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THE 1972 MIDYEAR REVIEW OF THE ECONOMY

REPORT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

TOGETHER WITH

SUPPLEMENTAL AND MINORITY VIEWS

AUGUST 28, 1972

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LETTER OF TRANSMITTAL

AUGUST 25, 1972.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the Joint Economic Committee and other Members of Congress is the report of the committee entitled "The 1972 Midyear Review of the Economy" together with supplemental and minority views.

This report is issued pursuant to hearings held in July on the state of the economy and contains the committee's recommendations for the domestic economic policies needed to further the mandate of the Employment Act of 1946 "to promote maximum employment, production, and purchasing power."

WILLIAM PROXMIRE,
Chairman, Joint Economic Committee.

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THE 1972 MIDYEAR REVIEW OF THE ECONOMY

I. INTRODUCTION AND SUMMARY

The wide publicity given to the improvements in economic performance in the last few months should not delude the public into believing that all is well with the economy. For the last three years the economy has experienced a prolonged recession brought on through a deliberate policy of restricting the growth of output and of employment in the vain hope that this would reduce inflation. It is only because output was first allowed to fall $80 billion below its potential and unemployment forced to rise to 6 percent and remain there for 18 long months that the rapid growth of GNP and the small decline in unemployment in the last few months look like good news by comparison.

Unemployment is still far too high and without further policy efforts to reduce it, it will remain far too high throughout this year and next. Many observers are predicting unemployment rates above 5 percent throughout 1973. Some, including Administration officials, appear to accept this prospect with complacency.

We regard this outlook and this attitude of complacency as totally unacceptable. In the body of this report we outline a program for reducing unemployment to 4 percent within the next 18 months. To do so will not be easy. It will require rates of growth of real output seldom matched in our recent history over a period of that length. But the costs of unemployment both to the individuals affected and to the society at large are so enormous that we feel the objective is worth an extraordinary effort.

Nor should we be satisfied with a 4 percent unemployment rate, except as a short-run interim target. Our longer run objective should be an unemployment rate no higher than 3 percent. To achieve this objective and to do so within a context of reasonable price stability will require a sustained effort. There is no reason not to begin now.

We regret that the Administration has not seen fit either to endorse our targets for employment or to put forward alternatives of their

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NOTES

Senator Sparkman states: "I am in agreement with much of the general emphasis of this report. However, because of my duties as Chairman of the Committee on Banking, Housing and Urban Affairs, it has been impossible for me to participate fully in the hearings and deliberations underlying this report. I do not believe it would be appropriate for me to take a position on the specific recommendations contained therein."

Representative Bolling could not participate fully in the midyear hearings and the preparation of this report due to the pressure of other responsibilities. He therefore reserves judgment on the recommendations made in this report.

own. We are reluctantly forced to the conclusion that they do not attach the same importance we do to providing jobs for all those able to work and seeking work.

The economic policies advocated by the Administration are unduly influenced by a fear of inflation and by a stubbornly held, but erroneous, belief that the way to control inflation is to restrict the growth of output and employment. We agree that inflation continues to be a most serious problem, but our best hopes for coming to grips with this problem lie in a rapid return to prosperity, accompanied by carefully formulated price and incomes policies.

We regret the silence of the Administration regarding the need for a price and incomes policy for the longer run. The present price and wage controls are a temporary expedient. They should not remain for long in their present form. But some form of continuing price and incomes policy will clearly be needed. In this report we outline the fundamental considerations of equity and effectiveness which should form a basis for this policy.

A summary of our major recommendations follows.

Summary of Recommendations

Employment

A reduction of unemployment to 4 percent remains an appropriate *interim* target. Policies should be directed toward achieving this target before the end of 1973. The Administration should either endorse this goal or offer a clear public explanation of why it is inappropriate.

An unemployment rate no higher than 3 percent remains an appropriate long-run target for the United States. If the necessary structural and institutional reforms are undertaken, this lower level of unemployment can be achieved and sustained in combination with reasonable price stability.

The Economic Outlook

A satisfactory rate of real output growth in the months ahead is by no means assured. At the end of this year, unemployment will still be far too high and the economy will still be operating far below its potential. The first task of economic policy is to sustain steady and rapid progress toward genuinely full employment. The recovery must not be choked off by premature moves toward monetary and fiscal restraint.

The Budget

The composition, as well as the total amount of Federal spending in fiscal 1973 must be such as to foster the needed growth of civilian employment. There should be a major expansion of the public service employment program. Military spending should be reduced below the levels projected by the Administration. With these military spending reductions, important social programs, such as water pollution control and adequate social security benefits can be financed within a budget total that is not inflationary.

Congress should not commit itself to an arbitrary expenditure limitation unrelated to the need to foster healthy economic growth and reduced unemployment and the need to reallocate expenditures toward high priority social objectives.[1]

Taxes

Tax increases should not take place while substantial unemployment remains. However, plans should be laid in 1973 to obtain additional revenues in 1974 or 1975, or as soon as the employment situation makes tax increases appropriate.[2] The pretense that additional revenues will not be needed should be abandoned in favor of a constructive discussion of how these revenues can be obtained. A time-table for reducing unemployment below 4 percent should be established and the resultant addition to Federal revenues estimated. The revenue producing potential of tax reform should be evaluated, and reforms should be enacted in 1973 so that these additional revenues can be obtained in subsequent years. Needed revenues should be obtained through reform of the income and inheritance taxes, not through a regressive new tax such as the value added tax.

We urge that the review of the tax law presently being conducted by the Treasury be made available to the Congress at the time the President makes his tax recommendations, and that at the very least this review include detailed examination of the special provisions proposed for first year review in the Mills-Mansfield Tax Policy Review Act. Only if it has complete information can the Congress adequately appraise the President's proposals.

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[1] Senator Proxmire states: "I disagree. I favor a ceiling on expenditures. A ceiling below the Administration's $250 billion is feasible. Promptly ending the Vietnam war, cutting an additional 5 percent from other military spending, sharply reducing the space program, eliminating all of the foreign military aid programs, replacing the unilateral foreign aid development programs with multilateral assistance and eliminating waste and duplication from all domestic programs would leave sufficient funds to permit significant improvements in human programs within a ceiling of $240 billion.

"The economy can be expanded by stimulative monetary policy and by shifting resources to public service programs where a recent study by the Bureau of Labor Statistics suggests that for each dollar spent, almost twice as many jobs are created as for each dollar spent on defense purchases.

"Also, a ceiling is an efficient and desirable way to force both the executive and the legislative branch to select their priorities. Failure to impose a ceiling means our elected officials are throwing in the sponge because they lack the courage to say which programs can and must be cut back."

[2] Senator Proxmire states: "I disagree. See my footnote on budget policy indicating how funds can and should be secured for necessary new programs without a tax increase. There is far too much waste in every phase of the Federal Government to justify tax increases. If the Administration would adopt the same critical attitude towards military and space spending as they have toward spending for domestic social programs, funds would be readily available to meet our future needs."

Monetary Policy

During the remainder of this year monetary policy should be conducted in such a way as to keep interest rates at or below their present levels and to provide adequate funds to all sectors of the economy, including housing, State and local government and small business.

Price and Incomes Policy

In developing price and incomes policy for the future, the emphasis should be on containing inflation in the concentrated sectors of the economy (big business and strong labor unions) and on mitigating supply shortages of specific commodities and services (such as health care, hides and lumber). This will require policies to make the economy more efficient, such as removal of import restrictions, effective enforcement of anti-trust laws, and reforms of government procurement. It will also require price and income guidelines. Temporary controls may be required at times for some commodities. Restriction of aggregate demand below the full employment level is both an ineffective and an unacceptably costly way to fight inflation.

Future policy must be fair and even-handed. Otherwise, there will not be the cooperation necessary to make policy work. The present policy appears to be controlling wages more firmly than prices. This is not fair, nor with its dampening effect on consumer spending, is it good economics. Certainly the Pay Board wage standard should not be revised downward in the absence of evidence that an equally stringent price standard can also be met.

II. THE DISTANCE TO FULL EMPLOYMENT

In the last few months, the long promised recovery from the 1969–70 recession appears at last to have begun. The rapid growth of real output in the second quarter, which was accompanied by a moderation in the rate of inflation, was especially encouraging. This does not mean that the present economic situation is satisfactory or that the outlook can be regarded with complacency. With 5 million unemployed, the Nation is continuing to pay enormous human costs for the long period of stagnation and recession which began in early 1969 and continued through all of 1970 and most of 1971. It is only by contrast with these three long and dreary years that the improved economic performance of the last few months seems encouraging.

