

Representative REUSS. Another question, Mrs. Whitman. In the prepared statement it is set forth:

> Suspension of convertability was to provide the freedom to expand rapidly and the basis for a realignment of exchange rates and readjustment of trade policies which in turn would help to convert a growing imbalance between exports and imports into a balanced position.

What do you mean by a balanced position? Is it equality between imports and exports or a trade surplus? And if so, of what size? What is your goal, to have the balance sound like even stephen?

Mrs. WHITMAN. Perhaps equilibrium would be a better word.

Certainly it is our feeling that the United States will, in the years ahead, need a fairly substantial current account surplus in order to support our various commitments on capital account.

The best we can tell is that, in order to get a current account surplus of adequate magnitude, we will need also a substantial trade surplus. Just precisely what the size needs to be, of course, depends on the other items in the account. You could think of a number of ways in which the current account could reach the kind of magnitude we assume that it would need. But you cannot set a single number for a trade surplus, since you have to consider also other things like amount of investment and so forth.

The answer to your question is, we would envisage a need for a trade surplus in order to get into an equilibrium position.

Representative REUSS. You are currently running a trade deficit on the order of $3 billion a year; is that not so?

Mrs. WHITMAN. At an annual rate, somewhat more.

Representative REUSS. At an annual rate of about $3 billion. And I have the impression that the Treasury at least envisages, in order to make our total accounts somewhere close to a balance, a trade surplus on the order of about $6 billion a year.

Does that sound like what you have heard?

Mrs. WHITMAN. That was certainly the working hypothesis at the time of the realinement. As I say, if certain other items in the current account were to come out somewhat more favorable, then it would be a little less, and vice versa.

But it is clear that we need a substantial trade surplus. As we said in our prepared statement, we have some hopeful indications that we may be seeing a turnaround in the trade balance now. You can't be sure because it is too soon. Obviously we have a good way to go. We do foresee an improvement in the trade account, and we do look forward to an improvement in the trade accounts over the remainder of this year. But we certainly will have a substantial distance to go beyond that.

What has happened so far is that we think there has been a turnaround in real terms, but the perverse price effect that you get from a devaluation has not yet permitted it to show up in nominal or money terms. But as I say, again, it is only the most recent evidence which indicates improvement in real terms, and we won't be sure for a number of months more.

Representative REUSS. Thank you very much.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Mr. Stein, I am sure that whether you claim credit or not for the statistics which have been coming out lately, they make your appearance here a good more comfortable than it might have been in previous years. We have had a splendid spate of economic news over the last few months. I congratulate you on these results. They look great.

Let me ask you, in the second quarter the real GNP rate apparently is rising at 8.9 percent?

Mr. STEIN. Correct.

Representative CONABLE. Is it realistic to expect such a growth rate, starting with the base we have in this country, over a protracted period?

Or are we just beginning to catch up from a long period of sluggish growth, and do we expect to continue what is a pretty cyclical pattern?

Mr. STEIN. Well, we think that the long-run potential rate of growth of the economy is 4.3 percent. That is a very hard thing to say, but it is in that neighborhood. So, the rate we had in the second quarter is twice the long-run rate of growth. Obviously you cannot go on doing that. But we started, as everybody knows, from a situation in which we are significantly below our potential.

In the whole postwar period there have been only 10 quarters, before this one, when the GNP gain was as high as in the second quarter of 1972. There have been only two cases when the gain was that high for two or more quarters in a row. And we are not predicting that we will go on that rapidly.

What we are expecting is that we will go on at a rate higher than the normal 4.3 percent, so that we will continuously reduce the gap below potential until we reach potential, and then move smoothly along with the potential.

Representative CONABLE. I notice you said little in the prepared statement about monetary policy, possibly from restraint based on the knowledge that Mr. Burns will be here Wednesday. I don't think this Mr. Burns will hesitate to talk about fiscal policy. I wonder if you would care to comment about the impact of monetary policy this year. Have you felt that monetary and fiscal policy were working in phase pretty well at this stage, and that that is part of the reason that we have had such splendid statistics.

Mr. STEIN. We think that the policies have been quite compatible, not only fiscal and monetary policies, but the behavior of the private economy. All three of them are working in a way which has achieved the best of trends. We have had a fairly moderate rate of growth in the money supply. We have not had the very large increase that we got in the first half of 1971, and the very tiny increase that we we got in the second half of 1971, but we have had something in between. The long-term interest rates have been fairly stable. And we have had a moderate rise of short-term interest rates such as one might expect in any period of vigorous recovery. On the whole the policy and its result have been compatible with our objectives and those of the Federal Reserve.

Representative CONABLE. Mr. Stein, no responsible committee of the Congress investigated to any extent the impact of the recent social security benefit increase. The President signed that bill. The Government was pretty much held hostage to it, as a matter of fact, because of its amendment to the debt ceiling extension. I wonder if you would care to comment on the fiscal impact of that particular bill, and also on the impact on the economy generally. It is well known that social security benefit increases have an extensive echo effect in the economy, because, of course, people receiving them have very little incentive to save, at their age, and because they generally are a more dependable element in the population.

What comments would you care to make about the economic effects of this increase generally?

Mr. Stein. Well, this action has to be looked at alongside what else was going on in the economy, and in the budget.

Of course, the President, as anybody else, would have been happy to have increased social security benefits by 20 percent if that were the end of the matter. But we believe that piled on top of a budget which was precariously balanced at full employment, and in a situation where the economy was expanding at a very rapid rate and we already foresaw a rapid further rate of expansion, this created an inflationary danger which would extract from the rest of the population, including a lot of elderly people, the benefits which are given to some through the increase.

We are also concerned, I may say, about the continuous process of raising the social security tax rate, the contribution rates, which we have been through.

Now, in this case the rates were not to be immediately raised to a level which would balance out the benefit increases, but still the act did provide for increases in the rate in 1973 and the base in 1973 and 1974. I believe. This was a very inappropriate thing to do when we are fighting both inflation and unemployment, because it adds to the cost of doing business, and it adds to the costs which a business has to think about in determining its prices, and it adds to the cost which the Price Commission has to think about in setting a price ceiling.

Also, by raising the cost of labor it interfers with employment. So we would have been, as the President said, happier to have gone about this more slowly.

Representative Conable. The villain with the black mustache in all these delays between changes in policy and the impact on the economy generally has generally been described as lack of consumer confidence. We have had a turnaround recently in real wages. To what extent do you think that will encourage consumers to accept new obligations? With real wages actually falling, most consumers were reluctant to accept new fixed obligations until recently when the turnaround occurred.

I can see that they would have been very cautious about taking on new obligations. Do you foresee a continuing rise in consumer confidence generally? And to what extent do you attribute this to increases in real wages?

Mr. Stein. I would expect a rising consumer confidence.

We have various measures of this which, taken all in all, would indicate that we have it. I suppose the best evidence, at least evidence from which the lack of consumer confidence was formerly deduced, was a rather high rate of consumer savings.

Well, we have had a considerable reduction in the rate of consumer savings in the first and second quarters. That is, consumers are spending a larger proportion of their aftertax income than they formerly did. To what extent that is due to the rather peculiar circumstance, and to what extent it is due to higher consumer confidence, we can't tell. But certainly the combination of increases in real wages at an extraordinarily rapid rate, and the reduction of unemployment, and something on which attention is not sufficiently placed, the very substantial reduction in layoffs—because it is the layoffs which threaten people and make them cautious, and we have had a very great reduction in the rate of layoffs from employment—all are contributing to strengthening consumer confidence.

This is one of the reasons why we expect the expansion to go on during the year.

Representative CONABLE. You haven't mentioned inventories. What is happening there at this point?

Mr. STEIN. Well, I must say that all the inventory figures have just been revised backward, and history needs to be reappraised somewhat.

But during 1971 we had a very sluggish increase in inventories. It now appears to have been somewhat larger than was first thought. But we have now in the second quarter got the first substantial increase in inventories of this recovery. And as you know, in almost every recovery it is the snapback of inventories that gives the greatest momentum to the revival of the economy, and we are beginning to get that.

Representative CONABLE. In the prepared statement, you describe the shortrun objectives as follows:

> To stimulate a much more rapid expansion of demand, at the same time to make sure that that expansion led to increases in real output and employment rather than to increases in prices.

Isn't it true that these objectives have been met for the most part? And if so, what conclusions would you draw about the probable duration of wage and price controls at his point? Wage and price controls are short run also, inevitably.

Mr. STEIN. Yes. We would certainly like to observe the experience for sometime longer before we declare that they achieved their objectives, and can be dismantled.

In answer to a question like that the other day, I said that whatever the probable terminal date of the controls was before we got these price figures, the probable date was brought a little closer. But I didn't know what the probable terminal date had been before. I think one thing we have always said is that we want to get the inflationary expectations out of the system. It is not sufficient that we have a few months with relatively low inflation, because of the psychological timelag. Expectations of inflation persist as if nothing had happened to the rate of inflation. It takes a while for this fact to become part of people's thinking, and that would be influential in determining when the controls can end.

There is one point I would like to make about the behavior of prices in June which I think is very significant. And that is that there is considerable evidence of market forces working to hold down the rate of inflation, not just the ceilings pressing on prices.

We had, in the case of food, large discounts, or at least price restraints, resulting from active competition among numerous food chains.

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And we had in June, also, intentionally large apparel sales which were not forced by sales, I mean not the volume of sales, but price cuts—and the price of apparel came down in June.

So we are encouraged by the evidence that the market, and that which influences it, as working against inflation.

Representative CONABLE. My time is up.

Chairman PROXMIRE. Mr. Stein, earlier you said in response to Senator Javits that you weren't in charge of politics. And then, in response to Congressman Reuss, you said you don't campaign for anybody. I am glad you express that view, because it seems to contradict some of the speeches you have been making around the country. And I am concerned about that.

And I say this in a completely serious and sober vein. We have a long, long history of the Chairmen of the Council of Economic Advisers who have been nonpartisan and nonpolitical, and confined their remarks to an evaluation of economic proposals rather than political proposals. And this would certainly be true of people like Mr. Burns, your immediate predecessor Mr. McCracken, and of people like Walter Heller and Arthur Okun and Keyserling, and so forth, they have been very vigorous in supporting the economic views they believe in, but they certainly haven't made personal attacks on the opposition.

I don't recall Walter Heller or Gordon Ackley attacking Barry Goldwater in 1964. But you have seemed to depart from that, and I wonder if it wouldn't have an effect on the effectiveness of the Council of Economic Advisers and your effectiveness as Chairman.

In fact, one columnist says you are becoming "an expert political pamphleteer ready at a moment's notice to act as a one-man truth squad to expose Nixon's political opponents."

On June 17 in a speech to the Virginia Bankers Association, you spoke of the "ferocious desire of middle-aged—and one might also say middle-class and Middle-Western—men to don the guise of new men and appeal to youth, and to the rest of the country which now idolizes the idea of youth." You went on to argue that such men are deliberately trying to divide the country for their own political benefit by raising such "divisive" issues as welfare, tax reform, and income redistribution.

This was widely regarded as a direct attack on Senator McGovern, at that time one of the leading candidates for the Presidency.

Earlier in the year at the Press Club, you are reported to have attacked Senator Muskie, at a time when a columnist says he still had some customers on his bandwagon. You mimicked and ridiculed the Maine Senator, and suggested that the economy couldn't be an issue in the campaign because Nixon had everything nicely under control.

The reason I say this is because your office has served the country well, and past administrations well, to have the Chairman of the Council avoid political personal attacks. And I wonder what you think it does to the reputation of the Council of Economic Advisers to have its Chairman participate in this kind of political attack on a presidential candidate. After a speech such as yours, can we have the same kind of trust and reliability in your views on tax reform, and on your views on other elements of the economic situation, which are so important?

I just wonder if Spiro Agnew needs all that help.

Mr. STEIN. Well, I think you have a great deal of evidence about the credibility of my views on taxation, on the economy, and a great many other matters. And I don't think that your judgment on that subject should be swayed by the fact that I may have mentioned one or another well-known national figure in some speech that I made. I think I have conformed to the description you made of a legitimate function of analyzing economic issues before the country. And I don't know in the first place whether you read my two speeches or not——

Chairman PROXMIRE. Yes, I have; I have them both right here.

Mr. STEIN. We have been the subject of this controversy. I think that in each of them I was analyzing issues which are very much in the public eye and very important in thinking about what the economic policy of this country should be.

Now, I will, I suppose, confess to the fact that my language is sometimes more colorful than that used by many of my predecessors.

Chairman PROXMIRE. I think that is an advantage in a way. And I think that is one of the great temptations; you are witty, you are literate, you are very good at this type of thing. I suppose Harold Ickes is best remembered not as the Secretary of the Interior, but as the fellow who called one of Roosevelt's opponents as a man with halitosis of the intellect, and who also charged that when Tom Dewey announced his candidacy in 1940 at the age of 38, "I see that Tom Dewey has tossed his diapers into the presidential ring."

But I just wonder if, having this remarkable and unusual knack of wit, you should use it in view of your present position. Maybe you just ought to write speeches for the vice president.

Mr. STEIN. That reminds me of one thing I do want to say which was either said or implied in the column from which you quoted.

It was said that the White House sent Herb Stein out to do a hatchet job on somebody. The fact is that the White House would never send me to say anything, has never suggested any subject on which I am to speak, and never suggested what I would say on anything. And I would be greatly disappointed if anybody thought that what I said was written by somebody else.

Chairman PROXMIRE. I am sure that it wasn't written by someone else; you alone have this remarkable and unique ability.

Mr. STEIN. I want to make one thing perfectly clear, that these speeches were not part of a program coming from the political people of the White House. I felt that the course of public discussion of these matters on these two occasions was in need of a certain clarification, and not seeing anybody else coming forward to do it, I undertook to do it.

But I do accept the point which you and others make about the language, and the fact that the Wall Street Journal, of all people, lectured me about acting as if economics is all fun and games. And I will try to be more sober in the future.

Chairman PROXMIRE. I don't want you to be more sober, just less partisan.

Representative CONABLE. Fortunately, if you have become too partisan, Mr. Stein, this committee retains its fine nonpartisanship. I would like to call your attention to the fact that the three outside economists who are going to come in and advise us objectively, without partisanship, are John Kenneth Galbraith, Walter Heller, and Paul Samuelson, scheduled later this week.

Chairman PROXMIRE. I might also point out that virtually every other witness is directly from the administration. I know, Mr. Stein, that you aren't one of the radical fringe. I know that Caspar Weinberger is not. I know that Arthur Burns is not. I know that Mr. Shultz is not. And I will ask Mr. Conable or any other Republican who wants to match the appearances before this committee, either last January or last February, or this month, of Republicans and Democrats, and the Republicans come out way ahead.

Let me ask you, defense spending increased in the first quarter of calendar 1972 at an annual rate of $4.5 billion. This increase put defense outlays higher than at any time since early 1970 and the rise in expenditures since mid-1971 is the fastest since the Vietnam buildup in 1966. Production of defense and space hardware has increased at an annual rate of 10 percent since January. The national income accounts project a rise in defense purchases of $3.5 billion for fiscal 1973. Isn't this new defense building creating the budget deficit for fiscal 1973 which will be much larger than was forecast? If the economy is headed for a new round of inflation and higher interest rates, isn't defense spending a major cause?

Mr. STEIN. With respect to the increases that have recently occurred, it is true that we have been going through a period in which rising costs, in the sense of rising prices, and rising pay of the Armed Forces, were being effectively offset in terms of the dollar volumes of expenditure by other reductions, particularly in the expenditures for Vietnam. But the expenditures for Vietnam have now reached a very low level, and the defense budget is exposed to the force of the rising pay and prices.

In addition, there is some increase in real defense outlays underway. But it is by no means a dominant factor in the increase in the budget in fiscal 1972 or fiscal 1973, or is it projected to be. Certainly it is part of the total picture.

Chairman PROXMIRE. Manufacturers Hanover Trust—and they may not be accurate—in their Financial Digest of June 9, 1972, estimates that on top of the defense spurt just mentioned, the recent expansion of the war in Vietnam is adding $1 billion to $2 billion monthly to defense costs. This would mean a $12 to $24 billion increase over a year's time. Do you deny that the war could be costing as much as Manufacturers Hanover Trust estimates? If you dispute their figures, can you tell us if you have made an independent estimate of your own?

Mr. STEIN. The increased cost of Vietnam?

Chairman PROXMIRE. The Vietnam war, in view of the stepup in bombing.

Mr. STEIN. I would rely on Secretary Laird's estimates. He estimated, as I recall, that the increased cost would be a billion and a half dollars if the accelerated rate of activity continue until the end of September, and there will be possibly another billion and a half dollars if it continues through the end of December.

Now, I don't know where Manufacturers Bank of Hanover got its figures. I see no reason to doubt Secretary Laird's estimates.

Chairman PROXMIRE. Isn't the inflationary impact of military spending of this kind just as inflationary, just as upsetting, as far as the budget is concerned as any kind of social spending for human programs?

Mr. STEIN. I would say that the inflationary impact of military spending is about the same dollar for dollar or billion for billion as other Government purchases.

Chairman PROXMIRE. Can you name any social program which has had this kind of increase without a corresponding increase as the social security has for revenues to counteract it? In other words, this would greatly outweigh the increased cost of any other individual social program, would it not?

Mr. STEIN. You mean increase above the budget; is that your question?

Chairman PROXMIRE. That is right.

Mr. STEIN. Well, at the moment I don't know how much this total is going to amount to. But the net budget effect of the social security amendments which were tacked onto the increase in the debt limit was a $3.7 billion change, taking the increased benefits and the deferrals of the effective date of the increase in the base.

Chairman PROXMIRE. That is less than what I understand Secretary Laird indicated that the increased cost of the Vietnam war was going to be. I understood him to say before this committee that it would be substantially higher than that.

Mr. STEIN. Substantially more than $3.7 billion?

Chairman PROXMIRE. Yes.

Mr. STEIN. My understanding was that he said it would be $1.5 billion if it continued at the accelerated rate until the end of September, and another billion and a half if it continued until the end of December.

Chairman PROXMIRE. And then he went on and said that he didn't see any end in sight and it would go on to the rest of the fiscal year?

Mr. STEIN. We have not asked for money for that.

Chairman PROXMIRE. "The President has said that the administration would propose"—I am quoting now a statement you made in your prepared statement that I think was quite surprising to me, maybe it is something that had been said before but I missed.

I understand, the staff tells me that this is what the President said in a press conference, the President said that the administration would propose a program of tax reform before the year is out. You say, one of the objectives we seek in developing such a program is to increase the equity of the tax system. Then you go on to point out that we shouldn't be too sanguine about how much this will raise. The President said before the year is out.

Does this mean that the President will propose to this Congress a tax reform proposal that he expects action on this year, or would that be for next year?

Mr. STEIN. That would be for action next year. We expect Congress to go home.

Chairman PROXMIRE. Would the proposal then be after Congress has adjourned?

Mr. STEIN. All the President has said is that it would be before the year is out. I can't give you any other date.

Chairman PROXMIRE. How much, if any——

Mr. STEIN. But I guess we can be clearer than that. I am sure he did not expect his proposal to be the subject of action this year.

Chairman PROXMIRE. Do you anticipate that the administration might generate such a proposal that would raise revenues significantly, say, by more than $2 or $3 billion, or would it be primarily a way of preventing tax avoidance than securing greater tax revenue?

Mr. STEIN. At the moment, no possibility is ruled out. I can't answer that question.

Chairman PROXMIRE. The reason I am asking this is that it was puzzling. Earlier former Secretary of the Treasury Connally indicated that tax reform was not likely to be productive, and the administration was unlikely to propose a tax reform. It would be very interesting to know what the President had in mind by this kind of thing.

Mr. STEIN. I don't remember that Secretary Connally said that.

Chairman PROXMIRE. At any rate, before I yield to Congressman Conable, let me just call your attention once again to the line of questioning I started off with. Mr. Okun indicated that we may be overlooking the greatest source of revenue in not doing everything we can to get the economy back to 4 percent employment. He said, any extra tax bite would be trivial, the variation in taxes are nickels and dimes, referring to a tax reform proposal, or even a tax increase, compared to the billions involved in good economic performance versus poor economic performance.

So, that all the effort should be, it would seem on the basis of Mr. Okun's view, concerned with producing a deficit, getting unemployment as quickly as possible as close as possible to 4 percent or lower unemployment.

Mr. STEIN. "As possible" is the critical phrase there. We are committed to as rapid an expansion of the economy and reduction of unemployment as we think is consistent with the other objectives that we and the country share.

But I do want to say something in the light of history. This kind of talk that the best way to get more revenue is to pump up the economy has turned out to be a great danger. We went through this in 1963–64, and we pumped up the economy, and we have had the problem from which we have been suffering for the last 5 years.

Chairman PROXMIRE. That was the Vietnam war, that wasn't pumping up the economy so much.

Mr. STEIN. Well, there was as big an increase of nondefense spending as of defense spending during the period of the Vietnam war. And there was a very slow reaction on the tax side. The country bought the pumping-the-economy argument wholeheartedly. It has a certain value, but we have to recognize that there is a limit.

Chairman PROXMIRE. Mr. Conable.

Representative CONABLE. Mr. Stein, these good economic statistics that we have been talking about today inevitably are going to affect tax revenue, aren't they? The combination of graduated income tax and the increasing economic activity usually results in an unexpected fiscal dividend. Some years it has been as high as $15 billion.

Do you see any reason, on the basis of the second quarter figures, to revise upward projections of Government income, or have they been largely offset by the various tax relief proposals which have been passed in the last couple of years?

Mr. STEIN. We will have to go over that. We just have had the new figures a few days, and we have to recognize that we have not only the new figures, but revisions of the last year. We know how much tax we got last year, but apparently the GNP was about $3 billion higher than we thought it was last year, so that the relation of revenues to GNP and income may be somewhat different than we previously estimated.

But we will be going through this process to see what light the new figures throw on the revenue possibilities.

Representative CONABLE. One last question.

We seem to be operating in a kind of trade vacuum nowadays. The President is going around and talking with Russia and China and we have dramatic international initiatives of one sort and another. But as far as the basic trade picture is concerned, the Congress, and those advocates of liberal trade here in Congress, are afraid to offer any initiatives for fear the protectionist tide will give the whole move a twist, and enact some portions of the Hartke-Burke bill, or some similar measure that would reflect our economic nationalism in some unfavorable way to world trade.

Are there any studies being made at this point as to whether or not some trade initiatives are likely to be possible if the economic picture continues to improve?

You indicate in the prepared statement that there has been some turnaround in the trade picture, presumably in part at least as a result of the currency realinements. I think you would agree with everyone else in the economic field that currency alinements by themselves are desirable, but that additional measures may be needed also. Do you have any comments about where we are headed. Are we going to continue indefinitely in the vacuum we seem to be in right now?

Mrs. WHITMAN. I trust not.

You are quite right, of course, that the currency realinement is just one step, a very important step, but nonetheless only one step in what we hope will happen in the readjustment of international trading and monetary relationships in general. It is expected that the major countries in the world will begin comprehensive trade negotiations sometime in 1973. And, of course, in order to get very far in serious negotiations, the President will need new authority. And there also are a number of other pieces of trade legislation hanging fire.

Yes, indeed, there is serious work being done on preparations for negotiations, and on the preliminary work that is necessary for a legislative program. I think the feeling right now is that we are not yet ready to present a legislative program, partly because of the intensive study and examination that is going on of various developments—the enlargement of the Common Market, the relationship between the trade side and the monetary side—and partly, quite frankly, because of the need for intensive discussions and consultatons, not only with other countries, but also with Members of the Congress, in order to establish an atmosphere of understanding and to share information before there would be an opportunity to get positive legislation and have it passed.

Representative CONABLE. I am sure you are familiar with the reasons for the dramatic fall off in the index of Japanese export prices this year. They appear to have fallen off very substantially despite currency realinements.

Mrs. WHITMAN. In their own currency?

Representative CONABLE. Yes.

Mrs. WHITMAN. This implies that they have reduced prices to partly offset the effects of the realinement, which is what one would expect.

Representative CONABLE. That would bear up your statement that something is going to be necessary in the trade field, following the currency realinement. By itself it is not the whole answer.

Mrs. WHITMAN. That is quite true. The currency realinement will be much more effective if it is accompanied by trade liberalization and increased access to foreign markets, such as the Japanese market, where access at the moment is still considerably restricted. They have taken certain liberalization measures. I think we have to recognize that these are honest attempts along the lines of liberalization. Much more needs to be done there.

Chairman PROXMIRE. I would like to ask you, Mr. Stein, and Mr. Solomon, and especially Mrs. Whitman, about the future of wage-price controls. I know you are not prepared to say precisely when the wage-price controls will be lifted, but I would like to get a few clues as to your thinking and philosophy in this respect.

Next year is going to be a much heavier year for collective bargaining than this year. I understand that contracts in industries such as electrical manufacturing, rubber, autos, trucking, railroads, agricultural implements, and so forth, all will be on the line. The auto pattern is likely to set the pace for steel, too, in the coming year. So, the coming year is very, very important. Under those circumstances do you see any prospect at all that when these wages and price laws expire on April 30, that they will not have to be renewed, or is it certain that they will have to be renewed?

Can you tell us about that?

Mrs. WHITMAN. I am afraid we can only repeat that we have said quite consistently, that we do not yet feel that we know what will be an appropriate time for the end of these controls. And obviously the question of whether the legislation has to be renewed or not depends on the prior question of when the time will come when it makes sense to get rid of the wage-price control program.

Chairman PROXMIRE. Can you respond to that particular point, that next year we have an especially heavy round of labor contracts up for negotiation, and if you repeal the wage and price law on April 30, that there would be apparently no basis for legal restraint.

Mrs. WHITMAN. Clearly this will be a factor which will have to be taken very seriously into consideration in considering the end of controls. I think it is worth pointing out that the atmosphere in which these negotiations take place is also going to be important. If, indeed, we have by then succeeded in squeezing inflationary expectations out of the economy, and if we have succeeded in having a fairly stable pattern of low inflation rates in the context of continuing expansion this will set a very different background for the wage negotiations than if it is not true.

Chairman PROXMIRE. Do you think it is possible, in spite of the fact that next year you are going to negotiate contracts coming up for negotiation, it will still be possible to simply let the wage-price law expire on April 30? It may be possible, I am not saying that you are asking for or predicting it, but that is a real possibility?

Mrs. WHITMAN. I guess at this point all things are possible, but that still does not alter our very strong feeling that we do not yet know when the time will come for the end of these controls.

Chairman PROXMIRE. Is there an alternative, is there a way that you can get at this without having the law specify as it does not that you can hold down wage increases due to five and a half percent? And I understand that the Wage Board is interested in reducing it below 5.5 percent, perhaps to 4.5 percent. Is there another alternative, such as the voluntary guidelines that we had in the early 1960's; is that in your view feasible?

Mrs. WHITMAN. Of course the law does not specify the 5.5 percent.

Chairman PROXMIRE. I know it does not. I notice that Business Week suggested that it is likely to go below that next year.

Mrs. WHITMAN. That was the standard set by the Pay Board when they set up their original working standards.

Of course, there are always alternatives. It is my impression that the past experience with the voluntary guidelines did not suggest that they were a very strong reed to lean on.

Chairman PROXMIRE. And, Mr. Stein, you have said this morning that you think that we have had great success with coping with inflation with the phase II operation. Under these circumstances would you feel that it would be wise to permit the wage and price controls to expire, or do you feel it is too early to say?

Mr. STEIN. I feel it is too early to say. In our prepared statement we did point out that the success we have had was due in part to some especially favorable circumstances, the duration of which one cannot be sure. But I think with respect to your point about guidelines, our present attitude is not to rule out any of these possibilities, even though we were, I was, very negative about guidelines before August 15. That was in the context of certain history, and we will have to look at that against the background of history we will then have. I don't mean to say that is what we are going to do, but I do intend to express an attitude of openmindedness about the question.

Chairman PROXMIRE. What plans are being made for a public policy to guide collective bargaining decisions next year? Can you tell us of any? I have read, for example, in the press that the Pay Board is considering more stringent guidelines than we had last year—that we have at the present time, I should say.

Mr. STEIN. Well, the administration, the Cost of Living Council, do not set the standards of the Pay Board. I would think that sometime when they have come to what they think—when they are on the verge of some conclusion—I expect they will discuss it with us. But up to this point they have not made any approaches to the Cost of Living Council on this subject, nor do they have to, however intensively they may be thinking about it.

Chairman PROXMIRE. Another thing I have heard is that there is a certain amount of conflict between the Price Commission on the one hand and the Cost of Living Council. The Price Commission wants to crack down, and the Cost of Living Council is concerned about the strict controls on profit and on busines recovery. What is your thinking as to the degree of profit controls compatible with recovery, and would you favor, for example, that change in the Price Commission rules that forbids the profit markup to allow cost pass through?

Mr. STEIN. First, let me say that there is no conflict between the Price Commission and the Cost of Living Council on this matter. This whole area has been one of continued examination by both of us. All kinds of possible attitudes get reported in the press which I think are not authentic reflections of what another body is thinking. However, as we say in the longer paper which we submitted, the present standards have been consistent, obviously, with a very rapid rate of economic expansion and with a high rate of investment.

And from that standpoint I would see no need to change them. I gues my general attitude is that I think the present standards are laudable ones, and I see no necessity for a radical switch. The Price Commission and the Cost of Living Council from time to time in specific cases have made changes where something seemed to be an urgent problem. I cannot speak for them, but I think their present standards are quite reasonable.

Chairman PROXMIRE. You say you see no reason for a radical switch. How about a more moderate, gradual, decontrol? You have a long association, I understand, with the Committee for Economic Development, in fact you were the moving force in that committee for many years. They just recommended that controls be abolished gradually by allowing industries which are not contributing to inflation to petition for decontrol. I would like to know what you think of that proposal. And also they have recommended stand-by legislative controls at all times. I would like to know what you think of that, so that it could be put into effect by the President whenever he feels that it would be appropriate.

Mr. STEIN. I really haven't studied the report. I have only skimmed over it. It has always been my thought that a very likely pattern would be selective decontrols, that it would not all fall apart one day like the one horse shay, but we would decide that there are certain sectors in which it might not be needed. I mean this is one possible pattern for decontrols. Of course, the difficult problem with the sentence you read is "industries which are not contributing to inflation." There is a kind of common view that industries whose prices are not rising are not contributing to inflation.

That is not a sufficient test. If we are going to have——

Chairman PROXMIRE. I agree wholeheartedly with that. It is a matter of the competitive situation in the industry. You may have falling costs, and they maintain rather than reduce their prices because they have a monopolistic control.

Mr. STEIN. Right. And with respect to the idea of standby legislation, I think that certainly is a point to be taken very seriously. That is all I would say about it.

Chairman PROXMIRE. Let me just sum up by asking you this. In general CED and other business groups seem quite resigned to some degree of Government interference. And I have noticed in talking with leading business people in Milwaukee and other cities outside of my State, too, that they aren't too anxious to have controls lifted, in fact, they think it would be a mistake, the ones I have talked to, to have them lifted now.

On the other hand, labor is very concerned about it. I am just wondering if this indicates that the controls are biting much harder on wages, less hard than they should on prices and profits.

Mr. Stein. I don't think that is true. And I don't think that explains the feeling. As we indicate in our prepared statement, wages have risen more rapidly than prices, and real wages have risen more rapidly during the control system than they have over long periods of time. There is a very interesting table in which we show that the ratio of the increase in profit to the increase in GNP in this expansion is substantially less than in any previous postwar expansion.

So, I don't think the system is operating to the benefit of profits. And I think there may be other sociological reasons why labor leaders would be more opposed to the controls than businessmen, one being that if the labor leader can't bargain there is not much for him to do, whereas the businessman does have other things to do.

I guess that is all I would say on the subject.

Chairman Proxmire. Mr. Stein and colleagues, I want to thank you very, very much. You have made a very interesting session.

And I hope that my remarks about our occasional partisanship doesn't prevent you from making sallies now and then. And I just hope that you attack Republicans as well as Democrats with equal fairness and impartiality.

The committee will stand in recess—incidentally, I want to call to Congressman Conable's attention the fact that the administration—the Republicans have 3 days, the Democrats have 1 day, the administration has six witnesses, and the Democrats have three witnesses. I am sure that the quality of the Democratic witnesses is quite high, but so is the quality we got this morning.

Representative Conable. Don't be so defensive, Mr. Chairman.

Chairman Proxmire. I was just answering you.

The committee stands in recess until tomorrow morning at 10 o'clock in this room.

(Whereupon, at 12:05 p.m., the committee was recessed, to reconvene at 10 a.m., Tuesday, July 25, 1972.)

THE 1972 MIDYEAR REVIEW OF THE ECONOMY

TUESDAY, JULY 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 1202, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Fulbright, Humphrey, and Javits; and Representative Reuss.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; John R. Karlik and Courtney 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.

Our witnesses today are Hon. George Shultz, Secretary of the Treasury, and Hon. Caspar Weinberger, Director of the Office of Management and Budget.

Yesterday, Mr. Herbert Stein, Chairman of the Council of Economic Advisers, presented the kind of lucid and erudite summary of economic conditions and prospects with which the Council of Economic Advisers so regulary and faithfully provides this committee. Quite properly and justifiably he chose to highlight some of the good economic news which we have had in the last few days, such as the hefty gain in real GNP in the second quarter and the moderation in the rate of inflation. These figures are indeeed good news. I have no intention of belittling their importance. For the sake of perspective, however, I have developed my own chronology of economic events since January 1969.

January 1969—Nixon Administration takes office. Unemployment is at 3.4 percent.

February 1970—Unemployment is at 4.2 percent. The President submits a balanced budget for fiscal 1971. The Council of Economic Advisers testifies before this committee that unemployment in 1970, will be in the zone of 4.3 percent.

July 1970—Unemployment hits 5 percent.

December 1970—Unemployment hits 6 percent.

January 1971—Unemployment is still at 6 percent. The President's budget message reveals that the "balanced" budget for fiscal 1971, is expected to have a deficit of $19 billion.

July 1971—Unemployment is still at 6 percent. It turns out that the fiscal 1971 deficit was actually $23 billion.

January 1972—Unemployment is still at 6 percent. The President's budget message announces that the budget deficit for 1972 is now expected to be $39 billion.

July 1972—The decline in the unemployment rate to only 5.7 percent in the second quarter is greeted with elation. The budget deficit for 1972 turns out to have been only $23 billion, thus showing the January estimate to have been only $16 billion in error. Rumors are planted that the fiscal 1973 budget deficit may reach $40 billion.

That, of course, is a highly selective chronology of the last 3½ years. It is a chronology which does not once mention inflation. Inflation has been with us throughout these 3½ years. We still have it. The GNP deflator improved in the second quarter, but recent increases in the wholesale price index strongly suggest that this improvement is largely temporary.

It was clear from Mr. Stein's remarks yesterday that this administration still regards inflation as its most serious problem. The administration has failed over the past 3½ years to develop a successful anti-inflationary policy. They have lost control of the 1973 budget. Now the administration is trying to identify Congress as the scapegoat for the continuation of an inflationary problem. Congress, they say wants to spend too much money. This is nonsense. It is not Congress which is responsible for the stepped-up cost of the Vietnam fighting, or for the higher overall level of defense spending requests. Defense is the biggest single item accounting for the probable increase of 1973 spending above the originally proposed budget. Defense spending is the most inflationary kind of spending. It creates demand but contributes nothing to the supply of civilian goods.

The Senate is right now debating on the floor a defense procurement bill which has already been cut some $2 billion below the President's spending request. There is no chance that cut will be restored on the floor. There is an excellent chance the spending cut may be deepened by several hundred millions.

Last night the Senate killed a foreign aid authorization for which the President requested more than $2 billion. You know, the fact is that for the last 25 years the Congress has cut Presidential requests for spending every year. Without exception, the Congress has year after year reduced the President's requests for spending below what he has asked. And that includes the spending requests of the Nixon administration. Every year we reduce those Nixon requests for spending. And every year from San Clemente or Key Biscayne or Camp David attacks will issue on the free-spending Congress. Now, it's true we don't reduce spending where the administration wants it reduced. But we do make an overall net cut. And every year—throughout the year, the administration blithely attacks the Congress for spending too much, and the press reports the President's complaints and the editorials attack the free-spending, wasteful Congress.

The attempt to set up a congressional scapegoat for inflation is not the most disturbing thing about recent administration statements. They try this trick every year. We are accustomed to it.

The disturbing thing about Mr. Stein's statement and other recent statements is the contrast between the repeated emphasis on inflation and the much more limited concern expressed over unemployment.

I, too, am concerned over inflation. I can suggest some powerful anti-inflationary actions that are presently being neglected. Removing oil import quotas would be one.

The one thing we should not do to fight inflation is to slow down the restoration of full employment. Mr. Stein referred yesterday to a quick return to very low unemployment as "the classical siren song which has lured many anti-inflationary efforts to disaster."

Economic policy ought not to be just an "anti-inflation" effort. It ought above all to be an antiunemployment effort. I was distressed that Mr. Stein could not suggest an unemployment target for 1973. Perhaps today's witnesses can be more forthcoming.

It seems to me that the answer to many of our problems is a four-letter word, and that four-letter word is "work." If we could put the country back to work, we could help so greatly and in so many areas. And the slowdown policies or even neutral economic policies, it seems to me, are just not enough.

Well, Mr. Shultz, having delivered myself of that sentiment this morning, it is a great pleasure to welcome you before this committee in your new capacity as Secretary of the Treasury.

And it is great to have the outstanding and able Director of the Office of Management and Budget, Mr. Weinberger.

I expect you are familiar with our 10-minute rule. Since we have two important witnesses today, we will have to keep track of the time.

Mr. Shultz, why don't you start off.

First, Senator Javits, the ranking minority member of the committee.

Senator Javits. I shall not make a statement. I know the new Secretary will make the most interesting one, as well as the Budget Director. I just wanted to welcome both gentlemen, both old friends, and to express my particular pleasure at the caliber of talent which is represented by the President's choices.

Chairman Proxmire. I thank Senator Javits, and I apologize for neglecting him.

This is the second time in a month Mr. Weinberger has been before us as Director of the Budget.

But this is the first time you have appeared in your new position, Secretary Shultz, though you have been before the committee many times in the past in your position of responsibility. And I congratulate you, it was an excellent selection. And I know you will do a fine job. Go right ahead.

STATEMENT OF HON. GEORGE P. SHULTZ, SECRETARY, DEPARTMENT OF THE TREASURY

Secretary Shultz. Mr. Chairman, I think in view of your 10-minute rule, which you mentioned, and in view of your very considerable opening, which according to my watch did not take 10 minutes, I will simply put my prepared statement in the record and make some comments on what you have said.

In the first place, I think the implication that this administration is not concerned about the problem of unemployment is totally misplaced. We have worried about that problem from the start; I have: the President has. And I think one of the most heartening aspects of the current economic situation is the very strong growth in employment, which has over the past year gone up by about 2.4 million—quite a sizable increase.

Now, I think there are a number of other indicators of the labor market that are also heartening for the future. The layoff rate in manufacturing is down to about 1.1 per hundred. That is the level of the very strong employment years of 1968–69. So, I think we have the situation now where the rate of layoff has reached an area that is on the whole probably about as low as it can be expected to go.

At the same time, the accession rate has been rising very rapidly, and is approaching the levels of boom years.

So, I think we are seeing the results of the expansion being reflected in the employment picture. And I think that is very good news, and it is something that we have been working for and wanting. And I personally think that the problem of maintaining low rates of unemployment is a very important one, and deserves our high priority, as the remarks in my prepared statement suggest.

Now, you left a few items out of your scenario that I would like to fill in for you.

You started back in 1969, and you have made quite a few comments about the Vietnam war, and the spending on the Vietnam war. You forgot to mention that when this administration came into office, there were 550,000 U.S. troops over in Vietnam, and that there has been a massive withdrawal of U.S. troops from Vietnam. You forgot to mention that in dealing with the whole structure of the Federal budget and the priorities as expressed by it, that this administration, through the winding down of the Vietnam war and its other policies, has reduced the number of people working on defense-related jobs, including the Armed Forces, the DOD, and private industry, on the order of 2 million. So, in the structure of employment as well as in the structure of the budget, there has been a massive rearrangement, while still providing, as we must provide, for a strong defense posture in this country.

You also didn't mention in your scenario that the budget on a full-employment basis had gotten totally out of hand in fiscal 1968, building up from 1966 and 1967. And I believe it is a widely shared view that this picture, this getting out of hand of the budget, was a key fact responsible for the rapidly escalating inflation which reached its peak in 1969, reflecting what had gone on earlier.

So the policies that had been followed earlier were responsible for the inflation that we inherited. I think it was widely recognized that something had to be done about it. And the 1969 budget did something about it.

I call your attention especially to that budget because I think it can fairly be said that it was a bipartisan budget. It was put together by President Johnson; it was administered in the last half more or less by President Nixon. And it represented a massive reversal in the budget picture that had developed over the 3 preceding years. The fallout from that and succeeding events has been a readjustment in the economy, inevitably.

At the same time, I think the record on inflation is a good one. From a 6.1 percent level in 1969, a level that we inherited from the previous administration, it has gone to 5.5 percent in 1970, to 3.8 percent in

1971 prior to the freeze, and to 2.7 percent since that time as measured by the Consumer Price Index.

So, I think there has been very real progress on that front, certainly in terms of budget policy and in terms of monetary policy and in terms of direct wage-price policy, as well as in other ways. The administration has tried very hard to work in a responsible fashion on the problem of inflation, and at the same time to express its concern about strong expansion in the economy by its willingness to accept large deficits in the Federal budget as a means of expanding the economy.

These large deficits have taken place, however, within the framework of the discipline—or at least we would like to think it is a discipline—of the full-employment balance. That is, we have kept expenditures within the range of full-employment revenues, so that as the economy expands, as it moves back toward full employment, we don't find the budget out of control, and we don't find ourselves returning to the error that we saw in 1966, 1967, and 1968.

That, I think, is where we stand today. We are now in fiscal year 1973. And I believe that we must struggle hard, together, to maintain a responsible budget posture this year and next year, so that we can consolidate the gains that have been made with considerable pain and agony over the past 3 years.

In the comments on spending, I think one of the problems which Mr. Weinberger can develop, I am sure, is that it isn't only the appropriations process that is involved in spending, but the flow of spending that results from contract authority completely outside the appropriations process.

More and more of the total budget lies outside the appropriations process. So, that when a law is passed that mandates spending or gives people rights to certain benefits, that creates spending, just as surely as if it were appropriated.

So, concentration on the appropriations process itself, important as that is, does not give you the full story.

I might just make one comment on the expansion, taken from my testimony, something that hasn't been noted particularly. And I think it is quite noteworthy. That is the contribution that I believe we have seen to the expansion of the economy from the relative industrial peace that we have experienced during the first half of 1972. It is notable that in May the number of workers going on strike was at its lowest level in 30 years. I think it is quite likely—although it is difficult to know how you would get at this in a truly exact and scholarly sense—that this relative industrial peace has contributed to the very strong economic performance that we have seen in this 6-month period, as contrasted to some of the earlier periods in this administration when we did have quite a high amount of strike activity.

You may remember in the third quarter of 1970 it seemed that the economy was starting to expand, and the real GNP had expanded. And then we were hit with the automobile strike which took about $20 billion out of the GNP, and set it back, and it had to gather itself together again and move forward beginning in 1971.

So, we have had a considerable amount of disruption from strikes. But this year we have been relatively free of that. It has been a very welcome development. Thank you, Mr. Chairman.

(The prepared statement of Secretary Shultz follows:)

PREPARED STATEMENT OF HON. GEORGE P. SHULTZ

Mr. Chairman and Members of the Joint Economic Committee, the view is now widespread that the economy is expanding with strength and in a cumulative fashion. This view also holds that the upward movement in the general level of prices is moderating, as increased productivity and smaller increases in average hourly earnings lead to a slower growth in unit costs; and that the average household has over the past 18 months seen the results of this process reflected in a sharp upward movement in real spendable earnings, after seven years in which this crucial measure of well-being failed to rise. The general view seems also to be that these favorable trends will continue. At the same time, many people are anxious about 1973 and 1974 insofar as the re-emergence of inflation is concerned.

I agree with this widespread assessment of the current situation and the outlook. I also agree that the problem of inflation must remain in the forefront of our thinking as we approach issues of economic policy. This is especially so since we must work constantly to see that all those who want a job have an opportunity to have one. Encouraging as are recent indicators of economic expansion, we are nevertheless still short of attaining that important goal!

The Council of Economic Advisers has prepared for you a detailed mid-year review of economic developments. Therefore, it is unnecessary for me to provide yet another recitation of what you already know, pleasant as it might be to dwell on recent developments.

Rather, I would like to call attention to certain aspects of policy and analysis, suggesting thereby some lessons from recent experience that we might appropriately apply in our continuing effort for peacetime prosperity with reasonably stable prices.

1. *The Need for Budget Discipline.*—The unified Federal Budget has been kept at roughly full employment balance for fiscal years 1969, 1970, 1971, and 1972, following the rising and large deficits in 1966, 1967, and 1968. There are many factors other than fiscal policy involved in controlling the economy. They include monetary policy and, in the last eleven months, the system of wage and price controls. This exercise in budget discipline has nevertheless been a powerful force in moving the rate of inflation down from 6.1 percent in 1969, to 5.5 percent in 1970, to 3.8 percent in 1971 prior to the freeze, to 2.7 percent in the ten succeeding months as measured by the Consumer Price Index.

As we move into FY 1973 and look ahead to the year following, will we be able to maintain this discipline? Recent actions by the Congress certainly leave the issue in doubt. There will be many actions on appropriations and contract authority taken in the next few weeks.

I urge the Congress to act with restraint on spending.

I urge the Congress to act favorably on the President's proposal for a firm ceiling on spending, one that would bind the Legislative as well as the Executive Branch.

Otherwise I fear that we may return to the budget excesses of 1966, 1967, and 1968, with the relentless pressure these excesses put on the price level.

2. *The Contribution of Industrial Peace.*—The country has benefited greatly this year from a level of strike activity far below that of other recent years. In fact, in May, 1972, the number of workers involved in new strikes was the lowest for any May in thirty years.

This remarkable degree of industrial peace is a tribute to labor and management and shows what can be done by the system of free collective bargaining. There have been many noteworthy achievements, including the settlement last week of the most difficult issues affecting the railroads and a record of settlements without strikes of many tough cases in the construction industry. The record in construction, noted and notable on the side of the levels of wage settlements, is as much so on the side of industrial peace.

I know that, in an exacting scholarly sense, it will not be possible to show just what contribution relative industrial peace has made to the strength of the economy this year. It is my belief, however, that freedom from the disruptions of widespread strikes has contributed significantly to the expansion.

The Secretary of Labor and the Director of the Mediation Service and their co-workers have worked hard to encourage free collective bargaining. The basic achievement, however, is one of labor and management together. They deserve our understanding and encouragement. They also deserve recognition for their contribution to the economy. I salute them for the record of free collective bargaining in 1972.

3. *The Impact of Tax Changes.*—The tax structure has undergone massive change in the last 2½ years and a further change, in the form of revenue sharing, is currently under review in the Senate.

The tax burden on individual incomes has been reduced, with the reductions benefiting low income earners proportionately more. These reductions have undoubtedly helped the expansion and account in some measure for the strong recent increases in personal consumption expenditures.

The highly regressive tax on youth derived from a combination of the draft with low pay in the Armed Forces has been replaced by strong movement toward a volunteer Armed Force.

Greater incentives for new investment, which creates jobs now and low costs for the future, have resulted from clearing the uncertainty surrounding the ADR system last year and by passage of the job development tax credit. While it is always difficult to disentangle cause and effect, it is worth noting that private spending on new investment has picked up sharply this year, adding pace and quality to the expansion. This shows up not only in the well-known data on plant and equipment spending by businesses but also in farm equipment, where outlays are up by one-fifth over a year ago, and in trucks, buses and trailers, which are up by one-third.

Much has recently been accomplished by way of tax reform. The President is determined to carry these efforts further, to simplify the tax system, to make it more equitable, and to so arrange it that it contributes as much as possible to the solution of our economic problems. It is an immensely complicated subject and changes must be made with care and with an understanding of the results of changes recently made. As we in the Treasury work on this subject, we welcome the discussion of it stimulated by this Committee, as well as by the Committees directly concerned.

4. *International Economic Developments.*—Last August 15 the United States embarked on a program to restore its external economic strength and to reform the international monetary system in the context of an open and liberal world trading order.

As I pointed out earlier, our economy is now growing vigorously. In contrast, many of our major competitors are in a period of relatively slow expansion. As their economies pick up, as they expect, so should foreign demand for our exports. Meanwhile, the relative price performance of the United States is helping to reinforce the effects of the recent exchange rate realignment. We are not satisfied with our performance—but it is improving, and better than others. We are determined to make additional progress in the future.

Many factors suggest that our balance of payments position should improve in the period ahead. But I believe it is evident we cannot afford to relax in the thought that the changes made so far provide an assured and lasting solution. To take advantage of the opportunity afforded, we must manage our economy properly, we must increase its vigor and competitiveness, we must reduce barriers abroad to our exports. We must obtain structural changes in our international economic relationships to better reflect the present balance of power and responsibility.

In recent months there have been periods of calm and periods of speculation in foreign exchange markets. There was sporadic market uncertainty through early March during what was an inevitable period of the Smithsonian Agreement. Markets then remained calm for 3½ months. During this period, a gradual unwinding of speculative positions and a reflux of short-term funds roughly offset—or more than offset—the continuing deficit in our trade and other accounts.

This calm was disturbed in the latter part of June, when strong speculative concerns re-emerged at the time of the U.K. decision to float the pound. We and other parties to the Smithsonian Agreement judged—and announced—that the speculation associated with the British move need not affect the basic exchange rate structure established at the Smithsonian. That continues to be our firm view.

Consistent with our view of the validity of the Smithsonian rates, we decided that some intervention from time to time in the exchange markets could provide a helpful deterrent to unwarranted speculation and to demonstrate the firmness of our view. This action does not in any way restore the convertibility of the dollar. Our basic policy approach toward monetary reform and the necessary efforts to achieve sustainable equilibrium in our balance of payments is unchanged.

These market developments emphasize—if emphasis were needed—the urgency of moving ahead with monetary reform. We must get on with this important work, and we must get the job done correctly.

Negotiations on reform of the monetary system have in a real sense been under way for some time. A process of discussion—much of it informal—among national governments has provided an opportunity to exchange views on the objectives of reform, and to clarify some of the major issues. Through this process, we gain understanding and lay the groundwork for developing the necessary consensus on which lasting reform must be based.

To handle the more formal negotiations of monetary reform, nations are now in substantial agreement on the formation of a "Committee of Twenty" under the general auspices of the IMF. The Uniited States has played a major role in establishing the new Committee. We believe that with its representative membership, and its breadth of approach enabling it to consider trade, interrelated investment and development, as well as monetary questions, it is well equipped for the challenging task of monetary reform. We expect the Committee to begin its work at the time of the Annual Meetings of the IMF in September.

If we are to find workable and lasting solutions to the difficult problems of international monetary reform, we will have to deal with fundamental issues of importance ot the national interest of the United States and other countries. Too often the smooth functioning of the monetary system is seen as simply a technical problem, involving nothing more than a search for efficient monetary devices. But discussion of these devices, important as they are, must not distract our focus from the basic issues.

As we come to grips with these important problems in the negotiations ahead, we intend to exercise our leadership to ensure that the monetary system which emerges will be sound and durable and fully meet the needs of a growing and changing world economy.

Chairman PROXMIRE. Thank you, Mr. Secretary.

Mr. Weinberger, please proceed.

STATEMENT OF HON. CASPAR W. WEINBERGER, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY DALE McOMBER, DEPUTY, BUDGET REVIEW DIVISION

Mr. WEINBERGER. Thank you, Mr. Chairman and members of the committee. I certainly appreciate your very kind words, almost disarming me. I would like to present Mr. Dale McOmber, Deputy, Budget Review Division, who accompanies me.

I am cognizant of the time limitation. I see the timer. And I will try to keep this within the 10-minute period. It is a very short statement. And you have already received testimony from the Council of Economic Advisers and George Shultz, Secretary of the Treasury.

