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THE PRESIDENT'S NEW ECONOMIC PROGRAM

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

FIRST SESSION

PART 4

SEPTEMBER 20, 21, 22, AND 23, 1971

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THE PRESIDENT'S NEW ECONOMIC PROGRAM

MONDAY, SEPTEMBER 20, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room G-308, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Bentsen, and Percy; 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., minority counsel; and Walter B. Laessig, economist for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

As we continue today to study the various facets of the President's new economic program, we have the benefit of testimony by one of the truly great labor leaders of our times, Mr. Leonard Woodcock, president of the United Automobile Workers.

Mr. Woodcock has spent the last 30 years in service to his union—a union which has shown itself time after time concerned not only with the welfare of the workingman but also with the welfare of the Nation. He has served at virtually all levels of the union from staff man to the highest level, succeeding another great union leader, Walter Reuther.

It has been repeatedly pointed out that the President's new economic program must have consensus support by business and labor leaders, indeed by all major groups if success is to be achieved.

We know that labor leaders have for some time been in favor of an incomes policy to halt the inflationary spiral, but it is also common knowledge that cooperation will be achieved only if all major groups, business as well as labor, are treated equitably.

I am convinced that no program will succeed which allows the return on capital to be raised at the expense of labor income. I am not at all certain how best to see that such a result does not happen. Virtually all economists we have heard have argued convincingly that going the excess profits tax route would not be a satisfactory resolution of this problem.

We are pleased to have you with us this morning, Mr. Woodcock. Will you come to the witness table?

I have read your excellent prepared statement and I would appreciate it if you could summarize it. The entire prepared statement will be printed in full in the record.

Will you now identify the distinguished gentlemen who are with you for this record?

First, I would like to call on Senator Percy.

Senator PERCY. Mr. Chairman, I would like to join in welcoming Mr. Woodcock this morning. I do not imagine that a labor union has ever done more for a political candidate than the Automobile Workers did for my distinguished predecessor, Senator Douglas. I developed a very healthy respect for the UAW's political participation. It was on the highest level, and in the best interest of labor. No one has ever done more for labor than Senator Paul Douglas. I would not have held the high respect I do, I do not think, for the UAW if they had not supported a man who stood behind labor for some 18 years. We all miss him very much in the Senate.

I have had the pleasure of working with Mr. Walter Reuther and Mr. Woodcock in programs for the interest of the country. Certainly their contribution to solving the problems of urban areas and of finding a better way of providing for the health of the Nation has been notable and highly creative.

So we welcome you very much indeed to discuss a highly controversial subject that again calls for the best in all of us to find a response to the economic crisis in which we find ourselves now. Your testimony will be very valuable indeed. Although we may have differing ideas on approaches, I think we can agree that we cannot expect nations abroad to exercise restraint and not to retaliate against us for the obvious things that we have done to stimulate our automobile industry unless we provide the example in this country of finding ways to work together—labor, management, government and the public—to develop a sensible program that can be enforced and will be enforced by the American people.

Your testimony this morning, Mr. Woodcock, will be very valuable indeed. We certainly welcome you.

STATEMENT OF LEONARD WOODCOCK, PRESIDENT, UNITED AUTOMOBILE WORKERS, ACCOMPANIED BY NAT WEINBERG, CHIEF ECONOMIST; AND JACK BEIDLER, LEGISLATIVE DIRECTOR

Mr. WOODCOCK. Thank you very much, Senator.

Thank you very much, Mr. Chairman. I have with me on my right, Mr. Nat Weinberg, who is the chief economist on our staff, and on my left, Mr. Jack Beidler, who is our legislative director.

I note that you state that the prepared statement in full will appear in the record, so with your permission, I would like to highlight it.

Chairman PROXMIRE. Fine; we would appreciate that.

Mr. WOODCOCK. The new economic policy addresses itself to three problems—unemployment, inflation, and the balance of payments. I do not need to stress that unemployment is a most serious and aggravating problem. With the exception of two recent months it is higher now than at any time since November 1961 by the official figures. And, of course, the official figures do not take into account possibly a million discouraged individuals who have dropped out of the labor market and

therefore are not counted as unemployed. Nor do they include another 3 million who are on short time, not at their option, but because of the difficult economic circumstances.

As of July, there were 54 major labor market areas with unemployment rates of 6 percent or more as compared to only 6 in January of 1969.

This human tragedy and waste has its counterpart in an industrial capacity that is limping along at 73 percent utilization, with a decelerating productivity which, although it has been picking up somewhat, is still far below the trend level. The gross national product is $70 billion, in terms of second quarter 1971 dollars, below the understated official measure of potential.

As we see it, our economy is in sharp need of the stimulus of increases in demand—increases in consumer spending by the tens of millions of families whose incomes are below the level determined by BLS to be the minimum necessary for a moderate standard of living; increases in Government spending to ease the financial plight of the cities, to cope with environmental pollution, to eliminate urban blight, to improve education, to bring adequate health care to all, to eliminate poverty, to provide efficient and reliable mass transportation, to create a sound system of criminal justice and rehabilitation, to improve public recreational facilities and to deal with all the other deficiencies in the public sector.

By tax cuts for low- and middle-income consumers and by stepped-up public spending, financed in part by closing tax loopholes that favor corporations and the wealthy, the administration could quickly provide work for the jobless, put idle productive capacity into operation, rapidly boost productivity, and close the gap between actual and potential GNP, while at the same time making sizable inroads on unmet and urgent public and private needs.

Instead, the administration proposes to open up huge new tax loopholes for business that will sharply diminish badly needed Government revenues indefinitely into the future, while throwing low- and middle-income consumers the bone of the one shot, 1-year advancement of an already scheduled tax cut that is dwarfed by the tax handouts offered the corporations.

The proposed revival of the investment tax credit is only one of several items in a multibillion-dollar giveaway of tax revenues to corporations under the guise of providing so-called "incentives" to do what they would largely do anyway for sound business reasons. The other elements are the change of depreciation rules made administratively a few months ago, the so-called asset depreciation range (ADR) whose legality is presently being challenged in the courts by the UAW, among others, the proposed Domestic International Sales Corporation (DISC) legislation, and an incentive for research and development whose details are as yet unspecified but which can safely be assumed to be of the same essential character as the other measures. In addition, in recent days, there have been reports that the administration will propose further incentive tax reductions to corporations allegedly for the purpose of stimulating them to train the so-called hard core unemployed.

Making a rough allowance for the cost of those measures which have not yet been spelled out in detail, it seems likely that they will add

up to an ongoing reduction of somewhere in the neighborhood of 20 to 25 percent of total corporate tax liabilities.

The investment credit, we maintain, is a windfall. It is available for investment that would have been made in any event as well as for any inevitably small and relatively minor amount of additional investment that would have been attributable to it. As a matter of fact, it is available even to a firm that responds to the credit by reducing the amount of its investment well below the previous levels.

The contention that the investment tax credit is a windfall was underscored by the statement of Mr. James M. Roche, chairman of the board of the General Motors Corp., in his statement on August 31, 1971, generally supportive of the President's program, who said:

> * * * the investment tax credit is intended to stimulate spending, especially by some smaller companies and those in weak financial condition. It should be understood that most companies of any size determine their purchases of equipment by the needs of the business and not by any short-term tax advantages.

Mr. Roche makes it very clear that whether there is an investment credit or not, the behavior of General Motors will be precisely the same. Of course, this was also true in the period 1962 to 1970 when the investment tax credit was on the books, but that did not prevent General Motors from taking back $297 million in investment tax credits for doing what they would have done in any event.

If the intention behind the investment credit is to stimulate spending "by some smaller companies and those in weak financial condition," the wastefulness of the credit is underlined. We suggest there are better ways than the investment credit to help those small businesses that need and deserve help, and at far less cost to the public Treasury.

One method would be protection of small firms against monopsonistic abuses by the large corporations to which they sell. A small manufacturer of original equipment, automobile parts or components, for example, has no market other than the giant auto corporations. As a result, he is at their mercy. We are in possession of an internal Ford Motor Company memorandum dated August 24, 1971, which reads as follows:

> *Vendor Price Reductions.*—In addition to avoiding future increases, we should attempt to 'roll-back' vendor prices, renegotiate prices already established. Reports should be submitted by August 30 * * * on the approach to be taken on this and the total potential savings, followed by weekly reports on actual savings achieved.

In the statement previously quoted, Mr. Roche of General Motors also made it clear that ADR, the asset depreciation range, represents a waste of revenues somewhat similar to the investment credit and that the trickle down theory on which the proposed taxes are based is entirely without merit, when he said:

> * * * it must be noted that the tax credit and accelerated depreciation apply only after equipment is purchased and put to use. This, like the other elements of the program, means very little unless we can achieve the improved economy the President has called for.

In other words, according to Mr. Roche, the real stimulus to investment is a healthy economy in which consumer and public demand press on existing productive capacity. To that belief, we of the UAW wholeheartedly subscribe.

ADR, as has been suggested, is a similar windfall to the investment credit. It represents a wasteful dissipation of tax revenues for the benefit of corporations and their stockholders, estimated variously at $37 to $39 billion over the next 10 years. If it has any effect at all on levels of investment, ADR, like the investment credit, will stimulate job-destroying modernization under present conditions rather than job-creating expansion.

The DISC proposal would exempt from taxes profits made by subsidiaries set up by manufacturing corporations to handle export sales unless and until, with a few minor exceptions, those profits have been paid out as dividends to the parent corporation. We do not propose to review in detail all of the loopholes for evasion of corporate profits taxes that would be opened up by enactment of DISC. Those were thoroughly explored and exposed in a confidential committee print of a report dated July 13, 1970, which was prepared for the House Ways and Means Committee by the staff of the Joint Committee on Internal Revenue Taxation.

The administration's main argument for the DISC proposal boils down in essence to the need to create a new tax loophole in order to mitigate the damage being done by an already existing tax loophole. In a statement presented to the House Ways and Means Committee, the Secretary of the Treasury said that the DISC proposal:

> * * * is designed to provide the same type of U.S. tax treatment for U.S. companies engaged in exporting as is presently available if they manufacture abroad through foreign subsidiaries. The DISC proposal is designed to create and preserve more jobs in the United States by causing a healthy expansion in U.S. exports, and by making it as attractive from a tax standpoint for U.S. companies to produce goods in the United States for export to world markets as it is for them to build their factories in foreign countries and produce abroad.

He was referring to the fact that profits made by such foreign subsidiaries are not presently taxed unless and until paid out as dividends to the U.S. parent corporation. This, we agree, does create an incentive to manufacture abroad, but we suggest that the way to deal with the problem is to close the existing loophole rather than create another one. The UAW has repeatedly urged that the profits of foreign subsidiaries of U.S. corporations be taxed currently, without waiting for their repatriation.

The Government has yet to spell out the details of its R. & D. and manpower training "incentives." On the assumption that the same incentive approach will be made, we think these two proposals can be rejected as wasteful.

To call such tax giveaways incentives is to ignore the fact that the revenues lost are grossly disproportionate to the results, if any, accomplished.

Turning those revenues over to the corporations in a slack economy is to drain them out of the stream of job-creating demand and to divert them into idle savings in corporate treasuries and the coffers of wealthy stockholding families.

To use them for public purposes, instead, or to improve the after-tax buying power of low-income families would be to generate high-velocity purchasing power, lifting the economy toward full employment, which is by far the best and most effective stimulus to increased investment and intensified training of the so-called hard-core unem-

ployed, financed voluntarily by business, which it has always done when there is a need.

The administration proposed to advance by 1 year, from January 1, 1973, to January 1, 1972, the increase in personal income tax exemptions to $750 and the increase in the standard deduction to 15 percent with a maximum of $2,000 already provided for by present law. This is a one-shot, once-and-for-all tax reduction. It means tax savings totaling $2.2 billion for calendar year 1972, including nine-tenths of a billion dollars in fiscal year 1972, with the remainder effective the following fiscal year. It will not reduce revenues available for public purposes in future years below what they would have been in the absence of the change proposed by the administration.

The tax handouts proposed for business, in contrast, are intended as permanent measures, recurring year after year. The investment tax credit would cost $2.7 billion in the current fiscal year, and $4.1 billion in fiscal 1973. According to the White House, the revenue cost will fall to $2.5 billion in fiscal 1974 as a result of the reduction in tax credit from 10 to 5 percent.

ADR, as noted, is estimated to cost approximately $3.9 billion per year averaged over the next 10 years. The on-going revenue cost of these two business windfalls is therefore $6.4 billion. To this should be added another billion dollars, approximately, unofficially estimated for DISC, plus something like $2 billion per year in R. & D. manpower training incentives.

The total thus becomes something less than $9 billion per year. Allowing for future growth, it is not unreasonable to say that the average will be $10 billion per year over a 10-year period. This is equal to 25 percent of the profits taxes paid by corporations in 1968, the all-time record high year for corporate profits.

The continuing giveaway to business on the order of $10 billion per year will not. of course, diminish the Government's requirement for revenues to finance public sector needs that are growing apace. The revenues will have to be sought elsewhere and the targets most likely will be the low- and middle-income families. Administration circles have for some time been making ominous references to a national value-added tax, which is merely a variant of the regressive sales tax.

With regard to the automobile excise tax, we can and do support the proposal to eliminate the excise tax on passenger cars. Anachronistic and discriminatory, the tax does affect low-income families as well as the more prosperous, because given the sad state into which urban mass transportation has been allowed to fall, cars are no longer luxuries but necessities. Low-income families unable to buy new cars will be aided nonetheless by elimination of the excise tax, because prices of used cars are affected by prices of new cars. As the latter are reduced by removal of the excise tax, the former will decrease also.

The industry has promised that the full savings of excise tax elimination will be passed on to consumers. Nevertheless, I for one share the misgivings others have expressed concerning the possibility of creeping recapture by the automobile corporations in years to come of excise tax savings intended to benefit consumers. The automobile is a changing product from year to year and the annual model change

provides a host of excuses to raise prices even if the unit production costs are not increased.

The pricing methods of the automobile corporations provide a means to assure, if Congress should be so inclined, that consumers will continue to reap the benefits of excise tax elimination despite the changes in the product. The industry follows a so-called standard volume pricing policy. This means that prices are fixed to yield a target rate of return on investment at a given level of output. Overhead costs per unit at that volume are added to labor, materials, and other direct costs. The total of such unit costs is then increased by a markup which, when multiplied by the number of units comprising standard volume, will yield a dollar total of profits equal to the target percentage return on investment.

It would be a relatively simple matter to specify in legislation that the excise tax removal would apply only to companies which annually, with the introduction of new models, and each time prices are changed, filed certifications by genuinely independent auditors that their prices do not represent a greater markup over the standard volume unit costs than did their prices on, say, their 1971 models. The auditors would have to certify, of course, that methods of determining standard volume and all other pertinent factors were the same as in 1971. An exception should be made for companies whose output in the preceding year accounted for less than 20 percent of the industry's total output. Such companies' prices are limited, in any event, by the prices fixed by their bigger competitors.

With regard to the impact of the removal of the excise tax on unemployment, we were bitterly disappointed to hear Mr. Cole of General Motors and Mr. Iacocca of Ford say that any increases in production resulting from the removal of the excise tax and imposition of the import surcharge would be achieved through overtime rather than the hiring of new workers.

We do believe the record shows that the proposed revenue reductions and spending cuts, in combination, represent a transfer from the poor to the rich, and we do not think the phrase "Robin Hood in reverse" is badly applied. The victims of the various spending cuts proposed are, in each case, the poor and middle-income groups. Welfare reform is to be postponed for 1 year. Also to be postponed is revenue sharing. We in the UAW have opposed this program because we consider it unsound, but the proposal to postpone it undoubtedly means that the administration will resist timely action to relieve the desperate financial plight of the cities by other, more desirable means. The 10-percent cut in economic aid is a blow to the poor and literally hungry peoples of the economically underdeveloped countries. It is difficult to understand why the President chose to cut economic aid rather than military aid, which goes largely to prop up dictatorships around the world.

The remaining victims of the spending cuts are the government workers, most of whom are in the low and lower middle income groups, and those who depend upon them for services, who are likely to be in the same income strata. Promised pay increases to government employees are to be postponed and the number of government workers is to be reduced by 5 percent.

In fact a 5 percent cut in government employees will wipe out as many jobs as would be created in the auto industry if excise tax

elimination and the import surcharge were to bring about an increase of 500,000 units in production of domestic cars and if that increased production were fully reflected in increased employment rather than overtime work. I think we should note that the ratio of 25,000 jobs for each 100,000 cars produced, a ratio often cited by the administration in recent weeks. applies not to jobs in the automobile industry as such, but rather to all jobs involved, from extraction of raw materials to the dealers' showrooms. There is reason to question whether that ratio would apply on an incremental basis, since many of the jobs involved represent overhead employment which does not vary in direct proportion to output.

Specific recommendations. Mr. Chairman, that we would have, are that Congress should rescind by legislative action the asset depreciation range system and should reject the administration's proposal to revive the investment tax credit. If Congress does not see fit to do this, the credit should be established on an incremental basis, with some base line of previous behavior to determine the amount of credit. And taking Mr. Roche's assertion at face value, the credit should either be limited to corporations below a specified size measured in terms of net worth, sales or employment, or if applied to all corporations, limited to a maximum amount related to the legitimate needs of the small firm. Half of the credit should be set aside temporarily in a government trust fund to cushion adjustment for workers who might be displaced as a result of investment for modernization purposes.

We believe Congress should reject the attempt to open the new DISC loophole in the tax laws for the benefit of a relative handful of giant international corporations. Instead, Congress should close the existing loophole which is used as the excuse for the DISC proposal—that is, profits of foreign subsidiaries of U.S. corporations should be taxed currently, whether or not they are immediately repatriated.

Congress, too, we believe, should reject any administration proposal to create a new tax windfall in the guise of a training incentive and, instead, should enact legislation based on the principles of the British Industrial Training Act, whereby a training tax is imposed on all employers and that tax rebated if in fact they establish approved training programs.

Similarly, Congress should reject proposals to create windfall tax handouts for research and development and again apply the principles of the British Industrial Training Act. An R. & D. tax should be imposed and rebated to employees with R. & D. programs meeting specified standard.

With regard to income tax changes, we believe the changes in personal income taxes should be made effective retroactive to January 1, 1971, instead of a year later, as proposed; that a flat dollar credit per exemption should be substituted for the total of $100 in exemption increases presently scheduled to take effect in two stages. This would redistribute the tax-savings involved toward low- and middle-income families. The total amount of the credit should be no less than the $4.1 billion involved in the presently scheduled exemption increases or at least $20 per exemption.

And the low income allowance should be increased substantially.

We continue to advocate that there should be a thoroughgoing revision of existing laws for the purpose of closing loopholes that

favor corporations and the wealthy, with the understanding that the additional revenues raised will be spent promptly on employment-generating programs serving national priority purposes.

I have already indicated that the discriminatory auto excise tax should be repealed; and in view of the fact that the presidents of the two leading automobile companies have said that increased production would be met by increased overtime and not by new hiring in spite of the state of vast unemployment, this calls for an increase in the overtime premium under the Fair Labor Standards Act. It is clear that the present premium no longer operates as a deterrent and should be at least double time instead of time and a half.

We believe the welfare reform bill now in the Senate should be improved and made effective at the earliest practicable date.

We believe that to meet the crying need for aid to the cities, liberalized financing for grant-in-aid programs should be substituted for the administration's revenue-sharing proposals and put into effect without delay.

We believe, too, the Congress should refuse concurrence in President Nixon's proposal to delay presently scheduled wage and salary increases for Federal employees, and should take whatever steps may be necessary to make sure that those increases are paid in accordance with the previously established timetable.

We also believe some effective means should be found by the Congress to force the release for spending of the $12 billion in appropriated funds that the administration has impounded. Prompt spending of that $12 billion will provide a major boost to employment, much of it in the service of the financially hard-pressed cities.

Despite threats of a veto, which should be overridden if it becomes a fact, Congress should provide for a substantial increase in the number of jobs available for the unemployed in public service employment.

The present intolerably high rate of unemployment is, by the record, the deliberate creation of the national Government. As the vice president of the Chase Manhattan Bank has said, if increased unemployment is the price of curbing inflation, then "the unemployed perform an important social service by being out of work; I do not see why they should not be paid for it." Therefore, without question, the unemployed have a legitimate claim to benefits higher than the miserable amounts now paid. The Congress should enact realistic minimum Federal standards governing benefit amounts and duration under the State unemployment insurance laws and provide for temporary Federal supplementation up to the level of those standards until the States have had an opportunity to conform.

We in the UAW support the two features of NEP aimed at correcting the balance-of-payments deficit. The suspension of gold convertibility was an essential step toward compelling the revaluation of undervalued currencies which put the United States at an unfair disadvantage in world trade, and toward reform of the world monetary system. The temporary import surcharge can also be a useful bargaining lever contributing to the same end and perhaps also to the relaxation of discriminatory and improper barriers to American exports.

It must be noted that those Europeans and Japanese who attribute to the plight of the dollar to the unbridled export of capital by large

U.S.-based international corporations are on sound ground. This problem and a host of associated problems flowing from it will continue to plague our country until capital exports by such corporations are brought under control. To that end, the UAW has proposed the creation of a Foreign Investment Licensing Board, which will permit only those foreign investments by American firms which can be shown to be in the interest of the United States.

We believe, too, that the investigation we have asked for of the dollar speculation by these same U.S.-based international corporations should be pursued.

The third factor contributing to the difficulties of the dollar and the deficit in the balance of payments is the refusal of certain American corporations to compete vigorously with foreign producers both in our domestic market and in the world market. Outstanding among these, of course, are the major automobile corporations. Here we have an industry whose profits persistently run at rates far higher than the average for all manufacturing corporations, while simultaneously, 16 percent of its domestic market is served by imports. Where these two conditions exist side by side, the conclusion is inescapable that the industry is refusing to engage in price competition with imports.

We think that a proposed tax, which we have called a competition promotion tax, could be an answer to this problem. It would apply only to corporations in industries where the average rate of profits on net worth for the industry had persistently, let's say over the preceding 5 years, and significantly, let's say by 15 percent, exceeded the average rate for all manufacturing corporations; and imports of the general type of product made by the industry have exceeded a specified percentage—for example, 10 percent—of total domestic consumption during the tax year.

Chairman PROXMIRE. Mr. Woodcock, may I just interrupt to ask, as I follow your prepared statement, you are about halfway through. Will you be able to complete your prepared statement in a reasonably short time?

Mr. WOODCOCK. Yes, I will try, sir.

Chairman PROXMIRE. I will appreciate that.

Mr. WOODCOCK. With such a tax in effect, the firms covered could increase their after-tax profits only by reducing their before-tax profits or by reducing the inflow of imports or by a combination of both. We seriously suggest the strong attention of this committee to this possibility, because I do not know how long we can continue to live with the anomaly of mounting imports, an enormously high profit target, and the refusal of the automobile industry and other industries to compete, either in our own domestic market or the world market.

The inequities under the freeze that we presently have are numerous and demanding and, at present, are being patiently withstood. How long that patience will last is a matter of speculation.

Certainly, we are not in the kind of situation that we had in the Korean war. At that time, long-term collective bargaining contracts were a rarity, most union contracts ran for a year, or if they ran for 2 years, had a wage opener in a second year and so could easily accommodate any changing situation. The UAW was one of the very few unions at that time which had a longer than 2-year contract. The Korean war freeze did not have the effect that today's freeze has had

of converting into profits moneys contractually committed to the workers. That is why we say that those raises now held up have to be paid. These contractual obligations are owed to the workers and there is no moral basis or possibly legal basis for taking that money from the workers simply to deposit it in the corporation treasuries of their employers.

With regard to what should come after the freeze, we have continued to pursue for the past 14 years a proposal for a permanent price-wage review board. Congressman Reuss in the House on September 13 introduced a bill, H.R. 10592, which would put this proposal into law. Very frankly, it goes to the question of those companies which are price-dominant—we estimate there are about 100 such—who could not increase their prices without a 60-day notice to a governmentally appointed board which is provided for on a tripartite basis. That board would have power of subpena, and a covered company proposing to increase prices would have to lay out under the power of subpena all of the economic facts on which it claimed the necessity to increase prices. If one of their claims was that demands of a labor union were creating this situation, then that union, too, would be required to come forward and lay all of its facts on the table.

We do not propose any powers of compulsion for this board, but that it have simply the right to make all of the facts available to the American people so that the power of democratic public opinion could play into what is now a closed-out dark recess of our ecomonic life.

We would hope that this committee, too, would give serious attention to equity because the fact of our inflation is not that it is caused by wage push. This inflation, like every inflation that we have had, began with a price inflation unrelated to labor cost push. Only after it had been in being, in this instance some 18 months, did the pressure of catching up on wages begin to have an impact on the situation.

We think the enactment of such a bill will go to what we claim is the basic cause of our present inflation, the real answer to the peculiar behavior of prices in recessionary periods, surfacing first in 1958 and again in 1970–71, where despite sharp drops in sales and heavy unemployment, prices continued to rise. We think an analysis of those prices will show that competitive prices follow the normal trend of competition and tend, in such periods, to drop. But administered prices, controlled by relatively small numbers of huge corporations, we think, are the cause of this anomaly, and we believe such a mechanism as described in our statement, now introduced into at least the House of Representatives, would provide a significant answer to this very troublesome problem.

We do not propose it as a practical matter immediately after the freeze, although it could be the answer to phase 2, but we certainly propose that it could be an on-going answer on a permanent basis, and we truly believe that had we had such machinery through the 1960's we would not find ourselves in the economic difficulties that we face today.

I would like to say that we are considerably disturbed by several suggestions made to this committee that there should be guidelines tied to productivity. That does not bother us too much, except we do not think there is any necessity for static governmental guidelines, because our contracts have historically followed national productivity, not the

productivity of the automobile industry, which is substantially higher than national productivity. But we are disturbed that there should be proposals that cost-of-living compensation should be limited to partial restoration of the prefreeze position.

In an inflationary period, when all prices are rising and incomes rise accordingly, to deliberately deny to one segment of the population, namely the working people—and most of the working people are under union contracts—their right to keep level with the rise in price is simply to take from them a portion of the increased total income and hand it to another section of the economic population. The cost-of-living proposal which we had to fight a year ago to win back in its equitable form, after a 67-day strike in the General Motors Corp., is counterinflationary, is good for the country. When the second and third year increases are tied to a 3 percent improvement factor as they are in the automobile and agricultural implement contracts, and the rest of it is tied to price increases, with that portion of the wage not paid if in fact prices do not increase, is the precise kind of permanent stabilization from collective bargaining which can meet a big piece of our on-going problem. We would hope that the committee does not give too much credence to wage guidelines that would restrict workers to a partial compensation for cost-of-living increases.

On the question of the myth of low profits, I do not have to advise you, Mr. Chairman, because you have pointed out the maldistribution of profits. But the fact is that profits through the second quarter of 1971 are very close to their maximum previous peaks made in 1968 and 1969; in the second quarter, the figures just released by FTC–SEC show that it was the third highest quarter in aggregate profits in history. Of course, when you extract the figure showing that the smaller companies are still going down, then it clearly underscores that the biggest companies are moving toward record levels that would, if unchecked, spell out beyond any doubt the inequities of the present performance.

I think, too, that the maldistribution of profits, with the corporations with assets of less than $1 billion losing ground in the first quarter of this year by 16.2 percent, as opposed to a year ago, whereas the profits of those over $1 billion have increased by 18.8 percent, further underscores the necessity of price review in that sector of the economy which is the administered pricing section, which takes in practically all of the corporations with assets over $1 billion.

With regard to the restriction on dividends, we find little to get excited about there. It makes not too much difference whether the holders of the stock get their increased advantage through immediate cash increase in their dividends or capital appreciation through the increased value of the stock, because profits are otherwise rising and not being immediately paid out.

We are not satisfied that interest rates are drifting down. We believe that the powers afforded the administration under the Credit Control Act, which include the rolling back of interest rates—certainly one of our most difficult inflationary problems—should be utilized precisely for the purpose of rolling back interest rates and not simply freezing them at their recent highest levels.

We also draw to the attention of the committee the income equalization tax, as we have called it, which, in its broad outline, was publicized in the British magazine, the Economist, in articles published in the

September 28 and November 30 issues of 1963, which provides that as other incomes, other nonwage incomes increase, to the extent that their rate of increase is greater than the rate of increase in wages, then there should be a tax to recapture that additional increase.

If we are to have wage restraints, then clearly there has to be a total across-the-board incomes policy which goes to all forms of income and not simply to wage income. Our statement describes in some detail the proposed tax.

I think it is quite obvious, too, that the contracts that are in existence have to be allowed to operate. In phase 2, if regulations are to be established, obviously, new negotiations have to conform to them. Most of the major industrial contracts concluded were heavily frontloaded, and most of them—practically all of them, I believe, in the second and third year—are clearly within what could be considered reasonable stabilization standards. We have said, and we mean it, that if our contracts are interfered with, as they never have been in the past under the most difficult of circumstances, as far as we are concerned there is no contract. If I had agreed last November to sell a house for $30,000 and I was now told that all I could get for that house was $25,000, I can say, well, I will not sell the house. There is no difference between a labor contract, which delivers for a 3-year period the willingness of people to work in that establishment, and any other kind of commercial contract in that regard.

We think, too, if we are in for a restraint period, the whole question of profit-sharing should be encouraged. Because clearly profit-sharing comes after the fact, after the prices have been established, after the prices have been paid, all expenses have been paid; and therefore, it is entirely noninflationary in its impact.

(The prepared statement of Mr. Woodcock follows:)

PREPARED STATEMENT OF LEONARD WOODCOCK

I appreciate this opportunity to comment on President Nixon's New Economic Policy (NEP) and to suggest practical, constructive and equitable alternatives to some of its features.

The NEP itself is a confession of the failure of the Administration's previous policy of deliberately engineering recession in the misguided belief that the way to combat inflation was to inflict unemployment upon millions of workers, to idle more than a fourth of the nation's industrial capacity and to suffer the loss of the many billions of dollars of wealth that the jobless workers and the unused capacity could have created.

In most of its main features, the new policy is equally misguided. It will have little, if any, effect in reducing the present intolerable level of unemployment. It is rife with inequities. And it reflects a perverse sense of national priorities.

The members of the UAW, and American workers generally, have a profound interest in NEP not only because the wage freeze and its aftermath will have a direct impact upon the welfare of their families but also because certain of its other features, if approved by Congress, will have far-reaching effects upon the distribution of income and the quality of life in America. I shall deal first with these latter features, next with those aspects of NEP bearing on imports and the balance of payments, and finally with price and wage stabilization.

TAXES AND UNEMPLOYMENT

The NEP, avowedly, addresses itself to three problems—unemployment, inflation and the balance of payments.

The seriousness of the unemployment problem cannot be exaggerated. At latest report, unemployment affected 6.1 percent of the labor force by the official measure—higher (except for two recent months when the rate reached 6.2 per-

cent) than at any time since November 1961. The official figure, however, takes no account of perhaps a million "discouraged" workers who are not counted as unemployed because, seeing no hope of obtaining work, they have given up the search for jobs and of another 3 million who are involuntarily on reduced working hours for economic reasons.

As of July 1971, there were 54 major labor market areas with unemployment rates of 6 percent or more compared to 6 in January 1969, when the Nixon Administration took office.

As is usual, the main victims of unemployment are the most disadvantaged members of our society—the unskilled, the poor and the black and, particularly, the youngest members of those groups, whose hopes have been blighted immediately upon their entrance into the labor force. In addition, the Administration's failure to plan the transition from a wartime to a peacetime economy has inflicted disproportionately high unemployment upon veterans and abnormally, perhaps unprecedentedly, high unemployment upon scientists and engineers, as well as others, displaced from defense production.

The human tragedy and waste of unemployment has its sad reflections in other forms of waste—an industrial capacity that is limping along inefficiently at 73 percent utilization, a slowdown of productivity which, despite recent acceleration, is far below the trend level and a GNP that is $70 billion (in second quarter 1971 dollars) below the understated official measure of potential.

Clearly, ours is an economy that now needs the stimulus of sharp increases in demand—increases in consumer spending by the tens of millions of families whose incomes are below the level determined by BLS to be the minimum necessary for a "moderate" standard of living—increases in government spending to ease the financial plight of the cities, to cope with environmental pollution, to eliminate urban blight, to improve education, to bring adequate health care within the reach of all, to end poverty, to provide efficient and reliable mass transportation, to create a sound system of criminal justice and rehabilitation, to improve public recreational facilities and to deal with all the other deficiencies in the public sector.

By tax cuts for low- and middle-income consumers and by stepped-up public spending—financed in part by closing tax loopholes that favor corporations and the wealthy—the Administration could quickly provide work for the jobless, put idle productive capacity into operation, rapidly boost productivity and close the gap between actual and potential GNP while, at the same time, making sizable inroads on unmet and urgent public and private needs.

Instead, the Administration proposes to open up huge new tax loopholes for business—which will sharply diminish badly needed government revenues indefinitely into the future—while throwing low- and middle-income consumers the bone of a one-shot, one-year advancement of an already scheduled tax cut that is dwarfed by the tax handouts offered corporations.

Although attention has centered on the proposal to revive the investment tax credit, this is only one of several items in a multi-billion dollar giveaway of tax revenues to corporations under the guise of providing so-called "incentives" to do what they would largely do anyway for sound business reasons. The other elements are the change in depreciation rules made administratively a few months ago—the so-called Asset Depreciation Range (ADR) whose legality is presently being challenged in the courts by the UAW, among others, the proposed Domestic International Sales Corporation (DISC) legislation, and an "incentive" for research and development whose details are as yet unspecified but which can safely be assumed to be of the same essential character as the other measures. In addition, in recent days, there have been reports that the Administration will propose further "incentive" tax reductions to corporations allegedly for the purpose of stimulating them to train the so-called "hard core" unemployed.

Making a rough allowance for the cost of those measures which have not yet been spelled out in detail, it seems likely that they will add up to an on-going reduction of somewhere in the neighborhood of 20 to 25 percent of total corporate tax liabilities.

Investment credit a windfall

While described as "incentives," these tax cuts are in reality windfalls. The investment tax credit, for example, is available for investment that would have been made in any event as well as for any—inevitably relatively small—amount of additional investment that might be attributable to it. (In fact, the credit is

available even to a firm that responds to the "incentive" by *reducing* the amounts of its investment below previous levels.) Thus, in the unlikely event that the credit stimulates an investment increase of as much as 10 percent, more than 90 percent (100 divided by 110) of the credit will represent tax revenues wasted in paying businesses for investments made for reasons that have absolutely nothing to do with the credit.

$297 million for GM

Any doubts on that score should be laid to rest by the press reports quoting numerous corporation executives who state flatly that their investment plans will not be changed if the credit is enacted. For example, in a prepared statement issued on August 31, 1971, in which he hailed the NEP, James Roche, chairman of the General Motors Corporation, said:

". . . the investment tax credit is intended to stimulate spending, especially by some smaller companies and those in weak financial condition. It should be understood that most companies of any size determine their purchases of equipment by the needs of the business and not by any short-term tax advantages."

The sweeping nature of Mr. Roche's statement makes it clear that GM's investment plans were equally unaffected by the investment tax credit when it was previously in effect. That, however, did not prevent GM from claiming the credit. In fact, it obtained $297 million in investment tax credits in the period 1962–70. From the standpoint of what the "incentive" accomplished, that was $297 million of public revenues washed down the drain—a sheer waste of monies that could have been put to good use for public purposes.

If the intention behind the investment credit is, in fact, as Mr. Roche believes, to stimulate spending "by some smaller companies and those in weak financial condition," the wastefulness of the credit is underlined. The overwhelming portion of the tax revenues lost as a result of the credit will go to benefit the largest and financially strongest corporations. *What sense is there to subsidizing GM to the tune of hundreds of millions of dollars in order to provide the few thousands of dollars that could be helpful to some small and shaky firm?*

There are better ways than the investment credit to help those small businesses that need and deserve help, and at far less cost to the public treasury.

One method, that deserves the most serious consideration by Congress would be protection of small firms against monopsonistic abuses by the larger corporations to which they sell. A small manufacturer of original equipment automobile parts or components, for example, has no market other than the giant auto corporations and, as a result, he is at their mercy—which is far from tender. The mail recently brought to the UAW an unsigned note enclosing a copy of an internal Ford Motor Company memorandum dated August 24, 1971, and signed by W. D. Innes, the Company's Executive Vice President. The memo instructed the recipients as to the steps to be taken for "Profit Improvements." Point 5 reads as follows:

"Vendor Price Reductions—In addition to avoiding future increases, we should attempt to 'roll-back' vendor prices—renegotiate prices already established. Reports should be submitted by August 30 by Mr. Mills (covering all activities except AAD) and by Mr. Bergmoser (for AAD) on the approach to be taken on this and the total potential savings, followed by weekly reports on actual savings achieved."

Later in this statement, I will propose other measures to help small business.

In the statement previously quoted, Mr. Roche of GM made it clear both that ADR represents a waste of revenues similar to the investment credit and that the trickle-down theory on which the Administration's tax proposals are based is entirely without merit. He said: "* * * it must be noted that the tax credit and accelerated depreciation apply only after equipment is purchased and put to use. This, like the other elements of the program, means very little unless we can achieve the improved economy the President has called for."

In other words, according to Mr. Roche, the real stimulus to investment is a healthy economy in which consumer and public demand press on existing productive capacity. To that belief we wholeheartedly subscribe.

NEP tax changes and unemployment

With the Madison Avenue gimmickry that is characteristic of the present Administration the investment tax credit has been labeled a "job development" credit. It is obvious, however, that with the effect of the credit on the level

of investment marginal, at best, its contribution to employment must also be marginal.

In fact, its effect on employment, to the extent that it has any effect at all, is more likely to be negative. With existing industrial capacity utilized only to the extent of 73 percent, there is little reason to invest in expansion. Such investment as will be made in the absence of major increases in demand will be for purposes of "modernization," i.e., to replace existing plant and equipment with more efficient facilities. In fact, the proponents of the credit argue that it will help to increase productivity. But unless markets expand, higher productivity means that fewer workers are required to satisfy demand for the products of industry. Thus, unless accompanied by measures designed to boost demand sharply, the investment tax credit, to the limited extent that it may tend to increase investment, will become a job destruction rather than a job development measure.

What industry lacks today is not machinery but customers and the investment credit could make the latter even scarcer.

Although the credit is unlikely to affect materially the volume of investment, the proposal to start it at 10 percent and then reduce it to 5 percent after August 1972 would undoubtedly affect the timing of investment. It would push forward already planned investment to the period before Election Day 1972. This proposed political manipulation of tax rates has serious economic dangers. According to the *New York Times* for September 15, 1971, the Chairman of the House Ways and Means Committee was joined by the ranking Republican member in expressing concern that the proposed drop in tax rates:

"* * * would induce businesses to order so much equipment in the next 12 months that the equipment producers would suffer a depression afterwards * * *"

ADR windfall

ADR, of course, is a smilar windfall. It merely permits corporations to reduce their taxes by charging depreciation at higher rates than were previously permitted on investments that already have been made, before the Administration promulgated ADR, and that would be made in the future even if ADR did not exist. It represents a wasteful dissipation of tax revenues for the benefit of corporations and their stockholders—estimated variously at $37 to $39 billion over the next 10 years. If it has any effect at all on levels of investments, ADR, like the investment credit, will stimulate job-destroying modernization under present conditions rather than job-creating expansion. In addition, the power of the Administration to put ADR into effect is at least questionable on legal grounds and the uncertainty created by the pending court challenge assures that, for the time being at least, it will have no effect on business decisions.

DISC windfall

The DISC proposal would exempt from taxes profits made by subsidiaries (so-called "Domestic International Sales Corporations" or "DISCs") set up by manufacturing corporations to handle export sales unless and until (with a few minor exceptions) those profits have been paid out as dividends to the parent corporation. The alleged purpose is to provide an "incentive" to stimulate exports.

This is not the place to review in detail all the loopholes for evasion of corporate profits taxes that would be opened up by enactment of DISC. Those were thoroughly explored and exposed in a "Confidential Committee Print" of a report dated July 13, 1970, which was prepared for the House Ways and Means Committee by the staff of the Joint Committee on Internal Revenue Taxation. One example, however, may be useful to indicate the general effect of the proposed legislation. The confidential report says that the rules for pricing products transferred to a DISC by its parent corporations:

". . . would, in effect, attribute to the DISC a significant proportion of the profits attributable to the parent's manufacturing activities.

* * * * * * *

"The special pricing rules which would apply to a DISC would have the effect of according tax exemption or deferral to profits that presently are considered to be manufacturing profits derived from U.S. sources. In other words, what is presently considered a U.S. source manufacturing profit could be channeled into the DISC and thereby exempted from U.S. tax when earned by the DISC and, in addition, treated as foreign source income when distributed by the DISC."

Aside from providing tax loopholes, the purely windfall character of DISC tax exemption is made evident in the following paragraph of the report:

"To obtain the benefits provided by the DISC proposal, a corporation is not required to increase its exports. A corporation presently engaged in exporting may channel its existing exports through a DISC subsidiary and thereby exempt or defer U.S. tax on the portion of its export profits which may be allocated to the DISC under the special pricing rules. In other words, the tax benefits granted under the DISC proposal are not conditioned on any increase in export sales."

In fact, it might be added that the tax exemption would be available even if exports were *reduced*. Thus, this alleged "incentive," like the investment tax credit, provides rich tax rewards for contributing *less* to the avowed purpose as well as for contributing more.

The report estimated that, if the *entire* tax saving were passed on in price reductions in order to obtain export sales (which is hardly likely to happen):

"* * * the $600 million revenue loss estimated by the Treasury * * * would give rise to an increase in export of about $300 million."

Others have estimated the annual revenue loss at nearer to $1 billion than to the Treasury's estimate of $600 million.

The Administration's main argument for the proposal boils down, in essence, to *the need to create a new tax loophole in order to mitigate the damage being done by an already existing tax loophole.* In a statement presented to the House Ways and Means Committee on September 8, 1971, Secretary of the Treasury Connally said that the DISC proposal:

"* * * is designed to provide the same type of U.S. tax treatment for U.S. companies engaged in exporting as is presently available if they manufacture abroad through foreign subsidiaries. The DISC proposal is designed to create and preserve more jobs in the United States by causing a healthy expansion in U.S. exports, and by making it as attractive from a tax standpoint for U.S. companies to produce goods in the United States for export to world markets as it is for them to build their factories in foreign countries and produce abroad."

He was referring to the fact that profits made by such foreign subsidiaries are not presently taxed unless and until paid out as dividends to the U.S. parent corporation. This undoubtedly does create an incentive to manufacture abroad rather than in the U.S. It apparently has not occurred to the Administration, however—despite its expressed concern to increase exports and otherwise improve the balance of payments—that the way to deal with the problem is to close the existing loophole rather than to create another one. The UAW has repeatedly urged that profits of foreign subsidiaries of U.S. corporations be taxed currently, without waiting for their repatriation. To do so, however, would increase rather than reduce the taxes payable by the corporations involved—which perhaps explains why the Nixon Administration overlooked that means of discouraging the growth of overseas manufacture by U.S. firms. (In passing, it should be noted that there is an obvious inconsistency between the Nixon Administration's plea for DISC on grounds that it will keep U.S. jobs from going abroad and its vigorous, in fact militant, efforts to obtain removal of restrictions that hamper American corporations seeking to invest in productive facilities in Japan—facilities intended to serve not only the Japanese market but also the U.S. and "third" markets.)

It is also probably of some relevance, given the biases of the present Administration, that the lion's share of the Administration's proposed DISC tax windfall would go to the largest corporation. The confidential staff report says:

"The major impact of the revenue loss from DISC would, of course, be concentrated among the major exporting companies. The Commerce Department estimates that roughly 100 of the largest U.S. firms account for the majority of our exports, more than 50 percent, although this is a rough guess. They would presumably receive approximately their proportionate share of the tax reduction. If they account for 50 percent of our exports, they would, of course, receive about $300 million out of $600 million."

Apparently the DISC proposal was too much even for the stomachs of a large number of the corporation executives who made up the membership of the Commission on International Trade and Investment Policy (the "Williams Commission"). According to the *Wall Street Journal* for September 14, 1971:

"The members 'failed to reach a consensus' on Mr. Nixon's Domestic International Sales Corp. bill, one insider says, because about half of them worried

that the cost of tax deferral on export profits would outweight the benefit of encouraging exports."

R. & D. and manpower training "incentives"

The Administration has yet to spell out the details of its R & D "incentive," referred to in President Nixon's August 15 address and the manpower training "incentive" mentioned in the press in recent days. Judging by the track record, however, it can be predicted that these will be of the same general nature as the investment tax credit and DISC: that they will provide tax reductions for R & D and training expenses that would have been incurred in any event and that the tax handouts will be available to firms that decrease as well as to those that increase such expenditures.

Tax "incentives" in general

To call such tax giveaways "incentives" is to bring to mind George Orwell's "Newspeak." To put it mildly, the revenues lost are grotesquely disproportionate to the results, if any, accomplished. The revenues involved would be far better used if devoted to public spending on the nation's priorities and to tax relief for those at the bottom of the income structure. To turn those revenues over to corporations in a slack economy is to drain them out of the stream of job-creating demand and to divert them into idle savings in corporate treasuries and the coffers of wealthy stockholding families. To use them, instead, for public purposes or to improve the after-tax buying power of low-income families would be to generate high-velocity purchasing power, lifting the economy toward full employment, which is by far the best and most effective stimulus to increase investment and intensified training of the so-called "hard core" unemployed financed voluntarily by business.

Tax changes for individuals

The Administration proposes to advance by one year, from January 1, 1973, to January 1, 1972, the increase in personal income tax exemptions to $750 and the increase in standard deduction to 15 percent (maximum $2,000) already provided for by present law. As noted, this is a one-shot, once-and-for-all tax reduction. It means tax savings totaling $2.2 billion for calendar year 1972, according to Secretary Connally, including $0.9 billion in fiscal year 1972 with the remainder effective the following fiscal year. It will *not* reduce revenues available for public purposes in future years below what they would have been in the absence of the change proposed by the Administration.

The tax handouts proposed for business, in contrast, are intended as permanent measures, continuing year after year, indefinitely into the future and reducing federal revenues below presently anticipated levels forever. The investment tax credit, by the Secretary's estimate, would cost $2.7 billion in the current fiscal year and $4.1 billion in fiscal year 1973. According to the White House, the revenue cost will fall to $2.5 billion in fiscal 1974 as a result of reduction of the credit from 10 percent to 5 percent. (It should increase in subsequent years as the volume of investment rises with the growth of the economy.) ADR, as noted, is estimated to cost approximately $3.9 billion per year, averaged over the next 10 years. The ongoing revenue cost of these two business windfalls is therefore $6.4 billion. To this should be added another $1 billion, approximately, unofficially estimated for DISC, plus—to make a guess that probably underestimates the Administration's generosity to its business supporters—something like $2 billion per year in R & D and manpower training "incentives."

The total thus becomes something on the order of $9 billion per year. Allowing for future growth, it is not unreasonable to say that the average will be $10 billion per year over a 10 year period. This is equal to *25 percent* of the profits taxes paid by corporations in 1968, the all-time record high year for corporate profits. (Taking into account the fact that part of the tax giveaways involved would go to unincorporated businesses, the aggregate tax savings to corporations would still amount to between one-fourth and one-fifth of their peak year taxes.) By the eleventh year, the continuing benefits to business would have equalled 50 times the one-shot $2.2 billion tax savings to individuals.

It is little wonder that corporations have accepted so readily the 90-day freeze on their prices with such lavish benefits promised them in return.

A continuing giveaway to business on the order of $10 billion per year will not, of course, diminish the government's requirements for revenues to finance public sector needs that are growing apace. The revenues will have to be sought elsewhere and the targets, most likely, will be the low- and middle-income

families to whom the Administration proposes to throw a one-shot tax reduction bone. Administration circles have for some time been making ominous references to a national value added tax—which is merely a variant of the regressive sales tax. If the corporate giveaways are enacted, low- and middle-income families will pay dearly for their tax bone in the not-too-distant future.

The bone, moreover, is a bare one at that. A $50 exemption increase for a family in the 14 percent tax bracket amounts to $7 per *year* per person in taxes saved. The same exemption increase is worth $35 per person to families in the 70 percent bracket.

The Nixon Administration is impelled to discriminate against low- and middle-income families even when such miserly amounts are involved. The ADR is already in effect (although under challenge in the courts) but the Administration can brook no delay in adding investment credit billions to ADR billions. The investment credit is proposed to be made effective August 15, 1971; but tax reduction for individuals is proposed to be delayed until January 1972. (The Administration has indicated that it would not object to making the investment credit retroactive to April 1, 1971—i.e., to giving corporations an "incentive" to do what they already have done.)

Auto excise tax

We can and do support the proposal to eliminate the excise tax on passenger cars. This is an anachronistic and discriminatory tax. It is one of the few excise taxes increased to finance first World War II and then again the Korean War that still remains at the World War II level. It affects low-income families as well as the more prosperous because, given the sad state into which urban mass transportation has been permitted to fall, cars are no longer luxuries but necessities. Residents of urban ghettos are often unable to accept available jobs, which are increasingly in the suburbs, for lack both of public transportation and of cars to enable them to get to work. They and other low-income families unable to buy new cars will be aided, nevertheless, by elimination of the excise tax because prices of used cars are affected by prices of new cars. As the latter are reduced by removal of the excise, the former will decrease also.

The industry has promised that the full savings of excise tax elimination will be passed on to consumers. The auto corporations, in fact, are publicly committed to rebate the excise to consumers who buy cars at present frozen prices between August 15 and the date excise tax elimination is enacted, assuming retroactivity to that date.

Nevertheless, I share the misgivings others have expressed concerning the possibility of creeping recapture by the auto corporations in years to come of excise tax savings intended to benefit consumers. The automobile is a changing product from year to year and the annual model change provides a host of excuses to raise prices even if unit production costs are not increased.

The pricing methods of the auto corporations provide a means to assure, if Congress should be so inclined, that consumers will continue to reap the benefits of excise tax elimination despite changes in the product. The industry follows a so-called "standard volume" pricing policy. This means that prices are fixed to yield a target rate of return on investment at a given level of output. Overhead costs per unit at that volume are added to labor, materials and other direct costs. The total of such unit costs is then increased by a mark-up which, when multiplied by the number of units comprising standard volume, will yield a dollar total of profits equal to the target percentage return on investment.

It would be a relatively simple matter to specify in legislation that the excise tax removal shall apply only to companies which annually, with the introduction of new models, and each time prices are changed, file certifications by genuinely independent auditors that their prices do not represent a greater mark-up over standard volume unit costs than did their prices on, say, their 1971 models. The auditors would have to certify, of course, that methods of determining standard volume and all other pertinent factors were the same as in 1971. In order to allow flexibility in the pricing of individual car models, it would be sufficient to require a single certification covering each company's entire range of cars. Such legislation would have the additional value of, in effect, setting a ceiling on the auto corporations' mark-ups over costs which are already much too high.

An exception should be made, however, for companies whose output in the preceding year accounted for less than 20 percent of the industry's total output. Such companies' prices are limited, in any event, by the prices fixed by their bigger competitors and their rates of return on investment tend to be lower than

those of the larger firms. Excepting them from the certification requirement would enable them to retain the benefits of reductions in unit costs achieved through increasing their shares of the total market, if they were able to do so.

Auto excise and employment

Removal of the auto excise tax is the one element of NEP that seemed to offer genuine promise of significantly increasing employment. That promise has now been brought into question by the Presidents of the two major automobile corporations, Edward N. Cole of General Motors and Lee A. Iacocca of Ford. Both of them were quoted in the press as indicating that increases in production resulting from removal of the excise and imposition of the import surcharge would be achieved through overtime rather than through hiring new workers from the ranks of the unemployed.

Mr. Iacocca said that if demand hit an annual rate of 11 million vehicles in the last quarter "you would see a lot of overtime raising average weekly earnings." Mr. Cole's statement was to the same general effect and GM's position was made even clearer by John Z. DeLorean, GM vice president and head of the Chevrolet Division. The latter said:

"The first step to new job is overtime. If increased production is needed over a longer period of time, then we'll put people on."

As I said at the time in a statement released to the press:

"This make a mockery of the stated intention of President Nixon's new 'game plan' as it relates to the auto industry. The elimination of the auto excise tax, the higher duty on foreign cars and the devaluation of the dollar—all designed to boost domestic car sales—were supposed to create thousands of new jobs. Instead, they will apparently create only overtime pay."

Spending cuts

Whatever limited possibilities there might be of increased employment resulting from the tax cuts called for in NEP will be more than offset by the proposed reductions in government spending. According to the Administration's own figures, as released at the White House August 15, the net reductions in revenues under NEP would be $4.2 billion in fiscal 1972 while expenditure reductions would total $4.7 billion. Thus, the government would be taking out of the economy with one hand a half-billion dollars more of demand than it would be putting in with the other hand. Even setting aside the fact that the revenue reductions would go largely into corporate and stockholder savings, while the expenditure reductions are at the expense of persons who save little or nothing, the net effect would be to reduce rather than to increase employment. The Nobel-Prize-winning economist, Paul Samuelson, properly concluded:

"* * * that won't create one extra job. It will create negative jobs * * *. That would completely emasculate his whole program."

Perverse priorities

In effect, the revenue reductions and spending cuts in combination represent a transfer from the poor to the rich. It is this fact that has given rise to the phrase "Robin Hood in reverse."

The victims of the various spending cuts proposed are, in each case, the poor and middle income groups. Welfare reform, the one forward-looking program proposed by the Administration, is to be postponed for one year. The President apparently thinks he will no longer be able to afford it after bestowing his largesse upon the corporations. Also to be postponed is revenue sharing. We in the UAW have opposed this program because we consider it unsound. But the proposal to postpone it undoubtedly means that the Administration will resist timely action to relieve the desperate financial plight of the cities by other, more desirable means. Again, the poor are the victims because it is they who suffer most when the cities are unable to finance essential services. The 10 percent cut in economic aid is a blow to the poor and literally hungry of the economically underdeveloped countries. The recently announced exemption of Latin America from the cut in aid is all to the good—provided it does not mean that other continents, equally or more severely afflicted by poverty, will have to take cuts greater than 10 percent. It is difficult, in fact impossible, to understand why the President chose economic aid for this cut rather than military aid which goes largely to prop up dictatorships.

The remaining victims of the spending cuts are the government workers—most of whom are in the low- and lower-middle-income groups—and those who depend upon them for services, who are likely to be in the same income strata. Promised

pay increases to government employees are to be postponed and the number of government workers is to be reduced by 5 percent.

The fact that the reduction of government employment is to be accomplished through attrition does not alter the essential fact that the total number of job opporunities available in the economy will be significantly decreased. In fact, a 5 percent cut in government employment will wipe out as many jobs as would be created in the auto industry if excise tax elimination and the import surcharge were to bring about an increase of 500,000 units in production of domestic cars and if that increased production were fully reflected in increased employment rather than in overtime work. (Incidentally, it might be well to note for the benefit of the Committee that the ratio of 25,000 jobs for each 100,000 cars produced—a ratio often cited by the Administration in recent weeks—applies not to jobs in the auto industry as such but rather to all jobs involved from extraction of the new raw materials to the dealers' showrooms. There is reason to question whether that ratio would apply on an incremental basis since many of the jobs involved represent overhead employment which does not vary in direct proportion to output.)

Failure on employment front

The most puzzling aspect of NEP is its failure to come directly to grips with the most serious unemployment problem the nation has faced in a decade. Unless it is completely blinded by its trickle-down ideology, the Administration must know that its proposed tax handouts to business, at best, will make only a minimal contribution to employment and one that could well be offset by its expenditure cuts.

The rationale for government intervention into the price-wage field, which is NEP's biggest break with the Administration's past policy on the domestic economic front. is that, absent such intervention, measures to boost employment might aggravate inflation. Now the Administration has bitten the bullet with its (grossly inequitable) wage-price freeze and its commitment to continue with some form of stabilization following the end of the freeze. The cause of previous inhibitions having been thus removed, the Administration should now be moving full steam ahead to increase employment. Its political interests, if nothing else, would seem to so dictate.

Yet, although the Administration is attempting to sell NEP as a program, in the President's words, for "creating new jobs and halting inflation," it includes no measures that can be counted upon to bring about a sharp reduction of the unemployment rate.

RECOMMENDATIONS REGARDING TAXES AND EMPLOYMENT

The analysis in the preceding pages foreshadows many of the recommendations I wish to place before the Committee for its consideration in connection with the tax and employment aspects of NEP. I have deliberately withheld those recommendations to this point, however, in order that they may be evaluated in their totality and in the light of the analysis as a whole.

Taxes

With regard to the tax proposals listed below, I would like to emphasize again that this country is in serious danger of eroding to the vanishing point—in the name of "incentives"—important sources of tax revenues desperately needed to meet urgent problems that seem to be crowding in upon us at an accelerating pace.

I recognize fully that carefully devised tax measures can provide powerful impetus for corporations to enlist in the service of important public purposes. But those measures need not always take the form of offering rewards—at the expense of the Treasury—for doing what is desired (and certainly not rewards for doing what corporations would do in any event in their own interests). Equally powerful, and often more powerful, are tax measures that add to revenues at the expense of those who refuse to cooperate toward the attainment of society's goals. Few, in fact, will withhold their cooperation if such measures are carefully designed. Thus, the end result is to accomplish the desired social purpose without impairment of public revenues.

Specific examples of the kinds of tax measures I have in mind appear below in connection with incentives for research and development and manpower training.

Recommendations

The recommendations with regard to taxes and employment are as follows:

1. ADR: Congress should rescind ADR by legislative action and should prohibit any future changes in depreciation rules by the Executive Branch.

2. Investment tax credit: Congress should reject the Administration's proposal to revive the credit.

To subsidize private investment indiscriminately out of government revenues is both unsound and highly distasteful. The soundest and most effective means for stimulating investment is a full employment economy. In the event, however, that Congress should find politically irresistible the pressure for some form of credit, I would propose that:

(*a*) The credit should be established on an incremental basis. This would mean that the credit would be available only for investment in excess of (i) the dollar amount of investment in excess of the average during a base period of, say, the preceding 3 years, or (ii) the amount of investment in excess of the average ratio of investment to sales in a similar base period, or (iii) the amount of investment in excess of the depreciation taken for tax purposes in the same year. This approach at least would make the results more nearly commensurate with the revenue loss.

(*b*) Given the assertions by Mr. Roche and other business spokesmen that the investment plans of large corporations are not affected by the credit, the credit should be either (i) limited to corporations below a specified size measured in terms of net worth, sales or employment, or (ii) if applied to all corporations, limited to a maximum amount related to the legitimate needs of small firms.

(*c*) Half of the credits should be set aside temporarily in a government trust fund to cushion adjustment for workers who might be displaced as a result of investment for "modernization" purposes. The monies involved would be held in the reserve for 5 years during which period it would be used to pay specified benefits to adversely affected workers. The amount required to be set aside would be reduced for companies that established sound programs to pay such benefits. Monies remaining at the end of five years would revert to the company involved. Thus, the firm would have an incentive to plan carefully to minimize dislocation of its workers. If the firm's reserve proved inadequate to pay the specified benefits, the deficiency would be made up by the Treasury. (The National Commission on Technology, Automation and Economic Progress, popularly known as the "Automation Commission," commended this proposal for study by the Treasury, the Council of Economic Advisers and other appropriate agencies.)

3. DISC: Congress should reject the Administration's attempt to open this new loophole in the tax laws for the benefit of a relative handful of giant international corporations. Instead, Congress should close the existing loophole which is used as the excuse for the DISC proposal—i.e., profits of foreign subsidiaries of U.S. corporations should be taxed currently, whether or not they are immediately repatriated.

4. Manpower Training Incentive: Congress should reject any Administration proposal to create a new tax windfall under guise of a training "incentive" and, instead, should enact legislation based upon the principles of the British Industrial Training Act. That Act imposes a training tax on all employers. Those who establish approved training programs receive rebates of their taxes (plus additional funds, if needed) to finance the training. Small employers may pool their training activities in order to obtain the tax rebates. This approach has proved highly successful in Britain.

5. R. & D. Incentive: Congress should similarly reject proposals to create windfall tax handouts for R & D and, instead, should apply the principles of the British Industrial Training Act to stimulate R & D. An R & D tax should be imposed on all firms with rebates to those with R & D programs that meet specified standards. Small firms would be permitted to pool their R & D activities in order to obtain the rebates. If antitrust legislation should be found to prohibit pooling of R & D by small firms, carefully safeguarded amendments should be adopted to legalize such pooling. There are many industries in which the typical firm is so small as to make impossible any significant R & D. Some are industries suffering severely from import competition, to the detriment of the balance of payments. The approach suggested would help them to become more competitive with imports.

6. Income tax changes: In order to create employment opportunities and to raise the living standards of low- and middle-income families:

(*a*) Changes in personal income taxes should be made effective retroactively to January 1, 1971, instead of a year later as proposed by the President.

(*b*) A flat dollar credit per exemption should be substituted for the total of $100 in exemption increases presently scheduled to take effect in two stages at the beginning of 1972 and 1973, respectively. This would redistribute the tax savings involved in favor if low- and middle-income families. The total amount of the credit should be no less than the $4.1 billion dollars involved in the presently scheduled exemption increases or at least $20 per exemption.

(*c*) The "low income allowance" should be increased substantially.

7. Loophole closing: A thoroughgoing revision of existing law should be undertaken to close loopholes that favor corporations and the wealthy, with the understanding that the additional revenues raised will be spent promptly on employment-generating programs serving national priority purposes.

8. Auto Excise Tax: This discriminatory tax should be repealed promptly, conditioned upon assurances that the auto manufacturers will give consumers the full benefit of the tax savings on a continuing basis. Congress should consider reinforcing such assurances legislatively by the means suggested earlier in this statement.

9. Overtime Premium: In view of the fact that the two leading auto corporations have indicated an intention to meet increased production schedules flowing from excise tax removal through overtime rather than through increased employment, and the likelihood the other industries will take the same course. Congress should move promptly to increase the overtime premium under the Fair Labor Standards Act from the present time-and-a-half to double time. The growth of fringe benefits whose costs are related to numbers employed rather than to hours worked has made the present premium ineffective as a deterrent to scheduling overtime work and therefore ineffective in opening up job opportunities for the unemployed.

10. Welfare Reform: The welfare reform bill passed by the House should be improved in the Senate (to provide, among other things, for maintenance with federal financing of existing benefit levels higher than the national minimum) and made effective at the earliest practicable date.

11. Aid to cities: Greatly liberalized financing for grant-in-aid programs should be substituted for the Administration's revenue sharing proposals and put into effect without delay. The grant-in-aid approach should be extended to meet important urban needs not now covered. Red tape and overlapping involved in such programs should be eliminated. The coordinated package approach applied in Gary, Indiana, should be used on a broad scale, embracing all related programs. In addition, consideration should be given to the proposal made by former Budget Bureau director, Charles Schultze, for a temporary program of direct aid to cities whose finances have been impaired by the recession in the national economy.

12. Federal Employees: Congress should refuse concurrence in President Nixon's proposal to delay presently scheduled wage and salary increases and should take whatever steps may be necessary to assure that those increases are paid in accordance with the previously established timetable. In addition, Congress should use all means available to it to assure that no reductions in federal employment are made which would either impair the execution of governmental programs or impose an unduly heavy workload on government employees.

13. Release of impounded funds: Congress should seek means to compel President Nixon to release for spending the $12 billion in appropriated funds that he has impounded. One method which may perhaps not be the best, would be to provide that the proportion spent out of monies appropriated to the Department of Defense shall at no time exceed the proportion spent out of the presently impounded $12 billion. Prompt spending of the $12 billion would provide a major boost to employment, much of it in the service of the financially hard-pressed cities.

14. Public Service Employment: Despite threats of a veto (which should be overridden if it materializes), Congress should provide for a substantial increase in the number of jobs available for the unemployed in public service employment. This program, also, would be of great help to the cities as well as to the jobless.

15. Unemployment insurance: The present intolerably high rate of unemploy-

ment is the deliberate creation of the national government. As William Butler, vice president of the Chase Manhattan Bank, has said, if increased unemployment is the price of curbing inflation, then: "* * * the unemployed perform an important social service by being out of work. I do not see why they should not be paid for it."

Certainly, the unemployed have a legitimate claim to benefits higher than the miserably inadequate amounts now paid. Congress, therefore, should promptly enact realistic minimum federal standards governing benefit amounts and duration under the state unemployment insurance laws and provide for temporary federal supplementation of benefits up to the level of those standards until the states have had time to conform their laws to the standards. The standards with respect to benefit amounts should take into account the value of fringe benefits, as well as of wages, lost by unemployed workers.

BALANCE OF PAYMENTS

We in the UAW support the two features of NEP aimed at correcting the balance of payments deficit. Suspension of gold convertibility was an essential step toward compelling the revaluation of undervalued currencies, which put the U.S. under an unfair disadvantage in world trade, and toward reform of the world monetary system. The temporary import surcharge can also be a useful bargaining lever contributing to the same end and perhaps also to the relaxation of discriminatory and improper barriers to American exports. We are aware, however, that these measures have created serious problems in other countries. We hope that escalating retaliation and counter-retaliation can be avoided and that negotiations will proceed smoothly to a conclusion acceptable, even if not perfectly satisfactory, to all nations involved.

It must be noted, however, that those Europeans and Japanese who attribute the plight of the dollar to the unbridled export of capital by large U.S.-based international corporations are on sound ground. This problem—and a host of associated problems flowing from it—will continue to plague our country until capital exports by such corporations are brought under control. To that end, the UAW has proposed creation of a Foreign Investment Licensing Board which would permit only those foreign investments by American firms which can be shown to be in the interests of the United States. I hope there will be opportunity at some time to explain the proposal in detail to this Committee and to other Congressional bodies because I believe it merits the most serious consideration.

The difficulties of the dollar in world money markets were aggravated, as President Nixon said, by "international money speculators" who "have been waging an all-out war on the American dollar." He neglected to say, however, that prominent among those speculators were some of the U.S.-based international corporations mentioned above. They are within reach of our government and its laws but the President called for no action to penalize them or to curb their damaging activities. On behalf of the UAW, I have asked Chairman Patman of the House Banking and Currency Committee to launch a searching investigation of the monetary manipulations of such corporations with a view to enactment of legislation which will prevent future speculation by Americans inimical to the interests of their own country.

A third factor contributing to the difficulties of the dollar and the deficit in the balance of payments is the refusal of certain American corporations to compete vigorously with foreign producers both in our domestic market and in the world market. Outstanding among these are the major automobile corporations.

Here we have an industry whose profits persistently run at rates far higher than the average for all manufacturing corporations while, simultaneously, 16 percent of its domestic market is served by imports. Where these two conditions exist side by side, *the conclusion is inescapable that the industry is refusing to engage in price competition with imports.*

In an economy whose basic premise is competition, clear-cut refusal to compete provides ample justification for any action required to remedy the situation, no matter how drastic it may appear. I will outline below a form of tax that would give the auto industry, and other industries similarly guilty of refusal to compete with imports, a powerful incentive to change their ways. The tax, at first glance, may seem harsh but it should be kept in mind that some of the remedies for noncompetition under antitrust legislation, although infrequently

applied, are even harsher. Breaking up a firm is certainly a more radical procedure than imposing a special tax designed to induce competition.

Competition promotion tax

The proposed tax might be called a "Competition Promotion Tax" because that would express its purpose. It would apply only to corporations in industries where:

(1) average rates of profits on net worth for the industry had persistently (e.g., over the preceding 5 years) and significantly (e.g., by 15 percent) exceeded the average rate for all manufacturing corporations; and

(2) imports of the general type of product made by the industry exceeded a specified percentage (e.g., 10 percent) of total domestic consumption during the tax year.

If both those conditions existed, the special tax would be calculated in accordance with the following formula:

$$T_s = \left(1.05 - \frac{P_a(1-T)}{P_c}\right) \times \left(\frac{C_b}{C_y}\right)^2$$

where: T_s is the special tax rate to be applied to the corporations in question;
T is the regular corporate profits tax rate (48 percent at present);
P_a is the average before-tax rate of return on net worth for all manufacturing industry;
P_c is the before-tax rate of return on net worth of the particular corporation subject to the special tax;
C_b is the percentage of consumption accounted for by domestic production in the base year; and
C_y is the corresponding percentage for the tax year.

Effect of tax

With such a tax in effect, the firms covered could increase their after-tax profits only by reducing their before-tax profits (which would require price cuts) or by reducing the inflow of imports or by a combination of both. The reduction of prices, of course, would contribute to the reduction of imports.

So long as the industry remained subject to the tax, none of its constituent corporations could realistically hope to obtain a rate of return as high as the average for all U.S. manufacturing firms.

The industry, however, would have two escape hatches by which to free itself from the tax—both consistent with the purpose for which it would be imposed. The tax would cease to apply if, during a period of five consecutive years, average rates of return in the industry fell to less than 15 percent above the all-manufacturing average for the same period. The tax would be removed in that case even though imports remained above 10 percent of consumption but the decrease in profit rates presumably would attest to reductions in prices, reflecting an effort to compete.

Alternatively, the firms in the industry could free themselves from the special tax by competitive actions—price reduction, quality improvement, production of less expensive models, etc.—which would reduce imports below 10 percent of domestic consumption. While no firm might be able single-handedly to reduce imports below that level, all in the industry would be impelled by the tax to try to do so and price cuts put into effect by one or more for that purpose would compel the others to follow.

The tax would have no effect (except in an extraordinarily profitable year) on firms, such as American Motors in the auto industry, whose rates of return run lower than the average rate for all manufacturing corporations. They would pay the normal profits tax (now 48 percent) which would be the minimum rate applicable to all firms in the industry regardless of the rate computed from the formula.

The incentive provided by the tax would be extremely powerful because the formula is highly sensitive to even small changes in prices or in the level of imports. Any increase in either or both would reduce after-tax profits. Any reduction in prices or imports or both would increase after-tax profits.

The purpose of the tax is not to raise revenues but to stimulate competition against imports. It would not be inconsistent with that purpose to give reasonable advance notice to the industries concerned—to provide in the legislation imposing the tax that it not become effective until, say, three years after enactment. Such

advance notice might induce the desired competitive behavior and thus create conditions under which the tax would not be payable (i.e., industry profits less than 15 percent above the all-manufacturing average, or imports less than 10 percent of consumption, or both).

The proposed tax is novel, of course. But novelty should not deter serious consideration of its merits. The phenomenon of corporations that deliberately refuse to compete is also rather novel. New problems require new solutions.

I urge this Committee to look into the possibility of this type of tax as one means to correct the payments deficit, to create additional employment in domestic industry and to regain the former share of the United States in the world market for automobiles and for other products as well.

HALTING INFLATION

It is now almost universally recognized that the wage-price freeze imposed as part of NEP creates so many serious inequities that its continuation for more than 90 days would be intolerable. The Administration has committed itself to limit the freeze to 90 days and to substitute some other form of stabilization thereafter.

Inequities under the freeze

It is imperative even before the freeze period ends, however, to begin to apply that provision of the Economic Stabilization Act which authorizes "the making of such adjustments as may be necessary to prevent gross inequities." The Cost of Living Council (CLC), delegated by the President to exercise the powers granted him by the Act, has, by interpretation, provided significant price leeway to industry. Noteworthy in this connection was the reinterpretation for the benefit of the steel industry of the words "substantial volume of actual transactions . . . during the 30-day period ending August 14, 1971." Steel corporations were permitted to consider "substantial" sales equal to more than 10 percent of total sales made *after* the last price increase they had imposed during the 30-day period.

The CLC has yet to show comparable flexibility, however, even with respect to the most glaring types of inequities on the wage front.

I will not burden the Committee with the many serious types of inequities being inflicted on UAW members by the free because of the failure of CLC to show the same sympathetic understanding for workers' problems as it has shown for industry's. I have no doubt, however, that, if I were to recite some of the inequities that our members are now suffering, the members of the Committee would wonder, first, why they have not been corrected, and second, why the workers have been so patient in waiting for correction.

It is urgent that there be no further delay.

I would point out to the Committee, however, one significant difference between the current situation and that under the freeze imposed temporarily during the Korean War. At that time, long-term collective bargaining contracts were a rarity. Most contracts ran for one year or, at most, for two years with provision for renegotiation of wages at the end of the first year. The UAW was one of a very few unions that had longer term contracts providing for deferred wage increases rather than renegotiation.

Thus, generally speaking, the Korean-War freeze did not have the effect, as today's freeze does, of converting into profits monies contractually committed to workers. We in the UAW were compelled, during the 1951 freeze, to warn the stabilization authorities that if the wage increase provisions of our contracts were made inoperative, we would have to consider the contracts null and void and would deem ourselves free to use whatever means might be necessary to negotiate acceptable new contracts. Fortunately, the freeze was relaxed in time to permit payment on schedule of a cost-of-living increase, which came due first, and, later, of an annual improvement factor wage increase.

Today's freeze must be similarly relaxed to permit effectuation within the 90-day period of the economic provisions of existing contracts. Every collective bargaining contract contains provisions (generally non-economic) sought by the employer as well as economic provisions for the benefit of workers. It is obviously unfair to permit the employer to retain the benefit of provisions written into the contract on his behalf while denying workers the benefits they obtained in return.

After the freeze

What should follow the freeze? It should now be evident to all that we need a permanent program for price stability. We should not have to lurch from a

vacuum of policy, to an inequitable freeze, to rigid bureaucratic controls, back to the vacuum and so on *ad infinitum.*

The UAW, for more than 14 years, has been urging such a program in the form of a Price-Wage Review Board, the detailed specifications of which have now been set forth in legislative language in HR 10592 introduced by Congressman Reuss on September 13. I am strongly of the opinion that, had that legislation been in effect during the 1960's, the present inflationary spiral would never have started.

Premise of bill

Congressman Reuss's Bill is based upon the same premise as that underlying other voluntary stabilization measures (as distinguished from price and wage controls) such as guideposts or incomes policies. Proponents of all such measures recognize that the restraining influence of effective price competition is absent from certain important industries having significant effect on the general price level. They therefore propose to make up for that lack by substituting the restraining influence of public opinion.

The Council of Economic Advisers, for example, in its initial statement of its guideposts in its 1962 annual report, said:

"An informed public, aware of the significance of major wage bargains and price decisions, and equipped to judge for itself their compatibility with the national interest, can help to create an atmosphere in which the parties to such decisions will exercise their powers responsibly."

It is important that the nature of the problem be clearly understood. It was well-stated, I believe, in a letter that Walter Reuther sent to President Kennedy on April 12, 1962, immediately after the President had publicly denounced U.S. Steel for increasing its prices. The letter said in part:

"There is no room to doubt any longer either the power of the giant corporations in certain industries to rig prices against the public interest or their readiness to do so. Both were amply documented in the hearings of the Senate Antitrust and Monopoly Subcommittee on administered prices in the drug, steel, and automobile industries, among others. Any lingering doubts that some might have entertained should have been dispelled by the guilty pleas in the recent antitrust case against the electrical equipment manufacturers. If the corporations involved in that trial—some of which rank among the largest and (formerly) most reputable in the country—are prepared, in direct violation of law to conspire to rig prices on products sold to the government of the United States only the most gullible would believe that they and leading corporations in other industries would hesitate to rig the prices they charge their private customers—especially when the latter can be done without running afoul of the law.

"We confront a phenomenon anticipated neither by Adam Smith nor by our antitrust laws—the phenomenon of 'price leadership' in industries where prices are administered and not determined by market forces. Where one corporate giant dominates an industry prices can be rigged at monopolistic levels without the necessity for an actual conspiracy that would involve a conflict with the law. The unseemingly haste of U.S. Steel's 'competitors' in following its lead did not necessarily require communication between the leader and the rest of the pack. The latter dare not set their prices higher than U.S. Steel's for fear of losing customers. They dare not set them lower for fear the giant will retaliate. They comfort themselves in these conditions of their existence by grasping eagerly the opportunities for higher profits that become available to them when the giant by raising its prices permits them to raise theirs.

"Thus we have the fact of monopoly prices set by a single corporation, without the overt appearance of actual monopoly. We have the effects which the antitrust laws were intended to prevent without the only causes—monopoly or conspiracy—that can set the machinery of the laws in motion. U.S. Steel has shown us once again that we need new legislation aimed at today's price leaders in administered price industries instead of at the obsolete concept of conspiracies which reflected economic facts of past years—legislation drafted to meet the monopoly and conspiracy problems of more than half a century ago."

The above describes the problem with which we propose to deal by informing and mobilizing public opinion.

Public opinion can be invoked effectively, however, only when pertinent information is made available to all who are interested. The Kennedy-Johnson guideposts broke down, among other reasons, because of a failure to equip the public

with the data needed to judge the propriety of price actions in general and, particularly, in cases of maintenance of excessive prices that should have been reduced. HR 10592 is designed to assure that the public is fully informed.

Summary of bill

HR 10592 would require the price-leading corporation in each major administered price industry to give advance notice of proposed price increases. Other firms could be brought under the procedure by the President if he thought it necessary in the interests of price stability. A tripartite Price-Wage Review Board, with members representing labor, industry and the public, would hold hearings on the proposed increases with a Consumer Counsel representing the public interest. The subpoena power would be used to assure the presence of needed witnesses and the availability of all pertinent books and records. The Consumer Counsel would be empowered to initiate hearings aimed at bringing about reductions of prices he considered excessive. Unions would be required to participate in the hearings if the corporation proposing the price increase alleged that granting union demands would necessitate the increase.

At the conclusion of the hearings, the Board would not pass on the merits of the proposed price increases (or union demands) but would issue findings of fact designed to enable the public to make its own judgment of the merits. After the notice period expired, the corporation would be free to raise its prices and the union, if any were involved, would be free to press its demands. Both would act, however, in the knowledge that the public had the facts required to pass informed judgment on their actions.

Explanation

The above summary of H.R. 10592 is largely self-explanatory, It may be desirable, however, to elaborate on certain of its features and to emphasize the significance of certain others.

To begin with, the Bill's approach differs from that of the now discredited guideposts in a number of highly important respects:

1. Focus on prices: The Bill recognizes the obvious fact that the goal of stabilization policy is to achieve reasonable stability of the *price* level. It therefore parts company with those who shift the conversation from prices to wages whenever inflation is discussed.

Government data show conclusively that the last three periods of inflation (including the present one) began at times when unit labor costs were actually declining. Thus, it is clear that wage restraint will not prevent prices from rising. On the other hand, price restraint will make unnecessary the augmented wage increases that are required to compensate workers for the erosion of their buying power by inflation. Wage increases are relevant to price stability only when they would necessitate price increases or would prevent price reductions that otherwise would be put into effect.

For these reasons, wages would be involved in the proposed procedure only when a corporation alleges that its proposed price increases (or refusal to reduce excessive prices) is attributable to the cost of meeting union demands that have been presented to it. Under those circumstances, the union involved would have to justify its demands in public hearings side by side with the corporation employing its members.

The focus on prices also recognizes that it is both perfectly proper and entirely compatible with price stability for labor and management to bargain over their relative shares in the income generated by an industry or enterprise. This principle was recognized under the guideposts. In fact, in the Council of Economic Advisers 1962 *Report*, which presented the initial statement of the guideposts in 1962, it was stated and restated three times, as follows:

On page 186:

"* * * there is nothing immutable in fact or in justice about the distribution of the total product between labor and non-labor incomes."

On page 188:

"The proportions in which labor and nonlabor incomes share the product of industry have not been immutable throughout American history, nor can they be expected to stand forever where they are today. *It is desirable that labor and management should bargain explicity about the distribution of the income of particular firms or industries.* It is, however, undesirable that they should bargain implicity about the general price level." [Italic added.]

On page 190:

"Finally, it must be reiterated that collective bargaining within an industry over the division of the proceeds between labor and nonlabor income is not necessarily disruptive of overall price stability. The relative shares can change within the bounds of noninflationary price behavior."

The same thought was reiterated in subsequent Council reports.

The principle involved was recognized as a practical matter under the stabilization programs established during both World War II and the Korean War. Executive Order No. 9599, issued on August 18, 1945, after the war with Japan ended, permitted wage increases to be put into effect:

"* * * without the necessity of obtaining approval therefor, upon the condition that such increases will not be used in whole or in part as the basis for seeking an increase in price ceilings, or for resisting otherwise justifiable reductions in price ceiling * * *."

Similarly, during the Korean War, wage increases comparable to the UAW's annual improvement factor increases were permitted to be paid provided the employer agreed not to use them as a basis for seeking approval of price increases.

It would be senseless, in any case, to waste the time and facilities of the Board in the hashing out of collective bargaining issues which, by the employers' own admissions (in not claiming them as the basis for proposed price increases) have no bearing on price stability.

2. Availability of facts: The Council of Economic Advisers, in its 1967 annual report, lamented that its efforts to apply its guideposts to prices were frustrated because it:

"* * * ordinarily does not have the detailed information which would permit a clear judgment as to the appropriateness of the proposed price changes on either the basis of the guidepost standards or other relevant considerations."

The Bill would meet that problem by equipping the Consumer Counsel with subpoena power to assure that all necessary witnesses and all pertinent data are available for examination in the public hearings.

3. Price reductions: The Bill would empower the Consumer Counsel to initiate hearings designed to mobilize public opinion in support of price reductions where the facts show existing prices to be excessive. The guideposts, as the Council confessed, were a complete failure in this respect. For example, the Council's 1967 annual report declared:

"In general terms, the greatest failure of observance of the price guidepost lies in the failure to reduce prices on a considerable number of the product lines of a large number of industries."

Yet, a major factor causing inflation has been the refusal of industries with rapidly advancing productivity or abnormally high profits to reduce their prices. The general price level obviously cannot be stabilized if industries with rising costs raise prices while those with low or falling costs maintain or even increase their prices.

4. Keeping the task manageable: The guideposts represented a scatter-gun approach. In theory they applied to every firm and every union in the entire country. In practice, the price guidepost was used to mobilize public opinion in only a handful of cases while the wage guidepost became a shibboleth for employers generally both in the public forum and across the bargaining table.

Application of the Bill would be confined to the potential sources of serious inflationary abuses—the price-leading corporation in major administered price industries and to such other firms or industries as the President might from time to time find necessary to bring under the legislation.

The price leader (or "price-dominant" corporation, in the language of the Bill) is defined as the firm that accounts for 25 percent or more of the sales in a product category and more than the sales of any other corporation in the same category. Any field in which one firm controls that large a part of the total market is obviously one in which price administration or oligopoly prevails. Product categories would be established only for products having "a significant effect on overall price stability." If public opinion is to be effectively mobilized, it would be unwise to apply the procedure to industries or products having only negligible effect on the general price level.

It would be enough to confine the notification and hearings procedure to the price leader (i.e., the dominant corporation) in each industry because its decisions necessarily determine the prices of other firms in the same industry. The auto industry provides numerous examples of situations in which Ford and

Chrysler adjusted their prices—up or down—to approximately the levels set by General Motors for comparable cars or optional equipment.

An analysis made by UAW economists some years ago indicated that *coverage of only about 100 corporations in all would be sufficient to exert significant leverage on over-all price level changes.*

At the same time the Bill would enable the President to bring other firms or industries under the procedure when necessary to safeguard price stability.

5. Advance notice: HR 10592 would assure that the public had advance notice of impending price increases in important industries. The facts would be brought out and public opinion would be able to exert its influence before the price increase became a *fait accompli.* Under the guideposts the Council often could do little more than wring its hand after an inexcusable price increase had been put into effect. *Post-mortems* on price increases conducted by Congressional committees have been revealing but have come too late to have any practical effect.

Unions are now required by law to give advance notice of intention to modify or terminate their contracts which, among other things, generally means to seek wage increases. This part of the Bill would do nothing more than to put a small number of corporations under a similar obligation with respect to price increases.

6. Case-by-case approach: President Johnson's tripartite (labor, management, public) Advisory Committee on Labor-Management Policy recognized the need for a case-by-case approach to problems of price stability. In a statement adopted August 18, 1966, after thorough and careful review of experience under the guideposts, the Committee felt compelled to say:

"* * * it is impractical if not impossible to translate the goals reflected in the guideposts into formulae for application to every particular price or wage decision."

That conclusion applies with even greater force to the current situation because of the extremely uneven distribution among workers and firms of the gains from and sacrifices imposed by years of inflation. Attempts, under these circumstances, to hold wage and price changes within the confines of uniform formulae would be doomed to failure, for no system of voluntary restraint will work if its end product is flagrant inequity.

Implicit in the qualifications and exceptions noted in the Council's original 1962 statement of the guideposts was the necessity to look carefully into the facts of each case. Today's circumstances emphasize that need. H.R. 19592 provides for the required case-by-case approach and would establish machinery to assure that all pertinent facts of each situation are elicited and brought to the public's attention.

Other features of bill

I believe it will be useful to call to the Committee's attention certain other features, aspects or probable effects of the Bill which lead us to believe that it would be a workable mechanism contributing in important degree to price stability.

1. Deterrent: We believe it would create an effective deterrent to unjustifiable price increases. With the Bill in effect, we doubt that any major corporation would even formally propose to make any price increase for which it could not make at least a presentable case. It is almost inconceivable, for example, that U.S. Steel would have proposed the 1962 price increase which President Kennedy succeeded in rolling back if it had had to contemplate the prospect that its officers would have been required to submit to cross-examination in public hearings, with all pertinent data available, concerning the necessity and justification for the price decision.

The Bill contemplates that every reasonable effort would be made to give the hearings the widest possible publicity. Televising the hearings would be useful both for informing the public and for strengthening the deterrent effect of the procedure.

2. Relatively few hearings: The deterrent effect would have the further value of limiting the number of hearings which would have to be held. Public attention could therefore be focused sharply on relatively few cases. Toward this same end, the Bill would permit the Board, with the consent of the Consumer Counsel, to waive hearings where, for example, preliminary examination of the data indicated that the proposed price increase was clearly justified or where it would have negligible effect on the general price level or where it would be offset by price decreases for other products of the same company. With only about 100 corporations in all normally covered by the procedure, its scope would be sufficiently

narrow to permit public opinion to zero in effectively on clear-cut cases of abusive price increases. Consumer groups and business or government customers having an important interest in the particular prices involved could be counted upon to help bring the pertinent facts of significant cases to public attention. It would be more difficult to do so effectively if the number of covered corporations were too large.

3. Permanent machinery: The Price-Wage Review Board and the Consumer Counsel are intended as permanent agencies. This would enable them and their staffs to develop a high level of expertise in dealing with price issues and in presenting their findings in a manner readily understandable by the public. The existence of the machinery on a permanent basis would also help to avoid the initiation of inflationary spirals. As is clear from the record of the present and past inflations, such spirals start with prices. Once some important prices rise, they work their way into the costs of other businesses or into consumer prices, inducing or compelling increases in other prices or in wages, which then, in turn, lead to further increases in prices and wages, etc. If public opinion is mobilized effectively to halt the initial price increases, there will be no spiral.

4. Emergency price increases: The Bill recognizes that on occasion firms may be confronted with sharp increases in costs which necessitate immediate price increases in order to avoid serious impairment of profits. It would therefore permit such price increases to be put into effect prior to the expiration of the period of advance notice which would otherwise apply. Severe penalties would be imposed, however, for price increases improperly made under false claim, or exaggeration of the extent, of an emergency. The amount of the penalty could be objectively determined on the basis of the size of the price increase measured against the actual cost increase, if any. The Board, in consultation with the Consumer Counsel could develop standards and regulations concerning, for example, the extent of impairment of profits that could be considered to create an emergency and methods of measuring such impairment.