A sustained period of growth of real output at rates of 6 percent or higher is still required to restore the economy to anything approaching full employment. Past recoveries have often petered out, or have been choked off, before full employment was reached. It is essential that this not be allowed to happen again, but the prospects of any early return to full employment are clouded by the fact that there presently exists no clear agreement on what our employment objectives should be. The widespread agreement which once existed regarding an interim unemployment target of 4 percent has vanished, and the present Administration refuses to establish any specific employment objective. The remainder of this chapter spells out what this Committee believes our employment goals should be and discusses the present economic outlook in the perspective of our hopes for meeting these goals. Chapter Two describes the fiscal, monetary and price-incomes policies required to move us toward these goals.

An Interim Target for Unemployment

In early 1962 when unemployment stood at 5.8 percent, the Kennedy Administration set a 4 percent unemployment rate as their *interim* objective for economic policy. Until recently, 4 percent was a widely accepted short-run target. The analytic concepts of the "GNP potential" and the "full employment budget" are based on a 4 percent unemployment rate. That is, "potential GNP" refers to the output which would be produced if the economy were operating at a 4 percent unemployment rate, and the "potential growth rate" refers to the output growth required to absorb labor force growth and productivity gains and thus hold the unemployment rate steady at 4 percent. "Potential" does not refer to the maximum amount which could or should be produced at any given time. Similarly, the "full employment" budget refers to the Federal receipts and expenditures which it is estimated would occur if the unemployment rate were 4 percent. An even lower unemployment rate would lead to substantially higher receipts and to some further reduction in expenditures on programs such as unemployment compensation and welfare. The analytic concepts of "GNP potential" and "full employment" budget thus represent not the best we can do, but simply a consistent, objective standard against which to evaluate current performance.

A 4 percent unemployment rate should not be accepted as a satisfactory long-run target. We can do better. But it is an appropriate short-run objective at a time when unemployment is obviously far too high. Despite our repeated requests, the Administration has refused to endorse such a target, or indeed to set any specific target or time-table for reducing unemployment, other than to estimate that unemployment will be "in the neighborhood" of 5 percent at the end of this year. This is in sharp contrast to their specific and repeatedly stated goal of reducing inflation below 3 percent by the end of this year.

The reluctance of the Administration to establish a 4 percent unemployment target apparently stems from their unacknowledged belief that unemployment must be kept well above 4 percent in order to control inflation. Dr. Walter Heller, former Chairman of the Council of Economic Advisers, testified at our Mid-Year Review that "to all intents and purposes the Administration now associates the U.S. economic potential with an unemployment rate of 5 percent or a bit below."

We do not share this highly negative assessment of the relation between unemployment and inflation. The productivity gains which would be associated with a reduction in unemployment to 4 percent would substantially help ease the cost-push pressures which have been the recent cause of inflation. When it is remembered that a 4 percent unemployment rate still means 3½ million unemployed, and possibly 2 million working involuntary part time and 600,000 discouraged workers who have lost hope of finding a job, it becomes hard to believe that a reduction in unemployment to 4 percent must bring with it strong inflationary pressures stemming from excess demand. A proper combination of fiscal, monetary, and price-incomes policies should make possible a reduction of unemployment to 4 percent before the end of 1973 without the generation of unacceptable new inflationary pressures.

A reduction of unemployment to 4 percent remains an appropriate *interim* target. Policies should be directed toward achieving this target before the end of 1973.

The Administration should either endorse this goal or offer a clear public explanation of why it is inappropriate.

Longer-Run Employment Goals

When 4 percent was established as an interim target in the early 1960's, it was made clear that the economy could and should do better than this in the long run. The 1962 Annual Report of the Council of Economic Advisers stated:

> In the existing economic circumstances, an unemployment rate of about 4 percent is a reasonable and prudent full employment target for stabilization policy. If we move firmly to reduce the impact of structural unemployment, we will be able to move the unemployment target steadily from 4 percent to successively lower rates.

Some unemployment is inevitable. In a free society, people must be free to enter and to leave the labor force or to leave one job in search of another, better job. This type of voluntary short-term unemployment is generally termed "frictional" unemployment. While precise measurement is difficult, competent studies indicate that frictional unemployment is something less than 3 percent of the labor force. Unemployment in excess of 3 percent represents either insufficient demand in the overall economy or structural barriers to the employment of particular groups of workers. Sound aggregate policy to restore a healthy level of overall economic activity, coupled with active policies to reduce such structural barriers as racial discrimination, poor training opportunities, and geographic immobility, can certainly succeed over time in reducing unemployment to 3 percent without destroying reasonable price stability.

An unemployment rate no higher than 3 percent remains an appropriate long-run target for the United States. If the necessary structural and institutional reforms are undertaken, this lower level of unemployment can be achieved and sustained in combination with reasonable price stability.

It may be that we can do even better than this. There has been a tendency in the United States to set our sights too low and to accept far too high a level of unemployment as inevitable. Little thought has been given to the benefits which would follow from the achievement of genuinely full employment. This is in sharp contrast to many other industrialized countries. Japan, Australia, and many European countries consistently maintain unemployment rates of 2 percent or less, even after adjustment of their statistics to the U.S. definition of unemployment. In these countries a 4 percent unemployment rate would be politically unthinkable. Why are we in the United States so comparatively timid and undemanding of our economic policy?

Part of the answer lies in the failure of our political leadership to make clear the benefits of lower unemployment. If the unemployment rate could be reduced to, say, 2 percent, long-term structural unemployment would be virtually eliminated, no one who wished to work would be made to feel that society had no use for his services, employers would be forced to provide effective on-the-job training, political pressures for import restrictions would be greatly reduced, race and sex discrimination in hiring would break down, income distribution would improve, and the Federal budget would be in a far healthier position due to the reduced expenditures on poverty-related programs and to the extra revenues produced by higher employment.

Some disadvantages would also follow from very low unemployment. Inflationary pressures might necessitate strict wage and price controls. As stated above, some frictional unemployment is necessary to a free society. Perhaps a 2 percent unemployment rate would not make adequate allowance for this voluntary changing of jobs. But surely the question deserves examination. This Committee has recently commissioned a study of this question, the first results of which will be available in a few weeks. It is to be hoped that this initial study will lead to greatly increased interest and to further studies of this question. In particular, we feel that some of the vast resources of the Executive branch should be devoted to the study of this question and to the formulation of policies designed to achieve the lowest rate of unemployment which can be made compatible with the other requirements of a free society and an efficient economy. We are convinced that this rate is far lower than those which we have been accustomed to tolerate.

Recent Economic Performance in Perspective

During the past nine months, the economy has shown a healthy rate of growth of real output. This is a welcome contrast to the three dreary years of stagnation from the end of 1968 until late 1971, a period during which real output growth remained consistently below the rate needed to keep the economy from falling ever further below a full employment level of output. Yet, when compared to earlier periods of recovery from recession, the past nine months still represent the most anemic recovery of the post World War II period.

Table 1 compares the period since November 1970 with previous recovery periods. In each of these earlier periods, rapid rates of real growth occurred beginning in the quarter immediately following the lower turning point, or trough, of the recession, and significant reductions in the unemployment rate occurred within three quarters. In the present recession, recovery did not really begin for almost a year after the November 1970 low point. It is only in the most recent three quarters that the economy has begun to show some of the characteristics which typify a recovery period. Moreover, the rate of real growth in these most recent quarters has on the average been below that of previous recovery periods, the rate of inflation has in general been somewhat higher, and most disappointing of all, the unemployment rate remains stubbornly close to its 6.0 percent peak.