I share their assessment of the economy, and the prospects for good economic news during the next 12 months, but I am worried that we must take steps now not to overdo a good thing. The Federal budget must certainly not be used or allowed to overstimulate the economy, and proper safeguards are very clearly necessary.

The June 5 midsession report, which is before you, shows that the unified budget was expected to be in deficit by $26 billion, and the full employment budget was expected to be in deficit by $5 billion.

The fiscal year ended 3½ weeks ago, and yesterday we released the preliminary totals for June showing that the deficit for the year was $3 billion less than the June 5 estimate of $26 billion. Revenues were about $1½ billion higher and outlays $1½ billion lower. On the full-employment basis, the 1972 budget was down to a $3.6 billion deficit.

The midsession report also estimated that fiscal year 1973 would show a unified budget deficit of $27 billion with a full employment budget deficit of $3 billion.

Instead of maintaining a full-employment balance, as proposed in the January budget, we faced a $3 billion full-employment deficit as of last June 5. This arose chiefly from the black lung benefit bill initiated by the Congress and the need for a retroactive payment in fiscal 1973 occasioned by the delay in enacting general revenue sharing. The delay in enacting general revenue sharing merely shifts part of the deficit from fiscal year 1972 to fiscal year 1973. On this account, the 2-year total deficit remained unchanged, and we did not consider such a shift as a violation of the full-employment budget-balance principle.

But since June 5, the budgetary outlook has materially worsened. For example, the social security provisions added to the debt limit bill will raise the 1973 deficits by $3.7 billion, unless and until we find the offsets the President requested. Disaster relief measures brought on by tropical storm Agnes and the amendments to the Defense budget caused primarily by the unsuccessful North Vietnamese invasion of South Vietnam—again, if no offset by spending cuts—could enlarge the deficit in excess of $2 billion more.

The need to find budgetary reductions to bring the deficit down closer to balance with full-employment revenues is apparent, and it is pressing. At the direction of the President, I am working with the heads of the executive departments and major spending agencies to secure offsets.

But, so far, I find such work extremely difficult, because these agency heads see the Congress moving persistently in the other direction. Pending bills, a few already passed by both Houses and awaiting final agreement, would add billions more to the 1973 deficit unless the trend they establish can be quickly reversed.

I was interested in your statement that the Congress never adds to spending. The simple fact is that there have now been passed by the House in this session bills which would add $10.3 billion to the 1973 deficit should they all be enacted. In the Senate, similar bills would add $9.4 billion to the 1973 deficit should they all be enacted.

And there have actually been enacted by both Houses measures which add 4.9 billion to the 1973 deficit.

So, I think a reference to appropriation bills only and a statement that the Congress cuts some and adds to others but never adds to the total submitted by the President cannot possibly be sustained.

I would like to mention just three bills specifically.

Final agreement on the water quality bill now in Senate-House conference, the rural development bill awaiting final action on a conference report, and the Labor-HEW appropriation bill on which conferees were appointed last week, could add at least $2 billion to 1973 outlays and a very great deal more in 1974 and later years. Furthermore, the programmatic advantages of the spending in excess of the President's budget called for in these three bills is certainly less than apparent. And the worst of it is that these are only the first three on a much longer list.

Sadly, the congressional performance thus far demonstrates that the old myth that you solve problems by lavishing Federal cash on them is still much in vogue on Capitol Hill.

At a time when, after a serious bout of inflation, the economic recovery is in full swing and promises to return the country to full employment without rekindling inflationary pressures, congressional enactments that will force excessively large full employment deficits would be sheer folly.

The widsom of the President's proposal of last January for a fixed, rigid spending ceiling to apply to both the Congress and the executive becomes increasingly apparent with each passing day. We did not request such a ceiling idly. The results of the failure of the Congress to enact such a limit prior to its consideration of other legislation, as the President had recommended, are now apparent.

However, it is still not too late, although the task is much more difficult. The Congress should now set, and maintain, a fixed expenditure ceiling. An appropriate level would be $250 billion. Thus any legislation that would cause total outlays to exceed that ceiling would have to be offset by reductions in other program outlays.

And as Mr. Shultz said yesterday, this is not precisely a starvation budget; you would think we could get along reasonably well with a quarter of a trillion dollars in outlays.

The ceiling would be good discipline for both the executive and legislative branches. It would focus attention on the budget total. Each spending initiative could be more responsibly considered against all spending items, and thereby insure that the budget total will not become the engine of inflation or result in unwelcome tax increases.

More than that, and not to put too fine a point on it, a spending ceiling is one of the few routes left open to fiscal salvation.

Certainly, events during the latter half of the 1960's suggest full employment deficits can overstimulate the economy, drive prices up, and dampen gains in purchasing power.

As the secretary has just pointed out, if Congress adds significantly to current proposals without making compensating adjustments elsewhere, a highly stimulating and, under present circumstances, inflationary deficit could emerge this fiscal year and then almost certainly force another on us in fiscal year 1974 and beyond. Both the executive branch and the legislative branch must make a commitment to act responsibly, or we will rob the people either through higher prices, higher taxes, or, most likely, both.

It is not only the budget of the U.S. Government that is broken by irresponsible congressional actions. It is something far more important. It is the budget of virtually every family in the United States.

Mr. Chairman, I would like to comment in the time remaining on just one or two points you made, particularly one, in your opening statement.

You said that rumors have been planted of a $40 billion deficit in the 1973 budget. I don't know to whom you were referring. Certainly we have done no rumor planting, nor do we intend to. The only statement or colloquy that I can think of that might have given rise to your statement was a series of questions I was asked in, I believe, the Senate Finance Committee, when we were testifying on the debt ceiling bill. Some of the Senators started listing various measures, and said, if this one is enacted, and this one is enacted, what would the total be.

And so I asked them then, to be perfectly certain, if they would add it up. And they said, this looks like $37 billion.

And I said, yes, if all these bills were passed, that is what would happen.

I don't think that is planting rumors, and I don't think it is even a very useful form of question, because it is just an exercise in addition, and it is certainly true that if you add 2, 4, 6 and 8 you are going to get whatever that total brings out.

That is the only thing I can think of that is going to be in that category. We are certainly not planting any rumors, as it is our earnest hope that the Congress will enact a spending ceiling to help us in our work of trying to hold the outlays in the $250 range that we have spoken of.

Thank you very much, sir.

Chairman PROXMIRE. Gentlemen, we have before us two of the men most responsible in this administration for the budget, and most knowledgeable about the budget, and men who are in the best position to give us answers as to why the estimates should have been so very far away from what developed.

It is my understanding that the fiscal 1972 deficit, the year just ended, was $23 billion. That is the most recent figure we have, and I doubt if it will be corrected much further. But this is $16 billion, as I indicated, below your January estimate. That January estimate was a very inaccurate estimate. And yet the administration's GNP forecast, which was supposed to be consistent with your fiscal policy, is turning out to be pretty accurate.

I asked Mr. Stein yesterday how the fiscal policy forecast could be so bad, and the GNP forecast so good. One explanation of course, is that fiscal policy, taxing, and spending, just doesn't have any effect upon the economy. Even if you are way off, the forecasting has no relationship to what our taxes and spending are.

Now, Mr. Shultz, you have a reputation for being a "monetarist," that is, for believing in monetary policy, which is, perhaps, more important than fiscal policy. Is fiscal policy irrelevant, or doesn't the administration know all the time that the deficit would not be $39 billion, but they wanted to start with a big number that could be subsequently reduced?

What is your explanation for the budget estimating error?

Secretary SHULTZ. Well, I think you have to take it apart and see where the errors occur, and then follow through the explanation that way.

First of all, in terms of budget outlays, about 18 months ago, for the fiscal 1972 budget, we estimated outlays at $229 billion, roughly. The figures released yesterday, which are the final figures on the fiscal 1972 budget, had outlays of $231.6 billion.

Now, the composition was different from that originally estimated, but nevertheless, given the size of those numbers, that is fairly close.

We had thought last January that the outlays would be roughly $5 billion higher than that. The reasons why we have fallen short of those January estimates of outlays are largely due to our disappointment in congressional action. That is, we have been working for and hoping for congressional action on revenue sharing, which the President proposed about 3 years ago.

Chairman PROXMIRE. Are you saying Congress didn't spend the money fast enough?

Secretary SHULTZ. He has proposed it. It has been part of the President's budget proposals right along. And we had hoped that the first half-year increment would be passed in time to be in the fiscal 1972 budget. We now hope and expect that this bill will be acted upon by the

Congress before you leave, and that the $2.2 billion budget in fiscal 1972 will show up in fiscal 1973, it will be displaced in time slightly.

There have always been delays in authorizations in certain environmental areas, and I think in the Veterans' Administration, and one or two other places, that have delayed the start of construction programs there.

And those together account for a fair proportion of the $5 billion shortfall of expenditures.

In addition, however, the economy in the first half of 1972, has been stronger than we expected. And so we see in such items as unemployment compensation and certain of the welfare categories the impact of the strengthening of the economy, since the outlays are less than we had estimated.

Chairman PROXMIRE. Wasn't you GNP prediction accurate? You say the economy was stronger than you anticipated, but it was just about what you estimated it would be?

Secretary SHULTZ. I think the economy in the first half was above the projections that we made.

Chairman PROXMIRE. How much?

Secretary SHULTZ. We have not revised the overall projection for the real increase, but certainly the first half is somewhat above it, and the inflation picture is a little better than we expected. But at any rate, the strong performance has reduced our obligations for unemployment insurance and some other things, and that accounts for the fact that the outlays estimated at $236.6 billion in January——

Chairman PROXMIRE. You say the strong performance has mitigated your estimates on unemployment compensation. Unemployment is higher than you expected; is it not, substantially?

Secretary SHULTZ. We made an estimate of the unemployment compensation payments for fiscal year 1972, and they are revised in each successive reestimation, and it was reestimated and included in the new 1972 totals that you got last January.

The amount of unemployment compensation drawn in the second half of the fiscal year, the first half of the calendar year, was actually less than we estimated.

Chairman PROXMIRE. It is higher unemployment?

Mr. WEINBERGER. It was less by nearly $700 million, a combination of unemployment insurance, unemployment benefits for former Federal employees and servicemen, and emergency employment assistance.

Chairman PROXMIRE. It is hard for me to understand that, because I understood that you were more optimistic on unemployment than was borne out by the actual developments. You didn't anticipate that you would have 5.7 percent unemployment in the second quarter, for example, when you made that estimate.

Secretary SHULTZ. It is very important when looking at these unemployment figures to disentangle them somewhat.

Chairman PROXMIRE. Isn't it true that you had more long-term unemployment, and that unemployed people were running out of benefits so that they didn't have the benefits that you might have expected?

Secretary SHULTZ. Actually, about 2 years or so ago, a fairly substantial revision of the unemployment compensation system was passed by the Congress, and had been initiated by the President. It included a trigger mechanism under which benefits would be expanded when unemployment was above, I believe, 4.5 percent seasonally adjusted for 3 months, and then it would trigger off again when unemployment dropped below that as a national average.

And then there are State triggers, and so forth. Actually the trigger had been on at the time the bill took effect. And it triggered off not long thereafter.

So, we did have that process going on. And I think what we see here is the fact that our total unemployment picture includes many new entrants to the labor force. And those people typically have not qualified for unemployment insurance. They have no work experience on which to develop benefit rights. We have seen a good reduction in the unemployment among experienced workers. And that is what shows up in the unemployment insurance. You can see that the initial claims and average insured unemployment has gone down.

I have answered your question in the sense of trying to talk about the outlay side and what has happened to it, and why.

Chairman PROXMIRE. As I say, you estimated the status of the economy pretty well, and I would think that that would give you an opportunity to get the same kind of good performance on the revenue side. But that seems to have been where you went off the furthest.

Secretary SHULTZ. That is certainly where we went off the furthest.

Now, I think we have to remember that fiscal 1972 receipts are largely a reflection of calendar 1971. People are paying their taxes on calendar 1971 income, although the revenues we collect in the second half of the fiscal year reflect the withholding picture during that period. And as we all are aware, the withholding picture during that period is a little unusual as compared with most periods. We have an unanticipated inflow of revenues due to the way the withholding structure was changed in the 1971 Tax Act. And that has built up the revenues somewhat.

I think also what we are seeing is constant revisions in the 1971 GNP figures. As you may have noticed in the GNP figures that were released last Friday, there were also revisions in the 1971 GNP that brought it up to $1,050.4 billion, I believe. It had been at $1,047 billion.

So, on the whole, people's views of how good a year 1971 was seem to be changing. And certainly that is being reflected in these revenue estimates. We were working from the GNP estimates that we had at the end of last year.

Beyond that, I think that we must remember that there have been massive tax changes in the last two and a half years. While efforts were made at the time the tax changes were made to estimate their impact, and while in the revenue estimating process naturally you try to take account of those things, it still seems to me a mere presumption that we have not yet really calibrated the new relationships, say, between GNP, personal income, corporate profits, and so on, and the impact of these tax changes.

We are still trying to figure out precisely what they have done, and what their impact is. And in the process I think we probably can be off somewhat.

But again, I think the revenue estimate of 18 months ago for fiscal 1972, was $217 billion, and it turned out to be $208.6 billion, somewhat less. I think that is by and large due to the fact that our original estimate was built on a GNP of $1,065 billion, if you recall that number, and that turned out to be higher than actually came about.

Chairman PROXMIRE. In view of the importance of accurate budget estimating, I would think it would be extraordinarily important to those who are interested in the Government bond market, for example, and people interested in business conditions generally, and those who are very concerned about inflation and feel that a big deficit is going to contribute to inflation, and I think they are right in considering that.

What can be done in the future to prevent this kind of what I think is quite an astonishing error? And I don't mean to imply any criticism of either of you gentlemen.

As I say, I have great regard for your ability. But something went very seriously wrong here. Your main emphasis seems to come down to the changes in the structure of our revenue laws, and the overwithholding problem which was not analyzed properly.

Secretary SHULTZ. It is the whole complex of things. I don't think there is any one single point. I agree that it is important to be accurate in revenue estimates. And it is a subject that I certainly want to work on in the Treasury.

Let me just say, however, that we have tried to make a conceptual change in the way we think about the budget. And the conceptual change is to call attention to the importance of full employment revenues, in addition to actual revenues.

Now, I recognize that there is no gain saying, particularly in terms of the financial market, that a deficit is a deficit. Cash flows out, and receipts come in, and we have a minus number in between, and there it is. Nevertheless, from the standpoint of thinking about economic policy, and planning, we think that the full employment concept is a very useful one.

And it is in a way more important to judge our outlays by that than it is by our anticipated actual revenues. The Federal budget will be plannable more easily that way, and its economic impact will be more sensible that way than somehow trying always to get those outlays down to the actual receipts, whatever the state of the business cycle.

Chairman PROXMIRE. My time is just about up.

But before I yield to Senator Javits I would like to ask you one other question.

The administration keeps talking about expenditure cuts, and seems to be against tax increases. Obviously that is the position most people would like to take. It is a desirable position, and I think it is a position in which there is considerable wisdom. But as a practical matter, looking down the road at the colossal need of our Government in so many areas, and being as realistic as we can about this, won't we have to face up to the need for more revenues to meet the growing pressure for more social services, in your view? And if we do, where can we find those revenues?

Secretary SHULTZ. I believe that the job can be done on the outlay side. It is very important to try and keep track of and do the job on the outlay side.

I say that in the interest of effective use of the tax money that we have. I also say it from the standpoint of economic policy, because at least as I see it, I don't see any ground swell or desire among the American people to say that we think the Government spends money so wisely that we want to give you more of it. I don't see that the people are of that mind at all.

And that being the case, I think those who say, well we can blithely go ahead and spend, and spend beyond the revenues that the tax system will yield, and if it turns out that way, oh, well, we can just have a tax increase—I don't think it is going to be that, either.

Chairman PROXMIRE. But what I am trying to point out is the very serious health problem that we have in this country. The administration has recognized the need for a more comprehensive program, the need for a more comprehensive antipollution program, and the need for a more comprehensive mass transit program, and the need for doing something far more effective about housing and rebuilding our cities, and the need for combating pollution in a more vigorous and effective way.

All these things are enormously expensive. And you recognize the need for maintaining a strong defense. When you put all those things together, it is just very difficult to see how we can responsibly argue that we won't have to at least be alert to some kind of alternative way of raising revenues, in the event that the outlay side can't take care of it.

Secretary SHULTZ. Well, at the same time let's just take a look at your list and pick an item out——

Chairman PROXMIRE. I missed welfare, which, of course, is a big one.

Secretary SHULTZ. Right. There are lots of big ones, I am afraid.

But let's pick an item out that we are particularly concerned about, and have been very creative about in our own thinking. And that is the housing area, rebuilding housing, particularly in cities.

Now, there, it seems to me, we have an area where experience would suggest that we should go slow, we should be more careful. With all of our efforts, with all of our good intentions, we have a record of failure in that field.

There are public housing developments scattered around the country, some started in the Eisenhower administration, and some started later that are unoccupied, that have to be torn down. That represents the fact that we tried to do something, and it didn't work very well. And I don't have the feeling that we really know how to go about this.

It suggests that perhaps an approach that is more in terms of providing some flow of money to those units of government a little closer to the people than the Federal Government is, through revenue sharing, is a better way to get at this, plus the fact that if, in our consideration of whether to spend or whether to refrain from taxing, we leave a little bit more of the money in the hands of individuals themselves, they may have a better idea about whether they want to spend it than we do.

So, I think just by listing something like the fact, that we need housing and rebuilding of the cities, which we all acknowledge we need, this does not mean that, therefore, we ought to spend a lot of Federal money on it. Throwing Federal money on it has not contributed a particularly noteworthy result to date.

Chairman PROXMIRE. My time is up.

Senator Javits.

Senator JAVITS. Mr. Secretary, I would like to join Senator Proxmire in asking you the same questions, because I think that even your very intelligent answer—you are always very wise in those responses—fails to take account of the main point, which is the social imperative which is involved. The cities are suffocating, literally suffocating. And 70 percent of the people live in the cities. And their conditions are intolerable—I say that flatly—conditions of housing, conditions of drug addiction, conditions of pollution. And those social imperatives, I believe, will force more action.

And the State and local level, frankly, from my own experience, is not what it is cracked up to be, according to your gentlemen who are always laying it on the State and local level. The States and localities—many of them—have not performed. Indeed, almost every bill that I have been associated with—when you were Secretary of Labor, for example—has insisted upon cranking in a Federal responsibility if the State and localities didn't perform or couldn't perform, because of our experience with them.

And to place your reliance on that as the major social improvement I don't think is going to stand up.

So, I do think that we are in a very real bind, and it causes me to ask you this question on this spending, which has been emphasized by you and by Mr. Weinberger, and by Mr. Stein who testified yesterday.

Isn't it a fact that you are really telling us where we can cut and where we can't because you are telling us we can't cut the fence, and on the contrary we have to add to the fence? That is over a third of your $250 billion. And you are telling us we can't cut out the Vietnam war, because that is against the President's policy. And that brings it up to almost a hundred billion.

And there are other fixed expenses that you can't do anything with.

Now, if you are telling us that we can't cut there on spending, that we have to cut elsewhere. And when I asked Mr. Stein, well, where do you want us to cut, he couldn't tell us, he said the administration hadn't yet made up its mind.

Now, can you gentlemen tell us in where do you want us to cut?

Secretary SHULTZ. First, let me just say that I think that adding the Vietnam war cost to the defense budget and then thereby escalating the proportion from one-third to one-half the budget, I believe, isn't correct.

The defense budget includes the cost of what is being spent there. And there has been a supplemental sent up for, I believe, of $1.2 billion. If I am not mistaken, that reflects the actions that have been taken since the North Vietnamese most recent invasion of South Vietnam. But those costs are all included in the defense budget, which I think is approximately a third of the total, as you said.

Where cuts can be made? I suppose anybody who has been through the budget processes has his own list. I do. I know Mr. Weinberger does. But this is a process of cut and fit within the administration, and ultimately with the Congress. I think the first step in this process is to make people aware of the importance of doing it, and of really trying to go through and isolate programs that have zero-based budgets that just aren't working and have the courage to do that.

We think that there are many such areas where one can work in that way. I think the first step is to have a determined expression from the Congress as well as from the administration that this must be done.

I was personally impressed, as an outsider to Government, just watching as the 1969 budget was put forward—not by this administration, but by President Johnson. There was a heroic effort made there, and a real change in attitude and psychology, to get a little better control. And I think we can do the same thing this time.

We have to start with the attitude that it must be done. Then I think we can find places where it can be done.

Senator JAVITS. If the administration asks us to set a 250 billion dollar ceiling and if in setting that ceiling we decide that we want to cut, say, the figure which has been so widely discussed, $15 billion from defense, will the administration object to that in order to keep us within the ceiling and allocate priorities the way we think they ought to be allocated?

Secretary SHULTZ. Well, I think a $15 billion cut in the defense budget would be a tragedy from the standpoint of our ability to sustain a strong national defense. And we certainly oppose that.

Senator JAVITS. But don't you have to join us, as it were, in some recognition of our authority to deal with the components of the expenditure ceiling?

In other words, if you ask us to set an expenditure ceiling, and we set it, you can't also ask us to absolutely commit ourselves as to how we are going to divide it.

Secretary SHULTZ. The procedural problem involved is very difficult, I agree with you. And we have thought about that. We are certainly open to discussion about just how one might proceed. But if we could start with the notion that, say, $250 billion is it, it is binding on everybody, and it isn't going to be changed, and then start in on the process of how do we get there from here, I can think of various ways of doing it.

At one time in the past, I know, the Congress would try to pass all the appropriations bills and get all the money-connected authorizations done prior to the start of the fiscal year, or at least very close to the start of the fiscal year, so one could see what was happening. Then, having looked at the individual parts one by one, the budget was also looked at as a total. I don't know whether that is really practical or not. I was told by people who are here that it didn't work out very well. I can see that it would be a hard thing to bring off because the appropriation process stretches out so long.

So, the alternative, it seems to me, is to put it in the hands of the President. And I recognize that that causes difficulties for Congressional prerogatives, but nevertheless it is a way of getting it done. And it is very unpleasant to be the one who has to do the cutting.

But the President is willing to assume it. I hope that wouldn't result in the Congress voting more and more money for everthying, knowing that somehow or other the President is going to have to do the slicing.

If that is the way it is, he is going to have to face up to it. But a procedure is going to have to be worked out that takes cognizance of the overall result while Congress is working piece by piece on the budget which, as you know, goes on for a very long period of time.

Senator JAVITS. Mr. Secretary, I personally recommended some legislation, which will be before the Senate very shortly, to provide congressional office of goals and priorities so that we may do it ourselves with some intelligence.

Would you think well of this?

Secretary SHULTZ. Surely. I think that processes that make us go back and forth all the time between individual components and the total, and be conscious of both at the same time, are the essential procedural ingredients. And it is an ingredient that I think this committee can help with a great deal. Historically, the Joint Economic Committee has, in a sense, tried to stand for what the total is, because that is what makes the impact on economic policy overall.

Senator JAVITS. I would like to move to two other subjects very briefly.

One is the fact that it is widely rumored that the idea of trying to do anything about national emergency strikes or regional emergency strikes in this session was sort of vetoed by the administration. I notice you derived considerable satisfaction from labor peace.

Can either of you gentlemen give us any policy reason why we should not proceed with legislation dealing with national or regional emergency strikes in this session as the administration itself has recommended?

Secretary SHULTZ. Well, it is really just an observation, Senator. That legislation has been on the Hill for about two and a half years, I guess.

Senator JAVITS. More.

Secretary SHULTZ. Since the administration proposal was sent up, it has been very hard to get attention to it—very hard even to get hearings. It was difficult even to get somebody to introduce it into the U.S. Senate as an administration bill. I think Senator Griffin finally introduced it. It is not a subject that seems to attract avid people wanting to work on it.

In view of the fact that we believe and hope that the most acute strike threats in the transportation field are behind us now, and in view of the fact that we had almost no hearings, very little discussion, it seems to us that the thing to do now is to take stock and see if we can't think of something better and try to find an approach where we can really have some discussion. It didn't turn out to be possible to really have some discussion through the congressional process on this subject.

Senator JAVITS. Mr. Secretary, I try always to agree with you. I must confess I cannot in this. We have had very extensive hearings going into transportation and other fields. You have had a bill of mine, not for two and a half years, but for 5 or 6. The administration has had a bill through Senator Packwood that is officially his bill. This project is very far advanced. And I would urgently commend to the administration that if it really wants it—and I think it is urgently needed in the interests of the country—that the process be encouraged rather than discouraged.

And we had the distinct impression around here that it was being discouraged. So, I cannot agree that it hasn't had the attention or the discussion, or the bills, or enough legislative interest—the legislative interest is very great every time there is an emergency, and everybody says, let's have a permanent law. And I think we can get one.

And I hope very much the administration will lend its weight to getting it.

The other subject I would like to ask you about is convertibility of the dollar. I notice you say in your statement that this action—that is, the moving in on the market with the German marks swap—does not in any way restore convertibility of the dollar.

So that, we are still in midstream on monetary questions. And the point I would like to ask you is this. A lot is made of the fact that our productivity has increased in the last year, largely attributable, of course, to holding down overtime and firing some employee et cetera.

But as a matter of fact, isn't it true that productivity as well as deficit, et cetera, which you both testified to, is a critically important element in the ability to arrive at a reasonable monetary relationship in the world? And the question which I hope you come on is: One, is that an important factor, vital factor; and two, do you think we are doing enough about it in respect to the public policy of our country?

Secretary SHULTZ. I think it is a very pertinent factor, and I would trace it through this way: Productivity, together with the cost of the factor of production to which you are applying it, whether it is the productivity of labor or the productivity of capital, is what determines your labor or capital cost per unit of output. These costs are going to have a big impact on the ultimate prices that are charged by our domestic producers and by our exporters in the markets abroad. I believe that with all due respect to the importance of the details of international monetary arrangements which we must work on and develop, probably the most important thing that the United States can contribute is a productive and expanding economy and one that—as it has done recently—maintains relatively stable prices.

We can contribute that to the world trading and monetary system. It will be a gigantic contribution. And our own productivity is very closely tied in with our ability to do that.

Senator JAVITS. Mr. Chairman, I have a few more questions which I may not have time to ask. I ask unanimous consent that I may address those in writing to Secretary Shultz.

Chairman PROXMIRE. Without objection, it is so ordered.

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

RESPONSE OF HON. GEORGE P. SHULTZ TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR JAVITS

Question 1. On June 26 President Nixon took action against the high price of meat by ordering the suspension of meat imports. Just what has happened to the cost of meat at the supermarket?

Answer. The measures that we have taken against rising meat prices appear to be having some impact. Cattle prices reached a peak in early July and have dropped by \$2.50 per hundredweight to approximately \$37 over the last three weeks. In addition, the Agriculture Department has observed some beef price declines in late July in food chainstores.

The Agriculture Department has also reported that market conditions appear likely to produce further declines in cattle prices over the next several weeks, which is in line with our earlier expectations. These wholesale price reductions we fully expect to be translated into price cuts at the supermarket.

Question 2. The recently published Brookings Institution Study on Priorities concludes that full employment revenues under existing tax laws are not likely to be sufficient in 1975 to cover projected outlays based merely upon a continuation of policies and programs contained in the 1973 budget, and that the projected budget deficit in 1975—under the same assumptions—could be quite wide. The same study projects a very slim $5 billion surplus for 1977, assuming no changes in the tax law and no major new programs. Does this rather grim picture accord with Treasury Department estimates?

Answer. In January of this year, the Administration presented its projections of Federal revenues and expenditures in 1976 and 1977 and the associated budget margins (see *The Budget of the United States Government, Fiscal Year 1973*, pp. 47–53). These projections appear to be generally consistent with those contained in the recent Brookings publication (*Setting National Priorities The 1973 Budget*, Charles L. Schultze, *et al.*, pp. 410–422). To be sure, there are some differences of detail, but this would be expected with five-year budget projections done at different times and based on somewhat different assumptions.

The important thing is that both projections point to a very narrow margin of uncommitted budgetary resources even by 1977. Because of this outlook, the Administration has proposed a rigid ceiling on fiscal 1973 expenditures of $250 billion and a continuing effort to hold expenditures within available fiscal resources.

Question 3. At your press conference yesterday, you stated that the U.S. "will . . . have to take other actions" in addition to the recent market intervention, "to support the Smithsonian Agreement." What kind of additional actions do you contemplate?

Answer. The statement attributed to me in your question appears to have put the words of others in my mouth. I am reproducing below from the transcript of the press conference the two questions and my answers on this subject.

> *Question. Mr. Secretary, your predecessor, Mr. Connally, said yesterday that he thought this government would have to take some action beyond the intervention by the Federal Reserve in national monetary markets in order to support the Smithsonian Agreement. Do you have any idea what these actions may be or what he was referring to?*
>
> Secretary Shultz. No. I do not want to be commenting on things that other people may or may not have said, and I would just say that in terms of the international monetary arrangements, we did have quite a flurry a week or so ago. We thought about it very carefully, and we took certain actions which have been widely reported in the Press, and as far as I can see, that has, on the whole, been quite helpful.
>
> *Question. Are there, though, other actions that you are planning in the pattern of things?*
>
> Secretary Shultz. Well, no. I think the most important action, really is progress on developing a long-term new arrangement for international monetary and trade matters. That is, I think, the thing that will be most helpful. The Smithsonian Agreement, as I would understand it, was a heroic rearrangement of exchange rates but not thought of as a new, long-term system, but rather something that could serve for a period of time while a new, long-term system was evolved. And I think that the principal thing we need to do is work hard on getting that long-term system.

Question 4. In the Washington Post this morning, Hobart Rowen describes your remarks at the press conference yesterday as an argument for more rapid progress in getting an international agreement on monetary reform, and stated that this was "reversing what had been the pitch at the U.S. Treasury under John Connally." Do you believe that Mr. Rowen's characterization of your attitude is correct?

Answer. In the press conference I was not reversing any policies of the Treasury under Secretary Connally. In response to a question concerning actions to support the Smithsonian Agreement, I simply emphasized the importance of making progress in developing new long-term arrangements for international monetary and trade matters. In other words, it is important that we not expend all our efforts on the techniques for living under the admittedly interim arrangement which the Smithsonian Agreement established, at the expense of work on the fundamental, long-term problems. I don't think there is any disagreement anywhere about the urgency of moving ahead with monetary reform.

Question 5. Does the Treasury Department have a policy on what it considers *to be the proper composition, volume and use of reserves; the international role of the dollar; the nature of the exchange rate of adjustment mechanism; and methods of influencing capital flows: Has it stated its views on these problems in public?*

Answer. The Treasury has not put forward any detailed plan for international monetary reform, covering such specific elements of the monetary mechanism as the proper composition, volume and use of reserves or the nature of the exchange rate adjustment mechanism. The details of any specific element of reform can be assessed properly only in relation to other elements; it would not be realistic to develop a governmental policy on one element or the other *in abstracto*. And, up to this time, we have not been satisfied that publication of a comprehensive American plan would be helpful to the negotiations.

I would note, however, that the Treasury has indicated its view that gold should over time have a declining role as a component of reserves. We have indicated that we are openminded on the question of the international role of the dollar; and that for both practical and philosophical reasons, the United States would be inclined against a system which depended on capital controls for its operation. We have also drawn attention to the need for a more effective adjustment mechanism and recognized that this requires an exchange rate regime which provides for more flexibility than in the past to help adjust balance of trade and payments.

Our aim in these early stages of reform discussions has been to call attention to the basic issues of reform which we feel must be resolved. We have tried to point out that internationally consistent policy attitudes and objectives of major countries with respect to their balances on trade and payments accounts are more fundamental than monetary mechanisms and largely determine the success or failure of any such mechanisms.

Question 6. Last May the Federal Reserve Chairman Arthur Burns delivered a speech in Montreal in which he outlined 10 elements that he would expect to find in a new monetary system that met the test of both practicality and viability. What is the Treasury Department's attitude towards these 10 points?

Answer. Chairman Burns mentioned the following 10 elements that he would "expect to find in a new monetary system that met the test of both practicality and viability:"

> First, a significant further strengthening of the processes of international consultation and cooperation;
>
> Second, responsible domestic policies in all the major industrial countries;
>
> Third, a substantial degree of autonomy for domestic policies, so that no country would feel compelled to sacrifice high employment or price stability in order to achieve balance-of-payments equilibrium;
>
> Fourth, more prompt adjustments of payments imbalances, to be facilitated by definite guidelines and consultative machinery for determining when parities need to be changed;
>
> Fifth, a symmetrical division of responsibilities among surplus and deficit countries for initiating and implementing adjustments of payments imbalances;
>
> Sixth, systematic long-range plans for the evolution of world reserves and official credit arrangements;
>
> Seventh, a continued but diminishing role for gold as a reserve asset, with a corresponding increase in the importance of SDR's;
>
> Eighth, a better international consensus than exists at present about the proper role of reserve currencies in the new system;
>
> Ninth, re-establishment of some form of dollar convertibility in the future;
>
> And finally, tenth, a significant lessening of restrictive trading practices as the result of negotiations complementing the negotiations on monetary reform.

Chairman Burns was setting out what in his opinion would be some of the characteristics of the new system. He was not attempting to set forth a model for reform or to suggest U.S. positions on any specific proposals. Rather, he was stating some general principles which he considers valid. Certainly there would be a large degree of support for many of these general principles both in the United States and abroad. Obviously many of the broad subjects touched upon are among the elements of the reform question now under study in the Administration, and our views on any specific point will be determined by our assessment of the proposed system as a whole. Clearly much will depend on how these general principles would be translated into practical working elements of a monetary structure.

Question 7. In your prepared statement you state that a process of discussion—much of it informal—among national governments has provided an opportunity to exchange views on the objectives of international monetary reform and to clarify some of the major issues. However, in recent testimony before the House Banking and Currency Committee, Under Secretary Volcker stated that much of the discussion in which he has been exposed seems to slip past the fundamental points associated with reform. Would this characterize your views of the situation also? In your view, is this the fault of the U.S. Government, or are other countries doing most of the foot dragging?

Answer. There is no question that there are differences among nations in their views of the priority issues in monetary reform. As Under Secretary Volcker described in some detail in the statement to which you refer, the United States in its discussions with others has put forward a number of questions which it believes to be of key importance—such as whether nations are really willing to accept the disciplines of prompt adjustment of payments deficits and surpluses; and whether a common view can be reached on the degree to which controls should be relied on in a new system. In the earlier stages of discussions on reform, we felt that the significance of many of these questions was not fully appreciated abroad. Even now, some of our partners may not agree that they are the most important questions—in any event we are far from consensus on how these basic issues should be resolved.

On the other hand, Mr. Volcker also pointed out in his statement that some fundamental points of convergence were already emerging from those discussions—for example relating to the forums for and scope of negotiations, and to the need for an exchange rate regime which provides for greater flexibility than in the past. These are important points. Other major issues of substance remain to be resolved and will be the subject of negotiations.

I would not characterize this record as "foot-dragging" on anyone's part. Certainly, that is not the case of the United States. Our record in pressing for suitable negotiating forums and attempting to focus attention and discussions on central issues speaks for itself. More broadly, I believe there is appreciation on all sides of the difficulties of the issues involved, and of the importance of finding solutions which will endure and which are truly in the interests of the international community.

Question 8. The index of export prices for Japan stands at 107 based upon an index of 100 for 1963. Not only is this a low number in itself, but—even more important—this index has fallen 12 points since last August, indicating that the Japanese can remain price competitive despite the revaluation of the Yen and the devaluation of the dollar. In view of this, do you believe exchange rate adjustment is really the best way to change trade balances with those of our trading partners who rely heavily on exports?

Answer. The index of the unit value of exports in terms of yen, published by the Japanese Ministry of Finance, stood at 107.2 in February 1972 (1963=100), as against 120.4 in August 1971. Another index, that of the Bank of Japan, with different coverage and methodology, stood at 106.8 in April 1972, as against 110.8 in August 1971. The difference between the changes recorded by these two indices illustrates the statistical problem of measuring export price changes, particularly during a short span of time. In terms of dollars, the Bank of Japan index for the first quarter of 1972 was 125, as compared with 112 in the third quarter of 1971. For international competitive purposes, the dollar index may be more significant than the yen index, though the change in the dollar index would, of course, be smaller as measured by the Ministry of Finance index.

The effects of an exchange rate adjustment may vary from country to country, both in timing and magnitude. However, all of the countries involved in the realignment of last December clearly regarded an appreciation of the exchange rate as a measure tending to reduce their trade surpluses over time, and export interests in all countries have resisted proposals for revaluation. In the Japanese case, the reduction in yen prices of exports may, in part at least, result from decisions of exporters to reduce profit margins per unit in the effort to maintain dollar volume of sales. It is true that revaluation may also decrease the yen cost of imported materials entering into finished goods exported.

There are other measures, less comprehensive than an exchange adjustment, that can reduce a country's excessive trade surplus. One of these is unilateral trade liberalization, applicable to tariffs and non-tariff restrictions. Another is to relax export promotion or even to restrict exports; essentially, to be effective, such measures should cause a marginal shift of part of a nation's productive effort to supplying domestic customers instead of foreign customers. Measures of these types can be a supplement to or a partial substitute for an exchange rate appreciation.

Which measure is most effective can only be determined with reference to particular circumstances. In the Japanese instance, we have certainly felt measures apart from exchange rate action have been an essential ingredient.

Question 9. What do you believe can/should be done to control flows of short-term, speculative funds?

Answer. Any monetary system that requires exchange controls of one sort or another to hold it together over time would seem to me to have some basic defect. In general, we should strive to develop a system that requires a minimum of controls and ideally none.

I do, however, recognize that unwarranted speculation can cause short-run strains and problems in various countries from time to time, and lead to a desire to combat these forces by controls. One principal difficulty with controls is the inability to successfully distinguish a particular type of transaction—in this case the pure speculative transaction, from other transactions. The consequence is that what might be a narrow and acceptable objective is likely to be translated into broader unwarranted controls that continue to be widened in an effort to close loopholes. I would also qualify any acceptance of controls by noting that, in any event, they should be temporary.

From the standpoint of the United States, I would hope and expect that over time capital controls now administered by the Commerce Deaprtment and the voluntary program of the Federal Reserve can be eliminated. It would be extremely difficult, if not impossible, for the United States to impose controls over the vast amount of financial transactions that pour through our markets without seriously hampering overall trade and payments. Moreover, the situation and desire of other countries varies considerably as to their willingness to receive capital from the United States.

I think the U.S. stance should be one of understanding with respect to the ways in which some countries have tried to counter speculative movements, but basically one that looks toward a reduction both in the extent and the time over which these measures are employed.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Mr. Secretary, I congratulate you on your strong statements yesterday and again today about the urgency of moving ahead with international monetary reform.

I have a couple of questions about it. You say that you expect formal negotiations by the Committee of 20 to begin at the time of the IMF's annual meeting. That is in September, more than 2 months from now.

In view of the urgency, and if the others were agreeable, wouldn't it be a good idea to start those negotiations now?

Secretary SHULTZ. I think it would be fine. But I think that the process of forming the group is not completed as yet, and the selection process, and so forth. And that is something that has been proceeding with these IMF meetings in view.

Representative REUSS. It will be completed tomorrow. All the votes will be in. And I don't see why you couldn't get started Friday.

Secretary SHULTZ. You are a fast man.

Representative REUSS. By your logic, which I find impeccable, the longer one delays, the more likelihood there is that some of these turbulences will grow into something more difficult to manage.

Secretary SHULTZ. Yes.

On the other hand, there is a lot of discussion, interaction, and the forming of ideas and opinions here that is going on, and the exchanging of visits. I don't think that one would say by any means that we have a quiet scene as far as the discussions of this subject are concerned. Whether it is wise to pace the deliberations of this Committee of 20 earlier than the September period, I am not so sure. I would be inclined to think it ought to proceed as it is now set up. But I think it is a worthwhile question to explore.

Representative REUSS. Let me ask another question on the same subject.

When will the United States have ready the U.S. proposals on international monetary reform for submission to the Committee of 20, either privately or publicly, whatever the choice is?

Secretary SHULTZ. Well, we, of course, have been working on that subject. There is no dearth of plans of various kinds that one can think of. I do think it is important for us to try to work through not simply a U.S. plan, but to try to think through the variety of arrangements that might be agreeable as far as we are concerned, and then to see if we can't evolve a process of discussion.

It might be that at some point in that discussion it would be desirable to put forward a plan, or maybe it wouldn't be. But I think we are well in the stages of developing our own thoughts on that. We will be ready to put forward our ideas when we think the appropriate time has arrived.

I think you can ruin good ideas by putting them forward prematurely. So, it is a question of timing as well as the particular ideas themselves.

Representative REUSS. Turning to the domestic scene, I remind us all that this is our semiannual review under the Employment Act of 1946, of which the first commandment is maximum employment. I know that nothing has been said about the joblessness in the testimony this morning. At the start of the Nixon administration there were 2.8 million jobless in this country. Today there are almost 5 million. That to many of us is going in the wrong direction. What are your plans for bringing joblessness down at least to the level of 2.8 million that it was at when the Nixon administration assumed power?

Secretary SHULTZ. I tried to emphasize in my responses to the chairman's opening comments the importance that I attach, and I know the President attaches, to expanding employment, and reducing unemployment. I didn't read my full testimony, but I will read the paragraph commenting on the importance of doing something on unemployment and to continue our efforts there:

> This is especially so since we must work constantly to see that all those who want a job have an opportunity to have one. Encouraging as are recent indicators of economic expansion, we are nevertheless short of attaining that important goal.

I think we need to keep working on it. The most important thing that can be done to improve the labor market, of course, is to encourage expansion of employment, and preferably, very much preferably, in the private sector.

Here I think the fact that we have seen employment rise by about 2.4 million in the last year, and all the indicators are that employment now is moving very strongly, is extremely encouraging. So I think that the fundamental thing is to do everything we can to encourage a healthy expansion. That is what will get us to where we want to be.

But when we have an expansion that has accompanying it a renewal of the inflation that we have been struggling with for the past two and a half years, we just go through it all over again, and we haven't really solved the problem.

Representative REUSS. Although I agree surely with what you say about the desirability of avoiding another bout of inflation, hasn't the healthy expansion you talked about been largely one that benefited the 20 percent of the families in this country which is at the top of the income scale?

For instance, the Federal Reserve Board figures, which I find very interesting, disclose that for the first time in history under the Nixon administration—for the first time in 30 years of history under the Nixon administration—the shares of the national income accruing to the top 20 percent of American families has increased, while everybody else's share has gone down. That was between 1968, the last pre-Nixon year, and 1970, the last year for which we have figures.

Therefore, isn't this expansion that you are talking about largely one that benefits corporate profits and the people at the top, and doesn't that in part account for the very disturbing fact that our unemployment has almost doubled in the last three and a half years?

Secretary SHULTZ. I think that the fact is that the employment gains have been very widespread by industry, by occupation, by geographic area, and so on. We have seen a decline in unemployment among full-time workers. And we have seen a decline in unemployment among married men. That has preceded the current picture, where we are now seeing a decline among part-time workers, among youth, and so forth, which I think is most welcome. These are always segments of the labor market that are very hard for these statistics to measure with any degree of accuracy, because people tend to be in and out of the labor market quite a lot. But I think that the expansion has spread itself, and is offering opportunity very widely across the income band, across the geographical band, industrially, and occupationally.

Representative REUSS. You mention in your statement that the rapid depreciation corporation tax deduction and the 7 percent investment credit tax deduction have, as you put it, created jobs now.

Let me examine your evidence for saying that by a particular case—and this is a case I know about.

In a given office building there were three janitors who cleaned the floor by the old mop-and-soap method. Because of these incentives to make investment in equipment which the entrepreneur, the owner of the building, would not have made without the incentive, a shampooing machine was bought. And two of the three janitors were let go. The job of cleaning the floors was capably accomplished by one person and the machine.

Now, the production of that machine, I grant you, which would not otherwise have been purchased, meant some portions of jobs. But here were two jobs lost and two added to the welfare rolls.

What is your evidence for asserting that on balance these two Nixon programs, the asset depreciation and the investment tax credit, have made jobs rather than lost jobs?

Secretary SHULTZ. Of course, you are familiar with the facts in the case that you have brought forward. Is it the case that these people went from jobs to welfare rolls?

I think the problem is not so much a question of why did a person lose the job that he or she was on, but rather why wasn't there another job there for that person to go to?

Representative REUSS. According to Business Week magazine, the welfare rolls did indeed have to absorb that technological unemployment.

Secretary SHULTZ. On the whole, however, what we have seen so far this year—and when we were talking earlier about the budget totals, this came out—is that our welfare expenditures are a little less than we expected, and that the economic expansion is apparently having—at least it may be one of the factors—an impact on that. But I would say that generally we are always in this process, and must be. As we try to improve productivity—and Senator Javits was pointing up the importance of that, particularly both internally and internationally—we always are in the process, and people are in the process, of transition. It is very important for us to have good programs that help people make transitions. And we do have programs now that I think are superior to what we had 10 years ago.

Representative REUSS. Programs that raised unemployment from 2.5 million to 5 million can't be very good.

Secretary SHULTZ. The transition arrangements are unemployment compensation, which we have been striving to improve—and I think with the cooperation of the Congress have improved substantially during this presidental term—and manpower programs, on the other hand, that can help a person while unemployed make a successful transition to another job.

Now, it is critical, of course, for the workability of these programs that we have an expanding labor market. That is why I think the fact that we have seen employment go up by 2.4 million in the past year, the importance of the low layoff rates, the high accession rates, and so on, are very encouraging in this regard.

But I would say, coming back to your comment about the statement in my testimony, that what we see is a big stepup in expenditures on plant and equipment. From 1970 to 1971, the increase was on the order of 2 percent or so, and this year it looks as though it will be more on the order of 10, 11, 12 percent, or perhaps even higher, over the prior year.

So, we are seeing a big impact there. Of course, it will always take a while in a general sense for these major shifts to have their direct impact. On that basis, I would think there is a net immediate gain. But, of course, the big thing is the importance of having an economy that is competitive in world markets and which is capable of providing and improving the standard of living for people here at home.

Representative REUSS. That is important, and so is the dignity, and money, of having a job.

Secretary SHULTZ. I don't have any argument with you on that.

Representative REUSS. Could you for the record, when you look over your testimony, give me such evidence as you have of the number of men and women displaced from jobs as a result of the purchase of this new equipment whose purchase, as you say, is increasing at a very rapid rate? I think one has to do some balancing.

Secretary SHULTZ. I will do what I can with that. But I think it would be a hard thing to really disentangle.

Chairman PROXMIRE. Thank you, Mr. Chairman.
Senator Fulbright.

Senator FULBRIGHT. Thank you, Mr. Chairman.

Before I ask the Secretary of the Treasury, I wonder if I could ask Mr. Weinberger a question relative to the correspondence I have had with him recently about impoundment of funds. Are there any plans for the release of the money that has been impounded from the Farmers Home Administration for water and sewer projects?

Mr. WEINBERGER. I think we furnished a report on that as of June 30, Senator. I don't have the figures before me, but the information furnished in that report would be accurate. I believe we did release a portion of it, and are planning to use some during the balance of this fiscal year.

Senator FULBRIGHT. As I understand it, there were $58 million impounded in the 1972 appropriation funds for this purpose, which could be carried over for this fiscal year.

Mr. WEINBERGER. Yes. And we are planning to release some of that in this fiscal year.

Senator FULBRIGHT. I think you might do that.

Mr. WEINBERGER. Yes, sir.

Senator FULBRIGHT. A point that I would like to ask the Secretary about is the question of the administration policy with regard to the application of our funds. I have just come from a meeting in the Finance Committee in which there were 15 mayors of major cities pleading for funds from the Federal Government. Of course, they want some $30 million in the next 5 years, as you know, of revenue sharing. But, Mr. Secretary, let me read from the Brookings' study on the 1973 budget:

> The Federal Budget for fiscal 1973 provides for a substantial increase in spending on national defense, the major impact of which could come in future years. The President proposes that the United States spend $76.5 billion for defense purposes, $700 million more than in fiscal 1972, and an amount representing 6.4 percent of the gross national product, and 30 percent of the Federal Budget. The President asked for $83.2 billion in total obligational authority for the defense department, up $5.1 billion from fiscal 1972. For this reason when there is an increase in the defense program—

I am skipping a little here simply to get to the point, but it is all on page 40 of the report—

> for this reason, when there is an increase in the defense program measured by funds authorized, the accompanying increase in actual spending may not occur for some time, and maybe spread over several years. Much the same situation existed in the fiscal 1972 budget when total obligational authority exceeded outlays by $2.3 billion. Taken together, the budget for the two years provides authority for a substantial rise in defense outlays in the years immediately ahead.

That is the sentence I wanted to lead up to and emphasize. And I want to ask you what it is in the international situation or the domestic situation, what are the conditions or circumstances which in the opinion of the administration warrant this increase, substantial increase in expenditures for military affairs, in view of the extreme pressures for money from the local or for domestic affairs, as evidenced by the mayors, as evidenced by my own constituents' interest in such simple, fundamental things as water and sewer projects? It absolutely puzzles me why the administration insists that these large increases, this very large amount, 30 percent of the total Federal budget, must continue to be spent on military affairs, in the face of such developments as the SALT agreement, and more recently, the trade agreement with Russia, $750 million, we are told, and other private agreements, and in the face of our continuing trips to China—I think China, the papers report, has negotiated an agreement for $150 million in jets, 707's from Boeing, and now this morning says they are negotiating for two Concordes with France.

All this would seem to a layman who is not perhaps as well informed as the administration to lead to relaxation of the kind of hostility that has accounted for these vast expenditures in the past. And I am frankly completely puzzled as to your insistence, continued insistence upon increases in military expenditures in the face of domestic need, because the international situation I would have thought would lead one to believe this was a lessening of hostilities, and less probability of the need for these vast, costly weapons. I wonder if you could address a few remarks to that proposition as to why you feel it is absolutely essential that no substantial cuts be made in military affairs.

Secretary SHULTZ. Thank you, Senator. I would like to do that.

I think, first of all, I would like to remind you of some of the provisions in the budget. I have a table here in the budget that takes it over a 5-year span. In both 1965 and 1970 roughly 41 percent of the budget was spent on national defense. In the fiscal 1973 budget the portion is 31.8. The human resources area in 1965 were 29.9, I will say 30 percent. In 1970 it would be 37 percent, and, in 1973, 45 percent. So, I think the first comment that I would make is the substantial shift in the importance of the defense budget in the total budget.

Now, the second thing that I would say, speaking very generally, is that certainly we would hope we get—and the President has been working so hard to get it—the support of other nations and to work through negotiations toward a world where our competition is, let us say, in economic terms, rather than in military terms. I believe that great progress has been made by the President in bringing that about. I think the evidence is that you make progress on that sort of thing by leading from strength, and that you put yourself in a posture of strength, and you negotiate and work with other parties, and if you can thereby bring the defense effort of the countries involved down together, then you have real progress.

But if you don't get yourself in a posture of strength, you really have nothing to negotiate from and you will not be successful in turning the situation from one dominated by military thinking to one dominated by more of the spirit of competition.

Mr. WEINBERGER. I wonder if I might add one point there, too, because there is a fundamental error in Senator Fulbright's assumption. That is that there has not been any decrease in military activity or military affairs, as you put it.

There has been a major reduction in those affairs. The very fact that we were able to maintain a budget at the level of $77 billion over the past 3 years indicates a major reduction in activities, because we have had tremendous increases in pay and prices. Payroll-related expenses of the Defense Establishment is now, with something like four increases in pay in the last 12 months, 57 percent of the total defense budget.

If you were to have maintained your military affairs at exactly an even level, it would cost us well over $92 billion now, instead of $77 billion. So, to say that there has been no reduction in military affairs is just wrong.

Senator FULBRIGHT. I think I put it a reduction in the amount spent for it. I was reading from the report of Brookings. In dollars it is an increase over what it was, if this is at all correct.

Mr. WEINBERGER. There is an increase in budget authority. But the outlay figures for the 3 fiscal years since 1971 have been relatively level, with very little variation; not as much as a billion dollars, and in these terms that is a small variation. That means a very marked reduction in military activity or military affairs.