5. No recommendations: Under the Bill the Board would not pass on the merits of the proposed price (or wage) increase or make any recommendations as to whether or not it should be put into effect. The reason is that there is at present no generally accepted basis for determining the propriety of any level of prices, wages or profits nor, as previously noted, are there any general formulae that can properly be applied to the enormous variety of individual situations. Given the facts of particular cases, the public will begin to form, and to express, its own judgments as to what is or is not proper conduct under certain sets of conditions. Out of these judgments there should, in time, evolve generally accepted standards of proper conduct. When that occurs—but not before then—it may be possible to formulate criteria that could be used as the basis for recommendations and to write such criteria into law.

6. Findings of fact: Although the Bill would prohibit recommendations or judgments on the merits, it does call for the Board to issue findings of fact. The facts to be made public should include such matters as changes in production costs, the source of such changes (e.g., wage costs, materials prices, overhead costs, changes in volume of production, etc.), the degree to which cost increases are offset by cost savings (such as those flowing from advances in productivity), the profit position of the corporation, the effect of the proposed price increase upon per unit and total profits, the effect upon those profits if the ascertained net cost increases were to be absorbed by the corporation, and all similar matters which would enable the individual citizen to make an informed judgment as to the propriety or justification for the proposed price increase.

In order to insure that every area of pertinent fact is covered, the Bill contemplates that all parties to the hearings (which may include, besides the corporation proposing the price increase and the Consumer Counsel, unions, consumer organizations, customer corporations, government agencies, etc.) would be invited, at the conclusion of the hearing, to submit lists of their contentions based on the evidence presented at the hearing. The Board would issue its findings with respect to each such contention. For example, if a union contends that, after granting a proposed wage increase, the corporation would still have, at a given volume of output, a profit equal to X percent of its investment. the Board would make a finding of fact on that claim. If the corporation should contend that it requires a profit of Y percent in order to attract needed capital, the Board might issue a finding concerning profits earned by other corporations operating under similar risk factors and their experience in raising capital.

7. Flagrant cases: Despite the absence of provision for recommendations, the Bill definitely does not contemplate that responsible government authorities would do nothing in flagrant situations of abuse of pricing power. Although, as noted, there are no generally accepted standards of proper price behavior, it is possible to recognize clearly outrageous behavior totally unjustified by the facts of the situation. Where hearings had elicited evidence that effectuation of a proposed price (or wage) increase would be of that nature, it would be entirely appropriate for the President (or others high in government) to direct the fire of public opinion against the threatened abuse and to take such other action as might be appropriate. With the hearings having uncovered the facts, effective mobilization of public opinion would be greatly facilitated.

Other measures needed

I should make it clear that I do not advance HR 10592 as a panacea which, in and of itself, would eliminate the inflationary problem and all its damaging consequences. Administered price abuses are a major, probably the major, factor causing inflation in our economy. But there are other sources of inflation which have to be dealt with also. For example, there are serious supply bottlenecks in certain sectors of the economy, of which medical care is an outstanding example. There are situations in which disproportionate increases in certain forms of demand put inflationary pressures upon capacity. For example, rapid increases in profits following the end of a recession encourage and provide the means for speculative investment in new plant and equipment and in inventories. We need to be alert, always, to problems of these kinds and to develop a battery of selective measures designed to open up supply bottlenecks which interfere with the achievement of national priority goals, to suppress inflationary non-essential demand and, to the extent consistent with national needs and purposes, to route demand toward underutilized capacity and away from the supply bottlenecks.

Wise use of selective measures could help to prevent the onset of inflation. Such measures also could be helpful in ending inflations when they do occur and in minimizing the social damage and economic losses that flow from use of the blunderbuss of restrictive over-all fiscal and monetary policies to halt inflation. For example, selective credit policies could protect the flow of urgently needed funds for housing and the projects of state and local governments while choking off credit for excessive investment in new plant and equipment or for inventory speculation. Selective manpower measures, such as a public service employment program, for example could provide useful jobs, maintain family incomes, supply valuable training, and serve important public purposes even as demand was curtailed in certain areas of the economy to damp down the inflationary fires. Insofar as health care costs are concerned, I see no solution short of enactment of the Kennedy-Griffiths-Corman Health Security Bill.

We regard HR 10592 as merely one element—although an important element—in the arsenal of selective economic weapons needed to maintain price stability simultaneously with full employment.

H.R. 10592 meets Phase 2 requirements

I believe that HR 10592 meets the requirements of what has come to be known as "Phase 2"—the period immediately following the end of the freeze—as well as the need for on-going, permanent machinery to promote price stability. I am realist enough, however, to know that a direct move from the freeze to the machinery and procedures of HR 10592 is not going to occur. Nevertheless, I would like to state the reasons for concluding that HR 10592 would meet immediate as well as long range needs, in the hope that consideration of those reasons will contribute to the shortening of Phase 2 and its prompt replacement with the Bill's Price-Wage Review Board.

It is evident that the continuance of inflation does not have its source in those industries where price competition prevails. That would be most unlikely, if not in fact impossible, given the magnitude of present slack in the economy. Even a cursory reader of the newspapers prior to August 15 ,1971, must have been aware that important price increases were centered in the oligopolistic, administered price industries. As those industries raised their prices, firms in some of the competitive sectors may have had no alternative but to try to compensate for resultant cost increases. But many were finding it increasingly difficult to do so. (Their difficulty or outright inability to raise prices is reflected in the maldistribution of profit increases to which Senator Proxmire has called attention and which I will discuss later in this statement.)

It therefore should now be possible to break the spiral through application of the force of public opinion to the price leaders of the oligopolies—as provided for in HR 10592.

As matters now stand, however, the White House will bring forward its own program for Phase 2. Whether or not that program will require legislation is not now known. However, both the White House and the Congress should be fully aware that no program will work that is not acceptable to America's workers. Stabilization policy is a delicate matter and one that, far more than most, requires that essential ingredient of democracy—the consent of the governed.

Essential conditions

The union representatives who met with the President about 10 days ago made it clear that a price and wage stabilization program will be acceptable to America's organized workers only if it is *voluntary and tripartite and applies equitably to all forms of income.*

"Voluntary" means that the government keeps hands off, stays out and leaves all decisions including those pertaining to standards, rules, regulations and procedures to the sense of public responsibility of the labor and management parties directly concerned. It means also that those parties select their own representatives to develop and implement the program. "Tripartite" means that labor has an equal voice with management in all decisions, with deadlocks between them broken by public members who are independent of any form of government control and whose impartiality and integrity is beyond question.

The above is an exact description of the essential characteristics of mechanisms established for stabilization purposes in World War II and in the Korean War. There is no question but that those mechanisms worked—and with remarkable effectiveness. There were sharp differencse between the labor and management members at times but, once decisions were made, no matter how distasteful to one group or the other, both sides cooperated unreservedly in carrying them out.

Based up the proven success of the voluntary and tripartite approach, it would be a grave mistake to experiment now with other kinds of mechanisms. Particularly dangerous and futile would be to attempt to impose rules and standards from above and to administer them through an agency in which workers had no direct and effective voice and, therefore, no confidence. A number of witnesses before this Committee have stressed the importance of involving the affected parties. That proved essential under wartime conditions. It is far more essential now when there are no comparable external pressures for acquiesence in unpleasant measures.

No straitjacket

I feel compelled to make clear, with all the emphasis at my command, that *there must be no straitjacket of any kind on the voluntary process.* The tripartite body must not be restricted in any way—whether by the Administration or by Congress—with respect to the development of standards, rules, regulations and procedures.

I stress this point because of the various bills that have been submitted which would establish legislative guidelines of one kind or another to govern the movement of wages and/or prices.

At the point such guidelines are imposed, the stabilization process would cease in substance to be voluntary no matter what forms might be devised to disguise that fact. The parties to the voluntary, tripartite operations in two major wars demonstrated that they had the responsibility and the wisdom to establish their own standards without outside interference. There is no reason to believe that those who might be called upon to participate in a new voluntary stabilization effort would be any less wise or responsible.

Partial cost-of-living compensation

With all due respect, I must say in all frankness that I am particularly appalled by suggestions made to this Committee for the establishment of guidelines that would allow only partial compensation for increases in living costs.

That goes farther than the wage rules in effect at the height of the Korean War. UAW contracts providing for substantialy full compensation for increases in living costs were permitted to operate soon after the Korean War wage stabilization program became effective. Subsequently, under its General Wage Regulation 8, the Wage Stabilization Board permitted all cost-of-living wage increases (including those negotiated after the stabilization base date, Jan-

uary 25, 1951) to be put into effect without prior approval provided only that they did: "* * * not exceed the corresponding subsequent percentage increase in an acceptable index * * *." No one could reasonably expect workers to accept less protection against rising living costs under today's circumstances than they had during the Korean War.

The inequity of the proposal that workers be limited to partial protection seems to have escaped or to be of no concern to the proponents. It must not be forgotten that, as inflation increases the prices of goods and services, it also increases the total of all incomes in the economy proportionately. If some get smaller shares of the increased total income, others must get larger shares and the goods and services output of the economy is thereby redistributed at the expense of the first group and in favor of the second.

Traditionally, the reason for combatting inflation has been its inequitable redistributional effects. Now it is proposed that inequities be created in order to combat inflation. To compound the inequity, the workers who are singled out to be the victims of deliberately created inequity are the very persons who have been the prime victims of inflation itself. Need this Committee be reminded that the average after-tax real weekly earnings of some 48 million production and nonsupervisory workers in the private economy are now lower than in the last quarter of 1965—nearly six years ago? They have been on a treadmill while living standards, generally, were on the rise. Now, it is proposed to run the treadmill faster so that they will lose even more ground.

Making workers pay for price failures

It should be obvious that effective price restraint will make cost-of-living wage escalation inoperative. Escalator wage increases are paid only *after* prices have risen. To propose that workers receive only partial compensation for increased living costs is, therefore, to propose that *they bear the burden of the government's failure to stabilize prices.*

Any government genuinely determined to halt inflation of prices would have no hestiation in allowing wage escalators full and free play because the matter would be essentially academic. Proposals that limits be placed upon cost-of-living wage escalation therefore *bring into grave question the genuineness and sincerity of the intention to stabilize prices.* They cause me to wonder whether we will see in Phase 2 a continuance of the farcical "voluntary" price controls of the current freeze period during which wages are held in a straightjacket. Anyone who believes that there is in fact a freeze on prices will find it instructive to read the article in the September 20, 1971, issue of *Newsweek* headed "We Don't Want to be Heavyhanded." Heavyhandedness is confined to wages.

If the underlying assumption is that some prices will be free of restraint or that the price restraints cannot be expected to work perfectly, why should the workers be selected to be the victims? Doctors fees, for example, could prove particularly difficult to restrain. The proposal, therefore, could well have the effect of compelling workers to contribute, at the cost of their families' living standards, to further increases in the real incomes of doctors whose average annual net earnings were reported recently to exceed $40,000 per year.

Equity

The proposal to limit workers to partial compensation for increased living costs is in direct conflict with the third essential condition for success of any stabilization policy—absolute adherence to the principle of equity. Even under wartime conditions it was found necessary to establish at least some highly visible symbols of equity. There were stiff excess profits taxes during both World War II and the Korean War. In both cases, top-bracket personal income tax rates ranged up to levels that earlier would have been considered confiscatory. Moreover, in the Korean War period, as noted, it was recognized, based upon experience derived from World War II, that no rigid ceilings such as the Little Steel formula could be placed upon wage increases. Allowance was made for increases in *real* wages so that the distribution of income would not be distorted to the disadvantage of workers.

Under conditions such as those that prevail today, when we are hopefully disengaging from war, equity becomes all the more essential to the success of stabilization efforts. There must be equity not only among workers or groups of workers; there must also be equity as between workers and other elements of society whose incomes are from non-wage sources.

The problem of equity arises in the second of the above forms because wages, generally, tend to be the only form of income, as such, to which stabilization

policies apply. Certain other forms of income—interest, professional income, capital gains, executives' bonuses, stock options and expenses and other "perquisites"—are completely untouched. The attempt to restrain still other forms of income—profits and dividends—is usually indirect and based upon criteria concerning prices, ignoring the fact that profits can rise sharply even while prices remain unchanged. Ironically, the statistical record shows that wages—the only form of income to which stabilization policy usually directs itself—are a passave factor in the inflationary process. Wages do not initiate the spiral and their rate of increase tends to slow down as inflation itself abates.

The singling out of wages gives rise to inequities which bring the stabilization programs into disrepute and make them unworkable. The point was recognized and clearly expressed by President Johnson's Advisory Committee on Labor-Management Policy. In the statement quoted previously, the Committee said:

"We believe that in a free society any policy to achieve price stability will be acceptable and effective only if it bears equitably on all forms of incomes."

Other democratic countries have been compelled to the same conclusion. They had experimented with approaches similar to the U.S. guideposts which directly affected only income from wages. They found it necessary to place increasing emphasis on non-wage incomes.

They moved from wage policy toward "income policy." Instead of focusing upon the relationship between wages and productivity, they came to stress the relationship between *total money incomes and real national output.* Stress on the total of money incomes means that an incomes policy, among other things, is fully consistent with collective bargaining and with government policies designed to change the distribution of income by form or by size in the interests of equity and social justice.

The phrase "incomes policy" is being used in the United States today as a euphemism for measures that consider only wages and prices. Misuse of the phrase makes it important to emphasize that incomes policy contemplates a much broader scope.

The crucial difference is that incomes policy recognizes the need for equity as between workers and other groups in the society. Such recognition is reflected, for example, in a report of the Working Party on Costs of Production and Prices of the Organization for Economic Cooperation and Development (OEDC), of which the United States is a member. The report said:

"* * * experience shows that whatever may be the mechanism of cost inflation, wage earners will ask for some *quid pro quo* in return for any agreement to accept a more moderate increase in wages. As the Trade Union Advisory Committee has put it:

"'An argument can be made out for planning or guiding incomes; an argument can also be made out for leaving them unplanned and unguided; but there is nothing at all to be said for planning or guiding half the incomes and leaving the other half unguided and unplanned and subject to market forces or varying degrees of monopoly control.'

"The existence of a policy for wages clearly gives this argument considerable weight. Those whose incomes are subject to restraint will naturally demand the establishment of criteria by which the inflationary or noninflationary behavior of other incomes can be clearly established, and the assurance that action will be taken if the assumption that—discounting short period fluctuations—other incomes will follow the development of wages, turns out to be wrong.

"In other words, it is not enough for justice to be done—it must be seen to be done; and it must be seen that the government has the ability to intervene effectively in cases where intervention would be justified."

Profits

As other democratic nations wrestle, individually and through OECD and the International Labor Organization (ILO), with the problems involved in developing and implementing an incomes policy, they are confronted insistently with the role of profits in the inflationary process. The chairman of the OECD Working Party mentioned above, in introducing a study prepared for his group, wrote:

"During the preparation of its second report, the Working Party had several discussions on the role of profits in the process of cost inflation. It concluded that: 'While it is difficult to disentangle the role of different elements in total costs, it seems probable that the failure of cost reductions to be reflected fully

or immediately in prices is an important feature of the process by which costs and prices are levered up under conditions of cost inflation.'

"*As a result of the work of the experts, the Working Party feels that it should have been rather more positive about the role of profits.*

"In this connection, the evidence presented in Chapter VI of the report suggesting a quite strong relationship between profits and changes in profits, and wage movements, is both interesting and significant. While this evidence is open to alternative interpretations, it seems to provide further support for the view that a successful incomes policy *must cover prices, profits, and other non-wage incomes as well as income from employment.*" [Italic added.]

No democratic country has yet developed a successful incomes policy because none has met the test of equity as between workers and other groups in society. The guideposts collapsed in our country under the weight of the inequities to which they gave rise and a similar fate has met peacetime stabilization efforts in other countries for the same reason.

Any new stabilization effort to be made in the United States which goes beyond the principles of HR 10592 must therefore restrain all forms of non-wage incomes to the same degree as wages are restrained.

With regard to profits, I have hitherto urged an excess profits tax, despite its defects, because it is a familiar device to most Americans. Later in this statement, I will propose what I believe to be a better approach. Clearly, however, there is need to restrain the rise of profits by one means or another if wages are to be restrained to any degree.

The myth of "low" profits

Attempts have been made in recent weeks to create the impression that profits are too low and must be encouraged to increase. It has been said, in particular, that profits now form a smaller proportion of GNP than in 1938. To this there are several answers.

The first is that the comparison is between apples and oranges. The measure of profits in the national income accounts, upon which the comparison is based, reflects repeated changes in tax rules which have transformed a large part of what were formerly called "profits" into "capital consumption allowances." The monies involved still go to the corporations, but the labels on part of them have been changed.

The second answer is that economists generally would agree that, as capital becomes more abundant in relation to labor, rates of return on capital should decline. All other things being equal, this should have meant a significant decrease in the profit share of GNP since 1938. However, except for temporary cyclical dips, the evidence suggests that rates of return may actually have been on a rising trend.

The third answer is that profits, in the aggregate, are not low at all. In fact, in the second quarter of this year, *they were approximately at their all-time peak* and, by now, quite likely have exceeded it.

The Department of Commerce, on August 20, 1971, reported corporate profits before taxes were at an annual rate of $82.0 billion in the second quarter of this year. The same release stated, however, that the figure reflected an upward adjustment of $3¾ billion in depreciation charges because of ADR. Thus, before that adjustment, profits would have been $85.8 billion. The same release showed that profits in the record high year 1968 were $87.6 billion. The latter figure, obviously, reflects no ADR adjustment and is therefore comparable with $85.8 billion for the second quarter of 1971. The decrease from the peak year was thus only *2.1 percent.*

Narrowing the focus to manufacturing profits, it appears they also were approximately at their all-time peak in the second quarter of this year. The August 1971 issue of the First National City Bank's *Monthly Economic Letter* says:

"After adjustment for seasonal variation, FNCB's index of manufacturers' after-tax profits (1967=100) advanced 4% to 118. This puts it within striking distance of the all-time high of 119 reached in the fourth quarter of 1968. *In other words, virtually all of the 22% decline in manufacturing earnings during the recession has been made up during the first two quarters of recovery.*" [Italic added.]

Under the caption "Two sets of books?" the bank letter goes on to explain that its profit figures (and those of the FTC-SEC) reflect "accounting practices used by corporations for reports to their stockholders" while the Department of Commerce figures, which the Administration uses to argue that profits are low, reflect "accounting used on income tax returns."

It is remarkable that, after only two quarters of a most anemic recovery, profits had already approximately regained their all-time peaks.

There is every reason to believe, therefore, that as recovery continues and capacity (much of it, because of the pre-recession capital goods boom, consisting of the most advanced equipment obtainable) is more fully utilized, productivity will soar and profits will skyrocket *even if prices are held absolutely rigid.*

Clearly, measures are needed to keep profits in balance with wages if the latter are to be subject to any form of restraint.

Maldistribution of profits

While profits in the aggregate have recovered, the latest FTC-SEC report on profits of manufacturing corporations reveals a gross maldistribution of the recovery in profits as between the largest corporations, on the one hand, and those of small and medium size, on the other. Senator Proxmire deserves credit for calling attention to this fact.

Total before-tax profits of *all* manufacturing corporations in the first quarter of 1971 were 0.3 percent higher than in the same quarter of 1970.

However, corporations with assets of less than $1 billion showed a profit *decrease* of 16.2 percent for the period. The smallest corporations—those with assets of less than $1 million—suffered a *decrease* of 40.4 percent. Every one of the 8 asset size groups below $1 billion had lower profits in the first quarter of 1971 than in the same quarter a year earlier.

Profits of corporations in the $1 billion and over asset category, in marked contrast, *increased* by 18.8 percent in the same period.

While the percentage decreases varied irregularly among the asset size classes below $1 billion, the following picture emerges when the 9 FTC-SEC groupings are consolidated into 3 classes:

Change in pretax profits

Corporations with assets—	*Percent*
Under $100 million	−20.1
$100 million but less than $1 billion	−13.3
$1 billion and over	+18.8

The contrast between increased profits for the largest corporations and decreases for the others remains even if General Motors profits are eliminated on the theory that GM's post-strike "catch-up" sales tended to inflate 1971 profits in the $1 billion and over category. With GM profits subtracted in both 1970 and 1971, that category nevertheless showed an *increase* amounting to 11.8 percent.

Support for H.R. 10592 approach

I now turn back, parenthetically, to an earlier point. The maldistribution of profits reinforces the conclusion that the machinery provided for in HR 10592 would be appropriate for the present situation and Phase 2 as well as for the long term future.

The discrepancy in profit movements must, at least in significant part, reflect continued price increases by the oligopolies, on the one hand, and the inability of smaller firms to pass on the cost increases resulting from the giants' price increases, on the other. The same conclusion is supported by other evidence.

Thus, the spiral could be broken now by a Price-Wage Review Board that would concentrate its efforts on the price leaders of the oligopolies. Moreover, the danger that smaller firms might raise their prices as recovery proceeds could be minimized under HR 10592 by hearings held on the initiative of the proposed Consumer Counsel to bring the force of public opinion to bear upon existing oligopolistic prices that yield excessive profits. Public airing of the facts in such cases, or even the possibility of public examination, could bring about price roll-backs which would lessen the cost pressures upon smaller firms and permit price competition among them to operate above a lower cost floor.

The dividend charade

Returning now to forms of restraint other than HR 10592, it must be noted that restraint on dividends (although necessary to achieve equity) is not a substitute for restraint on profits as such. If profits are sufficient to pay increased dividends, it makes little difference to most stockholders whether dividends are actually increased. Dividend increases not paid now can always be paid later. Meanwhile (or if they are never paid) the monies involved become part of the corporation's net worth and (aside from short-term fluctuations) add to the market value of the stock. Many stockholders, in fact, would prefer that dividends not be increased because they prefer capital gains which are taxed at lower rates, to dividends which are subject to regular income tax rates.

In a transparent effort to distract attention from the Administration's omission to ask Congress for power to control profits, an elaborate charade is being acted out over the essentially meaningless issue of dividend increases during the 90-day freeze. First came the President's plea to corporations not to raise their dividends. Then there were the highly dramatized and publicized calls to Washington of executives of corporations that had ignored the plea. Next were the chants of victory over roll-backs of dividend increases—or over promises to reduce the next quarterly dividend. This, in turn, was followed by the issuance of a "dividend guideline" which actually relaxed the previous "guidance" not to increase dividends over the effective rate declared in the most recent dividend period prior to August 15, 1971.

The significance of all this was hardly commensurate with the dramatics.

Interest

Interest is a form of non-wage income the President did and does have power to control. He refused to use the authority granted him under the Credit Control Act on grounds, according to Administration spokesmen, that interest ceilings would become floors and, therefore, it would have been unwise to freeze interest rates at the high levels prevailing in August 1971.

This argument does violence to the facts of the situation because it ignores the authority provided in the Credit Control Act to *roll back* interest rates. The rates in effect in August are totally irrelevant. The Act states unequivocally that the Federal Reserve Board:

". . . upon being authorized by the President under section 205 and for such period of time as he may determine, may by regulation . . .

"(7) prescribe the maximum rate of interest, maximum maturity, minimum periodic payment, maximum period between payments, and any other specification or limitation of the terms and conditions of any extension of credit."

The powers available under the Act were not used despite the facts that interest rates have been a major causal factor of inflation and that a roll-back would have brought substantial relief from inflation to millions of families, to financially hard-pressed state and local governments and to thousands of small businesses.

Income equalization tax

The Administration's tender treatment of profits and interest in contrast to the freeze on wages emphasizes the need for measures to assure equity as betwen wage and non-wage incomes.

A means to achieve equity was presented by the British journal, *The Economist* in articles published in the September 28 and November 30, 1963, issues. Recognizing the essentiality of equity to the success of an incomes policy, the magazine proposed what it called an "Incomes Equalization Tax (IET)" to be applied to non-wage incomes. It then went on to say:

"The *principle* on which the proposal is based, which is assumed to be reasonably generally acceptable, is that the rewards to capital per unit should not increase faster than the rewards to labour per unit.

"The *method* of the proposal is to vary the tax on unearned incomes to make the average rate of increase in unearned incomes equal to the average rate of increase in wages." [Italic in original]

Without repeating the detailed arithmetical illustrations offered by *The Economist*, the IET may be explained as follows. An annual index would be computed for wage rates and for each form of non-wage income subject to the tax. Assume, for example, that in year X the index for wages was 115.7 and that for dividends was 126.4. The difference between the two indexes in favor of dividends is 10.7 index points. This figure is then divided by the index for dividends (10.7 divided by 126.4). The result (multiplied by 100 to convert it from a decimal to a percentage) is 8.5 percent, which is used as the IET rate applicable to dividends.

A tax of 8.5 percent applied to all dividend income would reduce the total of such income to the same level relative to the base period as the index for wages (126.4 x (100.0—8.5)=115.7). The regular income tax is then applied to the sum of all forms of income received by the taxpayer after deduction of the sum of the IET liabilities applicable to each form of non-wage income received.

To avoid imposing undue tax calculation burdens on individuals receiving relatively small amounts of non-wage income, persons with less than specified amounts of such forms of income could be exempted from IET. Certain forms of income which the individual has no means of increasing (pensions, for ex-

ample) could also be exempted. (Unlike *The Economist*, however, I would not propose tax remission for forms of income which lagged behind wages. The reason is that the tax assumes that only wage income is subject to direct restraint, so that non-wage incomes remain free to fluctuate in the normal manner. The purpose of the tax, therefore, must be to prevent increases in non-wage incomes from outstripping wages.)

This tax is subject to none of the criticisms usually directed at the excess-profits tax. In addition, it can be applied not only to profits but to *all* forms of non-wage income, thus making for across-the-board equity for wages. Applied to profits, it would not penalize unusually successful firms. Their IET rates would be no higher than those of the less successful. Similarly, the IET rate would be the same for all individuals receiving the same form of income regardless of whether their amounts of such income had increased or decreased in the year.

Effects of applying IET to profits

There is convincing evidence that an IET applied to profits would not only contribute to equity but also would contribute materially to the attainment of other highly desirable economic goals.

An article in the Summer, 1971, issue of the *Wharton Quarterly* (published by the Wharton School of Finance of the University of Pennsylvania) examined the effects of a hypothetical special tax that would confine increases in profits to the same rate of increase as wages. (The tax is not called "IET" and the article seems to have been written without knowledge of the proposal made by *The Economist.*) One of the authors of the article is Professor Lawrence R. Klein who is widely respected as an outstanding econometrician. The analysis involved use of the Wharton Econometric Model of the U.S. economy.

The conclusion is that such a tax would have the effects of *increasing output, sharply reducing unemployment and markedly retarding the rate of price increase.*

Several variants with the tax assumed to be in effect were run through the econometric model. All pointed to essentially the same general conclusions. One version, based upon quarterly data and assuming the tax had become effective in the fourth quarter of 1970, showed that over a two-year period:

Real GNP would be $17 billion higher (in 1958 prices) than it would have been in the absence of the tax.

The unemployment rate at the end of the period would be 3.39 percent instead of 4.83 in the absence of the tax.

The GNP price deflator would increase at a rate of 2 percent instead of 3.3 percent in the first year and by 1 percent instead of 2.4 percent in the second year.

In addition, the government deficit would be smaller than if the tax had not been in effect.

The analysis also shows that controls *on wage rates alone*, without the special tax on profits, would have the effects of *reducing real GNP and increasing unemployment.*

Carried to 1980 on the basis of annual data, the model shows that the special profits tax would yield similarly favorable results over a longer period. GNP in 1958 prices is $28 billion higher by 1980 than it otherwise would have been. The average unemployment rate for the 10 year period is substantially lower than in the absence of the tax. Practical price stability (an annular increase of 0.8 percent) is achieved by 1973 and beyond 1975 "the price index stays constant or drops a little."

Enact IET

I strongly urge enactment of IET if Phase 2 provides for any form of restraint of wages to which non-wage incomes are not subjected.

IET, as the *Wharton Quarterly* article demonstrates, would yield substantial economic gains as well as contribute materially to equity. With respect to importance of equity, the article is quite emphatic. It says:

"A deficiency of past guideline rules is that they overemphasized restraint in wage patterns to the exclusion of restraints in other income shares and that they have not been enforced or enforceable. A balanced policy stands a better chance of being acceptable now.

* * * * * * *

"There is a much greater chance that American labor will accept a guideline principle for earnings if there is a corresponding guideline principle for profits.

"Wage restraint, by itself, would tend to be reflected in unusually large profit increases and this would lead to an eventual breakdown of the principle."

Without equity as between wage and non-wage incomes, whether established through IET or some other device, the cooperation of American workers in the stabilization program cannot be expected and will not be deserved. Absent equity, the end result, as it has been in every democratic country where stabilization measures have been applied in peacetime, will be collapse of the stabilization program. Collapse, it should be added, has generally been followed by a wage explosion as workers act to remedy the inequities inflicted upon them.

Other problems of equity

Whatever form Phase 2 assumes, there will be other matters of equity that will urgently require attention. Without attempting a complete list, there is, for example, the necessity to assure retroactive payment of contractually owed wage increases withheld during the freeze period. Otherwise, the workers involved will have the right to consider their contracts cancelled and to negotiate others in their place.

Similar problems arise with respect to individual workers denied, during the freeze period, longevity and progression wage increases, additional days or weeks of vacation based upon length of service and a variety of other types of wage increases and fringe benefits.

For the longer run, it goes without saying that fairness will require, among other things, latitude for workers trapped by the accidental timing of the expiration of their contracts to restore their normal position relative to those who have recently negotiated new contracts. It will require, also, freedom to obtain wage increases that compensate fully for increases in living costs plus additional amounts to allow workers to share equitably in the growth of the economy's output (and more where more can be obtained without increasing prices), provision for correction of wage inequities and substandard wages and no impairment of existing contractual rights.

Respecting contractual rights

Respecting rights established under existing contracts, even though the wage increases provided for exceed standards that may be adopted by a tripartite board, does not mean acquiescence in continuing inflation. Newly negotiated contracts, of course, would have to conform to the established standards. This will mean—assuming price increases are effectively restrained—that the average rate of increase in wages will tend to decline. The declining tendency resulting from new contracts will be reinforced by existing contracts because many of the latter are heavily "front-loaded" with wage increases scheduled for the second year and beyond substantially lower than in the first year. In fact, second and third year increases provided under most contracts are within reasonable stabilization standards. As a result, the average rate of increase will steadily approach such standards and within a short time will conform to them if every contract now in effect is permitted to be implemented in full.

Profit sharing

I urge also that negotiation of profit sharing agreements be not only permitted but encouraged if wages are subject to any form of direct restraint. Profit sharing can under no circumstances be considered inflationary. Profits are a residual—computed after the consumer has paid the price involved and after all costs have been met. The sharing of that residual can neither add to the costs nor increase the price.

Any form of restraint requires some safety valve. If the possibility for economic gains is limited, improvement of working conditions will serve to some extent as the safety valve to relieve the pressure that cannot find an economic outlet. Under the World War II stabilization program, certain forms of fringe benefits served that purpose. Profit sharing can be an important additional safety valve, serving simultaneously to advance economic equity as between workers and stockholders.

Congress is ultimately responsible

The ultimate responsibility for an equitable stabilization policy rests squarely upon Congress. It was Congress that gave the President the power to impose the freeze. Congress alone can decide whether the President will be allowed to continue his inequitable use of those powers or whether the legislation involved shall be rewritten or replaced to assure an equitable and effective stabilization policy.

Reports in the press on the predictions of Secretary of Commerce Stans with respect to Phase 2 sound an ominous warning that the Administration may be bent on imposing grave inequities upon America's workers—to make them and them alone bear the sacrifices of combatting inflation. Only Congress can stand in the way and see to it that equity is done.

It is imperative that Congress accept its responsibility to assume by legislation that stabilization measures will be fair to all concerned.

I urge specifically that such legislation require the President to stabilize only through the voluntary and tripartite mechanism that I have described. I urge further that, whether through IET or some other device, Congress assure that equity prevails as between wages and all forms of non-wage income.

Chairman PROXMIRE. Thank you very much, Mr. Woodcock, for a real tour de force. This is a brilliant statement. I have had a chance to examine it fully and I think you have done an excellent job, especially on how hard you come down on the side of the need for stimulus of the economy for many reasons—not only because we need jobs here, but also as several previous witnesses have pointed out, because if we are going to be able to negotiate effectively for a devalued dollar, we negotiate far better in an atmosphere of prosperity than in an atmosphere of worldwide recession. If we have to negotiate from the standpoint of people in this country being desperately concerned with holding on to even short-term policies that would benefit jobs here, it is going to be very hard, it seems to me, to overcome the protection incentive that we have in this country and that every country has.

However, let me ask you first about something that does trouble me a lot. As I say, you come down hard on the side of stimulus, and I think that is all to the good. But you seem to come down very soft on the question of holding down prices. I say that even though it seems you have one element that gives it more restraint. You provide subpena powers. That is good. But what you also provide is a wage-price review board cut off from the Government and manned by labor and by business, and the public, with labor and business having a majority vote here in a situation, it seems to me, where we might have great trouble getting inflation under control. Especially since you advocate full wage compensation for, as I understand, previous increases in the cost of living, and full wage compensation for increases in productivity, both.

Now, I just calculated that if we followed your prescription here and had any kind of general guidelines, it would be a 7¾ increase in wages, which it seems to me would just carry on the inflation as we had. How do you meet this kind of objection?

Mr. WOODCOCK. I think the record shows, Mr. Chairman, that this works. During the Korean period, we had an economy that was under forced draft, in full throttle. We were actually rationing scarce metals because of the demands for them. Yet precisely the kind of contract that we now have with the automobile companies was specifically approved in a wage stabilization policy, which called for the improvement factor, which is a productivity factor, and which called for cost of living compensation.

Chairman PROXMIRE. But you see, what I am getting at is this: As I understand the presentations we had by Mr. Okun and Mr. Schultz, both of whom stressed that one-half of the increases in the cost of living would be on the assumption that in the coming year we are going to be able to hold down the cost of living. In fact, the assumptions they made were that labor would be far better off than they were last year

or the year before—any year in fact, since the early 1960's—because they would get an increase of 3 percent or more in their real income; that is, if you had a firm, effective price policy where you were able to hold prices down to less than a 2-percent increase. Then you could provide for about a 5-percent increase in wages and you would have a real increase in income for workers of 3 percent which would be, perhaps, better than you would have under what you proposed.

Now, if you talk about the Korean situation, as I understand it, we had comprehensive, across-the-board controls. Mike DiSalle, who was one of the administrators, testified before this committee that during the Korean war, we provided for controls not only in the concentrated sectors that you suggest, but virtually the whole economy.

Mr. WOODCOCK. But the fact is, Mr. Chairman, I must repeat the contract that we have with General Motors Corp. now was specifically approved under the wage stabilization policy in the Korean period, when we had a situation of too many dollars chasing too few goods. We do not have that situation now.

Chairman PROXMIRE. If we put into effect some kind of wage-price review board and some kind of control of wages and prices, and the prices increase during the coming year, the rest of 1971 and 1972, at only a 2-percent rate, that would be reflected, as I understand it, in full in the wage increases. Is that correct?

Mr. WOODCOCK. No, it so happens that our present contracts do not call for compensation in full, but that was part of the collective bargaining agreement. That was part of the bargain that was made.

Chairman PROXMIRE. Well, you see, what I am getting at is the very great importance under your notion of tieing in wage increases, to cost-of-living increases of holding prices down. And it just seems to me that this kind of a board, without any legal force to act to prevent prices from going up, or certainly not to roll prices back, simply does not give the clout we need. We need the assurance that prices will be held down.

Mr. WOODCOCK. Our statement says—I did not say orally that the board would have the power to lay out the facts where a rollback in prices was called for to see if public opinion would have some impact in regard to this.

Chairman PROXMIRE. But the President would not have any legal authority to do so under your proposal, would he, or you would not give him that?

Mr. WOODCOCK. He would have the authority to initiate process.

Chairman PROXMIRE. To hold the hearings?

Mr. WOODCOCK. Right.

Chairman PROXMIRE. And in the event that General Motors wanted to go ahead and raise prices, or some other big company wanted to go ahead, there is nothing to prevent them from doing it in the event that the negotiations were such that the union management decided that they would provide for an inflationary wage settlement. All the President could do would be to criticize it. He could not act—or could he?

Mr. WOODCOCK. Except that they are responsive to public opinion. I think they are responsive to public opinion. Right now the automobile companies say that because they are going to be required to pay a wage increase on December 22 and a cost-of-living increase after that, they are going to have to increase the price. They do not have to prove

a thing. In the Korean period, they accepted the rule that productivity wage increases obviously could not be the basis for them requesting an increase in price. We also have on record the statement of the president of General Motors Corp., made last April in Philadelphia that, for 21 years, productivity increases in the automobile industry matched or exceeded increases in labor costs. Now, that is in an annual compounded rate for those 21 years of 6.1 percent. Yet we were charged during those 21 years with being inflation breeders.

Now, long after the fact, the president of the General Motors Corp. says that is not true at all; the industry matched or exceeded the increases in labor costs.

Now, if those things were in the clear light of day, I think the General Motors top management would be responsive to the resulting public opinion. At least it is worth a try, rather than having bigger and bigger governmental bureaucracy interfering in our type of economy.

Chairman PROXMIRE. As I understand, the people who would be holding the hearings and making the determination would be representatives of labor, not appointed by the President or any governmental body, but nominated and in effect, appointed by labor itself; representatives of management, appointed by management; and then a public member. Is there not a likelihood that with that kind of line up, you would get a fairly soft view, very sympathetic to providing price increases? Perhaps not in an industry like the automobile industry, which is a strong industry, which, as you say, has been characterized by extraordinary profits and so forth, but in many other industries, it would seem to me there would be a very good chance that you would get a tendency to let prices rise in the trucking industry, the steel industry, many others.

Mr. WOODCOCK. Let me say, Mr. Chairman, that there is not the same necessity for the tripartite form in the kind of price-wage review we are proposing as an on-going permanent mechanism as there is in a wage review. That tripartite system is absolutely essential, from our point of view. But the principle of what we described as a permanent price-wage review board could operate just as well with a presidentially appointed board, with members sanctioned by the Senate of the United States. It would not have to be tripartite.

Chairman PROXMIRE. You would not object, then, to an alternative approach, or would you?

Mr. WOODCOCK. I would not, no, sir.

Chairman PROXMIRE. You would not object to a governmental appointed board, approved by the Senate? Would it have to be tripartite?

Mr. WOODCOCK. The bill that was introduced calls for that. But from my point of view, it would not necessarily have to be tripartite.

Chairman PROXMIRE. Would it have to be voluntary?

Mr. WOODCOCK. It is voluntary in the sense that we have always advocated that there would be freedom of action left. The only control would be the power of public opinion, which I think in a democracy is a mighty potent force.

Chairman PROXMIRE. Well, on the assumption that potent force would be effective most of the time, is it not a real possibility that it might not be effective in some cases, and that might blow the whole thing out of the water? As the airline strike blew the wage-price guide-

lines out of the water in 1966? If the President had the power to step in or some body had the power to step in——

Mr. WOODCOCK. The airlines strike, unfortunately, was prolonged because of the refusal of the industry to agree to an escalation clause. Subsequently, they agreed to a much higher increase plus a much higher escalation clause. I think it simply underscores our feeling about the whole situation.

I would, Mr. Chairman, like to draw the attention of the committee's staff to an article which appeared in a magazine, Challenge, for November-December 1966, by Prof. Alvin Hansen, then of Harvard University, which goes to this whole question of whether escalation clauses in themselves are inflationary. May I put this in the record?

Chairman PROXMIRE. Yes, indeed, by all means. Without objection, it will be printed in the record at this point.

(The article referred to follows:)

[From Challenge magazine, November-December 1966, vol. 15, No. 2]

INFLATION AND THE NEW ECONOMICS

(By Alvin H. Hansen)[1]

In sharp contrast to the "fiscal drag" syndrome of only two years ago, the fear of inflation once again dominates the economic news. Yesterday's problems are quickly forgotten as we look back wistfully to the 1960–65 era of "reasonable price stability."

But how about full employment? The fact is that along with so-called price stability came an average 1960–65 unemployment rate of 5.6 per cent.

Now that the United States has at long last become a high-employment, high-pressure economy, it is confronted with price increases like those which Europe has faced. Wishful thinking aside, it is difficult to escape the conclusion that, like the Europeans, we may have to learn to live with a somewhat higher, though still relatively moderate, rate of creeping inflation.

But there is no convincing evidence that strong, advanced countries are unable to manage creeping inflation sufficiently well to prevent it from escalating into galloping inflation. The problem, to be sure, requires continuous surveillance and responsible fiscal and monetary management.

The U.S. entered a new period of price behavior in about the middle of 1965. The milk, pork and other food shortages, a major factor in recent price movements, will hopefully prove to be self-correcting. More serious is the recent rapid rise in the prices of manufactured goods despite continued stability in unit labor costs.

The reason for these price hikes is quite simple. Profits soared in 1966 beyond the wildest dreams. And a guideposts policy is always in deep trouble when profits in relation to wages get out of line. Abnormally high profits render responsible collective bargaining well-nigh impossible. Britain's Labour government is facing the same problem with its "incomes policy."

Gardner Ackley was quite right when he pointed to excessive profits as the real inflation danger because of their impact on wage negotiations. One solution might be to give the President discretionary power to raise or lower taxe rates within proscribed limits, which to some degree would limit excessive profits. In pure theory, the ideal would be an administratively managed excess profits tax. If profits are restrained, employers can be counted on to hold excessive wage demands in check, and under these conditions the government, having already restricted profits, would be in a strong position to throw its full weight against excessive union demands.

But until consumer pressures become stronger, an excess profits tax, except in full-scale wartime, is scarcely probable. But a supplementary corporate and personal income tax, as recommended by the subcommittee on fiscal policy of the Joint Economic Committee, should not be impossible.

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[1] Alvin H. Hansen, Lucius N. Littauer Professor of Political Economy (Emeritus), Harvard University, is widely recognized as the "father" of Keynesian Economics in the United States.

The experience of early 1966 illustrates well the superiority of an administratively managed supplementary tax compared with a legislative change in tax rates. A flexible supplement can be adjusted up or down by small gradations as easily as the familiar adjustments of the discount rate. Since the changes would be small and could be reversed almost immediately as conditions demand, the White House would have little hesitation about using such power boldly and speedily.

But without this power, a President will always hesitate to ask Congress to raise taxes. It is one thing to ask Congress for a substantial, though temporary, change in rates. It is quite another matter to order small adjustments in the supplementary rate. Small changes would be taken in stride, just as is the case with the discount rate.

The Administration was, I suspect, quite right in its reluctance in early 1966 to go to Congress for a substantial increase. A small incremental change would, however, have been possible as a routine performance.

But what we really need is an integrated monetary and fiscal policy. If we had one, a tax increase combined with a relatively soft monetary policy would have been in order in the first quarter of 1966. But since the Fed launched its own antiinflationary program in direct opposition to the wishes of the Administration, the government was virtually compelled to go easy in tax policy in order to prevent excessive restraint.

I am unable to see how any rational person can argue that it is a good thing to have two independent, and at times antagonistic, drivers, each attempting to steer the economy, unless indeed he wants no effective control at all. We have gotten ourselves into this deplorable situation not by any clear-cut legislative mandate. It has evolved bit by bit from occasional overt acts of independence by the Fed followed up by frequent reiteration by the Chairman that the System is, in fact, by law an independent agency. Unfortunately, no President, as far as I know, has challenged these claims.

So where does this leave us? I fear that clarifying legislation is not possible, and if seriously undertaken might do much harm. If we were starting all over again, I am sure that no Congress would specifically set up the Federal Reserve System as an agency independent of whatever Administration, Democratic or Republican, happened to be in power. But it is quite a different matter openly to demote the Fed from its present alleged independence. The best we can hope for is a common-sense interpretation of the meaning of independence.

According to one definition it means that the Board is independent *outside* of the government. A Board member is regarded as duty-bound to vote his own convictions, even though they really run counter to the policies of the Administration.

But there is another, quite different, common-sense meaning of independence. In this view the Board is independent *within* the Administration. Each Federal Reserve Governor is duty-bound to fight for his convictions *inside* the government. But he should not defy the Administration. Disagreement may reach a point at which, as a man of integrity, he will feel compelled to resign. He should, of course, always be free to state his personal views before Congressional committees.

Let us hope that a sane view of this controversy will prevail. Let us hope that we shall not again see such a display of arrogance as we witnessed in December 1965, when the Fed defied the Administration and raised the discount rate.

Some commentators have tried to defend the Board's action on the ground that it was, in this case, right. I am unable to follow this argument. Witness the near crisis created by the interest rate war and the unholy scramble for deposits.

The issue here, however, is not a question of who was right. The point at issue transcends by far any specific incident. Surely an elected democratic government must be held responsible for its management of the economy. Every Administration, whether Republican or Democratic, must have command of all the instruments of control so that it can carry out its program.

One practical procedure might be to institutionalize the so-called quadriad consisting of the Chairman of the Council of Economic Advisers, the Secretary of the Treasury, the Director of the Budget and the Chairman of the Federal Reserve Board. Here differences of opinion, as represented by all the relevant agencies, can be thrashed out.

Vital decisions by majority vote of the quadriad would be reported to the President, and if approved by him should command the united support of all

the agencies concerned. No more would be demanded of a Board member than is now demanded of every Cabinet officer. Whenever a Governor of the Federal Reserve System felt that he could no longer go along with the overall governmental policy, it would be his duty to resign.

I should like to add a word about the relation of monetary to fiscal policy. We have been moving, in recent years, in a dangerous direction. Not only have we allowed the Fed to become increasingly independent, we have also tended to expect from monetary policy far more than it is capable of producing. In the past, our monetary authorities were content to make a modest contribution to stabilization policy. Not so in recent years.

In my view—I am aware that not all adherents of the New Economics would fully agree—monetary policy should always be relegated to the position of serving as a handmaiden to fiscal policy. In this capacity it can play an enormously important role. Money *is* important. No government can pursue an effectively expansionist fiscal policy without having at its beck and call the vast monetary powers of a central bank. Nor can it pursue an orderly program of fiscal restraint unless the central bank plays its supporting role in carrying out tax, expenditure and debt-management policies.

From the growth standpoint, I should hope that we can develop long-range government expenditure programs based on social priorities. These long-range projections could play an important stabilizing role with respect to planned private investment outlays. The long-run interest rate should be kept low to help stimulate growth. As for countercyclical policy, I should strongly favor primary reliance on tax policy. When we use fiscal policy, we know what we are doing. We can calculate fairly accurately the impact of tax and expenditure changes. Sharp changes in the rate of interest leave us groping in the dark, as the recent Federal Reserve fiasco illustrates.

Consumer price increases of the magnitude experienced by the high-pressure economies of Western Europe admittedly present equity problems in a society operating generally with fixed money contracts. Since all advanced countries prefer full employment, despite its attendant inflationary consequences, it would seem that the next order of business in the free world is to devise and build institutional arrangements to alleviate the inequities flowing from creeping inflation.

James Tobin emphasized this point in a recent book: "It is a major defect of our financial structure that inflation hedges are not available for the majority of the population. American inventiveness and ingenuity have been sadly lacking in this area. The government could issue bonds with purchasing power guarantees and life insurance companies could offer 'variable' annuities to protect beneficiaries against inflation." Paul Samuelson reaches a similar conclusion in his recent two-volume *Collected Scientific Papers*.

We have, of course, already made some starts in this direction. Some 2.5 million workers are protected by so-called cost-of-living escalator contracts. Private universities have learned to live and prosper in a period of creeping inflation. Social Security benefits have been raised periodically, but always with a lag. Inflation-proof arrangements need not necessarily exert an upward push on costs. Escalator wage contracts prevent *immediate* wage demands based on anticipated cost-of-living increases.

Such arrangements redistribute rather than add to aggregate income. By and large, they take income from the inflation-advantaged group and give it to the inflation-disadvantaged group. But these measures are not inflationary per se. And they will become increasingly necessary in a high-pressure, full-employment economy.

Living, as the whole Western world does, in an age of creeping inflation, the impact of this fact upon expectations becomes obviously a crucial matter. As I have already noted, there appears to be no evidence in advanced countries that creeping inflation necessarily leads to runaway inflation. How can one account for this fact?

In a perfectly fluid free market we should expect a rapid escalation of any inflationary movement. But the price system, fortunately, is not perfectly fluid. If it were, any movement away from equilibrium would rapidly cumulate. Not only is the system far from being fluid, it is in fact a network of contracts, partly legal and partly behavioristic. Inertia plays a big role. Any movement away from equilibrium makes headway against a sticky mass. The result fortunately, is a lagged adjustment to change.

What implications do these considerations have for the commonly held view that cost-of-living escalator clauses in collective bargaining contracts tend to accelerate creeping inflation? In my opinion, this view is a mistaken one.

Take the recent abortive contract (the one turned down by the membership) between the airlines and the machinists union. Aware of the continuous, though moderate, upward trend of consumer prices throughout the past 18 years, the union demanded a cost-of-living escalator clause. The airlines stood firm against this. The union, fearful that a consumer price rise of, say, 2.5 per cent or more, might largely nullify any intended increase in real wages, demanded, and was granted, still higher wages as compensation for surrendering the escalator clause. The revised (and finally accepted) contract was far more geneorous than the first. It provided both higher wage rates *and* an escalator clause, and crashed right through the Administration's wage guideposts. Thus, with or without the escalator clause, the expectation of creeping inflation affected the proposed settlement.

Higher wages, paid in *anticipation* of price increases, come immediately into play, and so at once operate to intensify inflationary pressures. *Future* wage increases, paid in accordance with an escalator clause, come *after* consumer prices have risen. Escalation validates a price increase that has already taken place, but is not the *cause* of the price increase that has already occurred.

The lag is highly important. Stability in a market economy is largely a function of lagged adjustments. At all events, there is no escape from the perfectly reasonable demand of workers that the Consumer Price Index must somehow be taken account of in wage contracts. It makes more sense to make the adjustment *after* the event than to force the issue before the event.

Clearly, the modern inflation problem presents many conflicting and often irreconcilable factors. What then? Should we abandon the wage-price guidepost? I think not. We do need a thorough overhaul of the statistical foundations upon which the guide-posts rest, and we need to clarify our concepts, and our goals, with respect to price stability. But as broad-gauge directives, the guideposts do point to basic relationships which cannot be ignored. The guideposts should be perfected, not abandoned.

Improving guideposts. Presidential authority to raise or lower taxes within specific limits and, finally, monetary policy working in tandem with fiscal policy, could give us full employment *and* "reasonable price stability." In the meantime, let us not blame our inflationary pressures on the New Economics.

Chairman PROXMIRE. You would concentrate these limitations on the big firms. You point out that that is where the big profits are, and you feel that is where the real problem is. The fact is, however, for over the last 10 years, by far the biggest increase in prices has been in the service area. And I suppose if there is one industry that has been characterized by inflation more than any other, it is the health industry. Would your proposal reach that kind of inflation?

Mr. WOODCOCK. Well, the problem in health care, I think, is unique and, of course, we are clearly on the record that we think the enactment of the principles of Senate bill 3 and House bills 22 and 23 is the only answer to the problem of inflationary health costs.

Chairman PROXMIRE. It may be that we need long-term health legislation, and no doubt we do. But that might take some time to get. I think you will agree with me that a realistic appraisal suggests that we will not get that for a long time. We have a real problem coming up on November 12. Do you still feel this should be concentrated entirely in this very limited sector?

Mr. WOODCOCK. First of all, with regard to phase 2, as a practical matter, I accept that the administration has a responsibility. We in labor have said that for our cooperation, we require a tripartite voluntary mechanism with a balancing party of public, not governmental, members with the same procedural rights and authority that prevailed in the Korean period and also in World War II.

Chairman PROXMIRE. The Korean period and World War II, we did have an across-the-board restriction on prices and wages. We did not confine them to the steel industry, the automobile industry, the other big industries, or the big corporation.

Now, you are suggesting a departure from that; is that right?

Mr. WOODCOCK. We are talking about two separate things, sir. I accept that phase 2 is going to be—I do not know what it is going to be. It could be general, it could be specific. I would think right now it would have to be general. But the on-going price-wage review we propose on a permanent basis.

Chairman PROXMIRE. I see; fine. You are proposing a permanent kind of structure to deal with prices in the administered areas where you have concentrated economic power. But you would not object to a more comprehensive, general kind of guideline to apply to the whole American economy, or virtually the whole American economy?

Mr. WOODCOCK. Yes; we object to guidelines. We think the American economy is so complex that you just cannot write any general guidelines.

Chairman PROXMIRE. How would you deal with inflation outside of these sectors? You say you have a long-term program that you have been talking about now to deal with the concentrated sector of the economy. What would you recommend for phase 2?

Mr. WOODCOCK. We think the maldistribution of profits, for example, shows the small companies with continuing difficulties, that they are affected by competition in price, but their general impact on the economy is not enough to offset the continuous upward price movement of the administered industries.

I think if you took a short span of time, the last 3 or 4 years, it would be clear that the administered price sector has been skyrocketing. When you go to the service industry, it is true in terms of percentages, they have had some sharp upward movements in the last few years, but that was from an abysmally low base, whether they be hospital workers or those holding low income jobs. When their increase is 200 percent, they started at a base of maybe a dollar; it is nothing again, to the economic impact of the powerful aggregates of capital I am talking about.

Phase 2 also does provide that the President would have the power to move in other areas that do not fall within the description of price dominance. If you had, say, in the construction industry or whatever, inflationary behavior, then the President could direct the board to move similarly in those situations.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Mr. Woodcock, you favored the repeal of the auto excise tax proposed by the administration. Do you have any position on the excise tax on trucks and on tires?

Mr. WEINBERG. When we think the first is discriminatory, we have to say the others are, too.

Senator PERCY. I get a great deal of mail complaining about excise tax on telephones. Does the UAW have a position on the excise tax on telephones?

Mr. WEINBERG. We have not taken any position with regard to it. I think when you get into that kind of a field, the usage of a public utility falls in a somewhat different area. It is certainly a convenient tax base.

Senator PERCY. There was no mention made of the problem of productivity in your remarks here today. If my figures are correct, between 1947 and 1966, the average rate of advance in output per manhour in the private sector was about 3 percent. Then, in 1967, it dropped to 2 percent, and there was practically no productivity increase between mid-1968 and mid-1970. And I think this has aggravated our problem.

Do you have any suggestions as to what we should do to increase work output and productivity?

Mr. WOODCOCK. There's a great deal said about productivity in the total statement. It is true that productivity was sagging in the time period you have described. In the first phase, it was due to the mini-recession of 1966. The second was due to the recession which began in 1969. And everytime we have a recessionary period, productivity falls. Because, as you know, sir, when sales drop, immediately the productive personnel not needed to produce the products not being sold are cut loose. But the nonproductive personnel are kept, on the assumption that there may be a turnaround in the very near future.

The nonproductive personnel, kept on the payroll while the productive personnel are let go, increase the overhead burden and this drops productivity. It is not until the recession is months in being that they begin to move to the nonproductive personnel. Consequently, as we move out of the recession, the rate of productivity soars. If we can move to stimulate purchasing power in the middle-income level and the economy moves up, productivity, without any investment, by that very fact will move up very sharply, and profits will move up very sharply with it.

Senator PERCY. In your statement, you quote some of the automobile companies and what they have said about overtime versus additional workers. This is the first time I had heard of those remarks. I was deeply distressed by it. It was my assumption that we would be hiring more people at our plants rather than just increasing overtime.

Do you have any suggestions as to what we can do to reverse this policy and add people, rather than just add overtime pay? I am concerned that wage increases for those working regularly might result in additional savings rather than more purchases. We are saving at a rate of 8 percent right now. It is a question not of adding to the wages of workers who are currently employed, but rather of hiring people. Would it help if we contacted the heads of the automobile companies and talked over this policy with them? They were in the forefront of hiring hard-core unemployed. Are the hard-core unemployed hired under the "Alliance for Business Program," the ones that have now been laid off?

Mr. WOODCOCK. Well, to the extent that they are on the low end of the seniority list, yes, they have been released.

Senator PERCY. Certainly, they ought to get a chance now to be rehired if we are giving an incentive to the automobile industry by taking the excise tax off and the 10 percent border tax. That is a great benefit to the automotive industry.

I think this is an area where we could all work together, and I certainly, as an individual, would be happy to talk with the heads of the automobile companies or their representatives to see what we can do to have them voluntarily adopt a policy that would be in the national interest, rather than just pay more overtime to people already working.

Mr. WOODCOCK. Well, as you have noted, Senator, we propose that one way to create a deterrent is to step up the fair labor standard penalty from time and a half to double time. But failing that, or in the absence of that, it would certainly help if you and others would talk to the heads of the companies.

We tried in our negotiations to make overtime a voluntary thing to the individual. They strongly resist that. We were not able to win it. We have found that in recessionary periods there is a deep sense of shame among our working members when they have to work a Saturday or the 9th and 10th hour, Monday through Friday, and come home and their next door neighbor is entirely without a job. They have a deep sense of shame, and bitterly resent it. But they are forced to do it under the contract.

Senator PERCY. I would like to ask your judgment on what we can do to make American industry more competitive? How can we compete more effectively in international markets when we consider that we will have a wage differential for a long time to come? I am concerned, for instance, that the steel industry is becoming less and less competitive. At the peak of World War II, Japan produced 9 million tons. By 1973, that amount will increase to 175 million tons. Two-thirds of the Japanese steel industry facilities are less than 9 years old; ours are getting old and obsolete. What can be done to make America's steel industry more competitive so that the U.S. market is not flooded with foreign steel?

Mr. WOODCOCK. Well, I am no expert on the steel industry, but I think it is a fact that over a long period of years, the American steel industry did not take the necessary steps to keep abreast technologically. That does not set aside the fact that the rebuilt economies, Japan and other countries, have had a tremendous advantage because they started from scratch and could take advantage of the latest technological capabilities.

But I think it is fair for us to say, getting back to the industry with which I am conversant, that the will to compete is not there. Volkswagen certainly has been terribly vulnerable. Last year, they had a tremendous upsurge in their worldwide sales, but their rate of profit was dropping precipitously, continuing to drop, possibly to a loss situation. If ever a company was vulnerable in the North American market, it was Volkswagen. I would have thought that price competition by the Vega and Pinto, and if that would have happened the Gremlin could have followed, could have driven Volkswagen at least out of the American domestic market. Instead, they increased the price and are now being bailed out by the surcharge and the proposal to eliminate the excise tax. It is this lack of willingness to compete in a true free enterprise sense that really bothers us.

Senator PERCY. Industry officials maintain the only new "green field" steel plant—that is, a plant constructed from scratch—that has been built in the last 10 years in the United States has been built in Illinois. When asked why this lack of ability to increase their capital goods investment, they say it is because the need for investment incentives is not fully recognized in this country and that they do not otherwise have the capital. Industry has pointed out that the United States today has the lowest percentage of investment in productive facilities in relation to GNP of any industrialized nation in the world, and that, as a result, our facilities are becoming obsolete very rapidly. Our rate

of percentage reinvestment was only 16.5 percent of our GNP, compared with 23 percent in West Germany, 24.5 percent in France, 34 percent in Japan. Then, in looking at the specific figures, the U.S. policy permits aggregate costs recovery allowance of only 7.7 percent in the first taxable year, against West Germany's first year writeoff of 16.5 percent; Italy 20; France 21.5; Japan 34.5; and the United Kingdom 57.8 percent.

I put the question: How can American industry effectively compete, then, with foreign companies given every incentive to invest?

I think here we have perhaps an honest difference of opinion as to how we can stimulate capital investment in this country through tax writeoffs or tax incentives, whatever it might be, other than the incentive that the U.S Government has now proposed. The investment tax credit was a Kennedy development in 1962, and it certainly stimulated the economy.

Mr. WOODCOCK. We opposed it then, Senator.

Senator PERCY. You did oppose it then?

Mr. WOODCOCK. Yes.

Senator PERCY. And you still oppose it now.

I would very much like to talk with some of our economists on this. When I testified at the Senate hearings, I offered to do this. I may have a blind spot, but I simply have not been able to come up with any other way to enable American industry to increase investment other than to give it every incentive to take modern machinery and update—and therefore use high-priced, high-quality American labor with more capital behind it. I would be very happy to discuss this point with your economists and see whether my blind spot could be removed, or whether the facts might prove that there might be a sound case to be made for this in lieu of any other alternatives.

My time is up, so I shall yield.

Chairman PROXMIRE. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman.

Mr. Woodcock, let me congratulate you on a very well-prepared and thoughtful presentation. I find myself in a position of having listened to a couple of experts here asking questions that I would have asked. But let me pursue it just a bit longer.

It is somewhat incongruous to see American labor today wanting to be a tripartite board without Government control. And much of American business apparently on the other side. This seems to be an incongruous thing with the free enterprise system.

But other than that comment, I am concerned too, about the question about increasing productivity. We had Arthur Burns testify before this committee, and he said that the way we really stop inflation is to increase productivity faster than wages and prices go up. It seems that is an axiom; it is basic. I have been given the figures that since 1960 productivity in this country increased 2.3 percent; that in Germany by 5 percent; in France it is 6.6 percent; and although you have seen an increase in wages in Japan of a compounded 15.1 percent, productivity has increased 14.2 percent. So, their unit cost has stayed reasonably constant. It seems to me this is one of the real serious problems that we have today in trying to save our balance of trade, save our balance of payments.

I share the concern that has been expressed by Senator Percy as to what we can do to increase productivity in this country to meet foreign competition. I have had the figures given to me also that in the United Kingdom, although they have a figure on a norm of some 50 percent plus that they are allowed to write off, in some instances on some industries, they are allowing 100 percent writeoff and getting new productive capacity indeed.

Then I heard you comment earlier about the problems we have with Japan and Germany, where they had to start from scratch and they had the very latest in technology now and that that was one of the things that made them very competitive. I think we really need some specifics in what we can do to try to become more productive in the face of foreign competition. This is where we can really use some help.

Mr. WOODCOCK. Well, Senator, if I may, the Monthly Labor Review, a publication of the U.S. Department of Labor, has two very interesting tables in the August number. One is for the period 1960 to 1965, rates of change in output per man-hour and hourly compensation and unit labor costs. It shows that for the period 1960–65, unit labor costs in the United States went down by seven-tenths of 1 percent. Only one other country went down; that was Canada, by 3 percent. All of the others went up. Japan went up by 4.3 percent, United Kingdom up by 2.4, and so on. So we were the second best in the 5-year period.

In the period 1965–70, which was marked by the mini-recession of 1966 and the recession of 1969–70, the unit labor costs in the United States went up by 3.9 percent. We were then the third highest in the rate of increase. But this is largely the product of recessions that we were going through. I think that it should be clear that stimulus and mass purchasing power, getting the economy going, will have an important effect on our productivity rate.

Now, to stay with something I know—I am, I repeat, no expert on the steel industry, but the automobile industry worldwide does not have the profit targets that the U.S. companies have on their home ground. The General Motors Corp., which was worth $1.4 billion in 1947, by 1970 was worth $10.2 billion and 91.3 percent of that was a result of reinvested profits. So, certainly that corporation did not need any additional stimulus. They were making tremendous reinvestment. And much of that 91.3 percent increase in worth was represented by the outflow of American dollars to buy additional General Motors control of other companies in other countries.

Senator BENTSEN. Well, I have heard the argument that if we increase consumer demand, that increases in turn productivity. I find some difference with that. I think that a lot of the capacity that has been laid aside, and approximately 25 percent of our capacity is idle today, is the least productive capacity in the world market today. Obviously the oldest plants, these are the farthest behind in technology that are idled first and consequently never put back into production again. I question seriously that just because you reach total capacity, you become more productive on a unit cost basis.

Mr. WEINBERG. The record does show, though, Senator that as the economy moves up, productivity moves up faster than normally.

Mr. WOODCOCK. In an ideal situation, lessening demand would mean that the least productive capacity goes off steam. In fact, that is not the

case. Closeness to market and other things have a big impact. The General Motors assembly plant in Freemont, Calif., one of their newest plants, is now operating with only one shift. I assume that was dictated by the market and not by the age of the facility, because it is one of their newest facilities.

Senator BENTSEN. Let me touch on another point here before my time expires. That is the question of a voluntary compliance with a tripartite board and you are feeling that public opinion would provide enough pressure. Now, is it also your feeling that this kind of public opinion was not generated in times past because information was not properly developed and presented to the public on which they could base that decision? Is that correct?

Mr. WOODCOCK. Well, again, we have the practical phase 2 problem, in which we have covered a multiplicity of situations and public opinion would have difficulty even keeping track of things, let alone bringing any pressure to bear. But in our on-going proposal for a Wage-Price Review Board, we say there are a hundred companies that are in the purview of that Board, who are dominant in the industry in which they operate. With that Board having the power of subpena in which they could bring out all of the relevant facts, there would be so few cases, not all at one time, that the spotlight of public opinion would focus, be right on it, and I think with all the facts laid out, that would be a very considerable deterrent to inflationary price increases.

Senator BENTSEN. I think a very simple approach to the solution you propose would be having a tripartite board, but my hangup is whether or not we would see sufficient public pressure, even if they were sufficiently informed, that it would have enough power to bring about the desired result. That is my concern.

Mr. WOODCOCK. All I can suggest, sir, is that we try it and find out.

Senator BENTSEN. Thank you, Mr. Chairman.

Chairman PROXMIRE. Following up that questioning by Senator Bentsen, the trouble I am having with your proposal here, Mr. Woodcock, is that I just do not see how a phase 2 board can influence public opinion on a highly complicated, confused subject if it does not have a relatively simple guideline for measuring and influencing behavior, a guideline which the public can understand. Is it not much harder for this Board to be effective if you proceed without any kind of notion of what is right, what is fair?

Mr. WOODCOCK. Again, I would like to try to sort this out. With regard to phase 2, where we are insistent that it has to be tripartite and has to be voluntary in the sense that that Board would have a right to set its own procedures and guidelines and the rest, it obviously would have to have some sanctioning power behind it to make it completely operative—that is one thing. The on-going Price-Wage Review Board which we would buy for phase 7—I do not want to mix it up with phase 2—does not have to be tripartite, as I have emphasized before.

Chairman PROXMIRE. But phase 2, you say, does have to be tripartite, it has to be voluntary and there could be no guidelines. It seems to me the most useful element of guidelines is that the overwhelming majority of price decisions and wage decisions would not have to come to Government. They would be made on the basis of what they know. It seems to me all of the decisions, and there are a whale of a lot of

considerations in the wage-price guidelines that we had from 1962 to 1966, at least they had a fairly simple guideline—3.2 percent, long-range productivity increases—there were violations of it, but you did not have to act in each specific case. It seems to me that what you are proposing here is that every time a big settlement is made in any of these industries or anywhere where the Wage-Price Review Board would have any influence, they have to consider that particular determination and decide whether that determination is fair or unfair.

Mr. WOODCOCK. With regard to the permanent Price-Wage Review Board, phase 3 or whatever, that would not even come to the attention of the Board unless the particular company involved proposed to increase price, or unless the consumer council provided for it.

Chairman PROXMIRE. Under these circumstances, after November 12, I would assume that there would be a tremendous number, literally thousands of decisions, to increase prices. If I were in charge of a business that had any kind of discretion on increasing prices and the Government did not say that you freeze prices—we are saying now, the President has said we are not going to do that—if it simply said hold prices down and do not make too much of an inflationary settlement, I do not think it would have much influence on me.

Mr. WOODCOCK. When we talk about the phase 2 tripartite board, that has to do with wages. We made it clear to the President that there had to be in company with that an effective price mechanism. We did not specify in what way. That same board would not control both. It would have to be an effective price mechanism.

Chairman PROXMIRE. OK, you say an effective price mechanism. I agree. I think that is the heart of it, the guts of it. If we do not have an effective price mechanism, the President and this country are going to lose the inflation battle. It would have to be effective. To be effective, I would think it would have to have some kind of guideline.

Mr. WOODCOCK. Beyond that, we say there has to be effective control, on an equitable basis, of all forms of incomes.

Mr. WEINBERG. Senator, if I may intervene for a minute, in World War II and during the Korean period, there were tripartite boards that concerned themselves with wages. Those boards did not have standards imposed on them from outside, whether by the administration or by Congress. They developed their own standards. A tripartite mechanism developed standards that they applied to the cases that came before them. They issued regulations that permitted certain wage increases to be made without prior approval if they conformed to those standards. Yet they had the freedom to look at each situation case by case if it went beyond those standards to determine whether the proposed wage increase was proper in the light of general stabilization objectives.

There was the Little Steel formula in World War I. This was a standard that was adopted by the board, by a tripartite board—during World War II, rather. During the Korean period, there was a wage formula that essentially involved productivity plus the cost of living. They ratified, in effect, the kinds of agreements we had in the automobile industry. There were standards, but these standards were not imposed from outside. They were developed by the parties directly concerned, plus the aid of people drawn from the public.

Chairman PROXMIRE. What troubles me about that is that we have a situation entirely different from the Korean war and World War II. David Ginsburg testified on Friday, and I think very effectively, when he said this, "If we look back on what had been done, I think we are going to make a mistake."

What he had in mind is that today's conditions are vastly different from what we had in World War II and Korea. That is, we had a national determination to win World War II and to patriotically make whatever sacrifices are necessary to do so. We had a similar, although weaker, undoubtedly, national motivation in the Korean war. We have nothing like that now.

Mr. WEINBERG. There is a very significant difference that points in the other direction. Both in World War II and during the Korean period, we were operating in an economy where the pressure was such that the boiler was almost ready to burst. We had effective price controls. If we had an effective price control mechanism today, it could be concentrated on a very few areas, because we have a slack economy and competitive industries find it very difficult to raise their prices.

This is because of the fact that you called attention to, the fact that the smaller corporations in competitive industries are actually losing ground in terms of profits, because they are having difficulty in raising their prices; whereas the bigger corporations are increasing their prices and profits. So the pressure is less than it was in the past and given effective measures on the price side, the labor side takes care of itself with reasonable standards adopted by a tripartite board.

Chairman PROXMIRE. I would agree with much of that and it is very, very helpful to have you gentlemen appear before us this morning and to have the head of one of the biggest labor unions in the country, a very effective labor leader, argue that we have to have some kind of price control program; I think that is very useful. I join with you in that.

I would like to ask one or two questions. I want to join Senator Percy in saying one of the most devastating things about your analysis is the fact that you, in a real position to know what you are talking about, indicated that the industry the administration picked out to stimulate, No. 1, the automobile industry, is probably not going to create any more jobs. The investment tax credit is not going to help very much. The excise tax is not going to help very much. The devaluation of the dollar and so forth is not going to mean very much, because what is going to happen is that those working in the industry are going to work longer hours.

As a matter of fact, for other American industry, the hours now are relatively very low, I think 37 a week. If this is true in the automobile industry, it is likely to be much more true in other industries. You do not have to work them much overtime, just work them a 40-hour week instead of a 37-hour week.

I just have to ask you this, because it is so critical. Organized labor has indicated that they are very insistent on some kind of an excess profits tax, some kind of limitation on the compensation of capital. You propose two very ingenious approaches to this. One, the income equalization tax and the other the competition promotion tax. I would like to suggest on the first that you change the name. I think competi-

tion promotion sounds great and you will sell it. Income equalization sounds as if you want everybody's income to be equal. You do not want that, of course. In fact, you do not even expect profits to be equal on that basis. What I would like you to give, me, if you can, in a minute or two is the reason why this kind of approach you have proposed here would not eliminate much of the incentive that we have for holding down costs?

The reason I have persistently opposed a profits tax is that I am concerned that you take out of the act the most important discipline we have in our economy in holding costs down. Now, you argue, as I understand it, that the competition promotion tax, which is your fundamental taxing of profits, would not do so. Why is that?

Mr. WOODCOCK. The most persuasive argument we hear against the excess profits tax is that it encourages inefficiencies in what otherwise presumably are the most efficient producers. The IET, as we have called it, would apply across the board. For example, if it were shown that dividends had increased by a given percentage more than wages had increased, the difference would be reflected in a tax that would go to all dividends. There would be no penalty on being efficient, so there would be no penalty against inefficiency. That would remove all arguments advanced against the excess profits version.

Chairman PROXMIRE. Would it not mean that as you increase your profits by holding down your costs, your taxes would increase and, therefore, your incentive for holding down your costs would diminish, or would this simply apply to all industry?

Mr. WOODCOCK. This would apply across the board.

Chairman PROXMIRE. So, if you were more efficient than the rest of the industry or exercised greater ability in holding your costs down, you would get the reward?

Mr. WOODCOCK. Yes.

Chairman PROXMIRE. I did not get the rate you had in mind on that.

Mr. WEINBERG. The rate flows from the facts, Senator. This, as you know, is drawn from a proposal of the British magazine the Economist. What they proposed is that there would be an index of wage rates and comparable indexes for all——

Chairman PROXMIRE. I do not want to confuse these things. You are talking about the income equalization?

Mr. WEINBERG. Yes.

Chairman PROXMIRE. I am talking about competition promotion.

Mr. WEINBERG. Oh, the competition promotion tax bases the tax on two things, the differential of profits within a given industry above the average rate for all manufacturers, plus the progress made by the industry in reducing the inflow of imports. To the extent that profits increase above the average manufacturing level, the tax becomes heavier, or to the extent that the profits are reduced in relation to the average manufacturing level, profits come down nearer the average, the tax is similarly reduced.

Chairman PROXMIRE. How large is the tax?

Mr. WEINBERG. The tax is computed from the ratio of the industry's rate of profit against the rate of all the industry——

Chairman PROXMIRE. But you have to have some rate?

Mr. WEINBERG. The rate flows from the formula.

Chairman PROXMIRE. I saw that formula and it is pretty tough to understand it.

Mr. WEINBERG. I am trying to explain it in terms that do not involve mathematics.

It would vary the tax up or down depending upon whether profits in the industry were higher or were lower in relation to the average manufacturing rate.

Chairman PROXMIRE. The only thing I am getting at is this would increase taxes—if the corporation pays 48 percent now, would they pay 53 percent under your proposal, go up to 70 percent?

Mr. WEINBERG. It could be 53, 55, or 60 percent. It depends on how high the profits of a given industry were in relation to the profits of the average manufacturing firm. We start from the premise that if you have side-by-side a situation where profits are substantially and persistently above the average for manufacturing, and at the same time there is a huge invasion of the domestic market by imports, then that industry obviously is not competing in terms of price.

Chairman PROXMIRE. You would not apply this to the banks?

Mr. WEINBERG. I do not see any ready way to apply it to the banks, because the banks do not have an import problem.

Chairman PROXMIRE. They have been making tremendous profits recently.

Mr. WEINBERG. I do not see any comparable import problem in banking that you have in manufacturing industry.

Mr. WOODCOCK. This is our situation in the automobile industry where the average rate of profit runs twice the average rate for manufacturing generally, yet we are being drowned by imports.

Mr. WEINBERG. The other element of the formula would reduce the tax to the extent that that industry reduces the amount of consumption attributable to imports. Or the tax increases if imports increase.

Chairman PROXMIRE. As I say, I want to explore this. It is ingenious. Maybe we can get to it later on.

Mr. Widnall.

Representative WIDNALL. Thank you, Mr. Chairman. I regret I was not here as you were testifying earlier. But I certainly will read your testimony and go over the record completely.

I note in your testimony, you suggested that our economy now requires, "the stimulus of sharp increases in demand." You suggest a number of areas in which such increases would be appropriate. Could you tell us what level of increased governmental spending in these areas you would favor?

Mr. WOODCOCK. Well, it is partly rechanneling of governmental spending and certainly not to reduce Government revenues and give them back to the corporations; to utilize that money, rather, for aid to the cities and all the really desperate need areas that we have, to make it——

Representative WIDNALL. What inflationary impact would such sharp increases in demand have?

Mr. WOODCOCK. We think the inflationary problem is an anomaly. Inflation during a recessionary period should not be, according to the text books. But it is there. We have tried to find an answer to that. But what the economy most needs, in our opinion, is a stimulus in demand from the great mass of the American people, the low and

middle income groups. We think that feeds to the question of productivity, it feeds to a whole host of problems, including increases in governmental revenues.

Representative WIDNALL. You suggest the imposition of a competition promotion tax in certain industries with high rates of return on investment and in which imports constitute a fairly high proportion of total domestic consumption. What would you think of also applying such a tax in certain of our highly concentrated domestic industries which enjoy an average rate of return on investment significantly above the rate for all manufacturing corporations, regardless of the role which imports play in such specified industries?

Mr. WOODCOCK. Well, we think as that comes into the area where there are price-dominant situations, that would be responsive to our permanent Price-Wage Review Board proposal. We are reacting to the import problem in this tax proposal and I do not think we would be prepared to widen it just because the logic would seem to make a relationship. It just does not make any sense to us that the automobile industry, which has profits twice the manufacturing average, should be beset by imports because they cannot compete on price. It does not add up.

Representative WIDNALL. Is not one of the troubles in the automobile industry that the cars are completed at the factories with all the accessories on them in most instances, and that causes a greater consumer price because you have all the gadgets added as extras? The advertised price might be $3,000, but you are buying a $5,200 car with the various additions that go on that. That is where a great deal of the profit is, is that not true?

Mr. WOODCOCK. Well, of course, that comes back to the individual decision. The individual decides whether he wants all those options and gadgets and if he can afford them, fine.

Representative WIDNALL. How long does it take for him to get a car that has none of the gadgets?

Mr. WOODCOCK. Most cars are really built to customer order; 75 percent of all the cars sold are because a customer said, "I want precisely this kind of a car," rather than buying it off the showroom floor.

Representative WIDNALL. An awful lot of people would go in and just take it as is, then they are astounded at how much the price is built up when they look at the additions to it—the air conditioner, the radio, the heater, the various kinds of glass and so on.

Mr. WOODCOCK. Well, there are some very persuasive salesmen on those showroom floors.

Representative WIDNALL. Some of the time, they just indicate that it is going to take quite a while to get the kind of car you want, because these things are all there, and we can give you this now.

Mr. WOODCOCK. That is part of the gimmickry.

Representative WIDNALL. So, if you are protecting the consumer, and I am, we should try to protect them from the manufacturer's alertness in putting everything on the car and saying, this is the car, and if you want to get a car now, here it is, all ready. All you have to do is polish it.

Mr. WOODCOCK. There comes a point in a free society when the individual, I am afraid, has to be on his own.

Representative WIDNALL. This I agree to, and I have made that suggestion many other times in many areas. Somebody testified in connec-

tion with the supermarkets that there should be a sign in every supermarket as you enter, "Housewives, do not leave your brains outside." Unfortunately, things look good and you think you are getting a great value, a great bargain many times.

What happens as far as imports are concerned, is we have been pricing ourselves out of the market by making a lot of our cars too fancy. People love to have all the luxury that goes with it. As a matter of fact, I think a lot of people think of them as their homes rather than the one with bricks and mortar and wood, and it is a major investment.

Do you think that such a tax could operate to give us better price competition in many of the oligopolies which control many of our basic industries?

Mr. WOODCOCK. The competition tax?

Representative WIDNALL. Yes.

Mr. WOODCOCK. That is our obvious announced purpose in proposing it.

Representative WIDNALL. It is an ingenious proposal.

Mr. WOODCOCK. Certainly, if General Motors wanted really to compete against Toyota and Datsun and Mazda and Volkswagen, they could lick them in this market. They beat them in their home market of Germany. Volkswagen sales have been falling in Germany under the competition of Ford and General Motors, but they have been rising in the United States and other foreign markets at the expense of General Motors and Ford. It does not make any sense, but that is the way it is.

Representative WIDNALL. A lot of the major manufacturers over here have been blind to the fact that there has been competition provided, increased competition, and they have been inclined to laugh it off and say, well, we have an American product and it is going to be sold because people know our product is a good product. They are getting products from overseas now and they cannot laugh off the competition they get. I just hope that industry, labor, and everybody else is aware of the seriousness of the competition that we are getting from overseas. I have seen so many things with my own eyes over there that I was not aware of as to the extent of that competition, the extent of the quality of the product and so forth. We can learn a lot from other countries. I hope we will in the housing field, too.

That is all. Thank you.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Mr. Woodcock, last April or May I gave a speech on the floor of the Senate in regard to the automobile industry. I was concerned about the softness of our bargining position with respect to other countries, particularly Japan. At that time I computed the disparity in the situation. If you took a $1,400 wholesale car, an automobile, which is a pretty good price for a Japanese car, unrealistic for an American export, but that is a good price for the Japanese and a fair price. If they import that car into our country at that time, there was an internal tax that they had to pay, the importer, of $229, about 16 percent. If we exported to them a $1,400 car, the Japanese Government would charge $1,654 in taxes, a 74 percent tax; and if it were a $4,000 car, which is more realistic, it would be $2,771 or 70 percent.

Now, there is no possibility of American automotive exports competing with imported Japanese cars under that kind of condition.

Do you feel that a large part of our problem has been that we have

given way too much in the bargaining process and that other countries have not responded enough? Do you think for that reason we face a crisis now with this temporary—I hope it is temporary—border tax, and that a large part of our answer can be found in equalizing the bargaining position that we have with respect to imports and exports reflecting other countries?

Mr. WOODCOCK. Obviously, what you have described as a fact is absolutely unfair and improper and I hope it can be bargained away. But let us suppose it could be magically wiped away tomorrow. It would make no difference in our problem. Because the American industry solves its problem by buying into the so-called competing economies with the export of American capital. Chrysler in Mitsubishi, Ford in Toyo Kogyo and General Motors in Isuzu. They satisfy themselves in that way. If they were restricted to this continent, the North American Continent, they would fight very hard to protect this economy. But as long as they can buy into these others, that solves their problem. It does not solve the problem of the American worker or the American people.

Senator PERCY. The staff of our Joint Economic Committee has made a computerized projection of the economy. What they have taken is a certain given amount of money that has to be dealt with in three different ways. The first way was to reduce personal income taxes. The second way was to reduce corporate income taxes. The third way was to use part of it for reduction in corporate and a large part of it for an investment tax credit. Their computerized projections show that a simple personal tax cut in the first quarter of 1972, if done immediately, would create 100,000 additional jobs, and by the end of 1972, we would be at the rate of creating 200,000 additional jobs. If a corporation's taxes were cut simply, virtually no increase in job creation in the first quarter is shown and only 100,000 annual rate by the second quarter. But by coupling it with the investment incentive, they show 300,000 additional jobs in the first quarter and 700,000 additional jobs by the last quarter, increasing additional personal income by $8.5 billion.

I would like the full schedule of this computerized projection to be put into the record and furnished to you and I would very much appreciate your staff analyzing this to see if there are holes in it; if there are, I hope you will point them out to us in order to continue the dialog as to the best way to create more jobs. We are earnestly looking for the right answer to this. We want more people put to work. I think that this JEC research conclusion should be subjected to that kind of scrutiny, and we will furnish you a copy.

Chairman PROXMIRE. Will the Senator yield to me?

Senator PERCY. I will be happy to.

Chairman PROXMIRE. I am glad the Senator brought that up. I would like to point out that was the minority staff of the committee. The majority staff did not join in that. It is my understanding they disagree rather vigorously with some of the assumptions that went into the computer, in effect. As you know, computers will show whatever your assumptions are.

Senator PERCY. This is why I asked some experts to look into this. I should have pointed out that it was the minority staff that did it. I did not want to give them undue credit.

Chairman PROXMIRE. A great staff.

Senator PERCY. I wanted to show no partisanship at all on our Joint Economic Committee meetings. It was done by the minority staff. I think, therefore, they should be put on the spot to defend what they have done against experts.

Mr. WOODCOCK. We will be glad to have a chance to react, sir.

Senator PERCY. Senator Javits is not here, unfortunately, this morning. He very much wanted to be here and has been detained in returning to the city. I joined together with him in a group of what we like to call progressive Republicans in making some suggestions for stimulating the economy. One of the suggestions that has been made is to have industry productivity councils. I have supported that specific suggestion for a long time. The purpose of the councils would be to point out inefficiencies in industry (inventory accumulations of whatever it may be) that are contributing to a lack of productivity increases.

Would the UAW cooperate, if such councils were set up, by working together with management and Government to find ways to increase our productivity within the automotive field and all the other fields that the UAW serves?

Mr. WOODCOCK. If they were relevant and commensurate with the facts, yes, of course, we would.

Senator PERCY. I was interested in your comments on DISC. I must say I have been very concerned. It provided a tax credit where there could be no increase in the exports, and this seems to me to be unwise. Why give something away when there is no increase? Would you feel we should take a look at seeing what could be done to stimulate exports abroad and cause companies to direct more attention to markets abroad? We are too complacent in business about just the comfortable U.S. market, wanting to protect this market and raise barriers against outside interference, and are not willing to take risks abroad. Would you feel differently about this proposal if it provided incentive only if a company increased its exports over the level that now exists, and would you be willing to find some such method?

Mr. WOODCOCK. We would not be closed minded about the matter.

Senator PERCY. Let us see if we can do some creative thinking on it.

I was delighted to see your concern about welfare reform and deferral of this program. How urgently do you feel this reform is needed? Do you feel in the UAW that reform in welfare and the family assistance plan is necessary for the country to rectify some of our injustices? How high a priority should Congress assign to moving this program forward?

Mr. WOODCOCK. We think it has a very high priority and it stands very high in our hoped-for scheme of things.

Senator PERCY. As you might know, a number of us voted to override the Presidential veto on the public service jobs. I believe it is crucial and essential that we have programs of this type and I am pleased that now the administration is supporting it. Could you be specific about the additional number of jobs you feel that the public sector should carry at this particular stage? We have now created something over 200,000 public service jobs. Where should be be going in this area, what priorities should be put on expenditures for public service jobs?

Mr. WOODCOCK. Of course, we have been supportive of the whole concept of employer of last resort, which would expand the number very significantly. It certainly needs to be much greater than the 200,000. We have, I understand, talked in terms of a minimum of 500,000.

Senator PERCY. I think that is a good figure. I think it is a logical figure. And I very much appreciate the support UAW has given in this area. I hope we can all work toward that. I think it is the best investment we can make, certainly better than just continuing welfare costs without getting the productivity output that people are capable of giving and want to give if they can find a job.

Thank you very much for appearing.

Chairman PROXMIRE. I might point out, Mr. Woodcock said a minimum of 500,000 jobs. The full committee recommended a fiscal program which we calculate will provide a million jobs. Frankly, I do not think that is enough, and I do not think it is enough for many reasons. We are going to have an increase in the work force of a million next year. We are going to need another three million jobs to keep pace with the productivity increase in the economy in addition to that. We are going to have an addition to the work force just by the discharge of the military and so on. So, I think we need a tremendous increase and I have not seen a program yet which in my judgment is likely to be adequate to do the job.

I want to thank you so much. We have a lot of other questions we would like to ask, because you have presented so much in your excellent statement, but the hour is late.

Mr. WOODCOCK. Mr. Chairman, may I have permission to place in the record the UAW executive board's statement on "Licensing U.S. Corporations' Foreign Investments"?

Chairman PROXMIRE. Without objection, of course.

(The statement referred to follows:)

LICENSING U.S. CORPORATIONS' FOREIGN INVESTMENTS

Thomas Jefferson, observing the practices of the business men of his day, wrote:

"Merchants have no country. The mere spot they stand on does not constitute so strong an attachment as that from which they draw their gains."

Those words, written more than 150 years ago, are an apt description of the attitude of today's international corporations. Operating in many countries, they acknowledge loyalty to none and seek to play each off against the others for their own selfish purposes. Among other things, they move their investment capital across international borders motivated solely by the desire to maximize profits and with total disregard of the economic and social consequences for the peoples either of the countries in which they are headquartered or of the host countries. All too often, pursuit of profits leads them to invest where labor costs are lowest, exploitation of workers is least restrained and the degree of social responsibility required of them is in general minimal. The people of both headquarters and host nations alike are regarded not as human beings but as mere instruments for the creation of profits, as Henry Ford II made clear when he said:

"In South Korea, Taiwan and Indonesia we see promising markets and we see an attractive supply of cheap labor."