TABLE 1.—GROWTH, INFLATION, AND UNEMPLOYMENT DURING RECOVERY PERIODS, 1949–72

Recession trough [1]	Number quarters after trough	Date quarters	Growth rate [2]	Inflation rate [3]	Unemployment rate
October 1949	1	1950: I	21.6	−2.6	6.4
	2	1950: II	11.0	3.5	5.6
	3	1950: III	17.5	9.2	4.6
August 1954	1	1954: IV	8.5	1.3	5.3
	2	1955: I	12.4	1.8	4.7
	3	1955: II	7.2	1.5	4.4
April 1958	1	1958: III	10.6	1.7	7.3
	2	1958: IV	10.0	1.9	6.4
	3	1959: I	6.2	2.1	5.8
February 1961	1	1961: II	8.7	.6	7.0
	2	1961: III	7.3	.1	6.8
	3	1961: IV	8.4	2.1	6.2
November 1970	1	1971: I	[4] 8.0	5.9	6.0
	2	1971: II	3.4	4.4	6.0
	3	1971: III	2.5	2.9	6.0
	4	1971: IV	6.7	1.5	5.9
	5	1972: I	6.5	5.1	5.8
	6	1972: II	9.4	1.8	5.7

[1] As identified by the National Bureau of Economic Research.
[2] Percent change in constant dollar GNP, seasonally adjusted annual rate.
[3] Percent change in GNP deflator, seasonally adjusted annual rate.
[4] Includes catch up in automobile production following 1970 strike. The average growth rate during 1970: IV and 1971: I, taken together was only 1.7 percent.

Source: Department of Commerce and Bureau of Labor Statistics.

The history of past recoveries should be kept in mind in appraising recent economic performance. In the recovery following the 1958 recession, for example, unemployment never did drop below 5 percent, despite the vigorous real growth in the early recovery quarters. There is little cause for complacency regarding the current economic situation. The stubborn perisistence of high unemployment remains the number one economic problem.

THE DISTANCE TO FULL EMPLOYMENT

The goal of reducing unemployment to 4 percent by the end of 1973 is an ambitious one. It is ambitious not because 4 percent unemployment is so low, which it is not, but because the present level of unemployment is so high. Simply to absorb growth in the labor force and improvements in productivity, and thereby to keep unemployment from rising, requires that real output grow between 4 and 4½ percent per year. To reduce unemployment from its present 5½ percent level to 4 percent by the end of next year would require a steady growth of real output at an annual rate slightly over 7½ percent. This growth path and some alternatives are illustrated in chart 1.

Sustained growth at a 7½ percent rate is certainly not typical of the U.S. economy, even during recovery periods. However, such growth would not be unprecedented. There have been several occasions in the past when similar rates of growth have been maintained for periods of 18 months or longer. Thus, the objective, while ambitious, is by no means impossible. In view of the enormous costs of high unemployment, more modest objectives are simply not acceptable.

Already the cumulative difference between actual output and the "potential" output which would have been produced with unemployment at 4 percent has reached $160 billion since early 1969. If the objective of reducing unemployment to 4 percent is realized by the end of 1973, the cumulative loss of output will still reach $190 billion. This wastage of our resources is an enormous price to pay for a misguided attempt to fight inflation by restricting output and employment. The waste is all the more tragic since the effort to control inflation by restricting output was so unsuccessful that it had to be superseded last summer by the first peacetime price and wage controls in our history.

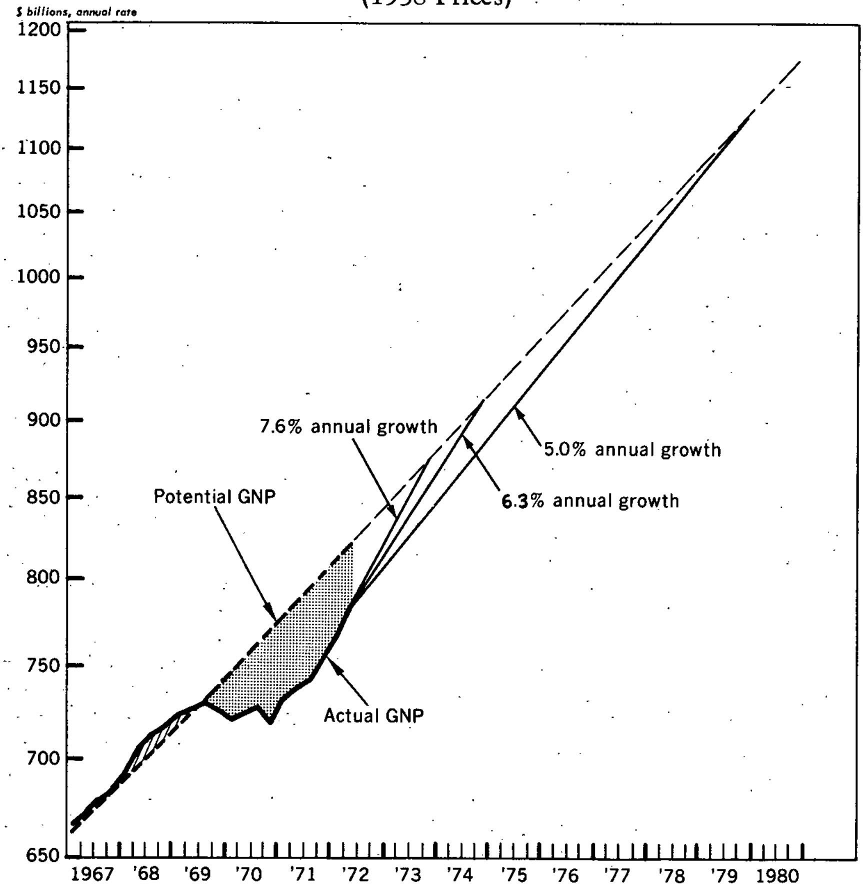
If the real growth rate should be allowed to fall even to 6 percent, unemployment would not drop to 4 percent until sometime in 1975. A 5 percent growth rate would imply unemployment remaining in excess of 4 percent throughout this decade. The vital question concerning the economic outlook over the next 18 months is not "Will the economy grow?" but "Will the economy grow fast enough to produce a reduction in unemployment to the interim target of 4 percent within a reasonable time?"

THE OUTLOOK

It appears unlikely that the strength of the private economy alone in the second half of 1972 will be sufficient to sustain the growth needed for rapid reduction of unemployment. Fiscal and monetary stimulus will continue to be needed. Those who are currently urging moves toward fiscal and monetary restraint either do not share our assessment

CHART 1

Alternative Growth Paths and Potential GNP
(1958 Prices)



of the outlook or, more probably, do not share our conviction that unemployment can and should be reduced to 4 percent within the next 18 months.

The indications are that several important sectors of the private economy, including residential construction and business investment, may show less vigorous growth in the second half of the year than they have in the first. As shown in Table 2, housing starts and residential building permits were fewer in the second quarter than the first, pointing to a leveling off or even a decline in residential construction activity in future quarters. The latest available Commerce Department survey indicates that businessmen anticipate a leveling off of plant and equipment expenditures in the second half. Revised data show that the ratio of manufacturing and trade inventories to sales is higher than previously believed, suggesting that inventory accumulation in the second half may be less than many analysts previously expected.

TABLE 2.—HOUSING STARTS AND BUILDING PERMITS

[Thousands of units, seasonally adjusted annual rate]

	Private housing starts	Building permits
1971:		
III	2,113	1,992
IV	2,241	2,059
1972:		
I	2,513	2,089
II	[1] 2,251	[1] 2,022

[1] Preliminary.

Source: Department of Commerce.

Consumer spending is always difficult to predict. Increased social security benefits will be a stimulus to consumer spending. On the other hand, the increase in real compensation per man hour for workers in the private nonfarm economy was very small in the second quarter, apparently indicating that the Phase II controls are more effective on wages than on prices. If this hold-down of real wages persists, it will have a dampening effect on consumer spending. Consumer spending advanced rapidly in the first half. There seems little reason to expect that it could advance even more rapidly in the second so as to offset the expected slower growth of residential construction and business investment.

On balance then, growth of the private economy will probably be somewhat slower in the second half than it was in the first. What about the government sector? Federal purchases, which increased very rapidly in the first half, will grow much less, if at all, in the second. State and local government purchases will continue and perhaps accelerate their growth, but the severe budget constraint faced by most of these governments places a limit on how fast these expenditures can increase.

In sum, a satisfactory rate of real output growth in the months ahead is by no means assured. At the end of this year, unemployment will still be far too high and the economy will still be operating far below its potential. The first task of economic policy is to sustain steady and rapid progress toward genuinely full employment. The recovery must not be choked off by premature moves toward monetary and fiscal restraint.

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III. POLICIES FOR FULL EMPLOYMENT WITHOUT INFLATION

As discussed in the previous chapter, a reduction in the unemployment rate to 4 percent within the next 18 months is both possible and desirable. This objective can be achieved only through a carefully designed program of fiscal and monetary stimulus coupled with an effective set of policies to control inflation. The longer-term objective of further reducing unemployment to 3 percent or less will also require a carefully co-ordinated and sustained policy effort. This chapter outlines the policies we judge to be appropriate during the next year to 18 months.