Senator FULBRIGHT. I would reemphasize that it says a substantial rise in the defense outlays in the years immediately ahead. The obligational authority is where the big increase has been.

Mr. WEINBERGER. That is not the same as outlays, Senator.

The only way in which the President was able to get anyone to listen to him on the other side was to go in with credible strength and a credible defense budget; otherwise, we would not have had any opportunity to have discussions.

Senator FULBRIGHT. Mr. Weinberger, I don't accept that. That is another argument, the idea that because we have wasted $10 to $15 billion on ABM and got the SALT agreement I don't think makes any sense. That is a matter of merit.

Mr. WEINBERGER. I think "wasting" is an argumentative word. I don't think we could agree that the money has been wasted if it provided an opportunity for meaningful discussion and negotiation, and I think it has.

Senator FULBRIGHT. That is a matter that would take much longer than we have got here. This is a matter that our commitee and others have been engaged in.

But coming back to this question of priorities, it sounds as if this idea that we have to have a bargaining shift, which I take it you call strength, in order to make agreements, seems to me is a very questionable assumption. The Chinese invited the President. I don't know of any bargaining pressures or threats that he was exposed to. I don't think it stands up at all to say that there will be a change in attitude of these people, the Chinese. And I think there is very little evidence with regard to the Russians. And there is nothing really to support the idea that the ABM is a significant and useful instrument.

However, I am glad the President has done what he has done. And I approve of it. But what I don't understand is the continued and now increasing obligational authority for military affairs in the face of this. It would seem to me that the only common sense is that if these various agreements—and I take them as meaning that, I don't think the Russians are trying to fool us in buying our wheat or making the SALT agreement preparatory to an attack. I think everything would indicate that they do not intend to attack us with nuclear weapons. And yet in the face of that we are being asked—we will today in the present bill—to authorize a trial, a very questionable program, in the B-1, and the F-14, which includes almost as big a lemon, if not a worse one as the TFX. It has crashed time after time, and it is a dubious kind of a program.

I just don't understand why the common sense is that we authorize the acceleration of these programs, because what you are asking for is an acceleration of the Trident, but beyond what was originally planned by about three times, as I understand it, in this year's budget. And when you go listen to the mayor and you listen to the small towns in my State, I don't understand the priorities. If you are not really apprehensive that the Russians are about to attack us, why do you accelerate such a weapons systems as the Trident? There is no indication that the Russians are ready to attack us. I just don't think the comment is a very persuasive one, in view of the President's policies and what has happened. That we just continued to accelerate that kind of program.

I don't know that there is more that I can say. It seems a very strange sense of judgment as to what is likely. And all everybody can know in the international scene is that everything that has happened recently for a month or 2 months would indicate that the Russians are not planning to attack this country in the foreseeable future.

That being so, why does one accelerate a long-term program such as Trident that goes over many years, increasing it from somewhere around $350 million to nearly a billion in this year's budget? It is the acceleration. Nobody is saying that we should lay down all development programs that are not even considered new improvements, but here is an acceleration, and the only justification would seem to be an apprehension that we are going to be attacked sooner, and we need to get all our weapons in order. I think this is a very strange interpretation of the events which have taken place in the last 2 or 3 months.

Mr. WEINBERGER. I think your assessment is very comforting, Senator, but unfortunately it isn't one that is fully shared by everybody. The President has the responsibility, and his budget, I don't think I need to remind you, provided for both the defensive capabilities that he thinks are necessary and revenue sharing, which the mayors are properly calling for. And it is simply the delays that have been encountered that have prevented both being enacted.

The dollars are provided within the President's budget.

But there have been a lot of additions made for other programs.

Before you entered I remarked on the fact that the 1973 deficit has been increased or would be increased by $10.3 billion if all the bills passed by the House were enacted, or $9.4 billion if all bills passed by the Senate were enacted.

Now, priorities were set in the President's budget according to his view of the world situation. I don't think we accept your very comforting assessment of the world situation, and in view of the lag that is involved in the development of some of these weapon systems that are necessary to insure that not only this year but 5 or 6 years hence people on the other side will be interested and willing to talk to the representatives of the United States, whoever they might be, we felt it necessary to fund these programs now.

Senator FULBRIGHT. Then if I understand you, your conclusion is that these agreements do not have the effect of lessening the probability of warfare with Russia?

Mr. WEINBERGER. No; I didn't say that.

Senator FULBRIGHT. You don't share my feeling that there is any lack or lessening of the probability of the Russian attack? What did you say if you didn't say that?

Mr. WEINBERGER. I said that this kind of defense capability is provided in the budget because it is considered by the President to be necessary to maintain his credibility when he goes abroad to make arrangements under which we hope we will have a great deal more security than we have had under past policies.

Senator FULBRIGHT. My time is up.

Chairman PROXMIRE. Senator Humphrey.

Senator HUMPHREY. Mr. Chairman, I am sorry that I couldn't be here in the early part of this discussion; but I have had a chance to briefly scan the prepared statements and to see the general thrust of them.

I just have a series of questions, Mr. Chairman, that will get at some specifics.

As I look at the statements that are here from Mr. Weinberger and Mr. Shultz, I sense that the emphasis is that there is considerable worry on the part of the administration about congressional actions and congressional authorizations and appropriations that will exceed the President's budget; is that correct?

Mr. WEINBERGER. That is certainly correct as far as it goes, Senator. But you will notice that the spending ceiling that the President requested in January would be of equal application to the executive branch and the legislative branch. It is the total problem, the effect of that on the economy, the worry about starting inflation again, and the worry about setting the stage for a situation which could require higher taxes—these are the things that are of grave concern to the administration, and so we are, as you say, worried about that and seeking again what the President sought in January—a rigid spending ceiling that is applicable both to the legislative and the executive branches.

Senator HUMPHREY. Isn't it a fact that in the budgets for fiscal 1970, 1971, and 1972, those are the budgets that have been completed and enacted thus far, that the Congress actually reduced the total sum below the President's recommendations?

Mr. WEINBERGER. No, sir; that is, if I may respectfully describe it, a popular fallacy. Some of the appropriation bills were less than the President requested, and some were more. The precise totals I don't have before me that resulted from the appropriation process, but in each of the years you mentioned the Congress enacted bills that required additional spending, either because of very much higher authorization levels which created pressures for upward spending in later years or because they actually set uncontrollable formulas that required spending in later years.

Senator HUMPHREY. Authorizations do not have that impact you are talking about. Authorizations are a promise, not a fulfillment.

Mr. WEINBERGER. They are a promise which leads to expectations which, in turn, lead to pressures——

Senator HUMPHREY. But not many——

Mr. WEINBERGER. If I might finish—and that, in turn, leads to spending or withholding of appropriations by the executive branch, which, in turn, leads to more pressure. The simple fact, however, and a direct answer to your question, is that in each of these years the Congress either enacted or set in motion spending measures which far exceeded the requests of the President.

Senator HUMPHREY. Let's get it clear because the language gets a bit confusing here.

No. 1, authorizations do not mean appropriations, so let's not confuse the record.

Mr. WEINBERGER. Not automatically; no, sir.

Senator HUMPHREY. Not automatically; not at all. Authorizations are the levels which the Congress says that the appropriation process could reach if its is the judgment of the Congress that it so desires. I have seen a lot of authorizations around here but very few appropriations at times and items that I thought were very important, so let's not let the public record be consfusing.

Authorizations do not mean expenditure actually appropriated.

Mr. WEINBERGER. I would like to respond to that by saying that they do not mean it automatically. However, they set in motion things which require either disappointment of expectations, which the Congress has been very slow to impose on anyone, or they require withholding on the part of the executive branch that causes disappointment in the Congress and in other sectors of the public.

So authorizations—you are right—do not automatically mean appropriations or spending; but they set in motion a process that leads to a level of spending which is higher than that requested by the President in the last 3 years.

Senator HUMPHREY. But my point is, Mr. Weinberger, that while you may give this description of what the psychic impact of authorizations or the effects supposedly upon one's hopes and fears are, the fact is that the dollars that the Congress has appropriated in fiscal 1970, 1971, 1972, have not exceeded the President's request in his budget; isn't that a fact?

Mr. WEINBERGER. I don't think that is correct; no, sir, because you are talking only about the appropriation process. A lot of spending can come about as a result of actions in addition to the appropriation process. There are all kinds of contractual authority and various means of——

Senator HUMPHREY. I understand that; so it is the total outlays of the President's budget as compared to what the Congress appropriated and the other contractual obligations and so forth which the Congress authorizes?

Mr. WEINBERGER. My understanding is that spending that was required by congressional actions in those years exceeded the spending requested by the President.

Senator HUMPHREY. I would like a more precise statement if you can qualify it.

Mr. WEINBERGER. All right, sir.

Senator HUMPHREY. My understanding is to the contrary——

Chairman PROXMIRE. Would the Senator yield on that?

If the Senator would permit, I would like to have put into the record at this point the compilations of the Appropriations Committee which bear out Senator Humphrey's position, that the Congress has cut the appropriations requested by the President in these years.

Mr. WEINBERGER. Very well.

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

CONGRESSIONAL CHANGES IN BUDGET REQUESTS

There are a number of reasons why the effect of Congressional actions on appropriation bills is not a comprehensive measure of the effect of Congressional actions on budget spending estimates:

1. Changes in appropriation amounts generally do not have an equal effect on budget spending in the year for which appropriations are provided. Many relatively large changes in appropriations will cause a much smaller change in the latest budget spending estimates.

2. Similarly, changes in appropriations not affecting spending estimates for the budget year may not have a direct effect on future-year spending.

(*a*) Some appropriations are for stand-by or contingency authority, restoration of capital impairment, or intragovernmental payments and have little, if any, effect on subsequent outlays.

(*b*) Some reductions in appropriations may require subsequent appropriation requests for restoration of the decrease. Examples include deferrals of requests for necessary construction and reductions in programs for which payments are required under other statutes.

(*c*) Some small additions by the Congress may require subsequent requests for large appropriations. For example, Senate additions to the 1973 Public Works appropriation for various new construction starts total about $13 million. If this construction is initiated, over $800 million in future appropriations and spending will be necessary.

3. As Table 1 below demonstrates, there are many changes in budget spending which are caused by Congressional actions or inactions in bills other than appropriations.

(*a*) Some legislation outside appropriation acts provides obligational authority without subsequent appropriation action, e.g., acts providing borrowing authority for the Tennessee Valley Authority.

(*b*) Some legislation outside appropriation acts provides obligational authority which requires subsequent approval of spending authority in appropriation acts (not counted in appropriation bill totals), e.g., Federal Highway Acts.

(*c*) Some legislation outside appropriation acts *requires* subsequent appropriation requests, e.g., acts increasing veterans benefits or public assistance grants.

(*d*) Some legislation raises benefits for programs financed by earmarked taxes; amounts of added benefits for these programs directly affect spending but do not appear in appropriations, e.g., Social Security Act amendments.

4. Each year annual budget estimates are revised to take account of the spending effect of Congressional actions in the previous session. Statutes which raise salaries or benefits not only increase the current budget, but also raise the level of all subsequent budget requests. For example, the recently enacted increase in Social Security benefits will increase the level of payments shown in all future budgets by more than $6 billion each year over the levels contemplated by the January 1972 budget.

5. While amounts of changes in obligational authority can be determined fairly precisely, estimates of the spending effect are much less precise.

6. Some appropriation tabulations include amounts which cannot affect spending estimates for technical reasons. For example, tables in the annual publication, *Appropriations, Estimates, Etc.*, include reductions in proposed advance appropriations. This reduction is only a deferral and subsequent appropriations must be requested, with no effect on budget spending. (As is shown in Table 2 below, appropriation tabulations for the First and Second Sessions of the 91st Congress show reductions of $1.2 billion and $1.3 billion respectively in advance appropriations.)

The following tables show that the net effect of major Congressional actions and inactions on the 1970, 1971, and 1972 budgets was to increase spending in those years. Amounts in Table 2 showing changes in obligational authority are equal to figures appearing in the annual *Appropriations, Estimates, Etc.* Those changes show that *appropriations* were reduced, but for many of the reasons noted above, these reductions were not a complete measure of the spending actions of the Congress.

Table 1 summarizes details shown in Tables 2 through 5:

TABLE 1.—*Congressional changes in budget requests*

[Outlays in billions of dollars]

	Amount
Fiscal year 1970:	
91st Cong., 1st sess.:	
1. Congressional changes in appropriation requests	−3.0
2. Other actions requiring 1970 spending	+1.6
3. Inaction on budget requests	+1.3
Total, 91st Cong., 1st sess	−0.1
91st Cong., 2d sess.:	
1. Congressional changes in appropriation requests	+0.2
2. Other actions requiring 1970 spending	+0.1
3. Inaction on budget requests	+0.2
Total, 91st Cong., 2d sess	+0.4
Total, fiscal year 1970	+0.3
Fiscal year 1971:	
91st Cong., 2d sess.:	
1. Congressional changes in appropriation requests	+0.3
2. Other actions requiring 1971 spending	+2.4
3. Inaction on budget requests	+0.1
Total, 91st Cong., 2d sess	+2.9
92d Cong., 1st sess.:	
1. Congressional changes in appropriation requests	−0.4
2. Other actions requiring 1971 spending	+0.6
3. Inaction on budget requests	−0.3
Total, 92d Cong., 1st sess	−0.1
Total, fiscal year 1971	+2.8
Fiscal year 1972:	
92d Cong., 1st sess.:	
1. Congressional changes in appropriation requests	+0.4
2. Other actions requiring 1972 spending	+3.5
Total, 92d Cong., 1st sess	+3.9
92d Cong., 2d sess.:	
1. Congressional changes in appropriation requests	−0.3
2. Other actions requiring 1972 spending	−0.1
3. Inaction on budget requests	−3.0
Total, 92d Cong., 2d sess	−3.3
Total, fiscal year 1972	+0.6

TABLE 2.—CONGRESSIONAL CHANGES IN APPROPRIATION REQUESTS

[In billions]

Appropriation acts [1]	1970 Obligational authority	1970 Effect on 1970 spending	1971 Obligational authority	1971 Effect on 1971 spending	1972 Obligational authority	1972 Effect on 1972 spending
91st Cong., 1st sess.:						
Agriculture and related agencies, 1970	+0.3	+0.2				
Defense and military construction, 1970	−6.0	−2.9				
Independent offices, HUD, VA, 1970	−.4	(2)				
Public works and AEC, 1970	+.6	+.1				

See footnotes at end of table, p. 75.

TABLE 2.—CONGRESSIONAL CHANGES IN APPROPRIATION REQUESTS—Continued

[In billions]

Appropriation acts [1]	1970 Obligational authority	1970 Effect on 1970 spending	1971 Obligational authority	1971 Effect on 1971 spending	1972 Obligational authority	1972 Effect on 1972 spending
91st Cong. 1st sess.—Con.						
2d supplemental, 1969	[3] −.5	−.1				
Other (District of Columbia, Interior, Legislative, State-Justice-Commerce, Transportation, Treasury-Postal Service, 1st supplemental—all 1970)	−.2	−.2				
Total, 91st Cong., 1st sess	−6.2	−3.0				
91st Cong., 2d sess.:						
Foreign assistance, 1970	−1.2	−.1				
Labor-HEW, 1970	[4] −.8	[5] +.3		+0.2		
2d supplemental, 1970	−.4	−.1		+.1		
Agriculture and related agencies, 1971			+0.3	+.3		
Defense and military construction, 1971			−2.2	−.8		
Foreign assistance and related, 1971			−.3	−.1		
Independent offices, HUD, VA, 1971			+.2	(2)		
Labor-HEW, 1971			+.2	[6] +.4		
Education, 1971			[7] −.9	+.2		
Public works and AEC, 1971			(2)	(2)		
Other (District of Columbia, Interior, Legislative, State-Justice-Commerce, Treasury-Postal Service, 1st supplemental—all 1971)			−.4	(2)		
Total, 91st Cong., 2d sess	−2.4	+.2	−3.1	+.3		
92d Cong., 1st sess.:						
Transportation, 1971				(3)		
2d supplemental and urgent supplemental, 1971			−.9	−.4		
Agriculture and related agencies 1972					+1.2	+0.5
Defense and military construction, 1972					−3.1	−1.1
Independent offices, HUD, VA, 1972					+.9	+.3
Labor-HEW, 1972					+.6	[6] +.4
Education, 1972					(3)	+.4
Public Works and AEC, 1972					+.1	+.1
Other (District of Columbia, Interior, Legislative, State-Justice-Commerce, Treasury-Postal Service, 1st Supplemental—all 1972)					−.2	−.1
Total, 92d Cong., 1st sess			−.9	−.4	−.5	+.4
92d Cong., 2d sess.:						
Foreign assistqnce					−1.2	−.1
2d supplemental and disaster relief supplemental					−.4	−.3
Total, 92d Cong., 2d sess					−1.6	−.3
Total	−8.6	−2.9	−4.0	−.1	−2.1	+.1

[1] The title and coverage of individual appropriation acts changes from year to year. In this listing, general titles are used and, in several instances, amounts for 2 or more appropriation acts are combined.

[2] Less than $50,000,000.

[3] 1969 obligational authority.

[4] Includes deletion of $1,200,000,000 for requested 1971 advance appropriations. The reduction required a request for appropriation in the subsequent session of Congress and had no effect on 1970 or later spending.

[5] Reflects effect of bill enacted subsequent to veto of H.R. 13111. If enacted, the vetoed bill would have added $600,000,000 to 1970 spending.

[6] Includes effect of failure to enact a limitation on the social services program.

[7] Includes deletion of $1,300,000,000 of requested 1972 advance appropriations. The reduction required a request for appropriation in the subsequent session of Congress and had no effect on 1971 or later spending.

Note: Tables may not add due to rounding.

Source: For both sessions of the 91st Cong. (1st 4 amount cols.), amounts of obligational authority are those appearing in appropriations, estimates, etc., 1969–70 and 1970–71. For the 92d Cong., amounts of obligational authority are those appearing in various tables published by the House Committee on Appropriations and the Joint Committee on Reduction of Federal Expenditures. Spending effects were estimated by the Office of Management and Budget.

TABLE 3.—*Congressional changes in 1970 budget requests*

[Outlays in billions of dollars]

	Amount
Fiscal year 1970:	
91st Cong., 1st sess.:	
1. Congressional changes in appropriation requests (table 2)	−3.0
2. Other acts requiring 1970 spending:	
Social security benefits (Public Law 91–172)	+1.2
Expanded mortgage markets (Public Law 91–151)	+0.2
Various veterans bills (Public Law 91–22, 91–178, 91–102, 91–101, 91–96) and other bills requiring 1970 spending (Public Law 91–93, 91–114, 91–152, 91–179, 91–183)	+0.2
3. Inaction on budget requests:	
Postal rate increase	+0.6
Added sales of Veterans' and Farmers Home Administration loans	+0.4
Veterans reform legislation	+0.2
Medicaid reform	+0.1
Total effect on budget request, 91st Cong., 1st sess	−0.1
91st Cong., 2d sess.:	
1. Congressional changes in appropriation requests (table 2)	+0.2
2. Other acts affecting obligational authority or requiring 1972 spending: Veterans education assistance (Public Law 91–219) and Food for needy children (Public Law 91–207)	+0.1
3. Inaction on budget requests: Postal rate increase	+0.2
Total effect on budget requests, 91st Congress, 2d sess	+0.4
Total, 1970	+0.3

TABLE 4.—*Congressional changes in 1971 budget requests*

[Outlays in billions of dollars]

	Amount
Fiscal year 1971:	
91st Cong., 2d sess.:	
1. Congressional changes in appropriation requests (table 2)	+0.3
2. Other acts requiring 1971 spending:	
Postal reform (Public Law 91–375)	+1.4
Veterans education assistance (Public Law 91–376)	+0.2
Veterans education assitance (Public Law 91–219)	+0.2
Other Veterans legislation (Public Law 91–500, 91–291, 91–262, 91–506, 91–588, 91–584, 91–666)	+0.2
Employee health benefits (Public Law 91–418)	+0.1
Other legislation (Public Law 91–373, 91–658, 91–630, 91–388, 91–377, 91–297, 91–599, 91–258, 91–650)	+0.3
3. Inaction on budget requests:	
Family assistance	−0.5
Waste treatment grants and other	−0.2
Sale of stockpile surpluses	+0.2
Medicaid reform	+0.2
Other	+0.4
Total effect on budget requests, 91st Cong., 2d sess	+2.9
92d Cong., 1st sess.:	
1. Congressional changes in appropriation requests (table 2)	−0.4
2. Other acts requiring 1971 spending: Social security and railroad retirement increase (Public Law 92–5)	+0.6
3. Inaction on budget requests: Social security benefits and emergency school assistance	−0.3
Total effect on budget requests, 92d Cong., 1st sess	−0.1
Total, 1971	+2.8

TABLE 5.—*Congressional changes in 1972 budget requests*

[Outlays in billions of dollars]

	Amount
Fiscal year 1972:	
92d Cong., 1st sess.:	
1. Congressional changes in appropriation requests (table 2)	+0.4
2. Other acts requiring 1972 spending:	
Social security and railroad retirement increase (Public Law 92–5)	+1.4
Federal pay raise (Public Law 92–210)	+1.1
All-volunteer army (Public Law 92–129)	+0.6
School lunch (Public Law 92–32, 92–153)	+0.2
Railroad retirement increase (Public Law 92–46)	+0.2
Unemployment compensation (Public Law 92–224), and other legislation (Public Law 92–126, 92–198, 92–197, 92–95, 92–10)	+0.1
Total effect on budget requests, 92d Congress, 1st sess	+3.9
92d Cong., 2d sess.:	
1. Congressional changes in appropriation requests (table 2)	−0.3
2. Other acts requiring 1972 spending:	
Black lung benefits (Public Law 92–303; emergency school assistance, higher education ,etc. (Public Law 92–318)	−0.1
3. Inaction on legislative proposals:	
General revenue sharing (H.R. 14370)	−2.2
Veterans legislation (H.R. 13799, H.R. 12828)	−0.2
Water quality (S. 2770) and others	−0.5
Total effect on budget requests, 92d Cong., 2d sess	−3.3
Total, 1972	+0.6

[An article appearing in the New York Times, Sunday, August 6, 1972, explains further the ways in which Congress adds to spending]

SPENDING PARADOX BAFFLES CONGRESS

(By Edwin L. Dale, Jr.)

WASHINGTON.—A kind of "dialogue of the deaf" is going on between the Nixon Administration and the Democratic Congress over steeply rising Government spending and deficits.

Part of the reason is political. But a major part of the reason is that a large number of Congressmen, perhaps a majority, apparently do not understand how they add to the Government's budget totals.

Three Democratic Senators who have been in Congress for years—John J. Sparkman of Alabama, Hubert H. Humphrey of Minnesota and William Proxmire of Wisconsin—illustrated the point late last month at the hearings of the Joint Economic Committee. They all pointed out, accurately, that in all recent years Congress has actually reduced somewhat the total appropriations request of the President in power.

"How," asked Senator Humphrey, "can Congress be blamed for increasing spending?"

"Every year," said Senator Proxmire, "we reduce those Nixon requests for spending. Now it's true we don't reduce spending where the Administration wants its reduced. But we do make an over-all net cut."

This observer is willing to accept that these statements are made in good faith, apart from politics. It is clear from letters received by this column that the misunderstanding involved is not limited to members of Congress. But it is a misunderstanding—a grave one in the view of many economists.

Congress does increase total spending greatly, appropriations bills to the contrary notwithstanding.

The explanation of the paradox lies in the process by which, now, most Government spending occurs. The least important part of the process is the appropriations bill—though these bills can be important on items that are small in spending terms.

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At issue here is not the merits of added spending. Walter W. Heller, a leading Democratic economist, told the Joint Economic Committee that, in current conditions, additions to the President's budget are postively desirable. At issue is how spending rises.

The process can best be described by three specific pieces of legislation this year. All were passed by overwhelming majorities, including scores of Republican votes.

The Veterans Committees in both houses reported legislation changing the formula for compensation for disability, with the result of increases in benefits for the veterans concerned. The Government checks to the veterans automatically rise on the date specified. Later on, an appropriation bill "ratifies" the process, with no possibility of reduction. The Administration's appropriations request is increased, based simply on a computation of the number of veterans eligible and the benefits they are entitled to.

The Labor and Commerce Committees reported out a bill greatly enlarging eligibility for "black lung" benefits for coal miners. Once the President signed it, the spending was inevitable. All miners meeting the new tests will receive the benefits—an addition, in this case, of an estimated $1-billion in this fiscal year above what the President proposed. The appropriation follows later automatically, at a higher level than before.

The third example is Social Security, where benefit levels were raised $2.1-billion above what the President proposed. Here an appropriation is not even required because the benefits are paid from a trust fund.

All of these items are examples of formula-type or "open-ended" Government spending. The appropriation, where necessary, follows automatically the original legislative action. Medicaid welfare, civil service pay and farm subsidies are other examples: The amount of spending is determined by formulas established in the legislation, not by appropriation bills. Only last week, for example, the Senate passed, by a vote of 82 to 4, a bill that will add $1-billion a year to military pensions.

Another way of putting the point is to ask why successive Presidential appropriations requests have risen so much, regardless of whether the President at the time wanted a tight budget. These requests have been growing by close to $20-billion a year, much of it caused inexorably by past legislation of the formula type.

Congress can make a net cut in appropriations bills where there is some discretion but still appropriate far more each year than the year before. It has not yet fully understood why this is so.

An obscure committee of Congress itself, called the Joint Committee on Reduction on Nonessential Federal Expenditures, confirms that Congress, in recent years, has regularly added to spending. Its new score-keeping reports, which have not been challenged for accuracy, show, for example, that Congress this year has already widened the budget deficit by about $4.9-billion.

Caspar W. Weinberger, the President's budget chief, was confronted by Senator Humphrey's question (cited earlier) suggesting that Congress had cut spending, not increased it.

"That, Senator," said Mr. Weinberger, "is a widely believed fallacy."

In Congress it is clearly a nonpartisan fallacy.

Senator HUMPHREY. Mr. Secretary, no defense—the Congress has repeatedly in every year, starting with fiscal 1969, which was prepared by the previous administration, fiscal 1970, fiscal 1971, 1972, cut the Department's appropriation; is that not true?

Mr. WEINBERGER. I think that is correct, yes.

Senator HUMPHREY. Substantially, is that not true?

Mr. WEINBERGER. Well, they have cut it by quite a lot, yes, sir, depending on how you view these things; they have made cuts in the general area of $1.6 billion to $2.1 billion, out of a total request of——

Chairman PROXMIRE. One year it was over $6 billion, a total of $18 billion.

Mr. WEINBERGER. I think that was authorization.

Senator HUMPHREY. Anyway, the budget authority request has been reduced?

Mr. WEINBERGER. Budget authority.

Senator HUMPHREY. I think it is important for us to try to get the information and the concerns here in proper proportion because I have looked at your statement and your statement would indicate that the Congress is hellbent on a spending spree that is going to generate fires of inflation and cause all sorts of difficulties in our economy.

Mr. WEINBERGER. That's right.

Senator HUMPHREY. That is the thrust of the statement?

Mr. WEINBERGER. That is a somewhat lurid way of phrasing the fears that I have; yes, sir.

Senator HUMPHREY. Well, it is more precise.

Mr. WEINBERGER. I doubt that, but I am worried about those things. I think that both your fears and mine, Senator, could be quieted if the spending ceiling were adopted, because it would be of equal application to the executive and the legislative branches; then we could both not have to worry about blame. We are after a definite result; that is the thing we are interested in. We don't care who is to blame; we see ahead of us a very serious fiscal situation, and we are trying urgently to do all we can do on our side; but as we get further into the fiscal year and see the trend of spending, the only thing that we think will guarantee success is a ceiling.

Senator HUMPHREY. Yet with all this concern—and I will get back to the executive-type language—the possibility of excess spending, isn't it a fact that you are now telling us, both you and Secretary Shultz, that the economy has been responding, that unemployment is dropping, that the gross national product is improving?

Mr. WEINBERGER. We have been repeating the official figures. We haven't been telling you anything——

Senator HUMPHREY. I am not denying that; I am not arguing with you about the facts.

Mr. WEINBERGER. Well, we have been saying that, surely.

Senator HUMPHREY. Apparently the medicine that has been concocted over here in the Congress hasn't been so bad; you have been prescribing and we have been filling.

Mr. WEINBERGER. We have got a serious cause-and-effect problem that might take a lot of time to unravel, but I think what is happening is, the economic policies initiated by the administration, and thus far not stopped by the Congress, have certainly worked to get us back to a point where the economy is in remarkably good shape. The increases in the GNP and the decrease in inflation at the same time, the decreases in unemployment, the enormous increase in employment—all of these things are very, very encouraging. The worry that we have expressed, Senator, is that we are very much afraid that if this spending continues at this rate, with the normal lag that is involved, and the tremendous stimulation coming back into the economy next year from the return of withheld taxes, we are going to have a serious threat of inflation again; and that is what we are trying to avoid. We are trying to suggest the principal remedy that we think can prevent it.

Senator HUMPHREY. I likewise have concerns about what would happen to the economy. My main interest is in seeing that the economy provides the jobs that are necessary for people to have, if we have an increased productivity, and if we do expand our gross national product in real terms. My point is that despite all the talk about what the Congress did do or didn't do, since the Congress itself does set policy and frequently has set the forceful policy upon the administration, such as in the economic stabilization program, that things have not deteriorated according to your own official estimates; the things have supposedly improved.

Mr. WEINBERGER. I think they have improved enormously, yes.

Senator HUMPHREY. Then it seems to me that possibly on this end of the avenue, that outlays, the authorizations, the appropriations, the legislative process, has made a distinct contribution to make healthy development rather than having frightened people out of the market, or driven people away from jobs. I just don't want this record to indicate that the Congress of the United States has been derelict or irresponsible, or been on some sort of a wild chase with the economy. The fact is that the Congress has had to sometimes insist on things being done. The administration did not want wage and price controls. We had that out in this committee time after time. We had to insist upon it.

And may I say that the Congress of the United States had to force the issue of public employment; it wasn't as if somehow or other we were cajoled into it. I happen to believe that it has been a pretty good mix, that what we have done here, despite some resistance on the part of the executive branch, has worked to the basic good. But after getting all these reports I got a few other things. What about these impounded funds that we have appropriated around here? Senator Fulbright let you off a little easier, about $58 million of water and sewer projects. What is the total amount of impounded funds that have been appropriated by the fully elected representatives of the people in the Congress of the United States?

Mr. WEINBERGER. Well, it is about, Senator, as we furnished to you in the report for June, $1.5 billion. We have had a lot of talk this morning about the size of deficits and improper estimations and the inability to control the budget; if there were not some impounding done on a very modest scale, which is way under the percentage practiced by previous administrations, we would have had deficits much larger. We would have contributed, we believe, to additional inflation which we did not want.

The common figure used about impounding is much higher.

Senator HUMPHREY. Yes, it is.

Mr. WEINBERGER. But that is a figure that could be reduced only if you forced us to pay out funds in situations where there is, quite literally in many cases, no one there to receive them. The popular figure that is usually used about impounding includes, for example, moneys appropriated by the Congress for a battleship, and when the battleship is not built, in many cases isn't even designed yet——

Secretary SHULTZ. I hope we are not building any more battleships.

Mr. WEINBERGER. This is just an example.

Senator HUMPHREY. What about those funds we have for the feeding program?

Mr. WEINBERGER. Funds for the feeding program has been increased by a very substantial amount in recent years. They have more than doubled. And there have been various changes in the regulations.

But consistent with the existing regulations, all the appropriated funds for those programs have been released.

But you simply can't release funds and pay them out when there is no one there to receive them, when the building isn't designed, when the ship isn't built, and when there is no one literally there who can take them. We have certain responsibilities which you have given us over the years to insure that that doesn't happen, and that has been why not every nickel appropriated by every Congress has been spent within a given fiscal year.

Senator HUMPHREY. I won't belabor the point, but I most respectfully suggest that in my meetings with the mayors—and I do meet with them regularly and have for better than 2 years—in my meetings with the county officers I find that there are innumerable requests being made for funds here under programs that relate to urban improvement, for water and sewers, to land acquisition, to housing, that are not being met on the basis that the funds are not available even though the funds were appropriated. Now, we can go into that and we will. There is an honest difference between the report that you have sent to us as to what the Congress itself feels. Senator Ervin of North Carolina, myself, and others have gone into this. We feel that there is substantial difference. Your figure of $1.4 billion is not the figure that is generally accepted around these precincts.

Mr. WEINBERGER. It was fortunately accepted by the Comptroller General and the General Accounting Office.

Senator HUMPHREY. I submit that when you find the amount of money that we have appropriated for what I consider is really needed—domestically primarily, is what I am talking about, everything from our agricultural programs to our housing programs, to our water-sewer programs, to land acquisition programs—the figure is substantially larger.

I have a couple of other questions here. What is the trade deficit today? What is it running at?

Secretary SHULTZ. I don't have the number right at hand, Senator.

Senator HUMPHREY. What would you estimate it at?

Secretary SHULTZ. There is a very substantial trade deficit, and I think it results in a continuing problem, of course. It improved slightly in May. Whether that is the beginning of a general improvement remains to be seen. We do think that the situation is getting somewhat healthier, as the rate of inflation here is a lot less than that of most of our trading partners. We also have a situation where our economy is expanding strongly, more strongly than that of most of our trading partners, so we are tending to pull imports into our expanding market and we are not having that pull on our exports in other places that we looked for as their economies expand. So I think these reasons suggest that it ought to improve somewhat.

But there are some very fundamental problems here, and they are by no means solved.

Senator HUMPHREY. Most of our improvement in exports has been in agriculture, isn't that true?

Secretary SHULTZ. We have had very good success in agriculture; and, of course, we have had the recent announcement of sales to the Russians, which is very gratifying.

Senator HUMPHREY. It would appear that with the devaluation on the one hand and the price and wage controls on the other hand, and the Economic Stabilization Act authority with the DISC, with the special exporter arrangements on taxes, that we should have been going much better.

Secretary SHULTZ. I think that we are. I think those steps have all helped and it does take a little time for those things to really have impact. They are beginning to.

Senator HUMPHREY. This is a matter of information, not confrontation at all. On the recent activites of the Outer Seven and the Inner Six, the Common Market and EFTA, has any evaluation been made of what the impact will be of the expansion of that European market as it relates to our export and import situation?

Secretary SHULTZ. We are certainly evaluating that carefully and, of course, the problem that we are seeking to avoid is one in which not only a Common Market but also a large bloc, including people not in the Common Market, is put forward in a manner that excludes us from these markets. We are looking for, hoping for, and counseling with our friends abroad, and we hope that the Common Market, and those associated with it, be outward looking as we want to be outward looking in our monetary and trade arrangements.

Senator HUMPHREY. At a later time, Mr. Chairman, I want to go into this whole subject of the export of American capital, as I told you before, and its impact upon American job situation; recognizing the importance of multinational corporations which I do and the importance of international trade, I am deeply concerned over the unbelievable, unfavorable balance of payments that this country has. I know a lot of it is due to speculation and a good deal is due, of course, to overseas defense activity and not an overly large amount of it. But I can recall a few years back when the headlines of our newspapers were bigger than the sinking of the *Titanic* when we had a $4 billion or a $3 billion balance-of-payments deficit. What is the balance-of-payments deficit now running, or about, just scare us a little?

Secretary SHULTZ. I would have to look at it, but it was in the $13 to $15 billion range in the first quarter of 1972, at an annual rate.

Senator HUMPHREY. Substantially larger. Has it been improving, Mr. Secretary?

Secretary SHULTZ. No, the current balance did not improve in the first quarter, although I think it will start to improve. Of course, the so-called official settlements balance has improved; and, had it not been for all of the events that followed the floating of the pound, we might very well have had a second quarter in which the official settlements were actually in balance or in surplus.

Senator HUMPHREY. When can we expect a proposal from the administration on tax reform?

Secretary SHULTZ. The President has set the end of the year as a date by which he hopes to be able to make a statement, and that is currently putting heat on the Treasury and we are working on it very hard.

Senator HUMPHREY. We couldn't have anything just before the election, could we, Mr. Secretary, as to what your plans are?

Secretary SHULTZ. I don't know. We are working hard on the subject and we think it is important. Of course, I think it is very important to recognize how extensive have been the tax changes over the past two and a half years. I have alluded to them in my testimony. I think it has been very substantial and one of the things that we are trying to do as we think about further possible changes is to assess the changes that have been made. It really is quite early to make that assessment. We are hard at work on the subject.

Senator HUMPHREY. Thank you, Mr. Chairman.

Chairman PROXMIRE. Gentlemen, I think what we lack in both of your presentations—and I think, incidentally, that there are some very good points in them, I think you have come down hard and clear on the problem of inflation—but what we lack, it seems to me, is a real concern about unemployment and about a lack of economic growth.

It is true we had some progress last month but, over the years, it has been very bad; over the last half-year it has not been what it should be, and certainly over the last year it has been inadequate. I think it is time that the administration took a real look at the so-called conventional wisdom that, if you stimulate the economy vigorously enough, it would be inflationary.

Consider the fact that we do have 5 million people out of work. That just is not an inflationary context as far as labor resources, the most vital economic resources, are concerned. We still operate at 76 percent of capacity, a recession level. Certainly there is plenty of capacity there.

We have controls in effect, and with those controls in effect, even if we were pressing capacity, there is every reason to expect we could hold down inflation with the controls if we wanted to make them effective. The fact is that every other country except Canada, which sneezes every time we get a cold, but every other country, big industrial country, is doing much better.

Japan has 1.7 percent unemployment, Germany, 0.7 percent, less than 1 percent unemployment. France, Switzerland, the Scandinavian countries are also free enterprise economies, and yet they are able to operate at a much lower level of unemployment, and a much higher degree of utilization, and a much better degree of growth than we are, and they do not have controls in effect in most of those areas.

Then when we consider the terrific benefits, the really terrific benefits of getting unemployment down sharply—when you talk about tax reform, why, that is nickel-and-dime stuff compared to the increase in revenue if we get the unemployment rate down. The revenues would greatly increase.

We talk about a welfare problem, and Senator McGovern and President Nixon are both offering their own versions. The cost will be absolutely prohibitive unless we get the unemployment problem under better control.

We talk about improving productivity. The best way to improve productivity is to reduce unemployment so that you can negotiate automated increases in-plant and so forth, without the kind of resistance you get from unions when they are concerned about their people having to be out of work if you put productivity improvements into effect.

As far as the State and local governments are concerned, they are losing $10 billion a year because of the fact that we have high unemployment, and because we are operating at far below our real economic capacity.

We talk about the crux of the problem, maldistribution of income. You know, Hubert, the last time there was a real improvement in the maldistribution of income was in World War II. Why? Because everybody was at work.

Work is the answer to this. Put them to work, and you get a far greater improvement than you will in any kind of fooling around with the tax structure.

We talk about generally effective manpower training. By far the most effective way is creating a situation where employers have to hire people and train them, because there is a scarcity of labor available, and they have to get minority groups, women, teenagers, and put them to work.

We talk about elimination of barriers to free trade. The big basis for resisting free trade in this country of course is the fear of unemployment and the lack of capacity in what we have.

As I examine the statements of Mr. Stein yesterday and Mr. Weinberger and Mr. Shultz today, it seems to me they all give far too little emphasis to expanding the economy. It is a kind of fear that—we have a neutral fiscal policy now, we are talking about a balance of full employment in the fiscal area, and the attitude toward monetary policy is that we ought to go along at about the present rate, which I guess is a 5- or 6-percent increase in the money supply, which is pretty neutral, not very much stimulus.

We have had some in the past, some recovery, in various areas of the economy, as I say, but it is hard to see what we are going to get in the coming months, or certainly in the coming year to stimulate this economy.

It seems to me you gentlemen are accepting a situation where you have 5 percent or higher unemployment, where you have underutilization of our resources. I think we could solve so much of our economic problems if we could meet that.

I would like both of you gentlemen to answer that challenge.

Mr. WEINBERGER. I would simply say, Senator, that your question seems to me to carry with it an assumption that the only way you get a healthy or strong economy is by spending Government money.

Chairman PROXMIRE. I did not say that at all, that has not been my position or record in Congress. There are lots of other ways to do it. The monetary policy is one, and tax reduction is another way; there are lots of ways to do it.

Mr. WEINBERGER. There are lots of ways to do it, and we are trying to do it. I think the figures indicate a remarkable degree of success.

But I gather from your statement some feeling that we have a fear of stimulating the economy and reducing unemployment. That impression is totally wrong.

Chairman PROXMIRE. What are you doing to stimulate the economy?

Mr. WEINBERGER. I think all you have to do is look at the GNP figures, or the inflation which goes with it, which are a remarkable combination. Look at the decline in unemployment. Most of all, look at the increase in employment, and you will conclude from that that what has been done, without attempting to give credit or blame, is working reasonably well.

Chairman PROXMIRE. Mr. Weinberger, that is just where I have been looking.

Consider the fact that when President Nixon came into office there were 2.5 million unemployed, and today there are 5 million unemployed, twice as many. And we are still staggering along with close to 6-percent unemployment. We have not had any improvement in capacity utilization.

I do not take much comfort from the fact that we had a good month of June. I think that was a good June, just one month out of 40.

Mr. WEINBERGER. We have had a very greatly strengthened economy, and we have a good susbtantial increase in GNP, the highest increase in any single quarter since 1965.

Chairman PROXMIRE. You let it get so bad it had to go up.

Mr. WEINBERGER. The reason it got so bad is because we tried to fight a major war without any kind of trimming down of domestic expenditures. We got ourselves into a hideous inflation, which is just now being squeezed out of the economy.

I think the assumption that because we are not anxious to spend a lot more Federal money we are uninterested in unemployment is totally wrong, and it completely overlooks the fact that the best route to a strong economy that reaches full employment is one where you have an atmosphere that allows the private sector to expand and not be hampered with a lot of restrictions. We also must be sure not to hamper the private sector by spending policies which require more taxation, which would be the most deflationary thing you could have.

So it seems to me that on all counts we have demonstrated the exact opposite of a lack of concern about unemployment. As a matter of fact, if you look at the fact that we brought about two and a half million people home from the war and out of defense-related industry and have employed them, it seems to me it is a remarkable record, and one that certainly has put the country in a better shape than it was in 1969.

Chairman PROXMIRE. It is a very poor record compared to what happened in World War II.

After World War II you had 10 million people discharged in a matter of a couple of years. You had a gross national product 50 percent of which was going to war, and it dropped down well below 10 percent in a couple of years, but no unemployment.

Mr. WEINBERGER. You had throttled all kinds of domestic demand during that period.

Chairman PROXMIRE. We would have all kinds of domestic demand now if we had the imagination to know how to energize it and make it effective.

Let me ask you this: You have provided a target for inflation. You want to get inflation, as I understand it, down to 3 percent at the end of the year, close to that, in that area. There has been no target that I have ever heard of by President Nixon or anybody in the administration to lessen unemployment.

Mr. WEINBERGER. His target for unemployment is the traditional goal of 4 percent.

Chairman PROXMIRE. When, 1975 or 1980?

Mr. WEINBERGER. No, sir. He was talking about doing it as soon as the policies that he has recommended are enacted by the Congress.

Chairman PROXMIRE. A target means very little if you do not set a special date for it; you set a specific date for your inflation target, but no specific date for your unemployment target.

Mr. WEINBERGER. The specific date was set for the inflation target. We would want to keep controls in until we were assured that the target had been achieved.

Chairman PROXMIRE. There was a target date for inflation, as I recall, of 3 percent at the end of the year.

Now, would you commit yourself, you gentlemen, to a target of 4-percent unemployment by the end of, say, 1973?

Secretary SHULTZ. I think it is reasonable; it is desirable, in my judgment.

Chairman PROXMIRE. You said reasonable, but now you say desirable?

Secretary SHULTZ. I think it is desirable to get unemployment down, and I would like to see it down below 4 percent myself if we could possibly swing it. Whether we will get there by the end of 1973 or not I do not know. I think it is a reasonable possibility that we will get down to the 5-percent range by the end of this year, and we will be in a process where we will still be going in a downward direction. So I regard that as a hopeful thing.

Chairman PROXMIRE. But you would not set that as a target, you would not give us a target for unemployment of 4 percent by the end of 1973, toward which the administration is working?

Mr. WEINBERGER. Do you want a target or prediction?

Chairman PROXMIRE. I do not want a prediction, I want a target. We have the prediction in the budget deficit that was not very good, and I would not expect anybody to meet a prediction necessarily.

I want a target, something—you are saying that this is what you are committed to and you are going to get to, something you can measure the administration against. That is a reasonable request for this committee to ask.

Secretary SHULTZ. The trick is to get unemployment down to possibly below 4 percent in a manner and in an environment where you can keep it that way. The last time it was below 4 percent, it was accompanied by a fairly large-scale war and rapidly escalating inflation to the point where, as I said earlier, there was a consensus expressed in the 1969 budget—that Senator Humphrey pointed out was put in place by the Johnson administration—that the whole process had to be rearranged.

That and the following events have brought us now to the point where inflation is subsiding, and we are beginning to feel that we can say we have that under control, and the economy is expanding, and unemployment is coming down, and we are beginning to get where we are getting it all together.

The problem is to continue these trends, and to try to bring the inflation problem and the unemployment problem together in a sustainable way.

I think myself, from the standpoint of economic policy, that we came very close to getting there about 1964 or so. There was a very nice process going on then. One of the great tragedies, I think, was that somehow, through the combination of various events, just as we were getting into that golden circle, everything sort of flew out of control.

Chairman PROXMIRE. I think there is a lot to it.

The Vietnam war was what happened from 1964 on; is that not right?

Secretary SHULTZ. And so what we are trying to say to you here is, as I believe Senator Humphrey properly pointed out, somehow through this process of going back and forth, and so on, we have not done too badly together. The economy is now in a pretty good posture in terms of its trend.

If you look at the budget into 1973, and as we look into 1974—and this is something that everybody sees; it was in the President's budget, it is in the Brookings study, and it is in the study of anybody who takes a careful look at this budget problem—we see that it is genuinely a problem.

The constraints imposed by the general level of tax rates that we have are very severe on spending. So we are cautioning you on that, and pointing out to you—we want it pointed out to each other, and you want it pointed out to us—here is the time that the discipline has to be exercised.

Chairman PROXMIRE. I agree with you very strongly on holding down wasteful spending, but the greatest waste by far is the waste of unemployment. This is something that you can never recover. It is not only a personal tragedy; it is a deplorable waste, it is just a terrible economic waste.

When you have 5 million people out of work month after month and for a year and a half, and we do not have any target to get that down to a 4-percent level, it seems to me that this is the worst kind of waste. This is a waste that it seems to me overwhelms any kind of waste that you are talking about in the budgetary figures. This is the worst kind of waste that any country can be guilty of, not having jobs available for people who want to work.

When you tell us that the situation is pretty good when we have 10 percent of our black citizens that cannot find jobs, 15 percent of our teenagers that cannot find jobs, when you have 6 or 8 percent of our women who cannot find jobs, when you have almost twice as many married men who cannot find jobs than 3 or 4 years ago—I think you are absolutely right in saying that in 1964 we began to get off the track.

The Vietnam war had a terrible economic impact on this country, but there is no reason, it seems to me, why we cannot do what other countries can do.

In Japan they do not have any significant amount of defense spending in terms of their economy, and very little in Germany. They are able to operate at a very low level of unemployment. Why can they do that? What is so different about their operation?

Secretary SHULTZ. The reason why Japan has the very low defense budget that it has goes back to the treaties——

Chairman PROXMIRE. I am not talking about treaties——

Secretary SHULTZ. And, if I may say so, it goes back to the umbrella that the United States holds over Japan.

Chairman PROXMIRE. What I am talking about is how they can operate without control in a free enterprise economy and have unemployment down below 3 percent.

Mr. WEINBERGER. There is an 8-percent inflation rate in Germany.

Chairman PROXMIRE. What year?

Mr. WEINBERGER. The latest figure we have is for the first quarter of 1972, when Germany's rate was 8 percent on an annualized basis. And Japan's was 5.1 for the same period. They also do not have quite the free enterprise economy in Japan that I think you have indicated.

Chairman PROXMIRE. And you have France, Norway, and these other countries.

Mr. WEINBERGER. France is at 5 percent.

Chairman PROXMIRE. France's unemployment is about 2½ percent. I believe the inflation problem is a serious problem, but they do not have controls, and we do.

Let me ask you this: Your predecessor John Connally was Chairman of the Task Force on Unemployment, which was supposed to have a report last spring. Was there such a report? Have you ever seen it?

Secretary SHULTZ. This was an internal administration study trying to understand the nature of the unemployment problem better. I think that was a very helpful thing. I do not know that there has been any published report. I was under the impression that that was the objective.

Chairman PROXMIRE. It is my understanding that it might be released. Is it possible that that could be disclosed? It would be extremely interesting to us and very helpful if we could get that.

Maybe you want to change it somewhat or modify it, but we would like to see some kind of study, something out of the administration.

I asked Mr. Weinberger when he was here before to give us the kind of study that Mr. Otto Eckstein is to do for this committee to determine what happens if you get unemployment down to 2 percent with controls. Let's look at it and see what the tradeoff is. There is a cost to this, but the benefits are so tremendous that I think we ought to really consider it.

Secretary SHULTZ. I would like to insert a cautionary statement, if I might. A couple of times in your statement you suggested that controls can hold inflation in check no matter what else happens.

Chairman PROXMIRE. In World War II that happened.

Secretary SHULTZ. World War II was a special situation, I think, and rather different than what we have in a peacetime period.

My own judgment is that the Korean war controls did not work particularly well. And, of course, there were lots of strains and stresses on the World War II controls.

I think we have had good success with the controls program. I say that as one who has not been particularly favorable to that program, but that is a concession coming from me.

On the other hand, I think that it is clear that the timing of the use of control was very fortuitous. They have been essentially pushing things in a direction that they were going already, and, I think, in effect getting us there a little faster than we would have gotten there otherwise. To that extent I think they have been extremely helpful.

In other words, they are working with the tide. Now, if we steam up the boiler tremendously and we call for the controls to shift, and work against the tide, I do not think that we will have the success that we have now.

Chairman PROXMIRE. I want you to take another look at the controls in the Korean war.

As I recall, at the end of the Korean war period, even after they lifted the controls, we had unemployment down below 3 percent, and inflation below 1 percent. Those controls did not work too badly. It is true that we had inflation before the controls went into effect, but after 1951, 1952, and 1953, it was not as bad as the inflation we have had in the first 3 years of the Nixon administration.

Secretary SHULTZ. In the Korean war we had a period in which prices skyrocketed. They went up so high and so fast that in many cases the actual prices never reached the ceiling. It was a very odd episode from the standpoint of the controls. Also, I think you can find fairly careful articles written by people like Clark Kerr, who was chairman of the Wage Board at the time, giving his assessment in retrospect that, if anything, it tended to raise wages rather than lower them.

So I think that that period is one of very questionable applicability.

Chairman PROXMIRE. I do have some more questions I would like to ask that are much less argumentative; I think we can go through them rather rapidly, but I will yield to Senator Humphrey.

Senator HUMPHREY. I would like to keep this record somewhat in balance. I think the chairman has made the point very firmly and also very precisely that the problem of unemployment is the plaguing problem; it is the lingering problem; it is the one that chews at the economy, the lack of the use of our productive capacity and all the traditional standards, or traditional measurements of inflation, namely, overuse of the plant capacity and tight labor markets, are not present. And the point that the chairman makes here is that there seems to be a lack—there seems to be an overriding fear in the administration that if you do too much stimulating that things are going to get out of hand.

I was impressed and, may I say, somewhat concerned about the constant reference to what wasn't done in those years of 1965, 1966, 1967, and 1968. I had no power in those particular years; I didn't even have a vote; I was just the Vice President but I sat around and watched them worrying about the budget and I am not going to let this record stand the way it is because the fact of the matter is that whatever their views may be on the war and the particular cost of it, not only in dollars but in human life, what were the economic facts? The economic facts were that the budget deficits of 1965, 1966, 1967, and 1968, were a whole lot less than they are now, much less than they have been in 1969, 1970, 1971, and 1972. The worst one we had was that 1968 budget deficit, when the President couldn't get his tax bill through, and he warned us what was going to happen; and, second, on the one hand, we are told that previous administrations impounded more money than this one and one of the reasons was to try to control the rate of expenditure.