Today, when the United States is running a huge and historically unprecedented balance of payments deficit and the dollar is under attack in the world's foreign exchange markets, U.S. corporations continue to export capital in enormous volume to create and expand facilities in other countries. The operations of such facilities substitute, at least in significant part, for what would

otherwise be U.S. employment and production for both the domestic and foreign markets. The combined foreign exchange drain resulting from the outflow of capital and the replacement of U.S. by foreign production is greater than the total balance of payments deficit, large though that is.

The major U.S. automobile corporations provide a glaring illustration of the manner in which international corporations act in total disregard of the national interest. Although the UAW had foreseen the growth of demand by U.S. consumers for small cars and had urged the industry to manufacture them as early as January 1949, more than 22 years ago, the industry refused to do so until last year. As a result, imports, consisting mainly of small cars, flooded into the U.S. market. Introduction of U.S.-made compacts in the late 1950s showed that domestic production of smaller vehicles could turn back the tide of imports. But the reduction in imports was only temporary, for two reasons. First, the compacts were too large and too high-priced to provide direct competition for the car imported in the largest numbers—the Volkswagen, whose imports continued to increase even after the compacts were introduced. Second, the size of the compacts was considerably increased in the years following their introduction with the result that their prices were also increased.

Had production of small cars been started in the U.S. within a reasonable time after the UAW first urged it, the imports probably would never have gained a significant foothold in our market and we would, in addition, probably have been able to maintain our once dominant position in automotive exports. Thus, the nation's balance of payments would have been benefitted on both sides—by lower imports and higher exports—quite likely to the tune of billions of dollars annually.

Instead, the automotive Big Three invested U.S. capital heavily in overseas plants, which in itself damaged the balance of payments, used those plants to supply the world market with small cars and exported such cars from Europe to the U.S. Such exports cut almost as heavily into the U.S. balance of payments as would similar exports by foreign corporations, the difference being only a small amount in repatriated profits.

The small cars introduced by the U.S. producers last year are too high-priced to meet import competition as effectively as had been hoped. In addition, foreign car exporters to the U.S. have been given time to develop their dealer and service networks and parts inventories and, by now, they may be too well-established in the U.S. market to be easily uprooted by domestic competition. In short, the Big Three may have missed the boat in developing competition for the imports.

Now, with Japanese car imports rising rapidly, the U.S. auto industry has appearently decided to join them rather than make an all-out effort to lick them with competitive products. The Big Three have pressured the Japanese government into permitting them to invest in Japanese car-producing corporations—which involves another sizeable negative charge against the U.S. balance of payments.

The role of the auto corporations in undermining the U.S. balance of payments, although major, is but one of many similar tales that could be told about U.S.-based international corporations.

The problems created for the U.S. might be regarded as less serious if the negative effects of direct foreign investments were counterbalanced to a significant degree by constructive contributions to the economic development of the poor nations. However, aside from investment in the extraction of raw materials (notably oil), the overwhelming portion of U.S. direct foreign investment goes to advanced industrial nations capable of raising capital from other sources and such investment as does take place in less developed countries tends to be exploitative in character and is often harmful rather than helpful to economic development.

In addition, the exploitative aspects of the foreign activities of U.S. corporations often generate anti-American attitudes among the peoples of the host countries. As the latter strive to wrest control of their national economic destinies from the griup of U.S.-based international corporations, strains are placed on our country's international relations and our foreign policy is warped.

As war is too important to leave to the generals, so are U.S. foreign policy and foreign exchange resources too important to leave to self-serving international corporations. The nation's foreign exchange resources are assets that properly should be considered as belonging to the entire American people and,

therefore, not to be disposed of solely in the interests of a relative handful of corporations but rather to be carefully husbanded and used for the nation's highest priority international economic purposes.

To that end, the American people, acting through democratic economic processes, must recapture control over the use of the nation's foreign exchange.

After giving careful consideration to the problems arising from direct foreign investment by U.S. corporations, the UAW International Executive Board has concluded that there is a need for legislation, which it urges Congress to consider and enact promptly, to require governmental licenses for direct foreign investment of U.S. capital. As a starting point for Congressional consideration, and for discussion by citizens generally, we suggest, without attempting to be definitive, that the legislation might take the form outlined below.

All firms or individuals proposing to invest U.S. capital in any establishment operating in another country would be required to apply for a license to an agency that might be called the Foreign Investment Licensing Board. In order to assure that all interests affected would have an effective voice in licensing decisions, the Board would be tripartite, consisting of persons drawn in equal numbers from labor, industry and the general public.

The main criterion to be applied by the Board in acting on applications would be whether the proposed investment is in the interests of the people of the United States. The burden of proof would be upon the applicant for the license. In applying the criterion of U.S. interests, the Board would consider, among other things, the impact of the proposed investment (a) upon American workers and firms (including effects on employment opportunities, wages and other labor conditions), (b) upon U.S. communities dependent upon the production of products or services similar to or competitive with that involved in the proposed investment, (c) upon the U.S. balance of payments both in the short and long term and (d) upon U.S. relations with the people of the host country.

The Board would be directed to ignore balance of payments considerations in evaluating proposed investments in less developed countries. In addition, consideration should be given to the devising of other special standards which would encourage investments in such countries of a kind that would contribute to their economic and social progress.

The Board would be empowered to attach conditions to any licenses it issued. Failure of the applicant to abide by those conditions would result in revocation of his license and require him promptly to repatriate any capital invested under it. Certain of the conditions, which would be applicable to all licenses, would be specified in the statute and the Board would be empowered to add others it deemed to be necessary to accomplish the purposes of the legislation in connection with individual applications. In effect, such conditions would establish a code of good behavior to be adhered to by U.S. firms operating in other countries.

Among the generally applicable conditions to be specified in the legislation would be requirements that (1) the foreign establishment pay fair wage, reasonably related to the productivity of the workers employed, and otherwise maintain fair labor standards. (2) the workers' right to free collective bargaining through representatives of their own choosing be recognized and (3) the establishment will not discriminate against any worker or applicant for work on the basis of race or creed.

The first of the above conditions would be a step toward the implementation of the principle of international fair labor standards written into the Havana Charter for a United Nations Trade Organization and later urged by the U.S. government in GATT negotiations. The third condition mentioned would give our government leverage upon U.S. corporations operating in South Africa, for example, where they acquiesce in, and turn to their financial advantage, discriminatory practices outlawed in the United States.

A further condition would be made generally applicable in the interests of U.S. workers and their communities. The applicant would be required to guarantee to make whole—to compensate fully for loss of wages, fringe benefit protections and seniority rights—any of its U.S. workers who might be adversely affected, directly or indirectly, as a result of the proposed investment. The protection would cover losses of employment or income as a result either of a decrease in exports from the firm's U.S. facilities or an increase in imports from its foreign facilities.

The Board's licensing power would extend not only to proposed new investments but also to reinvestment in other countries of profits made by foreign branches, subsidiaries or affiliates of U.S.-based firms. The same criteria, standards and conditions would apply to such reinvestment as to new investment.

Refusal by the Board to issue a license for reinvestment of profits would require the firm to repatriate to the United States the profits involved.

Public and Congressional discussion of the proposal sketched out above will undoubtedly reveal the need for additional provisions to deal with other problems arising out of direct foreign investment by U.S. firms. We look forward to such discussion as the basis for development of the soundest legislation possible.

The need for governmental action along the lines proposed is imperative. Only through such legislation will the American people, through their government, be able to regain from the international corporations the mastery over political and economic foreign policy which is an essential attribute of national sovereignty.

Senator PERCY. Mr. Chairman, I would like to put on record that the largest part of the employment burden must be borne by the public sector. These jobs must be permanent additions, and I think the public sector can certainly provide more.

Chairman PROXMIRE. Not to prolong this dialog, I do want to point out that one problem here is that we do not want a permanent Government program begun now for temporary jobs. In fact, the advantage of the majority's proposal is that it would provide a stimulus without eroding the revenues that we get in the long run by stepping up income tax reductions, by postponing the social security tax increase, and so forth, and to provide assistance to the cities on the basis of what they need during this recession period to make up for this short fall—an increase of, as I understand it, $4 or $5 billion, to be phased down as unemployment drops. So, I want to stress the fact that we have to be ready for all these programs you spoke of so eloquently—a welfare program, antipollution program, health program—all of these programs are going to take enormous resources and we want to be prepared to provide those without inflation.

Thank you very much, Mr. Woodcock. It is most useful testimony.

Our next witness is the scholar, economist, Mr. Robert Roosa, currently a partner in Brown Brothers, Harriman & Co. Mr. Roosa was Under Secretary of the Treasury under Presidents Kennedy and Johnson. Before that he was a high official in the Federal Reserve System.

Thus, his experience provides a background sufficiently broad to help us understand all major phases of economic policy—fiscal, monetary, and international.

In addition, I should note that Mr. Roosa was one of the first eminent proponents of a wage-price freeze to break the inflationary spiral. In his appearance before this committee early in 1970, more than a year ago, he proposed a 6-month freeze on wages and prices. Let me just quote:

I think the fundamentals of policy have to have three legs. There has to be a monetary policy, a fiscal policy, and an incomes policy. I would hope that just as in the 1950's this committee led in the further articulation of the meaningful approach to monetary policy and in the 1960's to that in fiscal policy—the monetary earlier, the fiscal later—that the 1970's will see this committee leading the way toward the evolution for a full employment economy of a genuine and effective incomes policy.

Mr. Roosa went on to say:

I know it is easy to scoff at this; the administration has been denigrating it with the jawbone epithet, which I think is most misleading and deceptive. I think it ignores the fundamental role of Government in any economy to set up a framework of new boundaries—as evolution results in new conditions—within which the forces of the market can operate. And I certainly do not believe that there is any inconsistency between fundamental reliance on the principles of a market economy and some form of incomes policy.

We are happy to have you with us today so that we may assess the new economic program which represents, I believe, a vindication of your position expressed one year and a half before this administration recognized the need for an incomes policy.

I understand you have been a little under the weather. We very much appreciate your coming under those circumstances. You do not have a prepared statement. Go ahead and we will question you.

STATEMENT OF ROBERT V. ROOSA, PARTNER, BROWN BROTHERS, HARRIMAN & CO., ACCOMPANIED BY T. MICHAEL LONG

Mr. ROOSA. Thank you very much, Mr. Chairman.

I would like also to introduce my colleague, T. Michael Long, who works with me in Brown Brothers, Harriman, in New York, and who actually volunteered to prepare a statement while I was laid up last week, but I thought it would be better and, it now proves, mercifully that I had no statement to present in the little time that will remain for discussion with the committee.

I would just like to state two or three propositions with respect to the President's program as a whole.

First of all, that I am not going to quibble about timing. I am delighted that at last action has come.

I also feel it was quite wise to institute a freeze with the intention that the period of the freeze would be used to work out—with the hopefully full cooperation, as we have seen here this morning, of labor and management, and with both arms of the legislative branch—of a program that really would be meaningful for the second phase.

I trust that such a program will evolve by November 13 and that its form will include a wage-price review board whose powers will have many of the characteristics which you have already alluded to in the previous colloquy. I do not think it is possible in the present setting to think of turning this all back to a purely voluntary set of arrangements.

So I would urge, first, that the position the administration will take, I suspect—and that I hope the Congress will take—is that the President should have the power to reinforce decisions of whatever kind that are taken under the framework of a wage-price review board system.

I would also agree with what has been said here, principally from the rostrum, that the operation of the board should proceed with the benefit of some guidelines. I believe that, in the present setting, the problem of inequities is particularly great. Inequities intrude with a freeze at any point when the preceding momentum of rapid increases has been so great, as to cause the base at which one could follow another to be inevitably far behind, that would leave room and need for considerable redressing of position. During a transition period that may last for another year or longer, redressing will involve discretionary scope to permit increases that would be considerably outside those productivity bounds which would normally, I think, be appropriate for the guidance of settlements. This will be especially true of increases granted after a long delay in the normal contract cycle.

Then, I would also want to suggest that the power vested in the President should be so designed that it would be exercised only after

the full review procedures had been used, and moreover, that the findings of any board should be referred back to the parties in any particular negotiation with the advice that it was up to them to determine the context of prices and detailed wages that would satisfy the general finding.

These provisions are necessary so that there need be no intrusion of the board—and I would think a tripartite board is probably going to be inevitable and desirable—and so that the findings of the board need not enter into the details of any specific price or wage. However, if there should prove to be, once the contracts have been received and once the set of prices had been established, evidence adduced by any party that the results are clearly out of line with the general finding of fact—the rough range of percentage increases implied by that finding—then and only then should the President have the power to come in and even the power to set specific wages and prices. Without that residual power I believe that we cannot expect, in this present situation of still great disarray, that there will be an orderly outcome from the present, highly propitious, freeze, and the halting of the momentum of inflation which this has implied.

In other areas of the President's action, I will just mention a few points in my own view and then hope to have an opportunity to elaborate on whatever lines are of interest to the members of the committee.

I would disagree with the previous witness with respect to the investment credit. As you will remember, I supported the investment credit before this committee and, as Mr. Weinberg will remember, I guess I was the first representative of the administration to present it to the economists of the AFL–CIO in April of 1961. That was not a comfortable presentation. However, I supported the investment credit then; I do now.

I do not agree with the 10–5 division. It seems to me that whatever the percentage, it ought to be fixed and it ought to remain a permanent feature of the tax law, not a gimmick to be jiggled around. I think it is, in part, necessary as an offset to the competitive disadvantage that sometimes arises because American labor, as it should be, is paid better man-for-man and scale-for-scale than is prevalent in much of the world outside.

Now I think we need this as a built-in partial corrective for that, both for protection against inflationary pressure of occasional instances of cost-push, and to help preserve our competitive position in the world economy.

So that my reason for supporting the investment credit is somewhat different from that which others may suggest. It certainly points toward a permanent change in the tax structure and for a constant and not a variable rate.

In addition, I feel that it is most important soon to remove the Buy America feature for a variety of reasons. But I would think since that feature is itself linked to removal of the surcharge, it will have to stay on. My comments on the surcharge will suffice.

I believe that the surcharge has served an extremely useful purpose. It has staggered the world into a realization both of the immensity of the involvement with the U.S economy and of what it can mean to lose some of that market. At the same time others have begun

to realize how dreadful it would be if the world were to degenerate into a trade war with viciousness that extends both into national antagonisms and into the shrinking, rather than promoting, of a continued expansion of world trade.

So I think we are playing with a very dangerous instrument here. It is a little like applying a tourniquet; it can do a lot of good for 20 minutes. Much longer and you can lose the member you are trying to save. I think in the same way, it may be that we can keep a surcharge for 20 weeks, but not much longer without doing permanent destructive damage to the system as a whole.

I think that if what has been done will alert the world, we have achieved a great deal, and I think it would be unwise for anyone to specify the precise time period. When I use the 20 weeks as a figure of speech, it is only that—that is only to indicate that the aim is to have it temporary. It will be removed under certain conditions.

It may be that the administration's asking price has thus far been too high. I am not sure I know precisely what it has been. I admire them for trying.

I also hope that the atmosphere that will be forthcoming from our foreign colleagues in the other governments and the central banks and finance ministeries will be sufficiently rewarding, that it will not prove necessary or appropriate to continue the surcharge much longer. I am most hopeful that the initial improvement will come with respect to exchange rates. There is much there that still needs to be done, and beyond that the reform of the international monetary system.

In that last connection, Mr. Chairman, I did have an opportunity to comment at some length a week ago to the Senate Finance Committee, and the basis of comment there was——

Chairman PROXMIRE. We have your statement. It is a precise statement of 3½ pages. Without objection, that statement will be printed in full in the record at this point.

(The statement follows:)

TESTIMONY PREPARED FOR SUBMISSION TO THE SENATE FINANCE COMMITTEE ON SEPTEMBER 14, 1971, BY ROBERT V. ROOSA, PARTNER, BROWN BROTHERS, HARRIMAN & CO.

Mr. Chairman, I am very happy to be with you today. Since I was advised only late last week of this opportunity to testify, I regret that I cannot offer a full exposition of my views at this time. I am looking forward to the opportunity of discussing today all aspects of the President's new economic policies with which members of the Committee are concerned.

The President's new economic policies have an overriding importance for the future of the international monetary system, and for relations among the advanced nations. Although the pressures for changing the Bretton Woods system have been mounting for many years, the President's actions in imposing the 10 percent import surcharge, suspending the gold-convertibility of the dollar and in proposing a buy-American investment credit, have created a situation of international tension requiring prompt, sensitive, and creative plans and negotiations that will result in substantial changes in the international monetary system. The outcome of these negotiations will be of great and enduring importance for the American people.

In lieu of further initial comments, I should like to submit the text of my *Open Letters to the Group of Ten and the IMF* which was published in *The New York Times* last Sunday, September 12, 1971:

By cutting the dollar loose from gold convertibility in mid-August of 1971, the President has moved forward by at least a decade the timetable which many

members of the International Monetary Fund had implicity been following toward this fundamental change in the structure of the international monetary system. To be sure, no one was ready at this time, in spirit or in planning, for the mutation to which all knew they must eventually adjust. Yet now that the golden cord has been cut, the International Monetary Fund and all its members have a fortuitous opportunity to move with deliberate speed toward a new form of the Bretton Woods system—a form which hopefully may be as well attuned to the changing world economy over the remainder of the twentieth century as the original Bretton Woods design was for the quarter century that followed World War II.

A certain amount of tidying up of presently existing arrangements will have to occur first, in order to provide a reasonably calm environment for the deliberation and negotiation that must precede agreement on a major new design. An early upward adjustment of the exchange rate parities of a handful of currencies against the dollar should be speedily agreed upon. Provided the changes are sufficient to assure the credibility of the resulting structure of exchange rates, there is undoubtedly room for considerable differences as to the precise magnitudes to be chosen. And so long as a new flexibility can be expected to emerge as part of the new design, there need be no prolonged quibbling nor international deadlocks over the details of a few percentage points in the specific parities set for the end of 1971.

The agreements which should be reached promptly represent a sort of damage control operations, in order to avert further spreading and hardening of the trade restrictions, capital controls, and multiple exchange rates which have been rapidly splintering the international economic community over recent months. Moreover, so long as these restraints are proliferating, it is impossible to expect the nominal "floating" of the currencies of other leading countries to provide a sure clue to the appropriate levels of their parities. Since a severing of gold from the dollar had to come sometime, it would be most unfortunate, however, now that the step has been taken, if other countries or the IMF should expect the United States—as a sort of penance while new parities with the dollar are being set—to glue back together some pieces of the broken idol through a hastily contrived "return to gold" at some slight change in its dollar monetary price.

Once the immediate pressures toward economic isolationism can be checked, by reestablishing the customary modalities for making payments across the exchanges, the way will be open for further constructive consultations. The members of the International Monetary Fund, spurred by initiatives of the industrialized countries in the "Group of Ten," have already demonstrated their capability for creative innovation, during the four years of preparation that preceded the historic agreement in 1967 to establish Special Drawing Rights (SDR's) as a manmade substitute for gold reserves in the IMF. It is around these SDR's serving as a nucleus of reserves, that the world can now begin to develop a kind of monetary system that will be capable of maintaining stability—instead of permitting recurrent disruptions and distortions that inhibit international competition—in the payments flows among nations over the years ahead.

Just as the final collapse of the convertible gold-dollar version of Bretton Woods was precipitated by a sudden and rapid deterioration in the international economic position of the United States, so also the first steps in preparing the stage for a new Bretton Woods system are quite properly being initiated by our Government. By acting to halt the corrosive inflation, to stimulate greater productivity, and to enlarge employment and incomes, the Administration is positioning the United States to restore sustainable two-way flows of trade and capital between itself and the rest of the world. The immediate stage setting on the part of the United States also rightly includes fresh effort to cut the dollar costs of supporting military and economic assistance programs abroad, and to attack the many non-tariff barriers to the freer expansion of trade and capital movements.

One lesson that has become clear, over the four weeks following August 15, however, is that the dimensions of any of these economic and financial efforts which impinge on other countries are so large, and so intertwined with a myriad of powerful political and social considerations in these other countries—large or small, developed or developing—that no sweeping or swift agreements are likely to be found. The Administration is surely right to attack the immediate problems confronting the United States all at once, with fresh exhilaration and determination; it is equally right to urge other countries, particularly those with large balance of payments surpluses, to initiate proposals as a basis for

joint consideration and action; but it would just as surely be wrong to expect any large proportion of the imbalances among nations to be settled in a single massive negotiation. No country wants piecemeal correctives, with the risks they bring of new crises created by the disparities that still remain; but the needed total result may have to be reached through several separate, though parallel and interrelated, agreements or undertakings. In the necessary arraying of priorities, the time has come for a heightened concentration of attention on the longer range objectives to be sought in the redesign of the international monetary system.

Pleading only the special privilege of one who, in Dean Acheson's lofty phrase, was "present at the creation," I would like to put into the cauldron of discussion among the "Group of Ten," and hopefully the other members of the IMF as well, a seven-point program for adapting the Bretton Woods design to the flexibility that the world's monetary system now needs.

(1) The SDR's should be the principal reserve asset for use by central banks in making direct settlements among themselves. The dollar, and other currencies, should be held by central banks primarily as transactions balances, for use in intervening in the public markets for foreign exchange.

(2) Because most countries are not yet ready to demonetize gold completely, SDR's should be defined as a specified weight of gold in order to continue a role for gold within the Bretton Woods system. No central bank should be required to include gold within its reserves and no reserve settlement obligations should include a required gold component. All IMF requirements presently in terms of gold should be made interchangeable with SDR's. Any central bank should be at liberty to sell or buy gold, to or from anyone, provided the price does not exceed the equivalent of the established gold content of the SDR.

(3) The gold content of the SDR might be changed only through the same voting procedures as apply to a change in the Articles of the IMF itself.

(4) Each member country declaring an established parity for its currency to the IMF should define that parity in terms of SDR's.

(5) The acceptable normal range of variation in the market rate for any currency with an established parity, as defined in the Articles, should be widened from the present 1 per cent above or below the old dollar parity to 2½ per cent above or below the new SDR parity.

(6) Under conditions determined by the Executive Directors of the IMF, market rates should be permitted to fluctuate outside the 2½ per cent band for transitional periods of up to one year, by which time a new parity must be established.

(7) The scope provided in the original Articles for modest changes in parities without detailed IMF scrutiny or opprobrium has long since been fully used by most members. That original intention should be renewed by a change in the Articles to encourage more frequent and smaller adjustments of parities, subject to general provisions established from time to time by the Executive Directors.

This combination of suggestions preserves the essence of the Bretton Woods system: the IMF at the center as the ultimate source of needed reserves, and with related powers to exert some discipline upon individual countries whose actions seriously impair the well-being of the members as a whole; established parities for convertible currencies; and a numeraire for the setting of those parities. The major changes would be the increased reliance on the SDR (with the use of gold in reserves remaining a matter for the independent choice of each country), the elimination of gold convertibility requirements for the United States and the IMF, and the introduction of orderly arrangements for flexible adjustment of exchange rates and parities.

The deeper processes of change in the world economy certainly point toward the need for analysis well beyond the scope of this brief comment, and probably point toward action well beyond the range of any influences to be expected from greater or lesser flexibility in exchange rates alone. It is the rapid evolution of such forces which do in my mind, however, urgently emphasize the need for resuming the kind of intensive probing and appraisal that began in 1963, when the Deputies of the Group of Ten first began exploring the foundations of the system on which the SDR's have since been built.

Mr. Roosa. This is all I intended, Mr. Chairman. Sorry it took so long.

Chairman Proxmire. Oh, that was fine. It only took about 5 minutes, a little more.

You say the wage-price review board cannot be voluntary completely, that the President must reinforce decisions, that some guidelines should be provided, and that we ought to be very much aware of the necessity for working out inequities.

I think it would be very helpful if you could give us some specific example of just how this would work.

Let us take a particular industry; say it has average increases in productivity. What would you do in terms of their ability to raise prices? What would they have to do if they wanted to raise their price? Could they?

Would you provide a guideline that would prohibit it, and what could they do in terms of determining wages?

Mr. ROOSA. In a typical industry, I would follow very closely, I think, the approach that you have already heard from Arthur Okun. I think that the presumption would be that, overall, average price increases should remain within the 1- to 2-percent range.

If a case can be made—and prices do serve other purposes—that there is an allocative need for higher prices in a particular industry at a given stage of its development, that burden of proof would rest on the management involved. The presumption would be in the typical industry you have mentioned, for average price increases in the 1- to 2-percent range, and then reading back from that the costing out of any wage agreement, would be in terms of what the average productivity would be. I would say that the calculation of industry productivity will be misleading, that we should have overall productivity of economies as a whole.

There I think Arthur is using a figure in the 3½-percent area.

Then I would also go along with the notion that there has to be, since we do not have inflation licked yet, some recognition of the cost of living—I would take half, as he does—and then would expect that the 1- to 2-percent slippage on prices would be sufficient to cover whatever in excess of productivity gains was implied by the cost-of-living adjustment. I would confine it to half.

I think the justification for that is just as you gave earlier.

Chairman PROXMIRE. Say you have an increase, then, in wages, and I take it you would have to apply it across the board to permit increases of around 5 percent.

Mr. ROOSA. Yes.

Chairman PROXMIRE. Say you have a very productive industry which has a long record of being able to hold its costs down and reduce its costs year by year. It would be in a position, even if it just maintained prices without increasing them at all, of substantially increasing its profits because of the governmental policy of holding down wage increases to 5 percent. How would you handle that situation?

Mr. ROOSA. I first of all would be sure that I knew what the productivity calculation was and whether the fluke is likely to be able to continue in the years ahead.

If I were persuaded that it was, I would say that the board's obligation is to ask the management to present reasons why prices should not be reduced, before the board begins to assume that the price increase of 1 or 2 percent should persist throughout that particular firm or industry—with that larger pie somehow split between management and labor. I think it is the power to expose to review and to public

opinion the performance of average prices in a high productivity industry that may be a major longer run contribution of the wage-price review system.

I would not give the board the power to impose a precise reduction in prices. I know that arithmetically, mathematically, we like to think that gadgeteering of that kind would work. I would, however, give them the responsibility to ask management to establish why they consider it necessary to have 1- or 2-percent price increases, given their productivity performance; why they do not instead propose to reduce prices.

If, however, the management fails to make the case, then I would think that it is up to the board again to apply with some flexibility the basic principle that we cannot encourage gross inequity, and that labor in that particular industry should share in what are now being the reaped fruits of higher productivity.

Chairman Proxmire. So what you do is, in a productive industry, you feel that rolling back prices would be too much and that the best way to handle the profit that developed would be through profit sharing?

Mr. Roosa. Yes; although I would first expose the case both to the Wage Price Review Board—or a subunit hearing the case—and to public opinion. The Board should insist that the industry or firm demonstrates why it could not reduce prices on average. There I think public opinion can play a role. I think it becomes too intricate to try to devise what the individual prices should be and to impose them.

I think the review comes first, the review and exposure procedure and then, second, the sharing, because I do feel that labor has a case there. If there is going to be a reasonable assurance that wages will be held down, if you have a high productivity industry and there is not a reduction of prices, then there is clearly going to be an inequity.

Moreover, by having said this and if this became an established policy, I doubt very much if any industry would hesitate to both consider some price reduction and then, of course, pass along under the pressure of this arrangement a substantial part of whatever is the accruing windfall to its own labor.

Chairman Proxmire. Of course, this would be discriminatory. The labor that has the good fortune of working in a highly productive industry would get premium pay.

Mr. Roosa. Yes; it would, but I think it reflects what has to happen in a dynamic economy and it does also imply one of the concerns I had about our guideposts while we were using them. I felt they were splendid for the time and should have been continued, but that they would not last forever because there is too much change going on in a dynamic economy. It just flies in the face of commonsense—I think, most of us would agree—that all labor should be, from a given base date, subject to a percentage increase based on overall national projections for overall productivity and overall price change.

I think we have to see some difference there and this will lead to differences in the allocation of labor, even to the geographic movement of labor.

Chairman Proxmire. How long would that phase 2 last, in your view? Would you be working toward a completely free system without those controls?

Mr. ROOSA. Yet; I would, but I would qualify that, too.

I would like to think that we would keep the phase 2 review procedure in effect only so long as the dominant pressure toward inflation were the cost-push pressure, and that it would be possible to rely on a Presidential determination as to when this phase ends, just as we have had one now as to when it begins. I am not sure that I could judge whether that is feasible, but I do feel that it is important to distinguish between an inflationary phase which is predominantly "cost-push"—as I believe the present one is—from the "demand-pull" and monetary expansion induced varients of inflation.

I do not disagree with Mr. Woodcock in saying that the start of the present inflation was something else, but the cost-push took over long after the demand-pull had been killed; in fact, killed so well that we stifled the economy and are still struggling under that stifling influence.

Chairman PROXMIRE. How would you feel, Mr. Roosa, about Congress taking the initiative to provide legislation? It may be the administration, which was given, as you know, under the Economic Stabilization Act of 1970, just overwhelming power. They can do almost anything they want to without any further legislation at all.

You are proposing a program which might be quite different from the one the administration is likely to put into effect. Would you think it would be wise for us to step in and provide some limitations to the Economic Stabilization Act which, as I say, just gives the President carte blanche?

Mr. ROOSA. I do not think the President should have carte blanche. I do believe that for the first time around, the Economic Stabilization Act of 1970 was broad and, for any lasting legislation, much too broad.

You did protect yourselves by putting a time limit on it, which I thought was the only wise way to do it at that time.

Chairman PROXMIRE. The administration has just indicated that they may just come up and ask us to extend that time limit. I am very reluctant about that.

Mr. ROOSA. I think we have learned enough to close in the boundaries by now. I think, of course, something has to be done in execution, the primary responsibility of the administration should, hopefully, follow largely their design. But to think that you just simply fall over dead and let them arrange it as they wish is destroying the essence of our combined legislative and executive system.

So I would hope that in the process of at least reviewing the administration's legislative proposals, if not otherwise, there would be room for establishing boundaries of this kind.

I also hope that if the administration decides not to use the Wage-Price Review Board system—which allows for discrimination and the evening out of inequities—it should have a bit of a hard time justifying that in front of this committee and others, and that a very wholesome debate should occur.

I suspect that they may well come in with something at least bearing a faint resemblance to this approach and, therefore, it will be a matter more of tuning up detail rather than outright conflict. But certainly the specification should be provided, and I would see no harm, for example, in a provision in any renewal legislation that there would be a designated 2-year terminal date, and that it might be terminated,

in effect, sooner if the President should decide that the phase of a dominant cost-push impact on inflation had been reached sooner than that.

Chairman PROXMIRE. Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Bob, I want to welcome you before the committee. We all enjoy your testimony, and I know that it comes from somebody who has been a dedicated public servant, who is very intelligent and who has worked to accomplish a great deal for several administrations.

I often wonder whether or not Paul Volcker is catching up to your round trip record across the Atlantic.

Mr. ROOSA. I think he is; yes.

Representative WIDNALL. I know he is doing practically the same thing you were doing to try to meet the necessities of the times.

Would you describe to the committee what has happened to the Eurodollar market and the Eurodollar flows since the President's August 15 message?

Mr. ROOSA. The market has not been as moribund as might appear. The Euromarket, of course, consists of, broadly speaking, three parts.

There is the short term money, which consists of the very vast sums, so much of which moved shortly before August 15, enough to compel the President's action. Of course, the patterns of short term Eurodollar movement have died down considerably. Most of what could move had moved. Much of it had, some of it is gradually trickling back. There has not been as much coming back, partly because the exchange rates adjustments, in everybody's mind, are not over. The people who moved to protect themselves are not just greedy speculators, they, as people who have to preserve their own interests and protect themselves against loss of currency exposure until they see a greater degree of certainty as to where the exchange rates are going to settle, have been just seeking cover. So that, as far as the short term money movements of the Euromarket are concerned, since August 15 they have been relatively small.

And interest rate changes, although significant, have not gyrated anything like the period just before and very briefly after August 15.

The other markets are the Eurocurrency markets as distinct from the Eurodollar. Those have been somewhat more active than earlier, even though there is a currency uncertainty, and even though most central banks rather frown on having extensive markets in their own currencies in Europe.

The Swiss, for example, have done almost everything they could to prevent the development of a Euro-Swiss market, although in some ways it exists. The Japanese have discouraged an external yen market, although there is a very small one. You cannot do much business in it and that has not changed.

The external D-mark has been conditioned by the fact that controls on the use of the D-mark have, at least in short term bank balances, become tighter, as they have in Switzerland, of course. And you know as far as France and England are concerned, the flows in and out of their currency are rather tightly controlled. The British have always had controls and the French have their system.

So, while those controls are somewhat more active, the other Eurocurrencies are not taking the place of the Eurodollar as a longrun matter by any means.

Then, third, there is the market in securities or shares, which has been partly in terms of the D-mark, but is mainly a long term Eurodollar market. Surprisingly, the rates have not changed very much. They tend to follow the rates in the U.S. market. The volume, of course, stopped for some time, but just apropos of what Mr. Woodcock was referring to, shortly before this episode of August 15, General Motors had—and this is worth noting—in acquiring its purchase of Isuzu, had floated the issue to acquire the funds in Europe, not in the United States, and had made arrangements for the transfer of those proceeds into yen whenever they got the proceeds. The proceeds, however, were not to become available until after August 15.

The functioning of the market in handling this borrowing has been smooth, some of it is still in process. But as far as anyone reading the newspapers can tell, it has been handled smoothly. That market has functioned, the securities have been issued, and paid for after a couple of weeks lull, the Eurodollar market has reopened, and the pace of new issues, I suspect, in another month will be back, if not to previous rates, at least to a substantial volume.

So that while the world has been shellshocked, they now know there are limits to how far the dollar will devalue relative to the key other countries, and they also know that money is needed to carry on longer term investment, and I think the market will in a short time begin performing reasonably well.

Mr. Long reminds me that I should also mention that although this is not a part of the Eurodollar market any more, there was earlier on a very heavy pouring of central bank funds into the Eurodollar market which, even before August 15, had ceased, and the proceeds of the very sizable flows of funds into central bank reserves just before and after the 15th have now all come to this country. So that the holdings of central banks in the U.S. Treasury bill market have become larger by $10 to $12 billion. And of course, that has had some effect on lowering short term interest rates here.

Representative Widnall. Well, to turn to something else, do you believe the United States is correct in its stubborn refusal to change the price of gold vis-a-vis the dollar.

Mr. Roosa. I will give you a good yes and no answer.

I think the principal act already taken by the President is to suspend convertibility. Once that step has been taken, it should not be reversed. To the extent that anyone, here or abroad, suggests that the price of gold should be changed with a view to restoring gold convertibility, I would oppose it. To the extent that they say there should be a change in the price of gold just as a nominal gesture to indicate American contrition for whatever we have helped to contribute toward this current chaos, I think it is trival and irrelevant. It may have to be considered at some stage, at least indirectly, but I would much prefer instead to say that we are at a watershed in terms of the whole development of the international monetary system, that we should seize this opportunity to move forward as rapidly as we can to arrangements through which all currencies' parities will be defined in SDR's in the International Monetary Fund; and that the dollar will cease to be the unit of account. People can use the dollar if they wish, but it will be optional.

The SDR will also become available through the IMF and the dollar itself should have its parity determined in SDR's rather than in gold.

In turn the SDR should be, just again for nominal purposes, not because there is actual convertibility, but just for bookkeeping purposes, the SDR could be defined in terms of gold. For that purpose any change in the SDR gold price should be made in the same way that any change in the Fund articles can be made, so that it would be a decision of all countries, members of the Fund, and not a unilateral decision of the United States.

If under those arrangements a change in the gold price of the SDR were to be made, I have no quarrel whatsoever, but it seems to me we should seize the opportunity now to move in that way and not by stumbling backward in the direction from which we have come. I feel that, hopefully, we can leave the dollar price of gold behind.

Representative WIDNALL. My time is up at this time.

Chairman PROXMIRE. Mr. Roosa, I am delighted to hear you modify what I understood was your position. Perhaps I misread it, perhaps it was not reported correctly, but I understood you to say you were very much opposed to our devaluing the dollar even a little, even though it was trivial and irrelevant. I say I am glad to hear you say that because I think the rest of your response was so important.

We are expecting our trading partners, it seems to me, to go the whole way with almost nothing on our part. As I understand it, for example, if France should revalue the franc, it is one thing for it to do it when we devalue the dollar in terms of gold, because then they do not have to go all the way in terms of every other currency. Once they revalue the franc, it affects not only the dollar, but everything else. So it seems to me that just as a practical matter, we might consider the advice of Edward Bernstein, who came before us and suggested that we might devalue the dollar in terms of gold by, say, 8 percent, make it $38, and a fraction instead of $35 an ounce.

We do that and we do not help the speculators. We obviously are not going so far as to restore gold as the monetary unit. We can do it and accompany it with the statement that we want to go the SDR route, which you describe here.

It seems to me that is a much more sensible, logical kind of approach than sitting there with all the immense bargaining power that the United States of America does and just putting it to our trading partners and putting them in a position where they just have to back down and give up as much as we are asking them to give up.

Mr. ROOSA. Let me just put one qualification on that.

If I were doing the negotiating, I would not want to say that, because I would not want to give anyone the thought that by this little change in the gold price, without reestablishing convertibility, we would end the process of change. If, as leverage to assure that others will concur and to switch over to the SDR as the basic reserve currency (that is, the numeraire for defining party) if, as we wish to get that objective, we gain much more by going slowly on any U.S. change in the gold price, then I would certainly go slow on the U.S. gold price change. I think we have everyone up to a high pitch here where at least a commitment, if not legislative action, on a very significant change in the system can be within reach.

Representative WIDNALL. But you see, you say go slow on the gold price. That may also mean going slow on the surtax elimination.

Mr. ROOSA. I hope not.

Representative WIDNALL. And going slow on the "Buy American" phase of investment credit, because it seems to me this whole negotiating package is tied together.

We give up nothing and we are asking, as I say, partners who, with all their gains and all their advantages, are weaker.

I do not know if you have had a chance to see the statement by Secretary Ball.

Mr. ROOSA. I have.

Chairman PROXMIRE. He made a very, very effective presentation that we have not been taking a beating from our trading partners and documented it in great detail.

Mr. ROOSA. Yes; it sounded very good. He gave me an opportunity to read it before he gave it to you.

Chairman PROXMIRE. Do you dispute that analysis?

Mr. ROOSA. No; I thought it was splendid and he was preparing this because he had to go to Europe. I told him that he should send it down here by telegram, if necessary.

Chairman PROXMIRE. I put it in the record. I thought it was very good.

Mr. ROOSA. Absolutely, just splendid. I do not disagree with that. He and I discussed everything in his statement, so I would just say I endorse what is in his statement.

The key point I would like to make about this is, we have reached the stage now where we can at last do in the international monetary system what every domestic economy has recognized for years. That is that it is not some superficial formula for the backing of a currency that determines its value, it is how you control its quantity and what is in front of it to buy that determines its value. It is a very simple proposition, but it is a hard one to get established in the mores or the thinking of people of differing backgrounds and experience.

In this country, we know that it has not been necessary to have gold backing for the dollar to determine what its value would be and it would be irrelevant or impossible to consider it. We have reached that stage now in the international community and I would just like to be sure that we do not lose the momentum. Beyond that, any procedure that is feasible in terms of negotiation is all right with me.

I would say, though, that on your point about asking them to give up a lot, we give up a little; in fact, however, you look at it, it is their exchange rate against ours that will have to change. So I think Eddie Bernstein, when he was here, used the word "flim-flam" and that is what it is. But if we need a flimflam in order to get that achieved, all right.

My own hunch would be that we can probably get about as much as is reasonable in terms of the internal conditions of other countries in terms of exchange rate changes without that gold price change now, provided that at the same time we move with deliberate speed, and I mean so that all the legislative procedures could be finished by a year from now, to have the many other provisions of flexibility in the monetary fund that are included in this little statement I gave you.

And then if we do not have exactly the best set of exchange rate arrangements that we would have liked to have had before we lifted the surcharge, we will have had, first, a basic change in rates, and two, a commitment to go through with the improvement in flexibility in a short period of time. That, I think, is enough.

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Then once the flexibility is in being, the additional adjustments of rates which will be appropriate can be made, and by that time, if the United States were to make a change in the parity of the dollar defined in SDR's, that, too, could be made.

Chairman PROXMIRE. Let me ask you, I just wanted to step in at this point because I have great admiration for you and I indicated at the beginning how you were the first one to call for the freeze, to the best of my knowledge. But I just cannot resist pointing out that last August 7, this committee, the Joint Economic Committee, our Subcommittee on International Exchange and Payments, issued a report which seemed to trigger this cutting loose from gold because it brought so much attention to this situation.

Mr. ROOSA. Yes.

Chairman PROXMIRE. They suggested that the United States close the gold window and let the dollar float to bring about the exchange rate changes required to strengthen the U.S. balance of payments.

Mr. ROOSA. Yes.

Chairman PROXMIRE. Now, the President did that. However, before the President did it, in the New York Times of August 11 you were reported as asserting that the subcommittee's proposals were impractical.

Would you like to defend your judgment of August 11 in the light of what has happened?

Mr. ROOSA. Well, the Secretary has said he would eat some words; I will eat some.

I cannot remember the full context in which I might have said that, but certainly my judgment that it was impractical arose from my view on one other matter, and it is implied in what I said here, that I would not have been against closing the gold window. That, obviously, was practical and it was in the President's power to do that.

I did feel that it was impractical to "devalue the dollar and do it that way." I thought that for two reasons——

Chairman PROXMIRE. Do it what way, by closing the gold window?

Mr. ROOSA. No, do it by changing the gold price. Closing the gold window itself would do it.

Chairman PROXMIRE. I do not think our subcommittee proposed that.

Mr. ROOSA. You did not? I am hazy now on context, but at any rate, the key to my own view is that the devaluation of the dollar occurs because of the change in the exchange rate between the dollar and the other leading currencies and whether you call that devaluation or whether the others just float up against the dollar does not matter to me. But I did not think that there was any specific act that the United States could take other than closing the gold window which would do this, and second—this was the other part of it—I do believe that even now the U.S. dollar is in fact undervalued with respect to some hundred-odd other currencies in the world.

Chairman PROXMIRE. The U.S. dollar is undervalued?

Mr. ROOSA. Undervalued with respect to every currency that is not floating and even some that are floating—in South America, all of Africa, all of Southeast Asia—tremendous areas of the world that use the dollar are in fact using a currency which to them is even now undervalued, since we are the only currency that is uniformly used in

payment among all countries, and since a hundred-odd of them would find that devaluation of the dollar would in fact be very costly and difficult for them, that makes it easier for us to sell them exports and harder for them to sell to us.

Chairman PROXMIRE. Well, would we not expect that those currencies of the underdeveloped countries by and large would simply adjust? They would do the same thing we did?

Mr. ROOSA. Well, if they do——

Chairman PROXMIRE. And it would not be easier for the strong currencies to stand pat under these circumstances? If this were done, of course, on the basis of negotiations.

Mr. ROOSA. I doubt very much if it is easier. But the key, in any event, is the relation between the U.S. dollar and the other strong currencies, of which there are six, seven, or eight—at this moment. There may not even be that many that are so clearly out of line that they really have to have a change, that we could not wait until we have flexibility that would permit them to float into a new position. I am here thinking about the Scandinavians, British, and so on.

But I do certainly believe that the key now is in establishing the new arrangements for a system in which there will be flexibility on all sides, and I would grant that if the United States were to change its own parity in any way, then certainly something in the order of 100 other countries would probably have to make corresponding changes in order not to lose out because of the devaluation of the dollar against them.

Chairman PROXMIRE. Under present circumstances, will not deferring changes produce speculation?

Mr. ROOSA. Yes it will, and nothing is ever ideal. But there are other aspects to the problem. Just take the Japanese case. If you look at it from our side in terms of the trade relations and everything that Mr. Woodcock was talking about, certainly the case is very clear without the surcharge for at least 15-, possibly 20-percent revaluation, or however we do it. We could go down 10 when they go up 10, or whatever, but that total is the disparity now to be closed.

Yet, given the conditions of the Japanese economy, to make that charge at once is just such a terrible wrench, given an internal corporate structure that is so highly leveraged as theirs, that I really, even with the tremendous amount of government support and subsidies which they are contemplating, I shudder to think how I would ever be able to think this through if I were in the Japanese Finance Ministry.

They have a tremendous internal problem. There is no question that if they could have done 9 percent back when the Germans did it a couple of years ago and then started to float as the Germans did in May, the whole process of adjustment could have been accomplished stage by stage. As it is now, I see no way out other than to keep some unfortunate degree of uncertainty as to when and how much Japan may have to go again, even after some action is taken soon.

I am afraid it is just an unfortunate fact of the transition over to a new system. There are going to be inequities and difficult strains here, there, and in some other countries. We have to find a workable compromise among them. That is why negotiation is hard and is not helped by any of us sort of giving the impression that this is just a cat and

dog fight. It has to be a hard, quiet, respectful negotiation urgently pursued.

Chairman PROXMIRE. Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Roosa, in view of the fact that our dollar liabilities to foreigners exceed our gold stock by almost 400 percent, would any devaluation of the dollar short of a 400-percent markup for gold make any significant difference?

Mr. ROOSA. No; of course, as long as the convertibility to gold through the dollar is cut off, it, I think, is not going to make any difference in any case.

Again, what really determines the value of the dollar with the people is what they can use it for, not what they can go backwards and convert it into.

As I say, we have now reached the stage where that is going to be forcibly impressed on all minds and, thank goodness, we are going to have a more rational monetary system.

Representative WIDNALL. Could not the whole dollar devaluation situation be taken care of by directing the Fund to widen the margin for gold transactions, which they are empowered to do without amendment of the IMF charter?

Mr. ROOSA. I do not think so, because that would restore gold to a central position or imply going back in that direction. My own preference is much more for putting the SDR in that position in the future.

Representative WIDNALL. Along another line, would you describe the effect of the President's August 15 message on international business transactions generally? Has it significantly hampered foreign exchange operations?

Mr. ROOSA. Yes it has because of course most forward trading has been either suspended or nominal and for the continuing vigorous and expanding operation of world trade, there do have to be active markets, spot and forward, in the leading currencies vis-a-vis the dollar.

You find it very hard to get anything more than a nominal quote on most days for anything more than a small sum or usually spot or payment within 2 or 3 days. My own feeling is that if this condition continues with the present kind of stalemate on what may happen on exchange rates, on parities, that is, more than, oh, say, a couple of more months, we will begin to see the effects not only in considerable shrinkage of the goods moving in trade—that has been obscured now by dock strikes here, too, on the west coast—but also, by that time, we will begin to see much more in the way of restrictive practices on the part of other countries, who, finding that they cannot fulfill the pattern of gross exports and imports which they foresaw and to which they have been accustomed, may then begin to try to save on foreign exchange by restricting imports. That is the principal reason why I think it is poetic justice that the surcharge should be tied with the change in parities, the establishing of the new set of rules of the road for the time being, because the longer we avoid establishing reasonable parities, the closer we come to some deterioration, if not a breakdown, in world trade.

At the same time, the longer we keep on the surcharge, the more we encourage that kind of retaliation, which will be harmful for world trade.

Mind you, I do not imply here that I am critical of the surcharge having been imposed and I am not critical of its continuing to this moment, but I do feel that it has to be viewed as a temporary instrument and not a permanent device.

Representative WIDNALL. I agree with you on that.

Do you see any significant cancellations or fall-off in orders for imported goods at the present time?

Mr. ROOSA. I just am not sufficiently in a position to know. I am not actively in the importing game. I think probably it is a bit too soon to have judgment.

I did hear yesterday that you cannot buy a foreign car any more. The lots have been cleared out and the supply coming in, I guess, has temporarily been reduced while the market is appraised.

But as to specific evidence, I just do not have it.

Representative WIDNALL. That is all. Thank you.

Chairman PROXMIRE. Thank you very, very much, Mr. Roosa. You have done a fine job, most enlightening and helpful. You certainly bring useful, practical, understandable expertise in a complex area. It has been most commendable testimony. We are very grateful to you.

The committee will stand in recess until tomorrow morning when we hear at 10 o'clock in this room from Senator Philip Hart and Professor Lawrence Klein of Wharton.

(Whereupon, at 12:55 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, September 21, 1971.)

THE PRESIDENT'S NEW ECONOMIC PROGRAM

TUESDAY, SEPTEMBER 21, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room G-308, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Javits, and Percy.

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 Walter B. Laessig, economist for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

This morning, as we continue hearings on the new economic program, we will be exploring in greater detail several issues which have been touched on repeatedly during these hearings—including antitrust policy, trade policy, and the troublesome questions of taxes on profits. Our first witness will be the distinguished senior Senator from Michigan, Philip Hart. He will be followed by a panel of three economists: Mr. Lawrence Klein of the Wharton School, Mr. Lawrence Krause of Brookings, and Mr. Henry Wallich of Yale University.

One point which can hardly be stressed too often is that much of our inflationary problem results from the inefficient structure of our economy. If we had an economy in which there was less monopoly power; in which imports entered more freely; and in which the Federal Government's own purchasing power was used to promote price stability, we would have an economy with far less inflationary pressure. The task of any formal price and incomes policy would be infinitely easier.

The Senate Subcommittee on Antitrust and Monopoly has pioneered in uncovering the inefficiencies in our economy which contribute to inflation. The hearings which that subcommittee has held on antitrust, on administered pricing, on concentration of ownership, on import restrictions in the fuels industry, and on a host of related subjects, form a vast encyclopedia of information on the structure of the U.S. economy. It is a great privilege to have as our first witness this morning the chairman of that subcommittee, Senator Hart. Senator Hart, please go right ahead.

STATEMENT OF HON. PHILIP A. HART, A U.S. SENATOR FROM THE STATE OF MICHIGAN, ACCOMPANIED BY DAVID D. MARTIN, CHIEF ECONOMIST, SENATE ANTITRUST AND MONOPOLY SUBCOMMITTEE

Senator HART. Mr. Chairman, thank you. Let me ease the concern that you and your staff must have. This politician will get out of the way very quickly so that he and you and all of us may hear from three experts. We are all crises-oriented in the opening paragraph in the brief prepared statement that I have given you. That includes all of us, whether we are in or out of this business of politics. We scramble around for the short-term remedies which will at least calm a terrible situation, then we go on to the next crisis. That, I think, is a description of the situation we are in now. Things have become so terrible that by August 15, President Nixon was compelled to take drastic steps. And crisis still hangs heavy as we try to figure out what comes after the freeze. Here again, we are acting under the gun—as you, over a long period of months, have tried to persuade us all to understand.

The difficulty is that short-term solutions or responses to crises have a way of hanging around and becoming part of us and generally, they decline in merits as time goes on.

This seems a good time to decide how we got into such sad shape, so that radical responses were applied. The hope would be that we could work out long-term solutions and we would both avoid further such crises and cure the basic problems.

Now, naturally, a politician does not make a suggestion like that without also suggesting that he has a reasonably good answer. My suggestion as to how we got into this mess is that we did not have the courage to wrestle with the root of the problem: Economic power—excessive economic power—by which a few companies control the marketplace. Our fiscal and monetary policies were based on the theory that this was a competitive industrial society. I think that is not true. It depends on how you define competitive, I realize. The real pricing control power has been in executive suites across the country. When that proved to be an intolerable situation, that power on August 15 was removed from the suites and put in the White House.

Well, none of us is comfortable with this position, including, I am sure, the President. A combination of great political and economic power in a single office, we say, is not characteristic of our kind of democratic society. It is an element in the more extreme situations which we say we mistrust.

Clearly, now we have to face the difficult task of breaking up that economic concentration and reestablishing something more nearly related to a precise definition of competitive economy in this country.

The antitrust laws with some drastic stiffening are an appropriate tool. I hope in the next few weeks, I shall introduce legislation which should provide for that stiffening.

The economic reports to the Congress by the President and his economic advisers for 25 years have spoken of the need for vigorous enforcement of the antitrust laws. Yet throughout those years, five administrations and both parties, we have seen antitrust treated almost as an innocuous thing—much like the 1899 Refuse Act, until

that act finally recently was discovered to have magic. Only with the rising public outcry against the degradation of the environment by industrial discharges has it become politically feasible to bring that 1899 statute to bear on the pollution problem. Political feasibility for vigorous enforcement of the Sherman Act also has been lacking for those many years. In 1950, the law was greatly strengthened by the Celler-Kefauver Act. That amendment, I think, has contributed to preventing further concentration of markets brought about by horizontal mergers—at least until the National Steel and Granite City Steel merger was allowed to go through.

The merger law, however, has not served to undo the damage to competition brought about between 1895 and 1950. The Sherman Act prohibits every combination in restraint of trade in the form of trust or otherwise. Trade is restrained in far too many markets by combinations in the form of a few big firms sharing power to control prices. Such private price control already violates the spirit of the Sherman Act. To enforce the law vigorously—to make antitrust more than a charade—has been viewed as too radical a policy or too tough politically as we really do not know what may happen. We may go from the frying pan into the fire.

At this time of decision on measures profoundly affecting the economic organization of our society should not we ask: Is restructuring of concentrated markets really too radical a step?

The superimposition of Government controls on private government is also a radical step and one fraught with dangers whether we elect comprehensive controls, guideposts, or something in between.

The new, permanent arrangements for ordering economic activity will move us merely from one crisis to another unless we attempt to foresee both the dangers and the opportunities for constructive change. The Congress becomes a vestigial structure as individuals lose not only economic but political freedom. We say that around here all the time.

The mixing together of economic with political power has already progressed beyond the danger point in my opinion. Our goal should be the dissolution and decentralization of economic power so that an all-powerful state control of private government is unnecessary.

The old adage that human freedom is nurtured "not by bread alone" is true. But, when all the bread is in a few hands, human freedom surely is in jeopardy.

Clearly, the initial decision on what to do after the 90-day freeze will be made on a crisis basis. But, before extending the Economic Stabilization Act beyond its April 30, 1972, deadline, Congress ought to consider whether or not the free enterprise system is worth restoring.

Congress also must face up to the fact that present antitrust enforcement mechanisms are cumbersome, difficult, and enormously sensitive politically. Let us be plain about it. No attorney general will be willing to undertake the job needed. Congress must clearly reinforce our commitment to a free enterprise system and find new bottles for old wine.

Among possible solutions are:

A Federal corporate licensing system that could deny permits to firms with undue economic power.

A new enforcement commission with broad powers to break up existing concentration.

Adding more stringent guidelines to the old antitrust laws.

All have advantages and disadvantages, and it is impossible to say at the moment whether the plan should be one of these, a combination, or something totally new.

Economic concentration is a difficult concept to grasp. It does not lend itself to quick slogans and easy solutions. But I believe that public concern is building up, in important part because of the kind of hearings that you, Mr. Chairman, over long years, have conducted. I sense that we are now approaching a moment in history where real action is becoming not only socially necessary but politically imperative.

One proposition on which we can get general agreement in and out of the Congress is that if only one company produced all the manufactured goods in this Nation, we would be a vastly different people and society. There is almost universal agreement that we must not permit that to happen. We are now at the point where about two-thirds of our total manufacturing assets are in the hands of only 200 firms. Where do we draw the line—and how can we best do it? It is to these questions that I suggest—after you and your committee and others in the Congress and the White House have decided how to make the transition to the phase II—that we compel ourselves to take up and hopefully develop some constructive responses to them.

(The prepared statement of Senator Hart follows:)

PREPARED STATEMENT OF HON. PHILIP A. HART

The President's new economic program has been characterized as the most radical change in economic policy in forty years. Indeed, it is a radical set of policies.

A generation of efforts to achieve free trade through international negotiation has been replaced by unilateral measures that may set off retaliatory moves by other nations. The abandonment of the International Monetary Fund mechanism for adjusting exchange rates and the increases in tariff, even if temporary measures, are radical steps.

Many persons more expert than I already have testified that the fiscal policy proposals are biased toward the wealthy and largely disregard the disadvantaged. I will not belabor that issue—which is not to deny its importance.

The wage-price freeze is also a radical change from the traditional American free enterprise system in which most prices ostensibly are determined in free competitive markets.

Although the President imposed the wage-price freeze under authority granted by the Congress, I doubt that Congress intended that controls be imposed with so little administrative machinery for insuring equity. The simple freeze obviously can't be retained permanently. All signs point, however, to some permanent arrangement to superimpose government power on private transactions. Whether the permanent policy turns out to be full-fledged comprehensive controls or "guideposts with clout," we are witnessing a radical change in the Nation's economic organization.

Longrun, permanent changes in the structure of society are seldom planned. They result from shortrun responses to temporary crises. The policies formulated in the Fall of 1971 to cope with the crisis precipitated by the August 15th pronouncements will no doubt have long lasting effects. Should not we at such times seek to determine how we got into such sad shape that so radical a response was engendered, and also what we can do to remedy the underlying causes of the problem?

I. "WHY IS THE INFLATION SO STUBBORN?"

Last January the Council of Economic Advisers pointed out that the Administration earnestly has been trying to curb inflation since mid-1969. This claim appears in a section of the Council's 1971 Annual Report to the President which is

rather plaintively entitled, "Why Is The Inflation So Stubborn?" There was good reason for this question. Although the Council professed to see signs and portents that inflation was subsiding, prices continued to escalate and unemployment grew even more serious. By August 15 the Administration had precious little to show for more than two years' use of orthodox monetary and fiscal restraints; it had been able to achieve the highest interest rates and largest budgetary deficits since World War II without making a dent in inflation while increasing unemployment.

The Council suggested, in answer to its own question, that there are two schools of thought—the "Momentum" school and the "Economic Concentration" school. The "Momentum" approach was a new one to me, but, as explained by three most distinguished economists, it does not seem too difficult a concept: If inflation has been rolling along for, say, three years, it is pretty hard to slow it down in two. The Council took cognizance of economic concentration, but made it reasonably clear, I think, that its members adhere to the "Momentum" school.

Mr. Chairman, I believe it is reasonably clear that I belong to the "Economic Concentration" school. The "Momentum" argument to my mind does not explain the phenomenon. The current inflation appears to have gained momentum after the application of restraints to the point where the President felt forced to take his action of August 15. The question the Council should have asked is not "Why is this inflation so stubborn?", but rather, "Why haven't fiscal and monetary controls worked?".

Tightening of money supply in an inflationary period is supposed to curtail business investment and consumer investment in homes and expensive durable goods. The Administration's monetary policies helped to reduce manufacturing operations from 85 percent of overall capacity in 1968 to 73 percent of capacity in both the first and second quarters of 1971. As demand is choked off, competition among firms to maintain their sales levels is supposed to lead to price reductions. But prices did not fall or even remain stable. Instead, the price level rose and at an alarming rate.

Orthodox fiscal policy suggests that unemployment, at least, could be eased by deficit spending to increase demand. And with the economy operating well below capacity, market competition should prevent the increased unemployment from being accompanied by increasing prices. Administration spokesmen now inform us that the current budget is running a deficit on the order of a $28 billion annual rate—the highest peacetime deficit in our history. The result has been even greater pressure on prices with—contrary to theory—no noticeable reduction in unemployment.

Given the extensive field trials of our whole arsenal of fiscal and monetary weapons, the Council of Economic Advisers can be forgiven for asking "What's gone wrong?"

The Administration's economic policy previous to the freeze was ineffective, I think, because they assumed this was a competitive industrial society.

Using monetary and fiscal controls to slow a racing economy is like using a throttled-down engine to slow a racing auto. But the engine won't slow the wheels unless you have a transmission, and fiscal controls won't slow inflation unless you have price competition.

In short, here is the history of the thing as I see it:

For a time, the Administration assumed that the power to control prices was in the marketplace. That proved to be wrong. The real pricing power was in the executive suites of our major industries. And when that became an intolerable situation, the power on August 15 was removed from the executive suites and put in the White House.

But none of us is comfortable in this position, either. The President, I am sure, is not comfortable in this position. A combination of great political and economic power in a single office is not characteristic of democracy, but it is one definition of more extreme systems that we have learned to distrust: communism and fascism.

Absent competition, fiscal and monetary controls almost inevitably will be sabotaged—as they have been in the past—by the price and output decisions of firms so large that they control the market rather than the market controlling them.

The whole issue of economic concentration and economic power is hardly novel. The Congress was concerned about just this question in 1890 when it approved the Sherman Act. Economists began serious analytical study of the extent, the causes, and the consequences of economic concentration about 40 years ago. The first truly broad study was that of the Temporary National Economic Committee, under the chairmanship of Senator O'Mahoney 30 years ago.

That study, incidentally, was precipitated by the same question which faces us today: Why weren't the efforts of the Government to solve a major economic crisis proving successful? What was preventing the radical monetary and fiscal policies of that day (today's very orthodox policies) from accomplishing their purposes? It was indeed unfortunate that the final work of the TNEC was pretty well buried from public view and from possible Congressional action with our entry into World War II.

Interest in the subject revived after the Korean War, when we were faced with the phenomenon of rising prices in concentrated industries along with persistent unemployment and underutilization of productive capacity—a phenomenon which then, as now, failed to respond to the fiscal and monetary policies of the Administration.

The Subcommittee on Antitrust and Monopoly has been concerned with the nature of economic concentration now for many years. Recently, we have examined the pricing behavior in a variety of concentrated industries ranging from bread to petroleum.

This work aroused a great deal of interest among economists. It is certainly an area of interest to the public, if the standing of Cohen and Mintz' *America, Inc.*, on the best seller lists is an index of popular receptivity. This has ranked in the top four best sellers for weeks and is a documentation of the disastrous effects concentration has on consumers and society in general. We even may have persuaded some members of the Administration. In a speech on merger policy to the Georgia Bar Association on June 6, 1969, the Attorney General stated forcibly: "The danger that this superconcentration poses to our economic, political and social structure cannot be overestimated."

Unfortunately, I have yet to see any indication that the evidence on concentration has had any impact on public policy broadly conceived—as distinct from a highly desirable but limited tightening of standards for corporate mergers. What we have seen is great wisdom wrapped in a mythology of enforcement that has produced an enigma—a belief in a free enterprise system which has never effectively existed in modern history America.

Consider a single industry as a capsule of the insensitivity of concentrated industries to public policy. At the end of June 1957, President Eisenhower issued a call for "statesmanlike behavior" on the part of both labor and business to avoid inflationary wage and price increases. On July 1, the United States Steel Corporation, followed by the rest of the industry, raised prices by $6 a ton at a time when the operating rate of the industry was falling.

Early in 1971, following a succession of steel product price increases, the Cabinet Committee on Economic Policy set up a task force to look into the industry. In April the Council of Economic Advisers issued an "inflation alert" on steel prices. The industry's response to these expressions of public concern was to announce what the *Wall Street Journal* (August 3, 1971) described as "the biggest across-the-board price boost in the industry's history," at a time when the industry was suffering its lowest operating rate in years with no hope of substantial improvement.

Mr. Chairman, I must stress that in each of these situations the industry was operating well below capacity. If the industry was even reasonably competitive, there would have been no need for public concern because prices would have been going down instead of up as individual companies struggled to retain their customers. But the steel industry is not competitive.

Instead, the two leading firms in 1970 accounted for more than 38 percent of the industry's shipments in 1970; the four largest (allowing for National Steel's merger with Granite City) for 54 percent; and the eight largest for over 74 percent. Nowhere among the top eight or anywhere else in the industry will you find a single company willing to challenge the pricing decisions instituted or ratified by the two leading firms. The retaliatory power of U.S. Steel and Bethlehem is far too great to permit any other firm the luxury of making its own price decisions.

In light of its behavior we might have expected some pretty strong action against the steel industry simply to improve the effectiveness of the Government's overall policies, especially since the fewness of major firms facilitates collusion, whether tacit or overt. Since 1960 alone the Department of Justice has filed 20 cases against steel companies for price-fixing. All of these cases were terminated by consent decrees or nolo contendere pleas, with no noticeable change in the subsequent conduct of the industry. The very day after the August 15th Presidential pronouncements, the fourth largest steel company consummated a merger with the eleventh largest with no objection raised by the enforcement agencies.

Indeed, several Government policies have, if anything, served to consolidate the power of the industry. By the mid-1960's steel imports served as an increasingly effective counterbalance to the industry's power to raise its prices regardless of market conditions. How did this concentrated industry and its friendly Government react?

The Sherman Act prohibited U.S. steel companies from arranging any division of world markets with their foreign competitors. Our participation in GATT barred the U.S. Government from imposing, either unilaterally or through negotiation with foreign governments, any restrictions on imports. But a loophole was found. The State Department in 1968 negotiated agreements on behalf of the domestic companies with European and Japanese producers. Foreign producers agreed to cut back their 1969 imports to the 1968 level with a five percent growth factor in each of the next two years. Currently, the State Department is negotiating for an extension of the agreements—with the growth factor cut in half. For the U.S. Government to participate—in fact, to take the lead—in international cartelization of the world steel market is indeed strange behavior towards an industry which has been a prime contributor to inflationary crises.

Just to add some frosting to the cake, this Administration has ruled that the 10 percent import surcharge applies to steel imports, since the quantitative restrictions in force were not imposed by the United States but are the results of voluntary restraints exercised by foreign producers. The one hopeful weapon we had against the unfettered exercise of economic power by the steel companies has, in other words, been completely blunted.

Steel is not an isolated example, for the same behavior can be observed in virtually every other concentrated industry—such as petroleum, autos, chemicals and drugs, nonferrous metals, cereals—you choose to examine. In any of these industries, the dominant firms are not only able to enforce their pricing policies upon their smaller competitors; but they also are able to ensure that each of their industries will withstand any efforts by Government, short of direct controls, to preserve stability in the economy as a whole.

THE REMEDY

The Economic Reports to the Congress by the President and his Council of Economic Advisers for twenty-five years have spoken of the need for "vigorous enforcement of the antitrust laws." Yet, throughout those years, five Administrations of both parties have made antitrust almost as innocuous as was the 1899 Refuse Act until recently. Only with rising public outcry against industries' degradation of the environment has it become politically feasible to bring that statute to bear on the pollution problem. Politically feasibility for vigorous enforcement of the Sherman Act has also been lacking for many years.

The law on mergers was greatly strengthened by the 1950 Celler-Kefauver Act. That important statute has been very effective in preventing further concentration of control of markets brought about by horizontal mergers, at least until the recent failure of the enforcement agencies to act against the National Steel acquisition of Granite City Steel.

The merger law, however, has not served to undo the damage to competition brought about between 1895 and 1950. The Sherman Act prohibits every combination in restraint of trade in the form of trust or otherwise. Trade is restrained in far too many markets by combinations in the form of a few big firms sharing power to control prices. Such private price control already violates the spirit of the Sherman Act. To enforce the law vigorously, to make antitrust more than a charade, has been viewed as too radical a policy.

At this time of decision on measures profoundly affecting the economic organization of our society should not we ask: Is restructuring of concentrated markets really too radical a step?

The superimposition of Government controls on private government is also a radical step and one fraught with dangers whether we elect comprehensive controls, guideposts, or something in between.

The new, permanent arrangements for ordering economic activity will move us merely from one crisis to another unless we attempt to foresee both the dangers and the opportunities for constructive change. The Congress becomes a vestigial structure as individuals lose not only economic but political freedom.

The mixing together of economic with political power has already progressed beyond the danger point in my opinion. Our goal should be the dissolution and decentralization of economic power so that an all-powerful state control of private government is unnecessary.

The old adage that human freedom is nurtured "not by bread alone" is true. But, when all the bread is in a few hands, human freedom is surely in jeopardy.

Clearly, the initial decision on what to do after the 90-day freeze will be made on a crisis basis. But, before extending the Economic Stabilization Act beyond its April 30, 1972, deadline, Congress must consider whether or not the free enterprise system is worth restoring.

Congress must also face up to the fact that present antitrust enforcement mechanisms are cumbersome, difficult and politically sensitive. Let us be plain about it. No Attorney General will be willing to undertake the job needed. Congress must clearly reinforce our commitment to a free enterprise system and find new bottles for old wine.

Among possible solutions are:

A federal corporate licensing system that could deny permits to firms with undue economic power.

A new enforcement commission with broad powers to break up existing concentration.

Adding more stringent guidelines to the old antitrust laws.

All have advantages and disadvantages, and it is impossible to say at the moment whether the plan should be one of these, a combination or something totally new.

Economic concentration is a difficult concept to grasp. It doesn't lend itself to quick slogans and easy solutions. But public concern is building up, and I sense that we are now approaching a moment in history where real action is becoming not only socially necessary but politically imperative.

Chairman PROXMIRE. Thank you very much, Senator Hart.

This is most welcome. I might say that your full statement, which is substantially more detailed, will be printed in the record. We appreciate very much your abbreviation.

Senator HART. Mr. Chairman, may I for the record, introduce the individual to my left? He is Mr. David Martin, who is the chief economist of the Antitrust Subcommittee. He has availed himself, I am sure, of the facilities of your committee and for that, all of us are grateful.

Chairman PROXMIRE. We welcome you, Dr. Martin.

Senator, there is a great deal of concurrence among the economic profession as you know, in your conclusion that if we are going to have an effective stabilization policy, we ought to look at the structural weaknesses in our economy and you have put your finger on one of the most important, certainly, immense concentration of industry—some argue also of organized labor.

Senator HART. Well, I think those who argue that organized labor should have its muscle reduced also argue that big Government should be reduced. My hunch is that both big labor and big government responded to big economic concentration. If you cannot trim back the economic concentration, you are kidding yourself about trimming back big labor and big government.

Chairman PROXMIRE. I agree with that wholeheartedly, but do you also argue that you will get a pretty much automatic reduction in the concentration of labor power as you reduce the industrial power that you have?

You have indicated that you will get better government. It is big government at its most obvious when the President steps in and freezes all wages and prices by edict. Obviously, one of the reasons he had to do that was because of the concentration of industrial power.

You say that labor has to go through a power reduction period.

Senator HART. You asked me if I argue that it would. I do not. But my logic would suggest that as the size of the concentration, among

which labor is attempting to exert influence diminishes, so, to, will the concentration of——

Chairman PROXMIRE. At any rate, you think this is the first step in that direction for all three?

Senator HART. Unless we take this step, all those who are critical of big government and big labor are going to be able to do is make more speeches against them.

Chairman PROXMIRE. You argue that this is a long-range solution. You said whatever happens in phase 2, you would hope that we would start moving as soon as we can on this structural phase. Let me ask some questions about phase 2.

Do you agree that in the interim, we need an income policy which ought to have some limited sore of enforcement power, even though phase 2 be essentially a volunteer one?

Senator HART. I do.

Chairman PROXMIRE. Would you favor, for example, a wage-price board which would issue guidelines which would also have the power to roll back price increases? That is, that in its judgment exceeded the guidelines?

Senator HART. Yes.

Chairman PROXMIRE. Benefiting from your previous experience in studying firms that have excessive market power, how effective do you think that a completely volunteer wage-price board would be?

Senator HART. Well, if I thought it would be effective on a wholly volunteer basis, I would not have answered yes to your second question, a Board with ability and power to roll back.

Chairman PROXMIRE. One of the possible alternatives among the different wage and price control schemes is that of imposing controls only on the largest firms, only on the 100 or 200 largest firms and unions. Several witnesses before this committee have suggested that only those corporations and those unions that exercise excessive market power need to be controlled. You know the classic studies of Gardner Means, which have shown that certainly in the last couple of years, the principal inflationary element in the economy, certainly a large one, has been in these concentrated sectors. In the opinion of some of the witnesses, smaller firms respond to the pressures of competition. What is your reaction to this proposal that we concentrate on the larger firms?

Senator HART. If you were not here, I would say I would await the report of this committee.

I think all of us are hung up by the uncomfortable feeling that unless we can limit the reach of the phase 2 management by Government of the economy, we are buying an enormous bureacracy. So our tendency is always to hope, to wish that we can get the job done by zeroing in on just the 100 biggest. Frankly, I do not know whether we can or not. Professor Martin may have some reaction.

Chairman PROXMIRE. Professor Martin, would you like to comment?

Mr. MARTIN. Well, I think that one thing that is important to keep in mind is that the prices that go up as a result of temporary fluctuation and particular demand are likely to come down as the result of temporary fluctuations in the other direction. The prices of the firms that have a great deal of market power, when they go up, stay up. They move from one plateau to another. They may not in any short

term period appear as big in magnitude. But in terms of long run trends, this, I think, is the most serious part of the problem.

Chairman PROXMIRE. How about the problem that we have with some services—health services, for example, are tremendously, have been tremendously inflationary. Services generally over the last few years have risen far more rapidly than the price of manufactured goods. Do you feel that it would be realistic to concentrate on the manufacturing sector at this stage? It may well be that under present circumstances, the principal problem in the short term is in the concentrated manufacturing area.

Senator HART. We are buying an awful battle when we talk about moving to a period, an uncertain period from the point of time when you are going to have to ride herd on manufacturing or concentrated segments of manufacturing. If you then talk about effectively controlling everything from hospital services to theater tickets, are you not buying a battle in Congress that, even if you win, may not return the benefits commensurate with the effort? I really do not know.

Chairman PROXMIRE. Do you think it would be possible to have something like this, to have the kind of structure you and I have just been discussing for the concentrated industries, to have guidelines for all the industries, and then to have action taken in those cases where you have conspicuous violations of the guidelines at the discretion of the President?

Senator HART. It is easier, in the stating of it, it is easier to sell. I could not pretend any expertise that would make worthwhile any conclusion I would offer as to the effectiveness. Even if not effective, how significant would be the third category of activity in determination of our living costs?

Chairman PROXMIRE. I just feel that this next phase is so critical, just so crucial, that we should have as firm and effective a price policy as possible. A lot of other things will work themselves out if you can hold prices down. But I think the whole ball game is concentrated in whether or not we can be effective in achieving stability after November 12, that we should make an effort, even in these areas that seem very difficult and complicated, even if it does seem that we have to have a somewhat larger bureaucracy than the few hundred that some of the optimist say is all we need.

Senator Hart, could you give us a little more detail on the three possible solutions you have suggested in your statement? They are very intriguing and we have not had an opportunity to consider those.

Senator HART. The Antitrust Committee had very brief hearings, very brief discussion panels, on the first of those three, the Federal corporation. All of them are old hat. I know that Senator O'Mahoney, years ago, was beating the drum for Federal chartering of major economic segments, suggesting that a national interest could be better identified, restraints could attach. The activities that would be encouraged would be a reflection of so-called national interest.

The second suggestion most recently was voiced by Senator Javits' colleague from New York, Congressman Celler to have a commission—not a part of the Department of Justice—with authority and leverage to work with existing elements in the economy where the degree of concentration argue that it should be reduced, plan, devise patterns, sort of the reverse of the role that occurs when merger takes place—

more an attempt to adopt a pattern when the traditional Sherman Act orders have been entered requiring a dissolution.

On the third, the more stringent guidelines, here is something that Senator Javits has long been urging us to give attention to. The language of the basic antitrust laws is general. They carry with them some age. They produce a degree of uncertainty in the minds of business manufacturers. The suggestion here is not alone to produce some greater certainty but also to be a little restrictive in the degree to which concentration will be permitted to accumulate.

Chairman PROXMIRE. Each of these would require a substantial increase—or would they—in personnel to carry them out?

Senator HART. I doubt if the first would. The second would be hard—I think that none would require a substantial bureaucracy. Each would require some field of very wide——

Chairman PROXMIRE. I am just reminded of the presentation by Ralph Nader, who said one of the best investments we could make would be an adequate antitrust enforcement machinery. We do not enforce our present laws adequately. You have one or two or three fine young lawyers going up against a whole battery of the most competent legal talent that money can buy. So to make antitrust enforcement effective, I think you would have to have some increase. I am not talking about bureaucracy, I am talking about increasing the size of antitrust enforcement. Maybe you can do that without changing the law.

Senator HART. Some of us have urged upon our colleagues that we do just that.

Chairman PROXMIRE. My time is up.

Senator Javits.

Senator JAVITS. Senator Hart, first I think it is most admirable that you are taking on this great effort.

Second, knowing you as I do, I think it would be most unfair to you if the whole picture were not exposed for your comment. Now, the theory seems to be that if you break up concentrations, you will get greater efficiency and more adequate pricing. The main problem that you pose by your testimony is that if you just break up those concentrations, everything will right itself.

What about these two propositions? One, that the consumer is being admirably served by many concentrations—the best example is the supermarket—and second, and very importantly, that in the struggle for markets abroad, which is essential to the American worker, as he is now finding out by the way he is going after the so-called multinational corporation, there is a very different order of competition. It is just not we alone. Other people may permit mergers, consolidations, cross-licensing, and they can run our people out of many countries in which they could compete.

The third thing is this: I have been a lawyer for more years than I have been a Senator, and I have been a Senator for a long time. And I represented trade associations of small businessmen. I found that the cutting edge of the antitrust laws just cuts them down like sheaves of wheat. They are the people who take the rap and they are unable to compete precisely because of the antitrust laws. They are not able to have various cooperative methods for pricing, sizing, quality, advertising, and so on, because it is inhibited by the antitrust laws.

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So it may be that the mere effort to go after concentrations is too old fashioned. Perhaps we need a really new approach to what is the economy of 1971, and then express it through the antitrust laws. I have great hope, because as you know, I have tremendous admiration for you and faith in you, that in your hearings, which can be critical, and in the work of your committee—you know I agree with you as a liberal about issues such as concentration and monopoly and will go all the way with you on them—that we will bring into focus the other side of the picture. We cannot accept the idea that automatic adjustments in the marketplace will do for the free enterprise economy what needs to be done. That does not necessarily follow any more.

I think both the text of the antitrust laws and the theory of the antitrust laws may very well be out of date. And that is really what is troubling us.

Senator HART. That has been the concern that the Senator from New York has voiced to me for a good long time. I appreciate the opportunity to make clear that I do not suggest that those areas of economic concentration which would be identified as excessive and an effort made to reduce them—and you succeeded in the effort to deconcentrate—automatically will produce a Garden of Eden. But I think it is not old fashioned, and I know the members of the committee here do not regard it as old fashioned, constantly to recognize what happens in a society where we seek to permit an individual to make some independent judgments as fewer and fewer sources of production are available.

As I have concluded, where would we be? There is nothing old fashioned about throwing up our hands and saying "No" to the proposition that there is going to be one place that manufactures everything here. It would determine employment opportunity and location—it would be at least as powerful as government. If that remains a valid concept, then clearly, we have to attempt to put our finger on those segments of the economy where this trend increasingly becomes apparent.

Senator JAVITS. May I point out, Senator Hart, that concentration has produced economies of scale and quality and service. Where it goes over the edge is where concentration increases price or holds rigidly to price lines and uses its power to level to the ground the possibility of competition. But that arises just as much today by virtue of the vastness of required investment in order to meet the public's needs.

For example, you take the pharmaceutical business. It is built upon that power to finance research and development, give assurances of quality, and the little guy cannot begin to do that unless you let him combine—not deconcentrate. I say I know; I have represented them for years.

So all I urge upon you, and I came especially for that today, is that in considering what we ought to do, and even in your testimony, I hope very much that the whole spectrum of problems will be revealed to the American people so that they may have their choice in picking the means which will give them the most efficiency and the most control.

There are lots of factors here; for example, widespread public ownership of corporations where managements are essentially trustees, albeit under the lash of having to produce dividends and profits, but still trustees. There are very many critical factors to be cranked into the equation. And I hope very much that your committee may look

with real seriousness upon a measure which I have had a long time before you, in which Senator Morse joined with me for years in proposing before you. That is that 30 years after the TNEC, we ought to have another really broad scale look without any preconceptions that the Sherman antitrust law is necessarily gospel.

Thank you very much.

Senator HART. You find the fellow that does not have preconceptions with respect to the antitrust laws and you have found a fellow who just got in from Mars.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Senator Hart, I admire your ability to open up one of the most complex and profound problems. It is a good thing that it is now introduced here. I worry a great deal why, at a time of soft business when we are trying to expand sales, prices continue to go up. My whole theory was that if you need more business, you reduce your prices and try to expand your market. But it has not worked that way.

I also am concerned about the other side of it. At a time when, for instance, housing was so tight, we were down to 1.4 million housing units, when construction workers were looking for work unable to find it, and wages went up. How do you account for that in your theory now that economic concentration, not labor concentration, causes it? How do we get at it that way when wages are going up 20 or 25 cents an hour.

Senator HART. I do not account for it. I have heard the suggestion made that the construction industry, which seems so fragmented—and certainly not an example, I think, of concentration—indeed has a coordinated, cooperative understanding among contractors and unions alike, that many of the elements that characterize the traditional economic concentration area result from that kind of understanding and coordination, and I suppose it has been a kind of evolution.

Senator PERCY. You mean that contractors get together and decide how much costs are going to go up? Are there not thousands in all parts of the country? If there were ever a local type of business, that is it.

Senator HART. Here is a place where maybe I will take Senator Javits counsel and not make a guess until we get into it. Housing went down and labor wages went up.

Senator PERCY. Yes.

Senator HART. Unless Professor Martin wants to prejudge it, I will hold fast.

Senator PERCY. I agree with you that what I am seeking is an explanation as to what happens. You cannot hold fast to the economic concentration theory unless the phenomenon exists.

Senator HART. You perhaps were saying that economic concentration produces this phenomenon. Other things may, too.

Senator PERCY. Well, what are the other things in this case?

Senator HART. That is where I would like to hold fire.

Senator PERCY. Why, when housing is low and construction workers are out of jobs, looking for work, why do labor rates under those conditions continue to go up, when productivity has virtually not increased at all that particular year? In 1970, there was not any increase in

productivity. Yet labor rates went up, across the board, across the country, 20, 25 cents an hour.

Chairman PROXMIRE. A lot of it was a catch up, catch up from the enormous increase in——

Senator PERCY. Were they blind?

Chairman PROXMIRE. I am talking about overall wages going up.

Senator PERCY. Were they not the leaders, though, in leading off and touching this off?

Chairman PROXMIRE. No. No, in the period from 1959 to 1965, we had wage-cost stability. Prices began to creep up, then they went up much more rapidly after 1965. Then wages followed. You are concentrating in a particular area and that is different, I agree, construction wages.

Senator PERCY. Let's take another area. Let's take an area where I do not think there is a lot of economic concentration. All over the country, you have thousands of trucking companies. Yet at a time when business was not particularly firm, I remember when the rates went up across the country $1.65 an hour in one contract because Chicago, my own city, held out. I am sure the trucking industry has associations, but there are thousands of companies in that field. It is not like the automotive field, let us say, where there are just three big companies. There are thousands of trucking companies. Yet in that particular industry, the wage rates rose considerably. They have a good, strong union—let's face it. It is one of the most effective labor organizations in the country.

Senator HART. You cited two areas of the economy where a great many editorial writers conclude that the answer is labor concentration.

Senator PERCY. Well, I am asking your judgment.

Senator HART. I am telling you that I have read those editorials. I would not argue that deconcentrating in areas of the economy where there is admittedly high economic concentration will have a cure except with respect to pricing activities and the market discipline that then will apply to those then deconcentrated sectors. But with respect to those where the charts clearly identify, I am suggesting the desirability of attempting to reduce that kind of economic concentration and suggesting these are the kinds of benefits that will follow. If you can cite segments in the economy where there is no concentration and there are problems then one or another or all of us will have to come up with responses to that segment of the economy.

Senator PERCY. If we were members of those unions in construction or the Teamsters, we would have to say our leadership has fought against the economics of the condition many times and has really delivered to us contracts that have really been ahead of the parade, certainly. They have done their job, I suppose.

Senator HART. I suppose that the union members, if you and I were union members, would have the same reaction to that as we have to a corporation whose dividend return is vastly in excess of the national average.

Senator PERCY. Yes, it depends on how, though, and why.

Senator HART. I have never asked why some company produces more than others.

Senator PERCY. Some companies can do it through economic concentration. Others do it through sheer magnitude of technology. Eastman Kodak—the company I competed against for 25 years—is a good

example of the latter. What a whale of a return on investment through sheer technical competence. It is insurmountable, the technological advances they have been able to accrue. I felt it was through technical advance against which you could not legislate. You cannot really legislate against it. You would destroy America if you did that.

I would like to spend the few remaining moments I have asking you about the very intriguing solutions you suggest with regard to concentration of economic power. One of these you mention is a Federal corporate licensing system which could deny permits to firms with undue economic power.

Could you expand a litle bit, Senator Hart, on how that might work?

Senator HART. The only exposure I have had to it was from a panel discussion we had several years ago in the antitrust committee, but it is not a new idea. As I commented to the chairman, Senator O'Mahoney, when we first arrived here, was still beating the drum for it: I am suggesting economic units, at least, a switch from the State charter to a Federal charter. We charter the Red Cross and I guess the Daughters of the American Revolution, and we have problems with those. I can imagine the problems we would have if we were incorporating General Motors or United States Steel. But the theory is that the National Government would have a better concept of practices and goals which would serve best the national interests than the State licensing authority. And he sort of put the burden of proof on the applicant for a grant of authority, establishing a whole series of contributions that he would make and show that they are pluses and not minuses.

Senator PERCY. I will buy your premise that there are certain economic concentrations that have to be broken up. And I would be the first one to say let's try to find a way to do it that is logical and fair—antitrust regulations in this area. You have posed a possible solution, a new enforcement commission with broad powers to break up existing concentration. I wonder if you could help us think through how such a commission would work. What would its relationship be, for instance, with FTC or with the Department of Justice Antitrust Division, and what appeal would there be from its decisions and where you would take those appeals? Would you go to the district court or would you go direct to the court of appeals in the Federal system?

Senator HART. Most of the questions you raise have not even been surfaced in the committee's discussion of the possibility. The suggestion is that we would move somewhat as the action that followed the adoption of the public utility holding company; a series of plans applied to existing economic concentrations and that the procedural safeguards would have to be precise. We would all agree. But how that should be written I certainly am not prepared to say. It would be an enormously sensitive operation.

Senator PERCY. Oh, yes.

Senator HART. But it has been done on occasion as a result of court orders in traditional Sherman Act cases, where dissolution has been compelled.

Senator PERCY. The third possible solution of our problem of economic concentration which you offer consists of, and I will quote the language, "adding more stringent guidelines to the old antitrust laws." I suppose here is an area where all of us in the legislature get involved

with constituents—many times they are corporations who say, they just simply do not know whether they can take this action. Should we reveal it to the Government? If we do, would we be giving information to someone we should not be giving it to? But we do not know under the present antitrust laws whether what we intend to do that makes economic sense is national policy.

If the principal problems in obtaining antitrust enforcement under the existing antitrust laws are political ones, how could the addition of stringent guidelines overcome such political reluctance? Do you envision guidelines that might be so specific that there could be, then, no political judgment exercised one way or another? I say that because we are now in an evolving, changing climate in which the new Council on International Economic Policy is envisioning the problems of the future as related to our role in the world in an entirely different way than it were just a few months ago, 6 months ago. I have seen some of those presentations and I am sure you have. The economic concentration of power in Japan is one of the problems that our companies face in this country today. Our question is how do we respond to it? What kind of guidelines could be set up?

Senator HART. You have sensed the sort we had in mind. As the antitrust law is written now, the uncertainty attaches in terms of the business managers' lack of assurance that the conduct may not produce an antitrust action down the road. It leaves the decision to prosecute or file civilly, as I have indicated in my remarks, a difficult, sensitive thing for whatever administration is responsible for the Antitrust Division in Justice. If Congress did spell out with some precision—perhaps percentages of market—the point beyond which concentration would not be permitted under the law, it would then be a two plus two is four problem for the Justice Department, either it did or did not satisfy that guideline. Congress would mandate certain standards. Those would be known both by business and by the enforcement agencies. Clearly the processes of trying to decide what standards we would fix would be subject to all sorts of political wrestling. But the application of the standards, assuming honest administrators, would be automatic and hence free from a political problem.