THE FISCAL 1973 BUDGET

The 1973 fiscal year began last July 1 with unemployment still at 5½ percent. The Federal budget for fiscal 1973 should be designed to foster a rapid reduction in this unemployment. An appropriately stimulative budget will not be inflationary at a time when millions of workers remain unemployed and when manufacturing plant capacity utilization is still only 76 percent.

It must be stressed that the *composition* as well as the total amount of spending vitally influences the job creating impact of Federal expenditures. Data supplied by the Bureau of Labor Statistics show, for example, that on the average a billion dollars spent on defense purchases creates less than 60 thousand jobs, whereas a billion dollars of State and local expenditure on education creates over 100,000 jobs. These estimates refer to average rather than incremental spending. Further studies of the job-creating impact of various categories of additional expenditure are urgently needed. Nonetheless, these available data dramatically illustrate that *how* Federal money is spent does make a major difference in the number of jobs created.

Furthermore, some expenditures are more inflationary than others. Defense spending may create jobs and add to personal incomes and consumer demand. However, such spending contributes nothing to the production of civilian goods to satisfy this increased demand. Expenditure on public service employment, on the other hand, can put idle labor resources into productive use meeting civilian needs. Expenditures on education and training have throughout our history contributed in a major way to increased productivity. Such expenditures, therefore, make an important long-run contribution to our ability to sustain full employment without inflation.

The composition, as well as the total amount, of Federal spending in fiscal 1973 must be such as to foster the needed growth of civilian employment. There should be a major expansion of the public service employment program. Military spending should be reduced below the levels projected by the Administration. With these military spending reductions important social programs, such as water pollution control and adequate social security benefits can be financed within a budget total that is not inflationary.

Public Service Employment

The existing public service employment program, initiated by Congress over Administration objections, was providing employment for 168,000 persons at the end of fiscal 1972. The present authorization provides $1.25 billion for fiscal 1973, which will continue to finance these jobs for an additional year, but will not allow for any expansion. Given the continued high level of unemployment, this is far too modest a program. The machinery for administering public service employment is already in existence and a major expansion should be possible without undue loss of administrative efficiency. A program to create a total of 500,000 jobs would certainly not be excessive.

If, as we hope, unemployment can be reduced to about 4 percent by late next year, the level of public service employment expenditure can be cut back as more jobs become available in the private sector. To the maximum extent possible emergency public service jobs should provide experience and skill training which will enable individuals to find permanent employment.

Defense Spending

The Administration's fiscal 1973 budget originally requested $83.4 billion in spending authority for military and military assistance programs, an increase of $6 billion over the previous year.[1] Subsequent requests for supplemental spending authority brought this total to $85.9 billion. Congressional authorizing actions to date have reduced this total by $2.4 billion.[2] Appropriations decisions are yet to be made, but it seems probable that appropriations will also be cut significantly below the Administration request. Even so, there will, in our judgment, be room for additional saving through Presidential restraint in the expenditure of appropriated funds.

We find it strange that the Administration's professed concern over increases in Federal spending, a concern which has led them to urge Congress to enact a flat ceiling on 1973 expenditures, is not reflected in any Administration effort to hold down defense spending. Not only has there been the large increase in requested future spending authority, but current outlays, as shown in the Government sector of the national income accounts have been rising extremely rapidly. Defense purchases increased at a 19 percent rate between the second half of calendar 1971 and the first half of 1972. If the Administration seriously wishes to restrict expenditures, defense spending is the place to start.

An Expenditure Ceiling [3]

The President has recently urged Congress to enact a ceiling of $250 billion on Federal expenditures in fiscal 1973. This Committee would welcome a properly arrived at limitation on expenditures, and indeed, we have repeatedly urged that Congressional procedures for establishing such a limitation be established. At present, however, Congress

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1 Atomic energy and other defense related activities brought the total original request for defense spending authority to $85.4 billion.

2 This figure includes about $970 million in authorization requests for military activity in Southeast Asia which were received too late for inclusion in the regular authorization bill and may be reconsidered later.

3 Senator Proxmire states: "I disagree with this section. See my footnote on budget policy on p. 3."

lacks such procedures, and procedural reforms, no matter how promptly undertaken, could scarcely be made to apply to this year's budget.

An arbitrary expenditure ceiling dictated by the President is no substitute for an orderly deliberative process which would establish both the level and the composition of Federal spending appropriate for meeting the highest priority public needs in a manner consistent with meeting employment and price stability goals.

The President's request for an arbitrary expenditure ceiling of $250 billion should be rejected both because this is not an expenditure total designed to promote rapid reduction of unemployment and because all the indications are that, within this total, important civilian programs would be sacrificed in favor of what we consider excessive military expenditures.

The President has justified his request for a ceiling on the grounds that higher Federal spending would be inflationary. Deficit spending at a time when the economy is already at full employment can indeed be inflationary. But the economy will not approach full employment during the current fiscal year. One of the most effective anti-inflationary actions available is to hasten the return to full employment, thus putting more of our citizens productively to work. Administration officials failed to respond to our requests for an analysis of the employment impact of the requested expenditure ceiling. Private witnesses who testified at our mid-year hearings stated that expenditures in excess of the proposed ceiling—perhaps by as much as $10 billion—would hasten the return to full employment without generating additional inflation, provided these expenditures were directed toward domestic social objectives.

The "full employment" budget is a useful analytic device for measuring the stimulus contained in the budget. The Administration is to be commended for publishing full employment budget estimates. No arbitrary rule such as "full employment balance" will suffice, however, to determine the expenditure level best designed to reduce unemployment. It should be noted also that, were the economy at the 3 percent unemployment level which this Committee regards as a more appropriate long-range target, fiscal 1973 receipts might be as much as $257 to $260 billion, which is approximately the expenditure level our private witnesses judged appropriate.

Equally as disturbing as its failure to justify the recommended expenditure total is the Administration's failure to be specific as to the composition of spending. The Administration urges Congress to spend less, but refuses to specify where cuts can be made. Undoubtedly the Federal budget is riddled with wasteful expenditures, civilian as well as military, but the Administration is unwilling to take the politically unpopular step of stating what should be eliminated. Congress cannot make a well informed decision on an expenditure ceiling unless it is known what programs will have to be eliminated, or cut back.

Congress should not commit itself to an arbitrary expenditure limitation unrelated to the needs to foster healthy economic growth and reduced unemployment and to reallocate expenditures toward high priority social objectives.

The Budget in Future Years [4]

If Congress is to make intelligent fiscal policy decisions in future years, not only must it improve its own procedures for reviewing the budget, but it must be provided by the Executive branch with more complete, more accurate, and more candid information regarding the budget. The estimate provided by the Administration in January for the fiscal 1972 budget deficit was $16 billion in error. Recent discussion of the fiscal 1973 budget has been marked by much rhetoric and little concrete information. Indeed, much of the rhetoric seems designed to obscure rather than to make clear the difficult budget problems which will be confronted in 1974 and future years.

Beginning in 1974, built-in growth of existing programs and of new programs proposed by the Administration would cause expenditures to exceed the revenues which will be collected if the economy is operating at 4 percent unemployment. The Brookings study "Setting National Priorities" estimates a $17 billion "full employment" deficit by fiscal year 1975. In many respects this estimate is quite conservative. It includes, for example, a budgetary saving caused by the SALT talks of $1 billion a year that we may never see. The specific make-up of civilian expenditures may be altered, but it is highly doubtful that the totals will be significantly smaller. As the authors point out, they have not included additional expenditures for pressing needs in such areas as pollution control, education, and health care. While there is great scope for reducing wasteful expenditures and reallocating the savings toward these needs, it would be misleading to hold out hope that the total of Federal expenditures can be reduced below these projections. If we are going to prevent excessive deficits in future years, plans must be made now to increase revenues.

Two general possibilities for increasing revenues exist. One is to operate the economy at higher levels of employment. The other is to increase taxes. As discussed elsewhere in this report, we favor eventual reduction in unemployment to 3 percent or less. At 3 percent unemployment, receipts might be some $12 to $15 billion higher than at the 4 percent level used in estimating the full employment budget. Even if this reduced level of unemployment can be achieved, and this may take a number of years, it is unlikely that this will fully meet the need for increased revenues. Tax increases will still be needed.