Mr. WEINBERGER. That is exactly what we are doing.

Senator HUMPHREY. But my point is that you can't have it both ways; you can't paint this record—it was said here that there was fighting, a major war with no restraint on expenditures. Don't give me that because there were plenty of restraints on expenditures.

Mr. WEINBERGER. The deficits you are talking about, Senator, were deficits when we were at full employment and beyond, and so they were obviously inflationary. There is no need to stimulate the economy when it is at full employment.

Senator HUMPHREY. Without the rhetoric, Mr. Weinberger, what are the facts? The facts are that the rate of inflation in 1965 was 2 percent; 1966, 3 percent; 1967, 3 percent; 1968, 4 percent. Wouldn't you love to have that once again?

Mr. WEINBERGER. That would be nice.

Secretary SHULTZ. That isn't the problem, Senator. It was going up in 1969, 6 percent, the result of exactly this problem that you put your finger on.

Senator HUMPHREY. Let me finish my argument. The point is that it is everybody else's fault except this particular administration.

Let's take a look at the budget deficits, because all of this, according to what I have heard here, is cumulative—the fears and the worries about authorizations down the road—you can't have it cumulative one place and not another place:

Deficit, 1965, $1.6 billion; deficit, 1966, $3.8 billion; deficit, 1967, $8.7 billion; deficit, 1968, $25.2 billion. Everybody knows that 1968 was the rough year, but you have made $25.2 billion look like it was a contribution to the Little Sisters of the Poor in terms of what the budget deficits have been in this administration.

Secretary SHULTZ. That is what it has been.

Senator HUMPHREY. And all of this was when the unemployment——

Mr. WEINBERGER. The $25 billion deficit in 1968, Senator, was at a time when you were at full employment, and there was a year to a year and a half——

Senator HUMPHREY. No, we had 3.6 unemployment.

Mr. WEINBERGER. That's right, you were at better than full employment.

Senator HUMPHREY. I don't care about 4 percent unemployment; I think somebody just picked that out of the hat. What makes you think that that is full employment?

Mr. WEINBERGER. There is a year to a year and a half lag after you had that $25 billion deficit at full employment, and then the inflation rate was exceeding 6 percent and that is, I think, a very clear indication of what we have had to do.

Senator HUMPHREY. And may I say most respectfully that in 1969 we passed the tax bill which gave you the benefit of having the additional revenues coming into the Treasury which that administration did not get the use of. All I am saying is that you can't go around, as bad as it was, and nobody is happy about those days—I am not going to let the fiction and the facts of the period from 1964 to 1965 on up look so bad in this record because it is not so bad. The fact is that unemployment was at 4.5 in 1963, and 3.8 in 1966, and 3.8 in 1967, and 3.6 in 1968.

Mr. WEINBERGER. And a major war was going on.

Senator HUMPHREY. Just a minute. There wasn't a major war in 1965, and there wasn't a major war in 1966; we didn't have that many men there and not only that but, as the chairman has pointed out here, Germany, without any real defense budget, and Japan with little or no defense budget, have been able to keep their economies going at a tremendous pace. All this nonsense that you have got to have a big defense budget in order to keep your economy going is a lot of hogwash.

Mr. WEINBERGER. Nobody says that.

Senator HUMPHREY. Well, what are you saying? You can't have it both ways.

Mr. WEINBERGER. I am saying that Germany, with its fine unemployment rate, has an inflation rate of 8 percent at the moment, on the latest current figures.

Senator HUMPHREY. And how is the deutsche mark doing? How is it standing up, with that inflation rate? I asked how does the deutsche mark stand up as compared with the dollar?

Mr. WEINBERGER. It is moving up as compared to the dollar.

Senator HUMPHREY. It is in pretty good shape?

Mr. WEINBERGER. It depends on how you define it. We are interested in increasing our foreign trade, and if you are interested in increasing your foreign trade, valuations downward are not so bad.

Senator HUMPHREY. So are the Germans; they are not going into conniption fits over an 8-percent inflation rate; they are going right along keeping their people employed and expanding their foreign markets and their deutsche mark is a lot stronger than our dollar, is it not?

Mr. WEINBERGER. The last time they went around not worrying about their inflation rate you had to take a wheelbarrow of those marks to the supermarket to get your groceries.

Senator HUMPHREY. It is not quite that bad.

Mr. WEINBERGER. I wouldn't want to live with 8 percent more than half an hour.

Senator HUMPHREY. But they made a choice between some inflation and people unemployed. I don't think we have to have an 8-percent rate of inflation, but I am not going to let you off the hook with these figures. The fact of the matter is that the German economy today is strong; the fact of the matter is that our economy is not.

Mr. WEINBERGER. I disagree with you, Senator. I think our economy is very strong, and I am glad theirs is, too.

Senator HUMPHREY. Our economy with 5 percent unemployment is not as strong as it ought to be with 76 percent of the market capacity used; it is not as strong; with a trade deficit it is not strong; with a balance deficit of $14 billion—I don't give a darn how you paint it, sir, those figures are there and I don't care how you paint the period of 1965 to 1968; I am here to tell you that our budget deficits then were less than they are now; our unemployment was less than it is now; and our rate of inflation was less.

Mr. WEINBERGER. And you have left us a legacy of inflation that it has taken all these years to get rid of.

Senator HUMPHREY. You can use that for the first 2 years; but what is the target date when you are supposed to erase this? After all, you only had 1 bad year, in 1968, the 4 percent, and in 1969 it was 6.1; and what was it in 1970?

Secretary SHULTZ. 5.5.

Senator HUMPHREY. You had up to 7 percent inflation in this economy.

Secretary SHULTZ. I am talking about the annual rate; I am sure it jumped around.

Senator HUMPHREY. What is the present rate of inflation?

Secretary SHULTZ. Since the freeze——

Senator HUMPHREY. Yearly.

Secretary SHULTZ. Since the freeze, the annual rate is 2.7 percent.

Senator HUMPHREY. And it is presently 2.7?

Secretary SHULTZ. That is the annual rate since the freeze.

Senator HUMPHREY. Since the freeze. What will it average out in the years 1969, 1970, 1971 and 1972?

Secretary SHULTZ. You recall the years in which the rate of inflation ascended, beginning in 1965 and up until 1969, when it hit 6.1. That was the period of escaluating inflation. Since that time it has been coming down.

Senator HUMPHREY. The escalation was not that sharp—2, 3, and 4, that is not sharp escalation.

Secretary SHULTZ. I really think you have to put the 6-percent year in there, because it was the consequences of the process that was going on.

Senator HUMPHREY. But you got the advantage of the tax, too. Don't underestimate that. I remember all you economists coming around here and telling us that we had to have that big tax, the surtax that we put on, and you got the advantage of it. The previous adminstration didn't. I am just not going to let this record look one sided. Nobody says it is a beautiful record but I will tell you one thing. I will take a budget deficit of 1.6 in 1965 compared to anything that you had since 1969, or 3.8, or 8.7, or even 25.2—what was your budget deficit last year?

Secretary SHULTZ. I think that I would have to come around on Senator Proxmire's side here and say that it is important in budget policy to try to stimulate the economy as aggressively as you can, consistent with a longrun eye on being able to contain it when you get to full employment. Therefore, I think the administration was wise, and the Congress was wise in going along with it, to propose large deficits as a measure that helps to stimulate the economy. Now, as you were saying a little earlier in the discussion, we do have a situation where—particularly in the last 6 months—the economy has been expanding very strongly, and employment has been expanding strongly, and the rate of inflation has been coming down. These are all desirable trends. We want to see them kept going, so that if we can get the unemployment really down in there, we can do it accompanied by a rate of inflation that the American people will find tolerable. Otherwise, we will have to go through this whole process all over again.

Senator HUMPHREY. There is no argument there, Mr. Shultz. My point earlier was that with their fine report—this is the health report now—that you can't have it that way and at the same time have the kind of political rhetoric going out that Congress is somehow or other off on a spending spree, because if you are going to brag about the low rate of inflation—and I think you have a right to say we have done well, and the inflation rate is down—then you ought not to go off on a tangent; you or one of your associates, and say Congress is off on a spending spree, because if these rising expectations of authorizations are serious, then believe me, the reality of Government appropriations is much more serious; and the fact of the matter is that if you are going to claim the improved health of the economy that you do, then it seems to me that you have to kind of level off on what the Congress is doing, or is not doing. Apparently the Congress has been pretty good because you can't do one thing over there in that specific branch unless we pass the laws over here to appropriate the money; you have had it.

Secretary SHULTZ. Correct.

Senator HUMPHREY. And apparently while you have been doing some good prescreening, the effects over here on the end of the pharmacy have been filling the prescriptions.

Secretary SHULTZ. Well, we would like you to continue to do that.

Senator HUMPHREY. My only problem is, you have the unemployment.

Secretary SHULTZ. The problem ahead of us is—and it is widely recognized; I really don't think there is any argument here——

Chairman PROXMIRE. Oh, there is an argument——

Senator HUMPHREY. Yes, there is, Mr. Shultz. The argument is over the lag in this economy. The fact is that you give us reports that look good, but they ought to be better. It is exactly like the kid coming home with his report card to his dad and saying, "Look, I got a B" and the father looks at it and says, "But you should have got an A." And the fact is that as the chairman pointed out in his opening statement here, as to what is going on in the economy and is not going on, gives us a balanced picture. There is no target date for getting the unemployment rate down to 4 percent. When do you expect to get the economy producing at the optimum? And its optimum is between 85 and 90 percent; when did you expect to get the plant capacity producing at that rate? And when do you expect to get our exports so—up so that we no longer have an unfavorable balance of trade?

I think that these are reasonable questions of a responsible committee of the Congress; not that you will be able to do it, but what are the measurements by which we judge each other?

Chairman PROXMIRE. Could I make a correction? Mr. Weinberger, our staff has called the German finance minister, who informs us that the inflation rate in Germany currently is 5.4 percent. They point out that in the 8 years from 1964 through 1971 the inflation rate averaged 3 percent; they point out furthermore that the unemployment during that period averaged about 1 percent and during some periods it was less. It is true that in the last month inflation has shot up, but sometimes it goes up and down here. But if you take the year basis June to June, it is 5.4 percent.

Mr. WEINBERGER. The rate I am using, Mr. Chairman, which is the inflation rate from the fourth quarter of calendar year 1971 to the first quarter of calendar 1972, which are the latest figures I have, on an annualized basis the inflation rate was 8 percent, which I think is the proper way to look at it from the point of view of the current trend.

Chairman PROXMIRE. The point I make is that you have these aberrations from time to time and even 6 months isn't that long a period; if you take it over an 8-year period you find that the inflation rate in Germany has been averaging a little better than 3 percent; in some years it has been 5 and in some years less than 2. By and large, they have a reasonably good effort in fighting inflation with no controls and with an extraordinarily low unemployment.

Mr. WEINBERGER. The annual rates of increase for the last three quarters were 3.2, 4.8, and 8. I wouldn't consider that to be a good record on inflation; but we aren't here——

Secretary SHULTZ. I would be very anxious not to have us get into a discussion criticizing the German economy; it has been one of the wonders of the world and we wish them well.

Chairman PROXMIRE. The hour is so late that I apologize for holding you, but I am going to ask you just a couple of questions about one area, because you have assumed new responsibilities and I should have gotten to this earlier.

You are now the Secretary of the Treasury, and you are responsible for revenue matters, and yet I must confess that we are not familiar with your views in this area. John Connally, your predecessor, was very outspoken here. He seemed to feel that tax reform was something that was exaggerated and something that didn't promise very much and it would be more minuses than pluses; and I would like to know in general what is your position here? We had a very helpful appearance by Under Secretary Cohen the other day, who gave some indications that he felt that the administration could improve the tax situation and you could have some reform, but he did argue that wealthy individuals pay high taxes. He indicated that we could make some improvement in the depreciation area, the tax-exempt bond area, and the capital gains area.

Do you share this view, that we need improvement in the sense of greater tax equity, less tax avoidance and greater tax revenues?

Secretary SHULTZ. First, my observation is that in the last two and a half years there has been a tremendous amount of what is called tax reform, especially in the 1969 and 1971 tax acts, which have had a great impact. I am sure you are familiar with Under Secretary's Cohen's talk, given last April, which details the impact of these tax reform measures. It is quite an impressive document. We have also had tax reform in other ways, particularly in pay raises as we move toward the voluntary Armed Forces. Also, I think revenue sharing is a form of tax reform that is a substitution in a sense of the Federal tax structure for the State and local tax structure. I think those have all been good measures and I think at the same time this is a subject that we need to keep working at and we are working at it. We in the Treasury want to make the tax system more simple; it is very complicated for people to work with. We want to keep striving to improve the equity of the system. We also must keep our eye on the question of the impact of the tax system on the way the economy behaves, both in terms of the substance of what we do and the manner in which we do it. We have subjected the economy to an awful lot of tax change now and we are trying to assess what the real results are, as I said earlier, and feed that into the process of analysis we are undertaking in the Treasury.

Chairman PROXMIRE. Let me just ask you about one area: The changes that we have had in the last few years in the tax picture may be construed by some as tax reform; but in terms of tax avoidance and in terms of the burden placed on people with very high incomes, that is certainly highly debatable. I wonder if you have any feeling that it would be possible for you to recommend to the Congress, improvement that would reduce tax avoidance, that would require persons with high incomes to pay a higher proportion of their income in taxes, or if you think this would be desirable?

Secretary SHULTZ. Let us say, so far as whether or not the 1969 act was tax reform, it was labeled by the Ways and Means Committee as the most massive tax reform effort in many, many years. I also think there are at least some people who would think that it was quite substantial tax reform, and this table shows the percentage change in individual tax liability by income class from 1968 to 1972. It shows a gigantic shift in the proportionate impact of the tax system by income.

I am in the process of studying what additional tax reform measures I think ought to be recommended.

Chairman PROXMIRE. I understand that table that you are using doesn't show oil depletion, capital gains, and a number of other measures and at least one responsible news-gathering agency says that it distorts the picture. What is your response to that?

Secretary SHULTZ. It is a table that shows the adjusted gross income class——

Chairman PROXMIRE. But that excludes all the—some people call them loopholes and others call them incentives; but whatever they are, this excludes them, does it not?

Secretary SHULTZ. Some things don't get into adjusted gross income and that is a problem.

Chairman PROXMIRE. And if you use that it doesn't give you a picture of the incidence of the tax system, does it?

Secretary SHULTZ. I think it gives you a general picture. Additions can be made to it, but it is very impressive.

Since you have come back to it, we might just read some of these figures off. In the proportional change by income class in the zero to $3,000 income class, the reduction in tax liability over the last 4 years has been 82 percent; $3,000 to $5,000, 42.3 percent; $5,000 to $7,000, 27.4 percent; $7,000 to $10,000, 17.5; $10,000 to $15,000——

Chairman PROXMIRE. May I just interrupt to say, here is the problem. I am sure that you can show progressivity there but you take out so much of the income. No. 1 and No. 2, what has happened—and I don't say that Congress isn't as responsible as you are, but what has happened over the last 3 or 4 years is that we have enormously increased the payroll tax and we have reduced the incidence of the progressive income tax and the payroll tax is highly regressive, about as regressive as you can conceive. There is no payroll tax on income over a certain relatively modest amount; you only hit the low-income person and you hit him with a flat tax, so that by and large we are getting a tax system which is less progressive and more regressive than before; isn't that correct?

Secretary SHULTZ. I think that the problem of the rise in importance of the payroll tax is a real problem. You have mentioned it in terms of its regressivity and progressivity, and its scale. I think it is also a problem in terms of its impact on the employer who is considering whether to hire an additional worker. If he works his existing force a little longer, assuming that they have come to the top of the employer's social security tax contribution, it doesn't cost him anything additional in what are now very substantial payroll percentage costs that he must pay. Whereas, if he hires a new worker, he has to pay that right away and that has to be a factor when you build it up that much in this question of whether you work overtime or whether you hire additional persons.

So I think there is a problem there and this is certainly an issue that we will want to look at.

Chairman PROXMIRE. Could I ask Mr. Shultz—I want to make the same request that I made of your predecessor, Mr. Connally, and I didn't get a response from him; I thought he was going to come back with information but he didn't—I would like to ask you for the record because every independent economist who has appeared has had a different view than you do as to just what the administration tax policy is as to people with different incomes. Show us by quintiles the lowest 20 percent, and so forth, and show how the administration tax program has affected their overall taxes, including social security taxes—if you can show that the policies of the administration have been progressive, I will be delighted to eat the economic indicators.

Secretary SHULTZ. If you can satisfy that hunger that easily, I envy you.

Chairman PROXMIRE. I am, they say, underweight, so maybe it would be a good thing.

Senator Humphrey.

Senator HUMPHREY. I just want to emphasize that somewhere along the line we are going to have to be hardboiled enough around here to figure out how we are going to properly care for the public sector in this country without constant deficits. How are we going to provide the money? Because the relationship between the public sector and the private sector is an intimate and direct, simple thing. Plants do not come to small communities frequently because there is not enough money for a water and sewer system; it is just that simple, and plants do not come to a community because the airport isn't big enough, the runway isn't modern and long enough. These are little things that happen day after day in our country. This Nation is privately rich and publicly poor. You just take a look at the cities. Take a look at a Washington, D.C. I have got to get to the right committee to get on this one, but this is as good a place as any. Take a look at what is happening in a few blocks from this Capitol, as you go down Capitol Street, as you go toward Independence Avenue, as you go down New York, and go to the Southwest, and see the deterioration that sets in. Now, it is obviously due to the lack of public resources and we are going to have to do something about our tax structure to get that money, as well as the economy to generate it.

Secretary SHULTZ. I follow your line of thought, but, at the same time, I think that when you go down many of these city streets and you see what is happening, it is not a comment on the lack of public resources being invested there. It is a comment on the fact that we don't really know too well how to invest public resources in producing that kind of housing, because a lot of it is public housing, and it is just being abandoned.

Senator HUMPHREY. I am not talking so much about housing.

Secretary SHULTZ. It is an ineffective expenditure of public resources.

Senator HUMPHREY. I wasn't going into that field in particular; it is the whole public sector as such; it is transportation. How many cities in America could afford, for example, to even contemplate a Metro system like this great Nation's Capital is? It is just impossible. The cities are bankrupt in this country today and county governments are in trouble, and all I am saying is that somewhere along the line our tax structure—I am not making any value judgment here, but somewhere along the line we have got to ask ourselves some questions. We know first of all that the tax structure depends upon the rate of activity of the economy, because that is the pool from whence you draw your resources. So that is No. 1; but then we get to the tax structure ourselves, as to how, even though the economy is in good shape in terms of jobs, income, and profit, how do we fill out the amount that is needed to give some balance between the private and the public? I am not only talking about public housing; I am talking about cities and airports and transport and communications, the host of things that make up for a modern community, and the community, the American city today, and the American community is in serious trouble in terms of—for the lack of a better word—infrastructure. The sewers are too small; the water systems are old; the energy for the electrical energy that is needed—this is primarily private—is totally inadequate for the long-term plans of our economy.

Our communications system—so today around here the Government of the United States ought to find out why it takes longer to get a special delivery airmail letter delivered than it does just to send a post card. That would be a good thing for the economists of the Government to look into. Why is it that when you wire somebody from Western Union no longer do they deliver a wire? If you haven't got a telephone connection, you will never find out that your brother died or something happened in your family. These are just public services in this country that are deteriorating. The Postal Service is an outrage. It makes the pony express look fast; it is unbelievable. I just came back from my home city, and they have got a big article about how good the Postal Service is, and everybody in town knows that it would be better to get on your bicycle and deliver a handwritten note.

How long does it take to send a letter from here to New York?

Mr. WEINBERGER. Senator, we tried to privatize the Postal Service, but the Congress insisted on leaving it as a public service; it will not be possible to do much about it. I gather from your catalog that you think the Federal Government has the responsibility to take care of everything, including whether Western Union has a messenger boy. We don't have that all-inclusive kind of responsibility for the Federal Government or the public sector.

Senator HUMPHREY. I have the feeling that the Federal Government through the FCC licenses Western Union and gives them a monopoly. It has the responsibility to see that the telegram is delivered.

Mr. WEINBERGER. They don't have a monopoly.

Senator HUMPHREY. They literally have a monopoly.

Mr. WEINBERGER. No, sir.

Senator HUMPHREY. How many different kinds of Western Unions do you have?

Mr. WEINBERGER. There are two or three different competing services.

Secretary SHULTZ. The competition with Western Union is in the form of the telephone, and all those things have arisen, just as you might say the number of passenger trains has declined. Why have they declined? Because other modes of transportation apparently suit people better. You have this kind of thing going on in the economy all the time.

Senator HUMPHREY. I was trying to make the point of public service, and I do not accept the line laid down that I expect the Federal Government to do everything; as a matter of fact, I don't. I believe a great deal in local government and State government and mostly in the private sector. Western Union is private, but it operates under a Federal license; and when you have a Federal license, you have a responsibility to see that the people receiving the service get the service, or you take the license away. That is the way it ought to be. If they didn't clean up their restaurant when I was mayor of Minneapolis, I took their license away. If we licensed them, we saw that they operated. That is the way it ought to be, and that is what is wrong around this place.

There isn't enough of what I call the regulation once the license has been given. I don't want them to be denied profit. I want them to be profitable, but I want them to give service, and this goes for a lot of things in the Government sector today, and I think this gets back to our whole attitude of public and private. I am not asking for the Government to take over the communications system; that is the last thing I want, but I do think if you are going to license them they ought to perform or get off the stick.

Chairman PROXMIRE. Gentlemen, I want to thank you very, very much. This has been one of the most stimulating hearings we have had.

The committee will stand in recess until tomorrow at 10 a.m.

(Whereupon, at 12:50 p.m., the committee was recessed, to reconvene at 10 a.m., Wednesday, July 26, 1972.)

THE 1972 MIDYEAR REVIEW OF THE ECONOMY

WEDNESDAY, JULY 26, 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, Sparkman, and Javits; and Representative Widnall.

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

Testifying before us this morning we have Mr. Arthur F. Burns, Chairman of the Board of Governors of the Federal Reserve System.

Chairman Burns, the outstanding impression we have gained from 2 days of hearing administration witnesses is that they do not have a real commitment to assuring that every able-bodied man and woman, regardless of age or color, who wants a job should be assured of being able to find one.

There has been a strong concern and a proper concern about the problems of inflation, but far less concern about the very serious continuing nagging problem of unemployment.

We have in effect now, and we have had since August of last year, a method for controlling inflation. We have no program for putting the 5 million people who are out of work to work.

We had the Chairman of the Council of Economic Advisers, the Director of the Office of Management and Budget, and the Secretary of the Treasury, all expressing the deepest concern about inflation, and properly so, and anxious to combat it, but without a similar program that would put people to work.

We have a record now of the inflation situation improving considerably over the past several months, and not nearly as reassuring a record with respect to unemployment.

So I say, the big uncertainty, of course, is how large the fiscal 1973 Federal budget deficit is going to be, and how the Federal Reserve will either complement or offset what the administration fears may be a budget that is out of control. I hope you will outline to some extent the various options for monetary policy that are under consideration for implementation during the next year.

As I say, a fear is developing in the committee that a stimulative policy in the first part of 1972 will be replaced by a much more restrictive one later this year as concern mounts about Federal spending and more rapid inflation. Our first priority must be to continue reducing unemployment and to eliminate the waste of unused productive capacity.

Mr. Burns, you go right ahead. We have a number of other members who will be coming, they are slightly delayed. But we would appreciate it if you would give us your statement now.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. Burns. I am pleased to report to this committee once again the views of the Federal Reserve Board on the state of the economy.

Since my appearance before this committee in February, evidence has accumulated of a significant strengthening in the pace of economic expansion. The output of our Nation's factories and mines has increased rapidly since last fall and now exceeds the previous peak rate in September 1969.

Advancing levels of production and sales have resulted in a larger demand for labor by manufacturing plants, distributive firms, service establishments, and other places of business. Total employment since June of last year has risen by 3 million, and the length of the workweek has generally increased.

The improvement of labor markets has encouraged substantial numbers of women and younger workers to enter the labor force. The ranks of job seekers have also been swelled by a sizable reduction in the Armed Forces. As a consequence, unemployment has remained high despite better job opportunities. Last month, however, unemployment did show a heartening decline.

A major source of the quickening tempo of economic activity has been the recovery in business capital formation. Confidence of the business community was bolstered by the governmental measures adopted last year to moderate inflation and to stimulate employment and output. With incentives to invest strengthened, contracts for business construction and orders for machinery and equipment have been rising vigorously.

Higher residential construction has also been a stimulating factor. New housing starts have declined somewhat from the level reached early in 1972, but the effects of the pronounced rise in new housing starts last year are still ramifying. Sales of furniture and appliances, for example, have been soaring this year.

Consumer buying generally has been on a marked uptrend since the late summer of 1971. Spendable incomes of consumers have risen steadily and substantially, as employment has increased and the workweek has lengthened. After more than 5 years of stagnation, average weekly earnings of production workers have increased significantly in real terms since last summer. Confidence in the economic outlook has improved, and consumers are now borrowing at record rates to buy new autos and other durable goods.

In short, as we see the economic scene, the current expansion is now exhibiting the characteristics typical of cyclical recoveries. A strong revival of output in the durable goods trades is underway, employment is rising rapidly, and more and more branches of production are being caught up in the rising trend of activity.

There is good reason to expect this cumulative process of business expansion to continue on into 1973. Inventory accumulation should provide an upward thrust in the months immediately ahead. Stocks have fallen to low levels in relation to sales, and it appears that a pickup in inventory building is already in process. Business investment in fixed capital should continue to be a major expansive factor, since new orders and contracts for plant and equipment have been moving strongly upward for some time. If these categories of business spending rise briskly, as now seems likely, growth rates of employment and earnings will remain high. Disposable income will also gain from a rise in social security benefits this fall and sizable tax refunds next spring. With consumers in a more optimistic mood, these additions to purchasing power should stimulate demand further.

Thus, when I consider the recent course of economic activity and the prospects for the near-term future, I find reason for optimism. The expansion in real output and employment has remained orderly and well balanced. Most major sectors appear to be poised for a further rise in activity. And it seems likely that unemployment will diminish as real output continues to rise.

Progress has also been made in moderating the rate of increase in wages and prices. Over the first half of this year, average hourly earnings in the private nonfarm economy rose at an annual rate of about 5¼ percent, compared with 6¾ percent during the first 7 months of 1971. The control program has evidently had a salutary effect, although competitive forces may also have served to dampen the rise in wage rates.

Price indexes, too, indicate some reduction in the rate of inflation. A comprehensive measure of price performance—the fixed-weight index of prices of all private goods and services in the gross national product—rose over the first three quarters of last year at an annual rate of about 4.5 percent. In the three most recent quarters, the rate of increase has receded to about 3 percent.

Other price indexes also show improvement. Thus, consumer prices since last August have increased at an annual rate of 2.7 percent, compared with 3.8 percent in the first 7 months of 1971. In the last 4 months, the annual rate of increase averaged about 2 percent.

The need for further progress in curbing inflationary pressures remains great, however, particularly in view of potential developments in 1973. Next year, collective bargaining agreements covering large numbers of workers will be reopened in major industries. The negotiations will take place in a climate of improving labor markets and against the backdrop of a substantial increase in consumer prices over the past several years. If wage rate increases should accelerate, pressures on unit costs of production would intensify. And business firms would probably take advantage of receptive product markets to pass on cost increases to customers.

Greater success in our efforts to moderate inflation is therefore vital. If costs are to be stabilized, the wage guidelines—which now permit increases in wage rates well above long-term productivity gains—will need to be lowered. But any such wage development will necessitate measures to assure workers that their real earnings will not be eroded by continuing increases in consumer prices.

A tighter rein on inflation is needed not only to protect the incomes and savings of our people; it is needed also to restore equilibrium in our international accounts. Indeed, I seriously doubt whether this external objective can be achieved without a stable price level. The Smithsonian realinement of exchange rates last December laid the basis for a substantial improvement in our competitive position. But that potential will be dissipated if appreciable increases in domestic costs and prices continue.

Our international accounts are still seriously out of balance. Imports this year have increased substantially further, and while exports have also risen, our trade deficit has deepened. Such a development is not unusual in the months immediately following a currency depreciation, and the more advanced stage of our economic recovery relative to that of our major trading partners has undoubtedly been an aggravating factor. With economic conditions abroad again improving, the demand for our exports should rise more vigorously over the near term. Past experience suggests, however, that 2 or 3 years may need to elapse before the full benefit of last December's exchange rate realinement is realized.

The overall balance of payments was in substantial deficit during the first quarter. But beginning in mid-March, the overall balance became more favorable, due principally to short-term capital inflows. Indeed, we actually experienced a balance-of-payments surplus between mid-March and June 23, when the British pound was floated.

In the weeks immediately following the British decision, exchange markets around the world experienced renewed turmoil, and a sizable shift of dollars into European central banks occurred. Most recently, however, order has been reestablished on the foreign exchanges. The renewal of market confidence is due in no small measure to the intervention in the exchange markets by the Federal Reserve in collaboration with the Treasury.

The recent disturbances of exchange markets provide a clear warning. If repetitive monetary crises are to be avoided and an environment conducive to healthy expansion of foreign trade and investment is to be preserved, international negotiations on monetary reform must begin promptly. The recent disturbances are also a warning that turmoil in international financial markets may continue until the United States and its major trading partners find ways to rid their economies of the inflationary sickness that is plaguing us all.

Let me turn next to the course that our Nation's monetary and fiscal policies must pursue to offer hope of solving our inflation problem, and at the same time facilitate growth in production and employment.

Typically, expansions in economic activity are accompanied by pronounced pressures in credit markets, reflecting larger credit demands as well as more stringent monetary policies. Thus far, this expansion has been rather free from such pressures. Inflows of savings deposits to nonbank thrift institutions—though below earlier peaks—remain abundant, and these funds are being used actively in mortgage lending. Commercial banks, besides extending substantial amounts of credit to businesses and consumers this year, have been able to acquire a record volume of mortgages and to supply a major part of the funds raised in credit markets by State and local governments. And although interest rates on short-term securities have risen from their lows early this year, long-term rates of interest have changed very little. Actually, interest rates on practically all classes of loans and securities—including mortgages—are distinctly below their July 1971 levels.

A major reason for the relative stability of interest rates was the substantial reduction in the size of the Federal deficit for fiscal 1972 from earlier expectations. Moderation in business credit demands was also a contributing factor. Retained earnings of corporations were augmented by the rise in business profits, the release of funds by the investment tax credit and accelerated depreciation, and the 4-percent ceiling on dividends imposed by the Committee on Interest and Dividends. Businesses were thus in a good position to finance their needs for increased investment spending and working capital from internal sources.

Monetary policy over this past year also contributed to stability in credit markets. The Federal Reserve pursued a moderate course of monetary expansion, so that fears of a new wave of inflationary pressures would not be generated. But the Federal Reserve also saw to it that the economic recovery would not suffer for want of money or credit.

The moderate course of monetary policy is evidenced by the major monetary aggregates. During the 12 months ending in June, the narrowly defined money supply—currency plus demand deposits—increased by 5 percent, or less than the increase in the Nation's real output. The money supply defined more broadly, so as to include time deposits other than large-denomination certificates of deposit, rose faster as consumers built up liquid assets by adding to their time and savings accounts.

As this committee knows, rates of monetary expansion have recently varied considerably from one quarter to the next. The effects of such variations on economic activity can easily be exaggerated. Last fall, for example, growth in money balances slowed sharply, and concern was voiced in some quarters that the economic expansion would falter. Actually, there was no shortage of money or credit at that time. The abundant supply provided in the first half of last year was still there to meet the need of consumers and businesses. In fact, the slowdown served a useful function. For it assured the public that there was no intention to open the monetary spigot in a reckless effort to stimulate expansion, while wages and prices were being held in check with direct controls.

The Board recognizes, however, that fluctuations in growth rates of money and bank credit have at times gone beyond our intentions. To deal with this problem, techniques of implementing monetary policy have recently been altered in ways that might permit us to minimize undesired variations.

Early this year, the Federal Open Market Committee decided that the pursuit of its monetary goals might be aided by focusing less heavily on the Federal funds rate as an operating target and instead giving more weight to the desired growth of the bank reserves held against private deposits. This change in operating procedure did not, of course, mean that money and capital market developments would be disregarded. It merely meant that, in the Committee's judgment, greater emphasis could be placed on the reserves needed to attain the desired growth rates of the monetary aggregates, while still giving attention to interest rates and other dimensions of financial markets. Monetary developments since January seem to confirm that judgment, but more time will be needed to evaluate properly the new operating techniques.

At present, the Federal Reserve is in a favorable position to continue pursuing a path of moderate monetary growth, for economic expansion thus far has been orderly and supplies of real resources are still ample. And if, as seems likely, private credit demands advance at a temperate pace, interest rates near current levels could continue to prevail in the months immediately ahead.

Whether or to what degree this desirable outcome is realized will depend heavily on the state of the Federal budget. At the time of the midyear budget review, the deficit projected for fiscal 1973 was $27 billion. The recent passage of the social security bill has raised that figure appreciably. Supplements to defense spending not allowed for in the midyear budget review may add further to the deficit. And there will be a temporary but potentially dangerous bulge in the deficit next spring, when large refunds of overwithheld taxes will add to disposable income. This concentrated fiscal stimulus could have unfortunate consequences for prices.

I recognize that deficits are difficult to avoid when tax revenues fall below the levels that would be produced by an economy operating at full employment. But in fiscal 1973 the deficit may be growing at a time when the economy is expanding briskly and the margins of unused capacity are narrowing. Such a development would add explosive fuel to the fires of inflation. I therefore see no escape from the conclusion that the time has come when the Congress must put our fiscal house in order.

We stand at a crossroads in our fiscal arrangements. Many of our citizens are alarmed by the increasing share of their incomes that is taken away by Federal, State, and local taxes. Meanwhile, Federal expenditures have been rising at a rate well above the growth rate of our national income and product. The propensity to spend more than we are prepared to finance through taxes is becoming deep-seated and ominous. An early end to Federal deficits is not now in sight. Numerous Federal programs have a huge growth of expenditures built into them and there are proposals presently before the Congress that would raise expenditures by vast amounts in coming years.

The fundamental problem, therefore, is how to regain control over Federal expenditures. I do not think this can be accomplished without departing from our traditional methods of budgetary management.

I have long been an advocate of zero-base budgeting—a procedure that would require careful scrutiny by the congressional appropriations committees of the full expenditure requested for every Government program, rather than just the increase in expenditures. Such a procedure would help to weed out programs whose social usefulness has diminished or ended. It would take considerable time, however, to reform budgetary procedures along these lines even if the Congress were ready to adopt it.

To obtain immediate results, other steps are needed. Recently, a bipartisan group of Congressmen advanced a proposal that would prohibit consideration of any appropriation bills in the House of Representatives until the House had approved a resolution containing a comprehensive Federal budget. The proposal also would require a two-thirds majority vote for any appropriation bill exceeding the provisions of the overall budget resolution. This is a highly constructive suggestion. I hope the Congress will give it careful study and at the same time consider the desirability of establishing a Joint Committee of the Congress on Revenues and Expenditures.

Another proposal that could produce immediate beneficial results has already been studied by many members of the Congress—namely, the President's recommendation for a legislative ceiling on this year's budget expenditures. I strongly support this recommendation in the hope that the ceiling would be a rigid one, that it would admit of no escape hatches whatever, and that it would apply both to the Executive and to the Congress.

Reestablishment of order in our Federal finances has become a critical need in our Nation's struggle against inflation. In the Board's judgment an enduring prosperity cannot be achieved unless this need is attended to promptly and courageously by the Congress.

Thank you.

Chairman PROXMIRE. Thank you very much, Mr. Burns.

Before I get into questioning on the substance of this I do want to bring up one matter which I think is a good thing to get out of the way.

The economy will be a major issue in the political campaign this fall, it always is, and it should be. It is a great temptation to public officials to get involved in the campaign even to make decisions on economic policy which are designed to help one candidate or the other.

Earlier this week I criticized Mr. Stein, chairman of the Council of Economic Advisers, for his partisan attacks on Senator Muskie and Senator McGovern. This was a clear departure from any actions by any previous Chairman of the Council of Economic Advisers.

In the case of the Federal Reserve Board, the need for objectivity and nonpartisanship is even greater.

Mr. Burns, you have been a longtime friend and confidant and trusted adviser to President Nixon. We all remember that back in 1960 you advised President Eisenhower to move to stimulate the economy and reduce unemployment. If he had taken your advice perhaps President Nixon would have won that very, very close election. At least President Nixon is reported to have felt that economic conditions cost him the election that year.

I am sure that the President is anxious to see the economy in good shape this November. But, of course, you are no longer the President's personal adviser, you are the Chairman of the Federal Reserve Board.

Can you give this committee your firm assurance this morning that all your decisions between now and November will be made without regard to politics, and whatever advice you may be called upon to give the President will be objective and not political, and that your public statements will not be slanted so as to in any way obtain a more favorable economic picture than the facts merit?

Mr. BURNS. I give this committee not only firm assurance, but absolute assurance on that point. And I give this committee that assurance not only for the interval between now and November, but for the years beyond that date, so long as I am in my present post.

Chairman PROXMIRE. I am happy to hear that. I have, as you know, great respect for you. I think you are one of the outstanding Nixon appointees. I did think it was good to clear the air in that respect, because we all know of your great attachment to the President in the past. And I think it is a situation that is clarified by the kind of assurance you have given this committee.

Let me ask you this. The picture that you paint for us this morning is the same kind as we have been getting from the administration witnesses. It is one of an economy that is moving ahead briskly. It is one in which the principal problem is inflation.

You say the economy is booming. In fact in your statement you say that the "deficit may be growing at a time when the economy is expanding briskly and the margin of unused capacity narrowing," that the problem seems to be inflation primarily. Certainly the emphasis that you put on the international sector would suggest that we have to be concerned about inflation.

All these indicate that you are likely to be tempted, if not toward a restrictive monetary policy, at least not toward one that would give us any real encouragement that the economy is going to be stimulated and expanded and the unemployed put to work.

The aim of the administration, as I understand, is for a neutral fiscal policy, one with a balance at full employment. And in view of the fact that there is little change from last year, I understand that it will have a neutral effect. If monetary policy has a neutral or restraining effect, it is hard for me to see very much in the future.

So, I would like to run down some of the categories here that would indicate to me that there is not very much stimulation in the economy in the coming months and get your comment on it, because you obviously have a contrary view.

Residential construction, as you point out, appears to have passed its peak, although it is still relatively strong.

Business investment has gone well, but according to the Commerce Department's plant and equipment survey will level now, and not be a stimulative factor.

According to the survey evidence, inventory accumulation may strengthen only slightly from the second quarter level.

If the final 1973 budget is to achieve the full employment balance which I gather you favor, Federal purchases cannot increase very much if at all.

State and local government spending generally advances at a pretty steady pace, and I see no reason to expect any extraordinary growth there, especially in view of the serious financial plight of our cities.

That leaves consumption. Rising incomes and increased social security payments will help strengthen consumption. But will this be enough to compensate for the slowing down in other sectors, for the continued growth of our labor supply, for the fact that we all hope and expect that the defense situation will improve; that is, it will have less activity in Vietnam and more people entering the labor force from that sector.

What is your response to a situation which it seems to me is inadequately stimulative to get unemployment down?

Mr. BURNS. I see the economic picture a little differently, Senator. Business investment is now in a rapidly rising phase. Orders for business capital equipment have been rising rapidly for 9 months now. Therefore, in the second half of this year and the early part of next year, a rapidly rising trend of business capital spending is assured.

Chairman PROXMIRE. The Commerce Department says that they expect that to level out.

Mr. BURNS. The Commerce Department merely records the results of a survey of projected business capital expenditures, a survey that has elements of uncertainty surrounding it.

The figures that I have referred to on orders for business capital equipment are available monthly, in contrast to the Commerce Department's surveys, which come out at more distant intervals.

I place my judgment—and I have done so over many years—on statistics on capital appropriations, on statistics on contracts for business capital construction, on statistics for orders on machinery and equipment. All those have been pointing, for some months now, rather vigorously in an upward direction.

Therefore, I stay with my judgment about business capital investment.

As for inventory investment, it has been surprisingly low in the course of the current economic expansion. In view of the rise that is taking place in business sales at all levels, practically all economists are expecting a substantial rise in inventory investment in the months ahead. I share that opinion.

As far as State and local spending is concerned, it has been a stimulative factor, and I see no reason for expecting that to change. The issues of municipal securities are proceeding at an exceptionally high rate. State and local spending I think will do its part in stimulating the economy.

And you have referred, Senator, to the stimulative potential of consumer spending. I have nothing to add on that.

I, therefore, see the economy rising briskly, as I indicated in my statement.

Chairman PROXMIRE. Let me, just for a minute, take the other side. And suppose that your fears turn out to be the case. Supposing the Congress does appropriate too much. And supposing we do overstimulate the economy. Suppose, despite the restraint pleaded for by you and others, that we go too far. Is there a continuing danger that we might get into a credit crunch, that in order for the Federal Reserve Board to combat this that you might once again go to a policy which would give us high interest rates? And if that is the case, what steps are you prepared to take to see that housing and small business and local governments do not bear a disproportionately high cost of the crunch as they have in the past?

We know what this has done to housing so often in the past. How are you prepared to prevent that by monetary policy in the coming months?

Mr. BURNS. Senator, I am not prepared to say to you now what monetary policy is going to be in the coming months.

Chairman PROXMIRE. As you know, I didn't ask you that, sir. I said in that event, given that scenario, if you have to do that.

Mr. BURNS. I don't think I would want to speculate on what the Federal Reserve will do. Let me say only that I do not think that it is the responsibility of the Federal Reserve Board to correct every mistake that is committed by the private sector, every mistake that is committed by the Executive, and every mistake that is committed by the Congress.

As far as the Federal Reserve System at present is concerned, I have indicated that we are pursuing a path of moderate monetary growth. And I expect this policy to continue in the months ahead.

Chairman PROXMIRE. Let me be more precise and see if I can get into what the Federal Reserve Board might do.

I notice in your report on the impact of monetary policy on housing which we requested and secured you have many recommendations about what other agencies can do, but you are strangely silent on what the Federal Reserve Board can do.

For example, it makes no mention of the Credit Control Act of 1969, already on the books. Under that law, as you know, if the President declares a credit shortage, the Federal Reserve Board can directly limit the ability of large corporations to borrow on the credit market. If we have another credit shortage compared to 1969 and 1970, would you recommend to the President that this authority be activated, and would you use it?

Mr. BURNS. I am not able to comment on that, and I don't think I should.

Chairman PROXMIRE. I am disappointed that you feel you can't give us your views on that.

You were one of the first, Mr. Burns, to call for an incomes policy, and you were the leader in that respect. And I think you deserve great credit for the fact that the administration did shift gears, and many others counseled them against proceeding with some kind of policy to control inflation more directly.

You mention the large number of collective bargaining negotiations scheduled for next year. And that is a matter of real concern, of course, from an inflationary standpoint. I would like to get your view on the future of wage-price controls, because you have had such an interest in this and you are so competent in this area.

Can these controls be lifted any time soon? Could you, for example, proceed with the lifting of controls prior to this November?

Mr. BURNS. I doubt it very much.

Chairman PROXMIRE. Phase II ends on April 30, the law expires on that date, if the Congress doesn't act at the end of the control program. What should phase III look like? Should controls be completely lifted, or must we evolve some more permanent system of at least partial controls? Is there a way that we can move toward that point, so we can start thinking this morning toward a more gradual adjustment to inflation? Do we have to put this off until the eve of the April 30 expiration of the wage-price control act?

This is probably your last appearance before this committee, before the annual report in February. And that is, of course, close to the deadline when the law expires. So, I would like to get some thinking started. And I would like to get your suggestion as to what we might be working toward in a phase III program.

Mr. BURNS. Senator, I will be in a better position to advise the Congress in another few months when we see a little more clearly than we can now whether the reduction in the rate of inflation is continuing. I think that is critical. We must have those facts before us, I think, before we can wisely plan for phase III.

My own preliminary thought is—and I have said this before—there are abuses of power in our economic society—abuses of power by business, and abuses of power by trade unions. In thinking about phase III, we should give more attention to these abuses of power than we have.

Chairman PROXMIRE. Would you repeat that last?

Mr. BURNS. In thinking of phase III we should give more attention to abuses of power by business and trade unions than we have.

Chairman PROXMIRE. Now, when you appeared before the Banking Committee I recall you were very concerned about the dictatorial aspects by the Government in the event we passed this legislation. This was an enormous power that was easily abused. The power to set prices and set wages was a tremendous power. Your response now implies that you feel that there may have been too light a touch by the Government, it hasn't been firm enough, that the Government should have cracked down harder on some wage increases and some price increases, is that correct?

Mr. BURNS. I don't want to criticize other Government agencies on that point. I was really thinking in my last remark about some structural reforms that we need to consider in our country.

Chairman PROXMIRE. I want to get into that when my time comes again.

Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Burns, it is always very refreshing to have you before the Joint Economic Committee. I have thought your points were well made, well documented, very thoughtful. And as a result of my own feeling about you I was a little shocked by the opening remarks of the chairman of the committee which virtually required of you a loyalty oath and a pledge of allegiance in connection with your future conduct in the very important office that you have. I don't think that anything in your past record would lead anyone to feel that your opinions and your views and your suggestions would be other than those things that you honestly felt were in the very best interests of our people.

Mr. BURNS. I want to thank you most heartily, Congressman Widnall, for saying this to me this morning. Thank you very much.

Representative WIDNALL. Mr. Burns, on the final pages of your statement you say that our traditional method of budgetary management will not enable us to regain control over Federal expenditures. Among the alternatives you have raised are a zero-based budget, a resolution for a comprehensive Federal budget, and a legislative ceiling on this budget expenditures. Noticeably absent from your list is tax reform. What is your opinion on the need of this country for some sort of tax reform?

Mr. BURNS. I think tax reform is a subject that the Congress must work at steadily, year in and year out. Of course, I am in favor of a reexamination of our tax structure. As the world changes our economic and political thinking changes, and we must keep reexamining our tax structure constantly. Therefore, I am always in favor of reexamination of a kind that may lead to reform.

But let me remind you, Congressman, we had a very comprehensive examination of the tax structure in 1969, and a so-called tax reform bill was passed then. The Congress examined this question again in 1971. And I hope the Congress will continue dealing with that question in the years ahead.

Representative WIDNALL. I couldn't agree with you more as to the absolute necessity of the Congress doing this on a continuing basis and not just hit or miss every other term.

Do you think such an effort would succeed in replenishing the Treasury coffers?

Mr. BURNS. Well, I must say in all honesty to you that I am skeptical. Congress has worked on this problem over the years. There are numerous tax preferences in our Internal Revenue Code. Congress has seen fit to enact and continue these various tax preferences. True, under the Revenue Act of 1969, the investment tax credit was abolished, and that was hailed in many quarters as a tax reform. But only last year the investment tax credit was reenacted by the Congress.

Now, as I examine the various proposals that have been made for tax reform, I am skeptical whether the Congress is of a mind to adopt many of the proposed reforms. Therefore, I do not anticipate the revenue effect to be very large. But, of course, I may be mistaken in this. After all, the thinking of Congress does change with time. Even the composition of the Congress itself undergoes changes, as you gentlemen know so well.

Representative WIDNALL. We have recently begun to see excellent statistics on businessmen's inventory accumulation. How important is this figure to the confidence of the business community?

Mr. BURNS. I think it is of some importance, but it is not a fact that I would regard as being of primary importance in gaging the expectations of the business community. I think far more important are the indictation given by contracts for business construction, orders for machinery and equipment, and appropriations for capital expenditures. Historically, these have been the most reliable indicators of the state of mind of the business community.

Representative WIDNALL. At the present time these are all on the upside, isn't that so?

Mr. BURNS. Very much so.

Representative WIDNALL. For a long period of time we saw the anomaly of high rates of personal savings during a period of inflation. Usually people try to spend their money as they feel its value is eroding. Has the Federal done any study to try to explain why this phenomenum took place during the period of inflation?

Mr. BURNS. The Federal Reserve, to the best of my knowledge, has made no special studies of this. This, however, is a subject that I did study some years ago personally. When I reviewed the inflationary episodes around the world, what I found was that in the early stages of an inflation, when the price level was still rising moderately, money accumulated in the hands of people. They saved it. and they were hardly aware of what was happening. But once people did become aware that the price level was rising with some rapidity, that they were living in a new environment, that the prospect ahead was for prices to continue rising, then they began spending their money more rapidly. The rate of saving diminished, and the turnover of money was speeded up.

So you find very interestingly that there is a certain natural history of inflation, that in the early stages the savings rate and the velocity of money tend to diminish, but at a later stage of inflation the savings rate diminishes rapidly while the velocity of money is speeded up. And, of course, as a consequence the pace of inflation itself is again accelerated.

I have therefore not found the recent development very surprising. But I should say that this is a phenomenum that I looked into some years ago. The time has come for me to reexamine it and study it again. As I said, I am not aware of any special studies by the Federal Reserve Board of this subject. But I shall see to it that this subject is reviewed by the members of our staff.

Representative WIDNALL. Just one more question, Mr. Burns. In your statement you stress that "international negotiations on monetary reform must begin promptly" if we are to avoid repeating monetary crises.

Do you feel that you agree with or differ with the administration on this score?

Mr. BURNS. As far as I know there is no difference on this.

Representative WIDNALL. So you are in general agreement?

Mr. BURNS. I think we are all agreed that the need for permanent reform is here, and the time to get conversations underway is now.

Representative WIDNALL. That is all, Mr. Burns. Thank you.

Chairman PROXMIRE. Senator Sparkman.

Senator SPARKMAN. Mr. Burns, I join with the others in welcoming you here this morning. We are always pleased to have you here.

The first thing I want to ask you is regarding your statement that there was an improvement in the balance-of-payments situation from March through most of June. Is that likely to continue, or is that just a temporary upsurge?

Mr. BURNS. Let me explain the improvement that occurred between mid-March and June 23. As I indicated, our balance of payments on an official settlement basis was in surplus during that interval. The reason was not, Senator, that an improvement had occurred in our balance of trade. On the contrary, our balance of trade deteriorated. What happened was that while our basic balance of payments continued to be in very serious difficulty, we did have a substantial reflow of the dollars that had gone abroad. This reflow occurred for two reasons.

First, the interest rate differential that previously had existed between the United States and other countries was largely eliminated, so there was no longer much reason to hold money abroad for the sake of earning a little more interest.

There was also a second factor. With our economy advancing once again, with economic opportunity in our country broadening and widening, many individuals and corporations decided that it was better to bring the money home and put it to use here, rather than keep it abroad in the expectation of a slightly higher interest rate or in the expectation of some small gain through the foreign exchange market.

That is what happened in the interval between mid-March and June 23.

Senator SPARKMAN. I was just hoping that there might be a little spark of hope there. But it seems to me purely temporary, with unusual conditions prevailing at that particular time.

Mr. BURNS. With our economy advancing, and with investment opportunities at home becoming better, there are ample reasons why Americans who have sent their dollars abroad will be bringing them home. And there are also reasons why foreigners interested in a good return would be investing in our stock exchange securities.

Therefore, once the turmoil that has recently existed settles down and exchange markets stabilized, as they seem to be doing, I think this return flow will continue for a time.

However, our basic problem—and this is doubtless what you have in mind, Senator—is to restore some vigor to our foreign trade. We are still some distance away from doing that.

Senator SPARKMAN. Now, I want to move to another thing you mentioned. And that is regarding the deficit. You say the deficit projected for fiscal 1973 is $27 billion. Then you say, the recent passage of the Social Security bill has raised that figure appreciably. I don't quite understand because concurrently with the enactment of the Social Security increase, there was a tax increase that I understood was to take care of it.

And furthermore, Congressman Mills, chairman of the Ways and Means Committee, said at the time that a 20-percent raise could be established in social security without the necessity of increasing the taxes at all. But in spite of that, Congress did vote an increase in taxes which I understand was sufficient to take care, certainly take care of the increase in social security.