Senator PERCY. Senator Hart, I thank you for opening up a subject. We may disagree in some of our analyses of it, but it is certainly a subject that needs exploration and I think by opening it up, you have made a fine contribution to these hearings.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Well, I join in that view. I think that both Senator Hart and Senator Percy have made a very helpful contribution this morning.

I am sure that Senator Hart's determination, as he said, he has an open mind on this, and he is beginning to explore it. One of the elements that Senator Percy rightly raises that I am sure Senator Hart will have in mind is that we under no circumstances would take any, or unlikely circumstances, that we would take action that would result in enfeebling our economic processes simply to argue that we have a greater diversity. To the extent that concentration is essential to economic efficiency and productivity and international competition, you have a very strong argument in its favor—perhaps not compelling, but very powerful.

I am sure you have that firmly in mind. In fact, I would say it is so compelling that even if you were disposed to break it up, you probably could not succeed with the Congress or the President or any man who might be President.

Senator HART. We do have it. But in this business of overseas competition, sometimes the fellow that argues that you should relax antitrust to allow American participation really does not want a relaxation to permit him to compete but to permit him to join cartels. His plea really is for a ticket that will allow him to restrict and to monopolize and restrain. To that voice, we should turn a tin ear. But to those voices that cite the changes in international marketing and suggest that inhibitions under our existing antitrust laws do burn American competition overseas in respects 1, 2, and 3—to that plea, we certainly have to give ear.

Chairman PROXMIRE. Well, Senator Hart, thank you very much. You have certainly been most helpful to us. You have given us a far deeper and stronger insight than we have had from any other witness in this field, certainly in the essential need for a long-run stabilization policy.

Now, I would like to ask our next three witnesses to come together up to the witness table—Mr. Lawrence Klein, Mr. Lawrence Krause, and Mr. Henry Wallich.

Mr. Klein is a professor of economics, University of Pennsylvania and chairman of the board of trustees of Wharton Econometric Forecasting Associates. He has a fascinating analysis of what we can do about profits. I understand he has gone into this in more detail than most witnesses certainly have and made quite a contribution.

Mr. Klein has long been noted for his contributions to econometrics and economic forecasting. He is the author of "An Econometric Model of the United States 1929–1952" and "The Wharton Econometric Forecasting Model." In addition to a general assessment of the economic outlook, which Mr. Klein is eminently qualified to provide, we have asked him to speak particularly this morning about the question of whether it is either practical or desirable to attempt to control profits. Mr. Klein's recent article on this subject, which appeared in the summer issue of the Wharton Quarterly, has attracted widespread attention. It was referred to in Mr. Woodcock's statement yesterday.

I was out in California a couple of weeks ago at UCLA and it was called to my attention by Nat Goldfinger of the AFL–CIO. We look forward to hearing about this question in more detail.

Mr. Lawrence B. Krause is senior fellow at the Brookings Institution. Before joining the Brookings Institution, Dr. Krause was a professor of economics at Yale University, and he served as senior staff economist with the Council of Economic Advisers from 1968–69. He is the author of numerous publications relating to international economics, including a forthcoming book on reform of the international monetary system. We are most interested in hearing his views on this question.

Mr. Henry Wallich is professor of economics at Yale University. Mr. Wallich was a member of the Council of Economic Advisers from 1959–60 and he presently serves as a consultant to the Department of the Treasury. He is an old friend of this committee and really needs no introduction. We greatly appreciate his being here today to give us his evaluation of the President's program. He has a different view on controlling, limiting profits as we limit wages and prices.

We have many questions to ask. I would like to remind all the witnesses to please observe, if possible, a 10 to 15 minute rule.

Mr. Klein, I notice you have a very concise statement. The tables which you have at the back of your statement will be printed in full in the record. Go right ahead.

STATEMENT OF LAWRENCE R. KLEIN, BENJAMIN FRANKLIN PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA, AND CHAIRMAN OF THE BOARD OF TRUSTEES, WHARTON ECONOMETRIC FORECASTING ASSOCIATES

Mr. Klein. Thank you, Mr. Chairman. I will read my statement.

One of the most perplexing economic problems of our times is the joint maintenance of full employment and price stability. The so-called "new economics" was fairly successful during the 1960's in bringing the American economy to full employment, but it was not successful in containing inflation while full employment was being achieved. The "game plan" of the present administration as it existed before August 15 was not successful in stopping inflation and it has brought about an unacceptable level of unemployment. The "game plan" succeeded in cooling off the economy, and it may have eventually reduced the rate of inflation significantly, but the cost of doing this has been excessive in terms of present unemployment and in terms of the long waiting period in returning the economy to higher level employment.

Clearly, something needs to be done, and some new approaches to full employment with price stability need to be tried. During the past year, I have been working with my associates at the Wharton School on devising new kinds of guidelines for stabilization at full employment, and I would like to describe our findings to you today.

In July 1971, Mr. Vijaya Duggal and I published a paper in the Wharton Quarterly on a scheme that was first suggested to us by Mr. Edgar Scott, Jr., of Janney, Montgomery & Scott.

In that report, Dr. Duggal and I incorporated Mr. Scott's suggestion in forward projections of the Wharton model, a statistical equation system used by Wharton Econometric Forecasting Associates, Inc., in predicting United States economic trends. This is a statistical service that the Wharton group has been providing regularly, on a quarterly basis for the past 8 years.

The essential features of the Wharton stabilization scheme are:

(1) The percentage rate of increase of money wage earnings shall be not more than the percentage rate of growth of productivity. Earnings are measured as employee compensation per man-hour, and the growth rate of productivity is measured as an 8-quarter moving average of real private output (private GNP) per man-hour.

(2) The percentage rate of increase of after-tax profit per unit of capital shall be not more than the percentage rate of growth of productivity.

(3) Any extra taxes collected as a result of the profit rule shall be returned to the spending stream, either in the form of Federal Government transfer payments or expenditures on goods and services.

In terms of simulation performance of the Wharton model these guideline rules stabilize earning rates, price indexes and profit rates. The ratio of total wage payments to total after-tax profits in the na-

tional remains quite stable. This policy simultaneously achieves a simulated model performance of full employment and increasing real disposable income.

American economists have progressively lowered their sights on a full employment target as inflationary pressures built up. Many people used to think that 3.5 percent was a good target.

Chairman PROXMIRE. Are you talking about the unemployment picture?

Mr. KLEIN. Yes. This figure has been increased to 4.0 and 4.5 percent by many economists, but we think that the American economy is actually capable of functioning without inflation at a rate of unemployment as favorable at 3.5 percent with effective guidelines of the sort that we propose. Our newest projections reach 3.5 percent unemployment by mid-1973 with our guideline rules operating, and we simultaneously foresee a price increase of only 2.0 percent at that time. It is remarkable that these performance levels are reached with a slightly lower deficit than is expected to be realized in a more sluggish economy without our type of guideline.

Chairman PROXMIRE. Again you are referring to a deficit in the Federal budget?

Mr. KLEIN. The national income accounts' definition of the Federal deficit.

Chairman PROXMIRE. I understand.

Mr. KLEIN. The present wage-price freeze is a dramatic shock that has beneficial therapeutic effects in bringing people to appreciate and understand the inflationary process that has been going on for some years. Having shocked the American public, it is imperative that the administration and the Congress present a "phase II" stabilization program that is fair to all segments of the American economy and firm enough to be effective. If it is not fair, it will not gain acceptability and will not work. Toothless schemes have failed both in this country and abroad in previous trials.

During the 90-day freeze, productivity gains accrue to profits. The Wharton interpretation of Mr. Scott's scheme, on the other hand, is fair to both business and labor. At the same time, it holds a joint promise of full employment and price stability. These are the main attributes of the scheme, and I urge you to give them serious consideration. It is, I believe, a scheme that should be acceptable to the trade unions and corporate management when they fully consider its advantages, the dreadful experience of the past, and the alternatives that lie before us.

There are other aspects of the program that argue in its favor.

(*a*) It avoids detailed price control. There seems to be near unanimity on the desirability of not returning to the wartime apparatus of the OPA. We have well developed facilities for collecting corporate income taxes that would be needed to implement the guideline rule on profits. Similarly, established procedures for negotiating industry-wide wage contracts by collective bargaining can be used for implementation of wage rules. Wage guidelines and profit guidelines are feasible in the contemporary American scene. Price guidelines are not.

(*b*) We have a time-honored practice of regulating the rate of return in specific industries to achieve what is often called a "fair rate of return." The profit guideline rule attemps to use the tax system to

extend this concept to a broader coverage during these critical economic times.

In anticipation of arguments that a guideline rule for profits would stifle risk taking and the flow of venture capital, I should like to counter with the following points:

(*i*) The alternatives are much worse. The inflation and "cooling-off" unemployment that we have been experiencing are far worse for the American economy. The Wharton scheme attempts to substitute full employment stability for inflation and unemployment.

(*ii*) Profits rates are allowed to grow although at no more than productivity growth, which is also true of wage rates.

(*iii*) The full employment aspects of the Wharton program project a bigger income flow in which all economic units can share.

(*iv*) In longer run simulations with another Wharton model—the annual industry model—we have computed that after 5 years the profit guideline becomes redundant, and the taxation of profits to restrain them according to our imposed rule is not needed. The capital base grows sufficiently and prices stabilize such that the rate of return does not need to be restrained. The wage guideline alone in later years after the present transition period would assure fair shares, full employment, and a stable price level.

The nearly complete stabilization of prices in the longer run, when coupled with a money wage rate growing at the same rate as productivity, ensures that real wage rates will continue to improve in this setting.

I have presented one possible scheme to you today. All possible alternatives and compromise implementations have not been examined. Our model simulations have been worked out for a particular way of implementing the suggestion that wage and profit guidelines be instituted simultaneously. Various compromise combinations can be worked out; guidelines for other income payments (interest, rent, royalties, self-employed income) can be instituted; other ways of returning corporate income taxes to the spending stream can be considered. Mainly, I have tried to suggest an idea that I find to be attractive and appropriate for phase II. A good deal of careful economic research has gone into the development of this idea, and I hope that this committee will study it in the course of reaching their recommendations for the next phase of the new economic policy.

I would like to point out that the tables that are appended to the statement are sequenced so that they represent the Wharton econometric forecasts as they were presented just before the President's new economic policy was announced—that is, on August 2. The second panel of the table introduces our interpretation of the new economic policy through the eyes of our econometric model on August 28, and that is a forecast of the likely outcome of events.

The third panel represents the imposition of our wage-profit guidelines to modify the August 28 solution and it is assumed to take effect in the fourth quarter of 1971.

The final table has the same arrangement, but draws out some interesting statistics from the mass of those that we computed. These model solutions throw some light on the distribution of shares between wages and profits and overall income. Thank you.

(The following information was attached to Mr. Klein's oral statement:)

WHARTON ECONOMIC NEWSLETTER

Summer 1971

Guidelines in Economic Stabilization

Note: This copy of the "Wharton Economic Newsletter" is sent to you in advance of its publication as a regular section of the Summer 1971 "Wharton Quarterly."

VIJAYA G. DUGGAL *and* **LAWRENCE R. KLEIN** *apply both the short-term and the long range forecasting models to examine policy solutions that would reduce inflationary price rises. By testing solutions with wages and profits tied to productivity, they present . . .*

Guidelines in Economic Stabilization: a New Consideration

One of the most striking features of the American economy since the end of World War II has been the actual presence of inflation or fear of prospective inflation. Generally speaking, the 1940's, 50's and 60's have been an era of inflation. There have been notable slack periods, but these have regularly been swamped by subsequent inflationary periods. In the 1940's the main price index (implicit deflator of GNP) almost doubled. It rose by more than 25 per cent in the 1950's and again by more than 25 per cent in the 1960's.

In the past three years there have been vigorous anti-inflation policy actions by public authorities, but the results have been meager. During the most recent months (early 1971), there has been some indication of reduced rates of price increase, but these have been slow in coming, and there is no assurance that this new direction will be long lasting.

Fiscal and monetary policy have been the main instruments used to fight inflation, and they produced disappointing results during 1968, 1969 and 1970. It is possible that these policies are having some effect now, but pressures on the side of costs are powerful, and inflationary movements can easily be set in motion again. Agricultural prices have given about as much temporary relief during 1970 as can be expected. The same is true of interest rates. New taxes are being instituted by many state or local governments. Many of these raise the basic price indexes. Most of all, we can expect to see wage demands continue to be strong, and as long as this is so, the battle against inflation cannot be declared finished.

During the early years of the decade of the 60's, there were public guidelines for wage increases, and these may have restrained pressures on prices. Most of the inflation took place in the latter half of the decade, after the guidelines were dropped. The settlement of the airline mechanics' strike in Summer 1966 is generally regarded as the end of the guidelines in practice. We do not mean to imply, however, that the dropping of the guidelines was the principal cause of inflation after mid-decade. In other countries, guidelines, under the title of *incomes policy*, have also been used temporarily but have never been able to stand the test of time.

Needed: a Balanced Policy

Many economists feel that a balanced policy of fiscal, monetary and guideline rules is needed to achieve price stability in a full employment environment. The lack of any one ingredient in this mixture weakens the economy's resistance to inflationary pressure. The purpose of the present study is to investigate the possibility of devising a set of guideline rules that will be acceptable to labor and management alike.

A deficiency of past guideline rules is that they overemphasized restraint in wage patterns to the exclusion of restraints in other income shares and that they have not been enforced or enforceable. A balanced policy stands a better chance of being acceptable now. Price guidelines, coupled with wage

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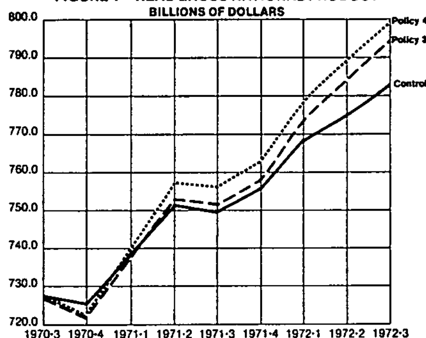
guidelines, imply guidelines for profits, but the implication is indirect and imprecise. It is our purpose to consider joint *wage and profit* guidelines.

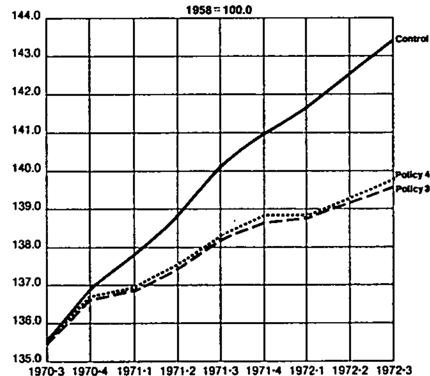
An accepted guideline pattern for wages is that earnings per employee should have the same precentage movement as productivity (output per employee). A parallel guideline for profits is that the percentage movement in rate of return on stock of capital should be the same as the percentage movement in productivity. The fairness in burden sharing among different socio-economic groups should be an attractive feature of this approach. There is a much greater chance that American labor will accept a guideline principle for earnings if there is a corresponding guideline principle for profits. Wage restraint, by itself, would tend to be reflected in unusually large profit increases and this would lead to an eventual breakdown of the principle.

Guidelines from Productivity

The proposal being studied proceeds in two main steps. First, it is assumed that guideline rules are imposed on wage increases so that earnings have the same rate of change from period to period as productivity. Numerical calculations are made of the additional profits that would accrue to business if unilateral wage restraint were imposed. Second, taxes are then prescribed to make after-tax profits what they would have been in the absence of special wage restraint. By itself, this step would reduce the level of economic activity and possibly cause unnecessary unemployment. The extra business taxes collected by public authorities are simultaneously programmed in our calculations to be paid out in government expenditures, either on goods and services or in the form of transfer payments, so that high level activity is maintained and surpluses are not generated in public budgets.

The two-step procedure outlined above is implemented through the Wharton Econometric Model. This is a system of simultaneous, dynamic equations, with statistical coefficients, that is regularly used to produce the Wharton Econometric Forecasts. Prior to the examination of the effects of guidelines, the Model is projected forward for two years, by quarters, in a *Control solution*, i.e. a baseline calculation that shows how the American economy is expected to perform on the basis of prospective domestic policies and overseas developments. The





Control solution shows a continuation of inflation, but not at the high rates of 1969-70. The working of guideline policies is studied in comparison with the baseline case. This provides a basis for determining targets for unemployment rates and budget levels.

Because the present study was initiated at the end of 1970, the starting point of the calculations was the fourth quarter of 1970. Values for the third quarter of 1970 and earlier periods served as initial inputs. Other inputs were forward projections of *exogenous* variables such as government spending, tax rates, discount rate, open market operations of the Federal Reserve, world trade projections, agricultural prices, etc. Since the *Control solutions* of the Wharton Model have been quite close to actual performance for the past several months, there is little loss in using calculations that originated last autumn.

Although there are two main steps to the calculations, intervening and alternative steps were also used. The calculations are laid out in four parts, called Policy 1, 2, 3 and 4.

In Policy 1, the relationships of the model that determine wage rates are replaced by the guideline rule. It is assumed that the quarterly percentage increase in private wage rates is exactly equal to the quarterly percentage increase in output per man hour averaged over the past two years. The averaging is done in order to get smoother calculations.

GNP Drops, Then Rises

This Policy generates an immediate drop in real gross national product of $4 billion in comparison with the Control solution. At first, real GNP trails the corresponding Control solution value, but makes up the total difference by the end of eight quarters. The major sector responsible for the initial drop in GNP is the consumer expenditures sector. The underlying cause for this phenomenon is embedded for the most part in the structural inter-relationships of the economy. Although the policy reduces the growth of wage rates the induced decline in the growth of prices is relatively modest in the first instance. Since the response of prices to lower wage rates is not immediate, real disposable income is less than that of the Control solution, generating reduced expenditure on consumption. Lower consumption with its multiplier (indirect) effect reduces real GNP by about $4 billion. Although consumer expenditures for all eight quarters are less than those of the Control solution, lower prices and lower interest rates stimulate housing, private investment and net exports enough to neutralize the drop in consumption by the end of the simulated period.

Another result worth noting at this point is the increase in the rate of unemployment in Policy 1 over the Control solution value. Unemployment remains higher under Policy 1, even at the end of the simulation period, although real GNP has caught up to the Control. Although total man hour requirements in Policy 1 at the end of the period are slightly higher than in the Control solution, with relatively more favorable wage rates, employers prefer to have present employees work overtime instead of hiring more employees.

No change has been made in Policy 1 in the set of exogenous variable assumptions used for the Control solution. The values for the government sector variables are unchanged. This neglects the fact that wage rates for government employees should also be restricted to grow at a slower rate. Since the goods and services the government buys will be cheaper, the price index for government goods and services should be lower.

This is done in Policy 2 in which wage rates earned by government employees and the price of government goods and services are restricted to grow at 2.5 per cent per annum, which is narrowly bracketed between the growth of prices and the growth of private wage rates generated by the simulation of Policy 1. It is assumed that the government makes the same current dollar outlay as in the Control solution. With lower prices and wage rates, the same expenditures can buy more goods and services. *Real* values for government variables and the number of government employees are consequently increased over the values in the Control solution. Thus, government uses more services itself.

In addition, more labor is needed by the private sector to provide government's higher demand for real goods. This gives a direct and an indirect push upward to employment, bringing down the rate of unemployment. Policy 2 has managed to combine a lower rate of unemployment with a lower rate of inflation. In spite of it, this policy is still not acceptable because of the enormous increase in profits generated by Policies 1 and 2 over the Control solution.

When prices respond to a slower growth in wage rates, corporate profits, calculated residually, rise. Profits cut into the extra funds taken from wage earners. The additional profits,

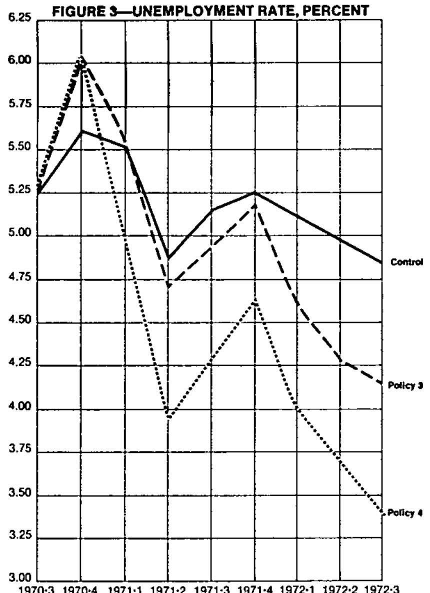


FIGURE 3—UNEMPLOYMENT RATE, PERCENT

except for a small part that goes into dividends, are not spent and have no impact effect on the system. This is responsible for depressed activity levels in Policies 1 and 2 below those of the Control solution in the first few quarters of the simulated period.

Both defects on Policy 2 are corrected in Policies 3 and 4, in which an additional restriction is imposed on the calculations. The percentage increase in corporate profits after taxes dollars per unit of capital stock is restricted to be equal to the percentage increase in over-all productivity, (output per man hour) averaged over the past two years. This means that the rate of return on capital must grow at the same guideline rate as wages. This is the novel feature of this study.

If after tax profits generated by the Model exceed what is allowed by the guideline rule, the difference is assumed to be taxed. The corporate profit tax thus collected is returned to the income stream in the form of additional transfer payments (Policy 3) or additional government expenditures on goods and services (Policy 4).

The assumptions of Policies 3 and 4 generate a higher level of activity but have no effect on prices. Prices generated by Policies 2, 3 and 4 are almost identical. Guideline policy is thus estimated to be effective in controlling inflation. The price index for GNP increases in the three policy experiments by about 2 per cent instead of the control forecast of 3.3 per cent during the first year and by one per cent instead of 2.4 per cent, the baseline forecast for the second year. Corporate profits after taxes are in line with Control solution values. What is even more important, the ratio of corporate profits after taxes to compensation of employees falls in line with the Control solution ratio. In addition to controlling distributive shares between capital and labor, the extra profits are used to generate more activity, more consumption, a higher rate of growth of real GNP and a lower rate of unemployment.

FIGURE 4—REAL GROSS NATIONAL PRODUCT

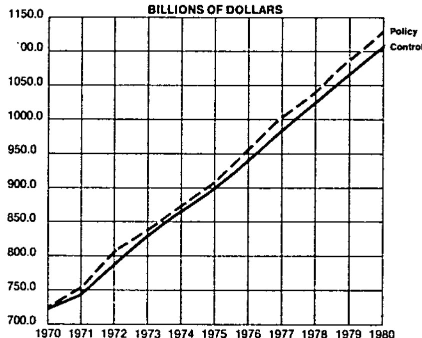
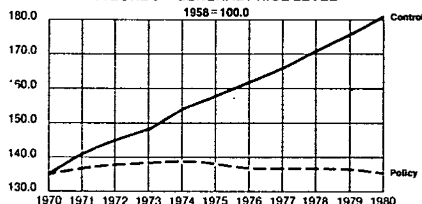


FIGURE 5—GENERAL PRICE LEVEL



Policy 4 generates so much additional activity that real GNP overtakes the Control solution value in the third quarter of simulation and exceeds Control solution GNP by $17 billion (1958 prices) at the end of the simulation, all with lower prices. The rate of unemployment except for the first quarter of the simulation is lower and is 1.4 per cent below the Control solution figure by the end of two years. Of course, the unemployment rate would be partly brought down directly by depressing government wage rates for the same outlay. Most of the drop, however, is due to increased activity generated by returning the profits tax back to the demand stream. The increased activity in Policies 3 and 4 reduces the government deficit below its value for the Control solution by generating additional tax receipts and lower unemployment insurance benefits.

As is expected, when additional profits go into transfer payments, the activity level generated is less than if they go into government expenditures. Real GNP generated by Policy 3 by the end of the simulation period is $6 billion below that achieved in Policy 4. The increased transfer payments do not enter GNP directly as do government expenditures in the first round. Transfers raise income and enter GNP for the first time when money is spent on consumption. Government expenditures go directly into GNP and at the same time raise income, inducing increases in other components of GNP via the multiplier process.

Favorable Results for Two Years

The simulated growth of *real* Gross National Product, general price level and the unemployment rate for Policies 3 and 4 are graphically presented, in figures 1 to 3, in contrast to the pattern observed in the baseline forecast. It can be inferred from these experiments that if labor and business were to abide by the guideline rule and if government authorities were to maintain their budget outlays as planned, using funds to buy more real goods and services than would have been possible in the absence of guideline restrictions, the rate of inflation would be reduced to almost half of the most probable forecast that uses no guidelines. The unemployment rate would drop 1.4 percentage points from 4.83 per cent to 3.39 per cent, at the end of two years, while the economy would enjoy $17 billion more real GNP, all this with a smaller public deficit.

The results of the quarterly model provide strong support for the effectiveness of wage-profit guideline policy for the first two years. Would the guidelines continue to restrain inflation for a longer period? If so, would there be need for further policy changes to enable the economy to experience continued prosperity with low rates of unemployment and no serious inflation? This is studied by implementing guideline rules through the Wharton Annual and Industry Forecasting Model that forms the basis of our long run forecasts.

The same procedures are used in studying the long term

effects of guidelines as in the quarterly calculations. First, a Control solution is generated for the decade starting in 1970 and ending in 1980, based on broadly accepted government policies. This Control solution forecasts the main price index to increase, on the average, at a rate of 3 per cent per annum.

The wage-profit guidelines are imposed starting in 1971. The rate of change of productivity is averaged over seven years instead of two years in this longer run calculation. The government is assumed to maintain the same current dollar outlay on goods and services as in the Control solution for the first two years. The profits tax is returned to the economy in the form of transfer payments. The assumptions of the first two years correspond exactly to those made in Policy 3 with the quarterly model.

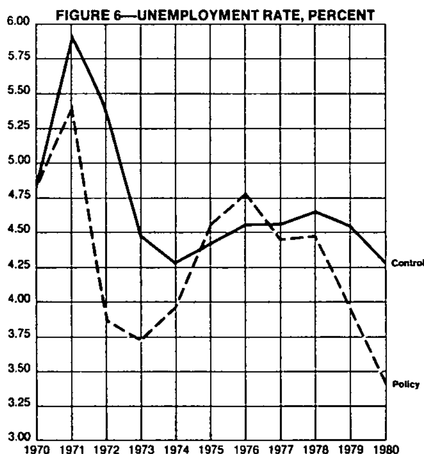
It is interesting to note that the Annual Model with guidelines generates results for the first two years that are almost identical to those generated by the corresponding Policy simulation with the short run model in the first eight quarters. The main price index rises by 1.79 per cent instead of the Control forecast of 7.47 per cent in two years. The unemployment rate drops 1.6 per cent from 5.41 per cent expected on the basis of Control forecast to 3.84 per cent. Real GNP with guidelines is $3.7 billion and $14.4 billion more than in the base-line solution for the first and second years, respectively. The response of prices to the restriction on wage rates is quicker and more sensitive in the Annual Model.

Beyond two years, it is assumed that government does not maintain current dollar outlay to Control solution levels. Public expenditures can be allowed to shrink since wage rates and price levels are smaller. We assume that government is interested in buying a given amount of *real* goods and services. There is, however, a need for a variety of policy changes mixing fiscal and monetary policies in order to maintain acceptable levels for the rate of unemployment, the rate of growth of output, and budget deficits with lower prices.

For example, with lower prices, the same real economic activity requires a smaller quantity of money in the economy. Open market operations are assumed to restrict the supply of money so that banks do not have abnormally large free reserves, which would depress interest rates. At the same time, we assume that the discount rate is lowered in order to stimulate expenditures on investment.

Although it is assumed that lower prices enable governm to spend less money to meet its fixed needs as stated in the Control solution beyond the first two years, government receipts fall more quickly. This is because the price index on which receipts are based drops more than the price index relevant for government purchases of goods and services, leading to a bigger deficit. In order to reduce the mounting deficit, the personal income tax rate is raised to obtain additional receipts. Furthermore, government expenditures are simultaneously raised by half as much as the increased tax receipts to prevent the higher tax rate from reducing economic activity.

The rate of unemployment between 1972 and 1980 varies in the guideline policy experiment between 3.4 per cent and 4.8 per cent. Real GNP with guidelines exceeds the corresponding control solution level for every year. It is $28 billion more by 1980. The government deficit remains below $4 billion. Real Gross National Product, the price index for GNP and the unemployment rate generated by the Policy simulation and the Control solution are graphed in figures 4 to 6.



Long Range Forecast: Stable Prices

From 1973 to 1975, the main price index rises on the average by .08 per cent per annum. This for all practical purpose amounts to stable prices. Beyond 1975, the price index stay constant or drops a little. This is the strikingly dramatic result of the decade simulation. If wage rate and profit rate grow as does productivity, prices rise very slowly in the first four years and are completely stabilized after five years. By 1980, the price index generated by the Policy simulation is 136 on a base value of 100 in 1958. This is in contrast to the Control forecast of 181.

Since prices are stabilized by 1975, there is no need in our calculations to impose a profits tax after 1975. Profits generated by the Model with our policy changes fall far below the ceiling drawn by the guideline rule. So the guideline rule on wage rate is adequate by itself as soon as the adjustment of prices to constant unit labor costs is complete, five years in the case of the Annual and Industry Model. In the intervening years, it is imperative that wage guidelines be accompanied by profit guidelines, not only because of the implied fairness in burden sharing among different socio-economic groups, but because of the need to return the additional profit to the income stream where it will work most efficiently to increase economic activity.

In these *simulated* patterns of economic development, either short or long run, we have painted a picture of an ideal situation. If all groups were to agree—employers, employees, public authorities—on a set of guideline rules, the American economy could have a decade pattern of good growth, high employment, fair shares for all and stable prices. This assumes a decade free of major economic disturbance with rational policy decisions.

WHARTON MARK III QUARTERLY MODEL

AUGUST 2, 1971 PRE-MEETING RELEASE: CONTROL SOLUTION

TABLE 1: SELECTED MAJOR ECONOMIC INDICATORS

LINE NO	MODEL VAR LABEL	ITEM	LAGGED 1971.2	1971.3	1971.4	1972.1	1972.2	1972.3	1972.4	1973.1	1973.2	ANNUAL 1970	1971	1972
1	1470 GNP$	GROSS NATIONAL PRODUCT	1040.5	1059.8	1090.5	1121.1	1142.8	1166.8	1191.6	1216.7	1244.6	974.1	1052.9	1155.4
2	%DGNP	% CHG: GROSS NATIONAL PRODUCT	7.95	7.62	12.12	11.69	7.98	6.67	6.78	9.38	8.81	4.84	8.09	9.75
3	530 X	REAL GROSS NATIONAL PRODUCT	736.3	740.9	755.5	770.1	778.9	786.6	798.1	808.1	817.9	720.0	740.6	783.9
4	%DX	% CHG: REAL GROSS NATL PRODUCT	3.67	2.50	8.15	7.94	4.68	5.07	4.08	5.11	4.93	-0.65	2.66	5.95
5	520 P	IMPLICIT PRICE DEFLATOR - GNP	1.413	1.430	1.443	1.456	1.467	1.480	1.493	1.508	1.522	1.353	1.422	1.474
6	%DP	% CHG: IMPLICIT GNP DEFLATOR	4.13	5.00	3.67	3.47	3.15	3.43	3.72	4.56	3.69	5.52	5.07	3.69
7	660 PPG	IMPLICIT PRICE DEFLATOR-PVT GNP	1.358	1.376	1.388	1.397	1.408	1.421	1.435	1.448	1.462	1.304	1.367	1.415
8	%DPPG	% CHG: PRIVATE GNP DEFLATOR	4.16	5.38	3.30	2.71	3.33	3.58	3.98	3.77	3.95	4.89	4.83	3.54
9	2240 PROD	REAL PRIVATE OUTPUT PER MANHOUR	12.02	12.03	12.19	12.30	12.35	12.42	12.49	12.56	12.63	11.60	12.04	12.39
10	%DPROD	%CHG: REAL PVT OUTPUT/MANHOUR	3.23	0.31	5.37	3.75	1.58	2.36	2.16	2.28	2.15	0.81	3.79	2.94
11	2460 PWPM	PRIVATE COMPENSATION PER MANHR	9.34	9.47	9.65	9.77	9.95	10.09	10.28	10.45	10.66	8.73	9.40	10.03
12	%DPWPM	%CHG: PVT COMPNESATION/MANHOUR	8.60	5.57	7.56	5.45	7.34	5.76	7.94	6.49	8.51	6.68	7.71	6.60
13	620 UN	UNEMPLOYMENT RATE (%)	5.97	6.23	6.21	5.85	5.45	5.16	4.89	4.49	4.20	5.00	6.09	5.31
14	580 CPMM	CAPACITY UTILIZATION:MFG+MINING	0.80	0.81	0.83	0.85	0.86	0.87	0.88	0.88	0.89	0.87	0.81	0.87
15	730 RSP	PERSONAL SAVINGS RATE (%)	8.28	7.67	7.78	7.51	7.34	7.51	7.61	7.95	8.11	7.85	7.99	7.49
16	%DMS	% CHANGE IN MONEY SUPPLY	12.25	10.08	6.97	6.84	6.29	6.09	4.66	5.00	5.93	4.06	7.43	7.25
17	508 IS	4-6 MONTH COMMERCIAL PAPER RATE	5.03	5.93	6.66	6.60	6.69	6.71	6.76	6.76	6.83	7.71	5.57	6.71
18	518 IL	MOODY'S TOTAL CORP BOND RATE	8.02	8.21	8.24	8.25	8.28	8.30	8.34	8.36	8.40	8.51	8.09	8.25
19	PCBIS	CORPORATE PROFITS BEFORE TAX	85.6	84.0	86.6	97.4	92.8	97.2	99.9	[illegible]	106.1	75.3	84.7	95.0
20	2990 SPFGS	FEDERAL SURPLUS, NIA BASIS	-20.1	-18.8	-18.6	-15.0	-14.2	-15.5	-14.6	-16.4	-16.7	-13.6	-15.4	-14.8

AUGUST 28, 1971 POST-MEETING RELEASE : CONTROL SOLUTION

LINE NO	MODEL VAR LABEL	ITEM	LAGGED 1971.2	1971.3	1971.4	1972.1	1972.2	1972.3	1972.4	1973.1	1973.2	ANNUAL 1970	1971	1972
1	1470 GNP$	GROSS NATIONAL PRODUCT	1041.3	1053.9	1080.9	1109.6	1135.0	1164.2	1188.9	1211.4	1236.5	974.1	1049.2	1149.4
2	%DGNP	% CHG: GROSS NATIONAL PRODUCT	8.28	4.92	10.67	11.03	9.47	10.69	8.77	7.79	8.55	4.84	7.71	9.55
3	530 X	REAL GROSS NATIONAL PRODUCT	737.0	742.3	757.1	771.7	782.5	793.9	804.1	814.1	823.9	720.0	741.5	788.1
4	%DX	% CHG: REAL GROSS NATL PRODUCT	4.06	2.92	8.22	7.94	5.71	5.93	5.28	5.04	4.90	-0.65	2.99	6.27
5	520 P	IMPLICIT PRICE DEFLATOR - GNP	1.413	1.420	1.428	1.438	1.450	1.466	1.478	1.488	1.501	1.353	1.415	1.458
6	%DP	% CHG: IMPLICIT GNP DEFLATOR	4.05	1.94	2.27	2.86	3.56	4.49	3.32	2.62	3.48	5.52	4.57	3.07
7	660 PPG	IMPLICIT PRICE DEFLATOR-PVT GNP	1.358	1.365	1.373	1.382	1.395	1.408	1.420	1.431	1.444	1.304	1.360	1.401
8	%DPPG	% CHG: PRIVATE GNP DEFLATOR	4.12	2.03	2.25	2.80	3.75	3.66	3.47	3.08	3.68	4.89	4.33	3.01
9	2240 PROD	REAL PRIVATE OUTPUT PER MANHOUR	11.97	12.00	12.14	12.26	12.32	12.41	12.47	12.53	12.60	11.60	12.00	12.36
10	%DPROD	%CHG: REAL PVT OUTPUT/MANHOUR	1.90	1.03	4.87	3.86	2.24	2.67	2.10	1.96	2.08	0.81	3.49	3.00
11	2460 PWPM	PRIVATE COMPENSATION PER MANHR	9.28	9.35	9.45	9.55	9.68	9.80	9.94	10.11	10.29	8.73	9.31	9.75
12	%DPWPM	%CHG: PVT COMPENSATION/MANHOUR	5.53	3.31	4.37	4.29	5.64	4.93	5.95	6.78	7.38	6.68	6.63	4.70
13	620 UN	UNEMPLOYMENT RATE (%)	5.97	6.03	5.83	5.63	5.32	5.04	4.70	4.41	4.07	5.00	5.94	5.17
14	580 CPMM	CAPACITY UTILIZATION:MFG+MINING	0.80	0.81	0.83	0.85	0.87	0.88	0.88	0.89	0.89	0.87	0.81	0.87
15	730 RSP	PERSONAL SAVINGS RATE (%)	8.22	7.94	7.74	7.64	7.47	7.90	7.95	7.84	7.99	7.85	8.00	7.74
16	%DMS	% CHANGE IN MONEY SUPPLY	12.25	9.95	6.33	4.81	4.49	4.22	5.00	5.06	6.35	4.06	7.37	6.03
17	508 IS	4-6 MONTH COMMERCIAL PAPER RATE	5.04	5.73	6.02	5.99	6.01	6.10	6.22	6.33	6.43	7.71	5.35	6.08
18	518 IL	MOODY'S TOTAL CORP BOND RATE	8.01	7.92	7.88	7.87	7.87	7.86	7.87	7.89	7.92	8.51	7.92	7.87
19	PCBIS	CORPORATE PROFITS BEFORE TAX	82.1	78.4	86.8	96.6	101.8	107.7	111.2	114.0	115.9	75.3	81.6	104.3
20	2990 SPFGS	FEDERAL SURPLUS, NIA BASIS	-22.5	-23.1	-24.6	-22.6	-19.3	-23.8	-23.0	-20.6	-19.9	-13.6	-21.9	-22.1

WAGE PROFIT GUIDELINES STARTING 1972 SUPERIMPOSED ON POST RELEASE CONTROL

LINE NO	MODEL VAR LABEL	ITEM	LAGGED 1971.2	1971.3	1971.4	1972.1	1972.2	1972.3	1972.4	1973.1	1973.2	ANNUAL 1970	1971	1972
1	1470 GNP$	GROSS NATIONAL PRODUCT	1041.3	1053.9	1080.9	1111.5	1137.0	1165.6	1187.9	1206.2	1225.6	974.1	1049.2	1150.5
2	%DGNP	% CHG: GROSS NATIONAL PRODUCT	8.28	4.92	10.67	11.78	9.53	10.42	7.91	6.30	6.58	4.84	7.71	9.65
3	530 X	REAL GROSS NATIONAL PRODUCT	737.0	742.3	757.1	773.7	785.2	799.1	809.2	817.7	826.4	720.0	741.5	791.8
4	%DX	% CHG: REAL GROSS NATL PRODUCT	4.06	2.92	8.22	9.06	6.09	7.22	5.17	4.26	4.36	-0.65	2.99	6.78
5	520 P	IMPLICIT PRICE DEFLATOR - GNP	1.413	1.420	1.428	1.437	1.448	1.459	1.468	1.475	1.483	1.353	1.415	1.453
6	%DP	% CHG: IMPLICIT GNP DEFLATOR	4.05	1.94	2.27	2.50	3.24	2.98	2.60	1.96	2.13	5.52	4.57	2.69
7	660 PPG	IMPLICIT PRICE DEFLATOR-PVT GNP	1.358	1.365	1.373	1.382	1.394	1.404	1.414	1.421	1.429	1.304	1.360	1.399
8	%DPPG	% CHG: PRIVATE GNP DEFLATOR	4.12	2.03	2.25	2.83	3.51	2.89	2.71	2.06	2.15	4.89	4.33	2.83
9	2240 PROD	REAL PRIVATE OUTPUT PER MANHOUR	11.97	12.00	12.14	12.27	12.35	12.44	12.50	12.56	12.62	11.60	12.00	12.39
10	%DPROD	%CHG: REAL PVT OUTPUT/MANHOUR	1.90	1.03	4.87	4.40	2.46	3.02	2.10	1.73	1.86	0.81	3.49	3.22
11	2460 PWPM	PRIVATE COMPENSATION PER MANHR	9.28	9.35	9.45	9.55	9.63	9.71	9.78	9.85	9.91	8.73	9.31	9.67
12	%DPWPM	%CHG: PVT COMPENSATION/MANHOUR	5.53	3.31	4.37	4.17	3.51	3.09	3.23	2.71	2.67	6.68	6.63	3.86
13	620 UN	UNEMPLOYMENT RATE (%)	5.97	6.03	5.83	5.41	5.01	4.29	3.93	3.80	3.50	5.00	5.94	4.66
14	580 CPMM	CAPACITY UTILIZATION:MFG+MINING	0.80	0.81	0.83	0.85	0.87	0.88	0.88	0.88	0.88	0.87	0.81	0.87
15	730 RSP	PERSONAL SAVINGS RATE (%)	8.22	7.94	7.74	7.94	7.74	8.11	8.00	7.65	7.53	7.85	8.00	7.95
16	%DMS	% CHANGE IN MONEY SUPPLY	12.25	9.95	6.33	4.47	3.93	3.62	4.58	4.96	6.57	4.06	7.37	5.73
17	508 IS	4-6 MONTH COMMERCIAL PAPER RATE	5.04	5.73	6.02	6.00	6.02	6.14	6.26	6.37	6.46	7.71	5.35	6.10
18	518 IL	MOODY'S TOTAL CORP BOND RATE	8.01	7.92	7.88	7.88	7.87	7.86	7.86	7.87	7.88	8.51	7.92	7.87
19	PCBIS	CORPORATE PROFITS BEFORE TAX	82.1	78.4	86.8	98.0	105.7	113.2	118.4	123.2	127.0	75.3	81.6	108.8
20	2990 SPFGS	FEDERAL SURPLUS, NIA BASIS	-22.5	-23.1	-24.6	-21.3	-17.2	-21.1	-20.2	-18.2	-18.3	-13.6	-21.9	-19.9

WHARTON MARK III QUARTERLY MODEL

AUGUST 2, 1971 PRE-MEETING RELEASE: CONTROL SOLUTION

	LAGGED 1971.2	1971.3	1971.4	1972.1	1972.2	1972.3	1972.4	1973.1	1973.2	ANNUAL 1970	ANNUAL 1971	ANNUAL 1972
Ratio of Corporate Profits after Taxes to Compensation of Employees, Percent	7.24*	6.93	6.96	7.19	7.04	7.24	7.28	7.42	7.39	6.84	7.07	7.18
Disposable Personal Income per Capita 1958$	2667.8	2662.1	2696.9	2723.5	2746.7	2777.6	2804.2	2842.4	2874.2	2595.7	2665.1	2763.0

*Preliminary guess by Wharton EFA

AUGUST 28, 1971 POST MEETING RELEASE: CONTROL SOLUTION

	LAGGED 1971.2	1971.3	1971.4	1972.1	1972.2	1972.3	1972.4	1973.1	1973.2	ANNUAL 1970	ANNUAL 1971	ANNUAL 1972
Ratio of Corporate Profits after Taxes to Compensation of Employees, Percent	6.97	6.52	7.74	8.43	8.71	9.02	9.13	9.04	8.85	6.84	7.02	8.82
Disposable Personal Income per Capita 1958$	2669.8	2670.8	2701.7	2728.1	2746.8	2787.4	2813.9	2833.3	2864.1	2595.7	2668.6	2769.0

WAGE PROFIT GUIDELINES STARTING 1972 SUPERIMPOSED ON POST RELEASE CONTROL

	LAGGED 1971.2	1971.3	1971.4	1972.1	1972.2	1972.3	1972.4	1973.1	1973.2	ANNUAL 1970	ANNUAL 1971	ANNUAL 1972
Ratio of Corporate Profits after Taxes to Compensation of Employees, Percent	6.97	6.52	7.74	7.75	7.76	7.75	7.79	7.85	7.90	6.84	7.02	7.76
Disposable Personal Income per Capita 1958$	2669.8	2670.8	2701.7	2742.0	2763.8	2808.0	2832.8	2843.8	2863.9	2595.7	2668.6	2786.6

Chairman PROXMIRE. Thank you for a fascinating proposal.
Mr. Krause, please proceed.

STATEMENT OF LAWRENCE B. KRAUSE, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. KRAUSE. I am very grateful to be able to accept your invitation to appear before this committee. My remarks will be addressed to the international portion of the President's new economic program.

Chairman PROXMIRE. I might say, Mr. Krause, if you abbreviate your statement, we will print the full statement in the record.

Mr. KRAUSE. I understand.

Because of the President's initiative, the United States can attempt to obtain two objectives; an improvement in the international competitive position of the U.S. economy, and a reform of the international monetary system so that the present type of monetary upheaval need not be repeated in the future to restore equilibrium values to world currencies.

In particular, I would like to answer four questions:

(1) Can the United States simply maintain the status quo and continue with a floating dollar indefinitely?

(2) Should we attempt to negotiate our two international objectives together or separately?

(3) Should we raise the monetary price of gold?

(4) What should a reformed international monetary system contain?

For an economist, like myself, who has argued for the theoretical attractions of a freely flexible exchange rate system, there is a great temptation to recommend that the United States merely stand pat and let the rest of the world learn how to live with flexible rates. This temptation, unfortunately, has to be resisted. The reason is that we do not have a freely fluctuating rate today and there is no clear road from here to there. The many restrictions that governments are now operating to influence market rates, and particularly the new surcharge and the old capital controls of the United States, effectively prevent the market from reaching equilibrium. An absence of internationally agreed upon rules does not guarantee a viable international economy as the tragic history of the 1930's so clearly reminds us. Unless other countries also want free exchange markets, they will intervene for their own domestic purposes and we could easily slip backward into competitive depreciations—the very condition that required a Bretton Woods system originally. Freely fluctuating exchange rates require internationally agreed upon rules of nonintervention by governments and central banks, and while I would heartily accept such a system, I cannot recommend to you that the United States immediately devote its energies to this end because other governments are so adamantly opposed. I fear that if the United States does not take some steps, in concert with other nations, to move toward an orderly exchange rate system that we can all live with, then we will be forced into one with many of the undesirable features of the present system.

Now let me turn to the question of whether we should try to achieve our two international objectives separately, or whether we should insist on one all-encompassing negotiation to settle everything. I strongly

support the two-stage process but not a three-stage process. The length of time required to negotiate a complete reform of the Bretton Woods system will be too long to leave unsettled the question of a new set of market exchange rates. Pressure will arise primarily in other countries and primarily as a result of our import surcharge combined with the discriminatory features of the proposed investment credit, that will require attention by other countries. Just because there has been no retaliation against our measures until today does not guarantee there will not be some tomorrow. What are foreign governments supposed to do in the face of certain political crises that will arise when particular foreign firms go bankrupt because they no longer can export to the United States because of our measures? And even if no retaliation should occur, the trade measures are very detrimental to the U.S. economy if they are maintained for very long. Indeed, the United States will be blamed for every economic catastrophe that occurs anywhere in the world, whether justified or not, while our own economy is distorted and suffers unnecessary inflation.

As a temporary strategy, there is ample justification and precedent for our restrictive measures, even though clearly illegal under GATT; but other governments have used such measures only in advance of an exchange rate change and then they were removed. If the United States is offered a reasonable deal on a realinement of exchange rates and we refuse to rescind our measures in return, then retaliation will surely follow. We would then have lost the surcharge as a bargaining tool, for we will have to give it up in order to get the foreign retaliations removed to restore the status quo ante. Rather I believe a reasonable exchange rate realinement can be negotiated in the not too distant future, and the United States should give up the import surcharge and other trade disciminations at that time primarily for our own domestic economic well-being as well as to forestall foreign retaliation. Then subsequently, with due deliberation, we can turn to the need for fundamental reforms of the monetary system. As long as we can recognize our long run interest, we need not fear a lack of bargaining leverage without the trade measures.

Next let me consider the very confusing issue of the price of gold. I understand that our European friends, the Japanese, and even the managing director of the IMF have recommended that the United States raise the price of gold. Often the phrase is used that "the United States must make a contribution to the realinement of currencies by changing the price of gold." This statement is very misleading because it suggests that the real burdens of adjustment are somehow determined by whether other countries appreciate their currencies relative to the dollar or whether the United States formally devalues the dollar by raising the monetary price of gold. I hope I can clarify this issue for you.

There are three analytically distinct burdens that are involved when a balance-of-payments disequilibrium is corrected through a change in exchange rates. First, the country correcting a deficit will be able to absorb fewer real resources than before. This real economic-welfare burden falls on the deficit country—in this case the United States—and the form of the adjustment makes no difference whatsoever in the economic outcome. Second, economic dislocation is involved because depreciating a currency causes stimulation and inflation in the deficit

country and appreciating a currency causes retardation and deflation in the surplus country. The degree of real burden that occurs depends on the existing domestic situation and on what policy measures governments take to offset these dislocations. But the important point here is that the dislocations are determined by the size of the changes in exchange rates and are not affected by whether other currencies appreciate or the United States raises the price of gold.

The third burden is political in nature. A government that initiates a change in exchange rates publicly admits to the failure of its previous economic polices—and, according to European views, the United States should take the initiative to change the price of gold so as to admit that our inflation has had much to do with the current monetary upheaval. While there is some justice in this view, if we are to take a symbolic act, then it should really be symbolic and not involve real consequences.

But there are three consequences that will result, if the United States raised the monetary gold price, that need exploring.

(1) In the realinement, the important world currencies should rise by different amounts relative to the dollar—the greatest appreciation should be by the Japanese yen, next the German deutsche-mark, and so forth, therefore, appreciations will have to be undertaken to reach an appropriate set of rates and it could not all be done by U.S. initiative. However, there may be some minimum rate of appreciation to which all major countries could assent (even though some need much larger changes). If these minimum amounts were accomplished by a devaluation of the dollar, then there would be a stronger guarantee that no country would get a free ride through mere inaction. In other words, in our multinational discussions, the countries should be polled and the country willing to do the smallest appreciation relative to the dollar, would set the amount of a possible general dollar devaluation. Other countries would achieve their target appreciations by subtracting the general devaluation from their total appreciation and formally appreciate by the lesser amount. As a touchstone one might think if the British can only take a 3-percent revaluation to the dollar, then 3 percent would set the dollar devaluation part of the adjustment. If the British could appreciate more, then it could go up to around 5 percent.

(2) If the dollar is devalued as part of the realinement, central banks would suffer balance sheet losses on that part of their reserves held in dollars relative to those held in SDR's. The devaluation would thus help countries holding reserves predominantly in gold, including the United States, at the expense of those holding mainly dollars in reserves, like Japan and Germany.

(3) If the United States raises the price of gold—and this is the most important point—then by implication the United States must provide a market in which the higher gold price is effective. In other words, the United States will be back in the position of having to buy and sell gold on demand (at a slightly higher price) either directly with other countries or indirectly via our dealings with the International Monetary Fund. Otherwise what does it mean for the United States to have raised the price of gold? After all, as long as the IMF articles are in suspension, other countries can raise the dollar price of gold for transactions among themselves without U.S. approval.

However, if the United States were to raise the price of gold, it would signal a return to gold convertibility without a fundamental reform of the Fund, which would be a direct invitation for more financial crises and would prejudice the reform of the Fund that is certain to come.

What then should the United States do about gold? A rise in the price of gold at U.S. initiative would be detrimental, but a small devaluation of the dollar would probably be a good thing to help restore equilibrium. My suggestion is that we meet both of these conditions.

I suggest that the United States devalue the dollar only in terms of SDR's; the amounts would be determined by the short-term negotiation described above.

The new SDR value of the dollar would be formalized in the IMF, however, only after the longer-range reform of the Fund is negotiated. Thus the U.S. dollar would remain technically inconvertible during the period of the longer negotiation, which means that we cannot be called upon to deal in gold.

The thought that the U.S. dollar could remain inconvertible for a time may seem like a radical idea to some observers. But in truth the dollar has not been convertible into gold for major holders of dollars for many years. This move to establish temporary inconvertibility would just recognize an implicit reality. Furthermore, if a sensible realinement of currencies occurs—neither too little nor too much—then official holdings by other countries should not change very much on balance during the negotiations.

When the United States announces its intention to devalue the dollar, but only in terms of SDR's, in Europe it will be reported that the United States had raised the price of gold. Since in the Fund, the SDR value and gold are linked, there will be truth in the European announcement.

Any country acting under the IMF rules and wishing to deal in official gold would trade at the higher gold price implied by the U.S. SDR devaluation. But the United States would be under no obligation to trade in gold. The change in valuation of official reserve assets would occur as described under (2) above, but if the dollar devaluation is small, the consequences would not be great unless the United States were to trade in gold. The question of gold and dollars as reserve assets in the future must be considered as part of the fundamental reform of the fund to which I now turn.

Let me skip my suggestions for the reform of the International Monetary Fund because they are to be contained in a publication to be made available later this week. I will make copies of it available to the committee when it is available.

Chairman PROXMIRE. Thank you very much. We would like to get that.

Mr. KRAUSE. Let me conclude by saying that after reform, the dollar will not be just like other currencies, mainly because the international role of the dollar rests on the relative economic performance of the United States. When all the complications are stripped away, the domestic value of the dollar and its foreign value are one. The good economic performance the United States seeks for domestic purposes would also maintain the dollar as an international currency.

Some actions can be taken by the United States, however, to strengthen the international usefulness of the dollar. They involve removing restrictions on capital movements that have grown up over the last decade, including the interest equalization tax, the limitations on bank lending abroad, and the restrictions on direct investment. No foreign restrictions could as effectively limit the usefulness of the dollar abroad as those imposed by the United States. Removal of these capital controls should accompany the removal of the trade restrictions that resulted from the international monetary upheaval.

The international economy that is evolving in the 1970's is not centered exclusively on the United States. Because of their differing attributes, three centers of economic power now exist in the non-Communist world: The United States, the European Economic Community (EEC), and Japan.

These three centers of economic power will not and should not become insulated from one another. The thrust of history and economic rationality requires that the process of functional integration in goods and capital markets that has taken place during the entire postwar period should not be impeded in the future if maximum economic welfare is to be attained. The prosperity of other countries is also intimately bound up in this process. Economic relations among these three will require accommodations of various sorts. My proposals are meant to provide a mechanism for working out these accommodations in the monetary system. But accommodations may also be needed in commercial policy and other areas.

It is quite clear, however, that a successful accommodation in any of these areas calls for a spirit of cooperation in international economic relations. The recent wave of nationalistic and retaliatory rhetoric that has swept over a number of countries is certain to bring advantage to no one and will only serve to undermine world prosperity. The international economic system is not a zero-sum game. A country does not necessarily gain by inflicting a loss on another country; both countries experience a loss. The goal of policy must be to assure that all share equitably in the benefits and burdens of the system—and that the weak and the poor countries of this world be given according to their needs and not their power.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Krause follows:)

PREPARED STATEMENT OF LAWRENCE B. KRAUSE[1]

I am very grateful to be able to accept your invitation to appear before this Committee. My remarks will be addressed to the international portion of the President's new economic program. Because of the President's initiative, the United States can attempt to obtain two objectives; an improvement in the international competitive position of the U.S. economy, and a reform of the international monetary system so that the present type of monetary upheaval need not be repeated in the future to restore equilibrium values to world currencies.

In particular, I would like to answer four questions:

(1) Can the United States simply maintain the *status quo* and continue with a floating dollar indefinitely?

(2) Should we attempt to negotiate our two international objectives together or separately?

(3) Should we raise the monetary price of gold?

(4) What should a reformed international monetary system contain?

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[1] The views expressed here are those of the author and they should not be attributed to the trustees, officers, or staff members of the Brookings Institution.

For an economist, like myself, who has argued for the theoretical attractions of a freely flexible exchange rate system, there is a great temptation to recommend that the U.S. merely stand pat and let the rest of the world learn how to live with flexible rates. This temptation, unfortunately, has to be resisted. The reason is that we do not have a *freely* fluctuating rate today and there is no clear road from here to there. The many restrictions that governments are now operating to influence market rates, and particularly the new surcharge and the old capital controls of the United States, effectively prevent the market from reaching equilibrium. An absence of international rules does not guarantee a viable international economy as the tragic history of the 1930s so clearly reminds us. Unless other countries also want free exchange markets, they will intervene for their own domestic purposes and we could easily slip backward into competitive depreciations—the very condition that required a Bretton Woods System originally.

Freely fluctuating exchange rates require internationally agreed upon rules of *non-intervention* by governments and central banks, and while I would heartily accept such a system, I cannot recommend to you that the U.S. immediately devote its energies to this end because other governments are so adamantly opposed. I fear that if the United States does not take some steps, in concert with other nations, to move toward an orderly exchange rate system that we can all live with, then we will be forced into one with many of the undesirable features of the present system.

Now let me turn to the question of whether we should try to achieve our two international objectives separately, or whether we should insist on one all-encompassing negotiation to settle everything. I strongly support the two stage process, but the length of time required to negotiate a complete reform of the Bretton Woods System will be too long to leave unsettled the question of a new set of market exchange rates. Pressure will arise primarily in other countries and primarily as a result of our import surcharge combined with the discriminatory features of the proposed inevstment credit, that will require attention by other countries. Just because there has been no retaliation against our measures until today does not guarantee there will not be some tomorrow. What are foreign governments supposed to do in the face of certain political crises that will arise when particular foreign firms go bankrupt because they no longer can export to the United States because of our measures? Indeed the United States will be blamed for every economic catastrophe that occurs anywhere in the world, whether justified or not.

As a temporary strategy, there is ample justification and precedent for our restrictive measures, even though clearly illegal under GATT; but other governments have used such measures only in advance of an exchange rate change and then they were removed. If the U.S. is offered a reasonable deal on a realignment of exchange rates and we refuse to rescind our measures in return, then retaliation will surely follow. We would then have lost the surcharge as a bargaining tool, for we will have to give it up in order to get the foreign retaliations removed to restore the *status quo ante.*

Rather I believe a reasonable exchange rate realignment can be negotiated in the not too distant future, and the U.S. should give up our import surcharge and other trade discriminations at that time primarily for our own domestic economic wellbeing as well as to forestall foreign retaliation. Then subsequently, with due deliberation, we can turn to the need for fundamental reforms of the monetary system. As long as we can recognize our own long-run interest, we need not fear a lack of bargaining leverage without the trade measures.

Next let me consider the very confusing issue of the price of gold. I understand that our European friends, the Japanese, and even the Managing Director of the IMF have recommended that the U.S. raise the price of gold. Often the phrase is used that "the U.S. must make a contribution to the realignment of currencies by changing the price of gold." This statement is very misleading because it suggests that the real burdens of adjustment are somehow determined by whether other countries appreciate their currencies relative to the dollar or whether the U.S. formally devalues the dollar by raising the monetary price of gold. I hope I can clarify this issue for you.

There are three analytically distinct burdens that are involved when a balance-of-payments disequilibrium is corrected through a change in exchange rates. First, the country correcting a deficit will be able to absorb fewer real resources than before (and the revaluing surplus countries receive more real resources than previously). This real economic-welfare burden falls on the deficit country—in

this case the United States—and the form of the adjustment makes no difference whatsoever in the economic outcome. Second, economic dislocation is involved because depreciating a currency causes stimulation and inflation in the deficit country and appreciating a currency causes retardation in the surplus country. The degree of real burden that occurs depends on the existing domestic situation and on what policy measures governments take to offset these dislocations.

But the important point here is that the dislocations are determined by the size of the changes in exchange rates and are *not* affected by whether other currencies appreciate or the U.S. raises the price of gold.

The third burden is political in nature. A government that initiates a change in exchange rates publicly admits to the failure of its previous economic policies—and, according to European views, the U.S. should take the initiative to change the price of gold so as to admit that our inflation has had much to do with the current monetary upheaval. While there is some justice in this view, if we are to take a symbolic act, then it should really be symbolic and not involve real consequences.

But there are three consequences that will result if the U.S. raised the monetary gold price, that need exploring.

(1) In the realignment, the important world currencies should rise by different amounts relative to the dollar—the greatest appreciation should be by the Japanese yen, next the German D-Mark, etc., therefore, appreciations will have to be undertaken to reach an appropriate set of rates. However, there may be some minimum rate of appreciation to which all major countries could assent (even though some need much larger changes). If these minimum amounts were accomplished by a devaluation of the dollar, then there would be a stronger guarantee that no country would get a free ride through mere inaction. In other words, in our multinational discussions, the countries should be polled and the country willing to do the smallest appreciation relative to the dollar, would set the amount of a possible general dollar devaluation. Other countries would achieve their target appreciations by subtracting the general devaluation from their total appreciation and formally appreciate by the lesser amount. As a touchstone one might think that if the British can only take a 3 percent revaluation to the dollar, then 3 percent would set the dollar devaluation part of the adjustment. If the British could appreciate more, then it could go up to around 5 percent.

(2) If the dollar is devalued as part of the realignment, central banks would suffer balance sheet losses on that part of their reserves held in dollars relative to those held in SDR's. The devaluation would thus help countries holding reserves predominantly in gold, including the United States, the expense of those holding mainly dollars in reserves, like Japan and Germany. Alternatively, if the realignment is accomplished only by appreciation, then no central bank balance sheet is affected by the composition of its reserves (save holders of sterling and francs who would gain if these currencies are appreciated).

(3) If the United States raises the price of gold—and this is the most important point—then by implication the United States must provide a market in which the higher gold price is effective. In other words, the United States will be back in the position of having to buy and sell gold on demand (at a slightly higher price) either directly with other countries or indirectly via our dealings with the International Monetary Fund. Otherwise what does it mean for the United States to have raised the price of gold? After all, as long as the IMF articles are in suspension, other countries can raise the dollar price of gold for transactions among themselves without U.S. approval. However, if the U.S. were to raise the price of gold, it would signal a return to gold convertibility without a fundamental reform of the Fund, which would be a direct invitation for more financial crises and would prejudice the reform of the Fund that is certain to come.

What then should the U.S. do about gold? A rise in the price of gold at U.S. initiative would be detrimental, but a small devaluation of the dollar would probably be a good thing to help restore equilibrium. My suggestion is that we meet *both* of these conditions.

I suggest that the U.S. devalue the dollar only in terms of SDR's: the amounts would be determined by the short-term negotiation described above.

The new SDR value of the dollar would be formalized in the IMF, however, only after the longer-range reform of the Fund is negotiated. *Thus the U.S. dollar would remain technically inconvertible during the period of the longer negotiations*, which means that we cannot be called upon to deal in gold.

The thought that the U.S. dollar could remain inconvertible for a time may seem like a radical idea to some observers. But in truth the dollar has not been

convertible into gold for major holders of dollars for many years. This move to establish temporary inconvertibility would just recognize an implicit reality. Furthermore, if a sensible realignment of currencies occurs—neither too little nor too much—then official holdings by other countries should not change very much on balance during the negotiations (although for some technical market conditions they may decline somewhat).

When the United States announces its intention to devalue the dollar, but only in terms of SDRs, in Europe it will be reported that the U.S. had raised the price of gold. Since in the Fund, the SDR value and gold are linked, there will be truth in the European announcement. Any country acting under the IMF rules and wishing to deal in official gold would trade at the higher gold price implied by the U.S. SDR devaluation. But the U.S. would be under no obligation to trade in gold. These arrangements must satisfy the economic and political needs of all countries. The change in valuation of official reserve assets would occur as described under (2) above, but if the dollar devaluation is small, the consequences would not be great unless the U.S. were to trade in gold. The question of gold and dollars as reserve assets in the future must be considered as part of the fundamental reform of the Fund to which I now turn.

I am pleased to inform this Committee that my ideas on this subject are spelled out in my new Brookings publication, *Sequel to Bretton Woods: A Proposal to Reform the World Monetary System.* It is in press now and will be available later this week, but unfortunately not today. Let me briefly outline the major elements of my proposal for you. It includes the following:

(1) The specification of all par values in the IMF in terms of SDRs;

(2) The provision of wider margins on either side of par values, including an inner band in which central banks could not intervene;

(3) The replacement of gold, dollars, and other national currencies in official reserves with SDRs, using the gold-demonetization profits when they occur over time for aid to less developed countries;

(4) The removal of interest rate limitations on SDRs:

(5) A strengthening of the institutional role of the International Monetary Fund; and

(6) Some suggestions for possible compromises for a mini gold-block, and for currency areas.

I believe that my proposals would effectively cure the liquidity, confidence, and balance-of-payments adjustment problems that have plagued the Bretton Woods System in recent years. These problems have placed a burden on the United States and other countries, and the obvious outcome has been frequent financial crises.

For the United States, the most dramatic change contained in my proposal would be an end to the reserve role of the dollar. Thus in the eyes of the IMF, the United States would be treated as an equal to all other countries. While some prestige might be lost, little direct economic disadvantage to the United States would result. Because the United States pays the market rate of interest on foreign dollar holdings, this country earns no windfalls or seigniorage through its issue of official money. In return for this prestige symbol, the United States would regain the power to affect its own balance of payments.

But the dollar will still not be just another of the world's currencies. First, other governments will likely continue to use the dollar for exchange market intervention purpose, not because of an international agreement, but because it is the best currency for this purpose. Second, the dollar will continue to be used abroad for private transactions, because of its commercial convenience and its attractiveness as an asset. The essential point is that the dollar need not be a super-strong currency to be dominant in private transactions, it need only be better than any alternative currency.

If in economic performance some other country so far outdistances the United States (specially in the development of sophisticated financial institutions with freedom to operate and the ability to call on a large pool of domestic savings), then and only then will the dollar be dethroned.

Thus the basic element of the issue is that the international role of the dollar rests on the relative economic performance of the United States. When all the complications are stripped away, the domestic value of the dollar and its foreign value are one. The good economic performance the United States seeks for domestic purposes would also maintain the dollar as an international currency.

Some actions can be taken by the United States, however, to strengthen the international usefulness of the dollar. They involve removing restrictions on capital movements that have grown up over the last decade, including the Interest Equalization Tax, the limitations on bank lending abroad, and the restric-

tions on direct investment. No foreign restrictions could as effectively limit the usefulness of the dollar abroad as those imposed by the United States. Removal of these capital controls should accompany the removal of the trade restrictions that resulted from the international monetary upheaval.

Let me conclude by making some general remarks. The international economy that is evolving in the 1970s is not centered exclusively on the United States. Because of their differing attributes, three centers of economic power now exist in the noncommunist world: The United States, the European Economic Community (EEC), and Japan.

These three centers of economic power will not and should not become insulated from one another. The thrust of history and economic rationality requires that the process of functional integration in goods and capital markets that has taken place during the entire postwar period should not be impeded in the future if maximum economic welfare is to be attained. The prosperity of other countries is also intimately bound up in this process. Economic relations among these three will require accommodations of various sorts. My proposals are meant to provide a mechanism for working out these accommodations in the monetary system. But accommodations may also be needed in commercial policy and other areas.

It is quite clear, however, that a successful accommodation in any of these areas calls for a spirit of cooperation in international economic relations. The recent wave of nationalistic and retaliatory rhetoric that has swept over a number of countries is certain to bring advantage to no one and will only serve to undermine world prosperity. The international economic system is not a zero-sum game. A country does not necessarily gain by inflicting a loss on another country; both countries experience a loss. The goal of policy must be to assure that all share equitably in the benefits and burdens of the system—and that the weak and the poor countries of this world be given according to their needs and not their power.

Chairman PROXMIRE. Thank you.

Mr. Wallich.

I might say, again, Mr. Wallich, that your full statement will be put in the record.

STATEMENT OF HENRY C. WALLICH, SEYMOUR H. KNOX PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. WALLICH. Thank you.

I would like to say how much I appreciate this opportunity to address the committee. You have a wide range of topics in the President's new economic policy. There are, however, very few things that one can say to this committee that the members have not heard before. So I should like to ask for permission to focus on a few isolated points where perhaps a contribution in the way of innovation can be made, but without implying that these are the only reactions I have. I would not like to look as being excessively obsessed by gimmicks.

I would like to begin with the international picture. The closing of the gold window was, I think, a good move. Probably the dramatic impression it created has overstated the change brought about.

The imposition of the surcharge as a temporary measure, was an extremely sound move. I have supported a surcharge for the last 3 years as a means of getting from one exchange rate for the dollar, should that ever be necessary, to another. Now, it has been introduced as something in the nature of a bargaining instrument. As such, I think it should be used. It has to be labeled as temporary; otherwise, we court retaliation. On the other side, it should not be taken off prematurely, thereby depriving us of the powerful bargaining influence that it gives us.

Professor Krause has outlined the problem of how long we should hold on to the surcharge; should we negotiate new exchange rates first? Should we negotiate the whole package of the other problems?

I would like to be flexible on that. I would not necessarily give up the surcharge at an early point and I would like to be sure that other parts of the package, if not agreed, at least are well on their way before we give up the surcharge.

Now, I would like to mention two devices through which we could contribute to improving the international payments system and agreement on which might be part of the bargaining process that would go on in connection with lifting the surcharge. One device would be designed to reduce international short term capital movements. Those have been a large part of our problem, even though the basic deficit in the U.S. balance of payments has also been important. The situation has been a little like that of an individual who is suffering from cancer but who also catches pneumonia. It is possible to die of pneumonia while suffering from cancer. That is essentially the relationship of a flood of short-term funds which suddenly swamps the exchanges contrasted with the gradual eating away at our situation by the underlying basic deficit.

I would suggest that we treat American multinational corporations, including their subsidiaries, in a way which banks have often been treated by their supervisory authorities, if not in this country then abroad; namely, requiring them to stabilize their foreign exchange position. They could perform all the transactions they thought desirable. Each subsidiary would be completely free to do what it wished, but the Treasurer would have to watch so that the overall position of the parent company and subsidiaries did not lead to an overbought or oversold position in any one currency. That would mean that if one subsidiary moves funds into a country, say Germany, some other part of the company, maybe the parent company, would have to move funds out. The total position, for example, in Germany, then would not change. This would reduce, though certainly not solve, the problem of short-term capital movements, which is in good part one of the big multinational companies.

Another contribution to the solution of the long-term international monetary problem would be the following: The United States is being urged by other countries to pay for its deficits in reserve assets—gold, SDR's and foreign currencies—instead of paying in dollars. This is a request that is not completely without reason. On the other hand, it is quite impossible for us to pay for our short-term capital movements in anything but dollars, because these run into the billions, and tens of billions. Very often, they have nothing to do with the United States. There may be movements out of the Eurodollar market into national currencies, say, out of the Eurodollar market into marks. We cannot be held responsible for that and come up with SDR payments or drawings on the IMF. That has to be settled in dollars.

I would suggest the following procedure. The United States might offer to pay for its current account deficit, or basic deficit, or some such figure, or for some fraction thereof, in reserve assets. A rounded figure would be computed, and the reserve assets to be paid over would be placed at the disposal of the IMF. The IMF would distribute them,

against payment in dollars, to member countries in accordance with some formula, which could be based on members quotas, or their own surpluses, or some other criterion. Provision would have to be made that the United States, when it has a surplus, receives reserve assets in settlement, and does not receive only dollars, that is, its own obligations.

Now, I would like to go on to price stabilization. I think the freeze is working well, remarkably well. It can't go on indefinitely. I have seen problems of particular companies, in one case a company that stands to see its profits wiped out 100 percent, at a time when they have to build a $100 million plant. How are they going to finance on that basis, even if you accept that the disappearance of profits is a sacrifice worthwhile in the national interest? We need, therefore, a second stage that is effective. Everybody at this table seems to have agreed on this. The contribution I would like to make here is to supply a few variations of a scheme I have mentioned before and I apologize for repeating myself before this committee. It is the by-now-familiar tax on corporations granting excess wage increases.

I am glad to see a report from the London Times that senior ministers there have considered a scheme of this kind, which I happen to know goes back directly to Sidney Weintraub's and my proposal. While they have not decided to introduce it, at least it has been studied in detail.

The variants that I would like to introduce into this scheme that taxes companies for granting excess wage increases but does not compel them not to grant these increases, are three. First, instead of raising the income tax rate of the company, one could simply disallow the excess increase as a deduction from taxable income. That will exert some restraint on the granting of excess increases. It would not be as effective as a rise in the income tax, however, because it is shiftable, in the terminology of tax technicians.

A second possibility, designed to bring labor aboard this scheme, would be to apply the scheme to prices as well as to wages. This would raise a difficult question as to how to work out an index of price increases. It is difficult enough in the case of wage increases; it is worse with prices. But it would make the scheme more symmetrical in the eyes of labor.

Third, I think that perhaps one could find a way around the technical difficulty of computing exact wage and price increases by having a government board evaluate a wage or a price increase. It could thus be determined that an increase fell into a certain range, from 6 to 8 percent, for instance. The tax consequences provided by law would then apply. One would get around the difficulty of having to figure out what the wage increase really was in all the job classifications of the many plants that some companies have. The same would be the case with price increases. In a multi-product company with tens of thousands of prices, trying to figure out the exact percentage increase is very difficult. It could only be established ex post. A government agency that had some powers to evaluate and adjudicate an increase might get us out of that difficulty.

Turning to still another proposal, I would like to offer, as a sort of second or third best, a type of excess profits tax, if it should come to that. I am against all excess profits taxes, including my own. But if such

a tax were to become necessary, as an absolutely essential condition of a bargain to be struck, I think my proposal is less bad than others. I think it could be quite similar to what Professor Klein has proposed, although I had not known of his proposal before.

Instead of taxing the individual company and its "excess profits," one could raise the corporate income tax on all companies by a percentage sufficient to eliminate excess profits nationwide. If, say, you establish as a benchmark for corporate profits 10 percent of GNP, or of national income, or of corporate income, however expressed, and you find that profits go from 10 to 11 percent, raise the corporate income tax enough to bring back the posttax income to what it was when pretax profits were 10 percent. That would raise the corporate profits tax by a few points. It would not penalize heavily the efficient, nor subsidize the inefficient, as an excess profits tax otherwise does. The proposal ought to meet the demands of labor, because labor presumably is concerned with the share of profits in the GNP, not whether these profits are realized by company A or company B. My proposal is geared to controlling the share of aggregate corporate profits, not the share of any one company.

Now, let me close on the subject of stimulation of the economy. The last time I had the privilege of speaking to a subcommittee of this committee, I had just seen some very good April retail sales figures and I concluded that the need for stimulation had passed. I said so. I am sorry to say I was wrong; I confess that. The economy has not kept the promise that was implied in the April sales figures. It has been on a level since then and stimulation is needed.

I still think no great amount is needed. We have built a lot of monetary stimulation into the economy during the first half of the year. That surely will come out sooner or later—later perhaps rather than sooner, but we shall feel it. Hence I would be cautious in stimulating.

Nevertheless, some action is needed. The tax credit, as proposed by the President, is admittedly vulnerable to the interpretation that it favors business more than labor. I say that particularly when one couples it with accelerated depreciation. But this appearance is misleading. First, the accelerated depreciation, as far as I can judge, largely—probably not entirely—makes up for the deficient depreciation. It merely compensates, in other words, for the underdepreciation that we now engage in as a result of inflation. It is estimated that we underdepreciate by 15 percent. Replacement costs are higher than the amounts that the Government allows to be set aside for replacement. We could destroy jobs by underdepreciating, and it is reasonable to give compensation there.

The investment tax credit adds new jobs and adds new capacity. It is true that it does not look plausible to stimulate investment in a recession. But that is true also in a boom. Investment stimulation is like the farmer's roof. In a recession, one does not want to stimulate because there is excess capacity, so what is the use? In a boom, there is overinvestment and the economy must be restrained to avoid inflation. It never is a good time to stimulate investment.

I would say let us disregard these short term considerations which always oppose stimulating investment. Let us do what is desirable from a long term point of view. This economy has a great many things to do. We need housing, we need to protect the environment, we must

have more education, we must deal with urban problems. All this takes capital. It does not take consumption. It takes resources to invest and those will be provided by the investment credit.

With due respect to the needs of our consumers, they are not spending the money they have now, and one can make much the same argument about stimulating consumption that has been made with respect to stimulating investment; there is little need for it.

In closing, let me put in a plea for remembering that fiscal policy needs to be revitalized. Fiscal policy is in bad shape; that is why we cannot use monetary policy on the international front—we have to use it on the domestic front. Now Congress has a chance to use the investment tax credit on a flexible basis. It could be put in for a limited time, getting a big bang for a buck, then it could be taken off. That holds more promise for a flexible fiscal policy than the income tax changes that we have talked about for so many years.

Thank you.

(The prepared statement, with attachments, of Mr. Wallich follows:)

PREPARED STATEMENT OF HENRY C. WALLICH

SUMMARY

The New Economic Policy covers a wide range of subjects. In calling for a reform of the international monetary system, and for an incomes policy, it calls in effect for novel techniques of economic management. In this testimony I shall try to make a few contributions to that end. I would like it clearly understood that these proposals deal only with selected parts of the major problems and in no way constitute a plan or program. The principal points can be summarized briefly.

Limiting International Short-Term Capital Movements

Large short-term capital flows of the kind we recently experienced are inconsistent with stable exchange rates and independent national monetary policy. As a contribution to restraining these flows, multinational corporations could be required to stabilize their foreign exchange positions in particular currencies, while remaining free to engage in transactions that in the aggregate to not violate this constraint.

Settling the United States Deficit

So long as the dollar remains the vehicle currency for large international short-term capital movements, the United States would need enormous international reserves if it were to settle its deficits in reserve assets, as other countries do, instead of in dollars. To meet a reasonable demand that some settlement in reserve assets should occur, a limited convertibility of the dollar could be established if the United States were prepared to cover a basic deficit (current account plus long-term capital movements) in reserve assets. The allocation of these reserve assets among surplus countries, in return for payment in dollars, could be effected by the International Monetary Fund.

Price Stabilization

An incomes policy designed to rely on market forces rather than on administrative discretion could employ a surtax on corporations granting wage increases in excess of a government determined guideline. Alternatively, excess wage increases could be disallowed for purposes of computing corporate taxable income. Conceivably, the same principle could be applied to price increases in excess of a guideline.

An Excess Profits Tax?

An excess profits tax is economically indefensible and in any event inappropriate at present depressed levels of profits. Enactment of an effective incomes policy may nevertheless require such a tax. If that contingency cannot be avoided, a tax less demanding than an ordinary excess profits tax could be one that raises tax payments of all corporations sufficiently to reduce the share of corporate profits in the GNP to some benchmark level. This would eliminate "excess profits" on a nationwide basis without penalizing growth and efficiency.

THE NEW ECONOMIC PROGRAM

It is an honor to speak before this Committee on the New Economic Policy of President Nixon. The scope of this policy is very wide, encompassing as it does the areas of international trade and finance, the pursuit of price stability, and measures to return to full employment. It is only before this Committee that such a range of measures can be discussed as an interrelated whole.

After the hearings held so far, it is difficult to say something that the members of the Committee have not heard before. On most topics, therefore, I shall limit myself to registering my view without much supporting argument. On a few topics I have specific suggestions to make that I would like to bring to your attention.

The International Picture

In the sphere of international action, I support the measures taken by the President, especially the temporary inconvertibility of the dollar and the surcharge on imports. These, however, can only be the first steps in what is bound to be a long negotiation leading to new relationships of exchange rates and a changed international monetary system. Since 1968, I have supported a 10 per cent import surcharge as a means of redressing our balance of payments and of moving from one exchange rate of the dollar to another. The surcharge has now been introduced as a means principally to induce other countries to revalue against the dollar. It should be clearly labeled as temporary. Otherwise it will become not a lever for revaluation, but an obstacle to it. On the other hand, I see no reason for removing it before adequate new exchange rates have been agreed upon.

As regards the reform of the Bretton-Woods system, some elements already are clearly visible. We shall need a wider band for fluctuations around parity, facilities for limited floats subject to IMF supervision, and perhaps a crawling peg, for such countries as may wish to use it, likewise under specified rules. The main perplexity relates to the future role of the dollar in this system.

It should be noted that the Bretton-Woods system did not assign a special role to the dollar, other than that of an accounting unit. The founding fathers of Bretton-Woods treated all currencies symmetrically. That the dollar did acquire a special role was the result of the economic facts of life. I believe that these economic facts, which are continually evolving, will determine the role of the dollar, more than plans and regulations that may be drawn.

Two basic misconceptions becloud the future role of the dollar. On the one side is the view that an inconvertible dollar can serve as a world currency with respect to which other countries can peg, revalue, devalue, or float as they wish. It is even argued that the United States can be completely passive with respect to this international role of the dollar. That this view is in error has been demonstrated by the recent resistance of most major countries. The strains and stresses under which exchange rate adjustments are now occurring make clear, moreover, that the United States can by no means adopt a wholly passive role. The history of the last 30 years, beginning with the long-drawn-out preliminaries of the Bretton-Woods conference, demonstrates one thing very clearly: progress in the international monetary field is difficult to achieve without the active leadership of the United States. Hence, the future role of the dollar cannot be that of a universal currency, and the United States cannot disinterest itself in its balance of payments.

On the other side is the view, equally erroneous, that the United States is a country like any other that must settle its international payments deficits by paying out reserve assets, such as gold, SDRs, or foreign currencies, instead of settling in its own liabilities. This is not the situation of the United States. International capital movements happen to take place in dollars, rarely in other currencies. Often these flows have nothing to do with the United States, such as flows between the Euro-dollar market and national central banks. A system under which foreign official dollar acquisitions reflecting short-term capital movements must be settled in United States reserve assets would require either enormous reserves, running into the tens of billions of dollars, or a monetary policy aimed principally at minimizing short-term flows, including flows that do not originate in the United States. Neither solution is practicable for the United States. There remain, therefore, two alternatives. One is severely to limit the international financial markets, especially the Euro-dollar market, by tight controls. The other is to retain, at least in part, the system under which the United States settles its deficit not in reserves, but in dollars. I would like to make suggestions in both directions.

Limiting International Short-Term Capital Movements

Probably the largest international movements of funds are those executed by multinational corporations. These movements are not necessarily speculative. They may reflect interest rate considerations, or the effort to protect against exchange risk. A large part of these flows, moreover, do not take the form of payments from one currency or country to another explicitly designed to alter the exchange position of the firm. They may be implicit capital movements, resulting from decisions to accelerate or delay certain payments, to borrow or repay in this or that country or currency. It would be difficult, certainly for the United States, to impose controls on these operations, and it would not be desirable to do so because of the adverse impact on the operations of large enterprises.

Instead, I would propose the following procedure. Large corporations operating abroad directly or through subsidiaries should be required to stabilize their exchange position, including that of subsidiaries, in each foreign currency. Their shifts of particular funds would not be interfered with. But the aggregate of these shifts should always add up to an unchanged foreign exchange position. This is a procedure that has been imposed upon banks in a number of countries, and in fact tends to be followed by many banks in order to avoid undue exchange risks. Some flexibility naturally must be allowed. But the massive movements adding up to many billions of dollars engaged in by large corporations would come to an end. This would remove a substantial part of the short-term flows that we have observed during recent crises. There would be some disadvantages to the firms maintaining such a stabilized exchange position. They would no longer be able to take full advantage of interest rate differentials, and they would not be able to make large gains from exchange rate movements.

The gains foregone, however, do not represent an important part of the earnings of large corporations. These corporations are not primarily in the business of taking advantage of interest rate differentials and exchange rate movements. Even if only parent companies subject to United States laws were to be brought into this scheme, I doubt that serious competitive disadvantages would arise with respect to foreign multinational companies. Every effort should be made, of course, to induce other governments to institute the same regulations with respect to parent companies under their jurisdiction.

The proposed procedure is similar, in certain broad aspects, to the existing Foreign Direct Investment Program. It puts overall limits on financial flows, without interfering with individual transactions. Business naturally would prefer unhampered freedom to move funds. But when this freedom leads to flows large enough to destroy the whole system, the flows become uneconomical in a broader sense.

Settling the United States Deficit

As long as international short-term capital movements are conducted in dollars, it is not reasonable to expect the United States to settle resulting deficits, often largely statistical in nature, with reserve assets instead of with dollars. On the other hand, the world has become increasingly unwilling to accept dollars in settlement, without however accepting the need to revalue in order to avoid such inflows of dollars. A reasonable compromise suggests itself. A United States deficit can be divided, even though not with mathematical precision, into the basic deficit, which includes the current amount and long-term capital movements, and a remainder, at times very large, reflecting United States or other short-term capital movements. It seems not unreasonable to expect the United States to settle in reserve assets its basic deficit, an amount that until very recently has been of an annual magnitude of 2–4 billion dollars. It is both unreasonable and virtually impossible to expect the United States to pay for its own and others' short-term capital movements in any way other than through the dollars which are the vehicle for these movements.

Accordingly, the United States might annually make available to the rest of the world a volume of reserve assets equal to its basic deficit, if any, for the year. The distribution of these funds could be left to the IMF, which might offer them, against payment in dollars, to countries in proportion to the basic surplus in their balances of payments. (These surpluses would not, in general, be directly related to a bilateral surplus with the United States.) Alternatively the reserve assets supplied by the United States could be distributed in proportion to the IMF quota of the members, against payment to the United States in dollars. Some countries might prefer to retain their dollars rather than exchange them for SDRs or other reserve media.

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A scheme of this kind would go far in meeting reasonable demands of other countries that the United States "stop abusing the dollar exchange system" or "stop living beyond its means." On the other hand, it would take account of the fact that the dollar so far is the vehicle currency for international finance, i.e., the currency in which large international capital movements are effected.

PRICE STABILIZATION

I regard the freeze and the manner in which it is being administered as a proper and up to this time remarkably successful operation. Its function, nevertheless, can only be that of a holding operation, designed to administer a temporary restraint during which more lasting measures are put into place. My concern here will be the degree to which these measures should rely upon market forces rather than upon administrative intervention.

I would fear to strain the patience of this distinguished Committee by discussing at length a proposal that I have already mentioned twice in earlier testimony. Instead, I shall summarize briefly the basic principle and then turn to some variants of it that may make it more feasible from a legislative as well as from an administrative point of view.

Briefly, the suggestion is to levy a surcharge on the corporate income tax to be paid by corporations granting wage increases in excess of a guideline set by government. Without having knowledge of what may be proposed for phase two of the price stabilization action, it is not unreasonable to assume that the program may contain some guideline for the level of wage increases. A firm exceeding a guideline of this sort by, say, 1 per cent would see its corporate income tax raised from 48 per cent to 49 or 50 or 51 per cent, in other words by some multiple of the excess rate of wage increase. If the forces of the market, including union pressure, make it preferable for a company to pay an excess wage increase and face the additional tax, there would be no objection on the part of government. All that happens is a reweighting of the relative advantages of different courses of action. "Backboning" would replace "jawboning" or whatever other administrative means for restraining wage increases might be considered.

This is a proposal that has many admirers but few friends. Its virtue lies in reliance on the market instead of on regulation. It also appears to be reasonably even-handed, inasmuch as the tax is paid by business while the restraint falls upon labor. Reactions from the business and labor side indicate that each side believes itself to bear the greater burden. This seems to confirm the claim to even-handedness, but does not improve legislative prospects.

Two ways of responding to the objections raised by labor and business suggest themselves. To meet the claim of business that a penalty for excess wage increases should not fall altogether on the employer, the excess wage increase could be made non-deductible for income tax purposes. That would make it easier for the employer to shift the added tax burden, since it would take the form of a cost proportional to payroll, rather than a rise in the income tax rate. It is generally believed that payroll taxes are more easily shiftable than corporate income taxes.

This solution is not without drawbacks. Shiftability of the tax reduces the degree of restraint exerted on the employer's willingness to raise wages. It also contributes to price increases, although it can be shown that quantitatively this would not be important. In any event, this variant should be more acceptable to employers.