The timing of tax increases should depend on the state of the economy. In 1973 unemployment will still be high and the restrictive effect of tax increases would be undesirable. Whether tax increases will be appropriate by 1974 depends on the progress which can be made during the next 18 months in reducing unemployment. The year 1973 therefore should be the year in which the tax system is reviewed and legislation enacted to provide for additional revenues in 1974 or 1975, or at such future time as these increases are appropriate in terms of the employment situation.

Tax increases should not take place while substantial unemployment remains. However, plans should be laid in 1973 to obtain additional revenues in 1974 or 1975, or as soon as the

[4] Senator Proxmire states: "I disagree with the conclusion in this section that a tax increase will be necessary. See my footnote on tax policy on p. 3."

employment situation makes tax increases appropriate. The pretense that additional revenues will not be needed should be abandoned in favor of a constructive discussion of how these revenues can be obtained. A time-table for reducing unemployment below 4 percent should be established and the resultant addition to Federal revenues estimated. The revenue producing potential of tax reform should be evaluated, and reforms should be enacted in 1973 so that these additional revenues can be obtained in subsequent years. Needed revenues should be obtained through reform of the income and inheritance taxes, not through a regressive new tax such as the value added tax.

The Joint Economic Committee recently held hearings to investigate the possibilities of tax reform. Many witnesses presented a gloomy outlook for raising revenues from this source. Dr. Herbert Stein, Chairman of the Council of Economic Advisers, has stated that it would not be "prudent to count on a large or swift increase in revenue from closing (tax) loopholes." These witnesses point to Congress' past record where tax reform has almost invariably been accompanied by tax reduction. For example, the combined effect of the Revenue Acts of 1969 and 1971 will be to reduce fiscal year 1973 revenue by some $15 billion below what would have been realized without these tax changes.

The pessimists are correct in their reading of history, but the time has come for Congress to set new precedents. Faced with the first peacetime period in recent history when expenditures may seriously outrun full employment revenues, Congress must begin to plan for these needs. We cannot afford to overlook the revenue producing potential of tax reform.

In our 1972 annual report to the Congress, we stressed the pressing need for tax reform largely from the standpoint of distributing the tax burden more equitably. We should point out that increasing the fairness of the tax system and increasing Federal revenues are perfectly compatible objectives.

An essential part of tax reform must be to bring tax subsidies under control. Recent estimates of the budgetary costs of major Federal tax subsidies show that out of 36 comparable items, eight declined, eight remained unchanged, and *twenty* increased from 1971 to 1972.[5] The budgetary cost of these tax subsidies now stands at over $37½ billion. Once they become law, the amounts of these tax expenditures are not subject to control by either Congress or the Executive.

As potential sources of additional revenues, we suggest the following tax subsidies and other special tax provisions for re-examination:

(1) Corporate and individual capital gains taxation.
(2) Federal estate and gift tax provisions.
(3) Tax exemption for State and local bonds.

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[5] Original table in "Economics of Federal Subsidy Programs—A Staff Study." Most recent data in Appendix D to the prepared statement of Undersecretary of the Treasury Edwin S. Cohen before the Joint Economic Committee, July 21, 1972.

(4) Depreciation on buildings in excess of straight-line depreciation.

(5) Mineral depletion allowances.

(6) Expensing of exploration and development costs.

(7) Foreign tax preferences.

(8) Asset depreciation range.

This list is illustrative and limited to special tax provisions regarding which this Committee has had recent testimony or has published analytic studies. Table 3 gives the approximate 1971 revenue cost of six tax subsidies included in the above list and the distribution of these benefits to individuals by income class. It can be seen that the benefits to individuals are weighted very heavily in favor of upper income groups.

TABLE 3.—ESTIMATED DISTRIBUTION OF SELECTED TAX SUBSIDIES TO INDIVIDUALS, CALENDAR YEAR 1971

[Millions of dollars]

Adjusted gross income class (in thousands)	Individuals capital gains taxation [1]	Tax exemption for State and local bonds	Depreciation on buildings in excess of straight line	Mineral depletion allowance	Expensing of exploration and development costs	Asset depreciation range
0 to $5,000	90	5	7	3	1	2
$5,000 to $10,000	220	5	36	14	5	10
$10,000 to $15,000	230	10	40	12	4	12
$15,000 to $20,000	210	20	27	12	4	9
$20,000 to $50,000	960	100	106	50	16	37
$50,000 to $100,000	920 } 86.6%	300 } 95%	63 } 69.4%	43 } 79.5%	14 } 78.5%	23 } 67%
$100,000 and over	2,970	360	81	66	21	7
Total individual benefits	5,600	800	360	200	65	100
Total corporate benefits	NA	1,800	620	785	260	600
Total benefits	NA	2,600	980	985	[2] 325	700

[1] This amount represents the additional tax individuals would have paid if capital gains were taxed as regular income.

[2] Considered in isolation this estimate would be $800,000,000. However, if considered in conjunction with percentage depletion allowance the $325,000,000 gives a more accurate picture of the revenue effect.

NA. Not available.

Source: Statement of Edwin S. Cohen, Under Secretary of the Treasury, before the Joint Economic Committee, July 21, 1972.

We do not mean to imply that the entire cost of these tax subsidies can be recaptured through tax reform. For example, if State and local governments were to be given a Federal subsidy for issuing taxable bonds, there would be a substantial saving to the Federal Treasury, but it would not approach the $2.6 billion shown in the table as the cost of the tax free treatment of State and local bonds. Nonetheless, the items we list represent the potential for raising significant additional revenue, and this list is by no means exhaustive of the special provisions which require review and reform.

In our annual report we urged that the Administration provide to the Congress by this summer detailed evaluations of at least one-third of the special provisions in the individual and corporate tax laws, so that Congress could decide whether the provisions fairly distribute their benefits and efficiently achieve their objectives. This has not been done. However, we are pleased to learn that the Treasury is "conducting a thorough review of the tax law" [6] in preparation for the tax reform legislation President Nixon has promised to submit to Congress before the end of the year. The President's recommendations will be truly helpful only if they review and provide studies of a significant proportion of the special provisions in the tax law.

We, therefore, urge that the review of the tax law presently being conducted by the Treasury be made available to the Congress at the time the President makes his recommendations, and that at the very least this review include detailed examination of the special provisions proposed for first year review in the Mills-Mansfield Tax Policy Review Act. Only if it has complete information can the Congress adequately appraise the President's proposals.

Monetary Policy

The steady and rapid reduction in unemployment which we hope can be achieved over the next 18 months depends on an accommodative monetary policy as well as a stimulative fiscal policy. Even with the increase in velocity of circulation which normally characterizes a recovery period, the real output growth rates of 7 to 8 percent which we seek will require expansion of the money supply exceeding the range which would normally be considered appropriate in a full employment economy. When unemployment is so stubbornly and persistently high as at present, the monetary authorities should not feel constrained by monetary rules designed to apply to a full employment economy.

Many observers predict that monetary policy will tighten in the coming months and that interest rates will rise, and some are urging this as a policy course. Such a policy would be extremely damaging. Not only could tight money prematurely choke off recovery, but it would do so in ways which would be both destabilizing for the economy and damaging to widely agreed upon social objectives.

As has been demonstrated time and time again, the impact of tight money is on housing, State and local government, and small business. Credit restriction must be very severe in order to have a significant impact on the general level of business investment.

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[6] Statement of Undersecretary of the Treasury Edwin S. Cohen to the Joint Economic Committee, July 21, 1972.

If budget policy follows a responsible course such as we have outlined in the two previous sections, it should be possible for monetary policy to remain accommodative so long as the economy is below full employment.

During the remainder of this year monetary policy should be conducted in such a way as to keep interest rates at or below their present levels and to provide adequate funds to all sectors of the economy, including housing, State and local government and small business.

Policies To Control Inflation

This Committee has long stressed the need for a price and incomes policy as an integral and continuing part of total economic policy. We have also stressed that to the maximum extent possible, such policy should rely on the voluntary cooperation of business, labor and consumers.

In view of the continued large price increases in some areas, as evidenced by the wholesale price index, and in view of the forthcoming heavy round of labor negotiations, an active price and incomes policy will be needed in 1973. The present law authorizing price and wage controls expires April 30. The Administration has provided no information on what, if any, plans they are making to meet the need for policies which extend beyond the next few months.