So, why should the deficit be boosted because of that?

Mr. BURNS. I think what Congressman Mills had in mind, and what you have in mind, Senator, is the longer run effect. That is, the revenue yielded by our social security taxes has been growing, and this growing revenue could support larger social security benefits. But for the year ahead things will not work out in that fashion. The social security legislation will add some $2 billion to governmental outlays in fiscal 1973. The higher tax rate which will begin in January 1973 will yield about $500 million, but, the increase in the wage base which the administration previously had recommended, and which was to be retroactive to January 1, 1972, will not go into effect now until January 1973. So, we have this transitional problem which applies to fiscal year 1973.

Senator SPARKMAN. But it is a temporary thing brought about by the particular calendar date on which it became effective?

Mr. BURNS. I believe, Senator, that that is true. And that is the impression that I have tried to convey. But I should say in fairness to you and in fairness to the truth that I should check the observations that I have made here this morning.

Senator SPARKMAN. I was just curious about it, because I knew we enacted a tax that was supposed to counterbalance it.

Now, you have said that you see no escape from the conclusion that the time has come when the Congress must put our fiscal house in order. Now, is that a matter just of congressional responsibility? Doesn't the Executive have the responsibility there, too?

Mr. BURNS. The Executive has the responsibility of recommending, but it is Congress that passes our laws. And that what I had in mind.

Senator SPARKMAN. The Executive has the responsibility of recommending, but Congress has the responsibility of deciding what ought to be done with those recommendations doesn't it, under the Constitution?

Mr. BURNS. Of course it does.

Senator SPARKMAN. And then it seems to me that we are always overplaying what Congress ought to do, when we realize that the Executive must share that responsibility.

Mr. BURNS. Of course the Executive must share the responsibility.

Senator SPARKMAN. I just don't believe that the criticism ought to be directed at only the Congress.

Mr. BURNS. My aim was not to criticize the Congress, my aim was not to criticize anyone. I was calling on the Congress, which has the legislative power, to do its part. And I was doing that because I am appearing before a congressional committee. When I speak to my colleagues in the administration I assure you I urge them to do their part.

Senator SPARKMAN. I recall that last year the chairman of this committee placed in the Congressional Record and made a statement showing the appropriations by the Congress over a period of 26 years. And in every single year it had appropriated less money than the President had requested. I don't know what is going to happen this year. I hope that record can be maintained.

Mr. BURNS. I would like to share that hope with you, Senator.

Senator SPARKMAN. Just one thing. And this relates to requiring a two-thirds vote of Congress, two-thirds majority vote for any appropriation bill exceeding the provisions of the overall budget resolution. You are talking about a resolution of Congress that would set up a spending ceiling. I certainly agree with your recommendation with reference to the Joint Committee on Revenues and Expenditures. I think the big problem for a long, long time has been that very thing, that there is not proper coordination between revenues and expenditures. And it seems to me that that could be done.

I appreciate your testimony. And I do hope that your prediction of an improving economy stands up.

Thank you very much, Mr. Chairman.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Mr. Burns, first I would like to associate myself with the affirmation of your objectivity and nonpartisanship which has always characterized your service and your very high patriotism. I wish to state that flatly in a matter of most considered confidence on my part as a Senator who has served here and heard you for many years going back through the Eisenhower years.

I gather you don't place much hope on improvement of our fiscal situation either from tax reform, which has had a tendency to result in tax diminution rather than tax increase.

And history being what it is, expenditure ceilings have not done any too well, either, though I appreciate the methodology which is involved.

Now, what do you think about two other alternatives?

One would be a very material increase in productivity in this country. We have tremendous unused capacity. You yourself say in your statement that wage rates are well above long-term productivity gains. There is no question about that. Shouldn't that be the No. 1 American priority, to ride our strength, to increase our productivity power, and isn't one of the great overlooked opportunities the fact that the motivation, the morale of the American worker, are not being adequately enough appealed to, with incentives for the purpose of inducing him to increase his productive power.

Mr. Burns. I think you are raising a very crucial question, Senator. Our productivity has not been rising as it should. I have before me an article which may or may not have come to your attention, Senator, an article in the Monthly Labor Review for July of this year. That article presents statistics on output per man-hour in our country going back annually to 1960, and statistics of the same kind for 10 other industrial nations. Let me just read a few figures, from the article.

Between 1967 and 1971, output per man-hour in our manufacturing industry rose 11½ percent. That is a very small increase.

The average for 10 industrial nations was over 30 percent. And when I look down the list for individual countries, I find that even the United Kingdom and Canada showed larger improvement in productivity than we did.

Senator Javits. We were the low man on the totem pole.

Mr. Burns. We were, very definitely. The average increase was over 30 percent. The increase in the United Kingdom was 16½ percent, the increase in Canada was over 18 percent, and in our country, 11½ percent.

When you say this ought to be the No. 1 item on our agenda, I agree with you. Perhaps my statement was deficient in not bringing this out. My only defense is that I was mainly concerned with prospective developments for the coming year, whereas any program for improving productivity will not yield results quickly. Looking to the longer term, we certainly should concentrate on productivity.

I know of nothing more important, Senator, than your proposal to do what we can to raise productivity. And I want to commend this committee for your recent report in which you counseled the Commission on Productivity to proceed more vigorously in the important enterprise that the Congress has assigned to it than it has done so far.

Senator Javits. Mr. Burns, I would like to state to you, if I do nothing else in my 10 minutes, that I think it is an absolutely shocking failure of leadership to have failed in this respect, notwithstanding a national productivity commission, and some financing. The field is ready to be cultivated, there is an enormous range of measures going all the way from reform of pension and welfare plans to profit-sharing participation and plant operation decisions.

Quite apart from compensation, which could be utilized—there are enormous elements of compensation which would be utilized—and it is absolutely beyond my understanding the complacency in American life which allows these single greatest means for resolving our financial problems dealing with inflation and enable us to assume the role in the world which we are gradually relinquishing, which is the greatest force for peace in the world to go unused simply because we cannot grasp, or are simply seized with an inertia respecting this, the most important thing in our country. I just cannot understand it, Mr. Burns, And I am tremendously heartened by what you say.

And I don't see any sign that either candidate is going to make it the major issue in this campaign. And yet it deserves to be.

Mr. BURNS. Senator, you may be interested in the fact that one of our newest members of the Federal Reserve Board has taken upon himself the responsibility, in addition to attending to his regular duties, to go from city to city in our country and preach a sermon to businessmen on productivity, the need to improve productivity, the fact that productivity has languished in our country in recent years.

Senator JAVITS. That is Commissioner Sheehan.

Mr. BURNS. That is Governor Sheehan, yes.

Senator JAVITS. Now, just to move on to something else—because, as I said, that is all I can do in that regard so far, notwithstanding the monumental efforts on my part and this committee, is to cry out against it—Mr. Burns, isn't it a fact that with the dim prospect that the tax reform will add anything to revenues, and that the methodology such as you suggest, which we have tried before and always run into exceptions with, et cetera, is going to work, that pretty soon we are going to face the grim reality of finding some way of raising taxes, and that it may result in some form of national sales tax, simply because we will all go bankrupt unless we do, because we have failed for so long to really try to build up the base upon which taxes are built, and that is the base of more and great production?

Now, Erwin Miller, an outstanding industrialist, testified substantially to that effect. And it seems to me that this is a grim reality which the American people ought to be acquainted with if indeed we shall be facing it.

I ask if you would wish to comment, Mr. Burns? I don't want to embarrass you anyway or draw you into policy discussions which you may not want.

Mr. BURNS. I am just a little more hopeful than you are, Senator, about an expenditure ceiling. The Congress has enacted an expenditure ceiling several times since 1968. However, the expenditure ceilings previously enacted by the Congress have been rubbery. I think there is increasing realization in the Congress that our budgetary techniques, our techniques of matching revenues and expenditures, are defective. I sense a growing awareness of this problem, a growing interest in the Congress. And I am therefore hopeful that the Congress will see to it that a legislative budget ceiling is enacted, and that this legislative ceiling is a rigid one.

Sometimes when I talk in this vein I am reminded about the possibility of emergencies. Well, this might have been a problem years ago. But nowadays Members of the Congress work hard and continuously. You are here the year round. If there were an emergency calling for additional expenditures beyond the ceiling, I am sure the Congress would respond rather promptly.

So, I am a little more optimistic than you are, Senator, about an expenditure ceiling.

Senator JAVITS. Mr. Chairman, in view of the fact that we are the only members present, may I have 2 additional minutes to actually complete?

Chairman PROXMIRE. Oh, yes.

Senator JAVITS. Mr. Burns, yesterday we passed a bill in the Senate which set up an office of National Goals and Priorities for the Congress similar to the Controls Office, as a mechanism for ourselves to do exactly what you have in mind; that is, to give us an overview, to monitor an overall budget, to advise us what ought to be the priorities within it, and to give us that kind of control. The reason for its passage—and I am its author—was stated by me to be that we simply cannot be dependent upon the Executive to set the priorities within any budget ceiling. The problem around here is, as Mr. Stein testified just the other day, that if you set a budget ceiling, and the administration immediately tells you that a third of that budget has got to go to defense, you are hung right away.

So, that if the legislature puts those shackles on its own wrists and then accepts the budgetary findings of the administration, it has no way to challenge them, then we are dead pigeons, we lose our freedom of action respecting what the money is to be spent for.

And I would greatly appreciate your opinion on that.

Mr. BURNS. There is a difficulty with a legislative budget ceiling. You put your finger on the difficulty.

From my viewpoint, an equally good result would be achieved by a single appropriation bill. To the extent that this new committee—I am very much interested in it, Senator, this is the first time I have heard of it—to the extent that this new——

Senator JAVITS. It is an office.

Mr. BURNS (continuing). Office on goal priorities—to the extent that it will help the Congress to pass a comprehensive appropriation bill with an overall total reflecting the priorities of the Congress, I would be all in favor of that. That would accomplish the objective I have in mind, and would be free from the difficulty that you pointed out.

Senator JAVITS. Thank you, Mr. Burns.

One last question. There is some feeling, Mr. Burns, that coincides with that of the new Secretary of the Treasury, to give some support to the dollar nationally. Let me first express my own feeling that I think you have given enormous leadership in bringing about an international monetary agreement through the new policy which I hope—and I don't expect you to comment on this.

But I would like to ask you, in view of the fact that there are only two ways of giving convertibility or limited convertibility to the dollar—one is by buying and selling gold, and the other is by buying and selling foreign currencies—whether this may mark the opening of a policy of return by the United States to a limited dollar convertibility; in other words, that there is happening what many of our European trading partners have asked should happen?

Mr. BURNS. When European financiers speak of convertibility, what they have in mind is convertibility of dollars into ultimate reserve assets; namely, gold or SDR's or IMF position.

Now, what this new activity of ours in intervening in the exchange market—and let me say that the Federal Reserve and the new Secretary of the Treasury are in complete agreement—is doing has nothing to do with convertibility of the kind that financiers generally talk about. The aim is simply to reestablish order in foreign exchange markets so that an atmosphere favorable to permanent monetary reform would exist. This activity is not to be regarded as having any implications whatever with regard to what will be decided in later negotiations on the subject of convertibility.

Senator Javits. Thank you very much. Mr. Burns.

My staff points out, and I think rightly, that whatever the foreign financiers think, article 4 of the Articles of Agreement of the IMF say that this, what you are now doing, may well be the beginning of a limited convertibility.

And I ask unanimous consent that section 4 of article 4 of the Articles of Agreement of the International Monetary Fund may be made part of my remarks.

But to me the most significant thing you have said is that you and the Treasury are in agreement, you are doing this in harness. And I think that is a tremendous—I am using the word—new achievement for our country, and to me most promising. And I congratulate you and the new Secretary of the Treasury on it. Thank you very much.

Chairman Proxmire. Mr. Burns, apropos of Senator Javits' discussion of productivity—and I am delighted that he is hammering away at it, I agree with him wholeheartedly, it is very important. But you know it reminds me of something Paul Douglas always used to use as an analogy. There was a character in "David Copperfield" who, no matter what came up, would always react with a reference to King Charles' head. I don't think that Senator Javits is that way on productivity, but I am glad he is persisting on it. He is our productivity man.

Senator Fulbright often attributes our economic woes to the Vietnam war.

And my King Charles' head is unemployment. Now when we discuss productivity it seems to me the real answer is to get our unemployment down. That is where your real improvement in productivity will come, it is just bound to.

I had a relatively brief business experience, but I owned a printing company. If we could get those printing presses operating most of the time and get our people working most of the time, our productivity was enormously improved.

So, No. 1, to the extent that we can get this economy of ours moving much more rapidly than it has been and reduce unemployment, we will have full utilization of our manpower resources. And we are certainly far, far from that.

No. 2, full utilization of our plant and resources. We are only operating at 76 percent of capacity.

Very important is that we will be in a position to negotiate productivity improvement. I am referring to negotiating with the labor unions which are very reluctant to negotiate when unemployment is heavy, they don't want to see automation come in and put people out of a job when they can't find another job.

And then there will be pressure on scarce manpower if we have far more effective manpower training programs.

And also pressure for manpower saving by using automated equipment just because there is scarce manpower.

For all those reasons, it seems to me that if we talk about improving productivity without putting it in the context of a slack economy, we will be missing the major action we can take, just as I think the major way we can increase revenues is to get the economy moving. We can have not just a saving of the nickels and dimes you may get on tax reform, but real improvement in revenues if we can operate an economy that is moving with 4 percent or less unemployment. What is your reaction to that?

Mr. BURNS. I share fully your concern about the unemployment problem, Senator. I don't want to see unemployment at a depressed level of economic activity. I do think, however, that the Government, meaning both the Executive and the Congress, has released powerful stimulative forces. I do think that the private economy is now moving upward, and that momentum is being gathered in the course of this advance. Therefore, I see powerful forces at work to reduce unemployment.

Chairman PROXMIRE. Aren't we being deceived by many of the figures? It is true that we were in a recession in 1970, it is true that we have recovered some. But still if you look at the fundamental basis factor on the utilization of our resources, our manpower resources are far from being utilized; 5½ percent is a very unsatisfactory rate of employment. And certainly 76 percent of capacity is a very unsatisfactory rate of utilization.

So, you can talk about how we have improved our gross national product in the last quarter, but we had a lot of improvement to achieve.

Let me get into something else. I come back to the figures which seem to disagree with your diagnosis about this expansion.

The fourth quarter plant and equipment spending according to the commerce survey as estimated by businessmen in April and May show that they expect no increase over the second quarter.

Can you give us some instances in the past when you have second gussed the survey and found the survey wrong and you were right?

Mr. BURNS. Oh, yes. I may have testified before this committee in 1954, when there was a divergence between the statistics on contracts and orders on whih I relied chiefly, and the estimates on business capital expenditures. I stood my ground at the time. And I was proved right. That is a case that comes to mind immediately.

Chairman PROXMIRE. You see, because the estimates show a second quarter $90.69 billion for expenditure in new plant and equipment, and in the third quarter it goes down, $89.72 billion, and the fourth quarter about the same as the second quarter, $90.89 billion, no real improvement.

Mr. BURNS. I can't help that, Senator. All that I can say to you is that there is a substantial lag between the placing of an order and the making of an expenditure.

With contracts and orders for business capital going up as they have here in the past year, business expenditures on capital goods are virtually bound to go up in spite of what that survey shows.

Chairman PROXMIRE. I have great respect for your judgment. But it seems to me that when you ask the businessmen who are going to make the investment themselves—and that is what this survey does—

that is about as good a basis for estimates as you can get, isn't it? These are the people in the position of making judgments.

Mr. BURNS. No, it is not as good an estimate as you can get. The best estimate that you can get is not by asking what they think, but by finding out what they do. They have been placing the contracts, and they have been placing the orders. The people who answer the question about what might be spent are not always the people in the corporations who place the contracts and orders. I place my heaviest reliance on those statistics.

Chairman PROXMIRE. And then the Department of Commerce survey says, the manufacturer is expected to add $1½ billion to inventories to the second quarter, and $2 billion in the next. So, there is not much change there.

Mr. BURNS. This is a statistical no-man's land. I have not found a good method, really, of predicting inventory investment. My own judgment is based merely on the fact that by now, judging by historical standards, business inventory investment should have been rising briskly. There has been a delay, and I expect that delay to be made good.

Of course, some changes may be taking place in the business world, of a kind that I am not familiar with, that may run counter to this judgment. That could happen.

Chairman PROXMIRE. Let me ask you, Mr. Burns, what do you think is the level of unemployment which we should strive for over the long run as acceptable, 4 percent, 3½?

Mr. BURNS. Well, I am content, as a rough goal, with the 4 percent figure that has figured so heavily since the passage of the Employment Act in the thinking of the Council of Economic Advisers under different administrations, and, I believe, in the thinking of economists over the country. To the extent that I would name a figure, I would stick with the 4-percent figure that, by and large, has served our country well as a goal.

Chairman PROXMIRE. Mr. Burns, as I understand it, in order to get the 4 percent, not in 1972, not in 1973, not in 1974, but by 1975, 4 full years, we are going to have to have growth regularly at a 6 percent real rate. Under those circumstances do you really think that the present momentum is going to take us anywheres near this figure? And if so, when did you think we might expect to get there?

Mr. BURNS. I cannot forecast that. I think we are moving strongly in the right direction, Senator. I am not going to attempt a precise forecast.

Chairman PROXMIRE. You said that a future control mechanism, speaking of phase III, must give more attention to abuses of power. And then you spoke about business and cracking down on both prices and wage increases.

Can you give us some examples of abuses of power involved here?

Mr. BURNS. Well, I think examples are all around us. I think some of our trade unions have been abusing their power by acting monopolistically. And I think some of our business firms have been abusing their power in the market place as well.

Chairman PROXMIRE. I have asked for examples. Can you give us any?

Mr. BURNS. I would want to review the factual evidence and think very carefully before I resort to specific names.

Chairman PROXMIRE. You don't think corporate magnates have too much access to the White House?

Mr. BURNS. I have said no such thing. Those are your words, Senator.

Chairman PROXMIRE. You don't mean that?

Mr. BURNS. I have no knowledge of that, and therefore cannot mean that.

Chairman PROXMIRE. When you say abuse of power, we have a law on the books, we have a system of control in effect. Does this mean that the Government is too easy on the labor union, too easy on the particular corporations? It seems to me that this is a charge that if vaguely made doesn't mean anything, but if substantiated, gives us examples that mean something.

Mr. BURNS. I think some of our legislation needs to be reexamined, and also that our administration of existing laws can be improved upon.

Chairman PROXMIRE. Are you saying that these abuses are legal?

Mr. BURNS. I am not referring to legality. I am not charging anyone with illegality. But I am saying that there are pockets of excessive power in our society, and I would like to see these pockets reduced.

Chairman PROXMIRE. Give us some help. How can we do it? You are talking to a congressional committee. What can we do to reduce that monopoly power? Are you talking about changing the laws with respect to trade unions?

Mr. BURNS. That was one thing.

Chairman PROXMIRE. How do we change them?

Mr. BURNS. Well, I talked about some of that in a speech I gave in December 1970 at Pepperdine College. I gave some specific illustrations, but my list was not exhaustive. These suggestions are in the Congressional Record.

Chairman PROXMIRE. What changes do we make with respect to corporations and holding prices down?

Mr. BURNS. I would like to see our antitrust laws enforced more vigorously than they have been. That is the most important change that I can suggest at the present time.

Chairman PROXMIRE. You did refer in your Pepperdine speech to some list of needed actions. Let me go back to part of that. Little progress, it seems to me, has been made along these lines. We have not gotten rid of oil import quotas. We don't step up antitrust enforcement, as you now mentioned. We don't reform the regulatory agencies. We continue to tolerate great waste in government procurement. We continue to tolerate far too much discrimination in the labor market.

Can you point to any progress that has been made recently toward any of these structural reforms to combat inflation in an effective and substantive way?

Mr. BURNS. Without commenting on the substance of these proposals, Senator, I must point out that you are not reading from my Pepperdine speech.

Chairman PROXMIRE. That is correct, I am not.

Mr. BURNS. It wasn't clear to me——

Chairman PROXMIRE. I said, in your Pepperdine speech you did have a list, as I recall, of 11 recommendations, at any rate a whole series. And one of them at least was more vigorous antitrust enforcement. And you had others. But I am asking you if the administration has made any progress in any of these areas?

Mr. BURNS. Well, if you want me to tell you whether we are enforcing antitrust laws any better than we were in 1970, all I can say to you is that I simply do not know. It isn't a matter that I have had occasion to look into.

Chairman PROXMIRE. You have just said—I understood you to say that one way of combating inflation more effectively—that was the only specific recommendation you gave us—is more vigorous enforcement of the antitrust laws.

Mr. BURNS. Oh, yes.

Chairman PROXMIRE. And now as I understood you to respond, you don't know whether we have been doing that effectively or not; is that right?

Mr. BURNS. All that I have said was that I don't know what progress if any we have made since 1970. Regardless of the improvement we may have made, I still think plenty of improvement is possible, and we ought to attend to it.

Chairman PROXMIRE. In your statement you are very specific in indicating that you think that we ought to have a lower wage guideline, as I understand it, you think it ought to be lower than 5½ percent. I think you said that in your statement.

Do you have any corresponding recommendation with respect to administration of the price part of it? There have been many complaints that we have been very soft in the price area. The Proxmire amendment requires that the price commission hold public hearings before price increases are permitted. There hasn't been one single hearing. The law has been violated clearly.

Can you think of any other respect in which we can have a more effective price enforcement system?

Mr. BURNS. I can think of many, but I would want to think more carefully than I have before I make proposals to the Congress.

Chairman PROXMIRE. I wonder how this is going to be received by labor, which has felt, rightly or wrongly—and I think in some cases we have been too soft in permitting too big settlements in wage areas, certainly the 12-percent increase for longshoremen, and so forth, much to much in my view—at any rate, how labor is going to accept a crackdown below 5½ percent when you have enormous increases for Executive salaries, and when high salaried major league players in football and baseball and basketball are completely exempt from wage guidelines, how labor will accept a further tightening of these rules, especially when you have no open hearing on price increases.

Mr. BURNS. I don't see why labor groups or business groups or public groups should quarrel with my statement on the wage-price problem. What I pointed out was that wage increases have been in excess of improvements in productivity. As long as that condition exists, unit labor costs of production will rise. When unit labor costs of production rise, prices are virtually bound to go up. This is simply a matter of arithmetic.

Next, I went on to say that if wage increases are to be brought down to the level of productivity increase, then prices will also have to behave better than they have. I don't see how you can quarrel with that seriously, really I don't.

Chairman PROXMIRE. I hardly quarrel with it. At the same time I don't see any disposition on the part of the Price Commission to require companies to reduce prices, as they should do when their costs diminish.

Mr. BURNS. Well, you have been paying closer attention to the Price Commission than I have. If they are not doing their job properly, why don't you go after them, and go after them hard? And may God bless you in the process.

Chairman PROXMIRE. Well, we have tried to do that. We have asked them repeatedly to hold hearings. We have asked them to crack down. And we have written them asking them in this respect.

I would like to refer to a statement you made on July 23, 1970. That just happens to be about 3 or 4 months before the recovery began. The date of recovery was what?

Mr. BURNS. November 1970.

Chairman PROXMIRE. November 1970. So we are now in the 19th or 20th month of recovery. You said at that time: "The unemployment rate will drop by 1½ or 2 percentage points in a year or a little less than a year, once the economy begins recovering."

That is a quotation of your testimony before the Joint Economic Committee on July 23, 1970.

Mr. BURNS. I would like to think that the full reading of what I said would indicate that I was referring to past history; and as a historical statement that was and is correct.

(The following information was subsequently supplied for the record by Mr. Burns:)

In order to make the record perfectly clear, I should like to submit at this point excerpts from the Joint Economic Committee's hearing of July 23, 1970, on the state of the economy at midyear. These excerpts deal with my statements regarding the level of unemployment.

"Senator SYMINGTON. Mr. Chairman, the economy has declined considerably more in the first half of this year than most people had anticipated and we are now operating some $40 billion below our potential. As you say in your statement, there are some signs that the decline may bottom out in the near future but we are not certain it will. Our main problem now would appear to get the economy headed up towards its potential again. How long do you think it will take to restore the economy to its potential output level?

"Mr. BURNS. I cannot give you a definite date, Senator. I wish I could. Historical experience indicates that once the economy begins recovering, the unemployment rate will drop by 1½ or 2 percentage points in a year or in a little less than a year.

"Now, no two cases are alike. I feel that we should restore full employment some time in 1971. Whether we will do it by March or by July or by September I am really unable to say and any guess on my part would not serve the committee well.

"Senator PROXMIRE. Mr. Burns, you have given us a highly optimistic picture of our economic condition including an answer to a question—I understood you to say that we will be back to full employment in your view, sometime in 1971, without naming the month. You expect we are moving in that direction, is that true?

"Mr. BURNS. I did not make a categorical prediction. I am not a prophet. I am just an economic analyst. I referred to past experience and I stressed my hope and expectation."

Chairman PROXMIRE. I think that is right. And I think it is very, very important that that was a historical statement that was correct. And it is certainly not correct now; is it?

Mr. BURNS. Senator, we had an extraordinarily sluggish recovery up until last fall. Since then the economy has been advancing briskly.

The recovery for about a year or so was painfully slow, and disappointing. But conditions have changed.

Chairman PROXMIRE. Now do you see any actions that we should take or that you should take in the Federal Reserve Board to try to reduce the unemployment rate, in view of the fact that historically, as you say, it has not recovered the way it has in the past, we have had a sluggish recovery?

What can we do about it?

Mr. BURNS. I think Congress has done a great deal to stimulate the economy. And results are now being achieved. At the moment I am confident that enough stimulative action has been taken.

Chairman PROXMIRE. Let me ask you about the efficiency and productivity of the Federal Reserve Board.

This morning's Wall Street Journal had a very interesting article entitled, "The Fed's New Tactics Seem To Be Working but Perils Lie Ahead."

It would be fascinating to get your comment on this to the extent that you can. Let me read part of the article. It says: "In 1971 the Fed sought to promote a fairly smooth growth of the money supply."

And, of course, most of us feel that one of your main functions is adjusting the money supply, or credit, I should say, in such a way that we can stimulate the economy when we need it, or restrain it when it needs restraining.

And then it says:

> The Fed sought to promote a fairly smooth growth of money supply. What it got was a huge rise in the first half and a sharp slowdown in the final month of the year. Judging by the policy record of the open market, according to SECAUCUS Research Corporation, numerous members of the Committee were embarrassed by the behavior of the money supply in 1971.

And it goes on to say:

> The open market committee, composed of the seven Federal Reserve Board members and five of the 12 Reserve Board presidents, had to decide what to do about the embarrassment. What it decided was to pay more attention to the reserves that banks must maintain behind their checking accounts.

And it goes on to say:

> A month later the committee narrowed its attention to reserves available to support prior non-bank deposits, and to use the term RPD.

The articles goes on to say:

> This RPD approach has been extraordinarily successful, but over such a brief period that we don't know whether it is going to work effectively or not.

It says:

> Even over longer periods than a week, no one suggest that banks march in lock step with the money supply, when the banking system requires more reserves it gets the power to make more loans and thus creates deposits and boosts the money supply. It also has an incentive to use that power, since it earns nothing on idle funds in its reserve accounts. But exactly how soon it will act and just how large its acting will remain uncertain.

So, this is still a very inexact science, but it is one that seems to give great promise that you will be able to operate with much greater efficiency in the future than in the past, because you do have a new approach.

Now, is this overstating the case?

Mr. BURNS. We are using a modified operating technique. The results so far look promising. The time for evaluation is in the future rather than now. I would only add this, that I have no apology for what the Federal Reserve did in 1971.

Yes, the money supply grew very rapidly in the first half of the year. I think that was right at the time, because we wanted to give an extra stimulus to the economy. We did not want to continue that stimulus indefinitely, because the newly created money was already out there. There was no sense in adding to it at a rapid rate. The important thing then was to put that money to use, and there is nothing that the Federal Reserve can do about that.

When the new economic policy was announced last August, many people were fearful. They were afraid that since we have price and wage controls, Government officials would no longer worry about the budget or the money supply. They were afraid that the money supply would be allowed to grow very rapidly on the theory that prices and wages are taken care of. We, at the Federal Reserve, thought differently. In fact, I would say, if I may, Senator, we knew better. We knew that the fundamental cause of inflation is an excessively rapid growth of the money supply and budget deficits. Therefore, to help create confidence in the new economic policy, and to create confidence that inflation was going to be brought under control, instead of opening up the monetary spigot we clamped down for a little while. Enough money was already there to do its work. There was no shortage of money or bank credit. In fact, bankers were looking for customers at the time.

I think people who have criticized the Federal Reserve on this particular score are proceeding from a theory that what happens in the economy depends on short run variations in the rate of growth of the money supply. There is no substance in that theory. But if you take the growth of the money supply over 6 months or longer, you will find that there haven't been large variations in the rate of growth in the recent past.

Now, it is true that at times we have found that the behavior of the money supply has not fulfilled our intentions. The change in operating technique is by no means designed to achieve a stable, uniform rate of growth of the money supply regardless of economic or financial conditions. It is merely designed to assure in a better way a rate of growth of the money supply and of bank credit that conforms to the Federal Reserve's plans or intentions.

Chairman PROXMIRE. Now, is this reserve against private deposit, is this the technique that you are pursuing, and are you finding this technique, so far at least, on the basis of a brief period, to be promising?

Mr. BURNS. It looks very promising, Senator; yes.

Chairman PROXMIRE. It will give you a somewhat better opportunity to effect your aim than you have had in the past?

Mr. BURNS. That is our guess.

Whether things will work out that way or not over a longer run remains to be seen. But so far the experiment looks very promising.

Chairman PROXMIRE. I would like to follow up with what Senator Sparkman asked you about Congress engaging in excessive spending with a challenge. Administration officials who testified this week criticized Congress with strong language, too, but they made no special recommendations for budget cuts. The President has asked for more defense money. The President has asked for a very large amount for special flood relief because of the terrible floods that we have had lately. But he doesn't tell us what to cut to make room for these items.

Can you tell us where you think that we should make a reduction? You have been very helpful to us in the past in this kind of area. Can we cut defense, or can we cut some other area?

Mr. BURNS. Senator, I have been around this city for a while. I attend to my business chiefly. But as I look around me I have the impression that expenditures can be cut practically everywhere. That is my impression.

Chairman PROXMIRE. Well, how about defense, do you think we can cut our defense expenditures?

Mr. BURNS. Well, I have said——

Chairman PROXMIRE. You say practically everywhere.

Mr. BURNS. I have said my impression is that expenditures can be cut practically everywhere. And I did not mean to exclude defense.

Chairman PROXMIRE. Would you reduce expenditures for hurricane relief, flood relief?

Mr. BURNS. I don't know enough about that subject to comment on it usefully.

Chairman PROXMIRE. When you say they can be cut everywhere, do you mean that the level of services may be excessive and too high, or do you mean that there is too much inefficiency and waste in the Government, or both?

Mr. BURNS. I mean the latter, principally. I think there is a great deal of waste.

Chairman PROXMIRE. It would be helpful if you could indicate some services that you think we could reduce. Of course, getting that waste under control is something that we are all working for and feel strongly about. But could you indicate just one or two services particularly to highlight this. You get so many people that say to cut it. And when you say cut it everywhere, it is hard to put this into effect.

Mr. BURNS. There is such a thing as a meat ax, and it has been used at times very successfully.

Chairman PROXMIRE. Then you would support a 2 or 3 or 4 percent reduction across the board in everything; is that right?

Mr. BURNS. As a first approximation, I think it might be a very good idea. But I would want to be sensible and reasonable and make adjustments and corrections.

Chairman PROXMIRE. The staff has called to my attention—I neglected to read further in your testimony on the unemployment situation—you said:

> The unemployment rate will drop about 1½ or 2 percentage points in a year or a little less than a year after economic recovery. No two cases are alike. I feel that we should restore full employment sometime in 1971. Whether we do it by March or July or by September in 1971 I am unable to say, and any guess on my part would not serve the committee well.

Mr. BURNS. I repeat that statement, we should, yes.

Chairman PROXMIRE. Well, I go back to your statement in which you said you had second guessed the Commerce Department on the amount of investment in the past and you had been right. So your record as a predictor may be good, but it is not perfect.

Mr. BURNS. My record as a predictor is not perfect. I can give you more examples of that than you can cite.

Chairman PROXMIRE. I will bet you can.

Mr. Burns, I am disturbed by the numbers again. Some administration spokesmen seem to be playing with a deficit and overwithholding. It is very important to get your judgment in this area, because you can give us expertise and more objectivity perhaps than they can give us.

Yesterday Caspar Weinberger told us that the fiscal year 1972 deficit was $23 billion as compared to a January estimate of $38.8 billion. He mentioned that part of this reduction was because revenues were swelled by $6.5 billion in overwithholding. Now you tell us that there will be a bulge in the deficit next spring when we refund these overwithheld taxes. Yet just a month ago, Samuel Cohen told us that after the first year, "If you are still overwithholding, you collect it again and the net effect of the refunds roughly washes out." In fact, if incomes continue to rise, next year's overwithholding should exceed this year's refunds to artificially decrease the deficit again.

Also, Herb Stein just testified that there is evidence that consumers have been responding to their true incomes; that is, "to their incomes after their true tax liabilities, and not to their incomes after the amount that had been excessively withheld." This means that consumers may have already spent that refund they will receive next spring.

How do you square this with your statement that there will be a "dangerous" bulge next spring?

Mr. BURNS. As I remember the evidence submitted by the Treasury Department at a hearing of the Ways and Means Committee on the debt ceiling held in early June, a figure of $24 billion was estimated for refunds in fiscal 1973, in contrast to a figure of something like $13 or $14 billion in the preceding year.

Now, that estimated increase of $10 billion presumably is not accounted for entirely by overwithholding. But perhaps $8 billion of the $10 billion is due to overwithholding. Tax refunds become available normally in the interval between March and May. It now appears that a huge volume of tax refunds will be paid out to the American people between next March and next May, that the sum will be much larger than in any earlier year. That is the bulge that I referred to, a bulge that will come at a time when I anticipate the economy will be advancing very briskly.

Chairman PROXMIRE. What effect, if any, do you think that overwithholding will have if continued? And the anticipation is that it might be continued. And the point that is made by Mr. Cohen, a very able man, as you know, he said, "If you are still overwithholding you collect it again and the net effect of the refunds roughly washes out."

Do you disagree with that?

Mr. BURNS. I wouldn't want to disagree with a tax expert like Secretary Cohen. My guess is that he was referring to the next fiscal year rather than the fiscal year 1973.

Chairman PROXMIRE. So your point is that there will be a bulge in the spring, and there may be continued overwithholding which may have a counteracting effect, but that would be over a period of time, the bulge would come in the spring, and you will have an economic impact in the spring, and there will be an increase perhaps in consumer expenditures then as a stimulous for the economy; is that right?

Mr. BURNS. That is the essence of my point. Of course there is no way of knowing how people will use that money. Some will tell you, Senator, that people will simply save that money, and they may be right. And others may tell you that people will use that money, or a good portion of it, as a down payment on large credit purchases, and therefore these refunds may have a large multiplier effect.

I have no way of being sure of what will happen, but I do think that this bulge is potentially very troublesome. And because I believe this, I considered it my duty when I testified before the Ways and Means Committee to call attention to it, and I have done so again today.

Chairman PROXMIRE. Mr. Burns, there has been a lot of comment and a lot of interest expressed in the action of the Federal Reserve Board in purchasing dollars with deutsche marks. This has been viewed as a cooperative kind of an action and a helpful action to other countries.

The Treasury statement and reaction to limited purchases of dollars—I mean limited, from what I have heard they are quite limited—last week by the Federal Reserve says:

> The action reflects a willingness behind the statements to intervene in the exchange market on occasions when it feels that it is desirable to help deal with speculative forces.

I interpret this Treasury statement to mean that the United States has not committed itself to intervene in exchange markets wherever necessary to maintain the value of the dollar within two and a quarter precent of its new parity; is that correct?

Mr. BURNS. That is a fair interpretation; yes.

Chairman PROXMIRE. The trade negotiations scheduled to begin in 1973 should be comprehensive and include agriculture as well as industrial trade and nontariff as well as tariff barriers. Therefore, it would seem that if the Kennedy round experience is any indication, several years may be required to conclude these comprehensive trade negotiations. I hope that vigorous U.S. leadership in pursuing international monetary reform will not be contingent upon progress in trade negotiations, and that we would not postpone approval of an otherwise satisfactory plan for monetary reform because trade negotiations had not yet been concluded. Can you give me some assurance in this regard; can you tell me that my apprehensions are groundless?

Mr. BURNS. Well, the ultimate assurance would have to come from the administration. This is not a matter under Federal Reserve control. All that I can give you is my personal opinion. My opinion is that we ought to take a very active role in these GATT conversations. My opinion is also that we ought to carry on vigorous bilateral conversations with some countries, with a view to improving our trade balance with those countries, quite apart from the GATT conversations.

My opinion is, finally, that international monetary reform is urgent, and that if GATT conversations will stretch out as they may, monetary reform should not be postponed for that reason.

Chairman PROXMIRE. That is very reassuring.

I have got two other matters, Mr. Burns, that concern me very much. They don't go to the economy as well as they go to the Federal Reserve Board policy.

I know you have great regard for the two new men who have been appointed to the Federal Reserve Board. I don't. I voted against them and I spoke against them on the floor. I think the Federal Reserve Board is an extraordinarily important agency, and should be as professional as possible, and it should have as much competence as possible. It is water over the dam. I don't mean to review the Sheehan and Bucher appointments again this morning.

But I would hope in the future that when you have a voice in this—you don't make the appointment, but you have a voice in this, I am sure you must have—that the appointees be men with high professional qualifications who understand monetary policy, and that if they don't have experience in the credit area, they at least have a clear working knowledge of it, and some basis for understanding it, because frankly, I am very concerned about this agency which is so very vital and important for our economic health, which has improved so greatly in recent years, including the period of your leadership.

Can you give us any indication of your thinking as to the kind of people who should be appointed to the Federal Reserve Board, and why these people shouldn't be the most competent economists we can find in the country, or people who, if not economists, have solid experience in the credit area, so that they don't have to have on-the-job training?

Mr. BURNS. Senator, let me say, first of all, every member of the Federal Reserve Board—and I speak from experience, having been a member for two and a half years—receives on-the-job training. There is no escape from that.

Let me say second——

Chairman PROXMIRE. Of course all of us get on-the-job training, all of us in the Senate get on-the-job training, and every reporter in the room has on-the-job training, you learn more in your job than any other place.

But the question is whether these men come to the job with the kind of education and background that will enable them to understand the complicated, technical, and vital policies that confront them on the Board?

Mr. BURNS. All that I can say to you is that when I took my present post, I also took an oath of office. You may not recall this, but I do. If you had recalled it, Senator, you would not have asked me the question you did at the opening of this session. I also made a resolve; namely, to leave the Federal Reserve Board in a more excellent condition than I had found it. I am doing everything in my power, everything in my ability, to fulfill that promise which I made to myself, to leave the Federal Reserve Board an even finer institution than I found it.

I have no apologies whatever for the last two appointments. I think they were excellent appointments.

You have asked my views on future appointments. I will be very candid, as I always am with you and with this committee. I believe we need a variety of talents on the Federal Reserve Board. I would not want a Federal Reserve Board to consist exclusively of professional economists. My present thinking, however, is that we ought to have about four professional economists on the Federal Reserve Board. I am not tied to a rigid number; that number might be a little larger or smaller. But I would never want a Federal Reserve Board to consist exclusively of professional economists.

Chairman PROXMIRE. What would you think of a Supreme Court that had five lawyers, and the rest poets, philosophers, sociologists, and men that had a broader background than just the narrow one of lawyers?

Mr. BURNS. Well, I have known some extraordinary poets in my life. They might have made good Supreme Court judges, one or two of them that I know.

Chairman PROXMIRE. It seems to me that the Supreme Court has such a very, very broad constitutional responsibility. And the Federal Reserve Board, while vital, it seems to me is an economic, technical agency which has the responsibility for managing credit in this country, and for managing our central banks, and being our central banker. And it would seem that there is a much stronger argument here for a professional system than there is for the Supreme Court.

Mr. BURNS. There is a strong argument for professional expertise. And there is also a strong argument for having balanced judgment and practical wisdom on the part of members of the Board. Senator, if we had seven economists on the Board, my judgment is based on some experience, that many of our meetings would degenerate into discussions of peripheral or technical issues, so that the larger questions that concern us, and that you would want the Federal Reserve Board to be concerned with, might now and then be slighted.

I say this to you, that the noneconomists on the Federal Reserve Board—I don't like to say this about my profession, but it is a fact—have served a very important function in quieting the excessive enthusiasm that some of the professional economists on the Board now and then have for purely technical issues.

Chairman PROXMIRE. And because the economists know that the noneconomists don't know what they are talking about they don't talk about it?

Mr. BURNS. No, the economists like to talk shop. And the noneconomists like to remind the economists that there is more important business before the Federal Reserve Board. It is a useful function.

Chairman PROXMIRE. Now, the other point.

Mr. Burns, on numerous occasions you have acknowledge that the Federal Reserve Board is an agent of Congress, and that Congress delegated to it the power under article I, section 8, of the Constitution which reads: "Congress shall have the power to coin money and regulate the value of it." Is that not correct?

Mr. BURNS. That is right.

Chairman PROXMIRE. Why, then, on June 20, 1972, did you refuse to honor the request I made as a Senator and as a ranking member of the Senate Banking Committee that you review the names of banks and give the circumstances under which $6,300 in $100 bills were issued to the men bugging the Democratic National Headquarters?

Here is a highly partisan situation, one in which the executive branch is a party of interest. And I wanted to make certain this matter was not swept under the rug. The fact is that the Federal Reserve could quite easily determine the source of the financial instrument used to purchase those sixty-three $100 bills.

But not only did your staff give me the runaround, at the same time the FBI was telling my staff that they had already been in touch with the Federal Reserve to identify where these bills came from. I received a letter from you on Monday, June 19, stating "we of the Board have no knowledge of the Federal Reserve banks which issues those particular notes."

And then you as an agent of the Congress refused to give the Congress the information, but in fact you turned it over to the executive branch, which I say is a party of interest in this situation. And they certainly have been viewed by him as, if not responsible for the bugging, highly suspect.

Now, that was over a month ago, and nothing has been heard of it since. Frankly, Chairman Burns, one would have to be naive not to believe that the Federal Reserve Board is covering up for someone high in the executive branch. That is especially true since it has now been revealed that there were clear White House and reelect Nixon campaign connections with the event.

Will you now turn over to the Congress the information as to who received the $100 bills and the source of the financial instruments used to purchase them?

Mr. Burns. Senator, your question fills me with deep sorrow. The last thing that I want to do ever is to criticize the Congress or to criticize a Senator for whom I have such high regard. But you have asked me a question—you have made your meaning very plain—and I must answer you.

I received a letter from you on June 19 at 2:15 p.m., requesting information on currency involved in the Watergate matter. At 4:20 p.m., my reply went to you. And in that letter I stated: "We at the Board have no knowledge of the Federal Reserve bank which issued those particular notes or of the commercial bank to which they were transferred."

That statement was absolutely correct, we had no knowledge whatever.

Chairman Proxmire. Why didn't you have knowledge of that? Aren't you supposed to have knowledge of the transactions of that kind? Couldn't you have found that out within 2 hours?

Mr. Burns. Now, I want to answer your earlier question before I turn to this one. I think I should. I will answer your present question in due course.

You must remember, Senator, that we have Federal Reserve banks, and we also have a Federal Reserve Board. We have a decentralized system. Neither I nor any other member of the Board, or any member of the Federal Reserve Board staff, had any knowledge of this matter as of 4:20 p.m. on June 19 when I wrote to you.

Chairman Proxmire. Let me ask you, do you know now?

Mr. Burns. I personally do not know. Members of my staff do know now. They made inquiries. And let me read to you from a log that my office kept, because we wanted to be absolutely sure of the facts.

On June 20, 12 noon, the Federal Reserve staff was informed that the Philadelphia Reserve Bank had provided the FBI information regarding certain currency notes.

Later on, in the later afternoon of June 20, we learned from our unit in Miami that they had given the FBI certain information.

Our staff got in touch with the FBI, and with the U.S. attorney for the District of Columbia, and sought their counsel with regard to the request that members of your staff were making of us at the Federal Reserve Board. And we were informed by these law enforcement agencies that they were opposed to any disclosure of investigative evidence, for the reason that such prior disclosure might well impede the investigation under way.

Your business, Senator, is with the FBI, or the U.S. attorney, not with the Federal Reserve Board.

Chairman PROXMIRE. Did the Federal Bureau of Investigation or any other Federal agency specifically request that you not disclose this information?

Mr. BURNS. I can't make it that rigid. I did not carry on the conversations myself.

Chairman PROXMIRE. Is there anything in writing to indicate that they asked you to withhold that information?

Mr. BURNS. I don't have anything in writing. But I am perfectly willing to have members of my staff talk to members of your staff—I believe they already have—and tell them everything they were told, down to the last comma.

(The following information was subsequently supplied for the record by Mr. Burns:)

As I explained fully to Senator Proxmire right after the Committee hearing and in the presence of many individuals, I will make every scrap of information in the hands of my staff available to the Senator provided I have legal sanction for doing so.

Let me now recite the conversations that the Board's staff had with the U.S. Attorney, Harold Titus. Mr. Titus stated that, with respect to any case in his office, it was his firm policy not to disclose investigative evidence prior to presentation of the facts to a grand jury, and to disclose as little as possible prior to criminal trial in the event of an indictment by the grand jury. Mr. Titus said he saw no reason to depart from this policy in this case. He opposed the disclosure, to any member of Congress, or to any member of the press or the public, of information that the Federal Reserve may have regarding the incident at the Watergate Office Building because such disclosure could impede the investigation then underway and could jeopardize the defendants' rights to a fair trial.

The U.S. Attorney's position on this matter was reconfirmed on July 26. On July 27, the Board of Governors unanimously decided to honor the judgment of the U. S. Attorney. A letter conveying this decision to Chairman Proxmire was sent by me on July 28 as follows:

JULY 28, 1972.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: Our general counsel, Mr. O'Connell, has reported to me that at the conclusion of a conference with your staff yesterday afternoon, he was asked to consult once again with the U.S. Attorney for the District of Columbia regarding the Watergate affair.

Twice before he has consulted with the U.S. Attorney on this question, most recently on Wednesday of this week. Twice before I have consulted not only with the Board's legal advisors but also with the other Members of the Board, including Vice Chairman Robertson, who is, as you know, a lawyer with considerable experience in law enforcement.

Our legal advisers have recommended that the Board honor the judgment of the U.S. Attorney. The Board unanimously has decided to do so, after reviewing the question yesterday morning. We feel that the responsible course is to extend to the enforcement authorities the cooperation they say is necessary for the successful investigation and prosecution of this case. None of us here at the Board feel that any good purpose would be served by going back a third time to the U.S. Attorney.

Your charge that the Board "is covering up for someone high in the Executive Branch" is deeply resented. This charge is totally without foundation.

So that the record will be complete, I respectfully request that this letter be inserted at an appropriate place in the record of the hearing.

Sincerely yours,

(Signed) ARTHUR F. BURNS.

Chairman PROXMIRE. My staff will be happy to do that. So far, it hasn't been done.

This is a very, very difficult situation. The law enforcement agency happens to be, of course, part of the executive branch; and the executive branch, I took some pains to point out, is a party in interest here.

And we have the presence of the White House, but not the President, the White House has been implicated in the situation. And yet the information has been disclosed by this arm of Congress, this creature of Congress to the executive branch, but not to a duly elected Member of the Congress which has jurisdiction over it.

Mr. BURNS. Senator, I can't let the matter stop there. You put out a statement saying that the Federal Reserve Board ducked, misled, hid out, avoided calls, and so on, and gave you the idiot treatment. That statement is absolutely untrue. And there I will stop.

Chairman PROXMIRE. Well, the statement I am sure I can corroborate as being true. And I will be happy to supply a precise agendum of the calls that were made, and the denials that were made to my staff, and the refusal to furnish information to my staff. They called the Philadelphia Reserve Bank, and it refused to answer the call, and refused to give information.

Mr. BURNS. Senator, every statement that you got from the Federal Reserve Board was correct, absolutely true.

Now, as for this or that Federal Reserve bank official, there I cannot speak with such authority.

Chairman PROXMIRE. You are absolutely right when you say every statement we got from the Federal Reserve Board was true. We didn't get anything.

Mr. BURNS. Senator, when you asked me to supply you with information, when I sent you a letter saying that I know absolutely nothing, we have no knowledge, that happens to be a fact. I cannot fabricate things that I know nothing about.

Chairman PROXMIRE. Mr. Burns, a great deal of time has passed since then. Your staff, as you have told us this morning, stipulated to, knows a great deal about this. This is now July. This happened many weeks ago. We are still waiting for further information. You are absolutely correct, there is no question that your letter was right. You didn't know anything about it. But you could have found out about it. The staff knew something about it, and they could have informed us, and they did not.

Mr. BURNS. I am very glad to hear you say, Senator, that I was absolutely correct on that. That comforts me. Thank you.

Chairman PROXMIRE. Mr. Burns, I regret very much ending this hearing on this note, because, as you know, as I have said many times, and I repeat again, I have great respect for you, very great. And I think you have done your usual competent job this morning. We are delighted to have you. And we want to thank you very, very much for your responses.

The committee will stand in recess until tomorrow morning at 10 a.m. when we convene to hear Mr. Galbraith, Mr. Samuelson, and Mr. Heller.

(Whereupon, at 12:18 p.m., the committee was recessed, to reconvene at 10 a.m., Thursday, July 2, 1972.)

THE 1972 MIDYEAR REVIEW OF THE ECONOMY

THURSDAY, JULY 27, 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, Hon. William Proxmire (chairman of the committee) presiding.

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

Also present: John R. Stark, executive director; 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., minority counsel; and Leslie J. Bander, minority economist.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Other members of the committee will be coming shortly, but we are past 10 o'clock, so we will get started.

Throughout its existence, the Joint Economic Committee has been fortunate in securing the testimony of distinguished private economists. This committee, and the country at large, owe a great debt of gratitude to the hundreds of economists who have given unstintingly of the time and effort which the preparation of testimony requires. We have had many outstanding and exciting panels. Today's panel certainly maintains that tradition.

Our witnesses today are: John Kenneth Galbraith, professor of economics at Harvard University, author of "The Affluent Society," current president of the American Economic Association, and former Ambassador to India; Walter Heller, professor of economics at the University of Minnesota, former Chairman of the Council of Economic Advisers, author of "New Dimensions of Political Economy"; and Paul Samuelson, professor of economics at the Massachusetts Institute of Technology, author of the textbook which has introduced a whole generation of students to modern economics, and winner of the Nobel Prize in economics.

In announcing these hearings, I referred to today's witnesses as the "million-dollar panel." Actually, I don't think that does them justice. I recall that there was great celebration at the other end of this city on that day in late 1970 when GNP was estimated to have hit $1 trillion. Had it not been for the influence over economic policy which our witnesses this morning have exerted over a number of years, GNP might not yet have hit a trillion dollars. Furthermore, if their advice had been followed more closely, we would have hit the $1 trillion mark sooner, and it would have reflected more real output and less inflation. And perhaps I should describe today's witnesses as the trillion-dollar panel. So, may I say that I am not discussing what you fellows make out of economics, but I won't belabor that point.

Earlier this week we heard from the administration officials responsible for economic polcy. Some of what we have heard was reassuring. The second quarter gain in GNP and the moderation of inflation were good news. But much of what we have heard has been disturbing. In particular, I am disturbed that the official concern over inflation is not matched by a similar concern over unemployment. I am fearful that this concern over inflation, together with an incredibly stubborn adherence to the misguided belief that the way to control inflation is to keep unemployment high, will lead this administration to turn too quickly toward policies of fiscal and monetary restraint.