To make the proposal more acceptable to labor, consideration could be given to extending it to prices. A guideline for permissible price changes—and perhaps required price reductions—would have to be established. Increases above this guideline would be penalized by a surcharge on the corporate income tax. I do not hold a strong brief for this variant. It may lead to additional price increases simply to cover the tax, although, to the extent that the price fixed by the employer is dictated by the market, he would not improve his position by trying to raise it above that level. Administratively, the proposal would be hard to handle, because the exact amount of a price increase, for a firm with thousands and perhaps tens of thousands of separate prices, might not be easy to compute. This problem would arise, of course, with respect to any form of price control seeking to limit price increases to particular rates.

An analogous problem exists also with respect to the measurement of the rate of wage increases. The usual calculations made at the time of a major contract are fairly rough, as indicated by the frequent difference in the evaluation made by the company and the union. A precise calculation is not impossible

however. It requires elaboration of an index, based on the number of man-hours in each category of labor, weighted for the amount of such labor, and covering all parts of the enterprise. The necessary raw material for these calculations is available from corporate payroll records. With this technique, it would be possible to compute the exact tax liability of an employer resulting from an excess wage increase.

The accounting difficulties and the delay involved in these computations nevertheless are not inconsiderable. They could be avoided if a governmental body were given the power, after due examination of a particular wage contract, to adjudicate it as being of some particular magnitude. This procedure would avoid a great deal of accounting and work. Large errors on the part of the government presumably would still lead to litigation. But in case of minor disagreements the governmental evaluation would prevail.

This completes my summary of the tax-oriented incomes policy. I respectfully ask permission to put additional material into the record.

AN EXCESS PROFITS TAX?

An excess profits tax has been urged as a component of an incomes policy in order to make that policy "fair." I do not favor this suggestion, first because of the uneconomic nature of such a tax, and second because of the present low level of profits. Nevertheless, if an effective incomes policy cannot be enacted without an excess profits tax, I would like to make a proposal for such tax that I believe is less uneconomic than other types of excess profits taxes.

In this unpalatable case, I suggest that, instead of relating the concept of excess profits to the performance of a single company, it should be related to the share of all corporate profits in the GNP. A benchmark for "nonexcessive" profits would be established. This might be, for instance, the average ratio of pretax corporate profits to GNP over a number of recent years, preferably enough years to include a cyclical peak as well as a trough. When the actual profits/GNP ratio for the entire economy exceeds this benchmark, a surcharge would be such as to reduce post-tax corporate profits by some percentage of the excess over the level at which they would stand when pre-tax profits stand at the benchmark. In the extreme case, they could be reduced 100 per cent. This surcharge would apply to all corporations with income tax liabilities, regardless of their individual profit status.

The rationale for this procedure would be as follows. Labor's concern presumably is not with the income of particular firms, but with the division of national income between labor and other claimants, including business, in a broad sense. The proposed form of excess profits tax is designed to regulate the share of corporations, not the income of particular corporations. This, in fact, is the meaning of the words "incomes policy." By spreading the excess profits tax, in effect, over all profitable corporations, the device avoids throwing the entire burden of the tax on efficient and rapidly growing firms. Productivity throughout the economy will benefit.

Administratively, the problem would be to compute correctly the GNP share of profits. This share can be read from the Department of Commerce statistics with a lag of only a few months, but it may be revised statistically a couple of years later on the basis of tax returns, as happened recently. However, since the problem is essentially one of fixing a tax rate to meet a political need, there is no obligation to be mathematically accurate. The surcharge rate could be set on the basis of these figures for each given year, but adjustments could be made if revised figures later are substantially different. The tax should terminate, at the latest, when the corresponding wage restraints terminate, and I would like to repeat that I would much prefer to see an incomes policy that abstracts altogether from an excess profits tax of any kind.

STIMULATION OF THE ECONOMY

Contrary to what might have been expected last Spring, the economy has made only moderate progress since that time. Some stimulation therefore is in order. I do not advocate massive stimulation, however, in view of the expansionary potential already built into the economy by the very expansive monetary policy of recent months and by the shift of the budget in the direction of a full employment deficit that seems already to have taken place. The stimulus that will emerge from the President's proposals for the budget seems adequate to me.

The proposals regarding the investment tax credit have been criticized as being too much in favor of business. In their place, it has been suggested, there should

go a greater measure of tax relief to the lower income groups. I doubt the accuracy of underlying analysis because, prior at least to the introduction of the new depreciation rules, business was under-depreciating its capital equipment at a rate of perhaps 15 per cent below replacement requirements. This is the result of an inflation which causes the tax system to decapitalize the economy. Beyond this factual question, however, I believe that to focus exclusively on who gets what will not lead us to good social policies. Our guidance should come, rather, from the overall requirements of the economy. What the economy needs at this time are jobs, and the equipment to back them up. In addition, the economy needs enormous amounts of capital to carry forward our plans and programs for housing and protection of the environment. If in the face of these needs we insist on raising the share of our income going to consumption and reducing that which can go to investment, we shall not meet these needs.

The stimulation of investment is like fixing the farmer's roof—there is never a good time for it. In a recession, excess capacity is high and there seems to be no reason to stimulate business capital spending. In a boom, we have excess demand, and investment must be restrained to avoid inflation. Instead of allowing ourselves to be bemused by these short-run perplexities, we should look to the long-run needs of the country, which today more than ever call for permanent improvement rather than short-run satisfaction.

Principal Points To Be Covered by Legislation for TIP (Tax-Oriented Incomes Policy)

(By Henry C. Wallich)

The purpose of the tax is to combat inflation. Its mechanism is a surcharge on the corporate income tax, proportional to the excess of wage increases over and above a guideline level. The tax is expected to restrain business in granting such wage increases. It is believed to be reasonably even-handed inasmuch as, while it aims to restrain wages, it falls upon business.

A full description of the tax and its principal economic aspects is found in the attached article by Henry C. Wallich and Sidney Weintraub, which appeared in the *Journal of Economic Issues* of June, 1971. A list of the principal points to be covered by legislation follows. The list leaves a great deal to be handled by regulation, to be issued by the Internal Revenue Service. There is no doubt that these details will be complex. The overall concepts spelled out below, however, are simple. It is obvious that many of these points could be resolved differently; the proposals here listed are those that to me seem preferable.

A large body of experience with this type of legislation was accumulated during World War II and during the Korean War. This experience has been analysed in a volume, Wage Stabilization Programs 1950–1953, Wage Stabilization Board, Economic Stabilization Agency, June 30, 1953. While the nature of the wage restraints used in World War II and during the Korea period was different, the first embodying a freeze, the second involving disallowance of excess wage increases (instead of a surcharge on the income tax), many of the same problems would be encountered under the TIP.

Guidelines

Guidelines for maximum permissible wage increases would be established by the President. These guidelines would permit wage increases equal to nationwide productivity gains plus some fraction of the rate of inflation recently experienced, say one-half. With productivity gains equal to 3 per cent and inflation equal to 5 per cent, the guideline would be 5.5 per cent.

Rate of tax

The tax is to be a multiple, say three times, of the excess rate of wage increase. If the guideline is 5.5 per cent, and the wage increase is 7 per cent, the increase in the corporate income tax for the employer in question would be $1.5 \times 3 = 4.5$ per cent, making a total corporate tax rate of 52.5 per cent at present rates. For very high increases, the penalty tax should taper off, to avoid reducing profits to zero.

Determination of excess wage increases

A TIP Board is to be established to examine new wage contracts as they occur. The magnitude of an increase is to be defined by an index, which would represent the weighted average of all increases in all categories of labor covered by the

contract. The Board is to be given as much freedom as possible in evaluating a wage increase, and its determination is to be final, subject to such litigation as may be constitutionally unavoidable where employers can show, on the basis of their actual experience, that the determination made by the board was excessive.

Regional boards

Regional boards for each State or each major labor market area will be established to adjudicate wage increases subject to the authority of the main TIP Board.

Compensation

All forms of compensation of employees are to be covered and treated as components of a "wage increase," such as wages, piecework rates, pensions, other fringes, executives' bonuses, and commissions.

Coverage of enterprises

Employers with less than 250 employees, no-profit organizations, governmental units, unincorporated enterprises, and agricultural enterprises are to be excluded from the tax.

Absence of contracts

Employers that do not conclude periodic labor contracts, including non-unionized enterprises, are to report annually any increases granted. The Board will assess a surcharge wherever appropriate.

Long-term contracts

In the case of multi-year contracts, the increases for each year are to be evaluated separately, without averaging over the years.

Fiscal years

Where the period of an annual wage increase does not coincide with the fiscal year of the employer, the increases granted during the fiscal year are to be prorated and averaged.

New enterprises

Increases granted by new enterprises that do not have a wage base in a prior year are to be measured on the basis of the increase over the previous year's average wage rates in the respective industry within the same geographical area. The regional boards will determine the details of these comparisons. Where an enterprise is "new" only in name, the elements of comparability deriving from the history of the predecessor company or companies are to be employed, at the discretion of the regional board.

Duration of the surcharge

The tax surcharge is to be in effect for the taxable year or years during which the excess wage increase occurs. Where the period of the wage contracts does not coincide with the employer's fiscal year, it shall be prorated and averaged with the wage increase in effect for that part of the fiscal year not covered by the period of the wage contract.

Existing contracts

Wage increases required by pre-existing contracts will be subject to the tax.

Starting point of the tax

The tax shall become effective upon enactment. To the extent that the wage rate for the previous year is not sufficiently clearly defined to serve as a base of comparison, the Board shall determine the presumptive magnitude of the increase. The Board is to have power to make allowances for cases of exceptional uncertainty.

Hardship cases

The TIP Board and the regional boards are to have power to deal with hardship cases, subject to the need to avoid litigation as far as possible.

Consolidated returns

Companies that consolidate the returns of subsidiaries shall be allowed to average the wage increases of different subsidiaries for purposes of the tax. Conglomerate companies with subsidiaries in substantially different industries are not to average. The Board is to determine the meaning of "substantially different industries."

A TAX-BASED INCOMES POLICY

Henry C. Wallich and Sidney Weintraub

Our earlier suggestions for using the income tax mechanism to implement an anti-inflationary incomes policy have received some attention.[1] This article aims: (1) to present a full statement of the approach, (2) to extend the economic analysis underlying it, (3) to assess some troublesome technical matters, and (4) to demonstrate the advantages of an incomes policy relying on market forces over those that do violence to the market.

The facts of our intractable inflation need not be recited. Complicating the price rise has been an unduly high rate of unemployment. The twin goals of price level stability and full employment have so far eluded conventional monetary and fiscal techniques. New measures commend themselves to counter the new experience of 1969-70 in which prices and unemployment rose simultaneously in contrast to past business cycles when their paths diverged.[2]

It would be an error, however, to regard an incomes policy, such as we propose, as a substitute for monetary and fiscal policy. Instead, the proposal is conceived as a supplement to the familiar monetary-fiscal policies so that the economy might operate closer to full employment without the inflationary danger of excess demand and "overheating".

Professor of Economics, Yale University and the University of Waterloo (on leave from the University of Pennsylvania), respectively.

Fundamentally, an incomes policy in a wage-induced inflation involves mainly a redirection of the traditional emphasis. For both monetarists and fiscalists argue that to control inflation aggregate demand must be depressed, and that the ensuing unemployment will dampen wage and price increases. They involve *indirect* pressures on wages and prices.[3] An incomes policy projects a *direct* attack and can thus improve such a tradeoff between inflation and unemployment as may exist in the short run.

THE TIP PROPOSAL

We turn now to state the underlying principle of our tax-based incomes policy (hereafter TIP). Alternative proposals such as a wage-price "freeze", Kennedy guideposts, price and wage stabilization boards, or intervention in labor disputes will be by-passed. The shortcomings of these approaches are well known. The method we propose, instead of disrupting the market process, relies upon market forces, leaving business and labor free to make their own decisions.

The corporate income tax mechanism provides a ready lever for policing an incomes policy, with only nominal administrative costs and minor amendments (in principle) to prevailing tax laws.

In simplest terms, it is proposed to levy a surcharge on the corporate profits tax for firms granting wage increases in excess of some guidepost figure. If the wage guidepost were 5.5 per cent, and a wage increase of 7 per cent were granted, the corporate profits tax for the firm would rise above the present 48 per cent by some multiple of the 1.5 per cent excess. If the guidepost were 3.5 per cent, the excess would be 3.5 per cent and the multiple would be applied to that figure.

The added tax burden may be expected to stiffen the company's back in wage negotiations. The result would be a lower rate of wage increases, and a slowing of the rate of inflation.

In analyzing this form of incomes policy, we shall first discuss its general economic logic. Subsequently, we shall deal with a number of specific problems which relate mainly to the technique of tax administration but are nevertheless of great importance in evaluating the proposal.

Note that the proposal is asymetrical in character. The tax is levied on and paid by the corporation. While it is the advance of wages that is to be restrained. Thus one can argue that the proposal is broadly even-handed. Nonetheless, this claim needs to be supported by more detailed consideration.

Most forms of incomes policy address themselves to both wages and prices, or to wages, prices, and profits. It could be argued that under the present proposal, prices, too, should be controlled in some form. The reason why this is not done is that, on the historical evidence, the average markup of prices over unit labor costs has been remarkably constant. Expressed differently, the share of wages and salaries in the national income, or in gross business product, has been historically constant. If prices are in this form tied to wages, restraint of wage increases implies restraint of price increases. No separate control of prices is required. Furthermore, as we shall show in greater detail later on, the corporation paying the surcharge is unlikely to be able to shift it to the consumer in the form of higher prices. This circumstance, crucial to our proposal, likewise argues against the need for direct intervention in the price mechanism which would nullify the principal advantage claimed for the TIP.

The simple wage-cost marked-up price level (WCM) formula illustrates the argument. We have:

$$P = kw/A$$

That is, the price level equals the index for the wage level multiplied by the mark-up factor, divided by average labor productivity.

where: P = price level.
w = average money wage (an index).
A = average labor productivity.
k = average mark-up of prices over unit labor costs = the reciprocal of the wage and salary share in national income (more accurately the gross business product).[4]

Of all time series in economics that of k, the average mark-up, is most nearly constant, in the short-run and the long-run.[5] Annual fluctuations rarely exceed one or two index points. We can rely on k to remain firm – unless our economy is structurally altered almost beyond recognition. On this hypothesis we can surmise that the price level and unit labor costs will move in unison, or that for price level stability average wage-salary payments must be geared closely to average improvements in labor productivity. Over time productivity has risen by approximately 3 per cent per annum.

This means that, over time, prices have been closely tied to wages. Business, whether it has tried or not, has never effectively raised its mark-up for any length of time. It follows that a measure

slowing the rate of increase in wages will also slow the rate of increase in prices. Our incomes policy proposal rests in part on this proposition.

This view of the relation of wages and prices is also shared by the designers of most of the large econometric models of the American economy in use today. For the most part, these models assume that prices are related to wages by a fixed mark-up. This does not necessarily mean that all inflation must be regarded as cost-push inflation. It does mean, however, that when inflation is of the demand pull type, business does not succeed in significantly or durably increasing profit margins. Wages quickly follow to keep the markup and the wage share constant. A demand pull inflation, in any event, is more amenable to the traditional tools of monetary and fiscal policy. These work against aggregate demand, and they thus restrain the source of the demand-pull inflation. They are less appropriate for a cost-push inflation. Hence an incomes policy, the TIP or any other, is particularly appropriate to a cost-push inflation.

To conclude this comment on the absence of a price control component, it should be noted that the effect of a proposal for a surtax on profits is similar to that of a price freeze unaccompanied by a wage freeze. If business was not able to raise prices, wage increases would eat directly into profits, and management's resistance to wage increases would be stiffened. Precisely the same effect is achieved under the TIP. However, the harmful effects and administrative difficulties of a price freeze are avoided.

The tax surcharge, it is important to note, is a tax on the income of the corporation. It is not a tax on the excess payroll, nor on excess labor income. This feature, too, is an essential aspect of the TIP.

It might be argued that, if excessive wage demands on the part of labor are largely responsible for inflation, a penalty tax should be levied on the income of labor rather than of the corporation. This could be done by means of a payroll tax, or by making excess wage increases non-deductible for income tax purposes, or by taxing labor income directly. None of these techniques, however, would achieve the objective of restraining the corporation in the granting of wage increases.

The reason is that a wage tax or any similar tax can easily be shifted by the corporation. In the case of a payroll tax, which represents a direct increase in costs, this is obvious. Disallowance of the dollar amount of an excess wage increase for income tax purposes has the same effect of raising costs. A tax on labor income very likely would be included by labor in its wage demands and would thus be

translated into an increase in costs. Any tax that can readily be shifted leaves the profit margin of the corporation unchanged. If the volume of production does not change, the dollar amount of profits and hence the rate of return on capital also will not change. There would be no stiffening of backbones from such a tax.

A tax on the income of a corporation is very much less likely to be shifted. Both economic theory and empirical research seem to confirm this, especially with respect to short-run tax changes. The reason is that profits per unit of sales vary widely among corporations. For a highly profitable firm, profits per unit of sales are high, and therefore corporate profits tax per unit of sale is high. The opposite is true for a relatively unprofitable firm. For a firm with zero profit, the tax per unit of sale is also zero. Further differences in the amount of profit and of tax per unit of sales result from different degrees of "leverage," that is, differences in the amount of debt in the capital structure of the corporation. A tax that affects cost per unit very differently among firms evidently is harder to shift than a tax that affects all firms equally.

It is sometimes argued that the degree of shifting of the corporate income tax depends upon the structure of an industry. Highly concentrated industries might find shifting easier than highly competitive industries. If this effect were pronounced, however, it would tend to make concentrated industries more profitable than competitive industries, that is the rate of return on capital would be higher in the former. There is no strong evidence that this is generally the case.

If the tax were shifted, the result would be to raise the level of prices. During the period in which the shifting takes place, the rate of inflation would therefore accelerate. This effect would probably be small, as long as the revenue from the surcharge was small. An average surcharge of 5 percentage points on the corporate income tax would amount to less than $2 billion at present. Spread over a GNP of $1 trillion, the effect on prices would be minimal. However, if the tax were indeed shifted in this manner, it would lose its restraining effect upon business behavior. If corporations can shift the tax, they will have little more reason to resist wage increases than they had before. The issue of tax shifting, therefore, and the foregoing demonstration that large-scale shifting is unlikely, are important because a shifted tax constitutes no restraint at all.[6]

Partial shifting will reduce the wage restraint exerted by the tax without altogether eliminating it. More precisely, the firm's and the union's expectations of the degree of shifting will be decisive. Most students agree that more shifting will occur in the long run than in

the short. Unless a firm expects to be paying a TIP tax continuously, it can hardly plan on long-run shifting. Its expectations of being able to shift in the short run will be relevant.

The foregoing analysis suggests one further comment on the distributional effect of the TIP. We started by stressing the historical evidence that the share of labor in the total product has been quite constant or at most had edged up slightly. A slower rate of wage increases is not likely to reduce that share. With price increases also slowing, labor's real wage gains will continue unchanged. Historically, these real gains have been equal to the rate of productivity growth.

Nothing in the TIP proposal is likely to alter this. As the intention is to hold wage gains (nearly) equal to the average productivity improvement, the wage share will tend to be maintained.

This would be the minimum share-prospect for labor. If the wage-cost aspect of price movements were brought under control it would be an easier matter thereafter to clarify our understanding of the impact of monopoly on price making without our vision being clouded, and any study hopelessly confounded, by the facts on wage movements. A more intelligent scrutiny of monopolistic practices could ultimately contribute to improving labor's income share.

So far we have established grounds for believing that the corporation will be sensitive to the TIP. If it cannot shift more than a small part of the surcharge, its rate of return will be reduced. We must now procede to examine the response of the corporation to this changed condition, and also the response of the union.

In any bargaining situation, the two parties start at some distance from each other and end up together. This implies that one of the two or both change their initial position. They may do this because the initial position was just a bargaining stance, or because the ongoing negotiation, which may involve a strike, becomes increasingly costly to either or both of them.

This progress of a negotiation is shown systematically in Figure 1. It shows labor's wage claim curve, U, starting high and declining over time. The corporation's wage offer curve E starts low and rises. At the level and the point in time where the two curves intersect, the parties settle – point S of the diagram.

Suppose a TIP is introduced, with a guidepost level, G. The company may be expected to respond to this by lowering to E^T that part of its curve which goes above G. In the diagram this is indicated by a horizontal stretch at the level of the guidepost, where the company for some days or weeks refuses to increase its offer.

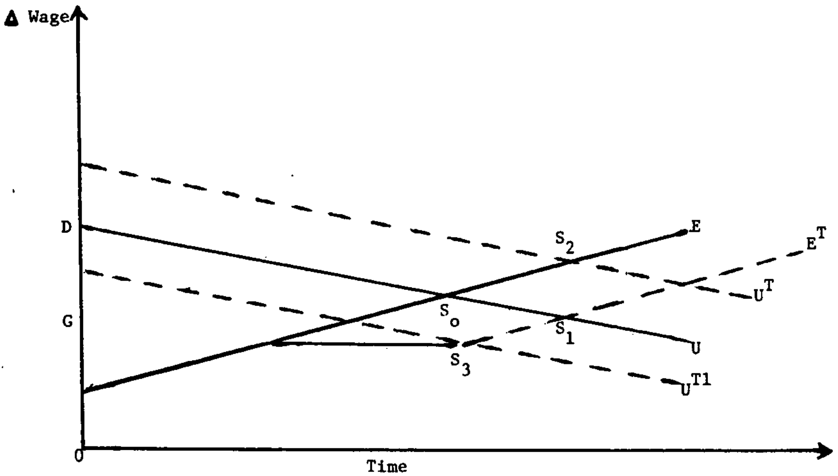

FIGURE 1

E = Employer settlement curve

E^T = Employer settlement curve after imposition of tax on firm

D = Original union demand

U = Union settlement curve

U^T = Union settlement curve after imposition of tax on labor

G = Guidepost level

U^{T1} = Settlement if labor reduces its demands in light of imposition of tax on firms.

S_o, S_1, S_2, S_3 = Alternative points of settlement, allowing for the alternative taxes.

If the union does not change its bargaining plan, the union curve will remain unchanged. In that case it will intersect with the revised company curve E^T at S_1, at a somewhat lower wage increase and after a somewhat longer negotiation or strike. This illustrates the effectiveness of TIP even on the unfavorable assumption that the union is quite unimpressed by the tax. If the union takes into account the reduced ability to pay of the corporation, it may lower its wage demand curve. This is indicated by the dotted line U^{T1}. In

that case it is possible that the settlement will not only be substantially lower, but also will occur earlier in time than without TIP.

It is theoretically conceivable that a union may be totally impervious to any of the forces at work – the passage of time, the mounting costs of the strike, the reduced ability to pay of the corporation after TIP becomes effective. This could be expressed, in the diagram, by a horizontal line along which the union maintains its original demand of D. Some observers or negotiators on the business side appear to believe this to be the typical union attitude. Several considerations suggest that it is an erroneous appraisal. In the first place, if unions assume a completely intransigent position, employing a kind of labor Boulwarism, corporations would be ill-advised ever to accept a strike. They ought to settle immediately, knowing that to hold out will avail nothing. The fact is, of course, that corporations do accept strikes in the expectation of getting a lower settlement. Only in cases where a large union confronts a small employer and thus faces negligible costs from a strike is a-take-it-or-leave-it bargaining stance at all plausible.

In the second place, a union that fails to take into account the impact of TIP upon the corporation's ability to pay is demonstrably not maximizing benefits for its members. Suppose that the union asks for wage gains estimated to cost $10,000,000 at a certain level of output, with or without TIP. If the union believes that the company could pay, in addition to these $10,000,000 a TIP of, say $3,000,000, it would not be maximizing its possible take if in the absence of a TIP it were to ask for only $10,000,000, or its hourly equivalent. Knowing that the company can pay $13,000,000, that is the amount it should demand in the absence of TIP. A union that does not respond to a corporation's reduced ability to pay under TIP would not be doing a good job for its members.

Let us take one further look at the diagram in order to illustrate a point made earlier. We argued that if TIP took the form of a tax on the income of labor, this would cause the union to raise its demands and incidentally also cause the company to shift the increase in cost to the customer. The position of the union's wage demand curve is shown in the diagram on the dotted line U^T. It will be seen that that curve intersects with the corporation's unchanged offer curve at a higher settlement than before, as well as later in time. This is why a tax on the income of the union's members would not restrain inflation. A TIP in the form of a payroll tax would in all probability not induce the corporation to lower its wage offer curve substantially, since that tax could be shifted to the consumer.

AN ALTERNATE TIP ANALYSIS

The same result can be realized by examining the problem from another angle.

In Figure 2 profits are measured vertically while the percentage wage change is measured horizontally. Curve 1, for example, is an *opportunity* curve: it assumes that regardless of the wage change, the firm recoups the *same* volume of profits: its higher wage costs are translated into proportionately higher prices and, with sales unchanged, its profits are unaffected. Curve 2, on the other hand, reports lower profits with higher wage movements: the firm is unable to transmit its higher costs into prices.

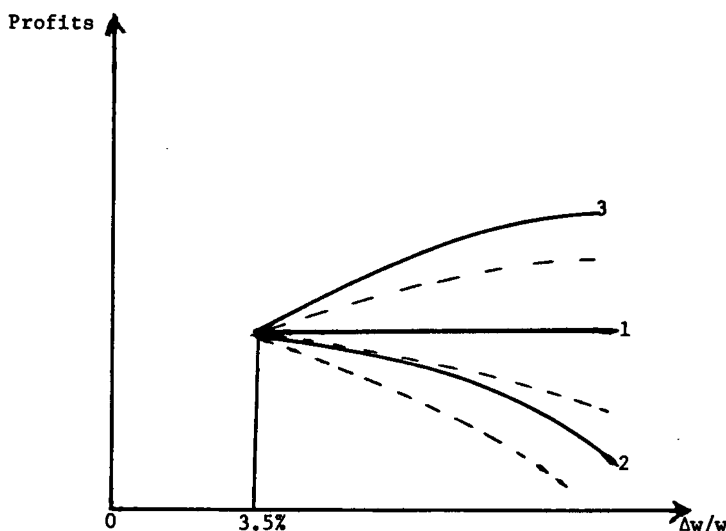

FIGURE 2

Curve 3 represents the case in which either the firm has failed to maximize profits at lower wage costs, or that as wages and prices rise, its debt burden eases and its profits rise.

For all three cases the dashed lines indicate the impact of the TIP program: profits are reduced for wage movements in excess of 3.5 per cent per annum.

Viewing curves 1, 2, 3 as *opportunity* curves, profit indifference curves can be superimposed. (We refrain from executing this simple exercise). With the firm dominated solely by profit objectives, the indifference curves are horizontal: in all cases, TIP *must* reduce the profit possibilities. Presumably, to maintain any level of profits – if the firm was not maximizing profits previously – there will be resistance to higher levels of wage increases.

If the firm is motivated by a "high wage" psychosis, the profit indifference contours will fall to the right. The general conclusions still follow: the maximum profit possibilities will be lower barring strange cases of *important* deviations from the maximum profit principle. But these cases of benevolence and philanthropic business behavior are not the stuff of sensible economic analysis; we may be permitted to neglect them in accord with common practice.

We conclude, therefore, that on (approximate) profit maximization analysis, the TIP proposal would lead firms to seek lower settlement terms. This force would tend to check the inflationary wage increase of recent years.

THE TIP TAX STRUCTURE

We turn now to the tax ingredients of the TIP proposal. For immediate purposes the statement will be primarily suggestive and tentative. Talks on the precise scale of tax progression would, at this time, have primarily an intuitive appeal.

A case can be made for a relatively low rate of TIP tax, say 1½ percentage points of corporate surcharge for each percentage point of excess wage increase. A 7.5 per cent wage increase, in the face of a 5.5 per cent guidepost, would then cost the corporation a 3 per cent surcharge over and above the regular corporate rate. The reason for such a moderate tax might be that TIP is new and experimental, and that part of its merit might be the informational and educational effect upon business, labor and the public. In the case of such a low tax, however, the control of inflation might very well require reliance upon additional forms of incomes policy.

A case for a heavier tax, say 3 or 4 percentage points of surcharge for every percentage point of excess wage increase, can also be defended. It would make TIP a powerful instrument. It might make superfluous the use of other forms of income policy, although not the use of proper monetary and fiscal restraint. In case of a high TIP rate, it might be well to put a substantial tax on any transgression of the wage guidepost, even if it were fractional.

Nevertheless, in no case should the tax be set so high as to completely erode the corporation's profit position. For instance, a very high excess wage settlement, say of 15 per cent, would completely wipe out the company's profit in case the tax rate is set high. Some kind of a tapering off or ceiling would have to be provided.

A SCHEMATIC VERSION

The main TIP choices appear in Figure 3. In curve B, TIP rates rise quickly for transgressions beyond a 3.5 per cent annual wage increment norm. The danger here is that if firms cannot hold the line, the tax penalty will become onerous; if the phenomenon is widespread, the general level of economic activity will be depressed as investment dries up.

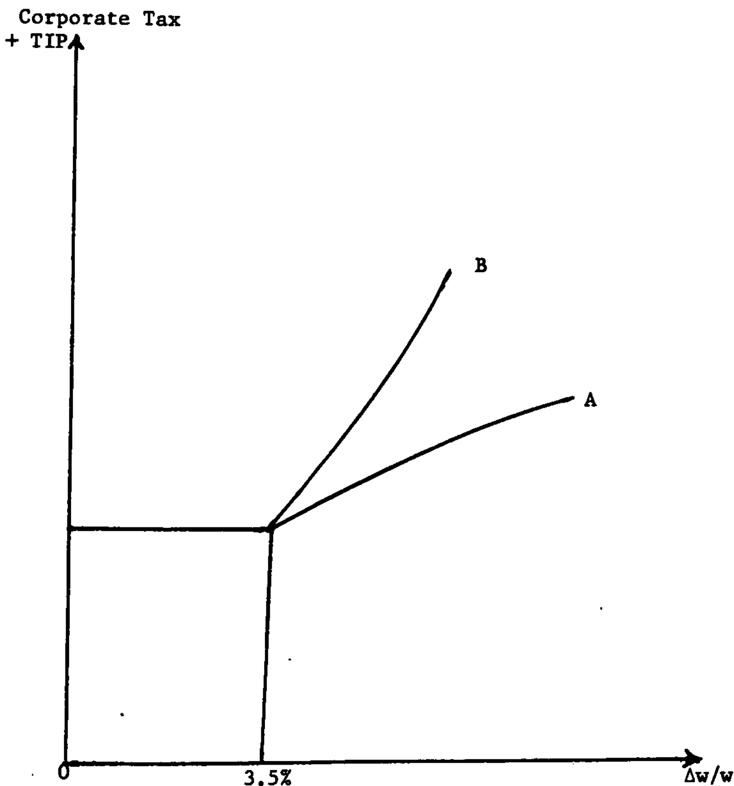

FIGURE 3

Considering the novelty of the proposal and the obscurity on the fundamental matters involved stemming from the lack of operating experience with it, only relatively minor additions to the ordinary tax imposts would be feasible with levies confined within 5 to 10 percentage points of existing corporate income taxes. Such levies would parallel past experience; also they are unlikely to be inimical to high level activity even if firms acceded to excessive wage settlements. Curve A would thus be the immediate object of policy and should tend to foster a greater adamancy toward excessive settlements.

SETTING THE TIP GUIDEPOST

The setting of the guidepost is a separable issue. The principle of a wage guidepost is by now well understood, thanks to the efforts of the Council of Economic Advisers. The principle is that wage increases should be governed by nationwide productivity gains and not by the gains of a firm or an industry. If productivity gains of a firm or industry were made the basis of wage increases, different firms and industries would soon have widely different wage levels. This would lead to spillover effects, the high wages pulling the low wages up, and prices would rise in consequence.

Equal wage increases throughout the economy, for comparable types of labor, would be the rule if labor markets were fully competitive. There could then be no differentials on account of different productivity gains, else labor would move out of the low gaining industries into the high gaining industries. The guidepost simply seeks to accomplish by rule what in a competitive labor market would happen automatically.

As for the level of the guidepost, anything from (1) the pure level of productivity gains, ignoring inflation, to (2) productivity gains plus the full rate of inflation, is conceivable. For instance, with productivity gains at 3 per cent and inflation at 5 per cent, the guidepost could be set anywhere between 3 and 8 per cent. A case can be made for setting it low, in order quickly to bring down the rate of inflation.

An alternative case can be made for taking into account part of the inflation, perhaps half, which under the conditions indicated would make the guidepost 5.5 per cent.

A low guidepost very probably would, at least for awhile, be exceeded by many corporations and cause a large amount of revenue to be raised by the surcharge. This could be compensated by a lower

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rate of surcharge, or perhaps by lowering the basic profits tax. On the whole, there is much to be said for not making many corporations pay the surcharge and for not collecting a large amount of revenue. This would argue for a relatively high guidepost, which would of course come down as the rate of inflation itself came down.

HOW TO COMPUTE THE TAX

Two principles must be observed by any tax proposal that hopes to prosper at the hands of the American bureaucracy and the tax writing Committees of the Congress. First, the tax must be entirely precise in all details, so that it can be audited by the Internal Revenue Service and if necessary taken to court. Any imprecision is bound to lead to conflict between IRS and the taxpayer, with an attendantly large number of law suits. The courts would then do the job that the legislator had failed to do.

Second, the tax must be reasonably equitable as among taxpayers, avoiding significant hardships or windfalls to particular firms or groups. Above all, there must be no opportunity for political opponents, whoever they may be, to construct horror cases.

The problem is to establish the exact amount of a wage increase. The amounts published at the time a contract is concluded are estimates and approximations. Hard numbers are needed for tax administration. This means, in the first place, that the tax cannot be computed until after the end of the company's fiscal year. If the year or years of the wage contract does not coincide with the fiscal year, averaging may be necessary. The wage data can be reasonably expected to be available from two sets of records: the tax records, which must show total wages, fringes and other deductions in arriving at taxable income, and the payroll records which the company needs to pay its employees and also to make up its tax return. The payroll records may indeed be rather widely dispersed among company offices, but they must have been available to the company's accountants for normal corporate purposes.

The wage increase can be computed on one of the following bases:

(1) Total wages, salaries, bonuses, fringes, and related payments divided by the number of employees on a particular date would give the average "wage" per employee and its increase over the same figure of the previous year. It is open to the simplest kind of manipulation, however, by adding to the number of employees on the critical date.

(2) Total wage and related payments divided by the daily average number of employees. This avoids the obvious difficulty of (1), but still raises the awkward question of how to define employees, consultants, and other non-employees receiving fees that are customarily entered as salaries. The most serious form of legal tax avoidance possible under this method probably would be a deliberate reduction in the number of weekly hours.

(3) Total wage and related payments divided by man-hours worked, adjusted for overtime. This would eliminate some of the difficulties under (1) and (2). It would still allow the employer, however, to change the labor force mix toward lower skilled employees. Very high wage increases in each job specification and grade would go untouched by the tax if the average skill level is reduced sufficiently. Effectiveness of the tax could be severely reduced by such maneuvers.

(4) Total wage and related payments in each job classification and grade, divided by the number of man-hours worked in the respective categories, and combined into a weighted index of wage increases. This would give a fairly water-tight specification of a wage increase. The data should be available on the records indicated above. The difficulty of computation might nevertheless be great for a large firm with numerous plants, and with different local payscales and job classifications all shifting as the product mix and the geographical mix of the company's output changes. These difficulties may have to be faced, however, because tax writing committees may well reject any lesser standard of accuracy.

SOME ALLOCATIVE AND DYNAMIC ASPECTS

We now consider some allocative shifts in the capital-labor resource use that might be induced by the proposal. For whenever a tax is introduced it will inevitably exert some repercussions on factor input combinations. A TIP designed according to models 1-3 above will create an inducement to reduce the average level of skill of the labor force. By firing a $10,000 man and hiring a $5,000 man, the average wage can be reduced for tax purposes if the numbers involved are large enough to influence the reported figure.

This phenomenon, should it develop, would not necessarily detract from the proposal. A cut in costs, tending to reduce prices, should be welcome. As lower-priced employees are demanded, moreover, and their wages thereby lifted most rapidly, some damping

of the shift-over will occur. Any tendency of the tax to encourage the use of less costly labor will contribute toward greater income equality. The greater balance in earnings, and the opening of more places for the (somewhat) less skilled, or for those lower in seniority, might be beneficial not only in terms of costs and prices, but in easing social tensions.

This would be particularly true at a time when, as at present, the supply of relatively unskilled labor is excessive. To the extent that an excess supply of low-skilled labor contributes to structural unemployment, strengthening the demand side of that market would improve resource allocation. It would help to lower the Phillips curve directly, in addition to the same effect that occurs indirectly when a successful incomes policy permits more expansive monetary and fiscal policies. Monetary and fiscal policies would insure that a changing structure of the demand for labor, should it become at all noticeable, would not lead to unemployment of the more highly skilled.

It will be noted that these tendencies toward downgrading the skill mix of the labor force would materialize only if the TIP is computed by methods (1), (2), and (3). Only they present opportunities to reduce the apparent magnitude of wage increases for tax purposes. In that case, a tendency might also arise to go slow on research and development and on the adoption of advanced technology. High technology is less easily combined with unskilled labor than with highly skilled.

An undesirable effect of this sort could be avoided by using computation method (4), which would prevent a rise in the proportion of skilled labor from showing up as an increase in average wage payments per man hour. Under methods (1), (2), and (3), this undesirable effect could under some conditions be avoided by an "averaging back" procedure over, say, three years. Suppose that, in year 1, the firm had an increase in its average wage payment per employee or per man hour of 8 percent, owing to the introduction of more advanced equipment and a consequent increase in the proportion of highly skilled labor. The firm therefore pays a TIP. On the basis of method (4), the wage increase, let us suppose, would have been only 3.5 percent. If the same rate of increase continues, the firm in the following two years will have weighted average wage increases of 3.5 percent each. Suppose the guidepost is 5 percent. The firm could then be allowed to average its wage increases for the three years, arriving at an average annual increase of 5 percent, and claim a refund.

These consequences of TIP would largely disappear if a tax base

somewhat like that described under (4) were adopted. In that case, employers could not escape the tax by reducing the skill level of the labor force. Neither would there be a check to innovational activity.

Could TIP be expected to create unemployment? If methods (1), (2), and (3) are employed, the demand for highly skilled labor would diminish relative to that for less skilled labor. This would not, however, imply a reduction in the aggregate demand for labor. On the contrary, the overall effect of a successful incomes policy, and therefore of TIP, should be to make possible a higher level of employment without increasing the rate of inflation. The Phillips curve – the tradeoff between inflation and unemployment – would be lowered. A lower level of unemployment would become consistent with a low or zero rate of inflation. This would, of course, be true also if method (4) were employed. The gains from a lower rate of unemployment would be substantial, quite aside from the non-economic benefits. According to a familiar rule of thumb, known as Okun's Law, a reduction in unemployment by 1 percentage point yields an increase in GNP of 3 percentage points. Without attempting to guess the magnitude of the effect that TIP might have, it is worth noting that a 1 percent reduction in unemployment would yield something like $30 billion additional GNP. It is hard to believe that adverse allocational or employment effects of TIP, should they occur, could approach this order of magnitude. Their occurrence is in any event unlikely for the reasons already stated.

Obviously, such comparisons are bound to be speculative. Moreover, the gain in employment would not be attributable to TIP as such. Any successful incomes policy would have the same effect. The proper comparison, in evaluating the possible employment benefits of TIP, is not so much with the status quo, but with the results of an alternative incomes policy.

OTHER TECHNICAL PROBLEMS

The discussion so far has abstracted from all technical problems of tax administration except the crucial one of how to define a wage increase. Obviously there are a great many. We list a few, giving a summary indication of the issues involved.

(1) *Coverage.* TIP, focusing on the corporate income tax, can be most easily applied to corporations. Application to unincorporated business or non-profit institutions would create difficulties. On the other hand, it can reasonably be asked whether TIP should be

applied even to the totality of corporations. Small firms, if they are unionized, usually confront a much larger union so that bargaining power is very unequal. In such a situation, the union might indeed be indifferent to the firms' profit position, because its demands would be guided by considerations extraneous to the particular negotiation. Freeing small firms from the paperwork of TIP would be a major administrative advantage. A good case can be made, therefore, for applying TIP only to large firms, say with profits of $1 million or some multiple thereof. Any cutoff point, to be sure, creates inequities and administrative difficulties. But such cutoffs are not unknown in corporate taxation.

It is true also that low profits do not necessarily imply a small firm. For the effectiveness of TIP, however, exemption of a moderate number of large firms with low profits would not matter greatly. Low profits should by themselves exert a substantial restraint on wage increases. Exemption from TIP would avoid aggravating the problems under which firms in that situation already find themselves.

(2) *New firms or defunct firms.* Special provisions would be required for large firms that disappear or emerge as a result of mergers and similar corporate reorganizations. Where ongoing enterprises are concerned, this should not present insuperable difficulties under any of the techniques 1 – 4. Where an enterprise stops operating altogether, or a new one is created, both the presumptive profit situation and the presumptive size of such enterprises suggest that coverage by TIP would not be important.

(3) *Existing Contracts.* Whether existing long term "excessive" wage contracts should be honored or excluded from the TIP raises difficult legal and institutional questions. The inequities arising here, however, are those that would occur also under a price and wage freeze. Contracts entered into shortly before and in contemplation of the enactment of TIP could be included by making TIP retroactive to the date when it was first legislatively proposed.

(4) *Public Utilities.* Since public utilities ordinarily are allowed, by their regulatory authorities, to earn some specific rate of return, the possibility of tax shifting clearly exists. It would probably be unwise to try to interfere with this well established procedure for the sake of making TIP fully effective with respect to utilities. However, the "regulatory lag" has often proved sufficiently long and costly to make utilities sensitive to changes in costs and income tax.

(5) *The Transitional Period.* The problems of implementing TIP in any year resemble those of introducing any major alteration of tax laws. While these aspects create problems, precedents exist for dealing with them.

(6) *Construction and Trucking.* These two industries lately have exhibited particularly pronounced upward wage trends. Many of the firms involved, moreover, are small and might be exempted from TIP. The effectiveness of TIP will be somewhat reduced if it cannot easily be applied to two industries where wage restraint is particularly urgently needed. The problems especially of the construction industry, however, are so different from those of other industries that special measures may in any event be needed.

THE TIP: CONCLUSIONS.

Analysis suggests that TIP should be able to make an important contribution to checking inflation. We do not regard it as necessarily more effective than any alternative incomes policy. It is simply less of a departure from reliance on free markets. Going beyond fiscal and monetary restraint to a TIP is less of a wrench than going to some form of direct intervention in wage and price setting.

The enactment of TIP will take time, perhaps something of the order of a year after it has first been seriously considered. If in the meantime inflation continues at a high rate, it may be necessary to move to another form of incomes policy that could be adapted almost instantly. Even then, however, TIP deserves consideration as a long run solution. One of the clearly demonstrated characteristics of other forms of incomes policy is that, even if they are effective initially, they tend to break apart in the course of time. The effectiveness of TIP should improve over time as administrative techniques are perfected and the market learns to respond to it.

FOOTNOTES

1. Our work was linked by Leonard Silk in articles in the *New York Times,* Nov. 18 and 25, 1970. Also, editorial, Dec. 6, 1970. Earlier writings include: Henry Wallich, *Newsweek,* September 5, 1966, December 14, 1970; *New York Times,* December 16, 1970.

Sidney Weintraub, "An Incomes Policy to Stop Inflation," *Lloyds Bank Review* (January 1970) and a truncated statement on "A Proposal to Halt the Spiral of Wages and Prices," *New York Times,* Nov. 29, 1970.

2. A. C. Pigou, *Industrial Fluctuations* (Macmillan 1929, 2nd ed.) p. 33. Pigou, among others, pointed out that prices or unemployment could serve as a cyclical measure for their movements were inverse. R. F. Harrod, similarly, argued that the empirical law was that prices and output moved in the *same* direction. This relation, therefore, was violated in late 1970. See *The Trade Cycle* (Oxford 1936), p. 39.

3. Sidney Weintraub, "Keynes and the Monetarists," *Canadian Journal of Economics* (February 1971) and "The Incomes Policy In The Monetarist Programme," *The Bankers' Magazine* (August 1970).

Chairman PROXMIRE. Thank you, Mr. Wallich. I want to thank all you gentlemen for competent and most interesting papers and for a great deal of imagination.

Mr. Klein, I think your suggestions are certainly impressive for helping us to consider how to meet the profit, a problem in stabilizing prices and wages with equity.

You put it in a very tempting guise. You are a fine salesman. You recognize what we want. You say what you propose will give us 3½ percent unemployment, a 2 percent price stability—only a 2 percent rise in the Consumer Price Index. You make it most attractive. Then you show that this comes out of the Wharton model. Wharton has a very good reputation for accuracy and for responsibility.

But you made a very concise statement. How does your system really work? Give me an example. How would this affect a company which, say, would be enjoying high profits in the coming year? What would the profit guideline do to either reduce that profit or what effect would it have on it?

Mr. KLEIN. Well, you must understand, of course, that the statistical scheme in which these rules are worked out is a national scheme, what we would call a macroeconomic scheme. I like it from that point of view, because I think detailed controls are going to be extremely difficult to implement in the near term now. I think it would actually work very much as Professor Wallich suggested. We would decide upon an overall national tax rate at a corporate level in order to make national corporate profits after tax come out right in terms of our guideline rules and every individual corporation would be taxed according to this national scheme.

Chairman PROXMIRE. So that if a firm were very efficient and did a good job, held down the costs, it would get the benefits of its efficiency in higher profits that would not be taxed away?

Mr. KLEIN. That is right.

Chairman PROXMIRE. It would have a clear incentive for keeping its costs down.

Mr. KLEIN. Yes, I think that is one of the virtues of this kind of scheme.

Chairman PROXMIRE. It would work then as Mr. Wallich describes it. What assumptions would you have to make?

Supposing this—this would require, of course, legislation, would it not, tax legislation?

Mr. KLEIN. That is right, and quite flexible tax legislation in the sense that we might decide with a certain amount of time delay retrospectively what taxes were in the last 6 months or so. Of course, we have a history of voting in retroactive taxes and it is not an unheard of scheme.

We would make mistakes, of course, by setting the taxes in advance according to these rules. But if we were accurate enough in extrapolating ahead, we could do it in advance rather than retrospectively.

Chairman PROXMIRE. I can see why this might be attractive to labor, perhaps. I cannot understand, however, how this would work in providing an incentive for pricing in the concentrated industries. What would this do to persuade a company to hold its prices down if it had the pricing power that the steel industry has, the automobile industry has, and so forth? Why would they not just go ahead and increase

their prices as they have in the past and pass on the corporation income tax increase in higher prices?

Mr. KLEIN. There are two approaches to this. One is by a change in the corporate rate and the other is through an excess profits tax. Of course, that is a dirty word these days and many economists have come out against it as being a very bad tax. If it is in the form of an excess profits tax, then there is no incentive to raise prices because the whole gain from the price increase would be taxed away. There is an incentive for a productivity gain, because all factors, both the labor factor and the capital factor, will share together.

Chairman PROXMIRE. You are getting away, then, from a national application of this tax. If, for example, General Motors through greater efficiency were able to hold its costs down and increase its profits, then would your express profits tax take the profit which they achieved because of the intelligent application of capital and labor?

Mr. KLEIN. We would say that—in retrospect, the national rate of taxation would be applied, so that all firms together would have to pay taxes. It would leave them profits that are no more than the guideline rule.

Chairman PROXMIRE. All right.

Mr. KLEIN. Now, we could do this also through regulating the corporate rate.

Chairman PROXMIRE. But I do not want to get away from what then happens to this firm that is able to determine its prices on the basis of its own decision without respect to the market.

Mr. KLEIN. I am saying then that this firm's after tax profits as a rate of return on its capital shall grow as productivity grows. And it has an incentive to try to get the productivity gain, but it does not have an incentive to try to get the price gain.

Chairman PROXMIRE. Well, you have to have a pretty thorough and meticulous examination of its costs.

Mr. KLEIN. Yes.

Chairman PROXMIRE. And some pretty competent analysis of its productivity.

Mr. KLEIN. Yes.

Chairman PROXMIRE. That is not easy, is it?

Mr. KLEIN. There is one more somewhat subtle point in our analysis. That is that this is a transition scheme for a period of, say, 3 or 4 years. But in our calculations on the longer term basis, the profit rule becomes redundant after the transition period has passed. That is due to the stabilization of prices and the growth of investment and capital base on this scheme. So that we would not have to restrict profits after 4 years, 5 years, of this.

Chairman PROXMIRE. But this would provide that in order not to complicate your fiscal policy—after all, you would increase your taxes as profits go up; therefore, you would increase your tax collections; therefore you would have a tendency to depress the economy, would you not? And you provide that you would increase your expenditures, as I understand it, as——

Mr. KLEIN. That was a part of it.

Chairman PROXMIRE. Is that not very difficult to do as a practical matter?

Mr. KLEIN. It means hitting it on the button, perhaps, in trying to be fairly accurate in our forecast. But I think it is definitely worth a

try. I think we have a good record in trying to anticipate what is happening in the economy, but we can do better. It is much better, than not trying a scheme like this at all.

Chairman PROXMIRE. I want to thank you, as I say, very much, for a most original and thoughtful proposal. We certainly want to examine it in great detail. It comes on me so suddenly that it is hard just to digest it and come to much of a conclusion on it right now. I want to study it in detail.

Mr. Krause, in your statement, you say, "If the United States raises the price of gold, then by implication, the United States must provide a market in which the higher gold price is effective."

Why in the world do we have to do that? We had a presentation by Mr. Bernstein here in which he suggested that we raise the price of gold by 8 percent or so to $38 an ounce, it would not compensate any speculators, but it would help other countries adjust. Now we are asking them to go all the way in revaluing their currency, a very painful action, politically a very unpopular action in every country, adversely affecting their balance of trade. Why do we have to do it in SDR's? Why can't we do it in gold without changing our gold position at all, still saying we are going to have the same policy the President announced on August 14; that is, that we are shutting the gold window and we are not going to trade in gold.

Mr. KRAUSE. Mr. Chairman, the question of how painful it is for other countries is a question only of the exchange rate we come to. It is not a question of how it is done, whether they have——

Chairman PROXMIRE. Yes, it is how it is done. If the other country has to take the action of revaluing the yen, of increasing the value of the yen all the way, that is much more painful, it would seem to me as a legislator, if I had to vote for something like that with respect to the dollar, much more painful than if the United States goes part of the way, a relatively small part of the way, and increases the value of gold and decreases the value of the dollar.

Mr. KRAUSE. It makes no difference to the manufacturer.

Chairman PROXMIRE. Well.

Mr. KRAUSE. Let's take the political side of it. Take the governor of the Central Bank of Japan, if Japan appreciates, his assets do not change at all. If, however, the U.S. dollar devalues relative to gold, he has to show a loss on his books equal to that dollar portion.

Chairman PROXMIRE. Yes, but then he can take it out on the U.S. Government, on the Congress, which would have to act in those circumstances, and on the President. We as elected officials are pretty much insulated from any political retaliation from the Japanese or German industrialists or from any other business people who would be unhappy. We are far from insulated, however, from the impact on our own producers, labor and management, just as are they from theirs.

Mr. KRAUSE. Yes. I would think that if we are going to do some scheming to ease their pain, then we should do something that is useful for them and not one that has counter effects.

Mr. Bernstein's scheme is not all very different from mine. He would have the United States announce a rise in the price of gold, but somehow imply that it has no meaning.

Chairman PROXMIRE. Not just somehow imply, say so.

Mr. KRAUSE. I would have us raise the value of SDR's, to which we will revert when the system is reformed. This fits into my scheme of

what the future of the monetary system should be like. I am concerned that the Bernstein scheme implies that we will subsequently come to deal in gold again. That is the sole difference between us. He wants to make the devaluation in terms of gold. To me, that implies we are going to trade in gold.

Chairman PROXMIRE. I agree with your position and from my own recollection of the testimony of Mr. Bernstein, he seemed to agree that we would not get back to gold.

I would like to ask Mr. Wallich to give his reaction to the suggestions by Mr. Krause.

Mr. WALLICH. Well, I agree with Mr. Krause that in the final analysis, it works out the same way economically whether all countries revalue in different degree against the dollar or whether the dollar goes down vis-a-vis all countries and the countries at the same time make these differential adjustments among themselves. Politically, I see the great difficulty of a large revaluation. That is why I think we need the surcharge to negotiate. The longer we wait, the higher currencies will float in any event. But the final push has to come from taking off the surcharge with a simultaneous revaluation of other currencies.

Shifting from gold to SDR's seems to me a sound long run proposition. I do not believe the United States should put itself in a position where it has to settle all deficits in SDR's. As I said during my testimony, part of what is called our deficit is the result of transactions in dollars which happen to be the vehicle in which all the world operates and in which short term capital movements take place. They really do not reflect any deficit of the U.S. economy. We should not be asked to contract our economy in order to sweat out such a deficit, or pay over tens of billions of reserve assets in order to redeem the acquisition of dollars by central banks.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. I have just one question, but first, I came because I have great respect for the witnesses. I wanted to hear Mr. Wallich and the others. But I have one question for Mr. Krause.

I am interested, intrigued by your plan, which I regard as especially novel, establishing the link based on the demonitizing of gold; that is, a new credit for developing areas. Could you help me with this one point, which is important to me? I am very troubled by the so-called French-induced gold clause in the SDR's as perhaps invalidating their being the linch pin for a reserve asset or composite currency, call it what you want. I like the idea. It does tend toward an international Federal Reserve and does involve discipline by the IMF. But I am concerned about the so-called French-added gold clause which makes the SDR's completely inflexible. Could you and the other witnesses speak to that?

Mr. KRAUSE. You put your finger on a very important point. Even if the others agree not to trade in gold, and if the IMF rules are not changed to accommodate this, then as soon as the United States comes back under the articles of agreement, we are obliged to trade in gold with the IMF because of the gold clause. Therefore, the monetary system must break that link.

I know that is politically difficult for some other countries, but I think it is possible to meet their needs without at the same time forc-

ing the United States to deal in gold. My proposal is addressed to the solution of these problems.

You do permit a gold bloc among those countries that want to trade in gold as long as they do not force their desire to trade in gold on other countries that do not want to. And indeed, it is possible to both live in this world and to have reserve needs taken care of by SDR creation.

Senator JAVITS. Thank you.

Would the others choose to comment on that?

Mr. WALLICH. I think we should be aware that our decision not to trade in gold is in itself a great bargaining weapon, because it deprives what has been called the other side—in other words, the gold bloc countries—of the use of part of their reserves with respect to dollar countries. If we do not buy dollars, their reserves have a diminished usefulness when they need dollars.

Now, there are ways around that. Other countries can always sell gold to IMF, but that has limits. It is also ultimately true that if we do not buy gold and do develop a surplus someday, the dollar will float up unless we buy foreign currencies. But subject to these qualifications, our decision partly to demonetize gold is an important bargaining instrument that we have to use appropriately.

Senator JAVITS. And would you agree with Mr. Krause that we should use it in trying to break this link which the French have formed into the SDR?

Mr. WALLICH. Yes. I see no long run benefit from that link. I recognize the French have a special interest in gold, but I do not think that that interest should stand in the way of world monetary progress.

Senator JAVITS. Mr. Klein, would you be willing to comment on this?

Mr. KLEIN. I am a little too far removed from the intricacies of international finance and I would rather not comment on it.

Senator JAVITS. Thank you very much, gentlemen. I appreciate that, because I think we have to realize that the Europeans are now in the process of painting us into a corner as the bad man of the world. I think it is extremely important that we indicate that there is a very real and serious built-in limitation of the SDR's when we come to the international monetary negotiation. I think it is fair to say that the President has the feeling that the United States has to be tough in pursuance of its own interest. But I think it is unfair to say that we have lost our interest in world cooperation, that we think that we can go it alone, that we spurn others' requirements, that we are going to be just cool and say come with your propositions and we will look at them.

I think it will be found that directly incident to the end of the 90-day freeze will be also a very considerable unfreezing of the American attitude, which had to be rigid momentarily, but which really is not, and which is very anxious to negotiate out a plan which will be important for the world and important for the developing countries. I only hope and pray that Japan, Germany, France—which will be very important, as I have just pointed out—consult the same standards in what they propose to do.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Senator Javits, I would like to state that I think what you have just said is a critically important statement and I trust it will be the policy of our Government. You can speak with some authority on that, having talked to the President recently.

Mr. Klein, I think all three of us—Senator Proxmire, Senator Javits and myself—could applaud the emphasis you have placed on productivity increases. We know they are essential. I am not sure that I would be inclined to rigidly say these are the only incentives or adequate incentives. Let us take a specific case.

Company "A" puts a million dollars of available capital into new machine tools and equipment, thereby increases productivity, and pockets the increase in profits.

Company "B" takes a million dollars and puts it into research and development and comes up with a startling new product, introduces that new product, hires a lot of people, increases its sales significantly, does not increase its overhead cost, its fixed expenses, and incurs a very extraordinary profit as a result of this. Under your plan, can he keep it or not?

It does not seem as though he would be able to keep it. It looks, therefore, as though you are saying do not put money into research and development, put it into productivity increases only. If that is true, you would end the whole free economic system and the free market conditions that we have.

Mr. KLEIN. I would like to say that we are asking for labor to take a wage geared to productivity and I think we do not have a ghost of a chance of success in that kind of a request unless simultaneously, we will ask recipients of other forms of income to take the same kind of guideline rule. I think to shake the inflationary bias that has crept into the economy, all sides have to participate together for a limited period of time in order to get back on a stable growth path.

A technical issue may be raised in the sense that new firms that have not yet established a capital base could be allowed rather large profits in this interim period until the capital base is established. I have put forward a rule of computing rate of return on capital and I think that one has to build in a safeguard in order to stimulate venture capital for the really new ventures that we want to see forthcoming.

Senator PERCY. Well, you admit, then, that you cannot stick rigidly to the formula that you have laid down, that you have to provide leeway?

Mr. KLEIN. I want to see something like this scheme adopted, but I think there are many compromise aspects that could be implemented in working out these rules. However, I want them to be rather firm and good rules so that people will not be free to violate them.

Senator PERCY. Well, much as I admire productivity increases and want to emphasize them, a strict adherence to your program and plan would end our economic system faster than any I can think of if rigidly laid down. The problem is how do you get away from a temporary thing? But I do think it is a valuable contribution to stimulate our thought.

Mr. Wallich, you have previously testified that we should be at full employment with only 2 percent inflation after 1973. Do you believe that the new economic policy is leading us in that direction at this time?

Mr. WALLICH. It is leading in that direction but not with that timing. I would be surprised—well, 1973 is too long to predict. If we find a good phase 2 policy and if it is adhered to and—this is very important—if we do not behind the shield of this policy overexpand our monetary and fiscal policy, then I think 2 percent by 1973 is in the ball park. But I would be concerned if we were to unleash once more the forces of demand-pull inflation. I do not think any set of guidelines is likely to stand up against that. We have tried it once before and have failed.

Senator PERCY. Mr. Krause, I think I hear increasingly across the country in the business community, particularly, that the United States has received a rather raw deal in our international trade negotiations. I think this feeling is reflected in the comment that was made that the United States is a man fighting with one hand tied behind his back. I think this opinion is contributing somewhat to the increasing protectionist mood, to an isolationist spirit in the country. Do you think the United States has been a bad trade bargainer over the years? Are the trade discrimination problems we face today such as the common market agriculture policies, Japanese quotas, and so forth, a result of weak, ineffectual representation of our trade interests?

Mr. KRAUSE. Mr. Senator, I do not share that belief. Let me start from the other side. There is some justification for that feeling—not that we have not negotiated good agreements, but that some of the enforcement of the agreements has not been carried through. Indeed, every discrimination that Japan has maintained has been illegal. If our hands were clean, we would have taken them to GATT for a remedy. The truth is that our restrictions are no better than their restrictions. And when we go and ask for restrictions on our side but want them to remove theirs, then we are in a pressured political negotiation.

You cannot go to GATT and say the rules are being broken, because we are breaking them ourselves. This is the same but less true of the Common Market. We are fairer in our negotiations with the Europeans than they are with us. When I was in a previous administration, I strongly urged that the whole Common Market agricultural policy be pursued in GATT since it was never ruled legal under the articles of agreement; and indeed, the whole scheme should have been ruled illegal in the sense that the agreement was not fully lived up to as we understood it.

So if the U.S. negotiators are to be challenged, I think that it would be placing the blame on the wrong person. The enforcement of the GATT agreement has been seriously undermined; this questions the whole efficacy of the GATT institution as an enforcement mechanism. I think that once we get finished with the monetary system, that has to be the first order of priority. It is an ineffective enforcement agency.

Senator PERCY. I think that many of us have supported the President's balanced program as a temporary measure to rectify problems of the past and to give us a bargaining position right now. But I share Senator Javits expressed concern about the continuation of the surcharge, the border tax, too long. I am afraid that industries might get used to this protection. It is like opium once we get on it, and it is going to be very, very hard to get off of it, particularly in a political atmosphere. Witnesses that have appeared before this committee have testified that the longer the surcharge remains in effect and exchange rates

continue uncertain, prosperity is going to be hurt in the free world.

How long is temporary? How long can we sustain this border tax before we must settle the major questions of exchange rates and trade balances—before very serious damage is done and real retaliation sets in? Our hands are not clean at this particular stage.

Mr. KRAUSE. You pose it in terms of time and I think the way to answer it is in terms of conditions. The United States cannot refuse a reasonable deal on exchange rates and try to maintain that border tax, because that is the precedent. The countries that have used it have done away with it when the exchange rates were changed. I think that it is a very potent bargaining weapon, as Professor Wallich agrees, and that we have to be prepared to remove it at the time that agreement on exchange rate adjustments can be reached. And I think that it can be done in a matter of months. Indeed, it could be done over a weekend because we know approximately what the change should be.

Why I say months is because some countries have to prepare their businesses for a kind of change in rights that may well be coming. But in terms of knowing what we are going to do, I think we could do it over a weekend.

You know, the timing is more interesting on the domestic side. There is a unity in the President's package that he pointed out and some observers had missed. The import surcharge and the devaluation of the dollar, whether it is done by the appreciation of other currencies or by ourselves, are inflationary measures. These are the ingredients that go into the phase 2 policy. The longer that surcharge remains in effect, the more inflationary it becomes. The greater an exchange rate change we receive, the more inflationary pressures we build into our economy. This has to be taken into account when we talk about price stability; because as is often pointed out, the competitive improvements you get today through a change in exchange rates can be lost in subsequent inflation.

So we do not want to overdo this change. We want to be reasonable not only because we fear retaliation but because our domestic economy cannot take it anyway.

Senator PERCY. Mr. Krause, you sold one copy of your book, "Sequel to Bretton Woods." You have sold another copy.

Chairman PROXMIRE. I will see if I can have the committee order a copy so I can read it.

Senator PERCY. Why do you not have them order three?

Mr. Wallich, could you comment on that last question? Is temporary in your judgment a weekend, over 3 months? I understand you are thinking in terms of several years, which is hardly temporary.

Mr. WALLICH. Well, a year or more, I would say, is a possibility. It is not inconceivable that a complete realinement could be negotiated over a weekend. I do not think that the very detailed things that need to be negotiated, about troop support, foreign aid, and reform of the IMF, could be negotiated over a weekend.

I do not worry so much about the difficulty of removing the surcharge or the inflationary effect of keeping it on, because if, at the time when we remove it, others raise their exchange rate or we lower ours, then there is no change in that regard. All that happens is that a change in the exchange rate substitutes for the surcharge. And what

is more, the inflationary effect of an exchange rate change will be greater because it will not only affect our imports, the competitive price of imports, but also the price of our exports, which will tend to rise. So while it is quite true that both devaluation or revaluation of currencies and the surcharge are inflationary, there is no way of getting from that by removing the surcharge.

Senator PERCY. Thank you very much.

Chairman PROXMIRE. The rollcall buzzer rang about 2 minutes ago, but I think I have time to ask one more question if you would permit it.

I would like to ask Mr. Klein and Mr. Wallich each a quick question.

Mr. Klein, our staff has been working all week, as I understand it, on your model, and they cannot figure out what monetary policy goes into it. Can you enlighten us?

Mr. KLEIN. Yes, I think we have an assumption about a stable discount rate. I think it is a 5-percent rate. Unborrowed reserves are growing at about the rate of the last 2 or 3 months. I think it produces about a 4- or 5-percent growth in total money supply. It is slightly easier than the monetary policy of the last 6 months or 9 months, but not tremendously easier. This brings somewhat lower interest rates but not very much.

I can give numerical values to your staff for our inputs.

Chairman PROXMIRE. I wish you would do that.

Mr. Wallich, what has trouble me a great deal about the President's program is it is weak on stimulus. I was gratified by your statement revising your April judgment. At that time you had said we did not need more stimulus, that it might be counterproductive or inflationary. You say now we might be able to us more.

You proceed to say, no mechanism of guidelines can stand up to demand pull inflation. Are we not very far away from that with more than 6 percent of our work force unemployed, with our plants working so far below capacity, with the enormous need for more jobs to meet the people coming into the work force?

I calculate we are going to need an additional 4 or 5 million jobs to hold unemployment steady in the next year at its present 6-percent level.

Mr. WALLICH. It will take half a year to a year for stimulus to become effective in the sense of permeating the economy, while the capital goods industry goes to work and the money spreads through the economy. When the tax credit comes off, the expansionary effect is by no means done. It keeps spreading and increasing demand. A year from now we might be at 5-percent unemployment—that was Otto Eckstein's calculation. I realize one can be of different views about that. When we are at the 5-percent level, ought to think about phasing into the full capacity ceiling, what Mr. McCracken has called the reentry problem, and we ought not to be pushing very hard at that point.

I would feel safer———

Chairman PROXMIRE. We are getting more and more pessimistic. There was a time when administration economics agreed that 3½-percent unemployment was acceptable, then 4. Secretary Connelly now calls 4 percent ridiculous, and says 4½ is the best we can do. You are saying 5 is the reentry ceiling. This very discouraging.

Mr. WALLICH. Well, Senator, to exonerate myself at least partly, I did present a scheme here for lowering that critical point. In other words, a scheme for bringing down the Phillips curve and the level of so-called full-employment unemployment. But I do not think we do ourselves any good without that kind of protection and hitting into the ceiling.

Chairman PROXMIRE. I want to thank all of you gentlemen very much. This was most interesting and helpful. We are going to recess until tomorrow morning at 10 o'clock when we hear from Mr. Gullander of the National Association of Manufacturers.

Then on Thursday, we are hearing from Professor Samuelson and Professor Freedman from the same platform at the same time.

Senator PERCY. Mr. Chairman, in view of the fact that we were not able to ask a number of questions because of this vote, would it be possible to submit questions to our witnesses?

Chairman PROXMIRE. Yes; we would appreciate it very much if you would answer them.

Senator PERCY. If they can send them in, we can put them into the record at this point.

The nature of your testimony has been so profound and the subject so important that the record would not be complete unless you are given a chance to expand on some items.

Chairman PROXMIRE. May I suggest that when you correct your transcripts, you answer the questions that Senator Percy and I and others may send to you.

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

RESPONSE OF HENRY C. WALLICH TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR PERCY

Question 1. Should the dollar be devalued as part of an overall settlement involving foreign currency revaluations, IMF rules, and trade measures? If so, by roughly what amount?

Answer. A change in the United States Government's well established policy of maintaining the present price of gold should be considered only in the presence of equally well established conditions which at the present time do not exist. Among these conditions would be:

1. Binding assurance by other countries that they would not nullify a change in the dollar price of gold by a similar change in their own gold parity.
2. Evidence that a desirable change in the value of the dollar in terms of other currencies cannot be achieved without a change in the dollar price of gold, and that it can in fact be achieved by such a change.
3. Creation of a world monetary system under which the United States would not be required to make dollars convertible into gold without limit.

The way in which the foregoing three conditions were met would determine whether and by how much it might be appropriate to change the dollar price of gold. In any event, however, if such a change were undertaken at all, it should be limited to the narrow range within which exchange rates might be realigned, and not extended to the very large changes that have typically been urged by proponents of a return to a world gold standard.

Question 2. What economic disadvantages would there be for the U.S. in a dollar devaluation?

Answer. The economic disadvantages for the United States of a rise in the dollar price of gold are several.

1. Raising the price of gold carries the danger of reemphasizing the role of gold in the world monetary system and of moving back toward a technologically and economically inferior system.

2. A change in the dollar price of gold might reduce the pressure upon certain other countries whose currencies are particularly undervalued to realign their currencies with respect to all others.

3. The United States would have to pay compensation in connection with our obligations denominated in gold, such as obligations to the International Monetary Fund and those established under the provisions governing Special Drawing Rights. To the extent that this compensation does not represent a sacrifice of real resources it nevertheless represents a burden on the Federal budget.

4. The "profit" from a rise in the price of gold has inflationary implications, and I do not regard it as an adequate offset to the various types of compensation that the United States may have to pay.

The weight of these objections depends of course upon the magnitude of the change in the price of gold contemplated.

Chairman PROXMIRE. The committee will stand in recess until tomorrow.

(Whereupon, at 12:20 p.m., the committee was adjourned until 10 a.m., Wednesday, September 22, 1971.)

THE PRESIDENT'S NEW ECONOMIC PROGRAM

WEDNESDAY, SEPTEMBER 22, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room G-308, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Fulbright, and Javits.

Also present: Loughlin F. McHugh, senior economist; Richard F. Kaufman and Courtenay M. Slater, economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Bander, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Last Monday, this committee heard testimony on the President's new economic program from one of the outstanding labor leaders of our times. Today we shall have the opportunity to discuss the NEP with one of the leading industrialists of the Nation, Mr. Gullander, president of the National Association of Manufacturers. Mr. Gullander has been president of that organization for almost a decade. Prior to that, he held top-level positions at General Dynamics Corp., Weyerhauser Co., and General Electric.

Mr. Gullander, we all know how vitally important is the President's efforts to contain inflation, reduce unemployment, and get the economy quickly back on the path of stable economic growth.

All of the witnesses who have appeared before this committee have stressed the essentiality of support and cooperation from all major elements of our society in the trying period ahead.

It did not appear at first that this support and cooperation would be forthcoming, but as the weeks have passed, there appears to have been some compromising of differences. I would now say that there is reason to hope that we can develop a program which will bring about a consensus.

I recognize that there are some differences in the way labor and business want phase 2 to operate and these are matters which I hope we can discuss today.

Of course, we also want to cover all major features of the program, for example, how to handle inequities which have developed in the freeze period; what kind of fiscal package will most quickly return us to full employment; how should the return to capital be treated to insure the maintenance of a balance of equity between labor and

capital; how can the consumer interest best be protected; what congressional actions are called for?

That is a big order, but you are a man with fine experience. You have an excellent statement. I know you agree with me that these are all highly important issues and have addressed your remarks to them.

I might just point out before I call on you that Sol Linowitz, chairman of the National Urban Coalition, who was scheduled to appear here today with you has informed me that a last minute tieup in his scheduling made it impossible for him to appear at this time. We hope we shall have a chance to hear from him at a later date.

You may proceed as you wish. If you would like to deliver your full statement, including your resolutions, I will be delighted to hear it. Go right ahead.

STATEMENT OF W. P. GULLANDER, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. GULLANDER. Thank you, Mr. Chairman. As you have already indicated, my name is W. P. Gullander. I am president of the National Association of Manufacturers.

It is a privilege to come before your committee at this time of critical decisionmaking on national economic policy. I am here to represent the National Association of Manufacturers, an association of manufacturing firms of all kinds and sizes and located in all sections of the country. My purpose is to present and explain the NAM's official views on the issues of Government economic action at this juncture.

My authority for this statement of the NAM's views is a series of three resolutions adopted by the NAM board of directors—the official policymaking body of our association—on September 14, just 8 days ago. I should explain to you that the NAM board of directors is not a small inner circle but a large body, broadly representative of our membership. There were almost 100 directors present at the meeting on September 14. The resolutions were thoroughly discussed before being adopted.

I will present these resolutions to you, and add some comments as to the reasons for taking the indicated stance.

The board prefaced its resolutions with the following explanatory comments:

> Rarely in the history of the United States has there been a time when the economic interests of this country, both domestic and international, have been more seriously threatened. It is imperative that American industry make every effort in the months immediately ahead, both in its own and in the overriding national interest, to constructively contribute by taking concrete actions to quickly and effectively restore our economy to a position of real strength.
>
> The NAM Board of Directors believes that no single remedy, in itself, will prove to be effective in the process of attacking the problems of inflation, unemployment, fiscal and monetary stability and international trade, rather, that a systematic, comprehensive approach, including a series of incentives to accelerate economic growth, will be required, some on a permanent, and others on a temporary basis. The accompanying resolutions embody such an approach.
>
> The Board of Directors of the NAM believes that some of the measures recommended by these resolutions are contrary to the basic principles of a free, competitive enterprise system, and should only be imposed on a temporary basis. The Board refers specifically to the wage-price guidelines and the implementing control mechanism established thereto.

SUSPENSION OF NAM POSITION IN OPPOSITION TO CONTROLS

The official text of the first resolution of the NAM board of directors on September 13 reads as follows:

Be it resolved, that the Board of Directors of the NAM, in an attempt to advance the economic well-being of the nation and in recognition of the national emergency that now exists, temporarily suspends its existing policy in opposition to wage and price controls, or to any governmental mechanism implemented in connection with stabilizing wages and prices.

Mr. Chairman, it took considerable soul-searching for the National Association of Manufacturers to suspend, even temporarily, its historic stand in opposition to wage and price controls or to any direct intervention by Government in the price and wage setting process. We have always believed, and still do, that such measures are incompatible with a free enterprise economy. We have been led to this action only by a recognition of the exceptional and overwhelming needs of the present economic situation. Inflation had become a self-sustaining process, both producing and produced by a widespread inflationary psychology. This was accompanied by an unsatisfactory rate of production and employment, and a rapidly mounting balance-of-payments deficit. It became necessary to break that pattern by an extraordinary form of Government action—action which the President initiated on August 15.

Heavy emphasis should be laid on the word "temporarily" in this resolution. We have no intention of supporting any permanent system of wage and price intervention by Government. It is our expectation and desire that a return be made as quickly as possible to the customary reliance on free markets.

If this is to be achieved, it is, of course, essential that the Nation's fiscal and monetary affairs be conducted in such a way as not to recreate inflationary pressures of the demand type. The existence of such pressures would both impair the current workability of the stabilization system, and postpone the time when we will be able to do without it.

In order that the intention of removing controls at an early date might be more than a pious hope, I would suggest that some advance thought be given to a mechanism for determining when controls might be terminated. In any case, I urge that the goal of an eventual return to free markets be kept always at the center of attention. Controls may be a useful crutch in a time of economic emergency; if we allow ourselves to become dependent on them, we will always be economically crippled.

WAGE-PRICE STABILIZATION

I will now read to you the second of the three resolutions of the NAM board of directors dealing with present national economic policy questions.

Be it resolved, that the NAM Board of Directors believes that the following program will prove to be the most effective approach following the termination of the 90-day "freeze" announced by the President of the United States on September 9, 1971.

That there should be designated by the President of the United States, through his authority under the Economic Stabilization Act of 1970 (as amended), an advisory Wage-Price Stabilization Board, operating directly under the Cost of Living Council; and, that this Stabilization Board be empowered to recommend

to the Council guidelines for controlling increases in both wages and prices; that the guidelines with respect to wages, including fringe benefits, be based upon productivity; and that the guidelines with respect to prices be predicated upon a "pass through" formula reflecting cost increases from an appropriate and equitable base, and that individuals appointed as members of this Board should be selected solely on the basis of their known objectivity, and not as "special interest" pleaders. Any such Board established because of the national emergency should be designated as a temporary mechanism.

This resolution outlines our views as to the proper method of operation of the wage-price stabilization system after the present freeze expires.

Note that it is not a flat endorsement of World War II type administered controls since we in no way mean to infer that these or the bureaucracy which necessarily accompanies them, are necessary under present circumstances.

Keeping this qualification in mind, we believe that the authority to control wages and prices delegated by Congress to the Persident, should in practice be vested in the Cost of Living Council. This is on the principle that governmental authority should be exercised by Government officials.

The Cost of Living Council will, of course, need all the information and wisdom it can get from any source. We, therefore, see a useful place for a Wage-Price Stabilization Board, operating in an advisory capacity to the Cost of Living Council. We would, however, urge strongly against making this Board a combination of persons each of whom is designated to represent a particular interest group. Even if a wide spectrum of interest groups is so represented, this is not, in our view, the way to achieve the balance required for a successful stabilization effort. On the contrary, it converts that effort into a process of controversy, bargaining, and compromise between various special interests—the very process which has contributed to the present inflationary problem. We believe that all members of a Wage-Price Stabilization Board should represent the same single interest—that of the American people as a whole.

Of course, the membership of such a board should be drawn from men of many different types of background. But they should be men of sufficient objectivity and vision to transcend the limitations of their own individual histories and to face their responsibilities from the broadest pont of view. The important thing is that the members of the Board, whoever they may be, should be instructed to act as representatives of the whole Nation, rather than as defenders of the narrow interests of some segment. Wage and price stabilization should be regarded as a technical problem, and not as an adversary procedure.

Now to comment specifically on the methods of determiing guidelines for wages and prices:

The guidelines for wages, based on productivity, should be applied to all forms of compensation for a person's services. We know well enough what the general trend of productivity has been over the past. The historical growth rate has been in the neighborhood of 3 percent a year. The important fact is that recent wage increases, particularly in highly-unionized industries, have been several times as great as any reasonable productivity criterion.

We would urge that, once a guideline for wage increases has been decided upon, it should be applied as rigidly and as universally as

possible. The allowance of any substantial exceptions would quickly destroy public support for adherence to the guideline in other cases, and the whole effort could be aborted.

Such a rigid enforcement of the guidepost would require some actions by Government that we would find difficult to defend in ordinary circumstances. It might, for example, require the abrogation of contracts entered into earlier in good faith. All one can say is that any wage and price control system, by its very nature, has to override commitments made between private parites in the precontrol period. The practical consideration is that we do not see much hope for success in a wage stabilization effort which divides the American labor force into two groups—those who are held to a guidepost figure and those who are able to receive much greater increases in compensation as a result of prior agreements.

The system of controlling prices will, of course, be of critical concern to the members of the NAM. But, from the point of view of the general public, the important consideration will be whether cost-price relationships permit and encourage production of the goods and services they want. From either point of view, it seems to us that the most logical approach to the problem would be to adjust price ceilings by a "cost pass-through" formula. The ceiling price on each item would be calculated by adding, to its actual price in some base period, an amount to reimburse the producer for increases in costs.

This would have to be applied on a product-by-product basis. The alternative—an adjustment of price ceilings on the basis of each company's overall profit position—would lead to chaos in the marketplace. Each company would then have an incentive to discontinue product lines on which costs had risen faster than prices, and concentrate on the more profitable lines. This is what happened during the end of the World War II control period, and the public was unable to obtain many types of goods they wanted and were willing to pay for. That was the most important reason for the ultimate breakdown of controls in 1946.

FISCAL POLICY

The third resolution passed by the NAM board of directors on September 14 outlined our recommendations in the area of national fiscal policy. It reads as follows:

Be it resolved, that the NAM board of directors, in the interest of healthy, stable and sustained economic growth,

(1) Urges the immediate enactment of an investment or other job development tax credit, established on a permanent basis, at the rate of 10 percent designed to stimulate widespread industrial investment in new and rebuilt equipment, and thereby providing, through rapidly accelerated investment, a great stimulus to employment in the industrial sector, and

(2) Endorses the liberalization of depreciation rules (the ADR system) and urges that this remain in effect on a permanent basis, and

(3) Endorses the elimination of the excise tax upon the sale of automobiles.

(4) Endorses the temporary 10 percent surcharge upon products imported into the United States, as part of a broader long-range program to be developed after consultation with industry and designed to improve our balance-of-payments and the climate for fair and equitable international trade. At the same time, however, due care must be exercised that the position with respect to raw materials already in short domestic supply is not worsened.

Finally, the board of directors believes that in both the short and long run, it is imperative that the Federal Government be always aware of, and act in full accordance with, a concern for sound fiscal and monetary policies, taking what-

ever steps are necessary to ensure that no measures temporarily adopted, act to restimulate the inflationary pressures that have marked our recent economic history.

The tax actions recommended in (1), (2), and (3) above would be a partial reversal of the enormous transfer of tax burdens from individuals to business which occurred as a result of the Tax Reform Act of 1969. We believed at that time that such an increase in business taxes was a serious mistake and would be an impediment to economic growth. Subsequent events have confirmed that view. The necessity of correcting that situation explains the character of the tax package that the NAM proposes.

The need for restoring a tax credit on purchases of capital equipment has become obvious in the present state of stagnation of business plant and equipment outlays. We urge that Congress take prompt action on this. The credit should be established at a uniform rate to continue permanently, lest variations in the rate lead to undesirable pileups of capital goods orders in certain time periods, leaving a dearth of orders at other times.

We realize that no Congress can limit the actions of any subsequent Congress. But it would be our hope that a restored investment tax credit would be regarded as a permanent part of the tax system. Past experiments in suspending, reinstating, and then terminating the investment tax credit have been a destabilizing influence on capital goods markets and the economy as a whole.

We have endorsed the enactment of an investment tax credit, the ADR system of liberalizing depreciation rules, and repeal of automobile excises, not because this is a time for general tax reduction but because of the pressing immediate need to remove specific barriers to a national return to prosperity and long-term growth. We would argue strongly against any broad-gage program of tax relief in the present budget situation. We, as much as anyone, hope that substantial tax relief for everyone will be possible in the future. That, however, must await a better control over the total of governmental expenditures. With a deficit of $23.2 billion in the last fiscal year, and another large deficit threatening this year, it would be irresponsible to undertake a program of general tax reduction.

We do not believe in the theory that deliberate enlargement of the Federal deficit will stimulate the economy to higher rates of production and employment and faster growth. If that were true, the American economy ought to have been at the peak of health in recent years. It is our belief that past efforts to apply the alleged stimulation of Federal deficits are among the basic causes of the inflation and instability which have plagued us.

Attempts at economic stabilization through guidelines or controls will certainly fail if they are accompanied by efforts to stimulate the economy through expanding the deficit. On the other hand, a position of fiscal and monetary restraint will greatly improve the workability of the wage-price stabilization measures. It should also help to assure a smooth and early return to free markets.

The gradual impairment of the competitive position of American industry in international markets has, of course, been a matter of grave concern to the NAM. We were greatly encouraged by the President's bold moves on August 15, that is, his suspension of the gold

convertibility and the temporary 10-percent surcharge on certain imports. While this did not, of course, solve all problems immediately, it was at least a seizure of the initiative on the part of the United States. We no longer have to wait helplessly for other nations to adjust exchange rates and trade policy to permit a more balanced flow of international trade. We should not abandon that position of strength until more permanent arrangements can be made to assure that we will not again be left helpless in the face of competitive disadvantages.

ADDITIONAL COMMENTS

Let me conclude by commenting briefly on two fallacies which have entered the discussion of national economic policy during the present emergency, and which might misdirect it.

The first is the idea that, since wages are being controlled, equity requires that there be some form of control on profits. The parallelism is an entirely false one. What is controlled is not the total amount paid by any firm in the form of wages, but the wage rate per hour paid to the individual employee. It is to be hoped that the total payroll of any given firm will be increased as its employment and production expand. This is one of the objectives of the whole new economic program. At the same time, we should expect and welcome an expansion of the firm's total dollar profits. This will be one of the signs of success in the effort.

The correct parallelism is between wage controls and price controls. A productivity guidepost for wages, combined with a cost pass-through system for establishing maximum prices, seems to us to insure balance and equity.

We believe that imposing a limitation directly on profits through, for example, an excess profits tax would be a serious mistake. We can't imagine where anyone finds evidence of the existence of excess profits. But any formula for establishing a profits base is inevitably arbitrary, and many firms might find themselves in the excess profits category for peculiar reasons. Firms which had expanded their operations and increased employment would be most likely to be subject to this tax penalty. Also, as previous experience has shown, an excess profits tax at a near confiscatory rate impairs efficiency since the incentive for curbing costs is destroyed. This is surely not the time (if there ever is one) for penalizing business expansion and productive efficiency.

One other fallacy is the idea that the best way of promoting economic growth is through increasing the purchasing power of consumers, particularly low-income consumers, by tax reductions concentrated in their behalf. Believers in this approach condemn any measure for a reduction of business taxes as a "trickle-down" theory.

We regret the use of such clichés as a substitute for serious thinking. If tax burdens were in fact unduly concentrated upon consumers, the NAM would be the first to agree that emergency tax measures should be concentrated on giving relief to consumers. Industry is well aware of its need for customers.

But the imbalance now is of the opposite character. The ability and incentive of industry to expand its operations, or even to hold its own in competition with foreign producers, has been impaired by the

tax burden it has to bear—especially since the repeal of the investment tax credit. That is why the NAM advocates a restoration of the investment tax credit and the liberalization of depreciation allowances. We can't think of any measures which would more directly assure long-term growth of output and employment and the improvement of productivity. More general tax relief must await more auspicious budgetary circumstances.

Past tax changes, for the most part, seem to have been dominated by the belief that, under any and all circumstances, they should be used to increase the purchasing power of consumers. The present combination of economic problems—a sluggish economy and an unacceptable rate of inflation—is in part the result of repeatedly applying that fallacious approach to fiscal policy. We should not use another dose of the same medicine in our effort to cure present ills. During the past 3 years, the total compensation of employees has increased by 24 percent, while the profits of corporations have declined by 7 percent. Thus it does not seem plausible that our economic ills can be due to a shortage of consumer purchasing power. The impairment of profits—both as the incentive for, and the source of funds for, business expansion—is clearly the critical problem. Tax action to improve our economic prospects should be concentrated on relieving the business tax burden.

Mr. Charman, the most important question in respect to all the governmental measures I have been discussing is their effectiveness in meeting the needs of the economy as a whole. The NAM has approached the subject in that spirit, rather than with a desire to further the particular interests of its members. If the stabilization effort should fail as a result of massive resistance or continual controversy, everyone would be worse off. That is why we have reconsidered our past opposition to economic controls and offered our cooperation in making them work.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you very much, Mr. Gullander. That is a most interesting and helpful and competent statement. I am especially glad that you took a little time at the beginning to point out how you arrived at this position and that this is representative of your organization; that you had, as you say, over 100 directors present at the time the resolutions were acted upon, and that this, therefore, as you say, was not the result of a small inner circle, but generally representative of the views of your membership as a whole.

I am sure from the tenor of it and from having talked with many businessmen in my own State, which is a fairly typical State, that you do represent the views of management very, very generally with respect to the recommendations you make here.

I notice that you refer in your first resolution to the fact that the NAM was only temporarily setting aside the long-term objections to wage and price controls because of the national emergency that now exists. Tell me a little bit about how you came to that conclusion. This is an unusual kind of an emergency. We do not have the kind of situation that we had in World War II or the Korean war; that is, a sudden big, huge, military effort, with the resulting shortages, with the obvious enormous pressure by demand on prices. This is a different kind of an inflation. How did you come to the conclusion that this was an

emergency, an economic emergency, that would warrant this kind of unusual action?

Mr. GULLANDER. Mr. Chairman, as you have already stated, the difference lies in the fact that last time, in World War II and the Korean war, it was a question of allocation of resources, because this Nation has, of course, limited resources, as every nation has. That was a case where the physical resources we had to control, and in order to tighten that, we had to tighten wage and price controls, because we had a demand pull.

Now we have a different type of control, because we have almost a runaway inflation. I see a flywheel type of action, where wages go up and therefore prices have to go up, and so on.