The Continuing Problem of Inflation

The recent performance of the Consumer Price Index and the GNP deflator indicate some welcome reduction in the rate of inflation. The recent performance of the Wholesale Price Index, however, gives cause for concern that some of the improvement in the other indices may be only temporary. As shown in Table 4, wholesale prices have risen more rapidly during Phase II of the control program than they did in the period prior to the price-wage freeze which began last August. Indeed, not since 1951 has the Wholesale Price Index risen as rapidly over an 8 month period as it has during Phase II.

TABLE 4.—WHOLESALE PRICE CHANGES, SELECTED ITEMS, BEFORE AND DURING THE PRICE-WAGE CONTROL PROGRAM

[Seasonally adjusted percent change, compound annual rate]

	12 months, December 1968–December 1969	12 months, December 1969–December 1970	8 months prior to freeze, December 1970–August 1971	3 months freeze, August 1971–November 1971	8 months, phase II, November 1971–July 1972
WPI					
All commodities	4.8	2.2	5.2	–.2	5.7
Industrial commodities	3.9	3.6	4.7	–.5	4.1
Farm products, processed foods, feeds	7.5	–1.4	6.5	1.1	9.5
Consumer finished goods	4.9	1.4	4.1	–1.1	4.5
Consumer foods	8.2	–2.5	6.8	.3	6.8
Consumer commodities, excluding food	2.9	4.0	2.2	–.4	3.0
Producer finished goods	4.6	4.9	3.7	–2.0	3.7
Selected commodity groups (not seasonally adjusted):					
Hides and skins	2.0	–11.8	18.7	29.7	108.9
Lumber	–9.8	–6.1	48.1	–13.1	20.8
Livestock	15.4	–16.3	32.9	–1.0	38.9

Source: Bureau of Labor Statistics.

The continued rise in wholesale industrial prices at a rate of about 4 percent per year is especially disturbing. The industrial sector is the sector in which high productivity gains should permit complete price stability or even declining prices. From 1959 to 1964, for example, wholesale industrial prices did not rise at all. The extremely high rates of price increases for certain specific commodities, such as hides, lumber and beef indicate that the control program has not so far succeeded in dealing with supply-demand imbalances in particular markets.

As discussed in more detail below, there has been more apparent progress in controlling wages than prices, a situation which raises serious equity questions. Almost twice as many workers will be involved in collective bargaining negotiations in 1973 as in 1972. To provide equity in these wage settlements while at the same time avoiding an inflationary pattern of wage increases will be a most difficult problem for public policy.

The Shape of Future Policy

A price and incomes policy will continue to be needed, though this does not necessarily mean that mandatory controls should be continued. The present system of controls suffers from many defects both of equity and of effectiveness. A number of these defects were discussed in a report issued by this Committee in May.[7] Any longer-term policy will require sweeping changes from the present program. It is unfortunate that there is presently so little serious discussion of a price and incomes policy for the future.

With reasonable fiscal and monetary policies there should be no need for a continuation of widespread control over the entire economy or even a major portion of it. There are, however, two general areas where some type of active government policy will continue to be required.

The first area is the concentrated sector of the economy, in which monopoly or semi-monopoly power permits prices and wages to be kept higher than those which would prevail under competitive conditions. With respect to this "big business-strong labor" sector of the economy government has two responsibilities. The first is to promote increased competition through such structural reforms as improved government procurement practices and removal of import restrictions.[8] The second is to encourage—through guidelines or controls—prices similar to those which would be set if competition were more fully effective. Compulsory control of this sector of the economy may need to be extended for a time, but for the longer run a policy of voluntary price-wage guideposts still appears preferable.

The second general type of situation in which government has a direct role is the situation of shortage of a particular commodity or service. As has been abundantly demonstrated in recent months, shortages and rapid price rises for specific commodities can occur even in a severely underemployed economy. The solution to such shortages

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7 *Price and Wage Controls: An Interim Report,* May 22, 1972.

8 Senator Humphrey states: "Restrictions may be required where the removal of such restrictions would have a direct adverse effect on the economy of an area."

lies in increasing supplies of the commodity or, in some cases, reducing demand. There are many ways the government can assist this process—such as removal of import restrictions or postponement of government procurement of the scarce commodity—but price control may also at times be temporarily necessary until more basic solutions can take effect.

As the history of the last three years so clearly indicates, reduction of overall demand below the full employment level is a most ineffective way to reduce inflation stemming from either of the above causes. Since mid-1969 the economic situation has been one of insufficient demand and idle resources. Yet, inflation remained so severe that it became necessary last summer to adopt the first peacetime wage and price controls in our history. If these controls had been limited to the problem areas which are causing inflation rather than being thinly and ineffectively spread over almost the entire economy, progress against inflation over the past year might have been far more noticeable.

In developing price and incomes policy for the future, the emphasis should be on containing inflation in the concentrated sectors of the economy (big business and strong labor unions) and on mitigating supply shortages of specific commodities and services (such as health care, hides and lumber). This will require policies to make the economy more efficient, such as removal of import restrictions, effective enforcement of anti-trust laws, and reforms of government procurement. It will also require price and income guidelines. Temporary controls may be required at times for some commodities. Restriction of aggregate demand below the full employment level is both an ineffective and an unacceptably costly way to fight inflation.

The Need for Equity

Inflation affects the distribution of income and so do policies to control inflation. Neither guidelines, controls, nor any other anti-inflation policy will succeed without the co-operation of all the major groups in the economy. This co-operation will not be forthcoming if the program contains any serious inequities or threatens to lead to unintended changes in the distribution of income.

In our report last May, we discussed the possible serious inequity that could arise if wages were controlled more firmly than prices. At that time we stated "At least one more quarter's statistics will be required before even a tentative conclusion about the effectiveness of wage control can be reached." Since that time an additional quarter's statistics have become available. These statistics suggest that wages are indeed being more firmly controlled than prices, with a consequent sharp reduction in the growth of workers' real income. If this situation persists, it will produce a degree of inequity which workers cannot and should not be expected to tolerate. Furthermore, such restraint of real income growth will have a dampening effect on consumer spending and thus threaten the prospects for any rapid return to full employment.

Table 5 brings together various statistics relating to wages, prices and profits. In the second quarter real compensation per man hour in the private non-farm sector increased at a rate of only 1.6 percent, a sharp slowdown from the previous quarter and well below the long-term trend of almost 3 percent per year. A single quarter's statistics do not permit firm conclusions, but the slowdown in real wage gains would appear to be a direct result of the control program.

TABLE 5.—SELECTED MEASURES OF WAGES, PRICES, AND PROFITS, 1971 AND 1972

	1971		1972	
	III	IV	I	II
Percent change over previous quarter at seasonally adjusted annual rate:				
Compensation per man hour [1]	5.6	6.0	8.7	[2] 4.7
Real compensation per man hour [1]	1.5	3.6	5.1	[2] 1.6
Unit profits [3]	−9.2	−11.8	20.9	17.8
	April	May	June	July
Hourly earnings index in constant dollars (1967=100) [1]	109.9	109.7	[2] 109.7	[2] 109.7
		1971		1st 6 months, 1972
Average percent change in wages, major collective bargaining settlements: [4]				
All industries		8.1		7.1
Contracts with escalator clauses		7.1		5.4
Contracts without escalator clauses		9.2		7.6
Manufacturing		7.2		5.5
Nonmanufacturing		9.0		7.9

[1] Private nonfarm sector.
[2] Preliminary.
[3] Nonfinancial corporations.
[4] Annual rate over life of contract.

Source: Bureau of Labor Statistics.

That wage control is having some effect is also illustrated in the statistics on major collective bargaining settlements. As shown in Table 5 average wage gains in manufacturing settlements approved by the Pay Board in the first six months of 1972 are only 5.5 percent per year, compared to 7.2 percent in 1971. These settlements conform to the Pay Board guidelines. They are equitable settlements only if price increases can be held to 2.5 percent per year, thus allowing for real wage gains of about 3 percent. Yet there is much discussion of a more stringent Pay Board standard for 1973 settlements, but little discussion of a correspondingly firm attitude on prices. The Pay Board has recently decided to leave the basic 5.5 percent guideline unchanged for now, but has indicated that this decision will be reviewed again later.

Future policy must be fair and even-handed. Otherwise, there will not be the cooperation necessary to make policy work. The present policy appears to be controlling wages more firmly than prices. This is not fair, nor with its dampening effect on consumer spending, is it good economics. Certainly the Pay Board wage standard should not be revised downward in the absence of evidence that an equally stringent price standard can also be met.

SUPPLEMENTAL VIEWS OF SENATOR FULBRIGHT

While other responsibilities have prevented me from fully participating in the recent hearings and deliberations of the Joint Economic Committee, I do support the general tenor of the Committee's recommendations in this mid-year report on the economy.