Yesterday the President called for a ceiling on spending at $250 billion. He said he would veto appropriation in excess of that. He said that excessive appropriations in the Congress are wrecking his anti-inflation and hold-down-taxes program.

I know this panel is likely to disagree with the President's position. And I know that your differences will be quite different than mine. As an elected U.S. Senator, as a Democrat, and as chairman of this committee I speak out this morning, because if I don't your statements may be construed as a partisan Democratic response to the President. And as say, I think you gentlemen would go one way, many of us Democrats in Congress would go another different way.

In my view, the President's spending ceiling is too high. It should be less than $250 billion. Furthermore, if the President would accept the will of the Congress, the $7 billion of additional spending the President accuses the Congress of engendering would disappear. The Congress isn't proposing to spend more than the President. It is proposing to reduce very sharply some Presidential spending requests. It is proposing to increase others. On net the Congress would reduce the President's proposed spending. And it would greatly change his priorities.

With the stepped-up activity in Vietnam we are spending about $7 or $8 billion in that war that we would not be spending if the war were over. Secretary Laird has indicated that as far as he is concerned, there is no ending to the Vietnam spending in sight. The Senate has approved an amendment that would end the war—stop that spending as well as the killing in 90 days. The House Foreign Affairs Committee—viewed by many as a hawk committee—has also called for a prompt ending to this action supported by the President, financed by our Government as Presidential insistence, and costing, as I say, $7 to $8 billion a year. In this case, the President's spending proposals exceed the congressional will by the full amount the President's alleged $7 billion of additional domestic spending. But the President somehow ignores this spending in talking about a free-spend Congress. For some reason, in the Nixon calculations Vietnam spending doesn't count.

No. 2, the Armed Services Committee has reported to the floor of the Senate a military procurement bill that is more than $2 billion below the President's requests. Here again it is the Congress that would cut excessive Presidential spending. But somehow this spending for weapons procurement doesn't count, in the President's attack on the free-spending Congress.

No. 3, The President sent to the Congress a military foreign aid bill calling for an additional $1.7 billion of new spending. Last Thursday night the Senate killed that bill. The Congress refused to permit the President to spend this sum. But somehow this additional spending by the President and slash in spending by the Congress doesn't count.

The Armed Services Committee has reported to the floor of the Senate a bill—a military procurement bill which is more than $2 billion below the President's request. Here again it is the Congress that would cut excessive Presidential spending. But somehow spending for weapons procurement doesn't count in the President's attack on the free-spending Congress.

At this very moment we are engaged on the floor of the Senate in a debate on the President's request for a 900 percent acceleration on spending on the Trident program. Many of us are trying to cut this Nixon spending request by $500 million. But somehow if Congress succeeded in cutting this Presidential spending request, it won't count.

Now, here are some $11 billon of Presidential requested spending proposals which the Congress has resisted. And that is only the beginning. Last year we killed the supersonic transport. The cost of that program would have been well in excess of $2 billion on the basis of the latest Boeing estimate, which they say would require an additional billion above the billion and a half that was expected to be spent on the SST.

Can anyone doubt that if the President and his subordinates had not lobbied mightily for the more than $1 billion we need for the new aircraft carrier, and the billions we need for other new weapons systems including additional nuclear arms, the B–1 bomber, and others we would not be spending the money for these programs.

It is the executive branch that signed the contracts and has complete—total control over the procurement of all our weapons systems that are now running more than $28 billion—in overruns—that is over the contracts that Congress approved when we authorized for these programs—it is Presidential concurrence in this extravagant wasteful spending that has driven up these costs so high.

Finally, the President is complaining that the Congress will push him into new taxes or a resurgence of inflation of both by Congress wild spending. The fact is that the President doesn't have to permit most of this spending. He like his predecessors, has impounded funds—prevented spending he doesn't want. He's done it in the past; he can do it now.

So no informed citizens should fall for the line that the Congress is engaged in an orgy of profligate spending. When you look at the whole picture—the spending in the Vietnam war, other military spending, the power of the President to spend or withhold spending, it is clear that if we have inflation caused by excessive Government spending or tax increases mandated by spending, the President must accept responsibility.

I look forward to putting many questions to our panel this morning and among the most important will be those relating to the strength of the economic recovery and to the possible need for further fiscal and monetary stimulus.

I mentioned to Congressman Conable—Congressman Widnall wasn't here when I brought this up—that I had this statement, and if he wanted to respond, that I would be happy to yield to him.

Representative Conable. Mr. Chairman, I wish to respond only in part. I do have a statement that I would like to make at this point, with some regret, may I say.

I have become increasingly concerned about the Joint Economic Committee becoming a political forum instead of hewing to its statutory responsibility of guiding the Congress in economic matters. In this context the performance of the chairman yesterday in cross-examining the Federal Reserve Chairman, Arthur Burns, on the Watergate incident, was highly inappropriate, and nongermane according to rule 13 of the Joint Economic Committee rules. It is one thing for witnesses to defend or attack economic policy, and the Joint Economic Committee provides a very useful forum in this regard. But it is another when the committee puts aside its purpose and engages in political diatribe.

Yesterday's performance does not do well for a committee which in the past has established a sound reputation of dealing fairly with issues of substance, and with informing the Congress and the American people on economic policy.

Speaking for the Republican side—and I have not cleared this statement with all members, although I regret that Senator Javits it not present, because I know he feels strongly about this also—we object to the fact that the chairman held off his cross-examination on the Watergate incident until all Republican members had left the committee meeting to attend sessions of the Senate and the House of Representatives.

Now, we have had an initial statement from the chairman at almost every meeting of this committee. In many cases the chairman speaks strongly. That is his privilege. I must say, though, that in total it adds up to an initial hearing statement of considerable partisanship which I think subverts the purpose of a hearing generally. And I must say that many of us who consider ourselves moderates in the partisan wars feel that we are quite in the middle here on this committee, and we regret being put in this position. And if the intensity of the attack on the administration by members of the committee, not by witnesses who are supposed to put on the evidence, continues, I don't know whether it will be constructive for us to continue to cooperate as we feel we should in this very significant area of concern.

Chairman Proxmire. Thank you, Congressman Conable. Any other statements?

Representative Widnall. Mr. Chairman, I would just like to second completely what Congressman Conable has said. I left the hearing early yesterday, because I had to attend a session of the Banking and Currency Committee, where we were marking up the current housing bill. And I read the testimony this morning when I came into the office.

And I was simply shocked by what had happened at the very end of the entire proceeding.

It seemed to me that we were not seeking facts, we were not trying to establish anything that was pertinent or germane. It was to me an unwarranted attack upon the good faith, the character, of the Chairman of the Federal Reserve Board and the Board itself. The record certainly clearly indicates their effort to cooperate, and the immediacy of their answer with respect to inquiries proposed by the chairman of the committee. And some of the things that were said yesterday I highly regret, as a member of this committee and as a Member of the Congress.

I just hope it is not going to happen again, Mr. Chairman. Because this should be, as Congressman Conable has said, a forum where we try to obtain the facts as to what is happening in the United States and not just a political forum with an attempt to make political points of one kind or another.

This committee has had a fine reputation through the years. And its work has been watched with interest, and with approval, I think, by the majority of the American people. It has been evenhanded in what it has been trying to do. And I hope in the future that we are not going to get into the same position that we did at the end of yesterday's testimony.

Chairman PROXMIRE. May I say to my good friend on the Republican side that I am not going to delay this hearing any longer. But at the end of the hearing I do have a response, and it will be at the end of the hearing. And if you gentlemen have to absent yourselves, one of the Republican members of the committee might want to be here, because I have a detailed response.

I think that the Federal Reserve Board has not been frank, they haven't given the information to the Congress. They are a creature of the Congress, they are not a creature of the executive agency. In the Watergate incident the executive branch was a party in interest. I am not going into further details on this, but I think it is a fascinating case, and we so rarely have the Chairman of the Federal Reserve Board publicly in front of us and I think here is the place where we want to bring all the facts up. And I thought that yesterday was a perfectly proper occasion for it.

I waited until the end because I thought it was not relevant to the very vital, substantive economic matters that were before us, it was a separate issue and should be brought up at the end. But I put my good friends on notice that it is going to be brought up again this morning after we finish going into these other matters, which, of course, do relate to the economy, and are not related to the partisan matter, which partisan activity was engendered by some Republican people, low-level White House people, those were the ones involved.

Representative CONABLE. This matter is in litigation, and you are making some rather interesting assumptions.

Chairman PROXMIRE. I want to look into the legislative aspect also. [Applause from the audience.]

Representative CONABLE. Is that a proper subject for consideration by the Joint Economic Committee?

Chairman PROXMIRE. No applause is proper in this hearing.

Senator FULBRIGHT. Mr. Chairman, may I say that having had experience for 2 or 3 years with this growing principle of executive privilege, in which the executive branch reserves its right to refuse all information to the Congress, I congratulate you if you got anything at all out of them.

Chairman PROXMIRE. We didn't; but we are trying.

Senator FULBRIGHT. In the Foreign Relations Committee we have found that anything they don't want to say is considered executive privilege.

Chairman PROXMIRE. The first witness this morning is the distinguished Prof. John Kenneth Galbraith.

STATEMENT OF JOHN KENNETH GALBRAITH, PAUL M. WARBURG PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. GALBRAITH. Mr. Chairman and members of the committee, we meet for this midyear review of the economic position under conditions which allow of a considerable agreement—something that does not always characterize the deliberations of economists.

Spokesmen for the administration and occasional critics such as my colleagues of this morning and myself will unite on two out of three basic propositions concerning economic performance. Accepting, though only for the moment, the conventional tests of such performance—the level of unemployment, the rate of inflation, the movement in industrial production, national income and product—all will agree that the past has been highly unsatisfactory. And all will agree that the present is less than good. The only difference of opinion concerns the future. Where economists are concerned, such convergence—on two propositions out of a possible three—amounts almost to unanimity.

It is currently being emphasized that the present is better than the recent past—that unemployment at 5.5 percent of the labor force is somewhat better than the August 1971 peak of 6.1 percent and that the rate of inflation (in the Consumer Price Index) of approximately 3 percent over the past 12 months is less than the 6.5 percent increase between 1969 and 1970 or the 5-percent increase between 1970 and 1971. And although the index of industrial production increased only fractionally in May and June—from 112.1 in April to 112.4 in May to 112.7 in June—there clearly has been a substantial increase so far this year in real national product as a whole.

I do not believe, however, that any administration spokesmen will wish to defend either the present level of unemployment or, on a balanced view of food and the industrial components, the present rate of inflation. And others will wish to reflect that until the advent of the present administration, the present combination of inflation and unemployment was thought, by the best scholars, to be impossible.

As I have said, the one point of disagreement concerns the future. This, as usual, is unrevealed even to economists although, at any given time, the profession includes a certain number who do not know that they do not know. For what it may be worth, I would except that under the combined stimulus of easy money and exceptionally daring deficit financing—policies that have not in the past been pillars of Republican policy—expansion will continue. And there could be some reduction in unemployment—although there is a distinction between policies designed to expand product with the existing labor force and those that are designed more deliberately to create jobs and the administration has strongly favored the first. Against this favorable prospect are two negative factors. The first is the considerable danger of continuing and accelerating inflation—especially if the policy on the industrial price controls continues, as in the past, to be one of ratifying price increases that would have occurred anyway.

The second negative factor is, of course, the unconcealed preoccupation with the performance of the economy not over the indefinite future but in the last week of October and the first week of November of this year. This raises the specter of abandoned controls and a sharply contractionist monetary and fiscal policy, sharply reversing the course of the present expansion, once the election is safely won—or lost.

In this connection, if I might depart for a moment from the strictly nonpolitical character of these proceedings, I would like to question the deeply held belief that the American people render their judgment on economic performance in accordance with the behavior of the economy in the week immediately preceding an election. This suggests that our compatriots are either singularly stupid or the victims of acute amnesia. A rational electorate must surely judge the performance of an administration whatever its political complexion over either the whole of its 4 years or some appreciable portion thereof.

Now I would like to change radically the subject and proceed to a question which, so it seems to me, should have been asked long ago in connection with these periodic examinations of economic performance. The question is whether it is fair and proper to appraise the economic performance of all administrations regardless of political complexion by the same economic tests. We take pride on all occasions of public ceremony in our possession of a two-party system. We do not suggest that the two parties appeal in economic matters to a homogeneous electorate; we take for granted that each appeals to a different—if not always sharply demarked—grouping of interests. Were it otherwise, elections, at least so far as domestic policy is concerned, would be important only for their recreational value. Instead of maintaining the myth that unemployment, inflation, industrial output and economic growh are comon and uiversal tests of all performance, it would seem to me obvious that we should test Democratic administrations by their service to the broad groups whose interest they avow and that, similarly, a Republican administration should be adjudged in relation to the groups with which it is identified.

If Democrats avow their affection for minorities, the poor, the young, the women and the blue collar worker, the family of average or subaverage income, it is by their service to such groups that they should be judged. And if a Republican administration is identified, generally, with the economically successful, the properties, and the otherwise affluent and the corporations, service to such interest should here likewise be a prime test of performance. There is nothing illegitimate in association between party and interest; no lawful interest is unworthy of voice and representation. Nor is such representation denied in practice. And not many will think me wrong in associating the present administration with the economically successful, the affluent and the corporations.

Tested by its service to this supporting interest, the economic performance of the administration becomes much more favorable. One can fairly say that, by such test, its policy has been very successful. Thus between 1968 and 1970 the income distributed to the highest fifth of families increased from 40.6 to 41.6 percent of all income going to families, that going to the top 5 percent increased from 14.0 to 14.4 percent. Figures are not yet at hand for 1971.

However, the recent improvement in profits and the change in the income tax effective last year allow one to predict with confidence a continuation of the earlier trend. Corporate profits show a similar and even more favorable response to administration policy. While, as noted, unemployment has remained high following the recent recession and median family income has kept pace only with inflation, profits have come back handsomely—from $75.4 billion in 1970 to an estimated annual rate of $91.9 billion in the first quarter of this year. The after-tax recovery has been even more rapid—from $41.2 billion in 1970 to a $52.5 billion rate in the first quarter of 1972—and with a sensational further 16-percent increase in the second quarter for 748 corporations just surveyed by the First National City Bank. These after-tax gains, as Congressman Charles A. Vanik has shown in his admirable recent testimony before this committee, are being helped by large and increasing concessions in corporate taxation—concessions which already by 1969 had reduced the effective rate to 37 percent of earnings for all corporations and to an even more advantageous 26.9 percent for the hundred largest firms. Although profits, are, by nature, the most mercurial item in the income accounts, the recent recovery—which has brought them to record levels—has been the most rapid in recent history. The result here is in contrast with the policy of stabilizing other income payments, most notably those to labor.

I notice that Chairman Burns yesterday called for more effective and more severe stabilization of wages. I didn't see the full report of his testimony. I don't want to be unfair to him. But I do hope that he did contrast the recommendation there with the policy that I have just cited on profits.

In all, as Mr. Nat Goldfinger of the AFL-CIO recently pointed out in U.S. Department of Treasury hearings, the share of corporations in all income taxes has declined over the last decade from a little less than 35 percent in 1960 to a little over 28 percent (estimated) for 1972. The tax position of persons of wealth has similarly improved. Personal income taxes, the tax that weighs most heavily on the affluent, more than doubled in yield between 1961 when it provided $41.3 billion and 1969 when it brought in $87.2 billion. Since then the yield has largely leveled off; the 1972 return will be an estimated $94.4 billion, that of 1973 an estimated $95.5 billion. The stock market, which may be taken perhaps more than any other indicator as mirroring the expectations of the very affluent, has reflected the foregoing changes. In recent months it has been near its all-time high. Very recent performance has been especially favorable. It would by common calculation have passed its previous peak, had there not been doubt about the continuation of some of the tax policies so favorable to the recent improvement. Thus by a rational performance test—one that measures the effect of economic policies on the interest which the administration seeks to serve—the recent economic record cannot be seriously faulted.

It will be suggested that if a Republican administration should be tested by its service to the corporations and the affluent, then a Democratic administration should be tested by its service to minorities, blue-collar workers, the young and the generally poor. And it will be held, further, that past Democratic administrations would fail their test.

With both points I agree; the new test of economic performance which I am here proposing—measurement of accomplishment in relation to interest served or service promised—will be even harder on Democratic than on Republican administrations. In recent times—if I may simplify slightly but not to the point of error—Republican administration have had an unavowed commitment to the rich which they have kept. The Democrats have had an avowed commitment to the poor which they fell far short of keeping. Reform requires of a Republican administration only that it declare its interest—that it affirm its commitment to the well-being of the affluent and the corporations.

Of the Democrats, reform requires that they keep more fully their promises. This means that something effective must be done about the redistribution of taxes and income which, we should remember, was bad before the Republicans made it modestly worse; that effective action must be taken to reduce black unemployment which is far higher than for whites; that there must be similar action on unemployment of young people and especially of black youngsters where it comes to perhaps a third of that part of the labor force; that there be effective improvement in the median income of all families matching the improvement in incomes of those receiving profits and property income; that the median income of black families which is only 60 percent of that of white be greatly increased; that steps be taken to arrest and reverse the slow increase, beginning in 1967, in families falling below the poverty line—a total of 25.6 million families in 1971; that the fantastically high proportion of black families 31 percent which fall below the poverty line be reduced; that earnings of working women—the low level of which is a major cause of poverty—be brought into line with those of men. The median income of working women in 1970 was only 59 percent of that of working males and accounted for 40 percent of all the families falling below the poverty line.

None of the foregoing will be easy, it is much easier, as I think my colleagues here will agree, as a purely technical matter, to keep faith with the rich than with the average man or the poor. Also another advantage of those who alined themselves with the less affluent may be disappearing.

In the past it was possible to make promises without it being seriously proposed that they would be kept. Increasingly one senses an expectation on the part of the less advantaged that promises will be kept—that something will in fact be done about the very unequal manifestation of what is called the American dream. This feeling—if I might strike another mildly political note—seems even to have communicated itself to wealthy idealists. For the first time some are asking whether promises currently being made are real, and are making no secret both of their personal anxiety and their inability to afford continued idealism. Thus my conclusion: Economic performance tests that reflect not the abstraction but the reality—which measure performance against the promised response, unavowed or avowed to recognized interest—are long overdue. And they will be less pleasant

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than the present tests for all concerned. But their severe application will add luster and distinction—and a large infusion of realism—to future proceedings of this valuable committee.

Thank you very much, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Galbraith.

I should have made it clear that at 10 minutes we will ring a bell here, and then you should bring your testimony to a conclusion as quickly as you can, and your entire prepared statement will be printed in the record.

Mr. Heller, please proceed.

STATEMENT OF WALTER W. HELLER, REGENT'S PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. HELLER. Mr. Chairman and members of the committee, now that the U.S. economy is at long last on the move and inflation is at long last on the wane—thanks largely to the fact that Mr. Nixon at long last—in his August 15, 1971, about-face and his liberal election-year budget—responded to persistent Democratic calls for fiscal stimulus, wage-price restraints, and liberation of the dollar—as I say, now that we are again on the move, the voice of overcautious conservatism is raised again at the other end of Pennsylvania Avenue: "Reach for the brakes, slash the budget, seek an end to wage-price restraints."

So, looking ahead to 1973, the constructive critic has a new job cut out for him, with three objectives in view:

First, prevent men of little faith in the U.S. economy from aborting the current recovery short of full-term; that is, short of full employment in fact, not just in name.

Second, restore fiscal responsibility without gutting the budget.

Third, correct the list to starboard of our present wage-price controls and batten down the hatches for next year's onslaught of cost pressure.

My prepared statement takes up each of these objectives, in turn.

First, let me comment on our unemployment problem. The greatest single threat to the 5 million unemployed in the United States today is the mistaken belief in high places, like the White House, the Treasury, and the Federal Reserve, that after only 9 months of up-to-snuff recovery—following 3 long years of economic slowdown, recession, and sluggishness—the limits to U.S. economic expansion are not far off. The Nixon policymakers, having found that their oft promised and oft predicted 4-percent unemployment level was beyond their grasp, seem to have concluded that it is also beyond their reach. So to all intents and purposes—except for the calculation of full-employment revenues, for which the 4-percent banner yet waves—the administration now associates the U.S. economic potential with an unemployment rate of 5 percent or a bit below. Coupled with expectations of a booming recovery, this view of the world foresees an economy bumping against its ceiling and overheating by mid-1973.

But there is another view of the world that sees the cup of economic recovery as not half full but two-thirds empty, with lots of room for expansion before the cup runneth over. Even using only the modest interim target of 4-percent unemployment—rather than the 3 percent on which Chairman Proxmire has set his sights—one finds that full employment and excess demand are still $60 billion away; that is, that our actual GNP is running $60 billion below our potential.

Since it takes an $80 billion annual advance in GNP just to stand still—that is, just to absorb the 4.4 percent annual growth in labor force and productivity and allow for 3-percent inflation—it would take at least two $110 billion GNP advances back to back or three consecutive $100 billion advances just to catch up once more with our economic potential. In this view of the world, which I share, we won't be reaching tolerable levels of unemployment and making full use of the potential of the U.S. economy until 1974.

Clearly, we face once again a test of faith in the power and flexibility of the American economy. What's at stake in this test? Just this: If the country accepts an economic policy that flinches at the first signs of real recovery, succumbs to the bogeys of timid economic thinking, and lowers its sights from a target of 4-percent to one of 5-percent unemployment, it will sacrifice each year about $35 billion of GNP, $10 billion of profits before taxes, and $10 to $12 billion of Federal tax revenues. Settling for 5-percent instead of 4-percent unemployment would mean denying jobs to 1 million people, and denying the country—and especially the poor and the nonwhite, to whom Mr. Galbraith has just directed his attention, who are at the end of the job line—the benefits of the better living standards and the social advances we can buy with $35 billion of added output and $10 billion of added Federal revenue per year.

As I see it, then, the battle for full-employment is far from over, it has really only just begun. The major policy prescription has to be a negative one: Don't prematurely cut off the monetary and fiscal lifeblood of this expansion. Don't choke it off in its infancy, but with the aid of carefully tailored wage-price policies and an eventual tax increase as we approach full-employment, permit it to grow to a balanced maturity.

I have been stressing the aggregate demand side of the problem. I don't mean to neglect the structural aspects of the problem, Mr. Chairman. And may I submit for the record an earlier statement making the case for the Reuss-Mondale bill that would put 500,000 people to work in public service jobs?

Chairman PROXMIRE. Without objection.

(The information referred to follows:)

[From the New York Times, Apr. 7, 1972]

NEEDED NOW: 'JOBS NOW'

(By Walter W. Heller)

MINNEAPOLIS—Given the continued intolerably high unemployment and slack in the economy under Mr. Nixon's policies, the need for the "Jobs Now" program—Congressman Reuss's proposal for 500,000 public service jobs—becomes more urgent with each passing day. That need has at least five facets.

First, the need for greater economic stimulus: The economy is running $80-billion below its full-employment potential. So even if the Nixon forecast of a 1972 G.N.P. of $1,145 billion were realized, output would still fall $60 billion short of our productive capacity. Under these circumstances, the increased authorization proposed by the "Jobs Now" bill (H.R. 12011)—to $2 billion for fiscal 1972 and $4 billion for fiscal 1973 (from the $1 billion for 1972 and $1.25 billion for 1973 now authorized under the Emergency Employment Act of 1971)—would be a modest but welcome tonic for an economy that still has tired blood.

Second, the need to meet our biggest single economic problem, unemployment, head-on: The public-service jobs bill recognizes that the shortest distance between two economic points is a straight line, that if we want to use Federal money to create jobs, the quickest and least expensive way to do it is to fund and fill jobs that are waiting to be done. Funding and filling 500,000 public service jobs goes straight to the heart of the unemployment problem.

Third, the need to tailor jobs to the changing structure of the jobless: The "Jobs Now" program zeroes in on the less skilled, less experienced jobless—the teen-aged, female, and minority-group workers—who are a growing proportion of the unemployed. Viewing the rising tide of youth and women in the labor force, some observers (including high officials of the Nixon Administration) have concluded that the 4 per cent unemployment goal is "a myth," that "6 per cent is not critical" because unemployment of teen-agers and women does not have a high hardship quotient anyway, and that we have to settle for a more modest unemployment target like 5 per cent in order to contain inflation.

Granted, it's tougher to get to 4 per cent than it used to be. But that's no excuse for ignoring the social costs and tensions that go with 10 per cent unemployment rates for blacks, 17 per cent for teen-agers, and over 30 per cent for black teen-agers. Tossing in the sponge and taking a "you-can't-get-there-from-here" attitude, as the White House seems to be doing, is precisely the wrong response.

Fourth, the associated need to do a better job of reconciling full employment with reasonable price stability: If we try to solve the unemployment problem solely through general fiscal and monetary stimulus, the resulting demand pressure will create shortages of skilled workers, generate bottlenecks, and boost prices long before its blessings reach the less skilled and least experienced members of the labor force. To employ them without creating new demand-pull pressures calls for carefully targeted measures like "Jobs Now" that require, not \$2 or \$3 of spending, but only \$1 (plus administrative expenses) to create \$1 of unskilled job opportunity.

Fifth, the need to create productive, not make-work jobs: Myriad public service jobs—in health care, education, public safety, pollution control, recreation, sanitation, urban maintenance and renewal—are crying to be done. But hard-pressed state-local treasuries—depleted by recession—simply cannot cope. These service jobs, being neither supported by expanding revenue sources like the Federal income tax or ear-marked taxes like payroll and gas taxes, nor saleable in the market place like private goods, bring up the rear of the budgetary queue.

The Nixon Administration is fond of scornful references to "dead-end W.P.A. jobs." This reflects not only a woeful ignorance of history but a distressing lack of understanding of the nature and needs of the unemployed. For although youth, women, and minorities do make up a larger part of the jobless today than ten or fifteen years ago, their average level of education and training is significantly higher. As Otto Eckstein has shown, the proportion of the 18–64 age group with education of twelve years or more rose from 48 per cent in 1957 to 57 per cent in 1964 and 68 per cent in 1971. The number of individuals in work and training programs rose from 135,000 in 1964 to over a million in 1969.

But education and training—as well as unemployment compensation, income maintenance, and work incentives for the unemployed—all lose their point unless there are decent jobs for them at the end of the line. It was Calvin Coolidge who made the profound observation that "for a man to have a job, someone has to hire him." He had something there. And "Jobs Now" has something here.

(Walter W. Heller is Regents Professor of Economics at the University of Minnesota.)

Mr. HELLER. Now, turning to budget policy, this is an area of high economic importance that is supercharged with politics in this election year. What we are witnessing at the moment is an unseemly and undignified scramble by the Nixon White House—which has plunged the country deep into deficits demanding a tax increase by 1974—to pin the blame on the Democrats.

Mr. Nixon yesterday joined his cohorts in drawing the red ink herring across the Democrat's trail. And yet it was the same Mr. Nixon who last year pushed through more than \$12 billion of permanent tax cuts, mostly for business, that the country could ill afford. This year, he has opened wide the election year spending spigots and initiated new and bigger programs that, by his own budget reckoning, would add about $25 billion to the budget within 3 years and $33 billion within 5 years. By the meticulous calculations of the Brookings study, the Nixon program of tax cuts and budget boosts is building in a $17 million annual deficit at full employment by 1974–75 in the absence of tax increases.

Yet, in the face of that record, the White House is busily spreading the canard that if a tax increase is needed and if inflation breaks out again, it's all the fault of a billion dollars here and a few hundred million there added by a Democratic Congress to beef up social programs. They would have us believe that when the Republicans pour on the budgetary coal to the tune of $10 and $20 billion, it generates the needed steam of expansion, but when Democrats add $3 or $4 billion, it feeds the fires of inflation. I doubt that they will get away with this blatantly cynical game of pin-the-tail-on-the-donkey—there is something incongruous about a donkey sporting an elephant's tail.

In playing his part of the game, Mr. Nixon was quoted in the morning paper as saying, "I will simply not let reckless spending of this kind destroy the tax reductions we have secured or the hard-won successes we have earned in the battle against inflation."

It reminds me a bit of William Jennings Bryan's story about the widower who married again 1 week after his wife died. This was in a small town, and his neighbors gathered outside his home in protest, pounding pans and tubs and shouting epithets. And he countered attacks by saying, "How dare you make all that racket so soon after my wife died?"

Since the White House has so thoroughly politicized the budget issue, one finds it difficult to sort out and stick to the economics of the issue, but let me try.

Short run—for 1972–73, as things are turning out, our national fiscal policy has stumbled into a posture that will help sustain vigorous economic expansion—Mr. Nixon's plan to generate a big full-employment deficit in the first half of 1972 and then turn it into a full employment surplus for fiscal 1973 has happily, for the economy, been turned around. Inexcusable blunders in underestimated tax withholding and overestimating the volume of new spending underlie this shift. As a consequence, the budget, after running at a roughly full employment balance on the NIA basis in 1972, will run a stimulative full-employment deficit in fiscal 1973. That will be good, not bad, for the economy.

Given (a) a large pool of unemployed to draw on, the 5 million visible job seekers, plus millions of invisible and part-time unemployed, (b) the large idle capacity implicit in 77 percent operating rates, and (c) the $60 billion of headroom for expansion—not to mention (d) the sharp productivity rises that accompany vigorous expansion—we are in a period of remission from both demand-pull and cost-push inflation. Barring a premature slamming on of the budget brakes, our fiscal policy—even if by inadvertence rather than design—is helping us capitalize on our large unused resources and declining inflationary pressures.

Turning to the long run, for the period beyond 1973, when we will again be approaching—indeed, with appropriate fiscal, monetary, and wage-price policies, not only approaching but reaching—full employment, the realities of Mr. Nixon's budget tell us that there is a tax increase in our future. Unless he suddenly decides to jettison revenue sharing, bury his family assistance plan and welfare reform, and lower rather than raise the defense budget—a series of highly improbable events—we will have to have a tax increase simply to finance already programed increases in expenditures.

If we fail to rise to this tax challenge, the alternatives are either (a) drastic slashes in needed programs, (b) an open invitation to a new wave of excess demand inflation, or (c) passing the buck to the Federal Reserve, which would mean drum-tight money and a credit crunch that will curl our hair. To ward off these grim alternatives will call for positive planning and action in 1973, to bring into being a tax increase for 1974 and beyond.

The case for that tax increase rests not alone on Mr. Nixon's current budget, but is strengthened by probable developments that will swell rather than shrink the budget expenditure totals.

In the light of these cold budget facts, it's high time for the administration in particular and politicians in general to end the doubletalk of promising higher spending side by side with promises of lower taxes and tell the public to face up to the reality that: It wants and needs these vital programs; it wants and needs State-local tax relief; it wants and needs protection against a renewed excess-demand inflation at full employment; automatic growth in revenues, even at $20 billion or better a year, cannot finance these wants and needs; and therefore, absent Draconian outs in defense outlays, there is only one place to get the money, namely Federal tax increases.

So let's stop the charade and chatter about whether a tax increase is necessary (it is); who is to blame for any coming increase (the ins when they are in and the outs when they are in); and get down to the nitty-gritty of how to raise the money; whether by the good old income tax or the bad new sales tax (VAT).

Just to summarize what I say in the rest of my testimony in 30 seconds, two things have to be done, it seems to me.

First, we have to correct the "list to starboard," the imbalance in our present wage-price controls. Then we have to convert them into a mechanism that can cope with the later renewed cost pressures without smothering economic freedom.

Contrary to the early fears that the Pay Board was going to be openhanded and the Price Commission was going to be tightfisted, we have had essentially—especially recently—the opposite trend. Not only are profits and cash flow being liberally aided by Mr. Nixon's tax breaks for business—which in a political sense subsidize the price side of phases I and II; i.e., they buy off, so to speak, those who might suffer from the price side—but the relatively liberal price rules plus the effective slowdown of wage increases are contributing further to rapid profit increases. Not that profits have yet regained a reasonable ratio to GNP, but the speed of their increase relative to the speed of real wage increases concerns me.

For the moment the productivity upsurge in muting this conflict; as President Kennedy used to say, "a rising tide lifts all the boats."

But this question of distributional fairness is central and disturbing. And I have the distinct impression that, first, in the unorganized labor-sector, employers are only too willing to help the Government administer the $5\frac{1}{2}$ percent standard and, second, too little of the productivity gain is being passed on to the consumer.

To correct this list to starboard the Price Commission has to tighten its net. A two and a half percent price standard is too generous in the light of current circumstances. Indeed, if the administration is to achieve its prime target in the light of $3\frac{1}{2}$ percent inflation in the service sector and the problems of containing food price increases, tier 1 companies are going to have to be satisfied with less than $2\frac{1}{2}$ percent price increases on the average.

I join Mr. Galbraith in saying that Arthur Burns, who has been one of the voices for sanity at the other end of Pennsylvania and Constitution Avenue, has got the thing wrong way around in advocating tighter wage controls first and then tighter price controls.

We need to toughen up on price increases, and then, if that is successfully done, toughen the wage standard, not the other way around.

Finally, we cannot abandon all price and wage controls in the face of three things coming up next year:

First, the gauntlet of critical wage negotiations that the economy has to run.

Second, the fact that many existing wage settlements have provisions for reopeners when and if the controls end.

Third, we are eventually going to run out of these lush productivity gains that are now cushioning and relieving the cost-pressures.

So I think we should go back to something like the "wage-price guideposts with clout," focusing on the people who sit in the seats of market power in both business and labor. We need an essentially semivoluntary program, backed up by sanctions to be used in cases of flagrant violations of the public interest.

Given a semivoluntary set of wage-price restraints, backed by responsible fiscal monetary policy—which will let demand have its head today, but curb excesses tomorrow—the country could really look forward to a third phase of our wage-price experience that will contradict the cliché that wage-price restraints and income policies do not work. They can, and they do.

Thank you.

(The prepared statement of Mr. Heller follows:)

Prepared Statement of Walter W. Heller

Mr. Chairman and members of the committee, now that the U.S. economy is at long last on the move and inflation is at long last on the wane—thanks largely to the fact that Mr. Nixon at long last (in his August 15, 1971, aboutface and his liberal election year budget) responded to persistent Democratic calls for fiscal stimulus, wage-price restraints, and liberation of the dollar—the voice of overcautious conservatism is raised again at the other end of Pennsylvania Avenue: "reach for the brakes, slash the budget, seek an end to wage-price restraints."

So, looking ahead to 1973, the constructive critic has a new job cut out for him, with three objectives in view:

First, prevent men of little faith in the U.S. economy from aborting the current recovery short of full-term, i.e. short of full employment in fact, not just in name.

Second, correct the list to starboard of our present wage-price controls and batten down the hatches for next year's onslaught of cost pressures.

Third, restore fiscal responsibility without gutting the budget.

THE UNEMPLOYMENT PROBLEM

The greatest single threat to the five million unemployed in the United States today is the mistaken belief in high places that after only three quarters of up-to-snuff recovery (following three long years of economic slow-down, recession, and sluggishness), the limits to U.S. economic expansion are not far off. The Nixon policy-makers, having found that their oft-promised and oft-predicted 4 percent unemployment level was beyond their grasp, seem to have concluded that is also beyond their reach. So to all intents and purposes (except for the calculation of full-employment revenues, for which the 4 percent banner yet waves), the Administration now associates the U.S. economic potential with an unemployment rate of 5 percent or a bit below. Coupled with expectations of a booming recovery, this view of the world foresees an economy bumping against its ceiling and overheating by mid-1973. Small wonder that such dark forebodings lead to thoughts of hitting the monetary and fiscal brakes and dismantling the wage-price controls before they are swamped by a new round of excess-demand inflation.

But there is another view of the world that sees the cup of econmic recovery as not half full but two-thirds empty, with lots of room for expansion before the cup runneth over. Even using only the modest interim target of 4 percent unemployment (rather than the 3 percent on which Chairman Proxmire has set his sights), one finds that full employment and evcess demand are still $60 billion away, i.e. that our actual GNP is running $60 billion below our potential. Since it takes an $80 billion annual advance in GNP just to stand still—i.e., just to absorb the 4.4 percent annual growth in labor force and productivity and allow for 3 percent inflation—it would take at least two $110-billion GNP advances back to back or three consecutive $100-billion advances just to catch up once more with our econmic potential. In this view of the world, which I share, we won't be reaching tolerable levels of unemployment and making full use of the potential of the U.S. economy until 1974.

Clearly, we face once again a test of faith in the power and flexibility of the American economy. What's at stake in this test? Just this: if the country accepts an econmic policy that flinches at the first signs of real recovery, succumbs to the bogeys of timid economic thinking, and lowers its sights from a target of 4-percent to one of 5-percent unemployment, it will be giving up each year about $35 billion of GNP, $10 billion of profits before taxes, and $10–12 billion of Federal tax revenues. Settling for 5 percent instead of 4 percent unemployment would mean denying jobs to one million people, and denying the country—and especially the poor and the non-white, who are at the end of the job line—the benefits of the better living standards and the social advances we can buy with $35 billion of added output and $10 billion of added Federal revenue per year.

Since there is so much at stake, let me be more specific about how the two schools of thought differ in assessing the amount of slack in the U.S. economy:

What we might call the "uptight school" stresses:

That today's unemployment rate of 5½–6 percent (a) includes much low-grade labor, (b) conceals the fact that less than 3 percent of adult married males are unemployed, (c) ignores the fact that it's as hard as ever to find good maids, gardeners, and handymen;

that current data showing 77 percent operating rates in manufacturing are based on slippery capacity numbers and include lots of obsolete productive capacity:

that the Department of Commerce estimate of the GNP gap (roughly a $60 billion, or 5½-percent, gap between actual and potential output) is based on the "old" target of 4-percent unemployment, so that $40 billion or less than 4 percent of GNP is a more realistic number.

In contrast, the "lots-of-head-room school" stresses

that today's unemployment rate doesn't even count millions of (a) hidden unemployed, i.e. discouraged dropouts and non-entrants who will seek jobs as the economy strengthens: (b) part-time workers who want full-time work; (c) skilled laborers and professionals forced to work well below their capacities;

that even if nearly half of the idle capacity (say 10 percent of total capacity) is classed as obsolete or inefficient, that still leaves 13 percentage points of manufacturing slack to be taken up. (Indeed, the index of manufacturing output has barely regained its peak of 3 years ago);

that an economy which was operating at 3⅓ percent unemployment when Mr. Nixon took office, ought to be able to get back to 4 percent without rampant inflation, given reasonable fiscal-monetary and wage-price policies.

As I see it, then, the battle for full-employment is far from over, it has really only just begun. The major policy prescription has to be a negative one: don't prematurely cut off the monetary and fiscal life blood of this expansion. Don't choke it off in its infancy, but with the aid of carefully tailored wage-price policies and an eventual tax increase as we approach full-employment, permit it to grow to a balanced maturity.

I have been stressing the aggregate demand side of the problem. As the Committee may know, I have also repeatedly directed attention to, and made recommendations on, the structual changes that have to be made in man-power policy and the urgency of adopting the "Jobs Now" program. The Reuss-Mondale Bill to put 500,000 of the unemployed into public service jobs that badly need doing, deserves not the calloused contempt it gets from Mr. Nixon, but immediate passage to help reduce unemployment, particularly for the young, the women, and the disadvantaged job-seekers, both active and discouraged.

BUDGET POLICY

Let me turn now to Federal budget policy, an area of high economic importance that is super-charged with politics in an election year. What we are witnessing at the moment is an unseemly and undignified scramble by the Nixon White House—which has plunged the country deep into deficits demanding a tax increase by 1974—to pin the blame on the Democrats. Last year, as part of his economic revival program, Mr. Nixon pushed through over $12 billion of permanent tax cuts that the country could ill-afford. This year, he has opened wide the election-year spending spigots and initiated new and bigger programs that, by his own budget reckoning, would add about $25 billion to the budget within three years and $33 billion within five years. By the meticulous calculations of the Brookings study, the Nixon program of tax cuts and budget boosts is building in a $17 million annual deficit at full employment by 1974–75 in the absence of tax increases.

Yet, in the face of that record, the White House is busily spreading the canard that if a tax increase is needed and if inflation breaks out again, it's all the fault of a billion dollars here and a few hundred million there added by a Democratic Congress to beef up social programs. They would have us believe that when the Republicans pour on the budgetary coal to the tune of $10 and $20 billion, it generates the needed steam of expansion, but when Democrats add $3 or $4 billion, it feeds the fires of inflation. I doubt that they will get away with this blatantly cynical game of pin-the-tail-on-the-donkey—there is something incongruous about a donkey sporting an elephant's tail!

Since the White House has so thoroughly politicized the budget issue, one finds it difficult to sort out and stick to the economics of the issue. One is even tempted to point out Mr. Nixon's all-time record in budget mismanagement, for example,

forecasting a $2 billion surplus for 1971, only to see it turn into a $23 billion deficit, a mere $25 billion budget boner;

forecasting a $12 billion deficit for FY 1972, then boosting the estimate to $39 billion last January and now, six months later, telling us proudly that it's only $23 billion (neglecting to mention the inexcusable blunders in underestimating tax withholding and overestimating expenditures that account for the latest dipsy-doo in the Nixon budget roller coaster).

Laying aside the record of budget chicanery and mismanagement, let's now look at budget economics.

Short run

For 1972–73, as things are turning out, our national fiscal policy has stumbled into a posture that will help sustain vigorous economic expansion:

Instead of the sequence projected in the Nixon budget—first a fiscal spurt generating a big full-employment deficit in the first half of 1972, and then putting the budget into reverse to generate a full-employment surplus in FY 1973—the over-withholding and under-spending miscues are generating just the reverse pattern. In national income accounts (NIA) terms, a full-employment surplus is now turning into a sizable full-employment deficit to provide further stimulus to economic recovery.

Given a large pool of unemployed to draw on (the five million visible job seekers, plus millions of invisible and parttime unemployed), the large idle capacity implicit in 77 percent operating rates, and the $60 million of head-room for expansion,—not to mention the sharp productivity rises that accompany vigorous expansion—we are in a period of remission from both demand-pull and cost-push inflation. Barring a premature slamming on of the budget brakes, our fiscal policy (even if by inadvertence rather than design) is helping us capitalize on our large unused resources and declining inflationary pressures.

Long run

For the period beyond 1973, when we will again be approaching—indeed, with appropriate fiscal, monetary, and wage-price policies, not only approaching but reaching—full-employment, the realities of Mr. Nixon's budget tell us that there is a tax increase in our future. Unless he suddently decides to jettison revenue sharing, bury his Family Assistance Plan and welfare reform, and lower rather than raise the defense budget—a series of highly improbable events—we will have to have a tax increase simply to finance already programmed increases in expenditures.

If we fail to rise to this tax challenge, the alternatives are either (a) drastic slashes in needed programs, (b) an open invitation to a new wave of excess demand inflation, or (c) passing the buck to the Federal Reserve, which would mean drum-tight money and a credit crunch that will curl our hair. To ward off these grim alternatives will call for positive planning and action in 1973, to bring into being a tax increase for 1974 and beyond.

The case for that tax increase rests not alone on Mr. Nixon's current budget, but is strengthened by probable developments that will swell rather than shrink the budget expenditure totals:

First are the add-ons that will inevitably come in the congressional process as well as future presidential budgets.

Second, Mr. Nixon's White House and HEW have dangled before the electorate the lure of $13 billion or so of property tax relief for local school districts. Democratic candidates have both preceded and followed Mr. Nixon in these promises for school tax relief and equalization. So if the Federal government lives up to its responsibilities in this area, expenditures will rise by a minimum of another $10–15 billion—with or without the value-added tax on which the White House made such favorable noises some months ago but then fell strangely silent.

Third, it is also worth noting that if this country were to backslide from 4 percent to 5 percent as our official unemployment target, it would logically involve us in another $10 billion-plus tax increase (unless we were willing to cut Federal expenditures by that amount). That is, if we retained a balanced full-employment budget as a general fiscal target, and accept 1 percent more unemployment as our economic target, we would have to subtract over $10 billion of lost revenues from the receipts side of the full-employment budget statement. This would call for corresponding cuts in Federal spending or boosts in Federal taxes to be consistent with a balanced budget at "full" employment.

In the light of these cold budget facts, it's high time for the Administration in particular and politicians in general to end the double talk of higher spending side by side with lower taxes and tell the public to face up to the reality that:

it wants and needs these vital programs;

it wants and needs state-local tax relief;

it wants and needs protection against a renewed excess-demand inflation at full-employment;

automatic growth in revenues, even at $20 billion dollars or better a year, can't finance these wants and needs;

therefore, absent Draconian cuts in defense outlays, there is only one place to get the money, namely, Federal tax increases.

So let's stop the charade and chatter about *whether* a tax increase is necessary (it is); *who is to blame* for any coming increase (the in's when *they're* in and the out's when *they're* in); and get down to the nitty-gritty of *how to raise the money:* whether by the good old income tax or the bad new sales tax (VAT).

WAGE-PRICE POLICY

Shaping national wage-price policies to fit the contours of expansion is a demanding business. It demands, among other things, that policy-makers—

don't clip the wings of our expansion prematurely, lest the cyclical productivity surge that underlies ebbing cost pressures be brought to an untimely end;

do face up to their fiscal responsibilities by putting through a tax increase to avoid the build-up of excess demand pressures in 1974–75.

Given a responsible fiscal-monetary policy, there is no reason that a gradually restructured wage-price restraint program cannot play a key role in permitting us to get to 4 percent unemployment and beyond without intolerable inflation. (The economist cannot provide a definition of "tolerable," since that is a choice the body politic must make, given the trade-offs between jobs, prices, and controls. But it is worth noting that a 3 percent rate of U.S. inflation will look pretty good relative to the projected 5 percent rate this year and 6 percent next year in the Common Market countries.) That restructuring must first correct the imbalance in present wage-price controls and then convert them into a mechanism that can cope with later renewed cost-pressures without smothering economic freedom.

What do I mean by the current problem of imbalance? Primarily that, contrary to the fears that the Pay Board would be open-handed and the Price Commission tight-fisted, thereby squeezing profits, the recent trend has been the other way. Not only are profits and cash-flow being liberally aided by Mr. Nixon's tax breaks for business (which, in a political sense, "subsidize" the price side of Phases I and II), but the relatively liberal price rules plus the effective slowdown of wage increases are contributing further to rapid profit increases.

My point is not that profits have yet regained a reasonable ratio to GNP—but that the speed of their recovery has to be balanced against the speed of real wage increases. For the moment, the productivity upswing is muting the potential conflict—as President Kennedy used to say, "A rising tide lifts all the boats." But the question of distributional fairness in the wage-price controls is central and disturbing. I have the distinct impression that, in spite of the Pay Board and Price Commission, two things are happening:

In the unorganized labor sector, employers are only too willing to help the government administer the 5.5% standard. So this very large sector (some 70% of all workers) is getting less than its fair share relative to both organized labor (which can use the strike threat to get a better break) and the profits sector.

Too little of the productivity gain is being passed on to consumers in price cuts or more moderate price increases.

Let me expand on that latter point a bit. As production responds to rising demand and overhead costs are spread thinner, the benevolent effects on unit labor costs can be dramatic. The second quarter numbers, given what we already know about rapidly rising output and moderating prices, will give bright testimony on this point. If left to themselves in these circumstances, producers will be sorely tempted to capture most of this productivity surge in higher profits and higher wages, sharing little of their gains with consumers. Here is where an *effective* incomes policy—a tough and balanced application of Phase II wage-price restraints—can nudge business and labor into sharing their gains with consumers and help convert rising output into receding inflation.

To correct the "list to starboard," then, the Price Commission has to tighten its net. A 2½% price standard is too generous in the light of current circumstances. Indeed, if the Administration is to achieve its price targets in the light of 3½% inflation in the service sector and the problems of containing food price increases, Tier I companies are going to have to be satisfied with less than 2½% price increases. Balance also requires a more even-handed treatment of organized and unorganized labor by the Pay Board.

Finally, a few words about the role of wage-price restraints in 1973 and beyond. One thing is crystal clear: To abandon wage-price controls completely in 1973 (and thereby repeat the mistake the Administration made in renouncing all wage-price intervention early in 1969) would be an open invitation to a resurgence of cost-push inflation:

In 1973 the country will have to run the gauntlet of critical wage negotiations in one big industry after another.

Moreover, many existing wage settlements have provisions for re-openers when and if controls end.

Eventually, we will run out of the lush productivity gains that are relieving cost pressures today.

Given this set of circumstances, active planning should be under way for Phase III of our price-wage restraint efforts. Contrary to the gloomy forecasts of the critics, Phase I helped break the back of expectational inflation and Phase II is helping (albeit, in an unbalanced and insufficient way) to convert rising productivity into a falling rate of inflation.

Now for Phase III: as 1973 unfolds, we should be converting mandatory controls into a set of semi-voluntary wage-price restraints focussed primarily on those who occupy the seats of market power in both labor and business. I will not retrace here the familiar ground of wage-price guideposts, with clout—i.e., the case for a set of wage-price rules, anchored in productivity, that injects the national interest into private wage-price decisions; a wage-price review board to help the President distinguish between the good guys and the bad guys, focussing the spotlight on the latter; and a set of sanctions to apply in cases of flagrant violations of the public interest.

Given a semi-voluntary set of wage-price restraints of this kind, backed by a responsible fiscal-monetary policy which will let demand have its head today but prevent excesses tomorrow, the country could look forward to the third phase of a wage-price experience that contradicts the cliche that wage-price restraints and income policies don't work.

Chairman PROXMIRE. Mr. Samuelson, please proceed.

STATEMENT OF PAUL A. SAMUELSON, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. Mr. Chairman, as a sheltered academic professor, I must express my appreciation of being able to appear here with these blue-collared gentlemen—referring to blue shirts worn by Mr. Galbraith and Mr. Heller—in a practical experience.

I apologize in advance for the brevity of my prepared statement, but I have learned from experience that such is the density of my thought that only one packed page is as much as your committee can take of my particular wisdom.

First, it should be emphasized that there has been no confusion of fiscal and monetary policy, that it has finally begun to pay off in terms of vigorous real expansion of output and employment. And let me say that those of us who were skeptical about the ability of the phase II wage and price controls to moderate the rate of inflation—and here I am not speaking for my fellow members of the panel, nor am I speaking for that group of articulate economists who claim that controls would not work or would make the problem worse—well, everyone should have been pleasantly surprised by the recent second quarter growth in real GNP at 8.9 percent annual rate, and the simmering down of the price-deflator index in that quarter to barely over a 2-percent annual rate, 2.1 percent.

This would seem to be the summer of our content. Even the stubborn index of unemployment dropped from 5.9 to 5.5 percent in June.

We have been reminded that total employment is up, and has been substantially. Profits are soaring, as predicted, and a bit beyond what was predicted. Even the Government economists, who this year have rejoined the club, are having a good year in their general forecasts for the year. It is a case where every prospect pleases, and only the Dow theory is vile.

The first thing to emphasize is that economic law does operate. If John Maynard Keynes could come back to life he could say, "I have seen the President, and it worked." Well, it has been working. You can take some credit.

The new macroeconomics has been working. The nagging of your committee, tedious as it may sometimes seem even to your own ears, is the Lord's work in this era when new ideologies and game plans attempted to set back the clock of governmental stabilization.

I think what needs to be emphasized here is the remarkable fact that the same medicine which has been working here at home has also been working abroad. Who can doubt that the successive crises in the foreign exchange markets, when taken against the background of the psychological slowdowns occurring in Germany, Italy, and Japan, would under the laissez-faire regime of a few decades back have led by now to a worldwide depression?

Instead, we see recoveries abroad from what have been mild and short-lived hesitations.

What you need to emphasize is that all this just did not happen. The present expansion required action—determined and sometimes unorthodox action—by the central banks and the legislatures of the modern mixed economies. Those who cursed the Federal Reserve for countenancing the growth in the money supply at an 11-percent annual rate earlier this year are rubbing their hands in glee at the gains in production and profits.

Congress has responsibly insisted upon budget deficits that by historical standards would have been considered large, but which the anatomy and physiology of the GNP accounts have shown to be vitally necessary to turn an anemic expansion into a vigorous one.

Mr. Chairman, you should not apologize when you go to heaven when St. Peter asks you what you did in your career in Congress. You should not say, "St. Peter, I held down Government expenditures." There is danger that you will have lamely to say that.