I see quite a different emergency from that that existed in the wartime period, other wartime periods. The NAM always, and I think all businessmen, has been dedicated to the principle that the American marketplace, the American people are the ones who know best what ought to be produced and at what price, and the marketplace is a vehicle whereby they communicate that to manufacturers. Now, when you go for controls, you in effect limit the capacity of the American people to dictate to us what we should make. Yet when we see what has happened to the value of the dollar in terms of purchasing power, what this is doing to fixed incomes, what it is doing to us in the light of the rest of the world, international trade, here is a situation which many of the members of the NAM as citizens of the United States had not faced before. This came about rather suddenly, because for years and years, as we have said, we stood against interference in the marketplace. But this thing got worse and worse, week after week, and very suddenly, we find a great willingness to participate and cooperate with the administration, with Government, to try to have a temporary solution to the problem.

Long range, to use controls would destroy our economy which has grown so well and so fast in the past. But to put a stop to the psychology of wage increases and price increases, this seems to be the only available course.

Our task force, of course, worked to find another solution, but we did not find another solution, as the President did not. So we pledged ourselves to try to make this work, always saying that it must be temporary and we must find some other way to work this over and we should go back to the American people to dictate what is best.

Chairman PROXMIRE. But you identified the emergency very largely on the domestic situation with respect to wages, the fact that you felt wages were developing a wage push inflation that seemed very hard to arrest or stop short of some kind of a freeze, some sort of at least limited wage and price controls.

Mr. GULLANDER. I do not think you can talk about wages without talking about their effect on prices, because not only does it affect the domestic market, but it put us at a great disadvantage overseas.

Chairman PROXMIRE. I am inclined to think that this is the reason the President acted and when he acted, that he acted as he did because of what was happening to our dollar, to the balance of trade, which for the first time since 1893, was heading for a deficit. I am inclined to think this was the emergency as he saw it.

But it is still somewhat puzzling to me that there should be a general recognition under these circumstances that this was an emergency

that would warrant suspending your long-term, firmly held view, and you say this should be a temporary suspension, you want to get back to free markets as fast as you can. I certainly concur in that.

Mr. GULLANDER. It is just like the situation of war. When we had to go to war, we cooperated and did what we had to do. I think this is a war against inflation.

Chairman PROXMIRE. Because you do see what you do, what follows in your recommendations is logical, that the first thing you have to do is get some relationship between wage increases and productivity so that we can get our prices under control.

Now, we had a witness on Monday representing UAW, Mr. Woodcock. He argued that not only should productivity be recognized as the basis for a wage increase, but the full increase in the cost of living should be also provided. You seem to reject that view.

Mr. GULLANDER. We do.

Chairman PROXMIRE. Why?

Mr. GULLANDER. For this reason: The whole purpose of this effort is to stop the inflationary trend—more than a trend, the inflationary movement in our economy. This is going to hurt somebody. Now, you can justify paying more money based on greater productivity, because the same amount of time spent working produces more goods and therefore that time is worth more. But when you incorporate cost of living, bear in mind there is a carryover effect coming out of the inflationary period and the cost of living is going to raise for awhile despite what happens here, and if you feed that back into this wage structure, you are perpetuating this cycle of inflation.

You can say this is hard on a man who sees the price of all things he buys go up and his wages only go up on productivity. This is a medicine we take. It is a distasteful medicine for labor, management, and the general public.

Chairman PROXMIRE. Why is it distasteful for management?

Mr. GULLANDER. Because our prices are going to be frozen and we lose the flexibility——

Chairman PROXMIRE. The prices will not necessarily be frozen in phase 2. You propose a cost pass-through.

Mr. GULLENDER. I mean frozen by control as such, which means we cannot respond really to the demand factor in the public. If I have a new product that has a great appeal or a remodeled product that has great appeal to the American public, I have set that price based on my ability to meet that demand. That we are not able to do under wage and price controls and that is something we give up willingly on the temporary basis.

In other words, if you have difficulty in moving your product, you must cut the price. If you have great ease in moving the product and there is limited supply, of course, you have to raise the price, depending on who really wants your product back in.

Chairman PROXMIRE. Would you go so far as to try to have the Government abridge the provisions for cost-of-living increases in contracts?

Mr. GULLANDER. Again, I say this is a distasteful thing for everyone to take. It is going to hurt somebody, there are going to be some inequities, for companies and for employees. I think this is a time where basically, if the Government says we have a freeze followed

by controls, you are in effect substituting those judgments for judgments already made. So in effect, yes; I think the choice is you abrogate the contracts and live with a control system.

Now, if you honor the contracts for labor wage rates, then you must, by the same token, honor the contracts for sale in the future. In other words, there are contracts made by customers for higher prices in the future. If you honor the contracts in wages, you must honor the contracts on prices.

Chairman PROXMIRE. The contracts on wages are very common. In many industries, they are the dominant factor. So abrogating those would be an enormous sacrifice for labor. On the other hand, contracts for price increases with customers are not uncommon, but they are not the rule.

Mr. GULLANDER. On the other hand, we must recognize that the whole purpose of this is to put a stop to inflation. Now, how soon do we want to get it done? I think the sooner we get it done, even with pain, the better. Obviously, if you try to do this without controls, it is going to take a lot longer. The sooner we get it done, the better off the working man is going to be, the better off the public is going to be, and the better off industry is going to be.

Chairman PROXMIRE. We had some evidence from some of the best economic minds in the country that the entire productivity figure be taken plus part of cost-of-living increase to determine wage guidelines, say, half of the cost of living of a given period be included in the wage guidelines. They said this would be a compromise position which would gradually work its way out because the cost-of-living increases would drop. As the cost-of-living increases diminished, that factor would diminish, too.

Why would that not be a reasonable compromise?

Mr. GULLANDER. Certainly anything less than 100 percent is some progress. But again it is a question of timing. How long do you want this in effect before we get into free markets? If you limit the cost-of-living increases to the commitments you have made in the past or cut them in half, you are making greater profits. What I am saying is the Congress, representing the American people, is going to have to decide, are we going to lick this thing as fast as possible, or are we going to dilly-dally?

Chairman PROXMIRE. Arthur Goldberg, who is a highly intelligent man, and as you know, a former Secretary of Labor, has thought about this a lot and said we ought to do part of what you say: He says, we ought to include only productivity increases. But he says also that we ought to stabilize prices. I am not sure we would do so by your pass-through notion.

I wonder if you would define it. It seems to contradict what you say in your statement. You say you do not want limitation on profits, as that takes out the discipline effect of holding costs down. I agree with this. But if you are going to allow the pass-through on prices, does that not do the same thing? What incentive is there for a manufacturer to hold down costs if he can pass his increased costs through?

Mr. GULLANDER. Of course, the life of a business, any business, is that you basically want your price as low as you can get it and still make a satisfactory product, because you get a bigger share of the marketplace. Your basic incentive is there, because you are still fight-

ing for your place in the marketplace. This is not a question of controls because of resources, shortage of resources. This is controls because of inflation. Prior to World War II, if you could pass all your cost through, what you say is true, because there were limited resources and you could not expand your market. Here we have plenty of resources. That is an entirely different thing. We are fighting inflation. There is an incentive to get the prices as low as possible.

In other words, the ceiling price established by controls is not the lowest price at which you can sell your goods. If you can get some economies in there and sell at a lower price, you can take some business away from your competitor.

The American public is not looking for a product at the ceiling price. He or she is looking for a product at the lowest price possible, which is a great incentive to lower your costs.

Chairman PROXMIRE. Before I yield to Senator Javits, let's see if I can clarify in my mind what this pass-through amounts to. Say you have an industry which enjoys a productivity increase in a year of 5 percent. Say it increases wages by 5 percent. Say that its wage costs therefore remain constant. Under those circumstances, I take it that you would have no pass-through, because there would be no increase in wage costs, even though there would be an increase in wages, is that right?

Mr. GULLANDER. It would be a question of the unit cost of the product. If the unit cost did not go up, the price would not go up.

Chairman PROXMIRE. Whatever the causes, and the causes may be incompetence on the part of management, you would permit a pass-through of costs?

That is what gets me. It seems to me there ought to be a reward for that management that is capable enough to hold its costs down and there ought to be a clear penalty, aside and apart from the marketplace factor, which is important, but it is of less importance in some industries than in others. I would hope we would do all we can to preserve the real discipline on management to fight hard constantly to hold its costs down. That is why I think our economic system has been productive. If you take any of that away, either by an excess profits tax or by a pass-through, I am very concerned about it.

Mr. GULLANDER. In effect what we are saying is a pass-through puts a ceiling on what price he can put on it. It does not say that has to be his price. He is going to conduct his business in the customary fashion, which is to try to get the maximum amount of business. Because with increased volume, his costs, of course, are going to fall. So he has all the incentive he has today to keep his costs down and his price down. He is fighting for the marketplace not just during the period of controls, but in the future as well.

To move from the base where you are, any manufacturer who can increase his price because of the cost of business, that is the base he moves from. He has the incentive to keep his costs down.

Chairman PROXMIRE. My time is up. Senator Javits.

Senator JAVITS. Thank you very much, Mr. Chairman. I shall be very brief, but I do have some questions of Mr. Gullander.

First, do your members reflect the decrease in productivity or the absence of gain normally in productivity based upon some erosion of motivation in the American worker?

Mr. GULLANDER. Can I interpret your question to say is there a lessening of motivation in the American worker?

Senator JAVITS. Right.

Mr. GULLANDER. I cannot give you statistics, of course, but there is no question in my mind in talks with many businessmen that this is one of the problems we are faced with.

Senator JAVITS. Of course, people are people, so I would assume the same might probably apply to management as well?

Mr. GULLANDER. Well, we have talked about going to the 4-day week for some of our working people and I am trying to get down to a 6-day week.

Let me say that by the very nature of things, we all start out as babies and we all go different places. Some people want to carry more responsibilities than others do. This is the nature of the human being. Some people want to be Senators and some people do not have the guts to try.

My point here is that when you get a group in management, I think fundamentally, they are people who would tend to be more motivated anyway, because that is how they got there in the first place. So I would think you would find as a general statement that management is motivated perhaps a little higher.

Senator JAVITS. There has been some discussion about the possibility of re-creating in order to stimulate motivation and interest, which is, after all, overriding all other considerations, including money, local productivity councils of the nature of those we had in World War II. Have you done any thinking about that or has the organization done any thinking about it?

Mr. GULLANDER. We have not tackled that problem as such, but I know from experience, of course, that any well run company is constantly working at the problem of greater productivity. This is the secret of staying in business, because your competitor is working at it and you are not.

I would like to add this, that I think that productivity is the basis for wage increases. I think you have to recognize that the critical thing we are trying to do here is slow down the rate of increases in wages and slow down the rate of increases in prices. Therefore, whatever mechanism you use in productivity is going to be a move in the right direction. And I suspect that is going to have to be a national productivity figure, not plant by plant, because you can get tremendous distortions if you went plant by plant, or even company by company.

Senator JAVITS. I think the guideline is the theory of a national guideline and an average of productivity, because, you know the famous example of the barber and the machine worker. But I am very interested in what can patriotically enlist the worker in what is a patriotic effort to stabilize the American economy.

One of the things that we are inventorying in that regard is the possibility of a return to the World War II plan of productivity councils on the local level—not necessarily plant by plant; this is a question of methodology—but essentially designed toward dealing with motivation, absenteeism, alcoholism, and a greater sense of dedication because there is a greater sense of purpose. Could the organization, if you are not prepared to do so now, give us any opinion on it?

Mr. GULLANDER. We would be glad to do this.
Senator JAVITS. If you would.
Maybe we can keep the record open for that, Mr. Chairman.
Senator PROXMIRE. By all means, yes indeed.
(The information referred to follows:)

STATEMENT OF MR. GULLANDER ON PRODUCTIVITY COUNCILS

The NAM favors the general principle of establishing two-way channels of communication between employers and employees.

Plant-by-plant joint labor-management productivity councils can serve a useful purpose, under appropriate circumstances. Participation should be voluntary by all parties. The councils could help to keep the importance of productivity at the center of attention. They could provide a forum for useful discussion of ways of removing barriers to productivity growth.

Senator JAVITS. The other thing I wanted to ask you about is also a specific. I noticed that in your resolution, you speak of the so-called investment tax credit as a job development credit. Now, is it not a fact that a good part of the American economy being in the service field, the sole criterion for earning this credit in view of its purpose should not be capital goods acquisition? That is not the only way in which you increase employment. Should we not crank into the legislation a true job development provision so that you can get the benefit of the investment tax credit not only by capital goods acquisition for the purpose of modernization, et cetera, which is very important, but also if you actually, based upon some fair criterion, increased the number of jobs?

Mr. GULLANDER. I think the motivation you talk about is a good point. I think from a practical standpoint, you have a very, very difficult problem in administration of that kind of a job development program. Because you increase jobs because of inefficiency and you increase jobs because of greater volume. Identifying which is which would be a difficult practical problem. Of course, one of the problems is in the service industry, and as you say very correctly this is getting to be a greater and greater part of our economy and a very vital factor in our inflation process. In the service areas, costs and wages and so forth have risen very high. The advantage of the investment tax credit to the administration is you can identify it.

Now, as to motivation, I frankly do not see a means or vehicle whereby this can be done. We say investment tax or some other job development. So we have left the door open, but we do not know the answer.

Senator JAVITS. But if it could be done, would that not be a much fairer shot at the reason why we are giving this tax break? There is great doubt about whether we ought to give this tax break solely for capital goods acquisition. Labor complains about it bitterly.

Mr. GULLANDER. That is where your increase in efficiency always comes. I think the greatest increase in the productivity of the American working force has come because of heavy investment in tools to help that man improve his productivity during the 8-hour period. It is not because we have to ask him to work harder and harder. That is not in our system. The basic thing is to give him better tools. That is really the basis for American leadership throughout the world in production.

Senator JAVITS. I agree, but does that necesarily include new initiatives, new enterprises, more complete staffing of the service industries, extension of the service industries, when you are running at an un-

acceptable rate of unemployment? Why should we not give that option, too, for the extension of the credit?

Mr. GULLANDER. I think if we had a new mechanism for doing this, we would be in a better position to judge, as you are.

Senator JAVITS. You do not quarrel with the principle, it in the methodology that bothers you?

Mr. GULLANDER. Yes; because when you find the methodology, then you really understand what the principle is doing.

Senator JAVITS. Thank you.

Would the Chair excuse me?

Chairman PROXMIRE. Yes; we want to thank you very much for coming.

I want to get back to the cost pass-through proposal you have. Does it work in reverse? Suppose you have a situation where costs are reduced, which I suppose would be true in efficient industries. Would you require that prices be reduced?

Mr. GULLANDER. No; because the market mechanism is still going to work. All we are talking about now is putting a ceiling on the market mechanism, that puts in power the American people. If you reduce costs——

Chairman PROXMIRE. If the market mechanism were working, we would not be here today. It is not working. We have no shortage of demand, we have an excess of demand. We have no shortage of goods, we have no shortage of production capacity. If the market mechanism were working, we would not have to worry about a price control system. It is not working for labor and it is not working for management. We have administered prices and administered wages.

That is our problem in the steel industry. They are operating far below capacity. It would make all the sense in the world for each individual firm to cut its prices. But that is not the way prices are determined in the steel industry.

Automobile prices are roughly the same, with some variation, but automobile prices are determined by one of the large companies and the other companies follow suit almost precisely—not exactly, but almost exactly. This is what we have to be concerned about. If we did not have that administered price power on the part of management on the one hand, and on the part of the big labor unions on the other, there would not be a problem under present circumstances, is that not right?

Mr. GULLANDER. Senator, I contend that even under controls, you merely put a ceiling on prices. They do not establish prices. Anyone who can run his business sufficiently well to sell below that ceiling is going to be a very successful businessman. Therefore, his costs fall. In order for each company to get a bigger share of the market, they are going to shave their price. Because if they do not, somebody else is going to. That mechanism is still working.

Chairman PROXMIRE. They are not shaving their prices, though.

Mr. GULLANDER. Because costs are not going down.

Chairman PROXMIRE. I know, but even though the costs may be fairly high because overhead in many of these industries is substantial and fixed, it would make sense for them to cut their prices so they could expand their volume and get more business; then their profits would increase. They do not do that, however, because they work in

conjunction in at least implicit collusion, so they recognize that if they do that, their competitors will do the same thing and they would not be ahead. So they operate together in steel, they operate together in autos, they operate together in many industries.

Mr. GULLANDER. Senator, I spent much of my life in industry or associated with industry in the last few years as president of NAM. That theory may sound very great, but I have never been privileged to work in any company where this is the way it works.

Chairman PROXMIRE. You do not deny that there is price leadership in the steel industry?

Mr. GULLANDER. Price leadership, of course.

Chairman PROXMIRE. Everybody follows to the third decimal point within 24 hours.

Mr. GULLANDER. That is price leadership, not collusion as such. If I am in the steel industry and I can cut my costs below Bethlehem or the rest of them, I am going to be the price leader and I can cut my price.

Chairman PROXMIRE. Suppose you have the combination of an administered price industry and a situation in which you have a greater productivity than average in the country. Then you have a great opportunity for the management to exploit this hold-down on wage increases. Because wage increases are held down and because it is possible for the industry as a whole to maintain its prices because they have price leadership and because their productivity is great, their costs go down and they do not have to roll back their prices; they maximize their profits that way.

Mr. GULLANDER. Most industry has no price leadership, as you well know. The same condition exists with no price leadership. If I am sufficiently efficient to produce my product at a lower cost than anybody else, two things happen. One is if I have limited capacity, I will charge the same price as my competitors and make a much more handsome profit. But then I am tempted to expand my capacity because I succeeded in doing this well. As I expand my capacity, then I need more and more business, then I tend to shave my price. In other words, this is not a fixed, cast-in-concrete situation. This fluctuates from day to day and week to week and it is the market forces that will do this. That is one reason why the sooner we can get rid of wage and price controls after we have licked inflation, the sooner we are going to have a much better economy.

Chairman PROXMIRE. Mr. Gullander, there may be a lot of wisdom in what you say, but you know as well as I that there would not be a chance in the world of winning support in Congress, and especially among the great labor organizations, if you say we are going to permit a pass-through, but not permit prices that will reflect any reduction in costs. You have to go both ways.

Mr. GULLANDER. From a practical standpoint, it would not work, because if I am a small producer and I succeed in reducing my costs—and of course, costs are not that difficult in the first place—and you say I have to reduce my price because of my efficiency and I have limited capacity——

Chairman PROXMIRE. I am not saying that. Let me explain what I am talking about. What I am talking about is you would permit the cost pass-through for the industry as a whole.

Mr. GULLANDER. Right.

Chairman PROXMIRE. You would require the reduction in prices where you have a reduction in cost for the industry as a whole. Any individual producer who is extraordinarily efficient could make extraordinary profits. If he is extraordinarily inefficient, he would suffer losses. That is the way our system works and it seems to me that the control system should try to adapt to it. In the steel industry, for example, if you had an extraordinary productivity increase, which is very doubtful, but say you had it in that industry, you would require the industry as a whole to hold down, possibly to roll back their prices. Any individual firm that was more efficient than the industry as a whole would get bigger profits.

Mr. GULLANDER. But, Senator, the pass-through has to be product by product. It can't be by a company's whole operation. Then you have an excess profits tax. That is what you are talking about.

Chairman PROXMIRE. I would agree it has to be product by product for the whole industry.

Mr. GULLANDER. It has to be product by product and there is such variation in products from one company to another that I do not think it is practical to do it on an industry-wide basis or even companywide.

Chairman PROXMIRE. Let me ask you, one of the stronger recommedations by Mr. Woodcock when he appeared on Monday was that the administrative agency should have subpena powers, should have the power to require management to show what their costs are, so they can arrive at a productivity level that is determined and realistic and accurate. This is something that the Government has not had in the past. We have had a different kind of price controls in the past—just freezes, in effect, in World War II. That is what we had. In the Korean war, much of the period, that is what we had. Now we will have something else, something that will require an understanding of and knowledge of productivity and cost. Would you agree that subpena power for this kind of agency would be appropriate?

Mr. GULLANDER. Any company that changes prices because of a pass-through situation that has been approved by Congress, whatever the agency is, must be in a position to prove his point is right. In other words, obviously, you have to have some enforcement. If you have a mandatory wage and price——

Chairman PROXMIRE. That would be helpful. Then they would have to come up and show their costs are higher.

Mr. GULLANDER. For my income tax return, I have to be able to prove that my costs were so much.

Chairman PROXMIRE. This is a real sticking point in industry. When the automobile industry increased its prices some years ago, I asked the council to give me a justification for it. But I was unable to get it; the automobile industry is not about to tell what its costs are.

My point is if you are going to have this, you are going to have to recognize that industry is going to have to do something they have not been willing to do in the past in many cases, which is to produce their costs and justify their price basis.

Mr. GULLANDER. You do the same thing you do on IRS data.

Chairman PROXMIRE. You mean make it confidential?

Mr. GULLANDER. Sure.

Chairman PROXMIRE. I am not too sure about that.

Mr. GULLANDER. That is where we have the difference about it.

Chairman PROXMIRE. In Wisconsin from 1923 to 1935, we had open, public inspection of all income tax returns, corporations and individuals. It worked very well. They finally repealed it over the objection of many of us.

During this brief period, I cannot see that there would be much sacrifice if you made it public. Only if you make it public would you get the kind of willingness, I would think, on the part of organized labor and others who might be critical to go along. If they know it is true, because they can prove it themselves they will go along.

Mr. GULLANDER. It seems to me the American public believes that when the IRS goes in and examines the tax return, they are looking after the general public's interest as it relates to the taxpayer. I do not see any difference between that and this kind of control problem.

Incidentally, I moved away from Wisconsin in 1917, and I did not get back in 1923, when they repealed this.

Chairman PROXMIRE. You must have been a baby in the crib.

Mr. GULLANDER. I appreciate that. I was not.

Chairman PROXMIRE. Senator Fulbright.

Senator FULBRIGHT. Mr. Chairman, thank you very much.

I am sorry I was late, but I had another meeting this morning, Mr. Gullander. If I ask you any questions that the chairman has already asked you, please say so. I do not want to bore you with repetition.

One thing I noticed in the paper this morning is that Mr. Reuss in the House, who has quite a following in the Congress—he is also from Wisconsin, I believe, is he not?

Chairman PROXMIRE. Yes, indeed.

Senator FULBRIGHT. I do not know why all these Wisconsin people seem to know more about business than anybody else.

He suggested we increase the price of gold. Do you have any views about that?

Mr. GULLANDER. I noticed that with interest myself this morning. It is quite a change in his approach.

I think when you talk about the change in the price of gold, you have to think about that in an entire restudy and reformation of the monetary system throughout the world. I have no doubt that there is a good possibility that the price of gold is going to be changed, but I do not think it should be changed just as one step. It should be part of a total package.

I think the President grasped considerable power when he applied the 10-percent import surcharge. As part of that total package of the development of a new monetary system, whether it is free-floating exchange or what it is, I think at that time, you ought to examine whether the price of gold should be changed.

From a practical standpoint, he suggested a rather modest price of gold. There is the modest rate the United States has been supporting, $35. So if you made that move, I doubt that it would have much effect on the trading of gold. I do think it is something that ought to be studied in the entire context.

Senator FULBRIGHT. I understood the President feels that there is no longer any significant relation of gold to the dollar. He is cutting it loose from gold. He has already said he would not redeem gold certificates because I suppose under contract, we no longer openly buy gold at $35.

Mr. GULLANDER. If you eliminated gold from the entire monetary system throughout the world, then gold would be like lead or iron or nickel, you would find the price of gold would go down pretty low.

Senator FULBRIGHT. Is that not what the President said, really?

Mr. GULLANDER. Perhaps, but it is still hanging out there.

Senator FULBRIGHT. All of this is still hanging out there.

Mr. GULLANDER. Again I say, I do not know what the monetary system of the world will be, but I say nobody knows but by negotiation and study; we have to find the best system we can.

Senator FULBRIGHT. I just ask that because I happened to see it in the paper a moment ago, and I wanted your reaction.

Mr. GULLANDER. I am glad, Senator, it was not about the ball team going to Texas. I am glad you did not ask me about that one.

Senator FULBRIGHT. Well, I did not think you were responsible for that. I think the reason it went to Texas is because it is such a poor team it did not draw any attendance here.

One or two other things. You recommend, I notice, the repeal of the excise tax on automobiles. This has always interested me. Do you think the reason foreign automobiles have gained such a following in this country is simply a matter of price?

Mr. GULLANDER. I do not think you can divorce any purchasing decision from price. It is not just price, of course.

Senator FULBRIGHT. Is it primarily price?

Mr. GULLANDER. I would say so.

Senator FULBRIGHT. This is a very debatable point. I wondered about this, because I rather think it is a matter of quality. Not only quality as such for the same size; rather it is quality of design. I think the small automobile in our urban civilization has a great appeal, and our domestic manufacturers have refused really to try to make a good small automobile comparable to the Volkswagen, which is the big seller. I do not know whether you call this price or not. I think it is design, design for a big city, design for the conditions which we have.

I never understood why our automobile manufacturers have refused to make a really competitive car to the Volkswagen. Why is that? You are in business. Why have they refused to do that?

Mr. GULLANDER. There are better witnesses to answer that question than I, Senator.

Senator FULBRIGHT. Well, you are in the NAM.

Mr. GULLANDER. I will make the observation as an automobile driver that I have never owned a small automobile. That is a question of personal choice. I have never owned an imported car, and that was before I was President of the NAM, when I would have been free to do so.

I think you have to recognize today that the American manufacturers are producing small cars for the American people. But also, there is a question of cost. The number of dollars you have to play with in producing a car when you build a small one is rather limited. With the higher labor costs we have in the United States, this is something that the manufacturers here up to now have had to compete with overseas—up to now.

I also think the manufacturers of American automobiles are probably some of the most skilled people in measuring the marketplace. They are so exposed, because all of us see if there is a failure in the automobile market. We all see it. It is a subject of conversation, it is

on the road, you can see the sales figures. There are many products that American manufacturers make and foreign manufacturers make that are not successful in the auto marketplace. So the auto is something, a vehicle that is exposed to a great deal of judgment of the people. They do not apply that judgment elsewhere.

I think you are seeing today the necessity of importing foreign components from England to make the small automobile because they cannot meet the price otherwise. I think there are a lot of big factors. Labor costs in Europe have been much lower than in the United States. The technology of manufacturing has improved tremendously and dramatically in Europe, and in Japan, where quality is very high compared to what Japanese quality used to be.

So you come down to high skills, good management, and low labor costs.

Senator FULBRIGHT. Let me move on to another point. I notice you also approve of the 10-percent surcharge. I come from an exporting State. I mean in the view of the national economy you may not consider it significant, but we exported in fiscal year 1971 over $300 million worth of soybeans, rice, cotton, and other commodities. We are, as you know, underdeveloped in a manufacturing sense. We have relatively small industry, and people in my State are very worried that this will cause our principal purchaser, Japan, to look elsewhere for their agricultural commodities. Once you lose these markets, you lose them. You know as well as I do it is very difficult to regain them. They are worried that the surcharge will induce Japan to look to Brazil or Russia or anywhere else for their soybeans and cotton and rice. It would be a very serious blow to them.

Arkansans feel that the automobile industry is being given this very special consideration and they are being kicked in the teeth if this surcharge stands up.

What do you say to that?

Mr. GULLANDER. You are referring to the 7-percent excise tax being eliminated?

Senator FULBRIGHT. That as well as the 10-percent surcharge.

Mr. GULLANDER. I would say in two respects. One is that the automobile industry has been penalized all these years with a 7-percent tax that the soybean grower was not penalized with. So we now put them on the same basis as far as the excise tax is concerned.

The 10 percent I agree is an action taken by the President, taken with great wisdom, in order to have a vehicle of power to deal with our foreign competitors, because we have been the good boys in the international business. We have not built up the nontariff barriers that many of our friends overseas have done. We have not had invisible restrictions against imports. They have had tax structures which are an advantage to the exporter which we do not have, because we have income taxes rather than value added taxes. All these things have been in the favor of the foreign manufacturer.

The President has finally used this as a device, as I understand it, to have power to negotiate and get rid of some of the nontariff barriers and some of the other barriers under which we have all suffered. In the process—he has to do it for the Nation as a whole—there is no question that some in agriculture are being hurt. But this is only a temporary situation. It is only a vehicle for bargaining and once the issue is laid on the table and settled, the 10 percent will go away.

Senator FULBRIGHT. You mentioned tariffs and that we have been good boys, which prompts one other question. What do you consider to be the No. 1 reason that has brought about this rather unusual and, I think, dangerous deterioration of our economy, the principal characteristics of which are excessive inflation and excessive unemployment? Both of them together are very bad indeed. What would you say, looking back on the last 20 years, is the No. 1 reason for this?

Mr. GULLANDER. Our fiscal and monetary policies. Bear in mind, this initiates—when you have fiscal and monetary policies which are inflationary, then you get what I referred to earlier as a sort of flywheel effect because in inflation, the dollar doesn't buy as much and labor, of course, asks for more money. When labor asks for more money, the employer has only one source of funds; that is in the price he gets for his product. Then you have an increase in wages, an increase in prices. This flywheel effect has a—I think that is why we are sitting here today with our problem of balancing our economy and inadequate employment.

Senator FULBRIGHT. Is it not tenable to say that the deficit and the fiscal and monetary policy are the symptoms of something much deeper and more serious than that? Can you trace back any reason why we have had this enormous deficit and from which grew the fiscal and monetary policy? Can we go a little one-step further as to the cause?

Mr. GULLANDER. Yes, Senator, I think it is because the American people somehow have developed a habit of demanding from you gentleman in Congress that Government do more and more for them, render more services, and not be willing to pay the taxes they cost. They want to go to the store and get the product, but they do not want to make a downpayment. So if the American people would recognize that the things they ask from Government are going to have to be paid for by themselves and use restraint in asking you for services and the things they want and we have a balanced budget, then you would not be faced with this situation.

Maybe we have to call on Congress to be very forthright with their constituencies, to point out if you want all these things, you are either going to have to pay for them or we are going to have inflation. Because there is nothing magic in the world.

Senator FULBRIGHT. My impression, coming from, as I say, a State which is not quite the same as New York and Massachusetts, was different. The American people, certainly the people of my State, have been deprived of things which they are entitled to, such as assistance in sewer and water projects, urban renewal projects, housing assistance, and school system assistance. There has been a great neglect of such needs. Could I suggest to you that we have spent, according to the Library of Congress, about $200 billion on the war in Vietnam? I would suggest this might have had something to do with this deficit from which these monetary and fiscal policies grew, because the then Government was afraid to confront the American people with the magnitude of the tragic mistake which it had made. It was trying to pretend it could fight a war and maintain a military machine and at the same time render its duties to the people here. That was absolutely false.

You do not think it has had any effect on this situation?

Mr. GULLANDER. Any time we have had a war, at least in this century, we have had deficits and they are always inflationary. Now, I

am not speaking of the merits one way or the other of the war. I am just saying this is a fact of life. If we are unwilling to tax the people sufficiently to pay the going costs of the war, you are going to end up with an inflationary effect. When I say the American people demand things, I suppose they did not stand up and demand a Korean war or a Vietnam war. But with that being thrust upon them one way or another, either by event or circumstances, whatever it may be, we still demanded all the butter from Government.

So regardless of the cost—let me put it in very homey fashion. A family of seven has to live within its income or it is faced with disaster. A family of 220 million has to live within its income or there is going to be disaster. I do not think there is any difference. I think the principles are the same, whether for a family of seven or 220 million. Whether that came from Government or military spending, the effect is the same.

Senator FULBRIGHT. I think if we are going to cure it, we have to identify what the cost is. They are asking for $80 billion for the military this year. Taking the last 10 years, I expect it has totaled about $800 billion. These figures get so astronomical that I hesitate to use them. But we have spent on military affairs since World War II, I think, about $1,500 billion. I do not think you can take that out of any economy.

Also, I happen to believe that much of this was on a misguided obsession with an ideological concept that we did not understand. I think it is high time we began to focus on it, at least to try to understand what is the real reason for it. It is nothing comparable to the waste of the amount of money that we put into military affairs. It is true it gives temporary employment, but there is nothing left with which you build the things that your family wants and our economy is based upon.

I think this is the real reason. If I am wrong, of course, I am just wrong, but if I am right, the business community ought to help the Government educate itself as to the proper policies in this field and the proper attitudes which have brought this about.

Mr. GULLANDER. Senator, I accept that. The business community does have a responsibility for voicing their views on those subjects as well. I might say that this is a great country and we cannot make up all our decisions because we are influenced in part by what other nations do or what we think they are doing. It is much more difficult to look forward to say, this is what we need to have because there is a U.S.S.R. threat, whatever the threat may be, compared to looking back and saying, well, I guess we did not really need this. I have some sympathy for the people who have to make this kind of decision.

Senator FULBRIGHT. I think it is very important because if you and people with the influence that you have insist on saying, well, the trouble is simply that people want too many schools and water systems and pure air and pure water and say nothing about the outrageous extravagance of the Military Establishment, then we will never be able to change it in the Congress. The chairman of this committee has made effort after effort—he has made to my view an absolutely unanswerable case in so many cases. But he has not had the votes except in one case, the SST. Some of these other cases are just as strong, in my opinion, so far as the public interest goes. But you see, people do not like to focus

on this. They do not like to take the responsibility of even looking into the question of whether or not China is a great and aggressive nation about to threaten Southeast Asia and California.

Only a few years ago, the then administration—not this one—was saying, if we do not stop them in Vietnam, they will be in California. This is such an absurd idea now as we look back on it; even the President is going to Peking. But we labored under that misconception.

All I am suggesting is that I think it is very important to pinpoint the reason why we have inflation and unemployment at the same time, this extreme distortion of our economy. I think it is misleading to not ever mention that the biggest single drain upon our resources in the past 15 years has been military expenditures. And in my opinion, much of that because of the illusion or a delusion of the then advisers and the President. That does not go for the just present administration. I am speaking of 15, 20 years ago.

Now, I am not saying this to blame them but to correct it and to take the proper measures under the very program we are talking about. It seems to me it is important to keep this in mind and as a part of the second phase of the economic game plan bring about a reduction in some of these more extravagant things like the Sanguine project in your State of Wisconsin. I have never heard of a more absurd proposal than that. They intend to lay out 6,400 acres with electric cables. They have not the vaguest idea whether it will work or not. But people go along with it because it is tied in with the military.

I think you have to live up to this. People say, well, it is the responsibility of the President. This is the No. 1 drain. If you cannot cure that, we will continue to have this fiscal and monetary problem.

Mr. GULLANDER. Senator, it is really a question of priorities. We have to learn to pick our priorities. We can afford so much. The military requires *x* amount and there is only so much left for others.

Senator FULBRIGHT. But nobody questions the military. What you and everybody else says is whatever the military wants, that is it. Nobody wants to question it except the chairman of this committee and a few Senators.

Mr. GULLANDER. Your problem is the information on which they base their judgments is not available to the general public.

Senator FULBRIGHT. Oh, yes; it is. That is an illusion that the administration puts out. That is not true. Most of this information is just as public as it can be. That real problem is they do not want to take the trouble to examine it because it requires some responsibility. It is not all secret.

The chairman of this committee has put this on the record. Nobody bothered to read it. It is not very thrilling. But I do not agree at all that it is not available. There is not any great secret about it. The only secrets are the plans as to whether or not they will bomb North Vietnam as of yesterday.

The secrets that they do keep in the recesses of the Pentagon and will not give the Congress, of course, are their plans on how much they are going to spend on foreign aid.

Mr. GULLANDER. Senator, I am really only saying I am not competent, of course.

Senator FULBRIGHT. I think you are competent if you will bother to do it. You are just as competent to do that as the others.

Mr. GULLANDER. Not to judge what Russia is doing. The only reason we are doing anything is to counteract somebody else. The people who have data and information such as it is with respect to the potential adversary are the ones who have to make the judgment. It is unfortunate, but I cannot judge Russia's threat to us or China's threat to us.

Senator FULBRIGHT. I do not know why you cannot judge that. They are human beings just as we are. You can judge it if you want to try. But everybody takes the attitude that that is some mystery for which Mr. Rostow or Mr. Kissinger have the responsibility. I think this is a very dangerous attitude and one that has got us in this trouble.

Everybody said that about Dean Rusk and Walt Rostow. They know best. But they did not know best. They had every cable that was written; the trouble is that their judgment was wrong. They did not read the cables and interpret them properly.

It is no secret. You have just as good judgment as anybody.

Mr. GULLANDER. Maybe when I am Secretary of State, I will do the best I can.

Senator FULBRIGHT. I just wanted to ask you about these things. You hesitated to even mention the war as contributing anything to our problem. Now, you ought to know that that is not really quite right. You know it has been a major contributor.

Mr. GULLANDER. Of course it has.

Senator FULBRIGHT. But you did not volunteer that. I was just asking to see if you would. But you are not the only businessman who seems to think this is beyond their responsibility. The main point I am trying to make that it is not, and to plead with you and your colleagues not to take this attitude that you are no competent to judge and that you do not know enough. You do know enough. And you can have a lot of effect upon members of this body.

The real trouble with what has happened here is that we have not gotten the votes. Nearly every time on these issues we lack about six or eight votes and a lot of those people could be influenced by the business community. And I plead with you to take this seriously in these efforts to restore a sound basis to your economy. It will never be really restored if we are going to continue to waste our money on these fantastic weapons systems and these delusions of grandeur.

The British found it out, the French found it out. All kinds of things that you are familiar with would indicate that the United States can't afford to police the world and to have 380 bases abroad to keep people in Germany and elsewhere indefinitely. You know as a businessman the limits of what you can afford.

This is what I mean. You have just as good judgment as anyone else if you take the trouble to look into it. We cannot afford it and it is very clear we cannot afford it. But we are having trouble getting enough votes to cut back. That is as simple as it is. There is no mystery about it if you will take the trouble to read the material that is put into the record time and again.

Well, I did not mean to lecture you, but you are a leading businessman, the leading businessman in your position, and the business community ought to take more interest in this, in their own interest.

I know what you are interested in. I think to ignore this, you are dealing with the symptom and not the basic causes. You deal only with

fiscal and monetary policy and have nothing to do with curtailing in areas that are not productive.

Mr. GULLANDER. Of course, that is a part of fiscal policy. As you have already said, that is the biggest element.

Senator FULBRIGHT. The biggest element contributing to the deficit has been the military.

I am sorry, Mr. Chairman. I do not often have an opportunity to talk to the President of the NAM, especially under conditions where he has to listen.

Chairman PROXMIRE. To get back to the phase 2 operation, you say in your statement, "we would urge, however, strongly against making this board"—that is, the price stabilization board—"a combination of persons each of whom is designated to represent a particular interest group." Then you have some indications of why you take this position. It seems to me we ought to have some sort of opportunity for organized labor as such, organized business as such to give their viewpoint on this if it is going to be effective.

Now, it may be that the board that does the administration should be a government board. But there ought to be some vehicle for the labor group and the business group to be constantly aware of what is going on, to make their contributions, their criticisms, their suggestions, to stay on top of this thing. I find that missing in your proposal.

Mr. GULLANDER. Our proposal here, in effect, says that the people serving on this advisory board should come from various walks of life. And we are saying labor, we are saying management, we are saying agriculture, we are saying perhaps academic. But there should be people who do not come representing just labor. It should not be me representing just the management of industry. It should not be one man just talking about agriculture. They should be people of broad experience who have only one thing in mind and that is what is the best thing for getting this job done and not come as advocates for particular groups as such. They do not have contact with everybody else.

Chairman PROXMIRE. I understand your reasoning behind it. You made a good statement in that connection. But we have problems here. We have labor unions with great power and great authority, as you know very well. We have business groups that have a lot of influence, too. We would like to get their cooperation. One way of getting their cooperation is to give them responsibility for working this out. Mr. Meany seems very definite and determined about this.

Mr. GULLANDER. That is an understatement.

Chairman PROXMIRE. That does not mean that we have to do it, but it means something that I think we ought to consider.

Why would it necessarily be less desirable if we can get a good end result to get labor and management both right in on it, negotiating, working, knowing their problems as only they do directly, and in a position therefore to influence their constituencies, to accept the decision that is arrived at?

Mr. GULLANDER. I think they should be people interested in the general welfare, not just their constituencies.

Chairman PROXMIRE. I think you know that both labor and management are not just interested in their own well-being. They are both interested in the public welfare.

Mr. GULLANDER. They should be identified as such, that that is their responsibility. You should not have a man from the union who, when he comes in, his prime and only responsibility is to look after his membership, his responsibility at the union. He should be responsible to the people as a whole.

Chairman PROXMIRE. The man we had up here on Monday, Leonard Woodcock, a labor leader, is certainly not that kind of man. He is interested in the public interest. He sees it from a different view.

Mr. GULLANDER. He has a political job. He is president of the union. He is not going to be president of that union unless his whole stance is to get everything he can possibly get.

Chairman PROXMIRE. His union, for example, would gain directly from going ahead with the SST. Yet, he had the courage to take a different position on that because he thought it was against the public interest.

Mr. GULLANDER. I am not saying he would not be a good appointment. My point is he should not come in only as a union leader to come in and speak for the union only. The objectivity of the members of this board should be such that the give and take should be for getting the job done.

Chairman PROXMIRE. Let me get on with the questions. You propose an investment credit of 10 percent being made permanent and not go down to 5 percent as I understand the present proposal is.

Mr. GULLANDER. Yes.

Chairman PROXMIRE. You also propose that the ADR—accelerated depreciation rules, be continued?

Mr. GULLANDER. That is right.

Chairman PROXMIRE. I agree with you we ought to have a permanent investment credit. I have always felt we need it for long-term efficiency and holding down our prices and encouraging productivity in our system. But it seems to me it is redundant to, in addition to that, have accelerated depreication and I do not think it is practical to expect to persuade the Congress to go along with both of them. Maybe they will, but I just wonder if maybe you should not either reduce or eliminate the accelerated depreciation, which has not been very effective in promoting the sale of equipment.

It has not helped the machine tool industry very much since it has been in effect.

Mr. GULLANDER. It is part of the question where the machine tool industry would be today if it had not been in effect.

Chairman PROXMIRE. Maybe, but it has been in sad shape up until recently.

Mr. GULLANDER. One of the questions we are concerned with is generating capital. If you cannot generate capital, you are not going to promote efficiency. If you have that, you can generate the creation of capital.

You must recognize the ADR is just a question of timing. You pay the same amount of taxes. You get to more depreciation than you would otherwise. You maybe get it earlier.

Chairman PROXMIRE. That is not quite the case. What you get is an interest free loan, in effect.

Mr. GULLANDER. Well, maybe that is right.

Chairman PROXMIRE. And that interest free loan is very, very valuable.

Mr. GULLANDER. And there is certainly a question, would we get more depreciation the other way. You are absolutely correct, it is interest free money and it is valuable because you get your money earlier than the normal system.

Again, the whole premise is this generates capital which can be used to replace inefficient equipment and to expand the facilities. Expand the facilities, and of course, you are increasing jobs again.

Of the two, there is no question in my mind that the investment credit is a more desirable tool long term. If we had to lose one, we should lose the ADR, not the investment credit.

Chairman PROXMIRE. The investment credit is more stimulative, as well as sounder.

Now, you go on to dispute some of the tax actions that have been recommended and say they would be a partial reversal of the enormous transfer of tax burdens from individuals to business which occurred as a result of the Tax Reform Act of 1969. Can you give me just a brief supporting documentation of that charge? I think that would surprise a lot of people who argue that this is a Christmas tree to some extent and that there is just about as much in the way of benefits to business and other groups as there was additional taxes.

Mr. GULLANDER. Well, the figures are that for a normal year, as calculated, the business taxes increased about $8 billion and nonbusiness taxes went down about $11 billion. So there is a difference of about $19 billion if you want to put the negative in that context.

Chairman PROXMIRE. For the record, will you give me your arithmetic on that? I am not going to ask you to do it now, but for the record?

Mr. GULLANDER. Sure.

Chairman PROXMIRE. I have not seen that kind of charge made before. It would be very helpful to have it because you are the first witness we have had who made that contention.

Mr. GULLANDER. I added something new.

(The data referred to follows:)

STATEMENT OF MR. GULLANDER ON TRANSFER OF TAX BURDENS

EFFECTS ON TAX LIABILITIES OF TAX REFORM ACT OF 1969—ULTIMATE REVENUE IMPACT, WHEN ALL MEASURES BECOME FULLY EFFECTIVE

[In billions]

	At 1969[1] levels of GNP	At 1971 levels of[2] GNP
Tax "reform" provisions[3]	+$3.3	$3.7
Repeal of investment credit	+3.3	3.7
Total	+6.6	+7.4
Income tax "relief" provisions[4]	−9.1	−10.3
Net effect	−2.5	−2.9

[1] Figures from "General Explanation of the Tax Reform Act of 1969." Prepared by staff of the Joint Committee on Internal Revenue Taxation, Dec. 3, 1970, table 1.

[2] Estimated as increasing between 1969 and 1971, in proportion to growth in GNP (assuming $1,050,000,000,000 GNP for 1971).

[3] Includes effects of: limitations on multiple corporations, percentage depletion, capital gains, depreciation on used property, and other provisions affecting mainly business-type incomes.

[4] Includes effects of low-income allowance, increase in standard deduction, increase in exemption, maximum rate on earned income, and other provisions affecting mainly non-business-type incomes.

As indicated in the above table, the Tax Reform Act of 1969 increased the tax burden on business by an amount which (at present levels of economic activity) comes to $7.4 billion. Tax relief provisions reduced the tax burden of individuals (mainly in the low income brackets) by $10.3 billion. The main thrust of the Act was to transfer a huge part of the tax burden of individuals on to business.

Chairman PROXMIRE. Now, then, you go on to argue in your statement that we should not erode our revenue structure, we should not be in a position of reducing taxes in such a way that we cannot meet our obligations.

I would agree wholeheartedly. But this is why it seems to me that we ought to aim as much as we can at taxes which would have a temporary effect on our revenue. What I am talking about is that the President's proposal to provide for individual income tax relief, providing the 1973 cut would come in 1972, it seems to me it does not erode our structure in the long run. We would get that anyway.

Mr. GULLANDER. Not long run. In the year in which it takes effect, of course, you have reduced your revenue and increased your deficit. It is right now that we are trying to do something about inflation and deficit.

Chairman PROXMIRE. Well, now, wait a minute. This year, we need a stimulus for the economy. We need jobs. We need people with more money in their pockets to go out and spend it. Is that not true?

Mr. GULLANDER. Right.

Chairman PROXMIRE. If you make this kind of personal income tax reduction, people have more money to spend. This is not inflationary provided you do not do it to such an enormous extent that you put pressure on resources. You have a $70 billion gap, demand gap, between what we would have if we had 4 percent unemployment and what we have now with 6.1 percent. The President's whole program, according to his prime economic advocate, Mr. McCracken, would only increase GNP by $15 billion and it only goes 20 percent toward filling that gap. It still leaves an immense amount of underutilized resources, heavy unemployment, of course.

Mr. GULLANDER. This is on the principle that spending money is the thing that does it rather than investment credit.

Chairman PROXMIRE. Not rather than, we have to have both. I agree with you on the investment credit. But it seems to me in addition to that, you have to have some sort of demand on the part of consumers.

Mr. GULLANDER. If you can reduce your Government spending sufficiently so you can give a reduction in the individual income taxes, you accomplish two things. One, you would stimulate greater spending because there would be more money, but you would not be doing it at the expense of a greater deficit. But as it is, the President has not proposed reducing expenditures sufficiently to cover any further reduction in individual taxes.

Chairman PROXMIRE. That is attractive. But Mr. Samuelson, who will be here tomorrow, one of the ablest economists in the world, argued at least initially that you end up with zero effect on the economy. If you add $5 billion tax relief for individuals and then take $5 billion from Government spending, the overall effect is nothing, in his view.

Mr. GULLANDER. In his view, and everybody does not agree with Mr. Samuelson.

Chairman PROXMIRE. Well, why is that wrong?

Mr. GULLANDER. In the first place, you are reducing taxes without reducing Government spending. In the first place, you increase your deficit, which is without question inflationary, right?

Chairman PROXMIRE. Well, it depends on the timing. It is certainly inflationary in a time when you have a shortage of goods, when you have excess demand. It would definitely be inflationary. But we had huge deficits in the 1930's that were not inflationary. Prices dropped. It depends on the circumstances.

Mr. GULLANDER. I would like to suggest that you have two eminent economists appear tomorrow and I suggest that you listen to the other one, too.

Chairman PROXMIRE. We certainly will. But I do think that there are circumstances in which some degree of stimulus for the economy for fiscal policy, giving consumers more to spend makes sense when you have a shortage of demand and are operating below capacity. It seems to me not to stimulate it at all is like using a sponge——

Mr. GULLANDER. The better way to stimulate it is to create an atmosphere in which industry can reduce its costs and its prices and in that way you get much more goods——

Chairman PROXMIRE. A better way for industry to reduce its prices is to get a larger volume. Then their unit costs would tend to go down.

Mr. GULLANDER. What you need, then, really to get back to the fundamentals, you need Americans to work harder and produce more, either through better tools or better effort. This applies to everybody. Perhaps one of the biggest factors, and I did not say that to Senator Fulbright when he asked me, is that we have not been working hard enough. The dollars only reflect what we are doing with our hands and our minds when we are creating greater goods and greater services.

Chairman PROXMIRE. I want to thank you, sir. I guess that takes care of it. I want to thank you for a most competent job. You have been very responsive and you have been on the firing line from Senator Javits, Senator Fulbright, and myself. I think you have provided us with most useful testimony, given much better balance to our record than we would have had, certainly, without you. We are most grateful.

You have those questions that we asked you to respond to for the record. If you could give that information, perhaps when you correct your transcript, that will be made available to you for correcting your remarks.

Mr. GULLANDER. Fine.

Chairman PROXMIRE. If, at the same time, you could provide those answers, that would be helpful.

Mr. GULLANDER. Fine.

Chairman PROXMIRE. Thank you very much.

Tomorrow we end up with a bout with Prof. Milton Friedman and Prof. Paul Samuelson, the battle of the century. That will be at 10 o'clock in the morning in this room.

Mr. GULLANDER. Thank you, Mr. Chairman.

(Whereupon, at 11:50 a.m., the committee adjourned until 10 a.m., Thursday, September 23, 1971.)

THE PRESIDENT'S NEW ECONOMIC PROGRAM

THURSDAY, SEPTEMBER 23, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room G-308, 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 Jasinowski, research economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Bander, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

Other members will come shortly, but I think we should get underway.

Today we conclude our current session of hearings on the President's new economic program. These hearings, which began on August 19, just 4 days following the President's announcement, have covered 15 days of testimony by administration witnesses, leading economists, and former Government officials, business and labor experts, constitutional lawyers, and representatives of consumer interests.

I cannot think of a more fitting climax for these Joint Economic Committee hearings than to have the two distinguished witnesses we have today. We hear today from two world-renowned economists who have a long record of helping Presidents and the Congress formulate sound economic policy: Professors Milton Friedman and Paul Samuelson.

These gentlemen do not always see eye to eye on matters of economic policy, as I believe will be made clear this morning. However, it is vitally important that at this point of time—which may well be a turning point in economic history—that we listen to the thoughtful advice of these two objective and distinguished scholars.

I shall not attempt to characterize their economic philosophies; they are far better able to do so themselves. I might say, Professor Friedman, virtually all the economists who have testified before the committee have supported the thrust of the President's NEP. I understand that while you support some of the measures taken, or believed

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to be contemplated for phase 2, you are in deep disagreement with the general approach, particularly the wage-price policies and the import surcharge. We are looking forward to hearing your views on these and related matters.

I guess we had best do this on an alphabetical basis, so Professor Friedman, you start off.

STATEMENT OF MILTON FRIEDMAN, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. FRIEDMAN. Thank you, Senator Proxmire. It is a great honor to be testifying before this committee on this set of issues. I have a brief statement, and I shall read it.

Chairman PROXMIRE. The entire statement will be printed in the record.

Senator JAVITS. Mr. Chairman.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Before Professor Friedman starts, I should like to make it very bipartisan and join the Chair in welcoming these two very distinguished economists and just make one other observation: I think more and more we are beginning to realize that not all the wisdom in life resides in Government or those who work in Government. Men like both of you are having a profound effect on our life and times, though you have no official status.

Similarly, I might add, I think the public is becoming enlightened to the fact that there are few Proxmires around, and that we are not just all vote comptometers and wooden Indians in Government.

I am very grateful to you both for being here.

Mr. FRIEDMAN. Thank you, Senator Javits. I think, and we all hope, that economics is a scientific matter and not a partisan matter.

The President's talk on August 15——

Chairman PROXMIRE. I might just interrupt for a minute to say I think you gentlemen are both here as officials of the Government in a sense. You are here officially to advise the Federal Reserve Board, is that correct?

Mr. FRIEDMAN. I am not involved today. I have in the past advised the Federal Reserve Board, but I have a conflicting engagement today.

Chairman PROXMIRE. Oh, then I misunderstood, or we were misinformed.

Mr. Samuelson, how about you?

Mr. SAMUELSON. No; I leave my plow occasionally as an academic consultant to the Federal Reserve and my duties in that regard. But it is true that I do advise the Federal Reserve.

Mr. FRIEDMAN. It is true that we are both advisers to the Federal Reserve Board, Senator, but I speak today entirely as an individual, as always, not for any official body.

The President's talk on August 15 involved two sets of measures: Those directed at international monetary relations, and those directed at domestic problems of inflation and unemployment.

Of the international measures, closing the window on gold is highly desirable and long overdue. The 10 percent surcharge is a powerful instrument for promoting desirable changes in the international monetary structure, but will harm us and the rest of the world if it is retained for long.

Of the domestic measures, I applaud the President for the proposed reductions in Government spending and taxes. The Government is now too big. It is urgent that we cut it down to size. On the other hand, I strongly oppose the wage-price freeze and the more limited control of wages and prices that will doubtless succeed the freeze. These are purely cosmetic measures that do not affect the basic sources of inflation. Those basic sources are government monetary and fiscal policy.

Insofar as wage and price controls have any effect, they distort the economic structure and do harm. Insofar as they are evaded, they do little economic harm but they add yet another mite to the weakening in the respect for law that is at the bottom of some of our social problems. The wage and price controls will ultimately collapse, leaving us still to deal with the real problems of inflation. The way to a free market is to keep it free, not first hobble it and then release the hobbles. Moreover, contrary to widely held views, I believe that a healthy economic expansion was underway before the freeze and that real, if slow, progress was being made against inflation. A radical change in policy was not required. I have attached for the record two Newsweek articles expanding more fully on these points.[1]

The rest of this formal statement deals entirely with the international area, where the immediate opportunities and dangers seem to me particularly great. The President's bold actions have dramatically widened the range of possibilities. It is urgent that we use the opportunity to promote a structure of international monetary arrangements that will not only resolve the present difficulties but also will provide flexibility and adaptability over the long run.

I propose to discuss these questions under four headings: First, a general review of the effects and likely consequences of the President's actions; second, the price of gold; third, the balance-of-payments deficit; and finally, conclusions about U.S. policy.

The closing of the gold window is the final step in a process that began on March 6, 1933, when President Roosevelt ended the internal convertibility of gold. This step is long overdue. I urged that it be taken in testimony before this committee nearly 8 years ago. Again, in early 1968, I said, in testifying before the Senate Committee on Banking and Currency:

> We should today—as we should have yesterday and a year ago and 10 years ago and in 1934—announce that the United States will no longer buy or sell gold at any fixed price. . . . We should simultaneously remove all legal restrictions on transactions by U.S. citizens in gold. We should let the price of gold be a free market price, not a pegged price. That would have no adverse economic effects—domestically or internationally. And it would take back the loaded guns we have handed to foreign holders of dollars.

If I may summarize to you briefly what I have said in the rest of this particular section, it is that the President's action gave a formal signal that the Bretton Woods system is dead, that it will no longer be revived. This opens the opportunity for a more meaningful development in world monetary relations.

The Central Bankers, the officials of the IMF and the other international groups still think they can put Humpty Dumpty together again. They still think they can return to a system like the Bretton Woods system. I think that is impossible. I think international sys-

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[1] See articles on pp. 704 and 705, respectfully.

tems grow out of real economic forces and cannot be invented, that basic economic forces are stronger than the Central Bankers or the international monetary officials. This is demonstrated internationally by the fact that as of today, four major currencies of the world are floating, a result that no central banker or no monetary official would have either predicted or desired. But it reflects the basic economic forces.

Those forces have produced a situation in which world is on a dollar standard. I do not like that fact; I would prefer that it not be. But like it or not, there is no blinking it.

The crucial thing is that now we are in this process of change, what form will it take? While I have long believed that the best system is one in which the currencies of major countries are floating vis-a-vis one another, I doubt very much that that will occur. I think the myth that confuses rigidity and stability, the myth that believes that rigid exchange rates are also stable rates, although much dented by the experience of the past decade is still strong and that central bankers will seek again to peg exchange rates.

However, I do not believe that they will any longer be as stubborn about it as they have been in recent years. I cannot believe that either Germany or Japan will once again pay $500 million for the dubious advantage of postponing the floating of their currencies by 2 weeks. It is a very high price for a very small return and next time if they repeg and get into a crisis, they will float in 2 hours, not 2 days or 2 weeks.

Therefore, I envision a situation in which at any point in time most currencies will have pegged rates, and some will be floating. However, which currencies will be pegged and which will be floating will vary from time to time.

Such a system would not be the ideal but it would be a great improvement on the system that developed out of Bretton Woods.

With this background, let me turn to the more immediate policy problems of the United States in the international area. What options are open to us, and how can we contribute to the most desirable restructuring of the international system? The great danger here, I believe, is the tendency to confuse false problems with real problems, particularly in two areas: the price of gold and the balance of payments.

The price of gold is the less important but also simpler problem, so I shall deal with it first. Many other governments would like the United States to raise the official price of gold, even though we continued neither to buy nor to sell gold. Such an action would be entirely symbolic. It would be a purely bookkeeping measure that need have no technical effects whatsoever. It need not change any exchange rates, since other governments that wished to keep the same exchange rate with the dollar yet continue the fiction that exchange rates are determined by the official prices assigned to gold, could raise their official gold price pari passu with the United States. It would not extend in any way the range of exchange rate structures available to the world. Why then do other nations wish such a change?

One argument is that a United States rise in the price of gold, by say 10 percent, would change all exchange rates vis-a-vis the dollar by 10 percent but leave them the same vis-a-vis one another; that this

same result could be accomplished by all other countries appreciating their currency by 10 percent; but that it is easier to have the United States alone move than to require all other countries to do so. This argument has much appeal at first glance, but dissolves if examined more deeply. The fact is that other countries have not had fixed buying and selling prices for gold; they have had fixed buying and selling prices for their currencies expressed in terms of dollars. In order for all of them to appreciate 10 percent vis-a-vis the dollar, each of them would still have to change its announced buying and selling prices for the dollar by 10 percent. And each would be free not to do so.

The basic reason other countries want the change, I believe, is for window-dressing pure and simple—to be able to say to their people and politicians, who cannot be expected to understand the intricacies of high international finance, that they are still on a gold standard and that, by raising the price of gold, the United States has not only done its share to solve the common problem, but also has admitted "mea culpa."

It would cost the United States absolutely nothing in any technical sense to go through the charade of raising the price of gold so long as we kept the gold window closed. It makes no difference at all if we do not buy gold at $35 an ounce, or if we do not buy it at $38, or if we do not sell it at $35 or do not sell it at $38.

Other countries would welcome our raising the official price of gold. We can make them happy at no cost to us. It is tempting to say that we should do so. Yet I do not believe we should. The reason is that it will only prolong illusion. We refrained from closing the gold window some years ago on such grounds. The only effect was to postpone the denouncement. Similarly now, it seems to me far healthier for all of us to face up to the real problem and not confuse the issue by arithmetic conjuring tricks designed only to save face.

I turn to the question of balance of payments. As a free trader, I dislike greatly the 10 percent import surcharge. Yet I have much sympathy with President Nixon's action in imposing it. Given the technical international financial situation, it was almost the only way in which the United States could get any bargaining power over other countries. The crucial question is, what should that bargaining power be used for? In my opinion, it should be used to dismantle barriers to international trade and to foster a flexible international monetary structure that will keep future crises from arising. I believe that it is a major mistake to use it to produce any particular change in our balance of payments deficit.

Given that the gold window is closed and the U.S. dollar floating, at least as far as the United States is concerned, the United States has and can have no balance-of-payments problem. Foreigners may accumulate dollars, and they may be recorded in our statistics as a deficit, but that raises no technical problem for us. The holders of the dollars can use them to buy goods or services or securities in the United States, or they can continue to hold them, but there is nothing that they can do that will raise difficulties for the United States. Balance-of-payments problems in the technical sense are a reflection of price-fixing, and of nothing else, and so long as the United States does not engage in trying to fix the price of either the dollar or gold, it cannot have a balance-of-payments problems.

If other countries try to fix the prices of their currencies, that may and will raise balance of payments problems for them. But it raises none for the United States.

Nonetheless, it is widely believed that the real problem is the size of our balance-of-payments deficit. That is a fallacy. Indeed, a large deficit is a blessing, rather than a problem, so long as we are not committed to fixing the price of either gold or dollars. If Japan, for example, sends us automobiles and chooses to accept in return crisp greenbacks, isn't that a good deal for us? We get useful products; the Japanese get pieces of paper that we can print at low cost. Of course, the Japanese will not take crisp greenbacks. They accumulate dollars in the form of interest bearing assets, which greatly reduces the net gain to us. It then consists in our being able to borrow at a lower interest rate than we otherwise could.

It cannot be repeated too often that the benefit from foreign trade is the imports that we get. The exports that we have to send out are the cost of the imports. Anything that increases the amount of imports that we can get for our exports adds to our gain from trade. Unfortunately, the fact that producer interests are more concentrated than consumer interests leads to a widespread belief to the contrary. In almost every country, the mercantilist view prevails that exports are good, imports bad, that the way to wealth is send out of the country more real goods than are brought back. Adam Smith's message is as much needed as ever—or should I say, falls on as deaf ears as ever.

If the size of the deficit is not the real problem, what are the real problems?

First, other countries will not in fact continue to accumulate dollar assets at anything like the recent rate. The real costs of that policy will make themselves felt. Other countries will then either reduce their balances, thus reversing the flows of goods and services, or at least, stop adding to them. Industries in the United States that were forced to contract by foreign competition will have to expand. The nation would still be ahead, in a realistic economic calculation, but the gains would be much less than if the other countries were willing indefinitely to send us goods for paper. And the political costs would be high of resisting the pressures of the affected industries to shield them from foreign competition—as has been all too evident. It might pay to resist this pressure for a permanent shift; it less clearly does so for a temporary shift.

Second, other countries have accumulated surpluses partly by measures interfering with the free flow of goods and services—the tariffs and direct controls used by Japan, the restrictions on agricultural imports into the EEC, and so on. These measures have distorted world investment, leading to a waste of capital in building plants simply to scale tariff walls. They have reduced and distorted world trade, lessening both imports and exports and preventing an efficient international division of labor.

Third, the fetish of fixed exchange rates has produced interferences with trade to avoid deficits as well as to produce surpluses. We are far from guiltless—witness the interest equalization tax, restrictions on foreign lending and on foreign investment, "Buy American" policies, and so forth. These measures were all unsuccessful in reducing the deficit—as was predictable for a world on the dollar standard. But they

have produced serious distortions in trade and finance. In particular, combined with the regulation Q ceilings on interest rates that banks may pay on deposits, they are largely responsible for the rapid growth of the Eurodollar market. In their absence, most of the financial business now done in the Eurodollar market would have been done in New York.

Fourth, the fixing of exchange rates has produced great instability and uncertainty, so that major crises have succeeded one another with distressing regularity. Rates have been rigid but not stable, changing only occasionally, but then, by sizable amounts.

These are the real problems. And we should use our bargaining power to resolve them: to achieve a real reduction in barriers to trade and a more flexible and adaptive exchange rate system in which minor problems produce minor corrective responses rather than being permitted, as they have been, to build up into major problems and to produce major crisis. I turn to the policies by the United States that will promote this objective.

On gold, we should:

(1) Make it absolutely clear that we shall continue to refuse to buy or sell gold at a fixed price.

(2) Remove present restrictions on the ownership, purchase, or sale of gold by residents of the United States. I may add that those restrictions never were justified and there is not the slightest shadow of a justification for them now that the use of gold in our monetary system has been abandoned.

(3) Abandon altogether the fiction that there is an "official" price of gold.

On the dollar, we should:

(4) Make it absolutely clear that we shall engage in no foreign exchange transactions for the purpose of affecting exchange rates.

(5) End present restrictions on foreign lending by banks.

(6) Repeal the interest-equalization tax.

(7) End the present restrictions on foreign investment by U.S. concerns.

(8) In cooperation with other countries, change the rules of the IMF to remove any restrictions on floating exchange rates and to widen the band within which currencies that set an official parity are permitted to float.

(9) Encourage other countries to let their currencies float freely.

On trade:

(10) Remove the 10-percent surcharge in return for items (8) and (9) and for a reduction in nontariff barriers to trade.

(11) Whether we succeed in item (10)—that is, in getting other countries to reduce their nontariff barriers—we should eliminate our own nontariff barriers to trade, in particular, quantitative import quotas.

A reduction in our trade barriers helps us, and also other countries, even if other countries do not reduce theirs. We would benefit still more, and so would other countries, if they reduced their barriers as well, so it is worth trying for a mutual reduction. Yet, we should not let failure to achieve mutual reductions prevent us from acting alone.

We are a great Nation, the leader of the free world. We should set a standard for the world by practicing the freedom of competition, of trade, of finance, and of enterprise that we preach. That will serve our enlightened economic self-interest. It will also do much to promote the reduction of barriers by others, to remove political frictions, and to promote a harmonious and peaceful world.

Chairman PROXMIRE. Thank you, Mr. Friedman.

May I say, without objection, the two articles from Newsweek, referred to in your statement, will be printed at this point in the record.

(The two articles referred to in Mr. Friedman's statement follow:)

[From Newsweek, Aug. 30, 1971]

WHY THE FREEZE IS A MISTAKE

(By Milton Friedman)

I applaud President Nixon's proposed reductions in both taxes and Federal spending. I applaud also his action in ending the fiction that the dollar is convertible into gold. But I regret exceedingly that he decided to impose a 90-day freeze on prices and wages. That is one of those "very plausible schemes," to quote what Edmund Burke said in a different connection, "with very pleasing commencements, [that] have often shameful and lamentable conclusions."

COSMETIC, NOT THERAPEUTIC

Freezing individual prices and wages in order to halt inflation is like freezing the rudder of a boat and making it impossible to steer, in order to correct a tendency for the boat to drift 1 degree off course. The "price level" has been rising at something like 4 per cent per year or one-third of 1 per cent per month, or 1 per cent in 90 days. Surely, you will say, preventing so minor a rise can do no harm. Why the outcry? Because the 1 per cent is the average of changes in literally millions of individual prices, some rising 10 or 20 per cent or more, others falling 10 or 20 per cent or more. These price changes reflect changes in conditions of demand and supply affecting particular goods and services. They are the way that we steer the economy. Preventing them leaves the economy rudderless, yet it does nothing to alter the basic force producing the average 1 per cent rise in prices. That basic force is a more rapid rise in money demand for goods and services than in the physical supply.

Of course, individual price and wage changes will not be prevented. In the main, price changes will simply be concealed by taking the form of changes in discounts, service and quality, and wage changes, in overtime, perquisites and so on. Even 60,000 bureaucrats backed by 300,000 volunteers plus widespread patriotism were unable during World War II to cope with the ingenuity of millions of people in finding ways to get around price and wage controls that conflicted with their individual sense of justice. The present, jerry-built freeze will be even less successful.

But to whatever extent the freeze is enforced, it will do harm by distorting relative prices.

SHIFTING THE BUCK

The freeze has reminded me forcefully of a personal experience during World War II, when I was working for the U.S. Treasury Department. In the course of a presentation to the House Ways and Means Committee on the need for additional taxes to prevent inflation, I was interrupted by one member who exclaimed, "Why do we need to worry about inflation in considering taxes? We have just passed General Max [the measure that put a ceiling on all wages and prices]. It is now up to Leon Henderson [director of the Office of Prime Administration] to control inflation." I had barely embarked on a learned discourse about how General Max would not work unless it was reinforced by measures to reduce purchasing power, when he interrupted me again. "I understand that," he said. "Mr. Henderson may fail, but we have discharged our responsibility by giving him the power. Now it's up to him."

Similarly today, every proponent of more government spending who had been restrained by fear that the spending would be inflationary will breathe a sigh of relief and say, "Full speed ahead. The price freeze will hold back inflation."

The proponents of tax cuts, and even the Federal Reserve Board, which deserves most of the blame for producing the inflation, will react similarly. The result is likely to be more inflationary pressure, not less.

APPEARANCE VS. REALITY

Whatever happens to the *actual* cost of products to customers or of labor to employers, *stated* prices and *stated* wages will be largely frozen. These are the prices and wages that enter into officially computed index numbers. These numbers will therefore show a dramatic improvement—and depart increasingly from reality. If the freeze were simply ended after 90 days, the indexes would spurt, even though the prices actually charged and the wages actually paid did not. This will create a dilemma for Mr. Nixon. He has a tiger by the tail. Reluctant as he was to grasp it, he will find it hard to let go. The outcome, I fear, will be a further move toward the kind of detailed control of prices and wages that Mr. Nixon has resisted so courageously for so long.

How will it end? Sooner or later, and the sooner the better, it will end as all previous attempts to freeze prices and wages have ended, from the time of the Roman emperor Diocletian to the present, in utter failure and the emergency into the open of the suppressed inflation. Fortunately, as Adam Smith once put it, "There is much ruin in a nation."

[From Newsweek, Sept. 27, 1971]

LAST READINGS ON THE OLD GAME PLAN

(By Milton Friedman)

By now, most sophisticated observers of the economic scene recognize that economic activity today reflects monetary and fiscal actions of many months ago, and that today's actions will have their major effects many months from now. Accordingly, the course of the economy over at least the next six months depends more on the old game plan for restoring prosperity without inflation than on the new one unveiled by the President on Aug. 15.

However, this fact will not keep the public at large from attributing whatever occurs during the coming months to the new game plan. And they will be encouraged to do so by the news media, with their almost hysterical emphasis on the immediate, their short-time perspective, and their craving for the dramatic.

Before this process goes very far—it began minutes after Mr. Nixon finished speaking—it may be worth recording what we now know about the state of the economy before Mr. Nixon spoke, as the last unambiguous evidence on the old game plan. This evidence belies the doom-and-gloom prophecies that did so much to force Mr. Nixon's hand.

INFLATION

Was it true that "no" or "negligible" progress was being made against inflation?

In July 1971, the consumer price index rose at the rate of 2.4 per cent per year—lower than in all but three months in the past three years, and two of those months were also in 1971. Of course, one month may be misleading, so here are the annual rates of price increase during the first seven months of the past five years:

1971 3.8 per cent.
1970 5.7 per cent.
1969 6.1 per cent.
1968 4.8 per cent.
1967 2.6 per cent.

One must go back to 1867 for a slower rate of price increase.

The more comprehensive index used to deflate the GNP tells the same story. For the second quarter of 1971, it records prices rising 4.1 per cent per year, the lowest rate for any quarter in nearly three years.

OUTPUT

The GNP estimates for the second quarter of 1971 show output growing at 4 per cent per year—still too slowly to absorb unused resources rapidly but a clear improvement over the 2 per cent average rate for the final quarter of 1970

and the first quarter of 1971 (it is best to combine these two quarters to avoid the distorting effects of the GM strike). Except for the post-GM-strike quarter, this is the highest rate in almost three years.

Other indicators confirm the impression that the economy was accelerating from a recession to a vigorous expansion. In the first seven months of this year, industrial production rose at the annual rate of more than 2 per cent, after declining at the rate of 5 per cent during the prior fifteen months. Housing, always an early starter, has been booming. In the first seven months of this year, housing starts were almost 50 per cent higher than in the same months of 1970.

CONSUMER SPENDING

There has been much wailing and gnashing of the teeth about the supposedly reluctant consumer, who was allegedly insisting on stashing away his income instead of spending it—not a bad thing, incidentally, particularly for interest rates. Yet in the second quarter of 1971, total consumer expenditures rose at a rate of more than 10 per cent per year. Retail sales have been even more buoyant. In the first eight months of this year, they rose at the rate of more than 14 per cent per year. Apparently, there is no satisfying some people.

UNEMPLOYMENT

Unemployment is always slow to decline in a recovery and highly erratic from month to month. Yet even so, unemployment, which reached a peak of 6.2 per cent in December 1970, and again in May 1971, was 5.8 per cent in July and 6.1 in August (the unemployment survey was completed prior to the President's talk).

PUTTING IT ALL TOGETHER

The evidence is entirely consistent with my forecast in this space several months ago of "a vigorous expansion with or without further fiscal measures . . . [T]he real danger is an expansion so rapid that it will reignite inflation" (NEWSWEEK, July 5).

Mr. Nixon's abandonment of the old game plan was forced by the international monetary crisis and by the widespread though mistaken belief that the economy was in serious trouble. It was not called for by the state of the economy. The old game plan was working. It will continue to produce a vigorous expansion despite the dust being thrown into the wheels of the economy by the freeze.

Chairman PROXMIRE. Professor Samuelson, you have a very terse, concise statement, go right ahead.

STATEMENT OF PAUL A. SAMUELSON, INSTITUTE PROFESSOR, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. In my judgment, the previous game plan was working itself out in a disappointing manner. I join with the vast majority of economists in applauding President Nixon's determination to pursue a vigorous, new economic program. I judge that on balance it will help to put life into what was an anemic recovery. On balance it will do something to moderate the rate of price and wage inflation this year and next.

However, the proposed program is nonoptimal in many respects. I believe that many changes should be made in it, and that the President with the help of the Congress can make these changes to the advantage of the nation and the international community.

First, I agree that the American dollar has been grossly overvalued at the previous parity structure. I may say that this is not something new. This has been true for more than a decade. But some slow progress toward lessening the amount of disequilibrium was perhaps discernible in the first half of the 1960's, but since the escalation of the Vietnam war, since the middle of the 1960's, the movement has been away

from equilibrium, a worsening of the situation, and a rather dramatic worsening of the situation in the last year or so.

Moreover, I know of no responsible expert in the field of international finance who has any convincing extrapolations or study to show that the previous parity in the years ahead—next year or 3 years from now or 5 years from now—was likely to work in the direction of equilibrium. We were in a dream world, we were on a collision course.

Therefore, I think the President was right to suspend official-gold convertibility of the dollar. Indeed, he had little choice: But for the exchange restrictions that make it difficult for speculators to convert dollars into yen, we would have been losing international reserves at the rate of billions of dollars per week. And perhaps billions of dollars per day. If you could have done what you could do on the German mark, just pick up the phone and take a position on the yen, you would have seen something more dramatic at that time. However, of course, it was not wanton speculation that brought the Bretton Woods system to its end, but rather the decade-long overvaluation of the dollar and undervaluation of the yen, the franc, the guilder, and other Western European currencies. If exchange parities were nearly right in 1949, before the Marshall plan, before the reconstruction of Europe, when Europe and Japan were on their backs, how could they have continued to be right after the miracle of the last 20 years?

Now, it is well known that this administration, like the Johnson administration before it, has been putting pressure in the background on the surplus countries to appreciate their currencies, individually and collectively and to introduce some much-needed flexibility into the Bretton Woods system of rigid parities. Whether this takes the form of crawling pegs or crawling pegs combined with widening of the points around the official parities is not important. And it should be noted that the Germans have responded to this situation with three appreciations since 1961; the Dutch guilder, the Austrian schilling, the Swiss franc, as well as the semifloating Belgian franc and Canadian dollar, have also made some adjustments. But the continuing and accelerating deterioration of the American trade and current-account position make it clear that a considerable further lowering of dollar parity is still needed. In particular the yen has long stood out as the most undervalued currency in the world; and it is a matter of consternation for all and a matter of surprise to me since August 15 that the Japanese have shown such resistance to any change in parity.

Professor Friedman spoke of countries which unwisely spent $500 million a week in order to put off the day of floating by 2 weeks. That is a gross understatement. In several days after August 15, the Japanese Government lost in hard reserves more than that amount of money in supporting the dollar, only to lose the game a few days later.

Mr. FRIEDMAN. Excuse me. The $500 million I meant was the exchange loss they would take on those reserves. The Japanese took in about $4 billion and they will sell it at a price which is 10 or 12 percent lower. I was multiplying the amount purchased by the percent less. My figure was not the amount of dollars brought in, but the amount they would ultimately lose.

Mr. SAMUELSON. Since I know Japanese scholars to be very clever people and Japanese merchants and industrialists to be very enterprising and clever, and since I know that 38 of the leading Japanese econ-

omists had advised the Japanese Government to appreciate the yen on its own prior to any emergency, and since I know that our Government behind the scenes has been putting on pressure in this direction and that all reasons point in that way, it has been a matter of extreme surprise and even of cynicism to me that the Japanese have reacted in the way that they did react after the August 15 move.

Well, now, what is needed ultimately, not necessarily in a hurry, it seems to me, is something like the following. We need a change in dollar parity which is not small, a change in dollar parity relative to the yen of, say, 10 to 15 percent. With respect to Western European currencies, perhaps two-thirds of this amount. Now, of course, we have had some adjustment on the part of the mark and the guilder, so I do not mean at the August 15 rates, but if we go back to the pre-May rates. There are some currencies that are not that hard—I am thinking of the pound—and halfway might be all right there. And the countries of the American bloc—Canada, say, and Latin American countries—many of those, no doubt, would want to go most of the way with us.

Now that, it seems to me, is about what is needed. It is very important to stress that it is not needed on August 17 and it is not needed on Christmas Day. If we know we are moving in that general direction, that would be a tremendous improvement.

Moreover, I do not think it is important that my guesses or the guesses of more expert economists than myself be right in this matter, provided that we also get what is very much needed, which is that in any new currency parity structure—that is, de facto or de jure created—there should be definite elements of flexibility allowing for at least gradual adjustments through time. So that any mistake made in the initial restabilization, plus any accumulating disequilibria, which are always likely in mixed economies, where different economies are subject to different productivity change, differing amounts of cost push Philip's Curve problems can be corrected. You need to have some flexibility and I would presume that it will serve our purpose to talk in terms of some kind of a sliding peg which would allow for changes—these are not emergency changes—of 1 or 2 percent per year, so that in the course of a decade, you would have changes of 12 to 25 percent. That ought to be enough for most gradual changes.

What I think is to be avoided is an immediate stabilization near the existing de facto parities. I suppose the yen at this moment is about 7 percent appreciated with respect to the dollar. The mark, I believe, is about 9½ percent compared to its pre-May position, which means roughly a couple of percent since President Nixon's program. And if you turn to the other continental currencies, it is more like 2 or 3 percent.

The whole exercise was hardly worthwhile if only such derisory changes are to take place. To stabilize at this level I think would be to prolong the agony into the future and would defer a similar crisis for only a brief period.

Now, the President on August 15 announced his 10 percent import surcharge. As I listened to this with the ears of one who believes in freer international trade and in a fruitful international division of labor in which each country in the world benefits from importing in a growing way, I felt that this was a shame, that it was an economic mis-

take. I hoped that it was only for the transitional period, because I knew as an economist that there is nothing that a 10-percent import surcharge can do which a proper depreciation of the dollar parity can't do better and in a more evenhanded way. Moreover, a proper depreciation of the dollar parity will also result in a subsidy to our export industries and better than an ad hoc tax gimmick subsidy or congressional appropriation.

So my first reaction was critical of this. I must confess to you that in view of what happened in Japan and certain other markets of the world, the stubbornness of the other countries to face up to the situation after the ball was thrown in their court, I must now think that the 10-percent import surcharge may have a significance as a bargaining weapon. No other act of President Nixon's seems to have impressed foreigners with the earnestness of the situation and our desire to correct it than that. This is a sad commentary upon the state of rationality of the statesmen of the world who run our affairs, but it has had that effect.

I should warn, however, that if it is to be used as a bargaining weapon, I hope that it will be used successfully and that it will disappear. And I must record the strong feeling that the 10-percent import surcharge has a resonant response in the protectionism which has been growing with each passing year in the United States. And I would not, myself, if I were in Las Vegas, like to give anything like even odds that after the first de facto stabilization is made, let us say by the time of the next election, that there will not be the 10-percent surcharge. In the interest of negotiation, we are playing with dynamite in terms of certain sentiments which run very deep in American life.

I may say that these sentiments are not simply that of the manufacturing employer who historically in many industries has been protectionist-minded. American labor, American organized labor was protectionist in the 1920's. After a long period of education and experience under the reciprocal trade acts, American labor became freer trading. American labor is now, it is very clear in utterances, reverting back to protectionism.

In a moment, I shall comment upon various policies of benign neglect which are urged upon you gentlemen. But one of the greatest costs of that policy in the past and one of the costs of that policy in the future if you accede to it will be a perpetuation of the employment problems associated with international trade. And you will feed the fire of protectionism.

Well, let me now turn to the problem of the dollar price of official paper gold—that is, SDR's. I listened very carefully to the President on August 15. Unless I missed something in his oral statement or in his written text, he did not take a strong position with respect to the official price of gold. And when I was invited to contribute an article for an English newspaper, and I had to shoot from the hip immediately, with no guidance from my pastor or my President, I wrote that probably what we should do is raise the dollar price of paper gold and the dollar price of official gold.

Now, notice the order in which I put that. It is extremely important from now on that the SDR's, paper gold, not be made an inferior currency within the official family. Any encouragement to Gresham's law for bad money to drive out good should not be provided. So whatever

changes are made in these matters, it should always be perfectly understood that along with official gold, official paper gold also has its normal price changed.

I suggested to my English readers that the official price might go up by about 12 percent just to give a rough number, and that the price of official gold and paper gold with respect to the yen not be changed at all. With respect to the other currencies, I suggested we realize the two-thirds formula and half formula that I spoke of earlier.

Now, I did this not because I am a gold fetishist. I have absolutely no interest in gold. Actually, I have no position on milk of magnesia. There are certain situations in which I am prepared to believe that milk of magnesia is indicated and to me, it is not a matter of deep ethical principle what your view is on this. So it is with respect to gold.

Now, when I wrote—this was on Monday, August 16—I did not know that the IMF was about to leak to the newspapers—or at least a leak took place—that it was in favor of such a change as this. I did not know that Dr. Edward Bernstein, probably our greatest international expert, would be testifying before Congress a little later that the official price of gold should be raised by 8 percent. I did not know that the erudite Congressman from Milwaukee, who had at an earlier date the position not to raise the official price of gold, might change his mind in this matter in the course of the next few weeks.

I did know that the French would want us to do this. I was able on a priori grounds to predict that.

I did not know that the Japanese would want us to do this; I did not know that the English would want us to do this; I did not know that the countries who make gold with us by and large with respect to gold holdings versus nongold holdings—I am thinking of the Germans and Japanese and not thinking of the French—would want to do this.

I did not realize, in other words, that nine out of the club of 10 would wish the price of nonofficial gold to be raised. But now I know that. That strengthens my belief that purely at the tactical level, the official price of gold should be changed—at least that should be a negotiable bargaining weapon. And it was with a heavy heart that I heard the President's news spokesman say, no, it is a tenet of this administration that the official price of gold will never be changed.

There was some gloss among columnists, and we know what to think of columnists, who said things like this: The President does not want to be the first Republican to tinker with the dollar and change the price of gold. He does not want to follow in the illustrious footsteps of Franklin Roosevelt, who changed the price of gold in 1933. Just as some columnists say the President does not want to be the most recent President to preside over cutting our losses in a war, following in the illustrious footsteps of President Eisenhower in the 1950's.

I urge upon him that that not be a fundamental tenet of faith, that this be a negotiating bargaining weapon and if the rest of the world wants this kind of milk of magnesia, if it helps agreements to be made, so be it.

It is an extremely unimportant issue. I want to make clear that the very strong and persuasive arguments against raising the price of gold which economists used earlier and with which I agreed, it seems to

me, are not really touched except with respect to one element, in the new situation. For example, it was always said that the South Africans and the Russians, as the nations which have the gold mines, would be the primary beneficiaries from a change in the price of gold. Well, we have a two-tier system now. Because of a grandfather clause in the Bretton Woods agreement, the South Africans have a right to sell gold in the unofficial tier, but when they cannot sell it at $35 an ounce, they have a right to sell it in the official tier. I will not judge the constitutionality or tactical wisdom of having given them that power. But my proposal is that they never be allowed to get more than $35 an ounce in their grandfather clause privilege in selling to the official tier, even though the price of gold within the official tier be marked up. So that particular argument carries no weight.

The Russians, of course, have no access to the official tier whatsoever.

I really have sublime indifference to what happens in the Zurich free market. That is a matter between one French peasant hoarder and another, one Eastern potentate and another, and one member of organized crime and another. I must say as an economist that I think if you do write up the official price of gold by 12 percent, it probably will increase the odds that the unofficial price of gold will in fact go up because that matter has no importance at all. It is simply a gambling casino between transfer payments. Gold for dentistry and gold for relays has no particular role in studying the price of that market and that is of no importance.

It would not matter if we left the price of gold the same and we appreciated the other currencies. But since they have resistance, since in order to prolong their illusions, as it has been put, if I could prolong illusions at so cheap a rate, I would do so in the future.

Now, there is one argument, I think, that in all justice I ought to mention, perhaps does come in here. Very many people have argued that we should get rid of gold completely from our monetary system. That is a view with which, in the long run, I am sympathetic.

Mr. Roosa, for example, has spoken out against raising the price of gold because he said you just encourage gold fetishism. I think you do not change the Las Vegas odds by this token change here, that 30 years from now gold will be out of the monetary system by 1 percent probability. That has to be fought on its merits. And I will remind you of what Mr. Roosa used to remind you of in testimony when he was in office years ago, that de facto, a large part of the world's reserves today are official gold. Those will have to be replaced.

I do not want to dwell on this in my initial discussion, but I do not believe the world is on a dollar standard. I do not believe the dollar is the prime asset to hold. I think we have had evidence for 10 years that everybody has thought that the next move for the dollar is adverse. The dollar was a preferred currency, and even then, not especially preferred. Only because the dollar was undervalued currency from 1933 to 1953, say, and the world for a certain period of time lived upon that illusion and as soon as it dispensed with that illusion, you found that people did not willingly hold dollars, and I have applied many different operational tests to what it means to being on a dollar standard. I cannot agree that in a meaningful sense, the world is on a dollar standard.

Well, let me leave international matters and very briefly comment on the other parts of the President's programs which, here at home, are admittedly the most important. To the man in the street, the wage-price freeze obviously was the biggest news. I judge—we are almost at the halfway point now—that its initial acceptance has been good, that compliance is good to excellent. And I take for granted that it has to be followed by review procedures with teeth, and that the ultimate targets and guidelines can't hope to roll back prices and wages or to stabilize prices, but they can hope to do something to moderate the price-wage creep. Since August 15, I have been doing my homework a little more intensively, and I have been reviewing the price and wage controls of various countries: Australia, Finland, Norway, Sweden, and Denmark. This experience suggests that it will not be easy for a country with our institutions and traditions to perfect an incomes policy. However, this experience does not, to me, bear out the generalization that all such policies are inefficient, and where they are not inefficient, they are inequitable and that they have at best shortrun effects which are almost surely going to be followed by compensating accelerations of inflation that follow.

Australia actually, in the very long run, has had a very good performance in this respect. I call your attention to Lloyds Bank Review, a rather conservative English magazine of April 1971. An article in that publication on the Australian economy today brings out this feature. Let me just quote. The author says: "More surprisingly in view of the current interest in incomes policies, few are aware that Australia has achieved lower unemployment and less price inflation than Britain and most other countries and with the help of something very like an effective incomes policy." (Lloyds Bank Review, April 1971.)