I want to emphasize particularly my agreement with the recommendations on defense spending. We continue to spend billions of dollars on unwise and unnecessary weapons systems while frequently neglecting domestic needs and our true national security. I strongly concur with the statement that, "If the Administration seriously wishes to restrict expenditures, defense spending is the place to start."

I am pleased that the Committee has given emphasis to this point, and I hope that the report and its recommendations will stimulate both the Administration and the Congress to focus on this important issue.

MINORITY VIEWS ON THE 1972 MIDYEAR REVIEW OF THE ECONOMY

I. Introduction

In our views on the Committee Report on Price and Wage Control published approximately 3 months ago, we asked certain questions regarding the success of the New Economic Policy in stimulating employment and economic growth and reducing inflation. In our opinion, the answers to those questions are becoming increasingly obvious. We now have available economic data for almost a full year period under the NEP. Because the strength of our economic performance in the last 6 to 9 months is so clear, in these views we wish to let this performance speak for itself, discussing the general economic situation and some of our principal economic indicators briefly, and forgoing all too common election year rhetoric regarding the economy.

II. Employment and Unemployment

From second quarter 1971 to second quarter 1972, total civilian employment increased by 2.4 million persons, one of the largest four-quarter rises in employment on record. In the last 2 months, this exceptional growth in total employment has been reflected in the overall unemployment rate, which has dropped substantially, from 5.9 percent in May 1971, where it had held for several months, to a level of 5.5 percent in June and July. The 3 percent rate of rise in employment from second quarter 1971 to second quarter 1972 is higher than the largest increases recorded in the 1960's and may be compared to the increase at at annual rate of 0.1 percent recorded in the four quarters preceding the adoption of the New Economic Policy last August.

We believe that continued expansion should enable us to reduce the overall unemployment rate further by the end of this year, to the neighborhood of 5 percent, inasmuch as the factors which caused a stable unemployment rate over the last year in the face of extraordinary growth in employment are expected to abate somewhat. Specifically, further large reductions in the Armed Forces are not now contemplated. Also, growth in the total labor force may be expected to return to a more normal level, since many of those persons who are drawn back into the labor force as economic conditions improve have already reentered the job market.

III. Inflation

In the last 6 months we have seen a substantial drop in the rate of increase in consumer prices. For the month of June 1972 the rise in the Consumer Price Index (CPI) was 0.1 percent, seasonally adjusted. The annual rate of change for second quarter 1972 was 2.2 percent, down substantially from the 3.6 percent annual rate of increase in the first quarter of the year. The progress made under the Economic Stabilization Program in combating inflation is apparent upon a comparison of the price increase record in the 10 months since August 1971 with the 8-month period prior to inauguration of the New Economic Policy. In the first 8 months of 1971, the CPI rose at a seasonally adjusted annual rate of 3.8 percent, compared with an increase at an annual rate of 2.7 percent since last August. The rate of change on an annual basis in the price of food dropped from 5 percent in the pre-August period to 3.3 percent from August 1971 through June 1972.

The Wholesale Price Index has also showed a smaller rate of increase in the post-August 1971 period. In the first 8 months of 1971, the annual rate of increase in the WPI, as seasonally adjusted, was 5.2 percent, compared to an annual rate of increase of 4 percent from September 1971 through July 1972. The annual rate of increase in prices of industrial commodities dropped from 4.7 percent in the earlier period, to 2.8 percent in the past 11 months. On the other hand, in the 8 months prior to the start of the Economic Stabilization Program, from January through August 1971, prices of farm products, processed foods, and feed rose at an annual rate of 6.5 percent, seasonally adjusted, compared with an annual rate of increase of 7.2 percent in the 11-month period from September 1971 through July 1972.

During July 1972 industrial commodities rose in price by only 0.2 percent. However, prices of farm products and processed foods and feed rose 1.8 percent. In the 6-month period which ended in July 1972, the all commodities WPI rose at a seasonally adjusted annual rate of 5.2 percent, with the rise in the last 3 months of the period almost double that in the first 3 months. This acceleration was attributable entirely to sizable increases in prices of food products in May and June and, especially, July. However, with 30 percent more heavy cattle on hand today compared with a year ago, increased supplies of meat in the months ahead are expected to be reflected in an easing of prices.[1]

IV. Real Wages and Productivity

The sharp growth in employment and progress against inflation have been accompanied by very encouraging gains in real wages and productivity. From 1965 to 1970, the spendable weekly wages of the average production worker rose substantially. However, his real wages declined, the dollar increases being entirely consumed by inflation. Since the beginning of 1971, this trend has been reversed, with real wages rising over the last 18 months. From June 1971 to June 1972, the real spendable weekly wages of the average production

[1] Senators Miller and Pearson state: "It seems only fair to point out that only 16 cents per consumer dollar is being spent for food—compared to 20 cents 12 years ago."

worker rose by 4 percent, as compared to an average annual increase of only 1.3 percent between 1960 and 1968.

As for productivity, recent large increases in output per man-hour have greatly improved prospects of returning to price-cost stability in the U.S. economy. Over the past three quarters, productivity increases in the private nonfarm economy have averaged about 5 percent at an annual rate—double the long term average rate of about 2½ percent from 1950 to 1970.

Because of the more rapid gains in productivity, unit labor cost—the cost of the amount of labor needed to produce a given amount of goods or services—has increased over the past three quarters in the private nonfarm economy at an average annual rate of only 1½ percent even though compensation per man-hour climbed at a rate of 6½ percent.

For the second quarter alone, the results were even more dramatic. The combination of smaller increases in wages, due to the administration's wage-price guidelines, and a large gain in productivity brought a slight decline in unit labor costs—the first since 1965. This stabilization of unit labor cost in the second quarter was accompanied by a significant reduction in the rate of inflation. The implicit price deflator for the private nonfarm economy, a broad measure of prices, increased at an annual rate of only 1.8 percent in the second quarter.

In the late 1960's, the combination of small productivity increases and large wage increases brought substantial increases in unit labor cost. As a result, prices rose sharply. Productivity started advancing at a faster pace with the economic recovery of 1971; the 3.7 percent increase that year was the largest in 7 years.

Part of the gain in 1971 was due to cost-cutting efforts by business firms following slower sales growth in 1970, and part was due to the general expansion of the economy that enabled business to operate at a higher and more efficient level of production. Thus, productivity gains usually are above average during expansionary periods. In the long run, however, productivity depends primarily on machines and other productive facilities, the education, motivation, skill, and experience of the labor force, and technological progress through research and development.

In the immediate future, continued above average gains in productivity can be expected as the economy continues to expand at a rapid pace. Moreover, new plant and equipment will be coming on stream at a faster rate. This should reinforce the cyclical increases in productivity.

V. 1972 Economic Performance

So far this year the economy has shown great strength. In second quarter 1972, the Department of Commerce has estimated that Gross National Product rose at an annual rate of 9.4 percent in real terms, while prices, as measured by the implicit price deflator for GNP, rose at an annual rate of 1.8 percent. These figures may be compared with first quarter 1972, in which real output increased at an annual rate of 6.5 percent, and prices rose by 5.1 percent. The increase in real output in the second quarter was the largest since 1965. Similarly, prices, as measured by the GNP implicit price deflator, rose at a rate in the second quarter that was the lowest in over 6 years (excluding the period of the price-wage freeze).

From the third quarter of 1971 through the second quarter of 1972, real output has increased at an annual rate of 7.5 percent; this compares to an increase in real GNP of only 2.2 percent in the full year between third quarter 1970 and 1971. The annual rate of increase in real output in the first half of 1972 at 7.8 percent makes it very likely that the $100 billion target increase in Gross National Product during 1972 will be met.

The relative strength of the current recovery is apparent from the table below.

Real GNP, six quarters after trough [1]

Recoveries following recessions of:	Percent
1954	7.2
1958	5.5
1961	8.9
1970	8.1
Average	(7.4)

[1] Percentage increase from previous cyclical peak.

Examination of some of our principal economic indicators shows, in our opinion, and in the opinion of the economic forecasting community generally, that the strong economic growth experienced in the last three quarters will continue.

Leading Indicators

In the last 6 months, the index of leading economic indicators has risen from 133.1 to 142.5, an increase of more than 7 percent, or 14 percent on an annual basis. The rise in the index in the last year, from July 1971 through June 1972, from 125.5 to 142.5, translates to an annual rate of gain of 13.5 percent. This record gives no hint that the present expansion may be ending or past its peak.