What you should be able to say to St. Peter is, "I arranged that wasteful Government expenditures were cut out, I insisted as far as my poor, soft, lone voice was concerned in the Congress that social priorities prevailed in the determination of the Government expenditures." And you should be able to say with good conscience that back in 1969, back in 1970, back in 1971, when different counsels were heard through the land, I was a responsible and prudent voice for modern macroeconomics to the second quarter.

Nobody expects an 8.9-percent increase in real output to last. The last part of the quarter was weaker than the first. If the Commerce Department comes to revise its GNP estimates, I suspect any significant change will be on the down rather than up side.

If Commerce comes to revise its estimates again, as you can confidently predict that it will, I suspect that it will be more likely to cut down a little bit upon that rate of growth than to add to it.

As has been already mentioned, the half-hearted converts to macroeconomic stabilization always tend, when the going improves, to fear that it is all too good to be tolerable. They can stand everything but success.

In the summer of our healthy advance, they look forward to the winter of our excess. Already official and unofficial witnesses are appearing before you—warning that the strong growth is too much of a good thing—that the Fed must hew back to some fancied target rate of range of long-run growth in the money supply, that Government expenditure that Congress considers necessary in the public interest be cut back to levels that unchanged tax rates can finance within some rigid limit on budget deficits.

I should emphasize that we are in danger of repeating the mistakes of the sorry Eisenhower decade. That is as close to a partisan statement as will emerge in my testimony.

When real GNP grew in early years of recovery from recession—7½ in 1955, 6⅜ in 1959—there appeared before you administration and public witnesses warning against the excesses of Sodom and Gomorrah: And we reap the winnow which they sowed.

The record of that sorry decade is that from 1953 or 1952 to 1960 we showed annual rates of real growth of only 2 percent, and unemployment of an unconscionable level.

Now, by contrast—and I can say it in the presence of Walter Heller only with some embarrassment.

In the Kennedy years, every time the economy showed signs of flagging prior to high employment, macroeconomic measures were renewed to keep the expansion a healthy one. No aesoteric "fine tuning" is required to implement this lean against the wind philosophy, but if it is to be dubbed fine tuning, then we should all try to be worthy of the title.

Let me conclude with a brief glance into the future.

No matter who wins the election, Congress will find itself legislating higher taxes next year. You do not have to read a Brookings study to realize the arithmetic of the problem. We are not an overtaxed Nation. We were not an overtaxed nation in 1965, when so many of our troubles came on the wake of the Vietnam escalation.

Each of you here, and those members of the committee who are not here, should ask themselves, where was I when a tax increase was needed in 1965, and in 1966, in 1967?

You cannot say that the economists of the Nation did not advise you to this effect. It is true, the President did not ask for that, but he must ask himself in retirement, where was he upon this occasion. We are not overtaxed. We were taxed instead by cruel inflation.

Now, let me comment upon the future in terms of the election outcome. Alienists have discredited themselves. You can get one to testify with respect to the sanity of a witness or his insanity, ad lib.

Econometrics is beginning to discredit itself. We have computers which are apparently Republican computers and which estimate that if that man wins the election, the grass will grow in the streets of Main Street and Wall Street, and they work it out to the last fraction of a billion dollars.

I am referring to the Michael Evans-Chase econometric computer. We have the Wharton School computer, or the Data Resources computer, which tell an opposite story.

Now, lest we throw our cigarette lighters into the technological works, let me point out that literary economics is in no better position. The Pierre Rinfrets we have always with us prepared to testify that if that man is elected a disaster will strike.

By my own count, there are thousands of assistant professors in this land who are prepared in a literary way to testify in the opposite direction.

It is relevant to the economic performance of the economy for the rest of this decade which policies, broad philosophical policies with respect to taxation, are adopted.

So let me just give you my own back-of-the-envelope estimate, which says that the decade of the 1970's will be better economically—and I mean better for all the constituencies, or almost all the constituencies—if we close the more flagrant tax loopholes.

Broadly, this means capital gains taxation, constructive capital gains taxation, at death, at the very least, and a lessening of the differential in the rate of taxation of so-called long-term realized capital gains, reducing percentage depletion allowances. If we always replace much of the present system of welfare aid with an intelligently formulated negative income tax and family income maintenance program, the country will be better off for it, Main Street will be better off for it, and even Wall Street will be better off for it.

Thank you.

(The prepared statement of Mr. Samuelson follows:)

PREPARED STATEMENT OF PAUL A. SAMUELSON

1. *Militant use of fiscal and monetary policy has finally begun to pay off in terms of vigorous real expansion of output and employment.* Those of us who were skeptical about the ability of Phase II wage and price controls to moderate the rate of inflation, to say nothing of those economists who claimed that controls would not work or would make the problem worse, have been pleasantly surprised by the second-quarter growth in real GNP at almost a 9% annual rate and the simmering down of the price-deflator-index to a near 2% annual rate.

This is the summer of our content. Even the stubborn index of unemployment dropped from 5.9% to 5.5% in June. Total employment is up. Profits are soaring, as predicted and a bit beyond what was predicted. Even the government economists, who this year have rejoined the club, are having a good year in their general forecasts for the year. It is a case where every prospect pleases and only the Dow-theory is vile.

2. The first thing to emphasize is that economic law does operate. The new macroeconomics has been working: the nagging of your Committee, tedious as it may sometimes seem even to your own ears, is the Lord's work in this era when new ideologies and gameplans attempted to set back the clock of governmental stabilization.

What needs emphasis is the remarkable fact that the same medicine which has been worikng here at home has also been working abroad. Who can doubt that the successive crises in the foreign exchange markets, when taken against the background of the cyclical slowdowns occurring in Germany, Italy and Japan, *would under the laissez faire regimes of a few decades back have led by now to a worldwide depression?* Instead we see recoveries abroad from what have been mild and short-lived hesitations.

All this didn't just happen. *The present expansion required action—determined and sometimes unorthodox action—by the central banks and the legislatures of the modern mixed economies.* Those who cursed the Federal Reserve for countenancing the growth in the money supply at an 11% annual rate earlier this year are rubbing their hands in glee at the gains in production and profits. Congress has responsibly insisted upon *budget deficits* that by historical standards would have been considered large, but which the *anatomy and physiology of the GNP accounts have shown to be vitally necessary to turn an enemic expansion into a vigorous one.*

3. The second thing to emphasize is that the recent euphoria concerning the economy's performance must be deflated by a recognition that chance elements contributed *transitory stimuli that cannot be expected to persist at so favorable a level.* The last half of the last quarter seems to have been weaker than the first; if the Commerce Department comes to revise its GNP estimates, I suspect any significant change will be on the down rather than up side. Similarly, the .4 of

1% drop in the unemployment rate in June, one guesses, is a statistical wobble that exaggerates the true degree of improvement. When inflation improvement reads like a story too good to be true, it is prudent to shade your belief in it.

4. Most important, the half-hearted converts to macroeconomic stabilization always tend, when the going improves, to fear that it is all too good to be tolerable. They can stand everything but success. In the summer of our healthy advance they look forward to the winter of our excess. Already official and unofficial witnesses are appearing before you warning that strong growth is too much of a good thing—that the Fed must hew back to some fancied target rate of range of long-run growth in the money supply, that government expenditure that Congress considers necessary in the public interest be cut back to levels that unchanged tax rates can finance within some rigid limit on budget deficits.

We are in danger of repeating the mistakes of the sorry Eisenhower decade. When real GNP grew in early years of recovery from recession—7½% in 1955, 6⅜% in 1959—there appeared before you Administration and public witnesses warning against the excesses of Sodom and Gomorrah. Alas, the record of average real growth in the Eisenhower years of little more than 2% per year testify that the Bureau of the Budget and the Federal Reserve made the nation reap what they had sowed. By contrast, in the Kennedy years, every time the economy showed signs of flagging prior to high employment, macroeconomic measures were renewed to keep the expansion a healthy one. *No esoteric "fine tuning" is required to implement this lean-against-the-wind philosophy; but if it be dubbed fine tuning, then we should all try to be worthy of the title.*

5. Let me conclude with a glance into the future. *No matter who wins the election, Congress will find itself legislating higher taxes next year.* We are not an overtaxed nation. And if non-regressive sources of taxing and of revenue sharing are selected by Congress, we shall all of us be the better off for it—the public as consumers and as producers.

Alienists, I am told, have discredited themselves as expert witnesses, since you can hire one to testify on either side of the case involving a person's sanity. Although I have never met a computer that could laugh, or weep tears, or love, we apparently today have Republican and Democratic computers. A Chase Bank computer will tell you that McGovern economics will stop GNP growth in its tracks; a Wharton School or Data Resources computer will tell you that this is just what the doctor ordered for good health of the GNP vector. However, before we jam shoes into the transistors, I must record the fact that literary economics throws up its Rinfrets and Janeways to predict the Dow-Jones index down to 500 if that man picks up in the Gallup polls; and more assistant professors than you could shake a slide rule at will aver the opposite.

My own back of the envelope says that *the decade of the 1970's will be the better economically if we close the more flagrant tax loopholes and replace much of welfare aid with a negative income tax and family-income maintenance program.*

Chairman PROXMIRE. Thank you, gentlemen, very much for stimulating, entertaining, and enjoyable statements, as well as very helpful advice.

I would like to ask each of you gentlemen to respond to the President's proposal for a ceiling on spending, and an attack on the spending policies of Congress as being inflationary.

I would like to ask first if, looking at the aggregate economic picture, you gentlemen judge that a $250 billion spending ceiling is likely to give the economy the proper stimulus that we need under the present circumstances. No. 1 and No. 2, would each of you volunteer on how Congress can adjust current priorities, particularly those imposed by the President, if the President's ceiling is established.

First, Mr. Galbraith.

Mr. GALBRAITH. I certainly would not like to see this done through a ceiling. It seems to me that the Congress must not abandon the responsibility for looking——

Chairman PROXMIRE. You said you would not, or you would?

Mr. GALBRAITH. I would not like to see this done through a ceiling. The problem is for the Congress and the administration effectively to address themselves to the problem of military spending. We have had in these last years a very substantial change in the attitude of the United States in respect to its foreign policy. We are no longer committing ourselves—even the Nixon administration is not committing itself—to the notion of policing the world against communism. And it remains in Vietnam only as a matter of habit and face. And yet we still have a military budget that is related to the military policy of 10 years ago—which even in our relations to the Soviet Union does not take account of the recent détente and doesn't relate itself to the phenomenom of overkill, and which reflects the most extraordinary arms agreement of all time—one that limits the arms race by requiring a substantial increase in arms spending.

So as long as this kind of expenditure is central to the budget as it is, then it would seem to me to be quite outrageous to have an overall ceiling. The overall effect, as the chairman will agree, from such expense will be on outlays for other than the Pentagon.

Chairman PROXMIRE. Mr. Heller.

Mr. HELLER. I associate myself with what Ken Galbraith has just said, and go on to note that an arbitrary ceiling tends to lead to arbitrary cuts. It leads to exactly those across-the-board cuts which seemed to be the main thing that Arthur Burns could cite yesterday.

Chairman PROXMIRE. Let me just interrupt to say that it may well be that a $250-billion ceiling is too high or too low. But it seems to me that the concept of a ceiling has some merit. It requires a Congress then to think in terms of overall priorities. What we do now is simply pass appropriations measures that aren't related to each other, that have come up to some figure that may be enough, or not enough. And first I would appreciate if you would say why the idea of ceiling doesn't force a priority conclusion on the part of the Congress that can be quite constructive, and then when the ceiling ought to be higher.

Mr. HELLER. My only way out, in response to your intelligent question, is to note that I said an arbitrary ceiling. And what I mean by that is this: I feel quite strongly that the concept of the Congress sitting down and saying to itself, "Here is what the Nation's priorities and economic policy of the time require," and setting an overall goal in those terms makes good sense. It has to be done more adeptly than our comic opera attempt in 1947 and 1948 when, you remember we had such a ceiling, and it was simply honored in the breach and not in the observance.

Chairman PROXMIRE. 1967?

Mr. HELLER. No; 1947 and 1948 when we had that procedure which required—that isn't before your time, is it, Senator?

We had the Monroney bill which required a joint committee—five members each of the two spending and two taxing committees as I recall—to set a ceiling within which Congress was then supposed to make its appropriations. And they set a ceiling of $37.7 billion. I don't know why that figure is etched on my mind. And Congress went right up through it into the 1940's. What you need is a whole new setup under which the Congress would have a larger staff to analyze the economic situation side by side with budget priorities, and then set a ceiling which would represent both social responsibilities and fiscal responsibility. And that kind of ceiling I would happily go along with.

There is one other thing. At the moment I am afraid that a rigid $250-billion ceiling would not be high enough to allow us to have the fiscal stimulus that this economy still needs. We have such a long way to go before we hit the kind of ceiling that men of great faith in the American economy believe exists—in other words, the 4-percent or less unemployment ceiling—that I think the $250-billion ceiling would be economically counterproductive.

Chairman PROXMIRE. Do you think that the $250-billion ceiling is too low?

Mr. HELLER. I think it is too low.

Chairman PROXMIRE. And you think we are not ready at the present time to arrange our priorities with such logic to make it work effectively, so that it gives the President the discretion to do whatever he wants to do within the ceiling?

Mr. HELLER. I am happy to have those words put in my mouth. You are precisely right, we are not geared up to this. What good is it to put in a $250-billion ceiling to which, now going back to the mechanics of it, the Congress can't possibly conform under its present organizational and staffing arrangements.

Chairman PROXMIRE. Senator Javits and Senator Mondale have just succeeded in getting a bill through the Senate establishing an Office of Goals and Priorities which would try to do this. But I take it that that is a few years off, or at least a year or two off.

Mr. HELLER. And without the Congress having that mechanism, it would all be left to the President to cut where he pleases.

Chairman PROXMIRE. Mr. Samuelson.

Mr. SAMUELSON. We have a good deal of experience with public debt ceiling and other kinds of ceilings. And these provide no substitutes for discipline by Congress in voting programs that can justify themselves in terms of intrinsic merits. Nor are ceilings at all closely related to correct working out of the exact amount that the economy needs for macroeconomic health.

Now, just to give an example, I have before me the estimate of Mr. Michael Levy of the Conference Board—no radical organization—for fiscal 1973. Without the escalated bombing in Vietnam, his estimate is $250 billion, and his highest estimate was something like $255 billion. You then add a $3- to $5-billion increase just for the escalated bombing. Does this mean that somebody in the innercity is going to have to starve because an item which is not under the control of Congress takes place? And certainly no Congressman that is responsible is going to send an airplane over the sky though unarmed and running out of ammunition. You know which programs are going to win out under those circumstances.

So instead of getting responsibility and responsive government spending and taxing to the needs of the people you get from ceilings more haphazard things, including deception. Time and again we have sold the post offices off on Friday and bought them back at a loss on Monday, in the various backdoor financing schemes that both political parties have learned to be so skillful at.

Any ceiling, if we came to a tough one, should include ceilings on backdoor tax spending. Then a $250 billion ceiling would be ample, if you really did something about the erosion of the tax base. But who is to say that in the appropriations committee you are in fact going to wait upon that to happen.

So I think you would be very poorly advised to go along with an across-the-board $250 billion ceiling.

Chairman PROXMIRE. Absent the ceiling, the President has indicated that he feels that the Congress will continue its spending program, and we are going to have a serious deflationary resurgence.

You gentlemen all seem to think that we need a tax increase—I get that impression, maybe I don't speak for all of you. And with the 5 million people out of work operating at 76 percent of capacity and with the economy, in spite of all the deficits we have in the past system moving so slowly, why can't we use a very vigorous physical stimulus?

Mr. Samuelson, you said that what has happened in the last few months has borne out macroeconomic theory. I question that, in view of the fact that the administration told us that we are going to have a bigger deficit, a $39 billion deficit, and it ought to be $23 billion, a fantastic overestimate.

Mr. Heller has told us this morning that the NIA budget, the budget you gentlemen seem to think is the best measure, was in surplus last year, a restraining factor and the increase in the money supply during the past full year, was a moderate 6 percent. Where is this stimulus that accounts for the big second quarter increase? It seems to me that there may be other factors in the economy that are working other than just the Government taxing and spending and monetary policy.

Do you want to start off with that, Mr. Samuelson?

Mr. SAMUELSON. I think that the strength of the advance in the second quarter of the year shows that we have been going at a rate of increase of more than 6 percent. Now, those are not high rates of increase by historical standards, in early years of recovery. What you have had since the end of what the National Bureau called the recession at the time of the settlement of the General Motors strike in November of 1970, is an exceptionally anemic expansion. And without question, if you had not had the deficit in the full employment budget.

Mr. HELLER. That is in the unified budget. I think the NIA budget, in full-employment terms was just about even-steven in fiscal 1972.

Mr. SAMUELSON. And if you had not had the Federal Reserve doing what the monetarists said they shouldn't be doing, expanding the rate of growth of the money supplies, beyond some obsolete targets that this committee set up at an earlier date, then I don't think you would have so strong an advance.

Now, where the rub comes in is that the easy part of recovery is behind us. The labor market from now on will begin to tighten in a meaningful way. And you cannot have the unholy alliance which we have had in the last few years, those people who want better social programs have been able to gang up with those who want more fiscal stimulus, and it has always been very pleasant, because no tax increase was involved. But the rate of increase in profits which has been mentioned here, which has been deplored, and perhaps, I think, overdeplored—because let's make no mistake about it, there has been an erosion of profits in the last few years, and if profits ever are to arise in a mixed economy like ours, all experience shows they rise in the first quarter of a recovery. I have had half a dozen estimates before me of the behavior of profits to be expected in the quarters ahead. They are on the beam pretty much as to what has happened, including the last report of numbers. But they don't show a continuation of the same rapid rate of increase next year, they have a fiscal dividend, to use Mr. Heller's expression, which is going to stay with you as the labor market tightens even if, as I hope, the goal will be something like 4 percent unemployment, and not something like the modified administration goal of 5 percent.

Chairman PROXMIRE. Would you comment on that, Mr. Heller?

Mr. HELLER. Yes.

I think we have to particularly stress the timing factor here. First, with respect to the tax increase. None of us is advocating that that tax increase go into effect before the economy gets back to something approaching full employment. I have been talking about a tax increase that goes into effect by 1974, but certainly not before that.

Chairman PROXMIRE. That is certainly not the impression I have gotten this morning. That is very helpful. You don't want a tax increase until 1974?

Mr. HELLER. That is right.

In other words, we should be planning on it, working on it in 1973 for implementation in 1974, but as long as the economy still has a lot of unused potential, a tax boost is the last thing we need. In other words, we still need fiscal stimulation. We have to have a two-way fiscal policy for stable full employment; namely, a stimulus when we are below par, and then responsible tax increases as we get close to that full-employment level.

Second, with respect to explaining the first and second quarters this year as good quarters, as well as the last quarter of last year, compared with the miserable record before that, we did have some fiscal stimulus. You get stimulus by reducing the surplus. In other words, we had a substantial full employment surplus the year before last in the NIA budget. We cut that to about zero, and probably less than zero, in the first half of this year. Also we had an increase in the money supply, a very large increase in the first half of last year, that probably had a delayed impact.

So I don't think you did our faith in macroeconomic policy sufficient justice, Paul, because there was both monetary and fiscal stimulus to help account, along with the natural forces of recovery, for what happened in the first and second quarters.

And finally, I find it rather strange that Paul was putting in quite that strong a word for profits. First, as I said in my prepared statement, atlhough they have yet to regain their appropriate proportion of GNP, they have been moving up awfully fast.

And second, you have to look not only at profits but cash flow. Accelerated depreciation provisions doesn't show up in profits. They show up in cash flow. And that is part of the beefing up of corporate prosperity.

Chairman PROXMIRE. Mr. Galbraith.

Mr. GALBRAITH. I was going to emphasize the last point and add one thing. It seems to me also that Paul Samuelson overlooks that part of the profit picture which is associated with the tax concessions that have been made in recent years, and which show up with considerable clarity in the Vanik testimony to which I adverted to earlier. The larger corporations have had very substantial tax relief. The consequence of this for after tax profits can hardly be associated with the normal movement in profits.

My earlier testimony must also be emphasized. I agree with my colleague that we are going to have to have a tax increase. I hope, however, that we have passed beyond the stage of talking about just a tax increase. We must talk about a tax increase for whom, we must talk about tax increases in relation to where the taxes fall, and to the need for greater equity in the distribution of income.

I might just add one other word. I myself am persuaded that we probably had better stop talking about closing loopholes. And we had better start talking about the ultimate objective in the tax system. The ultimate fact is that however a man is enriched by a given amount, he is damned well enriched by that amount. And whether it comes to him from capital gains, or from oil depletion allowances, or from accelerated depreciation, or from defrauding the McGraw-Hill Co., he has the money. We should apply the same progressive rate of taxation to the given amount of enrichment.

I was enormously pleased that Senator Harris has picked up this idea and made the effort that he did at Miami to get it into the platform for the Democratic Party. The notion that a dollar is a dollar is something we need now to accept. The kind of licensed discrimination we now have in favor of the affluent is something that we must bring to an end in the taxation.

Chairman PROXMIRE. I want to be sure you don't disagree with Mr. Heller. He said no tax increase until the economy is operating at a full employment level, in other words, not until 1974, or whenever full employment comes; is that right?

Mr. GALBRAITH. Yes; subject to my earlier remarks on a more rational view of the defense budget.

Chairman PROXMIRE. Do you agree, Mr. Samuelson?

Mr. SAMUELSON. I think that you must legislate in 1973 tax increases for 1974. But let me say this, that if Congress does what I hope it will do, which is to finally move onto a family allowance system, then I think that it will have to be paid for by the right kind of taxes.

I am also happy to have been corrected here. What I would like to emphasize is that if we move toward heavier taxation of corporate income, which is a reversal of what has been happening in recent times, that will spread the tax burden in a different way, in a way which many ethical observers will consider to be better. It will not be without effects.

Now, I want to speak of one of those effects. I think that the effect of that—as, for example, taking away investment tax credits, taking away faster depreciation—will do something over time to the fraction of the GNP that goes into investment. In that sense it will have some traceable effect upon the rate of growth.

I think the whole climate of opinion in this country has changed. We don't want growth just as growth. When I pointed to the 2 percent pitiful performance of the American economy in the 1950's, if I stopped there as I did, my own students will misunderstand me; they will say, what, are you in favor of pollution, are you in favor of nonecology, are you in favor of losing the amenities of life?

My answer would be, oh, no. What we got then was not the amenities of life, not good ecology, what we got was wasted resources spent in the wrong way.

Now, I think that the whole mood of the American people has changed in the direction that we would like the decade of the 1970's better if, instead of showing 1958 in real terms, as the Office of Business Economics of the Department of Commerce measures the real GNP, the net economic welfare, the corrective measure of the GNP for the amenities of life, for the labor of females which does not now get recognized, and for all the other things that we are worried about, if that number only went up by 40 percent, but it went up by 40 percent, that would be a very good trade-off.

And so what I am saying now is that the modern, if I may coin a phrase, affluent society can afford a slower rate of the old-fashioned kind of growth, and a faster rate of welfare growth.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Thank you very much, Mr. Chairman. And I hope the Chair won't feel troubled about the time. I thought the testimony was tremendously interesting and worthwhile.

But, gentlemen, you are a breath of fresh air to me, aside from Professor Galbraith's rather subtle thesis that the Republicans serve only the rich and the Democrats serve only the poor, which is a good way to get a political debate in an economics discussion——

Mr. GALBRAITH. Could I make this one comment——

Senator JAVITS. Not yet, not until I finish.

Mr. GALBRAITH. Will you yield for just one observation?

Senator JAVITS. No, I am sorry, I waited on you, and you will wait on me.

Mr. GALBRAITH. My observation will be helpful.

Senator JAVITS. Mr. Chairman, order.

Chairman PROXMIRE. Senator Javits has the floor.

Senator JAVITS. Mr. Chairman, I have no desire to make this a personal debate between Mr. Galbraith and myself. I made an observation, and he made many. And I hope he will be polite enough to bide his time to answer. I was.

I am very displeased. That seems to be characteristic of a political debate.

Now, as I said, I thought that this was a refreshing breath of fresh air. And you gentlemen are agreed, apparently, that we have to face the issue of higher taxes if we are to have better social services, and all the things that Americans want.

I would greatly appreciate it—because I think you have already indicated some ideas on the subject—if you could give us, each of you, perhaps now or even supply in writing, your ideas as to how this might be done. I am one Senator who is perfectly willing to face the issue. And I faced it in 1967, and in 1969, when I urged the President to consider the need for increasing taxes. And I do again. We can't have it both ways.

Now, do you gentlemen agree with the thesis—I will ask Professor Heller if he agrees with the thesis of Arthur Burns that you cannot get enough out of closing tax loopholes to answer what you gentlemen pose as the fundamental question in our national life?

Mr. HELLER. Senator, I would agree entirely with that in any kind of practical terms. In other words, closing loopholes or removing discrimination or ending the so-called tax expenditures is throughly desirable in and of itself, both in equity terms and from the standpoint of improving the impact of the tax system on resource allocation, of getting a more efficient economy.

But when it comes to looking to the elimination of tax discrimination, of tax shelters to solve our revenue problem, I don't think that as a practical matter we could get enough out of that to meet our revenue needs.

We should get all we can. And I would hope we would get $5 to $10 billion dollars. But that is not going to be enough. And consequently I would go beyond that to perhaps $10 to $15 billion of increases in income taxes. We have given $45 billion of income tax cuts since 1960. Or to put it the other way around, if we had 1960 rates and exemptions today, we would be collecting under the Federal corporate and individual income tax $45 billion more than we actually are. Let's take back $10 or $15 billion of that.

Senator JAVITS. So, you don't feel we need a value-added tax or a national sales tax or any such tax that you would consider oppressive?

Mr. HELLER. By no means. There is no need for bringing in a new sales tax.

Senator JAVITS. Professor Samuelson.

Mr. SAMUELSON. I completely agree with that statement.

Senator JAVITS. Now, Mr. Galbraith. I sat patiently and I didn't interrupt. And I don't like to be interrupted.

Mr. GALBRAITH. My desire was not in any way to be argumentative but to be helpful. I wanted Senator Javits before he committed himself to notice that I said the line between the two parties was in some instances subject to rather poor demarcation, and that many of us who are nominally Democrats would welcome him as a member. And I can think what enormous comfort that would be to him, particularly in his relation to the national ticket.

Senator JAVITS. I would like you to know, Professor Galbraith, that you are using my time.

Go ahead.

Mr. GALBRAITH. I associate myself with my colleagues, only emphasizing, it seems to me, what I have said before, that we must not talk about taxation in general; we must talk about taxation for whom.

But I would think, as would any reader of the Brookings report, that, projecting the tax requirement, we shall have to have a general increase in the yield; yes.

Senator JAVITS. Would you be willing, in perhaps a more considered way, to give us your ideas as to the direction in which we need to move in planning for what taxes our country needs?

Could I ask you that, Professor Heller, would you be willing to do that, just to broaden out the answer you gave, and give us in some perhaps technical way——

Mr. HELLER. Are you asking at the present, or to submit something for the record?

Senator JAVITS. Submit something for the record.

Mr. HELLER. Yes, I would be happy to.

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

Three main objectives would guide me in framing a program to raise added Federal revenues:

Fairness.—Persons in similar economic circumstances (chiefly, as to size of income and extent of family obligation) should be taxed equally.

Progressivity.—New tax legislation should seek a significant increase in the relative tax burden of the upper income groups, whose share of the total burden has been reduced by (a) income tax cuts, (b) use of tax shelters, (c) the rapid growth of regressive payroll taxes.

Economic efficiency.—Tax changes should promote economic efficiency in two senses, first, that tax preferences which pull resources from their most efficient uses should be reduced or eliminated, second, that marginal tax rates be kept within bounds that preserve incentives to work, save, and invest.

For purposes of indicating the directions in which planning for Federal tax increases should go, I have put together the following program on the "high" assumption that a $27 billion tax increase might be needed by 1974 if we are serious about financing our Federal social programs responsibly and, in addition, providing significant local school tax relief. If less revenue were needed, I would start with the program of structural tax reforms and then rely on individual and corporate tax increases across the board for the remainder of the needed funds.

Proposed tax action	*Added revenue (billions)*
1. Structural reforms to reduce income tax preferences ("loophole plugging")—see below	$12
2. Across-the-board increase of 2 percentage points in individual income tax rates resulting in a new schedule running from 16 percent to 72 percent (on a taxable income base of roughly $550 billion by 1974)	11
3. Across-the-board increase of 4 percentage points in corporate income tax (on a taxable income base of roughly $100 billion by 1974)	4
Total	27

The structural reforms to narrow or eliminate various tax preferences would include such high-priority items as the following:

Proposed tax action	*Added revenue (billions)*
A. Removal of accelerated depreciation provisions of the Revenue Act of 1971 (ADR's)	$2.5
B. Capital gains package—tax unrealized gains (above, say, $5,000) at gift or death, boost the inclusion rates of capital gains from 50 to 60 percent, and remove the alternative tax	2.8
C. Eliminate deductibility of gasoline tax	.5
D. Remove various real estate tax shelters	.7
E. Cut excess depletion deductions in half	.6
F. Remove $100 dividend exclusion	.4
G. Broaden coverage of present 10 percent tax on preference income and raise rate to one-half of regular tax rates (for both individuals & corporations)	4.5
Total	12.0

In putting together a program to raise as much as $27 billion of additional tax revenue by 1974, I have probably gone beyond the tolerance of the Congress and the country for added tax revenues. But since the question pertains to the direction of tax increases rather than a precise program, I felt it desirable to use a large enough figure to illustrate a rather wide range of possibilities. However, as noted above, the top priority under the three objectives set forth at the outset should be placed on the structural tax reforms. They deserve to be the first order of business by a White House and a Congress interested in fairness, progressivity, and economic efficiency.

Senator JAVITS. If you would do that, I would find it tremendously helpful. I find your testimony on the ceiling tremendously helpful. This is such a beguiling thing. I hope you recognize that we are simply not equipped for it. We are sure to break it, by the tyranny of Presidential budget requests, or otherwise, and either way is bad. And I personally feel very strongly on that subject, superficially attractive as it may sound.

The last thing that I would like to ask, if I may, relates to a very interesting point made by you, Professor Samuelson. Somehow or other "profits" seems to be a dirty word; there is something immoral about profits. It shouldn't be so. You are three highly sophisticated economists, as good as we have in the country.

Could you, Professor Samuelson, perhaps start us off on what might sound like a hornbook question, but a very serious one. Are profits necessary to the economy? What role do they serve? And why, therefore, should we have a national solicitor to see that they are realized? And I am talking about the nasty words "corporate profits," even big corporation profits.

Mr. Samuelson. You have opened up, Senator, a very large subject. Let me put it this way. A mixed economy like ours is a profit and loss system. And it is very easy for a mixed economy to operate very well when all of the factors are contributing toward very high profits.

But the test of the mixed economy system, I think, is how it will operate when all the factors are not contributing to high profits as often will happen for long periods of time. Any student of economic history knows there has been an erosion of profits. Right after World War II corporation after corporation that I knew would not take a project until it promised to return 30 percent. You didn't have to be much of a banker then, except to exclude submarginal items.

But there have been long periods since then when projects which corporations say in the chemicals industry wouldn't have deigned earlier to touch, they were very happy to get. For instance, take something as dull as the production of sulphuric acid which only yields you 8 percent—or maybe 10 percent before taxes, and then only if you are extremely efficient.

Now, I think that corporation profits have to be the handmaiden of the system, not the master of the system. And I don't think that a mixed economy like ours is going to work to the advantage of many of us. If you have found, for example, 5 years from now that the share of the GNP dollar, which is corporate profits which are running now before taxes just under 10 percent, not a high figure in comparison with their economies, and not a high figure in comparison with our own history, after taxes something like 5 percent.

Let's suppose that those numbers were to quarter in a short period of time. I think that you would have a great deal of difficulty for the constituency of all five of the political parties if that happened. But that doesn't mean that what we need to have is lobbyists soft on profits. The only good way to raise the GNP is by the trickled down philosophy of some kind of fancy multiplier, that if you are going to get a dollar into profits, that is the only way to have prosperity.

I did speak to profits because I didn't think that a balanced view was being given of what the profits situation was, taken over the whole business cycle.

The share of labor in the GNP—you would hardly believe this if you read the newspapers generally—is easing upward. And I think that is something which is to be welcome.

But let me say something very seriously. Lenin was quoted as saying that, "We shall debauch the capitalistic system by debauching the currency." And he had in mind presumably the turning of the crank of the printing press. I say he had that in mind presumably, because nobody knows what he had in mind; in fact, nobody can find the quotation. But I will improve upon the quotation and make it a more correct one. That is not the fear of our mixed economy changing, because some wild-eyed people, I think, told the political party that caused the printing press to be turned.

But I think you will have to look to Latin America to see where it is that will change a system. And if Peron had not existed we would have had to invent him. But we can name the stagnation of Argentina and countries like that on the basis of Peron now for 15 years. And the statute of limitations should run out. But in those countries you get governmental regimes which will raise money wages by 40 percent within a year. I don't mean now the 40 percent that keeps pace with inflation, because in some of these countries 40 percent a year is just holding your own in real terms.

And a presentday Lenin should be able to say, "I will tell you how to debauch the modern mixed economy in a very short period of time if we can get by a militant political force a drastic attempt to change, to shift the allocation of the social pie between the return to property and the return to wages, broadly speaking, by a tremendous degree." And then I assure you the economic destroyers will come back 10 years later, and they will report not that the good intentions of the militant group were realized, but that they set into motion a price change. Somebody has to be cheated in this game of Black Peter? Who is going to be left with the Black Prince in the card game? And inflation sets in.

And Arthur Burns at the nonpolitical Federal Reserve Board would under those circumstances find himself turning the crank, and it would be thought that he has suddenly lost his marbles, and there is no structural reason for him to be doing what he is doing.

I hope the antidote to what he is doing will follow very quickly.

Senator JAVITS. I am afraid my time is practically up.

Mr. Heller.

Mr. HELLER. First, profits aren't a dirty word. And adequate profits are a vital incentive, indeed propellant, to the mixed economy of which Paul Samuelson just spoke.

Second, it is the way profits are earned that is important. If it is on the basis of monopoly and tax bonanzas handed out on a silver platter, that is bad. If it is a concommitant of healthy expansion of the economy side by side with fair wage increases, that is good. And I make so bold as to refer to the great expansion on the first half of the 1960's, lead in larged part by consumer expansion, that doubled corporate profits.

By the way, that was my half of the sixties.

Third, my point was not that profits are high enough yet. I specifically said in the recovery process they have to go higher. But in the short term, it seemed to me, advances in prices, profit-producing price increases, are getting out of whack with advances in wages, and that we ought to adjust our price-wage mechanism accordingly.

Senator JAVITS. Mr. Galbraith.

Mr. GALBRAITH. I think I would go one step beyond that. It is absolutely essential that we recognize that in the handling of the economy, we have reached a position where the distributive shares—the shares going to various claimants on income—are substantially controlled by the Government. That is the meaning of wage stabilization, it is the meaning of price stabilization, and the meaning of agricultural policy, and so forth.

Perhaps the thing that historians will most attribute to the Nixon administration is the gigantic step it has taken away from what my colleagues have called the mixed economy.

When the Government intervenes to control the shares going to the several participant groups in the economy, when this distribution is no longer under the guise, however convenient, of the market, but is something that is managed at the other end of Pennsylvania Avenue, one can no longer escape the question of equity. One cannot escape the question of the relative increases in the shares going to the labor as against the shares going to property income. We now have, as my colleagues agree, a not unsuccessful effort so far to keep wages under control. And this is in combination with spectacular increases in profits.

Now, this cannot continue without serious jeopardy to the controls. Profits cannot continue to increase if it is necessary, as Walter Heller has said this morning, and as Arthur Burns said yesterday, that there be even a further tightening down on wage increases.

Under these circumstances it seems to me absolutely essential that steps be taken to have a much more effective price control, at the expense of the profits. We must also abandon those tax concessions which have been encouraging profits. And I would even go the further step of arguing for special profit taxation. This is a remote possibility. And I realize it is not going to be enacted.

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

Chairman PROXMIRE. Senator Fulbright.

Senator FULBRIGHT. Mr. Chairman, this has been an extremely interesting discussion this morning.

I would like to ask a very simple basic question. These terms that you have used—Mr. Samuelson particularly used them, and all of you referred to the gross national product, as if this were a very significant measure, or something—I am not quite sure what.

You also referred to a real GNP. Then I believe you referred to a welfare GNP.

Mr. SAMUELSON. NEW.

Senator FULBRIGHT. I wonder if, just as a matter of semantics—we have great difficulties in Congress in understanding these terms—if you would give me an elementary lesson.

What do you mean by GNP, and what is its significance?

Mr. SAMUELSON. You know, Senator, that you are not as illiterate as you claim to be, because I am reminded that back in 1960 when Kenneth Galbraith put on an uncharacteristic modest act, and I was talking about the GNP, he said, "Wait a minute, stop right there; what is this GNP you are talking about? First, how do you spell it?"

The gross national product is the estimate of the money value of goods and services in the economy.

Senator FULBRIGHT. All goods and services?

Mr. SAMUELSON. All goods and services in the economy, but disregarding double counting, so we do not put in the dough with the bread and also the final loaf of bread. It includes Government expenditures on goods and services, it includes consumer expenditures on goods and services, and it includes Government investment expenditures on goods and services, but it is reckoned in money terms. The yardstick of money changes as the price level changes. So the real GNP is simply that money number reflated as best we can by a measure of price change.

Now all that, if I may say so, is ancient history.

Senator FULBRIGHT. What do you mean, real? What is unreal?

Mr. SAMUELSON. The real means in real goods terms as against the dollar terms.

Senator FULBRIGHT. As against what base period? Is this as of the dollars of 1960, or 1950, or what?

Mr. SAMUELSON. When we say that the real GNP has increased at an average rate of a little better than 6½ percent over the last three quarters, annual rate, we are then simply talking about the price changes that took place in that period. We have corrected for price changes as best we can that have taken place in that period.

Senator FULBRIGHT. If we increase the bombing in Vietnam by a thousand percent, we will have a greatly increased GNP, will we not? Because we will have to buy the bombs, and this will generate a tremendous increase in GNP, will it not?

Mr. SAMUELSON. Not in a fully employed economy, it would not. It will replace some other part of the GNP.

Senator FULBRIGHT. We do not have full employment, but let's say if the Government goes out and buys a billion dollars worth of bombs tomorrow, it will increase the GNP.

Mr. GALBRAITH. Under the present circumstances, I think you will have to agree, Paul, that Senator Fulbright is right. He has come up with a very effective way of increasing the GNP, and one would only fear that the Nixon administration might be listening.

Mr. SAMUELSON. Yes; except that he must carry it too far and think that when a Congressman's salary is raised that that also increases the GNP.

Senator FULBRIGHT. Surely.

Mr. SAMUELSON. Because the real GNP, the deflator takes out that increase on the assumption—by the way, probably unwarranted—that after being higher paid, the Congressman is no more efficient than he was previously.

I would like to move on to the other part of your question.

Senator FULBRIGHT. That is a sound assumption, but what I was really trying to get at is, is there not any better criterion we can talk about for measuring the welfare of our country? I am not at all sure our concept is a good one—that is emphasis on industrialization and more and more production of useless goods that nobody is really able to buy—I am not sure that is progress. Is the GNP the best criteria you can offer us?

Mr. SAMUELSON. No, not the best; it was good for the first edition of my textbook, but in the ninth edition, the net economic welfare, NEW, was introduced to try to correct the GNP for obvious departures from what any reasonable jury would consider to be welfare considerations.

Senator FULBRIGHT. One reason I raised this is that we are constantly told that we are spending less of the GNP upon the military. Mr. Galbraith started out to say—and I think, if I understood what he said, that one of the first things Congress needs to do is to face up to this question of the overexpenditure of our resources for military activities. I have heard it estimated that we have spent something like $1,500 billion for military activities since World War II. That is somewhere in the ball park, I think. It is quite large, it is beyond comprehension. But what we are always being told is that it is a smaller percentage of the GNP today than it was 10 years ago. It seems a phony argument to me because it, along with garbage disposal and crime, all of this military spending has added tremendously to the GNP. It really is a meaningless way to justify the increased expenditure for military weapons.

Yesterday we had a vote in th› Senate—we lost it, that is my side lost it, 2 to 1—on whether to build a useless, an utterly useless aircraft carrier. The only justification I can think of is that it gives jobs and is going to help our unemployment, but what a futile way to give jobs and for a futile purpose, it seems to me.

Mr. SAMUELSON. I think that is sound economics——

Senator FULBRIGHT. I am faced with this argument every day. Earlier this week we had two Government people here. Mr. Weinberger was very offended, and so was Mr. Shultz. He said we are spending more for social services and less for armaments of the GNP. But they are always using the GNP, against which I am lost as to what to say about it, if you gentlemen and everybody still think that is a meaningful criteria. That is why I raised it, because I am constantly baffled by it. The Congress is not facing up to this. They voted 2 to 1 yesterday to go forward with a useless aircraft carrier.

We have the Trident today. We are not doing what Mr. Galbraith says we have to do, and what I think that we have to do.

You started to make a comment about the economics. Go ahead.

Mr. SAMUELSON. I think that no jury of competent modern economists would agree that expenditures upon aircraft carriers are more employment-creating than similar expenditures for some program of social priorities, which you tell me that some administration witness deplored in recent testimony. He did not do that on the basis of any present day analysis of modern macroeconomics.

Senator FULBRIGHT. I have not head of any case where they impounded funds for the ABM or for the aircraft carrier or the B–1, but they impounded funds for water and sewer systems in my State and all over the United States. They impounded funds for programs such as that.

You are talking about these ceilings. The President arbitrarily refuses to spend money that has been appropirated by legislation that he signed. Senator Ervin thinks it is unconstitutional, because the President signed it, and he should uphold the law, and he refused to do that. But that is another matter.

What bothers me about the economics of the—and regardless of what you may think, I am very unitiated in this area—is this question of trying to rearrange our priorities and to spend our money for a more useful purpose.

That is the lingo which is used to justify these certain expenditures in my view. I do not think you meant them to be used in that fashion, but I think they are used in that fashion.

Mr. HELLER. Senator, I ought to say one small word, at the risk of being run out of the country, but one small word in defense of the GNP number. It does have its uses, that is, to measure our total productive power and potential in the economy. We need to know what our potential GNP is, and we need to know what our actual is, so that we know how much stimulus the economy needs to get back to full use of our resources. When you have said that, you have just about said it all.

No economist that I know of regards the GNP as the Holy Grail. I think most economists would subscribe to what Petitsenn said: "Not what we have but what we enjoy constitutes our abundance." GNP does not measure welfare, it does not even pretend to. There are now attempts to cleanse it, to cleanse it of internal protection and external defense—in our jargon, the "regrettable necessities"—to cleanse it of our depletion of environmental amenities and resources, and to get this net economic welfare.

We have all been concerned about this.

Senator FULBRIGHT. I hope you will. It is very difficult for me to do it.

But you remind me that yesterday Professor Fairbanks from Harvard was meeting with the Foreign Relations Committee, talking about his recent trip to China. He described many conditions in China.

For example, they have full employment, and everybody has something to do, and so on. I would not reiterate it. And I am sure their GNP is very low. I did not happen to ask him that, but he is one of our greatest authorities on China, as you well know. He has been before our committee four times.

But what bothers me is that I am afraid this continued use of this kind of criteria misleads the American people and the Congress. It causes us to do things and to think we can afford things that we cannot afford, and it makes us arrogant and foolish in some of our public policies. And I would just like to break it down a little more realistically so we know what we are doing. I thought that Professor Fairbanks' testimony was extremely impressive testimony from a man who has had a long history of knowing what was going on in China. And many of the things we are now so troubled about they have overcome, in the field of crime, drug control, and employment. He doesn't say that they all have a good life, as many people think, but they have achieved a great many things that we are reluctant to admit, because of communism. It seems very disloyal to think that they have done anything worthwhile. But it raises this question, are we kidding ourselves that we can afford foreign aid all over the world, that we can afford aircraft carriers and Trident, which we will vote on today, and going to the moon and the space shuttle. I believe there is an initial cost of three and a half billion dollars for the shuttle—little playthings that will take three of four people into the sky. To me this is absurdity. And I think that the fact that the GNP has gone up a hundred billion dollars misleads us in decisions that are fundamental.

Mr. HELLER. Senator, just as a P.S. on that, this GNP does give us some concept of what economic power we can draw on, but it does not solve this key problem of priorities that you are talking about.

Senator FULBRIGHT. And it can be used to justify social program increases to fulfill known priorities, but really, when you are considering that it includes the increased costs of policemen that guard the industries, the garbage—there is an enormous cost of garbage disposal—the enormous cost of wagering at the race tracks and so on, does it have any real advantages to us doing what we ought to be doing for welfare of our own people?

Mr. HELLER. I think it does. But it doesn't justify defense expenditure.

Senator FULBRIGHT. It bothers me. But I don't know and I never know how to equate it.

Go ahead, Mr. Heller.

Mr. HELLER. Just one other comment. One of the things that is troubling us today is the inadvertent identification of defense with prosperity by the current administration. That has been reflected in their arguments both in the White House and in the Pentagon, that a large part of our problem of the slowdown and recession was the slowdown of Vietnam, and the drawing of people out of the Armed Forces, the Pentagon, and the defense industries. We should know enough by now to know that, as Professor Samuelson pointed out, through fiscal and monetary policy we can keep the country fully employed, we don't need even one dollar of defense expenditures to do that job.

Chairman PROXMIRE. Mr. Galbraith.

Mr. GALBRAITH. I would just like to add one word, which involves my soliciting some support from my conservative friends on any particular point. I have long felt, as I think my colleagues know, that we do have to give very much more attention to the content of the gross national product, and as I argued this morning, to its distribution. But we also have a very strong case for considering this in relation to the general functioning of the economy.

Your suggestion, Senator Fulbright, that we have spent somewhere in the neighborhood of $1,500 billion since World War II strikes me as being of the right order of magnitude. And we must notice that this has come out of the American economy. This expenditure on various occasions in the 1950's and 1960's caused us to tighten the money supply, and tighten the supply of capital that was available to our civilian industries, to shoes and textiles and electronics and other industries. In consequence these have had difficulty raising money in various periods in the past.

And let us notice that the two countries which were on the other side in World War II, Japan and Germany, are both limited as to arms expenditure—they have not had comparable military expenditures. Not having any comparable military expenditures, they have much easier capital markets. And therefore their civilian industries in precisely these fields were we have become weaker and weaker, have become stronger and stronger, and have even become stronger in our own market. It is not that the Japanese and the Germans, intelligent and able as they are, are smarter than Americans. It is that they have had the limitation imposed by the United States on the misuse of their resources—a limitation, alas, that we don't apply to ourselves.

One could go on, I imagine, to speculate on various outcomes of the Vietnam war. Perhaps the Hanoi Government would impose similar limitations on the United States at the end of that conflict. I think that is perhaps too much to hope for. I think it is something that we are going to have to do ourselves.

But this is not a problem that primarily should concern liberals. It seems to me that conservatives should be primarily concerned with the way in which the American economy has been damaged by the excessive commitment of the resources for military purposes.

Senator FULBRIGHT. Thank you, very much.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Gentlemen, my comments about the appropriate committee posture in this field in no way applies to you, and I hope you will understand it. Despite the fact that you have been identified with the Democratic Party, I would like to say that I think your testimony this morning has been very stimulating, and entirely appropriate, and as a matter of fact, very graceful also. I have enjoyed it a great deal.

I would like to take just a modest exception. Professor Galbraith, to your feeling that the political parties should be realigned along class lines.

I know that this has been a theme that you have written about, and that you would rather have the Democratic Party be liberal than to have it succeed. I realize this philosophy is being tested in this campaign.

I do think that it is a terribly important thing in American democracy that we have a high degree of dialog within our parties as well as between the parties.

I am not sure what role you ascribe to the middle class in this party realignment, but I regret any feeling that our parties should become monolithic in their economic interests. I simply want to make the statement that I do not acquiesce in your view of what should happen to the parties in this great country.

Mr. GALBRAITH. I would like to ask the Congressman a question, if I might reverse our roles.

I was not addressing myself to the ideal. I was merely saying that we should no longer conceal the reality, that the reality is a broad association between the corporations, the affluent, the economically successful and your party, and that I would be sorry if we did not now begin to test administrations by the service to their particular clientele.

Representative CONABLE. But you are assuming a certain clientele which does not reflect my own view of with whom the parties stand. I must say that I find, for instance, that our most liberal Members of the Congress are generally people of considerable inherited wealth.

Mr. GALBRAITH. I would not for a moment suggest that people are exclusively motivated by their personal incomes. I would certainly want to deny it as regards my colleagues on this panel, as well as myself.

Representative CONABLE. Thank you.

This being a midyear economic survey, and in the light of the great expertise you gentlemen have in your field, I would like to ask if you feel the projection of GNP, whether or not that is a worthy set of initials or not, whether those projections are in fact on line. It has been suggested that they are.

What do you all expect as a GNP this year?

Mr. SAMUELSON. If I could put in a plug for a prophet who forecast the future before it occurred—it is easier for most of us to do it while it is happening and afterward, although we do not always succeed in that—but Walter Heller in 1971 pretty much put his finger on what would happen, and it has happened.

The fashion forecasters are going to have a very good year. This year we are going to be very close in to the ball park. And since the administration forecast is right in with them, it is going to have a pretty good year.

There was one part of the administration forecast—this is the economic report of the President—which I thought could not scientifically be justified at the time it was made, on the basis of the rest of its forecast, namely, that unemployment at the end of the year would be in the neighborhood of 5 percent.

Now, my understanding of the language is that when you say something will be in the neighborhood of a certain number, you mean it could be a bit above it or a bit below it. So I tried to think of what with its own price forecast, with its own production forecast, would be a more scientifically defensible statement, and I came up with something like five and a quarter percent.

Now, that might be picayunish.

Representative CONABLE. Is that the average for the year or at the end of the year?

Mr. SAMUELSON. Let me say that it might be right in those terms, because up until recently I have no responsible forecasters that really thought that the unemployment rate was going to be anywhere near down to 5 percent by the end of the year. But I think the Wharton School model, which I have already quoted in another connection, I see in its latest forecasts the unemployment rate has improved. And it has for the first quarter of next year 4¾ percent unemployment, and for the last quarter of this year, right on the nose of 5 percent.

I would say that that, if it materializes, does look to me a little bit more optimistic than the general crowd would justify, even that part of the vector of the forecast.

Representative CONABLE. What about inflation, Mr. Samuelson? There has been a lot of feeling expressed here today that inflation should not be our major concern. What do you think is going to happen to the rate of inflation during this year?

Mr. SAMUELSON. There the administration goal has been a 2- to 3-percent rate of increase in prices by the end of 1972. As a nonpartisan scientist, I had earlier to say that I did not think that was going to be realized.

On the other hand, the latest numbers, such as the 2.1 percent, suggests that no jury will say that this is out of the ball park. In other words, it is quite different from last year, when some of us had cheap fun at the expense of the administration, because no sensible man without his tongue in his cheek—certainly nobody outside of Washington—could have defended the estimates which were then made; I never thought they would be seriously made by those people.

So I think that the expansion is progressing now, I would say, at a healthy rate. I am more optimistic than these forecasters, and I am more pessimistic than Walter Heller. I think that we are going to see some requickening of the price-wage rise of inflation as you move into 1973. But I have had to study the trade-off. And to me the trade-off is so overwhelmingly on the side of mankind, of human being welfare, that you buy so little when you abort the recovery in the interest of inflation—as we have seen from the old game plan—that I would counsel you to face up to the fact that when we have a mixed economy like ours which does its job well, you are going to be in a trade-off position.

I think we have been too hard in the years of this administration, up until the electorate spoke in 1970, when there was a seat change on inflation, and we have been too soft and too much in favor of human misery, letting that happen, in order to police the price line.

So I say that we can afford prosperity even though prosperity brings with it certain uncomfortable symptoms.

Representative CONABLE. Mr. Heller, would you quarrel with any of his general conclusions as to inflation and GNP?