On page 30 of that article, he gives a table showing how prices have behaved from 1960 to 1969 and also from 1969 to 1970. And if I covered up the names of all the countries, and did not tell you which was which and you were asked to pick out the better actors, you would undoubtedly include Australia in that best group.

Chairman PROXMIRE. Without objection, the table you refer to will be printed in the record.

Mr. SAMUELSON. Thank you.

(The table referred to follows:)

UNEMPLOYMENT AND INFLATION, 1960–70

	Annual rise in conumer prices (percent)		Average rate of unemployment (percent)
	1960–69	1969–70	1960–69
Australia	2.3	3.3	1.5
United States	2.4	6.0	4.8
West Germany	2.4	3.9	1.0
Canada	2.7	3.6	5.1
France	3.4	5.6	1.5
United Kingdom	3.7	5.9	2.0
Italy	3.7	4.8	3.0
Sweden	3.8	8.9	1.3
Japan	5.5	8.1	1.1

Source: ILO Year Book, National Institute Economic Review, and the Commonwealth of Australia's annual Labor Report.

Mr. SAMUELSON. I point out that the OECD has some monographs dealing with the Scandinavian countries. The one dealing with Finland suggests that for about 3 years, Finland has had a very good incomes policy. Although the returns are not fully in and will never be fully in, the judgment on the part of most people is that this has been a rather good case.

On the other hand, I want to call your attention to the fact that the bulk of studies made of mixed economies in the post-World War II period show that none of the mixed economies, whether they be the Netherlands or Sweden, whether they be England or Italy, have been able over the long run to have a successful incomes policy. What happens in most of these countries is that even with an incomes policy, prices rise and wages rise almost as much as in their parallel countries in which that does not happen. But they do succeed, it seems, in living with that creeping inflation at much lower levels of unemployment than we do, and lower levels of unemployment than we can understand in terms of the differences in our definitions of unemployment, and lower levels of unemployment than we can understand in terms of historical structures of our labor market and economy, say, if you compare earlier, before World War II and after World War II. So it may be that there is some net advantage. If I may put it this way, not everybody will understand me, the natural rate of unemployment—that is, the rate of unemployment at which some rate of prices can be stabilized—may be a lower rate of unemployment in the countries which have an incomes policy.

But let me make very clear that the Norwegian economy is vastly different from the American economy. We do not have any group of employers who can bargain for all employers; we do not have any centralized labor organization which can bargain for all labor. And it is a very great mistake to try to transplant the hopes and expectations of one institutional setup to another.

Now, I conclude by trying to appraise what the net effect of this is upon a recovery which, prior to August 15, looked to be disappointing and anemic.

The President's message was not worded in a way to gain him high marks from pedants in economics. He said, and I quote him fairly closely, that he is going to reduce taxes in order to make jobs, and he is going to cut Federal expenditure in order to fight inflation. There is no school of modern macroeconomics, and I think here you have the spectrum of macroeconomists, which would agree that that was a felicitously worded statement. On the one hand, he cut expenditures; and on the other hand, he cuts taxes. Until you go into the quantitative amounts, and until you go into the qualitative nature of the taxes and expenditures, it looks like a standoff.

Now, Professor Friedman has said that in season and out of season, it is always time to cut expenditures and taxes. This is not for macroeconomic reasons but for deep philosophical and other reasons. I do not share in that judgment. I think we have tremendous public needs and we have a need to tax in order to finance those.

Having scored this little verbal point against economist Nixon, let me say that nevertheless, as I add up all the score, I do think there is

net stimulus to domestic employment from his program. The surcharge, for example, although it collects tax revenues, does cause the substitution of American labor for foreign labor. I am not optimistic that the investment tax credit, either as proposed originally or as apparently Congress is likely to modify it, is likely to lead to a resonant response of add-on of fixed investment this time compared to what would otherwise have been the case. Nevertheless, I do give it some stimulus effect. I say this because we have had an investment boom just behind us. I would have expected a bigger kick from the same legislation in 1962 or 1963, say, than I would expect today.

Moreover, as I look at the Nation's priorities, I do not think a case can be made that the highest priority in the first years of the 1970's after that investment boom is to stimulate that part of the economy. Nevertheless, when I put all these things together, I do get a net stimulus.

Let me say in conclusion, though, that I think that most of the first macroeconomic models, the first computer runs which have been made—and I will simply point to one that was testified before you—Mr. Otto Frankenstein-Eckstein reported to you what his first pass was of his model. I speak from pretty good memory. I think what he found was that before NEP, real output was going to grow by about 5 percent in 1971 and after NEP, his computer decided it was going to grow by about 7 percent. Now my memory is imperfect. I think before NEP, at the end of 1972, unemployment was looked to be about 5.7 percent to the model and after NEP, about 5.0 percent. I could be wrong two-tenths of a percent on either one of those numbers, but that is the general order of magnitude.

The Wharton School made a first pass at this and came up with a similar conclusion. Its second pass was not quite as optimistic. The University of Michigan model came up with similar results.

Now, what you must realize, of course, is that a computer tells a consistent story. If the premises put into the computer represent truth, you get a consistent truth. If the guess of the man who runs the model is not correct, then you get a consistent fiction. Your credence in the computer can't give you credence in the forecasts above that of the model maker and the assumptions that go into it. Most of these models and now I will mention no names, but my impression is that—and I am perfectly happy to be corrected, in fact, I hope I am wrong—most of these computer models have operated in something like the following fashion. They have assumed that the rate of inflation is going to be about half. I do not know where they got that number—probably from their wives or mother-in-law or the nearest astrological column, or perhaps from rare intuitive judgment. But in any case, that number goes into the computer model and most of the computer models—not all—have their regression equations in money terms, not in real terms. As a result, the money terms remain about the same. The price inflation is halved right down to below the line and in real terms, comes out a bonus, a harvest, a dividend of the full amount.

Now, that may be the best that modern economic science can do at this point, but it is not good enough for me and when I talk to my mother-in-law, the modification that I am tempted to make is something like the following: It seems to me that the price-wage freeze is working very well now and it will show in some of the stated index

numbers after a few months. But I think it is overly optimistic to think that over a period of a year and a half or more, the rate of price inflation is halved over what otherwise it would have been. The Finnish, the Norwegian, the Australian, all these experiences I am talking about do not really justify that degree of optimism. So I would question that premise.

Moreover, I think lots of relations in the economy are in real terms. The result is that I shave these figures down, but I am left with a net increase. But I warn you, of course, that water can't rise above it source and I have revealed to you the impressionistic method I have used in making my own forecast. So I do not say it is a scientific forecast that should be given a great deal of credence.

Thank you very much.

(The prepared statement of Mr. Samuelson follows:)

PREPARED STATEMENT OF PAUL A. SAMUELSON

1. Because the previous game plan was working itself out in a disappointing manner, I join with the vast majority of economists in applauding President Nixon's determination to pursue a vigorous, new economic program. I judge on balance it will help to put life into what was an enemic recovery. On balance it will do something to moderate the rate of price and wage inflation this year and next.

2. However, the proposed program is non-optimal in many respects. I believe that many changes should be made in it, and that the President with the help of the Congress can make these changes to the advantage of the nation and the international community.

3. First, I agree that the American dollar has been grossly overvalued at the previous parity structure. The President was right therefore to suspend official-gold convertibility of the dollar. Indeed he had little choice: for the exchange restrictions that make it difficult for speculators to convert dollars into yen, we would have been losing international reserves at the rate of billions of dollars per week. However, it was not wanton speculation that brought the Bretton Woods system to its end, but rather the decade—long overvaluation of the dollar and undervaluation of the yen, the mark, the franc, the guilder, and other Western European currencies. This Administration like the Johnson Administration before it, has been putting pressure in the background on the surplus countries to appreciate their currencies individually and collectively and to introduce some much-needed flexibility into the Bretton Woods system of rigid parities. The Germans have responded to this situation with three appreciations since 1961; the Dutch guilder, the Austrian schilling, the Swiss franc, as well as the semi-floating Belgian franc and Canadian dollar, have also made some adjustments. But the continuing and accelerating deterioration of the American trade and current-account position make it clear that a considerable further lowering of dollar parity is still needed. In particular the yen has long stood out as the most undervalued currency in the world; and it is a matter of consternation that the Japanese authorities should not have long since unilaterally appreciated the yen as well as lessening impediments to imports and to movements.

What is needed utimately—not necessarily in a hurry—is change in dollar parity relative to the yen of at least 10 to 15. With respect to Western European currencies perhaps ⅔ of this amount, and with countries in North and South America moving more nearly with the dollar. Currencies of intermediate strength, such as the pound, might aim for a halfway change. It is not important that the exactly-correct guesses be made in these matters provided the new parity structure has allowance in it for gradual flexibility to accommodate to growing disequilibria and change. *What is to be avoided is an immediate stabilization near the existing de facto parities.* That would merely prolong the agony and defer the crisis for a brief period.

In my judgment, President Nixon should not insist upon no change in the dollar provides in the way of a surcharge on imports all that can be desired; in addition it gives a subsidy to our exports and to workers in the exports industries. Except as a transitional bargaining tool, it should be quickly abandonded—both for it's own inefficiency and lest a world-wide trade war involving trade and

exchange restrictions kill off the living-standard benefits of growing international trade.

In my judgment, President Nixon should not insist upon a change in the dollar price of official gold and official paper gold (i.e. SDR's). This should be a negotiable matter. If the IMF and the other nations of the Club of Ten can be more easily persuaded to adopt a new parity structure that is nearer to equilibrium by our agreeing to some revaluation of official gold, then no considerations of national or personal prestige should keep the President and the Congress from going along with this move. The campaign to drop gold eventually from our money system will not be vitally affected by such a decision, nor will the prospective degree of inflation. Moreover, the valid earlier arguments against raising the price of gold no longer apply now that we are living in the 2-tier system in which free gold is carefully sealed off from official-tier gold.

4. On the wage-price freeze I shall be brief. It's initial acceptance has been good. It must be followed by review procedures with teeth: the ultimate targets and guidelines cannot hope to roll back prices and wages or stabilize prices, but can hope to moderate the price-wage creep. Since August 15 I have been reviewing the experience with price and wage controls of various countries—Australia, Finland, Norway, Sweden and Denmark. This experience suggests that it will not be easy for a country with our institutions and traditions to perfect an "incomes policy." However, this experience does not bear out the generalization that all such policies are inefficient and inequitable, having at best short run effects which are followed by compensating accelerations of inflation. Australia in the long run, and Finland in the short run, are successful cases worth study in detail.

5. The Presidential message of August 15, in its assertion that taxes were to be reduced to create jobs and Federal expenditures reduced to fight inflation can't get high marks for understanding how macro-economic fiscal policy really works. But taken as a whole, the originally proposed fiscal measures would add to output growth and unemployment reduction in the next 18 mos. I must put into the record that the first computer appraisals of the N.E.P., such as Dr. Eckstein's before your Committee, seem too optimistic in their belief that 1972 will achieve 7% real growth, 2% more than before N.E.P. I think it unrealistic to expect the inflation rate will be halved. Unless Congress gives consumers lower income-tax rates, we shall not reach 4½% unemployment levels before 1973.

Chairman PROXMIRE. Thank you, Mr. Samuelson and Mr. Friedman. This is most enlightening.

Mr. Friedman, have you met with President Nixon since August 15, his speech on the new economic policy?

Mr. FRIEDMAN. No, I have not.

Chairman PROXMIRE. Have you, Mr. Samuelson?

Mr. SAMUELSON. As it happens, no.

Chairman PROXMIRE. I think this is very significant, because the President has made a very earnest effort to get the views of business, of labor, of Members of Congress, of consumers. I feel very strongly that he should meet with the leading economists in the country.

Mr. FRIEDMAN. Excuse me. I have not met personally with President Nixon, but I believe my views have been available to him.

Chairman PROXMIRE. Yes, but you know, there is a little difference between meeting with the President and having your views available. I think it would be desirable to meet with the President. I intend to write him and suggest that he do that.

He has told us that he is not going to make any quick decision. But he indicated he probably would not make any indications until September 30, and it will probably be between September 30 and sometime in October when the decision is made. It is very important that the people who have devoted their lives to economic policy and have a great competence in this field be involved. I certainly hope that he meets with leading economists.

Now, Mr. Friedman, you always make a most appealing and I could almost say seductive kind of analysis. It seems to me, however, that

it is based, in part, at least, on going pretty quickly over some of the fundamental problems in our economy. You make a statement which of course I would not expect you to document right now in detail, but you make a statement that a healthy economic expansion was underway before the freeze. If this is true, I would agree that much of the reason for the President's program evaporates, certainly the domestic part of it.

Now, all the indicators I have seen seem to contradict that. Unemployment has been hovering around 6 percent for 10 solid months; the capacity utilization figure is below 75 percent; hours of work average around 37½ a week, which is low. There is very little to indicate that even now, the economy is likely to improve. What makes you feel that a healthy expansion was underway and if we just let nature take its course, that would do it?

Mr. FRIEDMAN. I put most of the figures in this Newsweek column, and the article is appended there. But let me respond to your particular point.

First, with respect to unemployment, if you look at the chart of unemployment, you will see that it was rising rather sharply until it hit the 6.2 peak in December. Since then, unemployment had been wobbling. It has not been going down sharply; it has not been going up, however. This is typical for economic expansions. It has always been true that unemployment is a lagging indicator, that after the economy takes an upturn, unemployment is slow to respond because for a time, you have unused capacity to draw on. In addition, until economic activity is growing more rapidly than the labor force, you do not get a reduction in unemployment. But the picture was of a distinct change in unemployment since December and an irregular and mild decrease in it.

Second, as far as output is concerned, it is fascinating the extent to which almost all judgments seem to be based on the initially published figures without allowing and altering those judgments on the basis of the further revisions. It is fascinating to note that the first estimates that were released for the second quarter of this year showed a 3.6 percent annual rate of real growth. That rate was revised upward to 4 percent and I understand they have been revised further to 4.8 percent.

If you look at the figures on retail sales, they have been rising very rapidly this year. Again, if you look at the first report, the first revision and the second revision, it turns out that each time the first revision has been above the original and the second even further above. If you go back and look at the figures after they have been revised, I think you may get a different impression than you get from the original figures. This is not deliberate, it is because of the conservative instinct of statisticians. There is bias, but it is not a deliberately introduced or political bias.

So far as output is concerned, I do not think you can judge anything from the first quarter, because that was a reaction to the GM strike. You really have to put the fourth quarter of 1969 and the first quarter together as one unit. But if you do that and if you look at what has been happening over those two quarters, you had a 2-percent-per-year rate of real growth. In the second quarter, you had something like 4.8 percent.

Chairman PROXMIRE. Even that is short of what we need. We have a $70 billion gap in demand that was necessary to bring us to the em-

ployment level which seems to be the President's target and our target. We seem so very, very far short of this. They talked about a much more substantial growth than you have indicated here. You have argued that instead of creeping, we may be kind of moseying along. But there is no indication that we are really striding forward with any real vigor.

Mr. FRIEDMAN. Excuse me. I believe, Senator Proxmire, that we have to make our way between two very real abysses, two real problems. On the one hand, we certainly do want to reduce the level of unemployment and increase the level of output. On the other hand, we want to do it in a way that does not reawaken and restart inflationary forces. There would be no difficulty whatever in getting out of our unemployment difficulty if we were to increase the money supply at 20 percent a year, or, if you take a fiscalist view, if we were to create a budget deficit of a hundred billion dollars a year. But neither you nor I want to do that. We would both say that it is better to take a little longer to reduce unemployment than to fall into the abyss of inflation.

On the other side of the picture, we do not want to fight inflation so hard that we fall into the abyss of increased unemployment and deepened depression. I think that we must try to find a middle way between these two, my judgment is that the path we were on before August 15 was pretty well calculated to do that, that unemployment was declining and inflation was tapering off.

Again I have some figures in my Newsweek column about the annual rate of rise of consumer prices in the first 7 months of each of the past few years. It was 3.8 percent in 1971, 5.7 percent in 1970, 6.7 percent in 1969. So you were having a very definite tapering off of inflation. Again, the tapering off was too slow. Obviously, all of us would like to have a more rapid tapering off of inflation and a more rapid increase in output. But we cannot have both together.

Chairman PROXMIRE. As I look at the figures I have here from the most recently available September indicators—unfortunately, they are for May, June, July. The August figures we just have now. These figures indicate we are still moving on at an inflation rate of between 5 and 6 percent. In July—that was July. It will take a little longer period to get revisions. In the most recent months, it is at that level.

I have two more points about this. I would like to have Mr. Samuelson comment on this, too. One is that we are very, very far short of a situation in which we have demand pull inflation of the kind we experienced in the late 1960's, No. 1.

No. 2, one of the reasons, as I understood it, for the freeze, one of the reasons for a follow-on phase II is so that we can hold down some of the pressures in the economy, especially the wage push element in inflation, while giving the President and the Congress more leeway to stimulate the economy and provide more jobs. We are not satisfied with this program of permitting unemployment to drift along for another year at close to the 6 percent level.

Mr. FRIEDMAN. May I comment on that for a moment, because I thought you were adding that on to my comments and I do not want to let it stand that I agree with your judgment of that situation.

Chairman PROXMIRE. I know you do not agree with it.

Mr. FRIEDMAN. I, myself, do not believe that we have wage push. I believe the increases in union wages have in large part been make-up increases, that they have been the effect of earlier demand pull. I think it is a mistake to argue that there is anything different in the kind of inflationary pressure we have had now than earlier.

I may call to your attention that I recently went back and read a session of the American Economic Association in 1910 in which, as it happens, the professor at the University of Chicago, James Lawrence Laughlin, was taking the opposite position to the Chicago position today. He was arguing that the United States was then in the throes of cost push inflation. He was arguing that it was in the throes of cost push inflation in part because of the unions, which accounted for 1½ percent of the labor force, but mostly because of the growing trust movement.

On the other hand, he was opposed by a professor from Yale University, Irving Fisher who quite properly pointed out that Laughlin's analysis dealt with relative prices and not the absolute prices. So this is an old issue. I think there is no more evidence today than there was then that what is interpreted as cost push is anything other than the delayed impact of the earlier demand pull inflation.

I do not say that does not raise a problem about producing the transition. It does. It is the very reason why if you go too fast, you are going to reawaken inflation. But there has been nothing new added here that calls for a different approach to the problem than earlier.

Chairman PROXMIRE. Mr. Samuelson.

Mr. SAMUELSON. I strongly disagree that the previous game plan was working out properly. My goals for what would be a desirable compromise between the inflation and the unemployment problems would be higher than those of Professor Friedman. In this, value judgments are being expressed and also some scientific judgments about the longer term tradeoffs between unemployment now and unemployment later.

I also think that Professor Friedman's general views—and I am very proud to say that I monitor his views very carefully month through month—have been more optimistic about the months to follow each utterance of his than I recognize in the reality that followed those particular periods.

I also think that he and I would differ very much on what could be deemed a failure of the previous kind of game plan. If you were to ask me what stubbornness of unemployment, what reacceleration of inflation would make you, Professor Samuelson, approve of an incomes policy, let's say like that the President has proposed, I think I would give a different answer from the one Professor Friedman would give if you would address the same question to him.

I have often done thought experiments in place of counting sheep, asking myself, what if I were Professor Friedman; would a 7 percent open rate of inflation cause me to come out in favor of an incomes policy? And in my first pass at this problem, my answer is always no.

Then I try 8 percent and I still get no.

By this time, I fall asleep at night.

Mr. FRIEDMAN. I cannot justify or excuse Paul Samuelson's masochistic instincts, but I would like to correct his statement about my predictions. It so happens that his statement is false. In December

1969, when I gave a talk somewhere in New York, I predicted that there would be a recession in 1970 and said I expected to see the unemployment rate rise to something in the neighborhood of 6 percent. I think that was a pretty good forecast and was not in any way more optimistic than what actually happened.

Since that time, I have predicted that there would be a turn-around in the economy at the end of 1970. There was. I have said over and over again, whenever I have commented on this topic, that one of the things we know best from past experience is that mild recessions are followed by mild expansions. We had a very mild recession. The recession of 1970. I may say, so far as I can see, is the mildest one in the history of this country, not only in the post war period, but as far back as you go, with perhaps one very minor exception, right after World War I.

So given that it was a very mild recession, if you do not go down very far, you cannot go up very fast. It is a mistake to compare this recession with earlier ones in terms of the rise from the trough because in earlier recessions the trough was lower. In earlier post-war recessions, unemployment was in the neighborhood of 7 percent or more.

The right way to make comparisons is to compare where you are with the peak prior to the recession. If you make that comparison, you will find that this expansion is on the average roughly in line with earlier post-war expansions. It is not abnormally weak.

Therefore, I do not accept Paul's characterization of my predictions.

Chairman PROXMIRE. Senator Javits.

Senator JAVITS. Mr. Chairman, in view of the spirited exchange we have just heard, it seems to me most extraordinary to me and my colleague Congressman Conable had the same feeling, the extent to which you agree. Your colorful and exciting personalities, matched side by side, are attractive and interesting. But the substance of the matter is that we are here to look into the future and see what is going to happen and what we ought to do.

Let us bear in mind that it is the Congress that is going to do the doing. Relatively speaking, the President has done very little, because he can do very little. He cannot even change the $35 price of gold. The Congress has to do that. Both Congressman Reuss and I are up against that very hard nut in all of our ideas.

So as I see it, you gentlemen are very much together on the near term objective: that is, to change the rules of the IMF, as Professor Friedman puts it, to remove any restrictions on floating exchange rates, and to widen the bands within which currencies, if set at official parity, are permitted to float; second, to encourage other countries to let their currencies float; third, to accept as final the end of the gold link with the dollar; and fourth, and to me critically important, to treat the 10 percent surcharge, superficially seductive as it may seem to many, with the greatest care, on the ground that it may be all right for openers, but if it is permitted to become imbedded in the economy (and tied, which neither of you say, but which I know you are very well informed about, with a "Buy American" preference in an investment tax credit) it could become so imbedded that nobody could get it out. And, in that case, each of you say, the future promises nothing but trade war.

Now, these, it seems to me, are very clear guidelines which your great knowledge and the respect we hold for you both make it very impressive.

May I ask whether I have misstated or in any way changed your positions in trying to lay this out?

Mr. SAMUELSON. I think you have very correctly recognized a very strong area of agreement. I would just put in one caveat, that I do not have a very strong position that at this time it would be the policy of the United States to say that it will never, at any new parity structure or gold price structure, engage in gold conversions as part of the international settlement. I have no dogmatic position on that, including that we have decided as a Nation in these next few months to make that decision.

Senator JAVITS. Well, Professor Samuelson, never is a word I try never to use, as one in public affairs.

Mr. FRIEDMAN. I thought it was an entirely fair statement.

Senator JAVITS. I thank my colleague.

May we have from each of you what you consider to be our proper longer range objectives? Let me define those as the President has defined them: Essential to bring about a new international monetary system. I gather both of you feel that is years overdue.

I certainly do and most of my colleagues do, up here, anyhow.

Secondly, essential to get a greater contribution from other nations in what is called burden sharing for the tremendous load we carry in respect of world defense, deployment of our forces, the nuclear umbrella, and many other matters.

And third, he wishes a renewed effort, this time hopefully more successful, to reduce essentially the nontariff barriers to trade which seem to have become more formidable than the tariff barriers to trade, which we seem to have done pretty well with until we got to the 10 percent surcharge in the Kennedy and the other rounds we have gone through with GATT.

Now, there may be others, but I use those only to define my terms when I speak of longer term goals.

It seems to me one great problem presented by the President's presentation, perhaps even more by Secretary Connally's presentation, is that it has not been made clear that we do not expect every thing to be wrapped up and before we take off the 10 percent surcharge; that we are ready to negotiate with a good-faith agreement on these problems, and that is as far as we need to go in dealing with the temporary problem. I think that must be made clear, and I think it is very unclear.

Now, those, as I see it, are the longer term implications and we would greatly appreciate your views.

Mr. FRIEDMAN. I am glad to comment on them. With respect to the international monetary system, I think one thing is clear. You will not have a repetition of Bretton Woods in the sense of any kind of negotiating session lasting a long time among countries that will produce a new blueprint. That was possible only at the time of Bretton Woods because the world was at war, because international transactions were suspended and the United States was in a dominant position. Today it staggers the imagination to think of people sitting around a table for 6 months arguing about the monetary system while people are trading in the exchanges every day. The new international

monetary system will develop out of the actions of individual nations and will then be embodied ex post in the rules of IMF.

In this connection, I share what I think is the aim of the administration, namely, a system in which there is a very considerable element of flexibility. Personally, I would like one that involves complete floating, but I do not think that is likely. It does not matter too much so long as you have wider bands and so long as the countries involved let their exchange rates go more readily when they come under stress.

The most important ingredient, it seems to me, is flexibility. Speaking personally, I have always been opposed to SDR's. I think they are a bad arrangement. I have always had great doubts about an international central bank, as I have had even about a domestic central bank. I think it was against the American interests to promote SDR's. It was a mistake at that time, and it would be in our interest to have them abolished, rather than strengthened. That is speaking for myself. I do not know that it is the administration's position.

I think it is important to put these economic changes in a broader context. I believe that we have had a basic change in the thrust of American foreign policy in the past few years. From the time of Woodrow Wilson's election in 1916, until the time of President Nixon's election in 1968, the dominant position of the United States may be described as benevolent paternalism. The United States had the mission, in the words of Woodrow Wilson, to "make the world safe for democracy," or, in the words of others more recently, "to be a policeman for the world." I believe that is a bad policy for a nation. I think many people can be altruists. A government should be concerned primarily with the enlightened national self-interest.

There has been a great change in that attitude since 1968, in every area, whether it be withdrawal from Vietnam, the low profile policy, the attempt to change our relations with Red China. Mr. Nixon has been moving, as I sense it, away from that altruistic, policeman, paternalist view toward a view promoting our enlightened self-interest, toward making it clear to the rest of the world that the United States is no longer the one country that can be counted on to put other countries' interests ahead of its own.

I think our benevolent paternalism has not been good for other countries. We have done much harm by our well meaning—and I have no doubt that it has been well meaning—disinterested attitude. There are few programs of other countries that have been so unselfish and disinterested as the Marshall plan and similar programs. But I think nonetheless these programs have been harmful to the rest of the world.

What you speak of as a greater contribution to burden sharing, as a reduction in our contribution to European defense, both in money and in men, are all part of this general picture. The new trend in foreign policy, as I interpret it, seems to me on the whole very healthy. Yet it also offers great dangers that we must be careful to avoid. It would be very dangerous to have it slip back into a neoisolationism or an extreme isolationism. It should not be that. It should rather be a view of the world as one in which we are cooperative partners of other nations, rather than as one in which we are the pater familias and the other nations, our minor children or wards. I think it would be very healthy for the world if we can move to such a conception.

So I share very much the view that there should be a greater contribution by other countries to common cause. I agree very much with the effort to reduce nontariff barriers and I agree very much with your view that we should not make the removal of the import surcharge contingent on complete agreement on all these things.

It is urgently necessary that we get rid of the import surcharge as soon as possible, because I share your view that if it lasts very long, it will become too deeply imbeded to be eliminated.

Senator JAVITS. Thank you very much.

Mr. Chairman, my time is up.

Chairman PROXMIRE. Mr. Samuelson, go right ahead.

Mr. SAMUELSON. I am not going to comment upon the view of history we have just heard but confine myself to economics. I want to speak in a nonpartisan way.

I am not persuaded that the administration, this administration, speaks with one mind on the problem of protectionism versus freer trade. The same thing could be said about the last couple of administrations. But in particular, any economist who has been following matters closely must realize that there exists within the administration, most notably in the Department of Commerce, in the Secretary himself, and in certain Assistant Secretaries, a very strong protectionist sentiment. This is responsive, no doubt, to some very strong political pressures. But we have negotiated voluntary quotas. We have had White House-sponsored legislation for mandatory quotas in the field of textiles. There is strong talk at this time for more of that.

Now, I applaud the fact that the President has on many an occasion, and perhaps at the cost of some political following, spoken out in favor of fighting protectionism. On the other hand, in the rhetoric in which America will no longer fight with one hand tied behind us, and some other matters, it seems to me they do elicit a resonant response among the protectionists, who are very many.

Let me be concrete. Of course the Japanese should remove impediments to our exporting to them, impediments which go beyond, in many industries and many occasions, similar impediments which we put upon their products.

Or of course, if you talk to people in the steel industry, you will learn that to lay down a ton of American steel in France, even if you did it on a philanthropic basis, costs so much in terms of tariffs and red tape and so forth, that there is not a symmetry. And of course our negotiators should ask to have those removed.

But let us make no mistake about it: If those were removed and if the parities were anything like what they have been and if the cost structures in the respective countries continue to be, as I think they will be, much like what they have been, there is no chance that American steel would flood the French market. It is an illusion to think that after the Japanese have removed these impediments, equilibrium could be achieved in that way and that our lack of protectionism inducing them to have a lack of protectionism would be an important equilibrating element in the balance of payments.

Senator JAVITS. Thank you, gentlemen, very much. I personally feel that we profit much from the parallelling reviews by you and I do agree, if I may just finish, Mr. Chairman——

Chairman PROXMIRE. Yes, indeed.

Senator JAVITS. We need to be enlightened in this country, and it is a grave deficiency, on the true meaning of protectionism. In fact, rather than theory, the superficialities have misled, I think, organized labor and, right now, are misleading the public. I think protectionism is the worst possible medicine for exactly what is ailing the American economy and will only hurt us infinitely more than anybody else. The foreigners may not have respected our economy enough, and feel if they have to, they can get along without us as we can get along without them, but it will ruin us all.

Thank you.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman, for bringing these two titans before us again.

I want to ask a question of immediate importance on which you gentlemen, so I think, differ: The question of whether, in view of the fact that all of the Group of Ten, plus Switzerland, say they will do all the good things which you, Mr. Friedman, and you, Mr. Samuelson, and I think the members of this committee believe have to be done in the international monetary field, in view of the fact that we have what amounts to a unanimous offer from those people—the six plus Canada, Great Britain, Japan, Sweden, Switzerland—whether we will accompany the proposed realinement of currencies with a bit of give, a bit of devaluation on our side? The President and Secretary Connally have said no, never, we will never devalue the dollar by even a technical bookkeeping raise in the price of gold. Mr. Samuelson and myself—and if I misstate you, Mr. Samuelson, you can certainly tell me—feel that a modest $2 or $3 increase in the bookkeeping price of gold is free of all of the objections which have led all three of us in years gone by to say, we are not going to increase the price of gold. Indeed, I think, Mr. Friedman, you recognize that, because in your statement, you say "We can make other countries happy at no cost to us and it is tempting to say that we should do so."

Now, I come to my point, Mr. Friedman, you refuse to do what Mr. Samuelson and I think we should do; namely, switch around and say, all right, gentlemen, we will talk about a modest increase in the price of gold, let's see all your cards, let's get going, we have fooled around long enough.

Mr. Samuelson and I feel that ought to be the negotiating stance we should take. You say no because, quoting from your statement, "The basic reason other countries want the change is for window dressing pure and simple, to be able to say that by raising the price of gold, the United States has not only done its share to solve the common problem but also had admitted 'mea culpa.' "

I think that is a fair statement. I have talked privately to the ministers of finance, central bankers, making up the Group of Ten, and I think that is about what they have to say publicly. That is what they are saying, that sin is multilateral and you Americans have to admit to a bit of it, too.

I now come to my rather obvious question: Are you and President Nixon and Secretary Connally really ready to see American labor and American business clobbered by the refusal of other countries to let their currencies float, which they have made manifest by their interventions, clobbered by the apparent willingness of the Japanese,

which you have described so dramatically, to allow their people to ruin their eyesight making little electronic widgets in return for our leading export, paper dollars? Are you really willing to see American industry continue to have an uneconomic and fraudulent incentive to invest in foreign countries? Are you really willing to see foreign investment in this country denied this country by continued overvaluation of the dollar?

I think that is what you have to be saying. I wonder if the puristic, pristine, let's always be right about gold and recognize what a barbaric relic it is—I wonder if that joy really compensates for all those men out of work and businesses going broke.

Mr. FRIEDMAN. And when, Mr. Reuss, did you last beat your wife?

Seriously, I am obviously not in favor of all of those evil things that you attribute to me. And obviously, I take the position I do—I speak only for myself, I cannot say Mr. Nixon and Mr. Connally are taking this position for the same reason—not because I have any objection to our admitting our guilt. As I mentioned in my statement, I think we are very guilty. But I think a far more effective way for us to remove our guilt is by removing the restrictions that we have imposed on the moving of capital abroad, on investment abroad. That would be a more effective way of admitting guilt than a purely bookkeeping change.

The reason I object to what looks like a purely bookkeeping change that will cost nothing is because I do not believe it will cost nothing. The reason other countries want this change is for the reason of face-saving, but also because they want to see a future in which the change in the price of gold will be not only bookkeeping but will be real. The fact is that we will be agreeing to something with very different opinions on the two sides about what we are agreeing to. You and I would be agreeing to it on the ground that after all, if we make some entries on the book and do not sell gold at $35 an ounce, what difference will it make if we do not sell it at $38?

What the Europeans want from us is an agreement that we will work over the longer period for a restoration of the convertibility of dollars into gold or if not into gold, into SDR's or the equivalent. That is the reason I say here that I believe we should not do so because it will only prolong illusion.

We have at the moment an unusual, very rare opportunity to face up to the realities of the situation. We have a degree of fluidity and flexibility in the international monetary arrangements that you have not had for a long time and may not have again. I think it would be a shame to waste that by taking a step which will cause us difficulties later on and that we will have to face up to again.

If you look back over our past record in this connection, like you, I have long been in favor of ending the commitment to buy gold or sell gold at a fixed price. We postponed doing it. What was the effect of postponing doing it? To take a situation that could have been handled very easily to begin with and let it develop into a crisis so that we took measures in a crisis situation. Now we have a chance to clean the thing up and I hate to see us throw away that chance by engaging in what I fear will only develop into a later confrontation and will cause us to go through it again.

Let me go back to some of the other comments you made. The purpose of life is not to work; the purpose of work is life. We do not want to create jobs, we want to create productive jobs. We want to create jobs which will enable people in this country to have high standards of living. If the creation of jobs were all that is involved, we can have people dig holes in the ground. It is in our self-interest, though not in the Japanese, to have the Japanese slave over those widgets and send them to us for dollars. That does not mean in any way higher unemployment in this country. The alternatives to producing for export are to produce for domestic consumption. We must not fall into the fallacy of supposing that there are a fixed number of jobs to go around and if we have fewer jobs in export industries, we will have unemployment. That is not the alternative.

So many of the things that you describe here as evils have nothing to do with the price of gold. I would not accept your description of the consequences to the United States of these unwise, undesirable protectionist measures of Japan and other countries.

This is exactly what Mr. Javits was speaking about, it seems to me, about the misconceptions that generate protectionist instincts. And I know you do not intend that. I know you are also a free trader and wish to foster more free trade. Yet I think to put the issue as you have is to put it in terms that a protectionist would well accept.

Representative REUSS. I would like Mr. Samuelson to reply in just a minute, but first let me say that Samuelson and myself, in saying let's buy a good contract here by a slight increase in the official bookkeeping price of gold, we accompany that most rigidly by saying, and the gold window must stay closed and the two-tier agreement must be completely honored. If that is so, though I do not want to prolong the argument, I do not really think we are giving into gold buggy ties on the part of those who would like to revive them.

Mr. FRIEDMAN. You will accompany it by those qualifications, but will the Europeans?

Representative REUSS. My answer is yes, or no deal; yes or I will not sit still for that necessary act of Congress increasing the official bookkeeping price of gold from $35 an ounce to $37 or $38, whatever it ends up on. I want to see a firm agreement in writing, without quibbles, by the others. If they can be salved by this phony bookkeeping increase, great. I think we ought to try. I think your method, Connally's method, Nixon's method, keeps us from trying.

Mr. FRIEDMAN. But I would predict that the European countries' desire for this measure would disappear if the measure were accompanied in writing by those additional restrictions.

Representative REUSS. And I would answer that by saying that we have in writing for them, the September agreement of the six adhered to by the others. I go by that agreement. They say in that, that they envisage the washing out of gold. I would take them at their face value. They do not say a word about you Americans having to fudge about closing the gold window. Take them at their face value, which is surprisingly Friedmanesque. Let's start bargaining about it instead of closing the door.

Well, we cannot settle this.

Mr. FREIDMAN. I must have read a different communique, because I understood them to say that this is a first step, and as a later step,

we should explore the restoration of convertibility, the restoration of a role to gold in the system. Maybe I have misread them, and if they have said what you have said, that is something else.

Representative REUSS. Good.

Mr. Samuelson.

Mr. SAMUELSON. Mr. Dooley's bartender always spoke of "Teddy Roosevelt and I." So I too am basking in the glory of being associated with you, Congressman Reuss, in these positions.

Let me make two comments, one about the basic economics and the other about the tactics of the situation.

In connection with the basic economics, I am of the view that if there were a permanent set of imports that could come from abroad, if you could count upon them indefinitely because of some illusion of the rest of the world that they want to give us goods, and you could really count on that, then transferring many of our people out of industries in which workers now work and transferring them into other industries which have advanced economic policies which Senator Proximire would be shocked at, then we would all be better off and we would be better for it.

But my criticism of the benign neglect doctrine is that it is incredible to believe that free imports are going to happen on a long-term basis.

I want to introduce into the discussion one horrible thing which you did not mention, perhaps by inadvertence. The real danger is not that we go on getting goods for nothing forever and have to make adjustments for that. The real danger is that you are going to have exchange restrictions all around the map, and you are already having those since August 15. You have new restrictions upon capital movements. The result will not be the kind of alternative which I think has been painted here.

Now, on the tactical level, as I read the different ideologies of different parts of the world, by and large what all of us here have agreed upon as the ultimate goal of what is a more rational international order. The view in favor of that is more strongly held in the United States among American economists than among economists abroad. It is more strongly held—I do not make this as a chauvinistic statement, but just as my reading of the situation—among our Congressmen and the executive branch than elsewhere in the world.

Now, to make the whole rest of the world mad at us, we come in and ask for a $13 billion shift in the balance of payments. I thought I was the biggest demander of an increase in our balance of payments because I used to say we have to have an honest $8 billion on current accounts. Well, the ante has been raised, and this to be done in a short period of time.

We do all the things for which America has been criticized in the past, swinging our weight around, and often, swinging our balloon around when we do not have any weight in it.

I do not say that that is the way to end this illusion, that the goal that Professor Friedman wants so much is going to be brought forward by 1 year. I think it is going to be put back 10 years if we have a recalcitrant attitude. This is a very small token of our good faith, and I think it will give us the opportunity in the discussions of the world to press this rational viewpoint which, by divine providence, Americans seem to have been more endowed with than anybody else,

but as in the past, we shall carry the message forward, and I think in a more favorable climate if Congress does act in this particular way.

I want to go back to President Nixon's problem. There is no past commitment that we will never raise the price of gold which, upon sober understanding of diplomatic and monetary history, ought to be honored. There is nothing degrading in the pursuit of this policy in President Nixon's own eyes or even in the eyes of his conservative followers, because by chance, and I do not want to go into this, the conservatism people, who have been the real gold bugs, have been reading Harry Schultz's letters for years and have numbered Swiss accounts, and they are all for raising the price of gold. The crisis of confidence in Main Street, where the First and Second National Bank will be disturbed by the action of history, just will not happen. I think the electorate will not think less of President Nixon if this purely gadgetary thing which they will, most of them, never hear about, does go into effect.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Friends, I am always a little reluctant to intrude my innocence into an opportunity for discourse among two titans, to use Mr. Reuss' term. Certainly you stand on different peaks from which to survey the economic swamps we are in. I wonder, rather than relying on targets of opportunities presented by our questions, if either of you has any comment you would like to make about the testimony of the other this morning, selecting the subject yourself?

That is kind of a dirty trick, is it not? Would either of you care to say anything that has not been brought out by the questioning so far?

Mr. SAMUELSON. I have nothing to add to what is in the lines and between the lines.

Mr. FRIEDMAN. I have not commented in my own testimony in great detail about the immediate domestic situation.

Representative CONABLE. Yes, please do.

Mr. FRIEDMAN. In that respect, I might add that I do not, as I have made clear, I do not share the view that an incomes policy is either necessary or desirable. On the contrary, I believe it will do great harm.

And I might add a point on that score, which is not so much a commentary on Mr. Samuelson's statements as it is an additional elaboration of my own.

One of the reasons why I am personally very much concerned about the incomes policy is because I believe that there is very great danger that it will be a source of more inflation rather than less. It will be a source of more inflation because its existence will lead many people to say, well, now, we have the wage-price controls, we have the income-wage-price review boards to hold down inflation, we can forget about that in respect to the rest of our policies.

Representative CONABLE. Certainly any sort of rigid formula in acceptable wage-price increases during phase 2 would be very likely to become a floor as well as a ceiling, wouldn't it?

Mr. FRIEDMAN. Well, I think that is a real possibility. That is a problem. That is not the one I was referring to.

Representative CONABLE. You were referring, I think, to the more general situation where people will say, well, let's turn up the heat as long as we have a lid on the kettle.

Mr. FRIEDMAN. Exactly. And therefore, I fear very much that you will have a greater degree of inflationary pressure underneath that lid in two areas: No. 1, that you gentlemen in the Congress, any of you who have heretofore been held back, and I gather that there are some people who think you have not been held back, by fear that spending would be inflationary, will have that eliminated. You will now say, well, there is CLC, they are in the business of holding down wages and prices, we can go ahead and worry about expansion and put on more expansionary heat. And that has already shown up. There is a great danger that the budget deficit which promises to be large will be still larger.

Similar and equally important is the effect on monetary supply. This effect is of two kinds: In the first place, if the monetary authorities feel the same way and feel that now they can breathe a little easier, somebody else is taking care of inflation and, therefore, they can print more money, that will produce greater inflationary pressure. But there is another, much more important element. That is that the larger Government deficits, plus the investment tax credit, plus the removal of the tax on automobiles, are, in my opinion, measures that are calculated to produce a higher level of interest rates. They are interest rate raising measures, increases in the demand for credit without increasing the supply.

The only offset to that would be a reduction in inflationary expectations, which might lead people to accept lower interest rates. This has had the indicated effect temporarily.

Now, the way in which the Federal Reserve system has operated, it has, despite the pleadings of this committee over many years—and this committee, in this respect, has certainly been on the side of the angles—despite that, the Federal Reserve, although it has shifted its rhetoric and now pays more attention to the money supply than it did before, is still trying to ride two horses at the same time; on the one hand, interest rates; and on the other, money supply. The result is whenever external forces tend to increase interest rates, the Federal Reserve tends to raise the money supply.

Mr. Burns, when he testified before your committee some time ago, said exactly the same thing. I am just repeating his words.

In the past 2 months, you have a slowdown in the rate of monetary growth. Why? Partly because the Fed wanted to slow it down, but also, I believe, because external forces were tending to lower interest rates. That is, the immediate psychological effect of the President's message produced a decline in interest rates. This meant that the money supply grew less than the Fed intended.

Now, if, in coming months, my fears are realized and there is again upward pressure on interest rates, this will tend to produce a more rapid rise in the money supply. So you will have inflationary pressure building up under the controls, both from the monetary and the fiscal side.

Now, I ask, what happens then? The controls can contain the pressure perhaps for a time in terms of keeping stated prices down. The price index numbers can look well. But if you have such pressure building up, you will almost surely have a collapse of the controls. This has happened in many countries. I do not mean to say it has happened all the time, but it has happened enough to be concerned about it.

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Representative CONABLE. Or an effort to make them more comprehensive.

Mr. FRIEDMAN. Quite right, one or the other of those.

Let's take the first. Let's suppose you have a collapse and let's suppose price indexes start rising at the rate of 4, 5, 6, 7, 8 percent a year, which they might well do. If you look back at some of these episodes, our own experience after World War II when we took off the controls, the price indexes rose extremely rapidly. Real prices did not, but concealed price increases came out into the open.

Under those circumstances, I believe there would be great pressure on the part of the public and on the part of you gentlemen for measures that would stop that inflation. And you would, in my opinion, have thrown away what you gained at the cost of the mild recession in 1970. You would be back at first base, in which you would have to once again contemplate a very sharp stepping on the brakes of monetary and fiscal expansion in order to offset that inflation.

So in my opinion, the present situation contains within it the seeds of, I do not say it is a certainty by any means, but contains within it the possibility of putting us in a position where we are going to have to take another and much more severe recession than we did in 1970 in order to stop this inflationary move.

The question is what can be done about it? The only thing that can be done about it is for you gentlemen in your fiscal actions and the Federal Reserve in its monetary actions to be able and sophisticated enough to avoid this temptation, to be very tight, to have as small a budget deficit as possible and to have a relatively small increase in the rate of money. This is a policy that ought to appeal to those people who believe in the effectiveness of the wage-price controls. If you believe in the effectiveness of the wage-price controls, you believe prices are going to rise less. Then you need a smaller increase in nominal GNP to get the desired increase in real GNP.

I am not saying this is going to happen. But to answer your question, those are the dangers I see.

Representative CONABLE. I am interested in the fact that neither of you gentlemen this morning in dealing with the domestic policy has talked very much about the balance in the tax program—whether it is the right mix of consumer stimulation and business stimulation. The Ways and Means Committee yesterday reported out a measure which altered the President's balance to a minor degree. I wonder if either of you would be willing to comment on this issue as it relates to the specific proposals made.

Mr. Samuelson.

Mr. SAMUELSON. Yes, I was a critic quick off the mark to say that the new economic program will appear as a lop-sided probusiness program and in a time when consensus is needed among all parts of the community for a wage-price freeze. That is a bad thing. And in terms of both the value judgments which I hold and my diagnosis of which parts of the economy are most in need of stimulus at this time, I think it is an unbalanced program. Congress is making some modifications, but they are relatively minor.

The original program added to fast depreciation by executive order, of questionable legality in my judgment, and a definite departure

from the legislative principle, which is that we are taxing money income and not real income.

Added to that was the proposal for a temporary 10 percent investment tax credit, followed by a 5 percent tax credit. Well, it looks as if we are going to get a 7 percent and something is going to be taken away from the fast depreciation. That is a move in the right direction, in my view.

The exemption change proposed by the President, which is the only thing that would come down directly to the low- and middle-income classes and the lower income classes is being modified very slightly. But by and large, when you weigh against this the change in revenue sharing and the change in welfare reform, it seems to me that it is a lop-sided program and it would be a healthier recovery and more in accord with widely shared value judgments if it had been a more broad-based fiscal stimulus program.

Mr. FRIEDMAN. I would like to comment on it from two different levels. In the first place, so far as relative stimulus to the economy is concerned, I believe that we know almost nothing that will justify us in making very sweeping comments about that. Such evidence as I know suggests to me that fiscal changes of this kind do not have any significant stimulus in the sense of expansionary effect on the economy unless they are accompanied by more rapid monetary expansion. If they are not, their major effect is to make interest rates higher than they otherwise would be and to crowd out private expenditures by comparision with the Government. So from that point of view, I am really not going to comment one way or the other.

But I want to comment on something I think is much more important. I think that talk about tax cuts being probusiness or not is demagogy. Business does not pay any taxes, it can't. Only people pay taxes. The question is if you impose a tax that the corporation writes the check for, who pays it? Either the employees of that corporation or the customers of that corporation or the stockholders of that corporation. People pay. The corporation as such has no tax paying capacity.

Moreover, it has long seemed to me that our present system of taxation was very undesirable from that point of view. It seems to me that the Congress should impose taxes on people, not conceal the taxes that people are paying by having it imposed on entities indirectly like corporations.

I have long been in favor of an alteration of the tax structure in which the corporate tax would be entirely removed, but in which corporations would be required to attribute to individuals any income they earned which was not distributed. The only justification for a corporate tax is that it is a potential way of avoiding an individual tax. That could be eliminated, in my opinion, by the device of attributing income.

Then if you did that, it would seem to me it would be far better to be explicit about who is paying what taxes. So I do not go along at all with any of this talk and this argument about something being probusiness or antibusiness. The question we have to ask from an equity point of view is what is a desirable tax structure? If you believe that a desirable tax structure is one which rests more equally and in which people in similar conditions pay more nearly similar

taxes, then I believe essential elements of it consist of eliminating the corporate tax, attributing undistributed income, removing deductions in the personal income tax, having a much broader base in the personal income tax, and having much lower and less graduated rates. That seems to be more equitable.

Insofar as these measures move a mite in that direction, just a mite, but they do move a little in that direction in the sense that the investment tax credit and the depreciation allowance do in fact reduce the weight of the tax on corporations, then they are a good thing.

I want to add one other thing. That is that our tax structure is very defective in what it does about inflation. We have a tax structure in which both corporate taxes and individual taxes go up relative to income with inflation. If you have 5-percent inflation, that is not allowed in the depreciation base that the corporations may take and, therefore, their income is overstated. Corporate profits are overstated by the fact that they are not allowed to depreciate the real value of their capital, but only the nominal value.

On the individual tax, if all prices were to rise by 5 percent, the average rate of tax people pay would go up because you would have people pushed into higher rate brackets. It has long seemed to me that one of the most important reforms that Congress can make in this area would be to attach price escalator clauses to the base for depreciation in corporate depreciation accounting, to the exemptions in the personal income tax, and to the income tax brackets, so that you would have a tax that was levied on real income and not on nominal income.

That is getting kind of far away from your point, but I think it is very relevant to the point you made.

Mr. Samuelson. One man's demagogy is another man's analysis. May I give my analysis?

My response to your question may be related in terms of people, in terms of income recipients, by income class and what happens to their incomes, what happens to their accruing net worth. So I simply reformulate my answer by saying that the August 15 proposals taken as a whole are of the effect, in my judgment, to have beneficial effects at the middle middle-high income groups at the expense of middle, middle-low income groups. And this on the basis of accepting, as I do not accept, Professor Friedman's notion of the corporation as merely a conduit with no existence.

Chairman Proxmire. Mr. Samuelson, is it not true that there are two elements if we are going to get an effective negotiation in the international currency situation? Number 1 we have discussed at some length. There is one point here that I think has been missed. That is that if we increase the value of gold by, say, 8 percent, it makes it a great deal easier for a head of State or for a legislator in Japan or in Germany or in these other countries to go the other halfway with us. It seems to me it is extremely hard, if I were in their position, to take a step which would require a revaluation of the dollar if the situation were reversed, which would obviously cost my constituents jobs. That may not make any sense in the terms that Mr. Friedman describes it, but for them, it is very clear and understandable. They do not want shoes coming in from other countries competing with shoes made in Wisconsin. This is a pressure that I feel. It is a pressure

of a similar kind that the Japanese legislators and heads of state feel and they are very conscious of it. So that if we go a little way, especially since it does not have anything but a theoretical effect, it seem to me we are much more likely to get an effective compromise on their part and an effective devaluation of the dollar. Is that not so?

Mr. SAMUELSON. That is why I used the offensive metaphor of milk of magnesia.

Mr. FRIEDMAN. I do not believe, Senator Proxmire, that you can assume that it is purely meaningless. This is, again, the question of supposing that they are really willing to give something real for something that is zero, that you can get something for nothing.

Chairman PROXMIRE. Well, they are confronted with an immediate political fact now. They have to satisfy their constituents.

Mr. FRIEDMAN. Whatever happens to our nominal price of gold, they must alter by exactly the same amount their buying and selling prices for their currencies.

Chairman PROXMIRE. That is true, but they do not have to take the actual step themselves. It seems to me it would be easier to revalue the yen by 8 percent than 16 percent. Maybe not. If it does not make any difference to them. I think it would.

The experience I have had with 14 years in the Senate is that it would be much easier to go halfway than all the way. It seems to me it would be much easier if I had to take action that would adversely affect some of the producers or labor in my State than to take a position that would affect many more.

Mr. FRIEDMAN. This is not going halfway. It is not doing a thing.

Chairman PROXMIRE. Let's get back to something else that I think is a much more fundamental argument. This is an argument that Mr. Bernstein made and Mr. Okun made, too. I think we are missing it this morning.

If we are going to have effective negotiation, a great deal hangs on having relative prosperity in the world, especially in this country. One of the reasons protectionism increases here is because we have unemployment. We can feel that now. People in all of our States who are concerned with losing their jobs, who see others have lost their jobs, will fight to keep imports out and will fight to increase exports. If we can stimulate our economy so that there are more jobs here and we have a profound effect on economies in other countries, it seems to me they will be more willing to negotiate because they are in a better position to do so. We will be in a better position also to negotiate under these circumstances.

Is that logical, Mr. Samuelson?

Mr. SAMUELSON. I think I must agree that protectionism has grown in this country because as jobs have been lost to imports and as our exports have been lost, there have not been found new jobs for them as the theory of free trade presupposes.

Chairman PROXMIRE. Let me say that a distinguished international French financier observed at a recent meeting that no country would revalue the currency upward and no state would get the international realinement they are seeking to get if there is a recession.

That is why we have to tie these things together and we have to have an effective expansionary economy so we can do something about reducing our unemployemnt, something about giving people con-

fidence that this country is going to move ahead. It seems to me that is one of the weaknesses of the Nixon program.

Mr. FRIEDMAN. Senator Proxmire, there is no doubt that more rapid economic growth would have the effect you say.

But if it was accomplished by a speeding up of inflation, it would have precisely the opposite effect.

Chairman PROXMIRE. But you are almost alone. Your analysis is perhaps as appealing as any economist's. But you have a great array of economists who seem to disagree with your contention that we are now in a position where a substantial stimulus of economy from a fiscal standpoint and a monetary standpoint would give us the kind of demand inflation we have had in the past.

Mr. FRIEDMAN. As you and I know, Senator Proxmire, one man and the truth constitutes a majority and fortunately, truth has never been decided by a counting of heads.

Mr. SAMUELSON. And one man and an untruth constitutes a crank. [Laughter.]

Mr. FRIEDMAN. We will each accept our self-designation.

Mr. SAMUELSON. May I speak seriously? Professor Friedman, in many of the things which he has said here, represents a substantial part of the economics profession. But one of the things which he said here, and as a Friedman watcher, I had not noted this, was that he really does not think there is any change in the cost push mechanism that is operating in the 1960's and the 1970's as compared to earlier decades. If that was not his intention, I hope the record will now be clarified.

Mr. FRIEDMAN. I do not believe there is any change.

Mr. SAMUELSON. I do not believe there is any significant number of modern economicts whom Professor Friedman has yet persuaded of that position.

Mr. FRIEDMAN. I do not know whether that is true. But true or not, there is no doubt that there have been greater rigidities in wages and prices, not merely in the unionized industries but throughout the economy. There is no doubt that that raises the problem of a transition from a high level of inflation to a low level of inflation. The crucial question is whether it is in and of itself a source of inflation. And this is the respect in which I think there has been no fundamental difference.

It is worth noting that if you look at the areas in the economy where the prices have been rising more rapidly, except only for construction, they have been in the least unionized sectors. It has been in medical care, in personal services, it has been in the areas of that kind that you have had the most rapid price rise.

Chairman PROXMIRE. That was up until about 2 years ago. In the last couple of years, we have had a much more rapid rise in the concentrated sections of manufacturing than we had before.

Mr. FRIEDMAN. Particularly in construction. Construction is the extreme case.

Chairman PROXMIRE. I was not talking of construction so much. We have had a more rapid rate of inflation recently in the concentrated areas.

Mr. FRIEDMAN. What does happen is that the more concentrated and the more rigid the area, the later comes the inflationary effect. There is

no doubt that nonunion wages started going up earlier than unionized. Then unionized started going up later.

I am rather unaccustomed to defending trade unions. They do a great deal of harm, in my opinion, in denying opportunities to people who have low incomes; that is to say, through their restrictive measures. But the one thing I do not think they are guilty of is producing inflation. I believe that the large union increases which are regarded as cost push have in most cases been a delayed makeup for the fact that earlier contracts were made under the expectation of much smaller inflation than actually occurred; in the General Motors contract, both General Motors and the union anticipated that by 1970, General Motors would be paying a higher real wage than they were in fact paying, than General Motors intended to contract for. This large first year jump was to get you back onto the real wage that both sides had thought they were involved in.

This is the sense in which I believe it is true that there has been a difference in rigidity. This changes the time pattern of effects, but I do not think it produces any more inflation.

Chairman PROXMIRE. Mr. Friedman, I think your position is clear on a lot of questions I want to ask now. In the minute or two I have left, I would like to get an answer from Mr. Samuelson on a couple of points.

Should we expect an incomes policy as a permanent part of our economy in the future, some kind of incomes policy, at least on a standby basis?

Mr. SAMUELSON. Well, my suspicion is that the American society and the American economy will not stand for a permanent incomes policy and——

Chairman PROXMIRE. I am not talking about a freeze. I am talking about simply guidelines and that kind of approach.

Mr. SAMUELSON. No, I think there will be a permanent need for an incomes policy and I think every President will find himself pursuing something of an incomes policy. But I think we are now in a period of quasi-mandatory direct controls and that they can hope to make a contribution over a limited period of time, but it is unlikely, if I may speak as a prophet, that these will develop into permanent wage-price controls and what is more likely is that you will have something like that which you had at the time of the Korean war. After they have made whatever contribution for good or ill that they can make, there will be some unwinding of the formal controls.

Chairman PROXMIRE. To what extent do you think that business and labor should take part in administering the wage-price system? Should they serve directly on the board, a designee by the AFL–CIO, for example, and a designee by the business groups?

Mr. SAMUELSON. I would prefer that that not take place, for the reason that it seems to me that the labor representatives and the business representatives will then have to regard themselves as speaking for their constituents, and they will be deemed to be treacherous to the interests of their constituents if they do not vote on completely class lines. Therefore, if it is possible to get a consensus—and without some kind of consensus, the alternative is not going to work—I would prefer to see a different composition.

Chairman PROXMIRE. Should the policy in phase 2 be entirely voluntary as organized labor has asked, or in your view should there be a mandatory element?

Mr. SAMUELSON. I think there must be some mandatory element.

Chairman PROXMIRE. In other words, the President should be allowed to hold down a price increase which has been proposed which he thinks would be inflationary or a wage increase?

Mr. SAMUELSON. And there should be teeth in the penalties.

Chairman PROXMIRE. What consideration should be given to the cost of living to productivity, and to equity adjustments in setting guidelines? Should the guidelines be based exclusively on productivity?

Mr. SAMUELSON. No. Every study of guidelines and of the dynamics of intersectoral development shows that there are different easy rates of productivity change in different lines and to give current labor in those sectors the easy productivity changes which come without saying would be to create great discrepancies between wages and great inequities. I, alas, happen to be in the sector with the least productivity growth; teaching, for example.

Chairman PROXMIRE. What I am talking about is an overall productivity increase. Arthur Okun proposed that we recognize that throughout the economy, we have a 3½-percent increase, that you give that as a basis and then give some allowance for the cost of living increase.

Mr. SAMUELSON. Definitely, because I do not think you can roll back prices and wages by King Canute's edicts. I do not think you can stabilize prices at a consumer price index and wage rates at an overall average productivity. But I think you can hope, in the period in which you have mandatory controls, to take some fraction of the inflation in being and, so to speak, countenance that, but outlaw some fraction and so try to help the inflation burn itself out and approach a level, and the overall productivity is an extremely important variable in that problem.

Chairman PROXMIRE. Would you say on that kind of basis that you could arrive at something like one of the guidelines that has been suggested as a 5-percent increase for wages and a 1- or 2-percent increase for prices?

Mr. SAMUELSON. Something like that, including not giving everybody the escalator that economists want them to have.

Chairman PROXMIRE. Because if they increase their efficiency, they can increase their prices without increasing costs.

Mr. SAMUELSON. If everybody wants to catch up all the time to the previous situation, then you are going to have an egg-chicken-egg situation which will perpetuate the rate of inflation, in my opinion.

Chairman PROXMIRE. My time is up, but as I understand it, the reason you suggest this is that you think we do not have pure and perfect competition, we have great pricing power on the part of industry, obviously great wage determination power on the part of labor unions; and therefore, this element in the economy which is not determined competitively requires some kind of guidance when it gets out of line and it seems to be getting out of line.

Mr. SAMUELSON. It is a central fact that the American economy of the 1970's could not be showing the behavior it has been showing if

prices were set in auction-like markets that got cleared. You would have an entirely different pattern and the deviation from that which is a fact of life, of named prices, of administered prices, of named wages, administered wages, both in the union and nonunion sector, seems to me to be the significant underlying diagnostic reason why the American economy of 1971 does not behave like the American economy of 1921 or 1911.

Chairman PROXMIRE. May I ask on behalf of Senator Javits, before I yield to Congressman Reuss, just one brief question?

Mr. Friedman, Senator Javits asked me to ask you whether you would still object to a devaluation of gold in terms of dollars if it were done not by this Government but by the IMF?

Mr. FRIEDMAN. I am sorry, I do not see how the IMF could do it.

Chairman PROXMIRE. If the IMF made a recommendation—I presume that is what he had in mind.

Mr. FRIEDMAN. I assume he is speaking of the IMF widening the margin. But if the IMF widens the margin——

Chairman PROXMIRE. You are correct. I just had it called to my attention.

Mr. FRIEDMAN. I have no objection to the IMF widening the margin, but it does not have any impact on us whatsoever.

Chairman PROXMIRE. It will have impact on other countries.

Mr. FRIEDMAN. It does not change any gold price.

Chairman PROXMIRE. Why would it not have the same effect, a 5 percent widening of the margin, as a 5 percent of the dollar devaluation in terms of gold?

Mr. FRIEDMAN. Let's suppose it widened the margin. What is in that? If there are no sales, no purchases, how do you decide where you are in that margin? What leads you to believe you are in one and not the other?

Mr. SAMUELSON. A statement by the Executive, no longer needing the act of Congress, which would say, now we are widening the margin to $38 by 4.99 percent.

Mr. FRIEDMAN. But I do not understand. The IMF announces that the par value is plus or minus 5 percent. What determines whether you are at $35 minus five or $35 plus five? Does the IMF also make such an announcement? It does not now.

I do not see how that helps it. That only means that presumably, it would somehow or other permit the United States to assert that we are at the top end of that without an act of Congress. I may say that my opposition to changing the price of gold does not rest on whether it requires an act of Congress or not.

Chairman PROXMIRE. The act of Congress might be simply to conform to a new IMF agreement which permits a margin of this, 5 percent or maybe a little bit more. Then—I am not sure I understand this completely, but the IMF might act, that might achieve the same result, in the view of Senator Javits, without actually devaluing.

Mr. SAMUELSON. May I say there is an unreal quality about this discussion, because in the years ahead, no matter what the agreements or disagreements are, there will be official and paper gold transfers between governments in the "Club of Ten." Suspending convertibility does not mean that you will not settle balances. And it is important to know at what bookkeeping ratio those settlements are made.

Mr. FRIEDMAN. I understood nothing in the President's August 15

or Mr. Ziegler's utterances since that time which says that you will not have these settlements at some time in the future years. It is just that they are not automatic.

If I understand what the President said; and certainly if I understand what I myself favor, which I understand much better, I believe it rules out any settlements by the United States involving a physical transfer of gold, except perhaps maybe there are already some already in train, some carryover, some commitments. But as I understand it, there will be no physical transfer of gold as announced by the President. If that is so, I do not know what you need a bookkeeping change for.

Chairman PROXMIRE. Congressman Reuss.

Representative REUSS. Mr. Chairman, our witnesses have been very patient and are probably very hungry. I am going to be very brief.

Professor Friedman, you have said that the President's tax reduction program sounds very good to you. You set forth again your long-term proposal which I always found attractive: Why not cut down or out the corporate income tax and attribute the income to the stockholders; it will be an equitable and good thing.

Then you expressed yourself as mildly pleased, at least, with what had been done—namely, we cut down taxes by about $8 billion to corporations, but we did not do a nickel's worth of attributing. Can I count on you to lead the crusade of attributing the income to stockholders?

Mr. FRIEDMAN. I am strongly in favor of attributing to stockholders. I have been all along and I have not changed in the slightest.

Representative REUSS. Good. You are a potential ally and I am delighted.

Now, Mr. Samuelson, the morning after August 15, you told the world, and I happened to read it, that in your judgment, the President's fiscal program was a nothing because it had no budgetary impact. He was going to cut down on expenditures by the same amount he was going to reduce taxes. I thought you were right then and I still think you are right and I am a little distressed to find you seemingly back-tracking a bit on that. I would have thought that you would be even righter today than you looked like on August 15, because perfectly obviously, what President Nixon, given his predilections, is going to do is cut down on the jobs under things like the emergency residual public service program which he once vetoed, thus throwing a man out of work; and then the tax benefits are going to go largely to corporations which are unlikely to spend all that money, at least on job-creating activities. The investment tax credit, for example, goes to the whole existing $90 or $100 billion worth of investment that is going to be paid anyway. So why were you not right on August 15?

Mr. SAMUELSON. Your confidence in the uniform correctness of every utterance that falls from my pen exceeds my own. And I think if you read the whole of the testimony this morning, my position will be clarified. It may be that some of the things I said on this point were said when you were not in the room and since the hour is late, I beg your indulgence not to go into the whole position.

But let me say that the President's program, the new fiscal program, as it is going to be worked out in all likelihood, is more expansionary upon close examination than the President's rhetoric of August 15 would have suggested it was going to be.

Now, you cannot simply take the expenditure reductions and then the tax reductions and apply a simple textbook balanced budget multiplier to them.

Representative REUSS. Look at the quality?

Mr. SAMUELSON. Yes, look at the quality. In the first place, a lot of the expenditure cuts he said he was making, he does not already have those expenditures. There is what is possibly a phantom cut in his welfare program. He did not have his welfare program on August 14 and therefore in a real sense did not give it up on August 15.

He did not have the revenue sharing which he gave up. I am acting under the supposition that the attrition of the Federal labor force of 1 in 20 will not necessarily come to pass. I hope that Congress will have a lot to say about that.

I thought just as a matter of abstract economics that it was very odd that a man who attributed much of our increase in unemployment to attrition of the Armed Forces should have been obtuse in seeing that attrition of the Federal bureaucracy not in uniform would have the same kind of effect.

I may say that I never for a moment have accepted the notion that it was attrition of the armed forces and the winding up of the Vietnam war which was responsible for our unemployment. What is responsible for our unemployment has been the fight against inflation, or, if someone wants to put it this way, the need to fight against inflation. In many a past period, we have absorbed many more people into the labor market that have ever been released by the Armed Forces in the same period of time in a very healthy way.

Now, the reason that I think there is not that expansion is that when I look at the computer forecasts and look at the actual pre-NEP multiplicands, including all those of Government on the fiscal side, and then look at a controlled solution afterwards. Mr. Eckstein before you and in the record is an example of that, I do find some net expansion. If you look at the quality, Mr. Eckstein thinks there will be no increase in money plant equipment expenditure as a result of the investment tax credit, the one that Congress is now changing, but on that basis. But he does have a $3 billion increase in real terms. I do not go along with that magnitude, and I give my reasons why I think you do not give it a big stimulus now. But I do have an add-on for that.

If you take the import surcharge, that is a revenue collection in a simple macroeconomic model, such as the freshmen are working on at this time. If you treat it like other tax things, you would be wrong, because there are substitution effects between American workers and non-American workers.

When I put all these things together, I find that the President's program is better than his rhetoric and there is some increase. I just am not as optimistic as the Wharton School model, as Mr. Eckstein's model, that there is that much of an increase in real terms.

Representative REUSS. Mr. Friedman is torn between the desire of his head to answer you and the desire of his stomach to have lunch.

Mr. SAMUELSON. I know which one I am rooting for.

Representative REUSS. Mr. Chairman, I would like to have the text of the conclusion of the European Communities' Council of Ministers meeting included in the record.

Chairman PROXMIRE. Without objection.

(The information referred to follows:)

TEXT OF CONCLUSIONS OF THE EUROPEAN COMMUNITIES' COUNCIL OF MINISTERS MEETING (ON THE EFFECTS OF THE UNITED STATES' NEW ECONOMIC MEASURES) AT A MEETING OF FINANCE MINISTERS OF THE SIX IN BRUSSELS ON SEPTEMBER 13, 1971

Washington, D.C., Sept. 14.—Following is an unofficial translation of the main conclusions reached by the Finance Ministers of the six Common Market countries at their Council of Ministers meeting held yesterday in Brussels. The Ministers met to consider a common position with respect to recent U.S. trade and monetary measures.

I

The Council of the European Communities has again examined the problems arising from the measures taken by the United States on August 15, 1971.

The Council feels that the basic problem is one of the reconstruction of the international economic and monetary order, based on the institutions that have administered it so far (IMF and GATT), and one which would take into account the needs of developing countries.

The Council considers it necessary for Community countries to take a common position in close cooperation with applicant countries (Great Britain, Ireland, Denmark, and Norway).

The Council, after taking note of the work of the Monetary Committee of the European Communities and the Governors of the Central Banks as well as the communication of the Commission addressed to the Council on September 9, agreed that a common position by the Community (within the Group of Ten and the IMF) should be based on the following principles:

(A) The reforms to be carried out within the international monetary system must respect the principle of fixed parities which should be adjusted as soon as it becomes apparent that they are no longer realistic. Such a system is necessary for the orderly transaction and expansion of trade, in which the Community, as the most important trading unit, is particularly interested.

Satisfactory international payments relations based upon such principles will only be possible if differentiated realignment is introduced in parity relations between currencies of industrialized countries. Such a realignment should include the currencies of all countries concerned, including the dollar. It should be implemented in such a way as to take into account fair distribution of adjustment burdens with regard to the economic situation and the foreseeable development of the countries concerned.

(B) The correct functioning of the international monetary system thus reformed would require measures affecting the international movement of capital. These measures could consist of a limited increase in fluctuation bands in order to compensate for the consequences of interest rate differences and also of appropriate measures to discourage short-term capital movements.

(C) International reserve assets will continue to depend upon gold, and to an increasing degree, upon a collectively and internationally created-and-managed reserve system. This calls for the adaptation and the development of the special drawing rights system in connection with a gradual decrease in the importance of national currencies as reserve assets.

(D) The new international payments balance can only be maintained if, in the future, all countries or associations of countries respect, without fail, the obligations and constraints involved in the adjustment process of the balance of payments and if they implement appropriate internal policies.

(E) Within the framework of the reformed international monetary system, the authority and range of action of the IMF must be reinforced in all fields of competence. The member states should endeavor to adopt common positions within this institution.

Taking into consideration that the functioning of the IMF has become more difficult because of recent events, the Council feels that it is indispensable for this institution to be able to pursue its regular activities through internal arrangements relating to transactions of the main currencies used by the Fund. The pursuit of this activity is not only of interest to industrialized countries but even more so to developing countries. Moreover, it is indispensable to the proper functioning of a specific Community exchange system.

II

The Council has also examined the developments of the exchange markets within the Community.

It has noted that the functioning of these markets has so far not been seriously

upset, and expresses satisfaction that cooperation has sprung up among the Central Banks of the Community, which it would like to see continued.

The Council acknowledged that if the present monetary difficulties go on too long, they would undoubtedly endanger the proper functioning of the Community, in particular the common agricultural policy. The Council has asked the Commission to prepare a special report on the consequences of the present situation as far as the functioning of the agricultural common market is concerned. It reaffirmed the mandate given to the Monetary Committee and to the Governors of Central Banks on August 19, 1971, to set forth as soon as possible a solution to assure the stability of exchange rates among Community countries.

III

The Council stressed the seriousness of the U.S. decision to impose a ten per cent surtax on imports and to grant tax advantages in favor of internal investment and on exports. Such measures prevent the formation of realistic exchange rates. They also are an obstacle to the readjustment of parities. Furthermore, they can provoke serious disturbances in international trade. Thus, the Council requests that these measures be rescinded.

Chairman Proxmire. Mr. Conable.

Representative Conable. I have one more question. As a layman, I am always bemused in the area of economics by the relationship between myth and reality. You gentlemen seem to view different things as myths and as realities here.

For instance, Mr. Friedman, you say the balance of payments is a nonproblem. Yet other countries believe we have a balance of payments problem and, therefore, it exists at least in their relation with us. And apparently, you feel that major government involvement in income policy is likely to be ineffective, to be ultimately a myth.

I gather Mr. Samuelson thinks that somehow it will be more of a real factor in our economy.

Mr. Friedman. I do not believe it is a myth. I believe it will be very harmful. It is very real, but harmful.

Representative Conable. But a lot of people believe an incomes policy can be effective, so it has at least psychological effect.

Mr. Friedman. Partly and partly because insofar as it is effective, it distorts economic relations.

You know, I am really baffled by this talk about the incomes policy as a simple, obvious answer. Look at the numbers. Consumer prices are rising at 4 percent a year. Over 3 months, that means they rise by one percentage point. You erect this whole wage-price freeze to keep the average of prices from rising by one percentage point. That seems like nothing. But that one percentage point is the average of millions of prices, some of which are going up by 10 percent, some of which are going down by 10 percent. And it does great harm insofar as the incomes policy is effective to prevent those price changes from steering the economy.

In the same way, what is true for price changes is also true for wage changes. The freeze will do far more harm; the more effectively it is enforced. If people evade it, it is a real danger both by the ways of getting around it and because it weakens respect for the sanctity of law.

Representative Conable. I am not precisely defining what is a myth and a reality. We politicians, by believing myths, give a reality to them and perhaps cause the distortions you are talking about.

I think it has been a very constructive morning and I appreciate your testimony, gentlemen.

Chairman PROXMIRE. I have just one question for each of you gentlemen. That question is how should profits be controlled, if at all, during phase 2? We have had a firm request by organized labor for profit tax of some kind. We have had at least one economist who has come in and said he thought it was feasible and appropriate, Mr. Klein of the Wharton School. But they are in a distinct minority. I would like to get your views.

Mr. Samuelson.

Mr. SAMUELSON. I think the price of consensus for mandatory price and wage controls on an interim basis does require the government to do something about profit control. I would gladly welcome an excess profits tax except our past experience has been that it digs so deep with a sieve, meaning the exceptions. It makes work for lawyers and economists if it is of the previous type, and it is very hard on marginal decisions.

I would raise the corporate income tax, which has already effectively been lowered.

Chairman PROXMIRE. That is the kind of tax Mr. Klein was talking about. He would provide that as the share of capital compensation increases relative to wage compensation, he would raise the corporate income tax proportionately. If corporate income in relation to labor income went up by 10 percent, then he would raise the corporation tax.

Mr. FRIEDMAN. The fact is that corporate profits are lower in real terms than they have been for a decade, they are lower in nominal terms than for several years. There is no real justification for control over profits. It is undesirable to have control over profits. If for face-saving, we are back in the question of gold, how much do we give away for illusions?

Chairman PROXMIRE. Maybe recently, but in the past, they have risen as much as five times as fast as wages.

Mr. FRIEDMAN. Not only have they not been rising, they have been falling in real terms. I think it is false to suppose that there is any justification or basis for a profits tax.

Representative CONABLE. Does not an excess profits tax work inevitably against productivity?

Mr. FRIEDMAN. Of course.

Chairman PROXMIRE. An excess profits tax does. I agree wholeheartedly. The big part of my problem is that this is the real discipline; if you want to hold your costs down, you do it to increase your profits. Take away the incentive to increase profits, you take away the incentive ot hold down cost.

But increasing the overall corporation income tax would not mean an efficient firm that increased its efficiency would not be able to make a profit.

Mr. FRIEDMAN. I believe that corporation taxes are now too high. They ought to be lower. It just seems to me again it is a——

Mr. SAMUELSON. You understand that I do not believe that, organized labor does not believe that, and the lower income classes generally do not act as if they believe that.

Let me also say it would be a very strange cyclical experience if the expansion works out anywhere near as expansionary as almost all the witnesses have testified before you, if in some transitional period, cor-

porate profits did not rise rather rapidly relative to wages. I do not think Professor Friedman will find that the manufacturers of this country will ever get together and say, yes, we will settle to have our profits not go up more than in constant shares.

Mr. FRIEDMAN. I was only trying to illustrate what the nature of the problem was. I personally am opposed to any kind of profit control, even if you have wage and price control. That is an indirect control on profits already. It seems to me just to be promoting economic confusion of the kind we were talking about earlier to get the idea that profits are somehow not received by people.

Chairman PROXMIRE. Gentlemen, I want to thank you very, very much. This has been an excellent finish for our hearings.

The committee will stand adjourned. The record will be kept open for one week.

(Whereupon, at 12:30 p.m., the committee was adjourned, subject to the call of the Chair.)

STATEMENTS SUBMITTED FOR THE RECORD

STATEMENT OF GEORGE W. BALL, SENIOR MANAGING DIRECTOR, LEHMAN BROS., INC.

I regret that, due to professional obligations overseas, I have been unable to accept the Committee's invitation to appear before it in connection with the international aspects of the President's new economic measures. I thank the Committee for its invitation.

The comments offered in this statement are based on my experience as Under Secretary of State and as a member of the Cabinet Committee on the Balance of Payments for almost six years, from 1961 to 1966. They are addressed to the only aspect of the President's new economic program on which I feel competent to offer advice—our forthcoming negotiations with the other members of the international trading and financial community.

I

The principal measures that will play a role in those negotiations are three:

First, the decision to "shut the gold window," or, in other words, our refusal any longer to sell gold from our reserves at $35 an ounce;

Second, the imposition of a ten percent import surcharge; and

Third, the proposal to enact an investment tax credit limited to investments in American-made equipment.

Since the latter two measures are protectionist devices that violate the spirit, if not the letter, of the General Agreement on Tariffs and Trade which we have long supported, they cannot be justified as permanent features of American policy but only as tactical instruments designed to improve our bargaining leverage in seeking to achieve a realignment of the parities of major currencies sufficiently far-reaching to restore our balance of payments to equilibrium. They will prove useful, in other words, only if they can be traded away for a substantial *quid pro quo*. If this should not prove feasible and they should become permanent—or even if it proves necessary to maintain them for a protracted period—the international segment of the President's program will have failed. In that event, not only the economic health of the United States but the environment for healthy world trade will be in worse condition than before.

II

I underline this point because, in the transient euphoria that has followed the President's announcement, there has been an understandable tendency to confuse the announcement of the program with the attainment of its objectives—as though the President's actions by themselves had brought a solution to our international commercial and monetary difficulties, rather than merely providing the occasion and the tactical instruments for the development of a solution. Such euphoria is to be deplored, since it could lead to ill-conceived action—or inaction—particularly if we approach the problem of sorting out the parities of major world currencies in a mood of outraged innocence. For it seems fashionable in some quarters to espouse the self-pitying thesis that, because of the ineptitude and flatulence of our negotiators, we have been consistently taken advantage of by other less generous and idealistic governments; thus we now have every right to insist that our trading partners solve our problems for us.

Not only is this a foolishly wrong-headed attitude, but if we should let it guide our actions during the forthcoming negotiations, we could do enormous harm to the whole mechanism of international cooperation, while failing to achieve our objectives.

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III

By and large, in our trade negotiations with our major European trading partners, what has emerged from the Kennedy Round and other negotiations has represented a fair give and take. I think it significant, for example, that, though many American businessmen complain bitterly that the Europeans got far the better of the bargain, I have heard fully as many complaints from European businessmen that Europe gave more than it got in return. A recent study by the staff of the Commission of the European Economic Community asserts, for example, that after the Kennedy Round the average import duty in the United States was 12.8 percent as against 7 percent for the Common Market; while our own Government statistics show that with the completion of the Kennedy Round our average tariff on industrial products will be 8.3 percent against 8.4 percent for the Common Market. Such reciprocal discontent is, I would suggest, a good test of a fair negotiation.

That we still have some matters to complain about concerning our European partners is, of course, true—particularly the protectionist aspects of the EEC's Common Agricultural Policy, the Common Market's association arrangements with certain nations in Africa and on the Mediterranean littoral, and the border taxes associated with the fiscal system of valued-added taxes.

But the United States is far more innocent. While we have more low tariffs than the Common Market, we also have more high tariffs. Though we impose import quotas on something like 67 industrial product categories, including such major items as steel and oil, while the Europeans maintain quotas on 65 such items, our quotas cover almost 17 percent of our total industrial imports, as against only 4 percent for the Common Market.

Statistics such as theese are, of course, subject to almost infinite interpretation and manipulation, and I am certainly not suggesting that our record for liberalism is worse than that of our European trading partners, merely that it is not so conspicuously better that we can afford the luxury of self-righteousness. Let us not forget that we still maintain the so-called American Selling Price in computing the tariffs on certain important chemicals, even though that represents protectionism in is most extreme form. Nor should we fail to note that the surplus in our merchandise balance with the European Economic Community increased last year—which suggests that we are far from being shut out of European markets. In fact, the deterioration of our world-wide balance of trade, both visible and invisible, is due almost entirely to the adverse developments in our bilateral trading accounts with Japan and Canada, both of which deserve special atention.

IV

What should be clear beyond doubt is that we are entrapped in our present unhappy predicament not half so much because of the trading and financial policies of other nations, but because, for a number of years, we have failed to check powerful inflationary forces intensified by—but by no means altogether caused by—an overseas war. The result of this inflation has been to over-price many of our goods thus making them non-competitive in world markets. Thus our present predicament—and let us be quite honest with ourselves—is nobody's fault but our own and the world knows it.

What is clearly indispensable, if we are to regain a healthy economic posture, is that, after the present temporary freeze, we adopt and enforce measures that will effectively stop the inflation; otherwise, the President's program will have been an exercise in futility. In fact, it will have done more harm than good, since it will have disrupted world trade and finance without compensating benefits.

V

But let us assume that we do find a long-run solution to the excessive inflation of the past few years. How shall we go about achieving the correction of those imbalances that now mark our present unhappy position in the world economy?

The first priority, it seems to me, is for us to get rid of some of the illusions that have clouded the public discussion of the problem during these past few yeasty days.

The *first illusion* is that the determination of new parities can be left to market forces. There is no evidence whatever to suggest that any of the major nations whose currencies are out of line with real values have the slightest intention of letting those currencies float freely. Not only is it against the religion

of a central banker to refrain from intervention when he sees his national currency moving in a direction of substantial disadvantage but the operation of the import surcharge and the vast supply of available short-term money give present market forces an inevitable bias. If, then, we adopt a passive posture while waiting for the market to define what adjustments are needed, we will cruelly deceive ourselves.

A *second illusion*, equally dangerous, is that, once having stopped the engine of the Bretton Woods system by halting gold convertibility and seriously undercutting the GATT by unilaterally blocking access to the United States market, we can expect the other major trading nations on their own to develop new solutions. For a long while we have been preaching the doctrine that one nation's surplus is another nation's deficit and that surplus countries have as much of a responsibility as deficit countries for maintaining equilibrium within reasonable limits. Now we seem to be saying that, so far as the United States' deficit is concerned, we are passing the whole burden to the surplus countries to devise a solution through an upward valuation of their currencies, regardless of the deflationary consequences for their own domestic economies.

Such a position, it seems to me, ignores all the lessons of past experience. During the entire post-war period the United States has led in every constructive monetary and trade move (other than regional initiatives) that were directed at the improvement of the world's financial and trading systems. We have done so not merely out of the goodness of our heart—although our record, on the whole, is highly creditable—but because we commanded economic power equivalent to the combined power of four or five smaller nations—and, as a single nation, we were capable of incisive action.

In this regard our country is unique—and we dare not forget it. Though within the past few years Europe has made gratifying progress toward economic integration, the nations of the European Community are still far from having achieved anything resembling unity of decision and action. Thus, even now we are once more witnessing the familiar spectacle of the Community internally divided because of French insistence on its own doctrinal prejudices.

Under these circumstances there is clearly no single entity other than the United States that can command the authority to design and successfully promote a constructive initiative to realign currency parities. Yet, unhappily, that does not rule out the possibility that, if we fail to pursue an active diplomacy but permit the present stalemate to continue for a matter of months, one or more nations may be tempted to set in train a chain reaction of competitive protectionism, not necessarily as explicit retaliation for our actions but still using the American import surcharge as an excuse.

Not only does the situation require active American diplomacy, but that diplomacy must be directed with a sense of urgency. What we must seek to bring about is an adequate program of currency readjustments within not more than a month or six weeks from now. For the *third illusion* that we must rigorously put aside is the assumption that time is somehow on our side and that if we only maintain our protectionist measures and wait long enough, our bargaining leverage will be enhanced.

Nothing is further from the truth. Rather than increasing in potency, our protectionist measures are a wasting asset. Already there are reports that Japanese industry—cooperating, as it invariably does, with the government—is making plans to adjust its operations to the ten percent surcharge. That surcharge, it is argued, may not, after all, prove a bad thing. It may provide the necesasry impetus to long overdue rationalization. It could well lead to the concentration of investment in higher technology sectors, leaving labor-intensive production to lower-cost Asian countries. Meanwhile, the government is reported to be planning massive public works investment in a much needed improvement in the infrastructure while, at the same time, maintaining the momentum of industrial activity.

Once these internal adjustments are achieved, Japanese industry is likely to emerge more competitive than ever. To be sure, Japanese protectionist elements will almost certainly use the American surcharge to justify further delay in liberalizing trade and investment, while American companies trying to do business in Japan may well encounter even more formidable obstacles. But, as a bargaining counter, the surcharge will have lost much of its potency.

Nor is that all, for the longer the surcharge and the "buy American" features of the investment tax credit remain in effect, the more American industry will come to depend on them. Thus, vested interests will be built up in the mainte-

nance of these two protectionist devices, a healthy process of rationalization will be slowed down, and increased productivity will become less essential for meeting competition. The result: new distortions and new rigidities on both sides.

VI

Before we commit ourselves to any line of strategy, it is essential that we carefully appraise the strength of the weapons in our hands. Here again, in the euphoria of the past few days, we have shown a dangerous tendency to exaggerate the bargaining value of the import surcharge.

Though our ten percent import surcharge will adversely affect certain sectors of Japanese trade (roughly thirty percent of Japan's total merchandise exports), the resultant disadvantage would still be far less than a ten percent revaluation of the yen, since the surcharge would affect only visible trade with the United States, while an upward revision of the yen's parity would make both Japanese goods and services less competitive in every market of the world.

Yet what we are seeking is not a ten percent revaluation but something substantially more than that. Most recent speculation has ranged around fifteen percent, and I do not think that an impossible objective, provided we pursue a skillful diplomacy, as I shall suggest in a moment. But there has also been a good deal of loose talk about demanding trade concessions at the same time, not only from Japan but from other countries.

The same considerations apply to West Germany, where our surcharge affects only nine percent of the Federal Republic's exports; yet what we are apparently seeking is something approaching a fourteen percent revaluation of the Deutsch Mark that would affect all West German trade throughout the non-Communist world.

VII

This brings me to the *fourth* and final *illusion* which we should quickly discard—the illusion that we can successfully employ our protectionist bargaining counters to buy a whole shopping list of concessions from our trading partners not only in the form of currency readjustments but also in the area of commercial policy and even defense. Such an illusion is dangerous because it can lead to over-trading, bogging down negotiations in an endless and angry wrangle and ultimately causing irreparable damage to the whole system of international cooperation which we have so painfully built up since the war.

For not only is the import surcharge a limited instrument; it is a blunt instrument. Though we must necessarily regard the principal target in the forthcoming negotiations as Japan and its undervalued currency, the surcharge actually affects a far larger percentage of the total foreign trade of such innocent third nations as Mexico or Korea—whose currencies are not undervalued—than it does of Japan.

Since we dare not make exceptions to the general application of the surcharge without doing violence to the fundamental principle of non-discrimination that underpins our whole system of commercial policy, we must recognize the inadvertent damage we will cause if we leave the surcharge in effect too long in an effort to extract trade concessions from a mere handful of countries we regard as pursuing unfair trade practices.