Manufacturing Activity

Manufacturing activity in the first 6 months of this year evidenced an expanding economy. In second quarter 1972 manufacturers' total new orders for goods were 14.5 percent above the level of second quarter 1971 and 3.3 percent above first quarter 1972. In the important durable goods category, new orders in the second quarter of this year were a very strong 19.6 percent above the same quarter in 1971 and 5.2 percent above first quarter 1972. Nondurable goods, although not this strong, were still good. Total second quarter 1972 nondurable new orders were 8.8 percent above second quarter 1971 and 1.2 percent above first quarter 1972.

Manufacturers' shipments were also up strongly. Second quarter 1972 total manufacturers' shipments were 10.2 percent above second quarter 1971 and 2.8 percent above first quarter 1972. The durable goods component of total shipments was even stronger, with second quarter 1972 total shipments running at a level 11.6 percent above second quarter 1971 and 3.8 percent above first quarter 1972.

Very encouragingly, manufacturing inventories are beginning to show strength. The June rise in manufacturers' inventories of $697 million was the largest gain in more than 2 years. This 0.7 percent gain in a single month followed a May rise in inventories of 0.4 percent. These fairly substantial back-to-back monthly increases followed a period of approximately a year and a half in which inventories were relatively stable. A rise in inventories has been long awaited as an indicator of business confidence that a sustained general economic expansion is underway. We believe that the May and June inventory performances reveal that business is exhibiting such confidence.

Industrial Production

Industrial production, at the end of the first half of 1972, had risen for 8 months in a row. In June 1972, the index of total industrial production stood at 113.3, as compared to an index of 105.6 in August 1971, when President Nixon inaugurated the new economic policy. The change from August 1971 through June 1972 was equal to 8.7 percent at an annual rate. From the end of 1971 through June 1972, industrial production has increased at an annual rate of 9.6 percent.

Housing

Private housing starts played a strong role in the vigorous economic performance so far this year. From January through June, housing starts averaged almost 2.4 million on an annual basis. The strength of this figure is apparent upon a comparison with the projected housing starts for 1972, 2.2 million, made by the Council of Economic Advisers at the beginning of the year. The performance to date is more than 8 percent above that projection, and 9.3 percent above the annual rate of housing starts in the last 6 months of 1971. Additionally, housing activity in the first half of this year ran at an annual rate 23.6 percent above the rate of housing starts in the first half of 1971. Although the May and June, 1972 starts, at annual rates of 2,331,000 and 2,298,000, respectively, are somewhat below the average for the full half year, they are both substantially above the CEA projection for the full year. We expect demand for new housing to remain at a high level through the rest of 1972, with satisfaction of this demand aided by readily available mortgage money.

Construction Awards and Expenditures

In the first 6 months of 1972, construction contracts showed good strength, the level in the value of construction contracts rising to 15 percent above that in the first half of 1971. This 15-percent increase represents an average monthly gain of nearly $1 billion over the 1971 period. During the month of June, residential building contracts rose 26 percent above the year earlier level, to $4.38 billion from $3.46 billion in June 1971.

New construction expenditures have also been strong. Total new construction expenditures during June, at a seasonally adjusted annual rate of $123.3 billion, were up 0.7 percent from May's $122.4 billion. The June level was 13.6 percent above June 1971's $108.5 billion adjusted annual rate and 6.7 percent above December's 1971 $115.6 billion.

Retail Sales

Consumer confidence is also up. Although retail sales have remained somewhat changeable from month to month, the underlying trend in the last several periods has been encouraging. Total retail sales in the second quarter of 1972 ran at a level 3.2 percent above total sales in first quarter 1972, and 9.1 percent above sales in second quarter 1971. In the important durable goods category, total second quarter 1972 retail sales were 3.6 percent above total first quarter 1972 sales and a strong 13.0 percent above second quarter 1971 sales. The nondurable goods performance, although not as strong, was still good. Total second quarter sales were 2.7 percent above first quarter 1972 sales and 7.0 percent above second quarter 1971 sales.

During July, according to Department of Commerce preliminary figures, total retail sales rose to $37.36 billion from June's $36.67 billion, a rise of 2 percent in 1 month. Total July sales were 11 percent above those of July 1971.

Consumer Installment Credit

In the 10 full months since the inauguration of the New Economic Policy for which data is available, consumer installment credit outstanding, which is a sensitive barometer of public confidence in the economy, has shown exceptional strength. From September 1971 through June 1972, the average monthly increase in total consumer installment credit outstanding has been $1.09 billion. June 1972's increase of $1.33 billion was the fourth gain in a row of more than $1 billion and the third highest monthly increase ever recorded, falling behind only May 1972's record $1.44 billion rise and March's $1.36 billion increase.

The outstanding strength in this area is apparent upon comparing the more than $1 billion average monthly increase from September 1971 through June 1972 with the performance in the first 8 months of 1971. From January through August 1971, total consumer installment credit outstanding, as seasonally adjusted, rose monthly only an average $494 million, or less than half of the September 1971–June 1972 average. Given the exceptional performance from March through June of this year, when the average monthly increase in total installment credit outstanding was in excess of $1.3 billion, we believe that consumer confidence and the purchasing activity which that confidence stimulates will fuel further our already very strong economic expansion.

VI. Conclusion

The real test of economic policy is not whether we can create instant, perhaps short-lived, wealth for a few Americans, but rather whether we can create sustainable, long-term levels of prosperity and full employment. The test cannot be met by following the path of instant prosperity, but rather by setting long-range goals and constantly striving to attain them. We believe that the trends now underway show promise of fully meeting that test, and of ushering in a new era of responsible decisionmaking in economic policy.

ADDITIONAL VIEWS OF SENATOR JAVITS

I am most encouraged by many of the recent trends in the American economy. The last two quarters have shown an impressive rate of real economic growth, price inflation in many sectors has moderated, and the rate of unemployment which had been hovering at 6 percent for too many months is finally somewhat down.

However, despite this highly encouraging news, as a ranking minority member of the Joint Economic Committee, I would be doing our Nation a grave disservice if I claimed all was well with the American economy. The job before us today is to insure that our economy continues its recovery and that it moves toward full employment in a noninflationary context. This will not occur if we view the economy with complacency. It is in this spirit that I put forward the economic problems which should continue to concern us and the others of our Nation's policymakers.

While the rate of unemployment is downward, it has been too high too long and a 5.5-percent unemployment rate still remains clearly unacceptable. While the unemployment rate remains in this unacceptable range, it is incumbent on the Congress and the administration to maximize efforts to create transitional public service jobs; to insure that hardships do not set in when unemployment benefits for our Nation's unemployed are cut off by a preexisting statistical standard; and to develop better programs to insure that this continuing tragedy for almost 5 million unemployed Americans does not become another acceptable statistic. It is important that we act toward accomplishing these goals in spite of the fact that the real standard of living of most American families is again on the upturn. This unemployment in turn remains heavily concentrated among the minority groups and the young.

Again, while the wage and price controls have achieved notable successes in stemming inflationary pressure, America remains a long way from the promised land of continued price stability. At the present time food prices continue to rise at an unacceptable rate even though the President has taken such welcome steps as liberalizing meat import quotas. If this sharp upward trend in food prices continues, I see no alternative to extending price controls to the food area, including agricultural producers.

Finally, despite the rhetoric of the day, I am not convinced that the Nation's expenditure priorities are right or that the budget is under control.

Because of increased expenditures in Vietnam and because of congressional action in other areas of the budget, the Nation faces a serious full employment deficit situation in fiscal year 1973, perhaps extending into fiscal year 1974. If a full employment deficit is carried into and through next year when our economy will be operating on full throttle, the effect will be to lay the conditions for renewed inflation. As we all know renewed inflation levies the most regressive tax of all on every American citizen as well as undermining our competitive position abroad. Renewed inflation in turn would further undermine the strength of the American dollar.

Because the specter of renewed inflation in 1973 and 1974 is already upon us, it would be my hope that the political leadership of our Nation—both Republicans and Democrats—would begin to lay the facts before the American people. These facts may point up the need to reassess our priorities in expenditures and set us to thinking about how to pay the Government's bills.

Stating this unpleasant truth in an election year may not be popular; but I believe that the American people will welcome hearing what is necessary to prevent a resurgence of the inflation which has so ravaged our economy in recent years.

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