Mr. HELLER. Not really. I would pick up where he left off, first of all, and note that our roughly 3 percent rate of inflation looks pretty good compared to the five and a half percent that is expected in the Common Market this year, and 6 percent that is projected for next year.

I would underscore the fact that I am a little more optimistic than Paul about the period of remission on inflation. We have no demand-pull inflation. As I say, it is nearly $60 billion away. We have a diminishing cost-push, because as demand and production push up, and you spread your fixed costs over more units, you get these very nice dividends of productivity increases.

So I think we have a pretty good curb on inflation at the present time, and we are not likely to have any immediate recurrence. But next year's wage bargains do worry me, and next year's petering out of the productivity increases also worries me. That is why I suggest that we have to gear ourselves up to a new phase of cost-push inflation perhaps later in 1973, and we'll face demand-pull inflation if we do not have a tax increase by 1974.

Representative CONABLE. Would you agree on GNP figures generally?

Mr. HELLER. On the GNP, Mr. Samuelson was gracious enough to call attention to my forecast before the Detroit Economic Club on April 5, 1971, where I said, programing Mr. Nixon and Mr. Connally into my forecost, with November 7, 1972, coming up, we would have our first $100 billion GNP advance in history, about six to six and a half real, and around three and a half percent price.

Well, I am either sticking with or am stuck with that forecast. I was pretty lonesome up there for quite a while, but I find others have climbed aboard. And you never saw rats climb onto a sinking ship. So I feel it was at least a good forecast of what the model forecast was going to be. More seriously, I think it is a good forecast of how the year will turn out.

If anything, Mr. Conable, it may even be a bit modest. We have started out at a faster pace, and while I agree that we won't sustain the 8.9 percent rate of real growth that we had in the second quarter, we are going to have a good year. And side by side with these forces we are going to have some relief from inflation.

I also agree with Paul that for the longer run we have to think very hard about what we consider to be tolerable inflation. That is not an economic decision. That is a decision the country has to make. How much inflation are people willing to trade off for lower unemployment. What is their overall trade off between prices, jobs, and controls? We can do a better job than we have in the past.

Representative CONABLE. Mr. Galbraith, notwithstanding your feeling that there are flies in this ointment, would you care to talk about the basic statistics?

Do you think we are in the ball park?

Mr. GALBRAITH. I must say that I have very little to add.

I would like mildly to reprove my friend Paul Samuelson for continuing to speak of mixed economy. He used that term before the economy became generally controlled, and I would hope that he could revise and modernize his language and call it a controlled economy.

Having done so, it seems that one has to address himself to the relative strengths of the controls on different groups. And here I pick up a point of Walter Heller's. We are going to have a powerful cost-push next year unless something real is done about price control, unless something real is done to limit the rate of increase in profits.

Representative CONABLE. You said in your opening testimony, sir, that profits were at a record high. Are you in any general disagreement with what Mr. Heller said about profits, that they were not reasonable in ratio to the GNP even yet, although they have risen very sharply?

Mr. GALBRAITH. I think I would say that they are wholly adequate. I do not think that the economy is suffering from a deficiency of profits.

Representative CONABLE. I am talking as a matter of economic measure and not as a matter of the moral judgment on profits.

Mr. GALBRAITH. I would not even apply the grandfather clause to equity.

It seems to me one has to look at this problem the way trade unions will look at it and the public at large will look as it. Profits are recovering very rapidly, unemployment has been diminishing very slowly. And the average family income has been constant. This is the way in which it will be looked at.

Representative CONABLE. Are they at a record high as a matter of economic measure?

Mr. GALBRAITH. Yes; in dollar terms they are higher than ever before.

Representative CONABLE. As a percentage of GNP?

Mr. GALBRAITH. As a percentage of GNP I do not have the figure in mind.

Mr. HELLER. No; they are still below the percentage of GNP that they had during most of the sixties, and also in deflated dollars, they are not at an all-time high.

I do not want to cast myself in the role of defenders of excessive corporate profits, anything but that, but I think we have to be reasonable and balanced in our appraisal of profits.

Representative CONABLE. I am asking only about the measure and not the value judgments that are involved here.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

I would like to address myself to the current fiscal year 1973, which started a few weeks ago and, like all fiscal years, it is important.

You all expressed understandable outrage at the suggestion of the President that Congress legislate a $250 billion spending ceiling. Apparently, the philosophy of the administration is that the Government can spend up to the full employment deficit line, and then about $3 billion more, and all will be well—there will be about $220 billion worth of revenue and a full employment balanced budget would be at about $247 billion; in fact, Mr. Nixon says he will hold expenditures to $250 billion and, in fact, estimates of the actual appropriations, which, of course, aren't yet all made, range up to $260 billion, and so on; in other words, a total deficit of $39 or $40 billion.

Now, I will start with Mr. Heller. Do you see any place where expenditures do become too much of a good thing? I am sure you do, and we all know that we had too much of a good thing too fast—in 1967, for instance—and some of our woes are traceable to that, although they could have been cleared up, you and I think, sooner. But what is the black letter law on how to be a heavy spender yet responsible? How do you know when to stop?

Mr. HELLER. You know, first of all, that the answer to that is politically pretty unpopular. The way to be responsible is not to push spending beyond the level that you are willing to to match by taxes in terms of a full-employment economy, when you are at full employment. There is nothing sacrosanct about a full-employment balanced budget. We should run a full-employment deficit when we are in the kind of sluggish economy we have had; and then if we run into inflation problems we ought to run a full-employment surplus. But that is no way of deciding what the American people want by way of priorities between the public sector and the private sector. I don't think there is any magic way to determine that at all.

Representative REUSS. I perhaps am not making myself clear. When we actually, no fooling, get to 3-percent unemployment, then you and I will have no problem, assuming that we correctly interpret public desire for the kind of public goods they want. We then have to tax at an amount which will at least balance that budget; is that not true?

Mr. HELLER. Generally speaking, that is correct.

Representative REUSS. Is that not current wisdom?

Mr. HELLER. One can imagine an economy where you can't get to full employment and stay there without full-employment deficits. But I don't like to conclude that our economy is deficient in that respect.

Representative REUSS. The question is, how much more than a full-employment deficit do we need? A full-employment balance is needed when we actually get to full employment. But apparently, in the lore of spending, one is permitted a greater latitude when you are on your way up than when you are there. You come out this morning, faced with a $250 billion spending ceiling, and you say that isn't enough, and yet that $250 billion spending would take us past the full employment bulk line plus about $3 billion, and a cigar for errors.

Now, very frankly, I'm not sure I know what I'm doing. Can you help me? Where do we call a halt? Should we enact a $260 billion spending ceiling? 265, 255?

Mr. HELLER. I have already indicated—perhaps when you were out of the hearing room—that I don't believe Congress is now geared up to apply and hold a spending ceiling. There are circumstances under which that is a good idea, but as of now, those circumstances—just purely mechanical, physical, administrative arrangements—don't exist.

Now, what you are really asking me is not how high should spending be, but how high should the full-employment deficit be under circumstances where the economy is running $60 billion or so below full employment.

Representative REUSS. Exactly. Subtract from your spending ceiling what you are going to raise by quick yield taxes, loophole plugging, or anything else. Mr. Nixon says the deficit should be just about $3 billion over the full employment bulk line.

Mr. HELLER. He may say that but, of course, his deficit will be running about $9 billion in NIA terms at full employment in the current half-year. I think that is fine; let it run for the present because the economy——

Representative REUSS. How much more?

Mr. HELLER. Well, if I were sure that we could have instant reversal I would let it go even higher, but instant reversal is not in our system of government a very easy thing. So I would say let it go to $9 or $10 billion now, and then start tapering it off in 1973. The $20 billion automatic annual growth in revenues will help you do that. Later as you get closer to the resurgence of demand pressure—you don't try to handle cost-push pressure by the budget, that's a job for structural changes, manpower and wage-price policy—when you again face excess demand pressure, then put in these tax increases that are going to bring the budget back into balance, and if need be, into surplus. But don't do it prematurely and choke off what is really still a fledgling recovery by any reasonably ambitious standard for the U.S. economy.

Representative REUSS. I think I have almost grasped you. Let me make sure. When we actually get to no fooling, sure enough, real, only 3 percent unemployment, full employment, then you want no deficit, perhaps a surplus, but no deficit.

But what is your rule for the amount of the deficit while we are on our way? We have been on our way since the memory of man runneth not; but, anyway, what is your current 1972 rule?

Mr. HELLER. My current 1972 rule, in the light of the amount of demand being generated by the private economy, and particularly the amount of investment demand, is in the general range of a $10 billion deficit at an annual rate—in full employment, national income account terms—for the coming months; and then as you get into 1973, as you begin to get closer to the economy's potential, then that ought to be tapered off and eventually converted into a balanced budget or surplus.

Representative REUSS. Why 10? Why not 20?

Mr. HELLER. Well, this is on the basis of an assessment of (*a*) how much demand the private economy is generating; and (*b*) the speed limits that you have to observe in the economy in order to avoid shortages, excess demand in some sectors, and so forth. In other words, we have a capacity and a speed limit problem. If the Fed doesn't prematurely step on the brakes, and if the President doesn't ruthlessly slash the budget, this economy is going to be moving up at a very strong clip. That being the case, I think a $20 billion deficit would be inviting inflationary excesses.

Representative REUSS. Mr. Samuelson.

Mr. SAMUELSON. Mr. Reuss, may I put a caveat into the record which I hope you will not listen to. If you understand what Professor Heller said, it may be as much of the truth as you can use, fully use; but my conscience requires me to state what I regard as the truth.

I don't think that the proper way of running a railroad is to have full employment, a balanced budget. That is a shibboleth which is no better than the shibboleth of having a budget balanced at all times, even in 1932, in the depth of the depression.

But it could well be that in a full employment economy preserved in that happy state over a period of a decade, that the proper policy would require a surplus, or the proper policy could require a deficit, because it might be that the only way you stay at that full employment is by the needed stimulus.

Now, I have said that for my scientific conscience, and having said that, I hope you will disregard it.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PROXMIRE. Gentlemen, I am in a position here that is embarrassing for all of us, because Senator Javits does have to leave and Senator Javits wants to make a statement on what happened yesterday. I have some more questions and perhaps the other members do, too, and you are such a distinguished panel, and although the hour is late, I would like to ask a couple of questions that I think are very critical. But I yield 2 minutes—is what Senator Javits asked—for a statement he would like to make on what happened yesterday with Chairman Burns.

Senator JAVITS. I thank the chairman.

I really appreciate this because I am under very difficult time pressure, and I apologize to the witnesses.

Yesterday after I left the committee the chairman had quite a set-to with Chairman Burns of the Federal Reserve because the Chair felt—obviously very deeply, because the criticism was very harsh—Burns had not responded adequately to certain demands of the Chair about the sources, insofar as he could ascertain them, or the Board could ascertain them, of the certain Federal Reserve bills found on the miscreants who were arrested for bugging the Democratic National Committee's offices, and then found also in the quarters they occupied.

The statements were as follows:

> Frankly, Chairman Burns, one would have to be naive not to believe that the Federal Reserve Board is covering up for someone higher in the Executive Branch. That is especially true since it has now been revealed that there were clear the White House and Reelect Nixon campaign connections with the event.

Now, Mr. Chairman, I have known Arthur Burns for 22 years or more and I would affirm on my own honor his complete objectivity, his really basic nonpartisanship and the complete integrity of the man.

I think he was properly disturbed by such a charge, especially as it goes back to the controversy—this controversy which originated in June of 1972, when the Chair also was very harsh on him as the Chairman of the Board in a press release which said: "I think their refusal"—that of the Board—"to cooperate in these disclosures the Chair wanted was both a despicable act and unworthy of them as an arm of the Congress."

Now the Chairman of the Federal Reserve had issued a statement which I take absolutely—on June 21, pointing out that he had been asked, after they had this chance to get some of this information, not to disclose it as it might prejudice the conduct of the investigation and any subsequent prosecution and as a deputy of civil liberties he had to try to do what he could as an individual citizen in response to that injunction of the U.S. Attorney and the Department of Justice.

So, Mr. Chairman, I would like unanimous consent to include the various press releases in question, that of Senator Proxmire of June 19 and June 20, and that of Mr. Burns, or his organization, the Federal Reserve, on June 21.

Chairman PROXMIRE. Without objection, the press releases will be incorporated in the record at this point.

(The press releases follow:)

OFFICE OF SENATOR WILLIAM PROXMIRE, OF WISCONSIN, PRESS RELEASE, JUNE 19, 1972

Senator William Proxmire (D–Wis.) said Monday that "I have asked the Federal Reserve Board the name of the bank or banks and the circumstances under which an estimated $6,300 in $100 bills was issued to the men caught 'bugging' the Democratic Committee's National Headquarters."

Proxmire is ranking Democratic Member of the Senate Banking Committee and Chairman of its Financial Institutions Subcommittee.

"The press reports that some $2,300 in $100 bills were found on the men when they were caught. Another four packages of $100 bills were found in the suspects hotel rooms. Reports are that all the $100 bills were in numerical sequence.

"The Federal Reserve System is an agency of Congress and issues Federal Reserve notes to the Banking System. It is my understanding that in any transaction involving sums of this amount in bills of this size, banks are required to record the details of the transaction.

"In order to make certain that this matter is not swept under the rug, I have asked the Federal Reserve Board to report to me today the name of the bank or banks involved, the names of the person or persons receiving the funds, the amount and source of the check or financial instrument used to purchase the $100 bills, and other pertinent details.

"I have asked the Federal Reserve Board to report their progress to me by noon today and to give me the full details before the end of the day."

OFFICE OF SENATOR WILLIAM PROXMIRE, OF WISCONSIN, PRESS RELEASE, JUNE 20, 1972

Senator William Proxmire (D–Wis.) charged late Tuesday that "The Federal Reserve Board ducked, misled, hid out, avoided calls, and gave us the idiot treatment in connection with my request Monday for a report to me on the name of the bank or banks involved in issuing the $100 Federal Reserve bills found on the men caught bugging the Democratic National Committee.

"I think their refusal to co-operate was both a despicable act and unworthy of them as an arm of the Congress," Proxmire said.

"As the ranking Democratic Member of the Senate Banking Committee and as Chairman of the Financial Institutions Subcommittee, before 10:00 a.m. on Monday June 19th I not only requested the names of the bank or banks which issued the notes but also the name of the person or persons receiving the funds (estimated at $6,300), the source of the check or financial instrument used to purchase the $100 bills, and other pertinent details."

"I did this for several reasons. First, Federal Reserve notes were involved, they were in numerical sequence, and commercial banks keep details of transactions of this size. Those who paid for this job might be traced through the bills.

"Second, in this case the Executive Branch is a party of interest. One of the men caught was directly connected with the Nixon campaign. I hope that higher ups may be innocent of these wrong-doings. But with the Executive Branch having a conflict of interest, it was essential that the Federal Reserve Board, which is an agent of the Congress, should give Congress the facts promptly, fully, and completely.

"Until 4:00 p.m. on Tuesday, the Federal Reserve gave us the run-around. At the same time that the FBI told my staff on Monday they had already been in touch with the Federal Reserve to identify where the bills came from, Chairman Arthur Burns wrote me that 'We at the Board have no knowledge of the Federal Reserve bank which issues those particular notes . . .'

"Until 4:00 p.m. Tuesday, even after newsmen had traced the bills to the Miami and Philadelphia Federal Reserve Districts, the Federal Reserve was telling my staff they had no information and the Reserve Bank at Philadelphia refused to return our calls. Finally, at 4:00 Tuesday the Federal Reserve stated that the information '. . . should not be released to anyone other than the investigative authorities,' namely the FBI and Justice Department."

"The fact that the Federal Reserve, an agent of Congress and independent of the Executive Branch refused to co-operate with Congress while falling all over itself to aid the Executive Branch suggests they have something to hide.

"One would have to be extraordinarily naive not to feel the Federal Reserve may be covering up for someone high in the Executive Branch of our government who is directly involved with the espionage action against the Democratic National Committee.

"Chairman Arthur Burns should re-read the Constitution. It provides that Congress, not the Executive, has the money power. Under our Constitution the Federal Reserve Board is directly obligated to Congress and is independent of the Executive Branch.

"Certainly with the President of the United States and his supporters a party at interest, the Federal Reserve Board should recognize their clear Constitutional obligation to the Congress. In this case they have failed to do so!"

FEDERAL RESERVE, PRESS RELEASE, JUNE 21, 1972

In view of incorrect statements made concerning the Federal Reserve System in connection with a break-in at the national headquarters of the Democratic Party, the Federal Reserve Board today made the following statement:

"The Federal Reserve System is making every effort to assist the legally responsible law enforcement agencies in ascertaining the facts.

"The Federal Reserve Banks have supplied them with all pertinent information in their possession.

"We have been advised by the U.S. Attorney for the District of Columbia that disclosure at this time of any information that may be in our possession could prejudice the conduct of the investigation and any subsequent prosecuton, and that there consequently should be no disclosure except to the responsible law enforcement agencies.

"We wish to cooperate fully with all who are interested in ascertaining the facts, but we feel that our primary duty at this time is to accede to the advice of the legally constituted enforcement authorities, and we are doing so."

Chairman Burns received a letter from Senator Proxmire on June 19, and he replied the same day. A copy of Senator Proxmire's letter of June 19, which is the only direct communication from the Senator to the Board, is attached together with Chairman Burns' reply of the same day.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., June 19, 1972.

Hon. ARTHUR BURNS,
Chairman, The Federal Reserve Board,
Washington, D.C.

DEAR MR. CHAIRMAN: This letter is to confirm the verbal request my administrative assistant made of Mr. Rippey at 10:00 a.m. today for a report to me today of the name of the bank or banks involved in issuing the $100 bills found on the men caught "bugging" the Democratic National Committee. I also wish to know the name of the person or persons receiving those funds (estimated at $6,300), the source of the check or financial instrument used to purchase the $100 bills, and other pertinent details.

This is a most serious matter and must not be swept under the rug or hidden by the Treasury or Secret Service.

As $100 Federal Reserve notes were involved, as reportedly they were in numerical sequence, and as you and the banks keep details of transactions of this size, I am asking for the information forthwith.

With best wishes.

Sincerely,

WILLIAM PROXMIRE,
United States Senate, Chairman.

June 19, 1972.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I have your letter of June 19 and I am aware of newspaper stories concerning the event you mentioned.

We at the Board have no knowledge of the Federal Reserve bank which issued those particular notes or of the commercial bank to which they were transferred. Without this information, there is nothing that we can do to comply with your request.

We assume that the investigative authorities have pertinent factual information with respect to the notes. Upon request by the investigative authorities, and once they make such information available to us, we shall of course be glad to cooperate in every possible way.

Sincerely yours,

ARTHUR F. BURNS.

Senator JAVITS. I would just like to make these points: First, this is a nongermane issue; it was not germane to the committee's inquiry. If anything, it fell in the chairman's role as a member of the Banking and Currency Committee. Here we are dealing with a midyear review of the economy.

Second, the Chair has said, and I quote from yesterday's hearing: "Will you now turn over to the Congress the information as to who received the $100 bills?"

Well, with all respect, the chairman knows what I think of him. I think he is one of the finest Members we have and one of the finest Members in the history of the Senate, but he is still not the Congress, then, and neither am I, or neither is anybody else, and no committee or no Congress has asked that Chairman Burns do this.

Third, I think we have to understand a man's being between the devil and the deep blue sea. The prosecutor tells him not to do it and a Senator demands that he should do it; and fourth, as to good faith, honesty, and integrity and devotion to the Constitution, love of his country, nonpartisanship, I would stake my honor on Arthur Burns.

And that is all, Mr. Chairman; and these flurries have a way of blowing over and about the only thing that is left is the scar to the man. And, to me, this is the most important, and I make the statement for that purpose.

Chairman PROXMIRE. Well, Senator Javits, let me reply by saying that I have as much regard for Arthur Burns as you do; he is a man of complete integrity. I have never questioned his honesty and his honor. I am sure that he acted with integrity in this matter.

Let me simply give you—and I have a statement here—my view of what happened:

Last June 19, I both telephoned and wrote to the Federal Reserve Board asking them for the name of the bank or banks and the circumstances under which an estimated $6,300 in $100 bills was issued to the men caught bugging the Democratic National Committee Headquarters.

I wrote to the Board in my capacity as member of the Senate Banking Committee and chairman of its Financial Institutions Subcommittee. I sought this information from the Federal Reserve Board for several reasons: First of all, the Federal Reserve Board is an agent of the Congress. The Banking Committee has jurisdiction over them. We have delegated to them the power given by article 1, section 8 of the Constitution to "* * * coin money and regulate the value thereof" to Congress. I have as much right to ask them for information they have as I have to ask the General Accounting Office, the Secretary of the Senate, or the Library of Congress. They are a congressional body, not under the executive branch. That is why I asked them for information clearly in their domain, rather than to go to the FBI or the U.S. attorney or some executive branch agency.

Second, I asked them for the information because the executive branch, in this case, is a party of interest. The Democratic National Committee was "bugged." Those who did the "bugging" had connections with lower level members of the White House staff, persons who had worked for the Nixon Campaign Committee, and those who had been retained as consultants to staff members of the White House. I felt that with the executive branch having a conflict of interest it was essential for the Federal Reserve Board, which is an agent of Congress, to give us the facts promptly, fully and completely so that they would not be swept under the rug.

The third reason I asked the Federal Reserve Board was that from the nature of the circumstances, it was clear they had or could get detailed information about this matter. The reports were that the $100 bills were in numerical sequence; they had to be Federal Reserve notes. Records are kept as to which Federal Reserve District gets specific Federal Reserve notes. They, in turn, know which banks receive them. Banks generally keep records when large amounts in $100 bills are given out over the counter. Tellers write down that information or if they don't there is every reason to believe they would remember who got amounts of that size.

Furthermore, those who get the $100 bills from a specific bank, had to give that bank some financial instrument—a check, a money order, a cashier's check, or some other specific instrument for the bills. And that check or money order or cashier's check could itself be traced. It would most likely reveal who was behind this matter.

That would be a factual matter. The revelation that the financial instrument used to purchase the $100 bills was signed by Mr. X or Institution A or Campaign Committee B, could be no more damaging than the fact that the name of a White House consultant was found in the black book of those caught bugging.

The fact is that the mere revelation of whose name was on that financial instrument by no means would necessarily impede an investigation or jeopardize the rights of defendants. And that was the reason given yesterday by Mr. Burns for not turning over this information at my request.

Instead, this would be a fact, not a rumor. It would not be an allegation being investigated.

Someone paid for the $100 bills. The records should show who they are. The Fed is covering up for someone. The question is who.

Furthermore, if, after giving me the name or names, the Justice Department or FBI or U.S. Attorney's Office could show in good faith that revelation would, in fact, impede an investigation or harm the rights of a defendant, and that they were not using the fact as an excuse to cover this whole matter up or sweep it under the rug until after November, I would, in fact, agree not to reveal the name. But, instead, the Federal Reserve, apparently on its own initiative, even though it is an agent of Congress, has refused to reveal this factual information to me while at the same time giving it to the Executive Agencies of the Government which has an obvious conflict in the entire matter.

And let me make this point as well: At no time in my memory has the Federal Reserve said directly that the FBI or the U.S. Attorney has told them not to give us this information. Chairman Burns' reply to that question was indirect. He had no letter or formal request that this had happened. In addition, the Federal Reserve's initial statement did not say the information was prejudicial but only that it "could be" prejudicial.

Yesterday when I asked Chairman Burns, "* * * did the FBI or any other Federal agency specifically request that you not disclose this information?" Mr. Burns replied: "I can't make it that rigid. I did not carry on the conversation myself."

When I asked him, "Is there anything in writing to indicate that they asked you to withhold that information?" Mr. Burns replied: "I don't have anything in writing."

The question is, what right has any person who gave funds to purchase those $100 bills—the same bills that were found on the persons and in the rooms of those persons who broke into the Democratic National Committee Headquarters—what right has such a person to be protected from public revelation?

If he is innocent of any connection with the situation, he can say so. Let him explain to whom he gave the money and the circumstances. Public revelation could not damage him.

If Mr. Burns or the FBI or the U.S. Attorney can show how such revelation could either impede the investigation or damage the rights of a defendant, let them show us and tell us why.

Why, here's why: They are more concerned about impeding the reelection of President Nixon or damaging the image of the Nixon Campaign Committee rather than some newly found concern for the rights of a defendant by a Justice Department which has routinely requested legislation to limit rights of defendants.

Now, as I said, I have great respect for Mr. Burns. If this scars him or troubles him, I feel very badly about it. I don't see why any of this should make him feel that his integrity is being questioned. I asked for information and we have a right to get it; and I think there is a coverup here and I think I have every reason to press for full disclosure and I intend to do so.

Senator Javits. Mr. Chairman, I would just like to conclude by saying, first, that that is where the matter rests and, second, I deeply believe, Mr. Chairman, that there is no coverup and that Arthur Burns is proceeding as any man would who has a concern for civil liberties; and there is only one way to enforce the law and that is through established agencies and if our people think the law is going to be twisted in its enforcement as to the political parties, we are in a bad way.

However, we are not going to settle it; and I thank the Chair for giving me the opportunity of expressing myself frankly.

Chairman PROXMIRE. Thank you, Senator Javits, and perhaps now we can proceed to get back to the economic situation.

I would like to ask you gentlemen this: This committee has commissioned Data Resources, Incorporated, to make a study of what happens if we use our controls—we have in effect at the present time price and wage controls—and if we proceed to try to get the full employment down below 4 percent, now under 3 percent, maybe even down to 2 percent? It seems to me that this has enormous promise and great potential benefits. Now, there is a real cost here. We have to have controls in effect. Maybe we would have to have them in effect for a long time, and maybe 2 percent is too low, but, gentlemen, when we look at the record of other countries, when we look at the facts that France, for example, has an unemployment rate of 2.7 percent, Germany an unemployment rate of 0.7 of 1 percent, Japan an unemployment rate of 1.3 percent—in each case the inflation rate in those countries is very comparable to our inflation rate, a little higher, but not greatly higher. Germany has had that low unemployment rate of around 1 percent for 8 years now and they have averaged 3 percent inflation. Those are free enterprise economies; they don't even have controls.

What I would like to ask you is to comment, because you are three of the outstanding economists in the country, why can't we get off this notion that 4 percent unemployment is the full employment figure, or even 3 percent, and recognize the success that other countries have had, and consider readjusting ourselves.

Mr. Galbraith, would you lead off?

Mr. GALBRAITH. I just have two comments on that.

It seems to me that this is a very well taken point and something that needs to be taken very seriously.

There is an element of caution that always needs to be raised about the German figures and to some extent the other European figures. They draw their labor from Yugoslavia, Spain, southern Italy, and Turkey; and one doesn't count the unemployment or the disguised unemployment that exists back in those countries. So that in some degree the unemployment situation in Germany or in the Low Countries or Switzerland, gives a false picture in comparison with the countries where the "reserve" of workers is within the national boundaries as it is in our case.

Having said that, it does seem to me, however, that a much more powerful position on cost-push inflation involves a much stronger price control, a much stronger price control in the area where the cost-push inflation occurs, coupled with the kind of willingness that Walter Heller just mentioned, to reverse course very quickly when one sees the demand-pull inflation taking over, coupled, of course, with energetic measures to train workers to overcome structural problems of the labor force.

All of those things taken together should make possible the reduction of unemployment to very much below the levels that we are now talking about. We may remind ourselves that in World War II we got unemployment down to around 1 percent of the labor force, and we held prices for a substantial period in the face of a very large excess of demand.

Chairman PROXMIRE. Wasn't this true, Mr. Galbraith, that was the last time we had a really effective distribution of income, and in the most acceptable way—in a way that even conservative people can approve—by putting everyone to work.

Mr. GALBRAITH. This is an incredibly important point. This was also a period when one had a very rapid grading up of the less well paid parts of the labor force.

Chairman PROXMIRE. It seems to me that it is something that would help the minority groups in this country—the teenagers, the women, all those who are the fall guys in the present method of fighting inflation.

Mr. GALBRAITH. The greatest period of economic progress as far as black workers are concerned, for example, was during the years 1940–45. Under the pressure of demand they were trained and added to the labor force, and wage rates were graded up to the levels of the people who had already been there; there is no question about it.

Chairman PROXMIRE. At 2 percent unemployment, as I calculate, we would have about a $50 billion increase in Federal revenues with a tax increase.

Mr. GALBRAITH. We must, it seems to me, be clear on two points: We should not imagine that this allows us to have a continuing major excess of demand. The fiscal rules that Walter just announced still hold. We have got to maintain an approximate equilibrium between effective demand and supply at this level of employment. We have a little extra margin, perhaps, for some added pressure of demand; but this is not something which should be exploited.

The other point that I wanted to emphasize escapes my mind. It could not have been important.

Chairman PROXMIRE. Mr. Heller.

Mr. HELLER. I think you know, Senator, that I am very much in sympathy with the direction of your comments, and that indeed I have been criticizing current policy for being willing to settle for much too high an unemployment rate in the hope that they can combat inflation at the cost of precisely those groups you are talking about. I would hope that we could move to higher levels of unemployment through the structural measures to which Ken Galbraith just referred, coupled with a rather careful and selective set of wage-price restraints. You know the thing that stops us from going in a sense all the way with you is our fear that the only way you could get to 2 percent unemployment is by generating the kind of inflation that would require a complete straitjacket of controls over the American economy.

Now, I would put it this way: If we aren't ingenious and clever enough and courageous enough to work out a system of structural reforms and reasonable wage-price restraints that enable us to get below 4 percent unemployment, and if we aren't willing through the governmental budget to provide for these disadvantaged groups, then I would reluctantly have to say, OK, let's go to the World War II model. It would be with the greatest reluctance as a last resort, as a confession of social and political failure, but both you and Professor Galbraith are absolutely right—it was the one time we had true full employment, and we don't need war to do it. We have proxies, thank heaven, in terms of good social programs, proxies for war in economic terms. The black unemployment rate did go down to one-half of 1 percent; in other words, suppressed inflation in a sense did the job that we are refusing to do in terms of governmental programs and support for the disadvantaged.

As I say, it would be a last resort. I hope we can do it without that kind of a straitjacket economy, but if in the course of the coming years we find no other way to do it, we may be forced to that kind of a solution, to do essential social justice.

Chairman PROXMIRE. When you correct your remarks, will you supply some of the structural reforms that you think are essential in order to achieve this without a straitjacket?

Mr. HELLER. Yes.

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

A balanced program to shift the Phillips Curve—to better the trade-off between unemployment and inflation—would include at least four types of measures:

1. The semi-voluntary type of wage-price restraints briefly described in my prepared statement—this would be an institutional rather than a structural change as such.

2. Measures to step up the increase in productivity (i.e., getting more output per unit of input) by increased investment in human brainpower and skills, plant and equipment, and research and development. (This category overlaps somewhat with numbers 3 and 4.)

3. Labor market policy: Manpower training, development, and placement, including the whole array of pre-job, on-the-job, and between-jobs training and re-training; an improved and nationalized system of labor exchanges; specialized job-creation programs—public service jobs, youth opportunities, and the like—with emphasis on hiring young people, non-white, women, and other groups with a high incidence of unemployment; and adaptation of jobs to people, i.e., redesigning jobs in at least two ways, (a) to make some jobs more available to less skilled and experienced workers and (b) to make other jobs more challenging and less routine as a means of motivating skilled and experienced workers.

4. Structural changes to remove rigidities and impediments to efficient, least-cost, ways of doing things and to pull out artificial props that operate to hold prices at unnaturally high levels. The actions required here comprise a long, demanding, and politically painful list, for example, removing import quotas; renegotiating tariff rates; repealing the Davis-Bacon Act; eliminating featherbedding and other restrictive labor practices; modernizing and liberalizing archaic local building codes; eliminating racial discrimination in jobs and in the educational, training, and placement facilities that lead to jobs (measures that have been estimated to add about 4 percent, or $45 billion, a year to GNP); intensifying anti-trust activities; reducing farm price supports and redesigning farm subsidies to minimize their price-push effects; reforming our income tax laws to reduce or remove tax shelters for oil and gas, commercial housing, mining, hobby farming, and the like, i.e., cut back the "tax expenditure" subsidies that pull resources out of their natural channels into less efficient tax-favored pursuits; eliminate "fair trade" laws (which, according to recent estimates, add about three-tenths of a percentage point to the consumer price index); and in the field of transportation rates, rely more heavily on competition among and within various modes of transportation as a substitute for the relatively ineffectual regulatory processes that now obtain.

Chairman PROXMIRE. Mr. Galbraith.

Mr. GALBRAITH. I just want to add the one word that I had forgotten earlier.

We have a substantial area where demand still operates. That is why the fiscal balance is important. The key, however, is strong action on what is now called the tier 1 prices—the prices of the industrial corporations. Here we come to a very important political point. We will not have the kind of controls that are needed if one has a cozy relationship between the administration and the corporation being controlled. This calls for toughness.

I speak, I think, with perhaps more experience than any man still alive on this subject. I was in charge of this operation for the first 2 years of World War II. I have said many times that you needed a perverse desire to be disliked in order to do this job. And nobody ever left my office at the Office of Price Administration liking me. When I finished in 1943 President Roosevelt offered me a job in South Africa. South Africa at that time did not have the unfavorable connotation that it has since acquired, but even then I knew the President was trying to tell me something. This, it seems to me, is the problem with the present administration. It is politically and emotionally identified with the big corporations. It is not going to do this job with the necessary firmness—I don't think.

Chairman PROXMIRE. Mr. Samuelson.

Mr. SAMUELSON. I think that one can welcome any study that the Data Resources Corp. makes, and I applaud that. But I think when it makes that study, and if it surveys the other economies abroad, and the experience in peace and war, it will come up with the finding that the Phillips curve of the United States, the tradeoff between unemployment and inflation, can be, and has long been, a less favorable one than, say, that of the Federal German Republic, that running the railroad as it has been run in the last 20 years or as it has been run for the last couple of centuries cannot possibly permit you to have a 2-percent unemployment rate which will please your constituency in Wisconsin, both the conservative and the others, with reasonably stable price levels.

Now, this doesn't mean that if you depart from those patterns, that if you go in peacetime in the direction that you can go in wartime, and in which I may say you can go for the limited number of years of wartime, I don't think that World War II experience in the United States would have been the same if we had had a 10-year war as it was able to be when we had a war in which we were in it for 3 or 4 years. I welcome all the measures which can enable us to go from a 4-percent goal below a 4-percent goal. But they have to be new measures, they have to be public employment measures, they have to be manpower measures. And you are not able in advance, by analysis or by marshaling past experience, to assert with confidence how much each of those are going to get you.

As an example, I call to your attention the Brookings current reports.

A learned member of the Urban Institute prepared very good estimates of what you would gain in the way of extra reduction of unemployment by various manpower programs.

And another economist of no less stature deflated those by 90 percent.

Now, I don't know which of those is right, and I don't know at what point in between.

Chairman PROXMIRE. Isn't the best manpower training program scarce labor supply. So, that private employers have to train the people who are unskilled, and they have to train the blacks and the teenagers and the others that they aren't hiring now. And that has always been true.

Now, we have emphasis on manpower training programs in the Congress now. But when you train a person now it is very hard to assure that he gets a job. For many that training is a tough discipline for most people who are unskilled, and if there is no job at the end, it is a shattering experience for them.

Mr. SAMUELSON. Senator, don't push me into the corner of saying that high employment is not a good thing. It is a very good thing. But I thought you wanted a discussion——

Chairman PROXMIRE. Yes; I do.

Mr. SAMUELSON (continuing). Of what the range of probabilities are, as a consequence to that.

I reproached Members of this Congress for not having voted for higher taxes in the 1965 to 1968 period. Why should I have done that, if we were, as we were, far above the 2-percent unemployment level we are speaking of? I did so because it was my judgment, based upon the experience of countries abroad, and looking at these statistics which you have looked at, and looking at our experience, using analysis, that when we got very far below 4-percent unemployment without changing the rules—and we did get to 3½ percent—that you would find the stability of the price level—I correct myself—we had no stability of the price levels in those days, but we had a 1-percent increase, what we call reasonable price stability—that would vanish. And it did vanish. We had 3⅓-percent unemployment when this administration took over. And the realistic people who will study that experience said that this is not going to be compatible with the existing behavior of the price level, and it was not. We had the rate of inflation go up from 2 to 3 to 4 to 5 and to 6 percent, and then we stopped driving.

Now, I hope that when Data Resources does that study for you that it will find the confirming findings of economists everywhere and will scrutinize them.

I will simply say—if I may mention a man of great integrity who was brought into this discussion earlier—I had the unpleasant ordeal of debating in Washington years ago against Arthur Burns. We were debating wage-price controls. He was agin' them, I was supposed to be in defense of them. I did not look forward to the slaughter.

By the way, this is the same Mr. Burns who later urged upon the administration an incomes policy, and I applaud him for his change of position.

Being in need of ammunition, I was heartened by the fact that just this morning there arrived in the mail the page proofs of a new book by Mr. Kenneth Galbraith. And I would have taken help from the devil on that occasion. So, I literally flew through the index for ammunition in this regard.

And let me report my findings, because I am under oath here, and I do so.

What I found was in effect—and I knew this wouldn't stand up in that debate, and I didn't dare use it—that in wartime we control prices. Peace is not essentially different from war—I am glossing over some technical errors that marred the first edition of that book. And I think that you will not find it an easy thing to create the employment opportunities which I agree the war brought to the black minority workers by endeavoring to replicate in peacetime the demand siege economy which went down very well during the war. Moreover, that itself was not without consequences.

After the war, we had a tremendous jump in prices in 1947. If you examine the Federal Reserve Board statistics at that time, the rate of growth of the money supply—I understand that the people in the Middle West have done that during that period—if you examine fiscal policy, you could not find in any way of the multiplicands of the usual macroeconomics an explanation of why the price levels almost double. I suggest that these controls work very well in the short run, if there is strong determination on the part not of some Congressman but of the people at large to make them work, but they increasingly become difficult to be made to work.

And I think we can study the experience abroad, because many of those countries you will note did use wage and price controls.

But the way a country like Holland, with its homogeneity, can implement wage and price controls, or Sweden, is so different from this country. Who can speak for the employers of the country? A committee of responsible Swedish burghers can do that. Who can speak in this country for labor? Certainly not George Meany, when it comes to what the rate of increase of wages will be. And this room isn't big enough to put the number of people who are needed to speak for labor of the few hundred trade unions that deal with the thousands largest corporations, and none of them have any right to speak for the others.

Moreover, in those countries you have parliamentry government where the government is in there both as a referee, and as an auditor, and they cannot make these siege command economies correct.

I don't think that if there is a Swedish Galbraith, with all the rhetoric of Galbraith—and I don't suppose that that is the case—that it could be made to work in those countries.

Now, in order that we not go to some ridiculous 35 percent goal in place of 4 percent, your kind of argument may be a good argument to use, talk about 2 or 3 percent. But the betting odds are that unless you find some much better programs than as yet we have come with and Congress is willing to legislate, it is a cruel hoax on the American people and upon the constituency of the Wisconsin side to tell them that that extra $50 billion of taxes will be engendered by our succeeding in lowering the gap by that amount in a lasting regime with regional price stability.

Chairman PROXMIRE. What you are saying is that the Phillips curve is different in this country, perforce a worse trade-off between unemployment and inflation. You didn't say why, but I think we all recognize that there are differences—but it is not all clear why we can't have the kind of economic performance that they have in France, Japan, Germany, and every other economy in the world except Canada, which sneezes when we get a cold, they are so dependent on us. And I cannot understand that for the life of me. What makes a person employable should be a skill. There is no reason why the blacks, why women, why teenagers—who are the best educated we have ever had, better educated than adults by and large—why they should be unemployed. There is a matter of prejudice, there is a matter of custom and habit, and so forth. But that should not be enough.

Let me just ask one other question, because I think you gentlemen have made your position clear, and I think you can respond to this quite briefly. The spokesmen for the administration have refused to give us a goal for unemployment. They have indicated that they more or less favor 4 percent. But they won't tell us when. And my argument is that unless they tell us when they are going to achieve that goal, there is no way to measure their performance, and there is not the same kind of force behind this.

I can remember, Mr. Heller, that when you were Chairman of the Council of Economic Advisers you had a 4 percent-goal and you had a specific time to achieve it. We can't elicit that from this administration. I tried very hard to get Mr. Stein, and Secretary Shultz, and Mr. Weinberger, and Mr. Burns, and none of them would agree that we should try to get to 4 percent unemployment by the end of 1973 or 1974. And to get to 4 percent unemployment by the end of 1975 means we have to grow at 6 percent per year in real terms, as you know.

Now, wouldn't it be desirable—is it not desirable, isn't it essential, if we are going to give anything like the same kind of emphasis to unemployment as we do to inflation, to set a goal and a time to achieve that 4-percent level the same way we have set a goal and a time to achieve the 3-percent level of inflation? It looks like we are going to achieve that goal. We set the goal; and we are going to get to it, perhaps, it is certainly possible. But we haven't set any goal for unemployment. Would you agree that we should have a time as well as a figure, and it should be 4 percent?

Mr. HELLER. Mr. Chairman, I couldn't agree more. And the bias that Mr. Galbraith has talked about, it seems to me, is reflected in the fact that we do have a goal for inflation, but no goal for full employment.

Now, why don't we? Well, partly because when you—I was going to say psychoanalyze, but let's say economicanalyze—their thinking, and translate the calculations of the gap that they make, for example, back to the corresponding full employment goal, you find that they really are not aiming at 4 percent.

Let me give you one example. Paul McCracken, who was recently liberated from the administration, speaks, and spoke soon after he left, of a GNP gap—that is, the gap between our present and our potential GNP—that is between 2 and 3 percentage points smaller than the gap you get with a 4 percent unemployment target. I translate that back to an apparent goal of about 4¾ unemployment.

So, I think your No. 1 problem is, they don't really believe in 4 percent.

No. 2, they were burned so often in predicting, in saying that it was possible to get there without much inflation and indeed initially that you could get rid of inflation without unemployment, that I think that they are gun shy. They don't really in a sense believe in their own ability to get there. And that may call for certain changes.

But I don't want to inject a political note.

Chairman PROXMIRE. Mr. Galbraith.

Mr. GALBRAITH. I agree with that.

Chairman PROXMIRE. Mr. Samuelson.

Mr. SAMUELSON. I want to emphasize the point that I don't believe that the administration and the administration economists have their heart in 4 percent at all. In Boca Raton, Fla., I debated with Mr. Ezra Solomon just last December—you knew the economy was better, because the previous year no administration economist would appear on the platform with the likes of me. Well, times were better. And Mr. Solomon explained why 4 percent, if that was the right goal years ago why that would not be correct now in terms of demographic change. The last Secretary of the Treasury spoke of unrealistic goals which could be achieved only in wartime, and which could not be expected. And it was wrong of critics like myself to explain about the short fall of unemployment.

The President himself has spoken on that.

Now, if in your heart of hearts you don't believe that 4 percent is feasible at all, and if you realize, whether it is an election year or any year, that giving a number a good deal higher than that is going to be unpopular with people like that, and may not go down well with the countryside, I think you would be well advised to sit on executive privileges—I am speaking metaphorically—and not give a goal.

Chairman PROXMIRE. Senator Fulbright.

Senator FULBRIGHT. I wonder if I could ask one question.

You seem to be very puzzled about this. This discussion is always on such a high level of conjectural endeavor that it is difficult for me to really ask the proper question. I haven't yet heard any explanation as to why these other countries can achieve this degree of employment and we cannot. I wonder if there is something else other than economy. I wonder if there is something in the tradition in America about the nature of the work, the areas of prejudice against certain kinds of work because they have a certain aura of civility about them.

I was recalling when you were discussing this, that a number of our constituent employers in the service industries, in hotels, for example, have great difficulty getting anybody to work at all. There is a tremendous turnover. They simply regard that kind of work beneath the dignity of an American. And I have had people in small businesses, especially in woodwork—it is not particularly unpleasant, it smells better than an iron factory or some chemical factory—but it isn't big business, it isn't General Motors, and they have great difficulty in getting workers.

I still don't understand what Professor Galbraith said about Germany, because it recruits labor from other countries. It would seem to me if they didn't recruit it they would have to restrict their productivity because they wouldn't have the manpower. But isn't it something beyond just pure economics—that there is a difference in America from France or Germany or Sweden, Holland, Denmark?

Mr. GALBRAITH. I think there is, Senator Fulbright. One could easily oversimplify it. For example, those countries have a standard educational system, so that you have a working force that is graded up by national educational systems to the same level from one part of the country to the other. It used to be the pride of the French Minister of Education that he could say at any given hour of the day what any child in France was studying. And there is also the problem of greater social, racial, and other homogeneity, rather than the diversity in which we take pride.

On the other hand, if one takes the case of Switzerland, where on frequent occasions I have gone to write, there are no Swiss unemployed.

Your case that Americans do not like to do particular classes of menial work applies equally to the Swiss. Few Swiss do menial work any more—on the roads, collecting the garbage and the like. And one reason that Switzerland has no unemployment is that when labor is needed for less agreeable jobs, it imports Spaniards or Italians. And when there is no demand for work of that sort—or the number of foreigners seems to be getting altogether too high—they refuse the work permits.

Under those circumstances there is really no question as to why the unemployment in Switzerland is effectively zero.

Chairman PROXMIRE. If the Senator would yield, we import Mexicans the same way, and also people from the West Indies.

Mr. GALBRAITH. But not in the same proportion.

Senator FULBRIGHT. I was going to cite just such a case. I knew personally of quite a large operation in my State that grew okra. And no American, black, white, or any other, would pick okra, because it is unpleasant work. And that man had to stop growing okra when we put an embargo on Mexicans. We use to allow Mexicans to come and do this work, and pick cotton, and so on. And some years ago we put a flat prohibition upon them coming, so he went out of the okra business. And there were quite a lot of jobs in that particular operation.

And there are instances of this—I won't bore you with them—where they won't do it. It is beneath their dignity to do it. Americans have a very high opinion of their dignity—they ought not to have to do it, they are members of the richest country in the world, and there ought to be something for them to do at a higher level than a German or a Frenchman or a Dutchman will do.

Chairman PROXMIRE. If the Senator would yield, it seems to me that one answer here is that we are just too rigid and too inflexible in rewarding persons for the disutility of unpleasant work. If it is too unpleasant to pick okra, pay them $5 an hour—it is not that unpleasant—or $10 an hour. If it is unpleasant to carry somebody's bag in the hotel——

Senator FULBRIGHT. That is a ridiculous amount. There is a limit to what okra will bring. Okra goes into the soup, and you can't pay $5 an hour to pick okra, nobody can, you have to go out of business.

The reason I think this is important is this. If we don't identify the real reason for this, and we tried to solve it by simply greater injections of inflation, and so on, I think it would be a very great mistake. If there are other reasons that account for at least part of this, I think they ought to be identified. This is what I was trying to get at. If we are wrong in assuming that you just manipulate the economy and pump in more money and you have a bigger deficit, that this will take care of things. If there are these prejudices, if there are traditions which will mitigate against this, then it ought to be attacked in a different way.

You have mentioned education. I live in an area where they just sporadically collect the garbage, and where they never sweep the streets, although I pay high taxes. I haven't seen a streetsweeper there all this year. I don't know why, in a country that says it is right, that we can't clean up the streets. I don't know of any city, unless it is New York, that has dirtier streets. Certainly if you go into Madrid and go down the main street, they manage to get people to clean their streets. And we don't seem to be able to. Maybe if they would pay them $10 an hour they might. But in any case they don't do it.

And there are lots of things that need to be done. I am only suggesting that we ought to apply our minds to examining if there are other reasons that account for unemployment other than just the economic situation.

Is that unreasonble?

Mr. GALBRAITH. No. As far as I am concerned, I think it would be entirely reasonable. I think my colleagues would agree that we have a whole range of institutional and structural resistances which must always be worked upon. I don't think any of us were so committed to the macroeconomic system that Paul characterized earlier as to cause us to minimize the importance of the things you mentioned.

If I might just have one other word. I think we would make a mistake if we assumed that the Americans were unique in their aversion to tedious manual toil. If there is any common characteristic of all mankind, it is perhaps the desire the escape hard, disagreeable, physical labor.

Senator FULBRIGHT. The desire to do it—you mentioned Switzerland, which, of course, is probably the richest country in the world, in spite of your statistics, it is an unusual and unique country. In Spain, and many of the countries, it is true that there is a lower level. But there are many of these jobs—I think it is an attitude with regard to the dignity of the job rather than just solely the amount of pay. It is considered to be beneath the dignity of many people to do certain kinds of work—leaving out garbage collection, that is very special. But this is what I think is involved. And it reminds me again of what Professor Fairbanks said, which I mentioned earlier.

Again, I think there is an attitude that we have acquired that there is something demeaning about manual work. And this accounts, I think—it could possibly—I am not asserting that as I know this, I am only raising a question that we may be overlooking an important aspect of this a very difficult problem of unemployment. It seems to be the most stubborn of all of them. And I suggest that it might be worth looking into some other aspects of it. It might help explain it. And if so, there could be a different approach than simply pumping more money into the economy.

That is all I would suggest.

Chairman PROXMIRE. Gentlemen, I want to thank you very much. You have been a most stimulating panel. We have kept you very long.

The committee will stand adjourned. The record will stay open for 2 weeks.

(Whereupon, at 1:20 p.m., the committee adjourned, subject to call of the Chair.)

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

STATEMENT OF THE COOPERATIVE LEAGUE OF THE USA, BY STANLEY W. DREYER, PRESIDENT

Mr. Chairman and members of the Committee:

What follows is a brief summary of concerns having to do with the state of the economy at mid-year 1972 that are of particular importance to the cooperative segment of the American business community.

The Cooperative League of the U.S.A. is the 56-year old national federation comprising all types of customer-owned businesses in this country. These include producer and consumer cooperatives both urban and rural represented variously by rural electric, farm supply and marketing, credit unions, customer-owned prepaid group health plans, housing, student, grocery, day care, memorial societies, and other forms of doing business.

Freed of the investment profit orientation which characterizes the preponderance of the American business community, cooperatives view the economy as it is developing in the 1970's from a specialized point of view that permits an objectivity not always possible where the profit motive operates.

High on this list of concerns is the recognition that our country's economy suffers from a serious imbalance between the rural and urban sectors with no effective national policy to cope with it. The period since World War II has seen a vast unplanned movement of peoples from small towns and the open countryside into the cities, adding mightily to the problems of both. While draining off the leadership potential of rural America, this migration—the greatest population movement in the history of the Republic—has brought into already overburdened cities people untrained in the needs and lacking the skills required for modern industrial ilfe.

By pressing for a well-conceived rural development program the cooperative community seeks to stem this precipitate drift of people from the farms and small towns into cities unable to absorb them. Such a program as a basic condition for effectiveness calls for access to sources of credit through a National Development Bank. A credit institution as envisioned by the cooperative leadership would provide loans not only for rural and small community social projects but also for the pressing capital needs for similar projects for low income urban dwellers clustered in the inner city. The housing, health, and mass transportation needs found in these areas could receive development loans that would not only make these facilities possible but—equally important—would allow their control and ownership to remain in the hands of the same people they serve, giving them the right to decide how and where they are to be used.

In recent U.S. history a striking precedent with decades of successful experience behind it already exists in the example of the farm credit system which has served superbly for over forty years. From this singularly effective and peculiarly American credit institution can come the lessions of management, borrower counseling, and control that will enable its expertise to spread from its limited service area of the past to the whole spectrum of needs and interests covering the problems of a now predominantly urban society.

This will call first for speeding up the legislative process so that the translation of initiatives will move from formulation to enactment without the delays measured now in years because the leaders in the executive and legislative branches of our government complete destructively with each other instead of working together to realize the potential in this tried and proven technique of securing credit for vital social programs.

The American cooperatives pledge the availability of their leadership to help direct the innovative programs financed by the Bank, and the support as well of millions of consumer members to work for legislation creating the Bank.

The enduring record of the rural electrification and farm credit administrations are among the credentials our people present as a claim on the attention and support of the country as we put forward this strong recommendation as to how we think American society should face up to its problems. We are convinced that this will have a major positive impact on the economic health of this country.

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