Nor, because it is unfocused, is the surcharge likely to be effective outside the narrow area of currency readjustments. To be sure, we have a continuing argument with the Federal Republic of Germany as to the balance of payments effects (probably about $900 million net) of the cost of maintaining our troops in Europe. But it would be wholly impracticable to try to maintain a surcharge against the whole world's commerce simply to bludgeon the Germans into more favorable offset arrangements.

I strongly feel, therefore, that any attempt to settle too many loose ends and to bargain for concessions outside the area of parity realignments is likely to lead to total frustration. Though we should use every means at our command to correct the present payments imbalances, it would be the height of folly to try to achieve too much within the four walls of the present negotiation.

VIII

We will do well if we obtain a significant revaluation of the yen and some lesser readjustments of other major currencies. But to deal effectively with the Japanese will require a drastic revision of the tactics we have so far been pursuing.

In my judgment, the major mistake we have so far made in dealing with the Japanese Government is to try to resolve our problems in a bilateral setting. Among all the nations in the international trading community Japan is *sui generis*. It has been only a hundred years since it experienced the Meiji Restoration, which released it from the inward-looking feudalism that had insulated the Japanese people for three hundred years. To regard Japan today as simply another capitalistic country roughly in our own pattern is to misconceive the structure and history of the country. Not only the Japanese people, but the great Japanese corporate enterprises regard themselves as instruments dedicated to a common national purpose; in fact, many of the decisions of Japanese industry in approaching foreign markets are made not so much from the point of view of the corporate profit and loss statement as from the relevance of that market to the national objectives of Japan.

But if Japan differs in structure and outlook from the United States, it differs equally from the other major trading nations of the West. To bring Japan, with its special institutions, its unique structure of state-industry relations, and its distinct habits of thought, into a world financial and trading system designed largely in response to the institutions, structure and attitudes of the West is a task requiring both firmness and sensitivity. Clearly it is not a task that the United States should tackle by itself. If we continue trying to achieve it by our own efforts—through the use of instruments of coercion such as those now included in the President's Program—we will suffer the full onus of abrasive relations with Japan, while at the same time angering and alienating our Western trading partners by deflecting Japanese exports from our market to theirs.

What we should instead seek to do is quickly to bring our Western allies to understand that they have a common interest with us in resolving the special Japanese problem. That point is reasonably well understood in industrial circles in Britain, but, unhappily, I find very little understanding of it on the Continent, and it will take intensive education on the part of our Government, as well as American industry to persuade the Europeans that this is an urgent task requireing the closest transatlantic cooperation.

IX

Finally, what is urgently needed is to reinject into present negotiation that spirit of mutual give and take that has, in the past, marked all successful efforts to solve our trade and monetary problems. This will require intense activity and quiet leadership on our side and serious concentration on correcting the impression that America plans to employ no instrument of persuasion more subtle than a baseball bat. It will mean assiduously developing with the Group of Ten those common positions that can be translated into effective pressure on those member nations whose currencies are furthest out of line. Quite likely it would be useful to encourage the staff of the IMF, and particularly its very able director, M. Pierre-Paul Schweitzer, to put forward concrete proposals for revised parities. After all, the IMF is the only impartial agency that commands the respect of all the members, and, at the moment, its life and usefulness are in serious jeapardy.

Nor would I rule out the need—at an appropriate point and in a spirit of mutual concession—for the United States to offer to take some action having the equivalent effect of a modest increase in the gold price, although I would personally like to assure the demonetization of gold. At best, I would see gold only as a *numeraire*. We should not think of restoring gold convertibility. But, although I have no competence at all as a technician, I would think it possible to advance some American contribution to the achievement of new currency relationships by restating the value of the Special Drawing Rights in relation to the dollar.

Yet, if we are ever to return to a system of fixed parities (hopefully with some widening of the bands to provide increased flexibility), we must hurry, since I think it likely that if matters remain unresolved over many weeks, nations may discover that controlled floating is not all that painful. I recognize that some experts would regard such a state of affairs as attractive, but I can see many reasons why it would be hazardous to experiment with floating rates in the present widespread manner, and I hope we will not let things come to that result by default.

STATEMENT OF GARY FROMM, PROFESSOR OF ECONOMICS, AMERICAN UNIVERSITY

WAGE-PRICE-PROFIT GUIDELINES

Discussion of appropriate guidelines to succeed the wage-price freeze has been rampant the past few weeks. Unfortunately, most of the alternatives publicly proposed to date are merely variants of the 1962 Kennedy guideposts.[1] Those guideposts, leaving aside exceptional cases, provided that wages in every industry should rise no faster than national productivity, say 3.2% per year. They also indicated extremely vague price guidelines. Prices were supposed to be reduced by an indeterminate amount (related to unit labor costs) if productivity in an industry were greater than the national average and, conversely, rise if it were less than the average.

The Kennedy guideposts were never rigorously applied. The Council of Economic Advisers informally did pressure individual companies, unions and industries. Also, the government manipulated stockpiles of materials in attempts to decrease prices.

While the statistical evidence is not clear-cut, to the extent that these guideposts had an effect, they fell mainly on wages and not on prices or profits.[2] Thus, they were inequitable.

Moreover, since national productivity is the wage-price standard for all industries, these guideposts are highly inefficient from a resource allocation standpoint. Implicitly, they assume that the degree of substitutability between capital and labor is uniform for all industries and is equal to unity. If it is less than unity (as many studies have shown), then the capital share of industry income is favored. If the elasticity differs between industries, then the resource combination and cost implications also differ.[3]

Not only would some of the recently proposed guidelines reimpose the inequities and inefficiency of the earlier Kennedy guideposts, but they would guarantee the continuation of inflation, albeit at a lower rate than experienced the past few years. They do this by setting a floor under wages above the rate of increase of productivity. The excess of labor costs over productivity results in a rise in unit costs and therefore, certainly in the long run, an increase in prices.

Ideally the mechanism for influencing or controlling wages and prices should preserve the relative price and wage relationships which would arise from freely competitive markets. Some of these relationships apply in absolute form, some in percentage form and others in a combination of forms. This arises, for example, from the existence of specific (absolute levies) and *ad valorem* excise taxes. Therefore, not even absolute or percentage rollbacks preserve the ideal characteristics. Nor would adherence to prices and wages of a present or past point in time be a proper solution for a dynamic economy undergoing continual structural transformations. It might be noted, too, that aggregate monetary and fiscal policies also are not neutral with respect to wages, prices, factor demands, final demands or resource utilization.[4]

Consequently, no policy is truly ideal with regard to preserving competitive norms. Short of not intervening to slow or halt inflation, all policies will cause some distortions. What we are seeking then is not the ideal, but a "second-best" solution. From a normative standpoint, this should be one that preserves the freedom of action of firms and individuals and the operation of competitive markets while still inhibiting inflation. The following proposal was designed for this objective.

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[1] *Economic Report of the President,* January 1962, pp. 185–190.

[2] For example, it has been estimated that over the 1962–66 period for the manufacturing sector, the guideposts reduced the annual rate of increase of average hourly earnings of production workers by about 1.25%, the rate of increase of unit labor costs by approximately 2% and the wholesale price index by about 1.4%. The drop in the WPI increase mainly reflects the restraint on wages. See Gary Fromm, "The Wage-Price Issue: The Need for Guideposts," Testimony presented in *Hearings Before the Joint Economic Committee,* U.S. Congress, January 1968, pp. 3–7.

[3] The effects are extremely complicated and cannot be examined here. However, it is clear that relative capital-labor ratios would change.

[4] The world is more complicated than the simple pedagogical models that adorn economics textbooks. It is easy to show that relative proportions (price, wages, etc.) will change with the level of real or nominal demand in systems that are nonlinear, have constraints or suffer imperfections.

A GUIDEPOST ALTERNATIVE

Before turning to the specifics, some of the broad underlying principles should be stated. First, collective bargaining must be permitted to function and should, in fact, be encouraged. Wage increases, however, are subject to maximum limits. Second, firms must be free to set their prices as long as their average effective price on all sales (based on actual transactions) conforms to the guidelines. Third, both labor and management should be given incentives to increase productivity. Fourth, except as required for stabilization and growth purposes, interest rates should be prevented from rising by any significant amount. If necessary for balance of payments and monetary stability reasons, a two-tier exchange rate system or other measures should be instituted to deter massive, spectacular international money movements in U.S. dollars. Fifth, special provision must be made for selected activities, for example, government, small business and exceptional cases.

Now, to the specifics. Except as otherwise noted, all quantities below refer to percentage increases. For the Consumer Price Index, this is assumed to be positive. The time frame over which these increases are calculated and the administration of the guidelines will be discussed separately.

WAGES

The basic entity to which the guidelines pertain is the bargaining unit, the group which negotiates the terms and conditions of employment. This may be an industry, a company, an establishment or a combination of these. The management-labor agreement must be such that average labor compensation (wages plus fringe benefits) is limited so as not to exceed the *higher* of:

(a) Productivity (constant dollar output per manhour) for the bargaining unit,

(b) Consumer Price Index.[5]

The structure of wages within the bargaining unit could be changed, but the average increase would have to satisfy the guideline constraints. Labor would not be guaranteed the maximum limit or any minimum increase. It must bargain with management for whatever it can obtain, up to the maximum. If the bargaining unit had productivity gains less than the CPI, labor could still bargain to preserve its real income. If the unit had productivity increases greater than the CPI, labor could bargain to increase its real return. This should be an incentive to labor to help increase productivity.

For reasons of equity and proper resource allocation, the wage guidelines must be applied for non-union as well as unionized workers and for workers not covered by collective bargaining agreements as well as those who are. Most companies with unionized workers already maintain a stable wage structure vis-à-vis their non-union workers. Under the guidelines, this must be continued, with non-union personnel (including executives) receiving no greater percentage increases in compensation than their unionized counterparts. Companies that do not engage in collective bargaining also must adhere to the guidelines and can raise the compensation of their workers no more than productivity or the CPI (on a rate of increase basis).

PRICES

The basic entity to which the guidelines pertain is the price-setting unit. This might not be identical to the bargaining unit. For example, steel industry wages are negotiated on an industry-wide basis. Steel prices, however, are set by individual firms, and these are the price-setting units. If not otherwise identified, the pricing entity is defined as the unit which files an income tax return with the Internal Revenue Service.

Prices of individual commodities or services are not constrained by the guidelines. They can rise or fall by any amount. But the average effective price over all transactions (sales) of the price-setting unit is limited so as not to exceed the lower of:

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[5] The CPI does not include state and local income taxes. Since these have been rising, it may be desirable to adjust the index for these taxes and use the modified CPI as the standard. This would relieve pressure on real incomes of individuals and on fiscal constraints on state and local governments—at the expense of higher wages and prices, of course. Where bargaining is local or regional in nature, rather than national, it may also be desirable to use a CPI for approximately the same area.

(a) Average unit costs,[6]
(b) Consumer Price Index.[7]

If the rate of increase of unit costs exceeds that of the CPI, firms still could not raise prices beyond that of the rise in the CPI. They would thus be confronted with lower profits or higher losses.[8] That is, they would have to absorb a portion of the costs of their failure to increase productivity and restrain production expenses.

If average unit costs are greater than zero but less than the CPI (both in rate of increase terms), then the firm can raise its average price up to its unit cost increase.[9] The impact of this action on profits depends on the prices of competitors and substitutes and so forth. Again, *ceteris paribus*, there is an incentive to stimulate productivity.[10]

Finally, there is the case of falling average unit costs. Prices could be constrained to fall by a proportion, ranging from 0 to 100% of the unit cost drop. If the proportion selected is 100%, profits can only rise through increases in volume. With this prescription, the firm has far less incentive to restrain waste and costs and raise productivity than if it can keep a fraction of the gain. If the firm were operating in an unfettered competitive environment, prices would probably drop to some extent but not necessarily the full amount of the unit cost decrease. For example, this would occur where a firm obtained an advantage over its competitors by fashioning more efficient production techniques, developing superior products which permitted them to reap economies of scale and so on. Normative competitive theory, which yields a social welfare maximum, provides that prices are determined by marginal productivity and that efficient producers can earn extra returns (economic rents). Therefore, unless the guideline objective is to reduce prices to the barest minimum, an exact correspondence between unit costs and prices should not be ordered. This would violate the competitive criteria set forth for a "second-best" solution.

A good case can be made for the other extreme. If unit costs fall, prices cannot be increased, but they can be cut, with the firm left free to decide the amount. Even without constraints, it is doubtful that many firms would raise prices when unit costs were falling. Therefore, freedom of choice in this instance largely duplicates what would happen if there were no guidelines.

PROFITS

The wage-price guidelines proposed above should themselves limit profits to acceptable rates of increase in most cases. Companies with productivity lower than the CPI would be under strong bargaining pressure from labor and probably would experience no significant gains in unit costs and profits. Companies with high productivity gains that increased wage rates substantially, generally would not show marked profit improvement, unless labor costs were a minor component of total costs. Profits would rise dramatically for firms in which productivity jumps are high, wage rate increases are low and labor costs are the major component of production expenses. Other scenarios that generate extremely high profits can be imagined too.

While the percentage and number of firms that enjoy such profits is likely to be low, demands for equity vis-à-vis other firms whose returns are limited may require that "excess" profits be eliminated. This is largely a matter of the redistribution of income and wealth, always a sensitive political issue.

If required for political reasons, there are several ways to inhibit or curtail undue returns to capital. A multitude of tax schemes could do the job. Three

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[6] These are to be calculated over the same transactions as prices. Unit costs include interest payments but not profits or capital distributions. Investment expenditures must be amortized or depreciated under the same procedures followed on Internal Revenue Service income tax returns. For the same reasons given in footnote 5, an allowance may be permitted for state and local taxes.

[7] It is possible to employ other price indexes as the standard, for instance the WPI. The CPI was chosen here for reasons of symmetry with the wage guidelines. Whichever price index is selected for the standard, it should apply universally. Again, state and local tax adjustments may be deemed appropriate.

[8] Exceptions might be made for new or established firms (but not those merged for the purpose of possible exceptions) whose losses are substantial and whose solvency is threatened.

[9] A more stringent rule for slowing inflation would be to limit the average price increase to a fraction (for example, 80%) of the unit cost increase.

[10] If only a fraction of cost increases can be passed along as higher prices, productivity incentives are even greater.

have been prominently discussed. The first is an excess profits tax of the type levied during World War II and the Korean War. Experience with these taxes was not favorable, in that they stimulated avoidance, evasion and wasteful expenditures.

Another alternative would be to raise the corporate income tax rate. But this would apply to all corporations and not only to those earning excess profits. It would run counter to efforts to stimulate investment and economic activity. It would penalize firms that were less capital intensive and invested in assets with lower than average lives. It would dampen the growth prospects of new firms that are just beginning to become profitable.

The third tax possibility is to use criteria on returns on assets. The proposal has been made that the rate of increase of returns greater than that of national productivity be taxed on a 100% basis. Even if revenues generated by this tax were ploughed back in the form of higher expenditures, there are a number of serious drawbacks. It is not clear why the rate of increase of returns to capital should be tied to the rate of increase of productivity. This is tantamount to prescribing that interest yields on bonds should grow at the same rate as productivity. Next, no provision is made for firms that are experiencing losses or returns below their historical norms or are having difficulty raising capital. More importantly, since the tax is based on the rate of return on assets, no account is taken of different debt-equity ratios among firms and industries. The prescription would favor equity holders and cause firms to attempt to raise their leverage (the proportion of debt to assets), so as to maintain or raise returns to equity. The only way to avoid all this and the attendant distortions of financial structure and markets is to control all income payments, that is, to limit the rates of return on all financial instruments.

All of the above tax proposals have another deficiency. They benefit the Federal government without providing any actual or potential gains for labor, except through use of tax funds for higher government outlays. A mechanism that meets many of the above objections might take the following form.

The rate of increase of profits greater than the rate of increase of labor compensation rates (for the tax reporting unit) is to be taxed on a progressive scale, if:

(a) Profits are positive; that is, decreases in losses are not subject to tax,

(b) Profit levels exceed the highest absolute amount reported in the last, say five, taxable years.

Even if the previous high profit levels were exceeded. the real income of firms would be lower than that earned in earlier periods, because of the intervening inflation. Likewise, since the capital base has grown, rates of return would be lower, too.

Because the extra taxes are levied against a base determined by labor compensation, high profit firms have an incentive to raise wages to a greater extent than would otherwise prevail. They, of course, also have the alternatives of lowering prices or paying the taxes. In all probability, a combination of effects would occur, with firms, labor, government and consumers all sharing the gains of undue profit potential.

DIVIDENDS

No guidelines may be required for dividends, especially if profits are constrained. It is not desirable to limit dividends paid to the elderly, to pension funds, to universities and other nonprofit institutions and to those individuals with moderate incomes. As to the wealthy, they, too, have a right to share in the benefits of decreased inflation and higher real output. In any event, the progressive individual income tax schedule provides for government capture (70% in the highest bracket) of extremely large dividend payments. Some wealthy individuals escape these taxes through avoidance and evasion. Yet their number is sufficiently small that the inefficiency costs of hampering the economy with still another set of controls probably are far greater than losses in equity: dividend controls cannot easily be justified.

TIME FRAME FOR CALCULATING PERCENTAGE INCREASES

Most labor bargaining and contracts are for payments to be made in future periods. At times retroactive compensation is made for work performed during negotiations or to correct past inequities. But the principal focus is on future wages and working conditions. Similarly, prices are set for current and future

transactions. Therefore, the ideal time frame for guidelines would be to base standards on future productivity, unit costs and consumer prices. Forecasting these quantities cannot be done with a high degree of accuracy. Consequently, if predicted standards were applied rigorously, *ex post* corrections would be needed to adjust labor and capital returns for deviations between actual and predicted performance.

While feasible, the problems and costs of using predicted standards are sufficiently great that reliance on past results seems more attractive—another "second-best" solution. The question is which past period should be selected and whether it should be uniform for all entities.

The least inflationary solution would be to prescribe that all computations should be based on the period since the wage-price freeze was announced, August 14, 1971. Implicitly, this would involve the assumption that all wages, prices and the distribution of real income payments were in equilibrium on that date. This is obviously false. Certain industries had granted large wage increases and raised prices over the preceding few weeks and months, and other industries had not adjusted for inflation over the past few years. To freeze relative prices and wages to their August 1971 pattern would be highly inequitable and inefficient from a resource allocation standpoint. Moreover, it would ignore the hard-won gains of labor in wage settlements that have not yet been fully implemented.

An alternative time frame possibility takes these considerations into account, is more flexible and comes closer to reproducing the working of unfettered competitive markets. This is to use time frames tailored to individual bargaining units. Average rates of increase of productivity, consumer prices and unit costs would be calculated over the interval in which the latest contract was in effect.[11] Labor compensation agreements and prices then would be set to remain within the guidelines given above.

If prices and wages exceed the guidelines limits on the date that the guidelines are put into force, rollbacks would not be required. However, they could not be increased from those levels unless such increases were within the guideline standards. In essence, this holds the line on sectors with recent highly inflationary wage-price settlements, while allowing the rest of the economy to catch up to more normal real income positions. Recomputation of guidelines and adjustment of wages and prices would be permitted periodically (for example, monthly), if labor and management agree to bargain or contract on that basis.

SOME SPECIAL PROBLEMS

The difficulties of measuring productivity are well-known. Real output per manhour can be calculated relatively precisely for most goods-producing and many service sectors. Even if "true" productivity cannot be determined, closely related proxy indicators can suffice for the short run, during the interval for which the guideposts are in effect. Obtaining productivity and real output measures for the service sector is not as intractable as many believe. For example, average hospital days per patient, revenue-ton miles flown, nights of hotel room occupancy, insurance coverage issued (at constant dollar premium rates), passengers carried, cases handled and so forth, all provide a means for measuring real output of services. Combined with manhour and cost statistics, they yield productivity and unit cost assessments.

There are some sectors for which productivity measurements cannot be made readily or accurately. Government is one example. For these sectors, guideline standards should be taken from external sources, such as productivity increases and wage scales in comparable activities or professions. A last resort is to use national averages of productivity, wage and price behavior as a guide.

Guidelines for small business also present problems. Many have neither the records nor the expertise to perform the necessary calculations. Enforcing individualized guidelines here is administratively formidable and extremely costly. Nor may it be necessary. Small business is constrained by the actions of large firms (which would, of course, be controlled) and is strongly influenced by demonstration effects and market forces. If it were exempted from strict adherence to the guidelines (flagrant violations could be made subject to sanctions), little harm probably would ensue for wage-price stability or relative equity.

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[11] In the absence of contracts, a maximum statutory period (like the preceding twelve months) would serve as the base interval.

ADMINISTRATION

Structurally and administratively, the guidepost system should be partially self-policing. The proposal above has a number of countervailing checks to help bring this about. Labor compensation can rise no faster than productivity, nor can prices rise at a greater rate than unit costs (or, in both cases, than the CPI, if productivity is low). If the rate of productivity increase is overstated, unit costs are understated. That is, labor can bargain for higher wages, but management is limited to lower prices. The reverse occurs for understatement of productivity. Therefore, both labor and management have a stake in accurate productivity measurement.

Exactly which is the best administrative organization and mechanism for supervision of guideline compliance is not clear. It probably should include a high-level authority (guideline review board), which would have ultimate responsibility (aside from court-imposed and Congressional directives) for the program. Moreover, the burden of proof of compliance should be on bargaining, price-setting and tax-paying entities, not on the government. In addition, the Internal Revenue Service and regulating authorities (ICC, FCC, CAB) could assist in the review process. The reports on wages and prices should be consistent with income tax returns and regulatory reports. IRS and regulatory agents are familiar with the accounting practices and historical financial performance of many firms. They would be in a good position to spot manipulation of accounts for purposes of guidepost evasion.

Violations of the guideposts could be subjected to a number of sanctions. These need not necessarily be limited to fines but could include other deterrents, such as punitive rollbacks in prices, payment of multiple damages to overcharged customers, a surtax on profits and income tax liabilities, and so forth.

CONCLUDING REMARKS

The above guidepost proposal is more complicated than simple rules, such as limiting all wage increases to a fixed figure (say an estimate of national productivity, plus an arbitrary increment). Such rules tend to be inequitable and to distort resource allocation. Some inequities and distortions also would result from the guidelines proposed here. But they would be far less severe and pervasive than those from simpler alternatives.

STATEMENT OF RICHARD W. LINDHOLM, PROFESSOR OF FINANCE, GRADUATE SCHOOL OF MANAGEMENT AND BUSINESS, UNIVERSITY OF OREGON, EUGENE, OREG.

Is a National Value-Added Tax Just Around the Corner?

The economic program of the administration announced the Sunday evening of August 15 can be interpreted as the first step toward a national value added tax (VAT), of 10 per cent.

VAT is the tax used by very nearly all of the major trading nations of the world. It permits them to levy a border tax on imports and to grant tax refunds on exports equal to the rate of VAT applied. These rates currently are as low as around 6 per cent and as high as around 33 per cent. The trend of the rates has been upward and that of the base toward greater breadth.[1]

There are few who would deny that to assist in making international adjustments is an important plus for any domestic tax system to possess, and that if a general tax measured by value of product does this better than a general tax measured by income, then product taxation possesses an advantage justifying consideration. Support stops here if the acquisition of international strengths requires the surrender of important attributes a good domestic tax system must possess. Domestic tax effectiveness cannot be surrendered to gain international advantages. The tail cannot be permitted to wag the fiscal policy dog as it tends to in the case of the monetary policy dog.

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[1] VAT is either now in effect or legislation providing for it is in the process of being adopted in the following European nations: Austria, Belgium, Denmark, France, Germany, Great Britain, Ireland, Italy, Luxembourg, Norway and Sweden. VAT is levied on imports as a border tax.

ANTI-VAT ARGUMENTS

The first basic objection to use of a general national tax based on the value of product rather than business and personal incomes arising from sales of products and services is the difference in the effect on consumer prices, and on intermediate goods and services costs of collecting the same revenues in these two different ways.

The second basic objection is that taxes based on the value of goods and services cannot be related to ability to pay, as can income taxes, and, because this is the situation, are necessarily less just than income taxes.

A third basic objection is that taxes based on value, except retail sales taxes or where the tax is stamped on the product, are hidden taxes; and therefore, taxpayers are not aware of the tax cost of government activities.[2] This is believed to prevent citizen equating benefits of government service with tax cost, and this inability results in uneconomic use of resources.

A fourth basic objection is that tax collections based on transactions lose a large portion of the built-in cyclical flexibility enjoyed when collections arise largely from corporate and individual income taxes.

The fifth, and perhaps by far the most important, is the fear of the unknown and the unfamiliar. Much of this objection boils down to a belief VAT, if introduced, becomes just another tax and will reduce individual and business well-being.

Each of these five basic objections are undoubtedly offered by persons sincerely concerned. However, it is also true they are raised as a political smokescreen and utilized by those fearful of the destruction of a special privilege or an intellectual position long maintained and defended. When used in this fashion, the seriousness of the objection is apt to be exaggerated. This is often done by enumerating undesirable aspects of VAT without comparing these with the shortcomings of continuation of past practices.

PRO-VAT ARGUMENTS

For example, the price objection, to be given perspective, must be compared with price increases arising in the U.S. without a VAT and in Germany, for example, with a VAT. The consideration should also point out that spending financed with deficits has price increase impacts which do not provide a new substantial tax base to reduce next year's deficit as would be true if a national VAT were introduced.

More than likely, it is impossible to measure the variation in domestic prices of internationally traded goods and services that arises from a difference in the portion of total taxes collected through applying indirect and direct taxes.[3] If the export prices of a nation decrease substantially, and border charges increase as a result of a sharp decline in use of direct and increase in use of indirect taxes, other nations must react to this change and the domestic economy of the nation making the shift must change. Just what changes will take place cannot be forecast. But one would expect domestic prices of imports to increase in the short run. However, as foreign reaction takes place through changed exchange rates and a similar move to more indirect taxes, the original upward movement of import prices would be modified. Domestic export industries would experience an original stimulation. The length of the stimulation would depend to a large extent on the same actions that are expected to reduce price increases of imports.[4]

I see little to fear from price increases arising from the introduction of a major VAT in the near future. Price changes caused by taxes are much more closely related to total taxes collected and method of expenditure than to type of tax used. After all, it is a truism that all prices must be covered by prices charged. The movement to VAT could help to stabilize prices by reducing deficits

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[2] The study of VAT sponsored by the American Retail Federation came out favoring a VAT collected as an add-on as is the retail sales tax. Cambridge Research Institute, "The Value Added Tax in the United States—Its Implications for Retailers," Cambridge, Mass. American Retail Federation, 1970, pp. 153–154.

[3] Individual income taxes, payroll taxes and corporate profit taxes are called direct taxes. VAT, retail sales taxes, special excise taxes, and tariff duties are called indirect taxes. Under GATT only indirect taxes can be levied on imports and refunded on exports.

[4] Current studies show that Western European export prices have not increased along with domestic internal price levels. A portion, but perhaps not all, of this difference is explained by the more rapid increase of service prices and the protected domestic market for high cost goods not able to compete in the international markets. However, the wide use of VAT is also an element.

and the need to expand the money supply to meet U.S. Treasury financing needs. The common objection that VAT, and all indirect taxes, are not suited to graduated rates and, therefore, cannot be taxes "according to ability to pay" assumes that only a particular tax should be considered in evaluating a fiscal system of a nation. Actually it is the tax system, i.e., all the taxes, that must be included in the analysis. In addition, the manner in which the money collected is spent cannot be excluded when evaluating a nation's fiscal system.

In addition. those objceting to VAT on the ability to pay issue are frequently shedding crocodile tears. However, the fact they influence many unaware of the shortcomings of direct taxes in reaching taxpaying ability is important in the context of this discussion.

DISAPPOINTING INCOME REDISTRIBUTION EFFECT

In addition, those objecting to VAT on the ability to pay issue are frequently collection has been pushed more actively than in most other countries. Despite one of the world's highest top individual income tax rates, no provision for including corporate profits taxes as paid at source income taxes, the inclusion of capital gains in taxable income, and what must be the world's best income tax enforcement organization, America's progress toward the goal of more equal income distribution through tax collections has been disappointing. In recognition of the shortcomings of the progressive income tax in redistributing income, its use for this purpose has been nearly abandoned in Germany.[5]

Executive and Congressional herculean efforts brought forth the 1969 Revenue Act. It is too early to judge the impact it will have on the income redistribution power of the federal tax system. But failure to reach goals set in a number of important areas and added complexity reduce one's optimism that it will have a major impact.

The democratic method to help the poor is rapidly shifting from taxing policy to spending policy.[6] The size of the economic pie has increased rapidly and continuously since World War II. This new economic stability, expanding productivity and reduced armament expenditures point toward democratic governments spending to maintain income of citizens throughout life and more spending to increase citizen education and productivity to reduce poverty at the source.

Under the circumstances of the present and visible future, the role of taxation in a democracy will be to provide stable revenues while encouraging economic growth within an international framework where tax harmonization is of vital importance. This type of tax goal does not require liberal, democratic governments to continue their historical tax attitudes favoring substantial use of only those taxes that use graduated rates. In a broad and meaningful sense incomes are made, more than likely, more equal by government spending aimed at this goal, than through soak-the-rich taxes.

CAN SHOW VAT SEPARATELY

The "hidden tax" shortcoming of the third basic objection is not a necessary VAT feature. The general European practice separates VAT out and makes it a separate item on the invoice down on the retail level. The retail price, however, does not separate out VAT. More than likely, this is the correct approach and the one to be used in America. This would make VAT similar to the corporate profits tax and the property tax. However, if Americans should want to make this particular tax stand out, it could be quoted separately as are state and local retail sales taxes, and as recommended by the American Retail Federation study.

The third basic objection seems to be largely a strawman. As used in Europe, VAT is more visible than other taxes and this would also be the situation if adopted in America, even if it was not added on as are retail sales taxes.

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[5] Frederick G. Reuss, "Fiscal Policy for Growth Without Inflation," (Baltimore, Md.: Johns Hopkins Press, 1963) p. 82.

[6] At the same time as the Swedish government was presenting plans for adoption of a VAT and some reduction of income taxes, it was providing for large increases in children's allowances. Karl-Olaf Faxén, "A Programme for Tax Policy, 1966–1970," Skandinaviska Banken Quarterly Review, 1961 : 3, p. 77.

BUILT-IN TAX FLEXIBILITY MYTH

The loss of cyclical flexibility, the fourth basic objection, is a positive good possessed by VAT and not a weakness. Government has been a major creator and not an eliminator of post-war economic instability.[7]

The record demonstrates the federal tax on corporate profits at the basically flat rate of around 50 percent is by far the most cyclically sensitive major revenue source. This degree of sensitivity of a major revenue source is bad—both in good times and in bad times. Bad in good times because a large portion of the cash flow of companies creating the good times is drained off for use by the Treasury.[8] VAT does not have this weakness.[9]

The relative desirability of enjoying economic stability through government revenue stability and some built-in expenditure flexibility, e.g., unemployment benefit payments, seems to have suffered too great a decline since the fiscal and monetary policy discussions of the 1930's.

Built-in flexibility of tax collections makes government expenditure maintenance or expansion more difficult during periods of economic decline. The large budgetary deficit required for an appropriate expenditure program creates international monetary problems and frightens away middle-of-the-road and conservative political support. Therefore, a government expenditure program aimed at using uncommitted labor and capital resources during a recession is retarded by the major use of taxes that bring in sharply reduced revenues during a recession. Those favoring taxes with collections that fall sharply in a recession often fail to note that the recession caused decreased tax collections arise largely from a reduction of capital gains and business profits. Therefore, reduced tax collections do not represent an increase in private spending incentives as would be true if payroll taxes, for example, were reduced.

Basically, built-in tax flexibility as an economic stabilizer settles down to a monetary approach to the problem. It turns out to rest on the development of budget deficits and surpluses and a resulting change in the demand for savings and a change in the quantity of high powered money created by the Fed. It is doubtful if it is desirable to rest appropriate money supply on fiscal determinants. Under these conditions, monetary policy loses a degree of its independency and acquires a tendency to forego making independent judgments of appropriate policy.

The final major objection is fear of the unknown. Education and the experience of others are perhaps the only general cures for this. After this has been accomplished, and this point is about here relative to VAT, the next step is general awareness of a need.

Change becomes possible when need is demonstrated. The Presidential actions of August 15 began this process. The debates which have followed are continuing the process. It involves international trading relations, budget requirements as well as reconsideration of the elements of liberal fiscal policy.

STATEMENT OF GARDINER C. MEANS, ECONOMIC CONSULTANT

GUIDELINES FOR AN ANTI-INFLATION POLICY

It is the purpose of this article to outline a set of guidelines for the determination of wage rates and profit margins in order to limit inflationary price increases in the period in which monetary and fiscal policy is employed to expand aggregate demand and thus raise the economy from an unemployment rate of over 6 per cent and industrial activity of 73 per cent of capacity to an *interim* goal of appreciably below 4 per cent unemployment and industrial activity of over 86 per cent of capacity. These are designed to resist the inflationary pressures which restoration of full economic activity would engender, as well as to overcome the inflationary tendencies which the first Nixon game plan failed to

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[7] Wilfred Lewis, "Federal Fiscal Policy in the Post-war Recessions," (Washington, D.C.: The Brookings Institution, 1962), pp. 195–198.

[8] Economic Report of the President, 1963 (Washington, D.C., Council of Economic Advisers, 1963), pp. 66–68.

[9] Richard W. Lindholm, "Business Activity Tax," Michigan Tax Studies (Lansing, Mich.: Michigan Legislature, 1958), p. 275.

check, and at the same time not interfere with the forces that work toward full employment.

Whether adherence to anti-inflation measures is to be enforced by law or is to be voluntary, subject to the pressures of public opinion, the enunciation of guidelines is essential. Indeed, if adherence were to be subject to legal enforcement as under the Nixon 90 day freeze, the absence of clearcut guidelines or standards would make the legislation of doubtful constitutionality. Whatever program goes into effect after the 14th of November, guidelines are crucial and must be clearly enunciated as a part of the program.

THE NEW TYPE OF INFLATION

It is clear that the problem of simultaneous inflation and under-employment involves a new type of inflation which derives from the market power of big business and big labor. Economic theory is capable of explaining inflation as a result of an *excess of demand.* It is also capable of explaining excessive unemployment as a result of a *deficiency of demand.* But it is unable to explain both inflation and under-employment at the same time. The problem is a product of the modern big corporation and the organization of labor which corporate concentration engenders.

The new type of inflation has nothing in common with the demand inflation which is the only kind of inflation known to classical theory. It arises from the private administration of prices and of wage and salary rates and does not depend on an excess of demand.

The source of this new type of inflation could be either management or labor or a combination of the two. Management could cause it by unreasonably widening profit margins or by maintaining profit margins which should come down. If a particular inflation were solely from this source it could appropriately be called a "profit" inflation. But the new type of inflation could equally well develop from the side of labor as wage and salary rates were pushed up faster than is justified by increased national productivity and living costs. A particular inflation arising solely from the side of labor could appropriately be called a "wage" inflation. More often the new type of inflation comes from the management side in some industries, from the labor side in others and sometimes from both sides in the same industry. Its distinctive characteristic is that it arises from private administrative pricing decisions, whether of management or through collectve bargaining. Therefore this new type of inflation is appropriately called "administrative" inflation.

Finally, it is the very fact that the new type of inflation arises from private administration of prices and wages that opens up the possibility of limiting it. Classically competitive prices such as those of farm products are extremely difficult to control even in a major war. Without rationing, prices move to equate supply and demand. But where prices and wages are administered through private decisions, they are not *determined* by supply and demand and the actions of the decision-makers can be directly influenced. Those who think in terms of classically competitive prices and therefore say that inflation cannot be controlled are not discussing administrative inflation.

SOURCES OF THE CURRENT INFLATION

The present government seems to be confused as to the main source of the present administrative inflation. On the one hand it has been charging labor with the responsibility for forcing up prices by raising costs. On the other hand, the President, in announcing the price and wage freeze, said to labor: "In the four years between 1965 and 1969 your wage increases were completely eaten up by price increases. Your pay checks were higher but you were no better off". Yet in these years national productivity increased by more than 10 per cent. If the President's figures are correct, labor has been denied the gains in productivity which are legitimately due to it and cannot have been the main source of inflation in this period.

An examination of the national accounts published by the Department of Commerce indicates that the primary drive for inflation in recent months has been an expansion of profit margins. According to the Department's figures, compensation to employees per physical unit of Gross National Product produced by non-financial corporations remained constant in the first half of 1971. In the

same period, profit margins per unit of production increased over 6 per cent. This does not look like wage inflation.

More fundamental as a cause of the current inflation is a curious paradox. Labor holds the opinion that wage rates have not kept pace with increases in productivity and living costs and assumes that this is because profit margins are too high. Management holds the opinion that profit margins are low and assumes that this is because wage rates are too high. The paradox lies in the fact that both groups are right in their opinion and each is wrong in blaming the other. Wage rates have not kept pace with combined increases in productivity and living costs and profit margins are low by historical standards. Each group, seeking to obtain what it regards as its fair share, contributed to the administrative inflation. The sources of this paradox and the way it leads to inflationary decisions will be examined in connection with hardship adjustments after the basic guidelines have been proposed. It is enough here to notice that when labor and management each sincerely believes that its share of income is unreasonably low, market power results in administrative inflation. This is something more than the normal striving of each for more.

THE BASIC GUIDELINES

The two areas in which market power generates inflation involve the determination of wage rates and profit margins. If inflationary action in these two areas can be prevented, the major source of inflationary price increases will be eliminated.

Basic guidelines for these areas which limit administrative inflation must strike a balance between greater simplicity and greater perfection. For the short period of recovery, simplicity must dominate. For this purpose, two simple basic guidelines would serve, except for hardship cases which would require special adjustments:

1. Wage and salary increases should not exceed the combined increase in national productivity and living costs as measured from a base period, say the first half of 1971, or the whole of 1970.

2. Profit margins per unit of production should not rise above the level in the same base period, except for cost-of-living adjustments from the base period.

Such guidelines, if adhered to, would bring to labor the full benefits of increased *national* productivity plus adjustment for living costs from the base period, but any adjustment for a previous lag or for other inequities would come under hardship rules.

The profit guideline would allow management to pass on all legitimate increases in cost and would allow profits per unit to rise with the cost of living, but, apart from this, increased total profits would come from expanding production rather than from raising prices.

In operation, if there were no hardship cases and all wages and price decisions were current, the application of these guidelines could be relatively simple. An emergency guidance board could announce the changes from the base period in national productivity and living costs from time to time, and individual companies and unions could calculate the appropriate limits on wage and salary increases and in profit margins. In connection with other costs, this would allow management to set prices consistent with the guidelines. If these guidelines were adhered to, the pricing actions of labor and management would make no net contribution to inflation, and the objective of holding the line while employment and economic activity expands would be achieved.

But these basic guidelines would produce inequities if there were initial inequities in the base period and might produce inequities through the overly simple profit-margin guideline. Important inequities would require hardship adjustment lest they make the guidelines program break down. The guidelines for dealing with hardship cases should also be clearly stated in order to avoid lengthy and repetitive administrative negotiations.

PRINCIPLES FOR HARDSHIP ADJUSTMENTS

There are two general principles which should guide the allowance of adjustments in hardship cases:

1. No adjustment should be made for minor hardships. Under the guidance program all hardships cannot be eliminated in the short period of the recovery program. The guidelines should not allow any adjustment where a correction for

hardship would amount to less than, say, 5 per cent of the wage or profit margin involved.

2. Where substantial hardship would be involved in a strict adherence to the guidelines, adustment should be made, but only part of the hardship should be corrected, particularly where it is of long standing.

In its short duration, the guidance program cannot be expected to go far in correcting inequities in the system of wage rates and profit margins. In case of substantial hardship, e.g. more than 5 per cent of the wage rate or profit margin, the hardship allowance should be figured on the basis of the excess over 5 per cent. If the hardship has arisen *during* the period of the program because of its simplicity, the whole excess should be allowed. If it results from a low level in the base period, only a portion of the excess, say 20 per cent, should be allowed in any one year.

THE APPLICATION OF THE HARDSHIP PRINCIPLES TO EMPLOYEE COMPENSATION

The application of the hardship principles to wages and salaries would center on the compensation per hour being paid in the base period. In general, but probably with many exceptions, the compensation to employees has not kept pace with the historic rise in national productivity and living costs.

A considerable discrepancy developed during the four year period of the Kennedy guideposts. This occurred from the combination of 3 factors: The cost of living rose around 5 per cent in the four years. The guideposts allowed adjustment for increasing productivity but not for cost-of-living increases. And labor adhered so closely to the wage guidepost that labor cost per unit of production for all non-financial corporations did not go up at all and for manufacturing enterprises it actually went down nearly 3 per cent because, in that recovery period, productivity in manufacturing went up this much more than national productivity. In the subsequent period, some of this setback has been overcome but some still remains.

An emergency guidance board should take a short period of years prior to the Kennedy guideposts and report the estimated rise in employee compensation from that period to the base period the [last normal period]. The rise might not be much greater than the average rise in the compensation per man-hour. If this is the case, there would be a large number of cases in which no hardship adjustment from this source would be called for by the guidelines. But in some cases, compensation has lagged well behind this average and the hardship guideline would call for some adjustment.

The other major type of wage hardship would arise where, in the base period, employee compensation per hour in one activity was clearly out of line with compensation for other similar activities. If the difference were substantial, the guidelines should allow some adjustment, provided the compensation for the comparable activity was not substantially out of line in the opposite direction by the historical measure.

In all wage and salary guidelines, employee compensation should be defined to include fringe benefits and apply to hours actually worked and they should apply to management and directors as well as to non-management employees.

APPLICATION OF THE HARDSHIP PRINCIPLES TO PROFIT MARGINS

The application of the hardship principles to profit margins is complicated by the paradox already mentioned that both compensation to employees and profit margins appear to be low. The reason for the lowness of wage rates has already been indicated. The lowness of profit margins in the base period is quite another matter. It arises primarily from three sources. In part it is a result of changes in the handling of depreciation and to this extent is a fiction so far as the guidelines are concerned. In part it is a result of increased interest payments per unit of production and may be irrelevant to the guideline program. In part it arises from the low rate of operation which spreads overhead costs over a smaller number of units, thereby increasing unit costs and squeezing margins except where prices have been correspondingly increased.

The effect on profit margins of changes in the treatment of depreciation is simple. Progressively over the years the charges for depreciation have been shifted away from a straight line to an accelerated basis so that a larger proportion of the capital invested in new plant and equipment is recovered through depreciation charges in the early years of their lives. The depreciation benefits of $3.5 billion a year put into effect January 1 of this year are a continuation of this process. As a result of this single 1971 change, accounting profits before

taxes would be $3.5 billion less even if gross profits *before depreciation and taxes* were the same. The lower profits would be an accounting fiction. With exactly the same output, prices and costs except for the handling of depreciation, the new regulation would bring something like a 6 per cent reduction in profit margins per unit of production. Over a longer period the shift of income from profits to depreciation would be very much greater.

This in part explains why profit margins *look* so low. Capital is taking part of its compensation in the form of tax-exempt depreciation, not taxable profit. This means that in any comparison of profit margins at different times for guideline purposes the same methods of calculating depreciation must be used or an adjustment made for the difference.

This accounting shift of current profits into depreciation must be taken into account not only in applying the basic profit guideline but also in making hardship adjustments. For the basic guideline, where the method of calculating depreciation has changed it is the profit margin per unit *calculated with the identical method of charging depreciation* which should be kept constant. Similarly, in hardship adjustments, it is only historical comparisons of profit margins which have been adjusted for differences in the accounting for depreciation (including depletion) which can be accepted as a basis for determining hardship. This should be made clear in the guideline.

The second reason that profit margins have tended to be low is the increased role of interest payments in the compensation to capital. In the last fifteen years, interest costs per unit of physical output produced by non-financial corporations have increased more than fivefold. Part of this comes from the doubling of interest rates but more of it comes from a great increase in the proportion of industrial capital that is derived from debt rather than equity sources. These two reasons for the increase in interest payments per unit of production involve somewhat different problems in a guideline program.

The very substantial increase in the ratio of debt to equity means that a larger proportion of the compensation to capital comes in the form of tax-exempt interest rather than taxable profits. But the fact that corporate management chooses to finance with debt rather than stock does not provide any justification for higher prices. Rather, it means that profit margins per unit of production should be lower. If two companies are alike in all respects except that one has no debt and no interest costs while the other has obtained half its capital by borrowing and therefore has substantial interest costs there is no reason why consumers should pay the extra cost of interest in higher prices or why, at the same prices, the interest should come out of wages. Rather, the interest should come out of profits and the profit margin per unit of production should be less. This also should be spelled out in the guideline.

This example indicates that, to the extent that the debt-equity ratio has shifted to a larger proportion of debt, profit margins should be lower. To this extent, just as in the case of the shift in depreciation accounting, the lower profit margins do not represent a case of hardship. In measuring the stability of a company's profit margins or its average margin as compared with the base period, the profit guideline should require an adjustment for any substantial shift in the debt-equity ratio as compared with the base period. Likewise, in hardship cases an historical shift in this ratio should be taken into acount.

The less important problem presented by the increase in interest rates raises the issue of whose income should be lower because interest rates have risen. Should the extra cost come out of consumers, wages or profits? Though a perfect set of guidelines would resolve this problem, it is sufficiently small so that any inequities involved in disregarding it in calculating changes in profit margins from the base period and in making hardship adjustments will be small, especially if a successful effort is made to reduce interest rates.

The third major explanation for low profit margins is the relatively low rate of operations. This presents a problem which tends to differ among companies depending on how they have reacted to the diminished volume of sales and the increase in overhead costs per unit in the recession from mid 1969. Some companies administer their prices to keep their profit margins relatively constant in a recession, hoping to average out their aggregate profits over the cycle. Some companies price to widen their profit margins in a recession so as to make more nearly the same aggregate profits in spite of variations in sales. And still others reduce profit margins in recession.

In the period of recovery, a perfect guideline program would take these differences into account, but this would appreciably complicate the profit guideline.

For the short duration of the recovery program it may be preferable to neglect this factor in administering the basic guideline but to take it into account with respect to hardship cases. This would require a discount from actual profit margins in measuring the hardship where the margin had been increased in recession and an addition in measuring the hardship where the margin had been reduced. Of course, the guideline would allow a modification of the base period margin only if, after this and other modifications were made, the hardship was substantial.

One further subject also needs to be mentioned. If there had been a substantial change in the ratio of capital to labor used in production, the ratio of the compensation to employees and compensation to capital should shift in favor of the latter. It is well established that, even in constant dollars, the dollars invested per worker have been increasing. But this is not the important factor in a guideline program. What is important is whether the *value* of capital per worker has increased relative to the *value* of labor per worker. In the last ten years, real wage rates per hour in manufacturing went up approximately 30 per cent and the real capital used per man-hour went up in about the same magnitude. Thus there has been no substantial change in the ratio between the labor cost and the capital used in production. This factor would, therefore, not need to be taken into consideration.

OBTAINING ADHERENCE TO THE GUIDELINES

Since the market power of big business and big labor is the major source of the administrative inflation, the problem of adherence to the guidelines should focus on the exercise of this power. Any enterprise or union having significant market power should be encouraged to adhere to the guidelines during the emergency. But the formal effort to obtain adherence should be limited to the few hundred big corporations which constitute two thirds of industry and whose market power vests them with a major public interest.

An example of such a limitation is given in H.R. 2502 which would create an Emergency Guidance Board to limit inflation by establishing and seeking adherence to a set of voluntary price and wage guidelines. Its legal powers would apply only to: (1) corporations with capital assets in excess of $500 million, (2) corporations which supply more than 30 per cent of any market of substantial volume, and (3) any corporation with capital assets in excess of $100 million or supplying more than 10 per cent of any market of substantial volume where the Guidance Board determines such inclusion to be necessary to carry out the purposes of the act. We may take this proposal as a basis for examining the problem of adherence.

Such a limitation in legal scope would, at the outset, allow a guidance board to bring some 300 big corporations within its program immediately, thereby covering more than half of the nation's industrial capacity. Then, as experience was gained, other lesser big companies could be brought under the program to the extent required by the anti-inflation objective. It would leave smaller companies outside the board's activity.

Labor unions bargaining with these big companies should also be brought under the legal powers of an emergency price board.

With the problem of obtaining adherence limited to a few hundred corporations and a smaller number of unions, the problem of adherence would be greatly simplified, though it would still be complicated.

ADHERENCE BY ORGANIZED LABOR

Adherence by organized labor should not be difficult to achieve, provided labor is thoroughly sold on the need for the guidance program and the essential fairness of the actual guidelines, and believes that the profit guidelines will be enforced on management. There are three major reasons for this expectation. First, labor adhered remarkably closely to the Kennedy guideposts even though the latter were unfair to labor. Second, management will tend to use the labor guideline in resisting excessive demands, and third, the anti-inflation program outlined here will include a tax on corporations applicable to any *increases* in profit margins over the margin prevailing in the base period except as an emergency guidance board approves a specific adjustment for hardship.

Only in one situation should any union have to make reports to an emergency guidance board. Unions should be free to strike. But before any union bargaining with one or more of the big corporations subject to the legal powers of the board could strike it should be required to file with the board a substantial eco-

nomic justification for the increases in labor compensation and other terms for which the strike call was being issued, with evidence that the strike demands were consistent with the wage guidelines or in what ways they exceeded these lines. The board could then publish the justification, review it and if it found that, taking into account the hardship considerations in the guidelines, the demands were excessive it could make this conclusion public. Such a process would not abridge the right to strike but could bring public opinion to bear.

ADHERENCE BY THE MANAGEMENTS OF BIG CORPORATIONS

The problem of obtaining management adherence to the profit guideline is more difficult. Under the four years of the Kennedy guideposts, the compensation to capital per unit of production for all non-financial corporations went up 25 per cent while the compensation to employees per unit of production remained practically constant, declining a little. On average, almost all of the extra compensation to capital came from raising prices.

The difficulty stems from two major sources. There is no strong consumer organization to bargain with management on profit margins comparable to management in bargaining on wages, and, secondly, it is much more difficult to bring about a reduction in prices when costs per unit go down than it is to prevent an increase in price when costs per unit do not go up.

For the latter, an advance notice and economic justification for an intended price increase and a review by an emergency guidance board could contribute greatly to securing adherence. Such a board should have the legal power to require all the big corporations which it has found to come under its authority to file with it any planned price increases for any significant product or line of products, say 30 days before the increase would be made, and to provide evidence that the increase is consistent with the profit-margin guideline.

The board could then publish the justification, review it and if it found that, taking into account the hardship considerations in the guidelines, the proposed price increase was not warranted or was excessive, it could make this conclusion public. Such a process could considerably temper any tendency to raise prices. It would not, however, have any effect in limiting an increase in profit margins when costs per unit have gone down, since only price *increases* would be reported.

An effort to apply a reporting technique where costs go down would be much more difficult and cumbersome to handle. A price increase is a positive and easily reported event and only those corporations which proposed to raise prices would have to report. But reductions in cost are not so simple and monitoring them would require that practically every corporation should file a report on costs. This would overwhelm a guidance board.

A NEW TAX PROPOSAL—A MARGIN TAX

To deal with this difficulty and also to reduce price increases, it has been proposed that an excess-profits tax be imposed. Such a tax, however, would tend to be counter-productive because, once a corporation was making the allowable profits, the inducement to expand its production further and hire more workers would be diminished.

A much more effective tax would be to tax unjustified increases in *profit margins*. Each corporation would be required to report to the Treasury its total sales and its total profits after taxes in the base period. It would also report its total sales and total profits after taxes in a current period. If the ratio of profits to sales had increased, this would be prima facie evidence of a rise in profit margins. Unless this evidence was rebutted by evidence of a hardship accepted by the guidance board or by a change in product mix, the profits arising from the increase in ratio would be heavily taxed.

Where an emergency guidance board has found that a constant margin would create a severe hardship and has accepted a higher profit margin as consistent with the guidelines, the Treasury would be required to use the adjusted profit margin in calculating an increase. Likewise where the product mix has been changed because of a change in the degree of integration or for some other reason some adjustment should be made. If the change in mix arises from differences in the products of different subsidiaries, this could be eliminated by allowing corporations to report their margins for each subsidiary separtely. In other cases some adjustment would be necessary. Only these exceptions for hardship and product mix should be allowed. Otherwise the simple figures should be used.

In the decision on the tax rate to be charged on taxable increases in profit margins, account must be taken of the imperfection of the guidelines. If the guidelines were perfect and all hardships were adjusted for, it would be appropriate to tax away all profits resulting from increases in the adjusted profit margins. But because some legitimate increases in margins cannot be taken into account without greatly complicating the administration of the guidance program, some lesser proportion should be taken, say 50 per cent. This would provide a significant deterrent to unwarranted price increases and a clear incentive to price reductions where costs were lower. It would not be counterproductive but would, rather, focus the making of profit on expanding production and employment.

RESULTS TO BE EXPECTED

The main objective of the set of guidelines here proposed would be to provide employees of the big corporations with the gains from national productivity that are their due without having them taken away by a rise in living costs, and to give management the prime inducement to make profits by producing more, not by increasing profit margins. If adhered to, they would not prevent all inflation during the period of recovery. First, there would be the limited inflation resulting from the rise in classically competitive prices such as those for farm products and some industrial raw materials, but this source of inflation would cease once full employment was reached. Second, there would be some price increases due to the adjustment of hardship cases. Finally, there would be the probability of some price increases among the small and medium companies and services not subject to classical competition. At the same time, an expansion of demand through fiscal and monetary measures could expand production and employment with only a minor proportion diverted to inflation.

STATEMENT OF THE RETAIL CLERKS INTERNATIONAL ASSOCIATION

AN RCIA FULL EMPLOYMENT, ANTI-INFLATION PROGRAM

We respectfully call upon the President and the U.S. Congress to work together to implement the following 20-point program to bring the economy under control:

Enact tax legislation: to reduce tax rates for families earning less than $15,000 a year; to increase personal exemptions to $1,200; to increase standard deduction; allow deductions for child care and education; to close tax loopholes allowing corporations and individuals to avoid their fair tax burden; to oppose investment tax credits and accelerated depreciation allowances, particularly for investment in American owned plants and facilities located in foreign countries.

Enact an excess profits tax at least for period of wage-price restraints.

Enact a freeze on dividends at least for period of wage-price restraints.

Place presently authorized freeze on interest rates, particularly for mortgage, consumer, small business, and small farm loans.

Pursue NLRB action to extend contract bar application through period of wage-price freeze to protest bargaining unit stability and bargaining strength of organized workers.

Secure a meaningful and effective role for organized labor in the shaping of government policy and programs to follow the 90-day freeze.

Pursue action for interpretation, protest and, if necessary, litigation to change regulations which are arbitrary or beyond the scope of the Executive Order.

Release the $12 billion of funds appropriated for public facilities and services, which the President has impounded, to provide the increased public investment intended by Congress when the funds were appropriated.

Increase the federal minimum wage to at least $2 an hour immediately to boost consumer buying.

Increase Social Security benefits to allow those on fixed retirement or disability incomes to catch up to cost-of-living increases.

Extend unemployment compensation benefit payments to assist long-term jobless workers.

Upgrade and enact the Family Assistance Plan immediately.

Enact the National Health Security bill and no-fault auto insurance legislation to provide better, more equitable protection, while holding down the costs of medical and hospital care and auto insurance.

Enact the economic disaster bill to provide special assistance to communities affected by man-made economic disasters comparable to those provided for natural disasters.

Establish or expand research and development activities in such areas as the environment, pollution controls, mass transportation, land use, urban deevlopment, health services, and basic research to provide displaced scientists, engineers, and technicians with the opportunity to apply their talents and skills to enrich our nation.

Remove tax and other incentives for businesses to establish production and assembly facilities abroad, thereby discouraging the exporting of thousands of American jobs.

Establish international fair labor standards.

Require clear labeling of products to show the country of origin of components as well as the final product—a truth-in-labeling policy.

Provide that all imports conform strictly to all laws designed to protect the safety and health of American consumers.

Establish a national policy of fair and reciprocal international trade, demanding that countries that wish to continue trading with the United States remove barriers to international trade to the same degree that this country removes them.

STATEMENT OF THE SAN FRANCISCO COALITION FOR FULL EMPLOYMENT

OCTOBER 8, 1971.

Senator WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
U.S. Congress,
Washington, D.C.

DEAR SENATOR PROXMIRE: We are writing on behalf of the San Francisco Coalition for Full Employment, an organization formed in June of this year, with 18 affiliated groups (listed in Enclosure A). The very existence of our Coalition indicates the serious concern of all people in our City about unemployment.

Although many groups, from labor, business, the universities, and government, are now advising your committee and the White House about economic policy, we think they may not be involved as our Coalition members are in direct contacts with the unemployed, and in continuing efforts to assist them. With the help of coordinating groups like the Human Rights Commission of San Francisco, and educational groups like the Institute of Industrial Relations, University of California, Berkeley, we have made a careful analysis of the economics of unemployment at local, regional, state, and national levels. The Summary of Findings and Recommendations of our June 3rd Conference on Unemployment in San Francisco, attended by about 200 of our Coalition group leaders and their rank and file members, is enclosed along with a list of Conference participants (Enclosures B and C).

In determining the policies which will seek to deal with these issues, we urgently petition your careful consideration of the following points of view, which represent the thinking and sometimes the emotional response of unemployed people, and those who work with them and for them:

1. On the subject of inflation controls, the main issues now being overlooked or under-emphasized are:

   (a) That people who are already living below commonly defined poverty levels should be given special exemptions from any current or future wage controls. Industries which include low wage job categories should be studied to discover workers whose wages bring them below the Federally-defined poverty levels and who would therefore suffer from the denial of raises.

   (b) That any changes in tax policy should give special consideration and relief to those at the lowest earning levels, because they have the greatest spending needs and the highest effective demand for goods and services, and because a tax break could give many of them the helping hand they need to climb out of poverty.

   (c) That any further consideration of a delay in Social Security tax increases must include a much more careful analysis of the impact of such a delay on Social Security benefit levels. Millions of people are kept from poverty *only* by their Social Security entitlements, which must

advance to cover an increasing number of retirees and permit more than a bare subsistence level of existence for most of them.

(d) That any further consideration of delays in much needed and long promised reforms of our welfare, education and health care systems must include much more careful analysis of the dangers that arise in a democratic society when the distance between the extremes of poverty and wealth becomes too great for many to tolerate.

2. On the subject of creating jobs, not only the economic program unfolded by President Nixon, but also the national dialogue about that program have been increasingly disappointing to our Coalition, for these reasons.

(a) In cities like San Francisco, our public service needs are so much greater than our needs for most material goods that we cannot comprehend a program which promises more employment only if the Nation produces an even greater surfeit of manufactured goods. (On our public sector needs in San Francisco, please refer to the June 3 statement of our Coalition Subcommittee on the Causes of Unemployment (which is attached as Enclosure D)).

In the past 20 years, there is *no* record of *any* expansion of manufacturing employment in San Francisco in response to any economic *stimulus*, or for any other reason. Instead, our City has continually lost manufacturing jobs to the suburbs, while our public service needs have expanded. Our financial resources are no longer adequate to permit us to introduce the public service programs which would provide more jobs while we meet our real needs—even though we have probably done more than most cities in helping to develop important regional programs like the Bay Area Rapid Transit system.

San Francisco is not unique. We know that in recent years, national employment has been rising in the public and service sectors of the economy much more rapidly than in the private and manufacturing sectors. We believe that our most important needs are now public and social in nature, and will not be met with more toasters and light bulbs, or even automobiles.

Our leaders should insist on economic "stimulation" policies which emphasize both manufactured goods and public service jobs, and on real needs for community facilities and services, plus the capital and planning and jobs to meet these needs.

(b) If there is to be speedy relief of the estimated San Francisco unemployment rate of 7.3% (which itself is believed to be greatly underestimated, especially for the minority neighborhoods where 20% is a frequently mentioned figure) application of the "Trickle-Down Theory" (tax and other concessions to industry to encourage investment) will not be effective here. We fear a pattern of resistance by major employers as has been experienced in Detroit by the United Auto Workers. That is, monies saved through concessions are not used to hire more workers, but instead to raise amounts of overtime paid to these already employed. Therefore, we ask that there be more planning for controls on profits as well as the ones presently in effect on wages and that the profits controls would be loosened—or cancelled altogether—in those companies where it would be shown that a significant number of new jobs had been created.

(c) If it is argued that the rest of the world needs material things and if as a consequence multi-national corporations are to use American tax dollars to invest in their overseas plants and to expand their overseas production, we ask, what does this have to do with jobs for Americans? We are in favor of helping others to obtain needed manufactured goods, but at this point in our nation's economic history, we are more concerned about the desperate need of our own people for jobs. On the local scene, we don't want business running away to the suburbs or abroad.

(d) If the priority in allocating our material tax dollar is to be given American corporations at home and abroad through tax benefits and incentives, then how and when can we expect the Federal Government to have enough tax revenues for the development of public service jobs—and the filling of public service needs—in this country, and particularly in our City and County of San Francisco?

More is involved than decreasing the Federal Government's tax base by direct benefits to business, because the present Administration has held up more than 12 billion dollars of appropriations which Congress has already approved for

grants-in-aid and for public service and urban needs programs. This freeze in the funding of public sector programs cannot be justified in terms of economic policy.

On behalf of those people who are being asked to pay the price for economic policies which contribute to their continued unemployment, their insecurity, and their deprivation, we plead that there be a thorough modification of Administration policies which fail to consider the urgent needs of the unemployed both immediately, and in the long run.

Respectfully,

WILLIAM BECKER,
Acting Chairman.
(For Reverend Eugene Boyle, Chairman,
San Francisco Coalition for Full Employment).

SAN FRANCISCO COALITION FOR FULL EMPLOYMENT

New Arrivals Service Center
Sacred Heart Church
Community College District
American Indian Center
Institute of Industrial Relations
Employment Law Project—Legal Aid Society
Jewish Community Relations Council
Jewish Labor Committee
Youth For Service
National Alliance of Businessmen
Bay Area Urban League
Archdiocese of S.F. Commission on Social Justice
Mayor's Manpower Unit
Arriba Juntos
Bank of America
U.S. Human Resources Corp.
SF Conference on Religion & Race
Central City Foundation
Step Program, N.A.S.C.
Office of Senator George Moscone
Mayor's Deputy for Social Programs
Bayview-Hunter's Point Model Cities Agencies

SUMMARY OF FINDINGS AND RECOMMENDATIONS

CONFERENCE ON UNEMPLOYMENT

June 3, 1971

San Francisco, California

Cosponsored by

The Human Rights Commission of the City and County of San Francisco

and the

Institute of Industrial Relations, University of California, Berkeley

FINDINGS

There are three kinds of employment problems in San Francisco:

1. An insufficient number of jobs;
2. An unequal distribution of jobs that do exist;
3. An inadequacy of training programs to solve the problem of underemployment.

Because of the nature of the local economy, and the limitations of local finances, the problem of insufficient jobs can be met chiefly only by *federal action.*

The problem of the unequal distribution of jobs can be met chiefly by *local action,* with accompanying Federal and State action.

In short, it is massive governmental intervention which is required at this point; and it is therefore mainly political action which is required to stimulate that intervention.

RECOMMENDATIONS

TO PROVIDE SUFFICIENT JOBS

On the Federal Level

1. The establishment of a comprehensive program of public service employment by the federal government. In this situation, the federal government must serve as "employer of last resort."

However, this is to be seen not as a welfare program, but as a normative program for the country. Full employment—the official policy of the nation

since 1948—is to be seen not as the *result* of a healthy economy, but as the *cause* of a healthy economy. Thus, we have to stand our present concept of the relationship between economy and employment on its head. Nor is this a "WPA" make-work program. The jobs which government should provide should be in *needed* public services, such as the educational and health systems and on the ecology front. The National Commission on Technology, Automation and Economic Progress has identified 5 million such meaningful public service jobs which are not now being filled.

Special training and apprenticeship programs can be built into such jobs—as in the case, for example, of para-medical personnel.

2. The release of up to 12 billion dollars in construction funds by the Federal Government for the construction of needed buildings.

3. The funding of the accelerated public works program as passed by Congress, but not yet signed by the President.

On the Local Level

4. The promotion of local enterprise that will fit the labor market through tax incentives, in conjunction with the Federal Government.

5. The routine use of "hidden local funds"—such as the Gas Tax funds—to create a large pool of jobs for young people.

TO FAIRLY DISTRIBUTE JOBS

On the Local Level

6. The establishment and implementation of a residency requirement for all government and government-connected jobs, so that priority in hiring will be given to San Francisco residents.

7. Implementation of the legal requirement that builders, contractors and suppliers to the City Government engage in an affirmative action employment policy. Implementation depends on the Board of Supervisors and the Mayor providing funds for enforcement of the law already on the books.

8. The requirement that all high-rise developers train San Franciscans for the long-term jobs in their buildings, offices, service and maintenance.

9. A comprehensive affirmative action program by Civil Service, including reassessment of all tests and qualifications, and active search for qualified and qualifiable applicants, and necessary training programs.

10. Establishment of adequate child care system so that mothers capable of and interested in working can do so.

TO PROVIDE ADEQUATE TRAINING PROGRAMS

On Federal Level

11. Constraints and incentives by the Federal Government to impel private industry and labor to provide more training and apprenticeship programs within the framework of affirmative action.

12. Establishment of the government as "trainer of last resort." The use of the public institutions as training institutions, especially in the area of the public service jobs which are needed.

On the Local Level

13. The creation of other public educational institutions and programs that will relate more directly to the preparation for jobs in our modern society. This might include the development of more "4–4" situations in the schools.

TO ACTIVATE THESE RECOMMENDATIONS

14. The creation of a constituency or public which will be cohesively active on this specific political front. This should be a coalition of the many elements in the community which have a stake in these objectives. The first step should be a continuation committee flowing from this conference which will attempt to provide a network of communications on these issues and explore the development of an action coalition.

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PARTICIPATING ORGANIZATIONS FOR CONFERENCE ON UNEMPLOYMENT

Apprenticeship Opportunity Foundation
Archdiocesan Commission on Social Justice
Arriba Juntos—Organization for Business, Education, and Community Advancement

Assemblyman Willie L. Brown Jr.'s Office
Assemblyman John Burton's Office
Assemblyman Leo McCarthy's Office
Associated General Contractors of California

California Department of Human Resources Development
California State Council of Carpenters
Carpenters Bay Counties District Council
Centro Social Obrero
Chinatown-North Beach District Council, Inc.
Chinatown Youth Service and Coordinating Center
Chinese Newcomers Service Center
Civil Service Commission of San Francisco
Concentrated Employment Program—Economic Opportunity Council

Fil-Am South of Market Neighborhood Association

Greater Chinatown Community Service Association
Greater San Francisco Chamber of Commerce

Institute of Industrial Relations, University of California, Berkeley
International Longshoremen and Warehousemen's Union, Local 34 (Ship Clerks' Association)

Jewish Community Relations Council

Mayor's Office—Office of Social Programs
Mission Coalition Organization

National Alliance of Businessmen

Plumbing, Heating & Cooling Contractors of San Francisco, Inc.

San Francisco Community College District
San Francisco Conference on Religion, Race and Social Concerns
San Francisco Junior Chamber of Commerce
San Francisco Labor Council
San Francisco Neighborhood Legal Assistance Foundation
San Francisco Redevelopment Agency
San Francisco Retailers Community Relations Group
San Francisco Unified School District
Senator George Mascone's Office

United Filipino Association

Western Addition Project Area Committee

Youth For Service

STATEMENT OF DAVID J. STEINBERG, EXECUTIVE DIRECTOR, COMMITTEE FOR A NATIONAL TRADE POLICY

The idea of an import surcharge seems as ill-conceived in 1971 as were the Johnson Administration's balance-of-payments proposals in 1968. The Johnson Administration over-reacted to the balance-of-payments deficits of 1967. The Nixon Administration appears to be over-reacting to the balance-of-payments problem today. The 10 percent surcharge—boosting the cost of most dutiable imports by 10 percent—is a kind of overkill.

The purpose of the surcharge, the President said, is "to make certain that American products will not be at a disadvantage because of unfair exchange rates." But floating the dollar, the most important foreign-economic move in the Administration's emergency economic policy, will result in a cheapened dollar in relation to other currencies, thus itself making imports more expensive by an estimated 10 to 15 percent. The unfairness of the fixed exchange rates, which the import surcharge is supposed to correct, would thus be diminished by the consequences of the monetary action.

If the real purpose of the surcharge is psychological warfare with the Japanese and the West Europeans, this is a very risky gamble. If it was intended, at least in part, to dampen domestic pressures for import quotas, this is protectionism the country can ill afford. An import surcharge is, of course, preferable to an import quota, but the situation did not call for a choice between one or the other.

The surcharge also raises a host of complications for importers, and for businesses to whom they sell. Some of the importers are themselves manufacturers, some greatly dependent on imports. The surcharge can be added to prices even during the freeze. But this, in varying degrees, will be resisted by consumers. Some businesses using imported materials will be discouraged from using them in the short and possibly longer run. Imports already en route float on a sea of uncertainty. The tax is temporary, but far-reaching.

Besides being unnecessary and disruptive, the surcharge has magnified the considerable doubts already surrounding U.S. trade policy. U.S. policy has at best been drifting. Now more than ever, the drift seems backward. The new policy also requires purchase of American equipment as a condition for the proposed investment tax credit. "Buy American" has in the past applied to Federal government procurement. It is now, in a sense, being applied to industry investment as well. A rash of state and local "Buy American" laws should come as no surprise, even if their constitutionality is questionable. What train of trade restrictions has the new policy set in motion, at home and abroad? We are reacting shortsightly and counterproductively to symptoms, not prudently and constructively to the real ills and urgent needs of our international economic position.

This is a time of deep crisis in foreign econmic policy. But the United States gives too much evidence of unpreparedness for the steps needed to solve it. The time has come, not just to patch up the world monetary system, but to develop a comprehensive strategy to dismantle the trade barriers and distortions of the industrialized countries, up-date the rules of fair international competition, upgrade labor standards throughout the world trading system, and build a strong world monetary system that fosters fair competition and expanding international trade. We would do much more toward restoring world confidence in the dollar if we shunned direct or indirect devices for restricting imports, and instead launched such a dramatic initiative, backstopped by a coherent adjustment strategy at home. One result would be a highly productive stimulus to our economy.

To move dramatically in this direction now would be a sign of American strength. Resorting to import restrictions ,and lacking a coherent, dependable free-trade policy, are a sign of American weakness. Letting the dollar float is one thing. Letting trade policy drift is something else.

STATEMENT OF ROBERT TRIFFIN, FREDERICK WILLIAM BENINECKE PROFESSOR OF ECONOMICS, YALE UNIVERSITY

TOWARD AN INTERNATIONAL RESERVE SYSTEM

IT HAD TO HAPPEN AGAIN

August 15, 1971 calls back to mind September 21, 1931. Mr. Nixon has finally been forced to throw in the sponge, just as Mr. MacDonald forty years ago, and very much for the same reason: the ultimate unviability of a gold-exchange standard, whose functioning places unbearable burdens as well as "exorbitant privileges"—in President deGaulle's words—on the reserve-currency country.

The gold-exchange standard is indeed a three-act play.

The first act displays the euphoria and financial irresponsibility bred by the "exorbitant privilege" of being able to finance large and growing deficits through the country's own IOU's: sterling or dollar balances accumulated as currency reserves by other countries' central banks.

Economic and political woes emerge in the second act, as the defense of the country's declining net reserves forces it to increase interest rates, while the growing overvaluation of its currency spreads recession and unemployment in export industries and import-competing industries.

In the third act, domestic considerations prevail. Expansionist and low interest-rate policies accelerate external deficits, and in the last scene speculators rush in as the rise of gold-convertible obligations far above the level of vanishing gold stocks creates a growing "credibility gap" about the continued willingness, and even sheer ability, of the reserve-currency country to honor its gold commitments.

A HARD CHOICE

President Nixon's decision faces all other countries with an agonizing dilemma: whether (1) to continue to run their currency printing press to finance unpredictable U.S. deficits, arising from policies which may, at times, be highly distasteful to them, or (2) to stop buying dollars and let their own currency appreciate to levels that may be—or be deemed—uncompetitive by large and politically powerful sectors of their economy.

The short-run outcome is unlikely to be the same everywhere. A large number of countries will undoubtedly prefer the first term of the dilemma and gravitate toward a "dollar area" reminiscent of the post-1931 "sterling block." Others, and particularly the major surplus countries—Japan and most of Western Europe—have already opted for some degree, at least of currency revaluation, or will do so tomorrow to stem the dollar flood and obtain from Mr. Nixon a lifting of the 10% surcharge on their exports to the United States. They will, if need be, try to shelter their currency from excessive appreciation through various forms of capital controls—including possibly a two-tier exchange system *à la Belge*—and through some further, but limited, spontaneous or negotiated dollar accumulation.

The most naive illusion is that of those flexible exchange-rate fanatics who imagine that politicians will let free market forces, helped by speculators, determine the future levels and fluctuations of each country's exchange rates.

LOOKING AHEAD

This, however, is only the beginning of the story. The international monetary system must be reconstructed and, one must hope, on a basis vastly different from that which plagued Britain and the world in the late 1930's, and the United States and the world throughout the decade of the 1960's.

One feature of this reconstruction will certainly be an attempt to shelter the exchange-rate pattern of the world against wild and disorderly capital movements prompted by interest-rate distortions and currency speculation. This may entail a variety of national measures as well as better concertation and joint implementation of agreed policies, notably with relation to the Eurocurrencies and Eurobonds markets, the external transactions of banks and financial intermediaries, and even massive fund transfers from one market to another by large, particularly multinational corporations. Residual, reversible capital movements may also be offset, in part, by a broader network of short-term swap agreements and by compensatory transfers of funds by the IMF and national central banks.

Prompter readjustment of clearly undervalued as well as overvalued exchange-rates will also be encouraged. Wider "*bands*" around official currency *par values*—if and when restored—are also likely to emerge from the negotiations now in process, even though I would far prefer—for effective results—the definition of an agreed "*fork*" around "normal" *reserve levels*. Persistent, or excessive, reserve gains as well as reserve losses should trigger forced consultations in the IMF, sanctioned in case of disagreement by a flat prohibition—or gradual limitation—of further interventions by monetary authorities on the exchange market in defense of a clearly undervalued or overvalued exchange rate.

Equally, or more, important will be a system of reserve creation and management adjusting their total levels to world needs and making use of them for internationally agreed objectives. Reserve deposits with the IMF should ideally become the exclusive medium of reserve accumulation, replacing scarce gold and overflowing dollars, and merging gold and super-gold tranches on the Fund with SDR's and even Fund credit lines under so-called standby agreements. Such a radical solution is probably too simple and rational to be negotiable with routine-bound officials and puzzled politicians. Transitional agreements will be necessary, anyway, to ease the passage from the old system to the new, and deal with cost to $90 billions of gold and national currency reserves inherited from the ill-fated gold-exchange standard.

Currency reserves—primarily dollars—should be limited in the future—at least for major countries not joining a formal "dollar area" or other regional monetary group—to modest levels (15% of overall reserves?) of "working balances" needed for daily stabilization interventions by central banks in the exchange market. Any foreign currencies bought by them in excess of this ceiling should be promptly deposited with their IMF reserve account, and debited from the account of the debtor countries. An exception would have to be made, however, for all, or most, of the vast currency holdings accumulated under the many gears of functioning of the gold-exchange standard. These should preferably be

retained by the IMF as "consols", with appropriate interest and exchange-rate guarantees, and be amortized primarily from subsequent surpluses raising the debtor countries' gross reserves beyond their agreed "normal" level.

As for gold, central banks will undoubtedly insist on the right of retaining their present holdings until full confidence has been gained in the new system and makes acceptable an orderly disposal of surplus stocks in the private market. In the meantime, deficit countries whose gold proportion in their total reserves is higher than average might be required to use some gold—via the IMF—for settlement to the surplus countries whose gold proportion is lowest.

THE EUROPEAN COMMUNITY

The increased exchange-rate flexibility which is clearly in the wind of current negotiations will of course be incompatible with the commitment of the EEC countries—including Britain tomorrow—to full monetary union, and even with the survival of the Common Market as it now functions under the Treaty of Rome.

Space does not permit a full discussion of this issue. Suffice it to say that the only reasonable solution of the problem lies in an acceleration of the Werner plan calendar. The EEC countries will have to agree on a stable—but not yet irrevocably fixed—pattern of exchange rates among their own currencies, within existing—and indeed gradually declining—margins of authorized fluctuations. They will float *together* vis-à-vis the dollar, following the Benelux example. This will require the use of their national currencies—in lieu of the dollar—in market interventions needed to prevent excess fluctuations among their own currencies, and a close concertation of their interventions on the dollar market itself. Both of these requirements could hardly be implemented efficiently without the early setting up of the European Fund for Monetary Cooperation initially envisaged only for the end of the first stage, or the beginning of the second, but for which the Council of Ministers has already requested a detailed draft proposal before the end of next year.

CONCLUSION

Past experience should make us skeptical about a quick, orderly, and successful negotiation of these ambitious objectives. But, as Mr. Abba Eban said, "men and nations behave wisely . . . after all other alternatives have been exhausted."

STATEMENT OF JERRY VOORHIS, FORMER MEMBER OF THE HOUSE OF REPRESENTATIVES, ON INFLATION AND DEBT-MONEY

Until this nation's monetary system is radically changed, inflation may well be the price of survival of our economic system.

If that statement is a shocker in these days of wage-price freezes and usurious interest rates—so be it!

In Old Testament times the Hebrews had a law that all debts were cancelled every seven years. They knew that a limitless piling up of unpayable debt could never be endured by any people.

In more modern times two different methods of freeing nations from an insupportable debt burden have been used.

One of these has been runaway inflation such as Germany used after World War I. It wiped out all indebtedness, public and private, and made possible a new start for the German economy. France and other countries have done almost the same thing from time to time.

In the United States the method used in the years before the New Deal was the "panic" marked by waves of bankruptcies, which did away with much of private debt if not that of the government.

One of the decisions of the New Deal period—scarcely recognized at the time—was a decision that the nation should never again go through a period of panic and widespread bankruptcy. Instead the government would go into debt to whatever extent was necessary to obviate the necessity of private bankruptcy.

This was the beginning of deficit financing to revive a sick economy.

We are still at it—only more so.

The Nixon deficit for fiscal year 1971 was about $23 billion. And it may go much higher than that in 1972. In fact, Treasury Secretary Connally has estimated the deficit for fiscal year 1972 at $28 billion. The reason why the Nixon

Administration plans to incur these deficits is precisely the same reason that prompted the action of the New Deal.

Now there are valid reasons why the Federal Government should incur a deficit in periods of unemployment and shortage of people's buying power.

But a serious and increasingly dangerous problem looms ahead because of *the way* in which deficit financing is handled.

For if the actual desirability—even necessity—of a sharp inflation is to be avoided, deficit financing should—and must—be accomplished without increasing the public debt.

The Constitution of the United States requires that this be done.

So does every decent moral consideration.

So does the survival of an even partially "free" economic system.

And there is no reason whatsoever why we, the Federal Government of the United States, cannot inject additional buying power into the economy, when needed, without increasing the nation's debt and without the necessity of inflation.

As background let us see what has actually happened since the close of World War II.

In 1946 our national debt stood at $269 billion. Interest rates then were at reasonable levels so the interest bill was $5 billion.

When the Eisenhower Administration came to power in 1952 all the measures which had successfully held average interest rates on government securities—short and long term—at less than 2 percent, even during the war, were abandoned. And interest began to skyrocket. That skyrocketing has not stopped since.

Today, in autumn 1971, our national debt stands at $411 billion, about one and one-half times what it was in 1946. But interest on that debt will probably exceed $25 billion in this fiscal year, five times what it was in 1946! For comparison, that $25 billion is about eight times the amount which the Federal Government provides for education.

In 1968, the last Democratic year, interest on the public debt was $14 billion.

In 1969, the first Nixon year, it went to $16.9 billion. In 1970, it was $19.6 billion. And in fiscal year 1971, the year ending June 30, 1971, it is estimated to have exceed $21 billion. For 1972, as has been said, it will probably top $25 billion.

That is almost a 50 percent increase in the debt burden in just three years of the Nixon Administration.

The reason, of course, has been the highest level of interest rates since the Civil War. Even short-term, 15-month, U.S. bonds have been carrying an interest rate of more than 6 percent.

Now during the years since World War II, price inflation has been continuous. It is true that during the early years of the 1960's under Kennedy's and part of Johnson's Administration, inflation was nominal—not more than 1.5 percent in any one year. But in 1965 as a result of a 4 to 3 decision of the Federal Reserve Board to boost its rediscount rate by some 12½ percent, interest rates began to climb precipitously. And so did inflation.

As interest rates climbed so did the rate of inflation, even as the false excuse for high interest rates was given that they were "necessary to curb inflation." The cold figures make that excuse ridiculous. The rate of inflation in 1965–66 was 2.4 percent, in 1966–67 it was 3 percent, in 1967–68 it was 3.7 percent, in 1968–69 it was 4.9 percent, and in 1969–70 it was 6.2 percent.

In a way it was almost fortunate for the American people that they had to endure a 5 percent to 6 percent price inflation in 1969 and 1970. They might have suffered an even worse fate.

For let us see what would have happened had there not been inflation in the post-war years.

The dollar has lost more than half of its buying power since 1946. In other words each dollar represents only half as much real wealth as it did 25 years ago, which makes debts somewhat easier to pay.

Had there not been this inflation in the post-war years, the real debt burden today would be double what it is. We would be paying, in terms of real wealth of the people, not $21 billion or $25 billion in interest on the national debt, but $42 billion or $50 billion.

Even the most ardent of debt merchants and debt apologists would be a bit staggered by such a figure. It would be a quarter of our total national tax payments! And be it never forgotten that the larger the debt, public and private, becomes, the more vulnerable our country becomes to any downturn in economic activity. So the government must resort to more and more drastic action to

avoid the danger of a cycle of defaults setting in. But the remedy thus far applied has been, and is in the present crisis, to still further increase the mountain of debt!

This is, indeed, a gospel of despair.

Thus it almost seems that some fateful, and perhaps benign, hand has been pushing up our prices so we could live with our soaring debt and meet its exactions with cheaper dollars.

But the grim tragedy of the matter is that neither the inflation nor the staggering burden of debt are at all necessary.

The Constitution of the United States says: "Congress shall have power to coin money and regulate the value thereof."

Congress does no such thing.

Here is the heart of our trouble. Private banks coin our money and regulate its value.

In doing so they take from the government and people of the United States a large chunk of their sovereignty, a large chunk of the taxing power, and the key to a prosperous economy without inflation.

This is no sudden discovery of mine. The most unimpeachable authorities in the land have said the same thing. For example, in testimony before the Banking and Currency Committee of the House of Representatives, Marriner Eccles, then Chairman of the Federal Reserve Board itself, said this:

"In purchasing offerings of Government bonds, the banking system as a whole creates new money, or bank deposits. When the banks buy a million dollars of Government bonds as they are offered—and you have to consider the banking system as a whole—as a unit—the banks credit the deposit account of the Treasury with a billion dollars. They debit their Government bond account a billion dollars, or they actually create, by a bookkeeping entry, a billion dollars."

Here is how it works:

The private banking system of our country creates our money in the form of demand deposits on the banks' books. The reason it is able to do this is because no bank is required to have in its vaults anything like the amount of money which its depositors think they have in the banks.

Banks are only required by the Federal Reserve System, which the banks are sure they own, to have in their vaults anywhere from $1 to $1.50 for every $10 of demand deposits on their books.

Thus for every $1 or $1.50 which people—or the government—deposit in a bank, the banking system can create out of thin air and by the stroke of a pen some $10 of checkbook money or demand deposits. It can loan all that $10 into circulation at interest just so long as it has the $1 or a little more in reserve to back it up.

This is, of course, the "fractional reserve system" of banking. It is more or less controlled by the Federal Reserve System, whose only stock is held by the private banks of the Federal Reserve System, without a single share of such stock being held by the government or people of the United States, as should be the case.

Now let's see what happens to the Nixon $23 billion deficit for fiscal 1971. This deficit was caused by the economic recession, for the recession meant less earnings for businesses and individuals, hence less taxes collected by the government. So there is need to revive the economy by having the government put into the stream of commerce more money than it takes out. This, as always, is calculated to increase buying power and effective demand, and thus to get some of the 28 percent or idle productive capacity back to work.

It is important to remember that deficit financing is engaged in to bring about greater production, more employment, and more full use of productive capacity when much of it is idle. In other words we use deficit financing because we are confident that it will increase production, hence increase tax revenues, and hence *broaden the base of the nation's credit.*

Now to the extent that government bonds are sold for cash to individuals or to institutional *purchasers other than banks* the government is taking out of circulation approximately as many dollars as it will put back in when it spends the money.

To do any good, deficit financing must result in the creation of *new money*, and the use of it to increase mass buying power. Only if this happens will there be any stimulation of idle plants to go back into production, or more employment.

Under these circumstances what *ought* to happen is that the *credit* of this great nation should be drawn upon directly by the government—not that it should go more deeply into debt.

For the credit of this or any nation is squarely based upon and derived from the production of wealth by the nation as a whole and the power of the government to tax.

By whatever percentage it can be anticipated that production and hence potential tax revenues will increase as a result of deficit spending by that same amount the credit of the nation and its government will be increased. This same percentage of the volume of money previously in circulation should appear on the books of the Treasury as a credit entry to be drawn upon just like tax revenues. To do that would be nothing more than rational and proper bookkeeping. It would also be morally right bookkeeping.

But this is not what happens at all. Instead the sovereign government of the United States goes hat in hand to the private banking system and asks it to create the new money that the economy needs.

But not for nothing! No Sir! Despite the fact that it costs the banks considerably less than nothing to create the money in the form of brand new demand deposits or checkbook money; they are rewarded for such action by the receipt of very substantial interest from the taxpayers' pockets.

The government *gives*—the word is used advisedly—it *gives* to the banking system, including the Federal Reserve banks, government bonds, the debt of all the people. Interest bearing bonds, that is, bonds bearing as high an interest rate under today's regime as the banks decide to demand. Else they won't buy the bonds.

The banks "buy" the bonds with newly created demand deposit entries on their books—nothing more. It is fountain pen money and it is considerably *more* inflationary than would be the same amount of dollar bills created by the government, as will be explained.

Unlike other demand deposits which they create, the banks, by permission of an indefensible act of Congress, need have *no reserves at all* to back the demand deposits they create when the government bonds are given to them.

The deposits the banks create with which to own your debt and mine are backed by nothing *except the bonds themselves!* In other words, they are backed by the credit of the American people.

What the government has "borrowed" from the banks, what the people must for years pay high interest on, is nothing more nor less than the credit of the nation, which obviously the nation possessed in the first place or the bonds would be no good!

At long last, a few years ago the Federal Reserve made tacit acknowledgement of the facts just stated. As a direct result of logical and relentless agitation by members of Congress led by Congressman Patman, as well as by other competent monetary experts, the Federal Reserve began to pay to the U.S. Treasury a considerable part of its earnings from interest on government securities. This was done without public notice and few people, even today, know that it is being done. It was done, quite obviously, as acknowledgement that the Federal Reserve Banks were acting on the one hand as a national bank of issue, creating the nation's money, but on the other hand charging the nation interest on its own credit—which no true national bank of issue could conceivably, or with any show of justice, dare do.

But this is only part of the story. And the less discouraging part, at that. For where the commercial banks are concerned, there is no such repayment of the people's money.

We said a moment ago that the banks buy the bonds for less than nothing. This is true because the bonds once acquired can be counted as reserves by the banks possessing them. And for every $1 of such bonds which the banks hold they can create roughly another $9 of demand deposits and lend them into circulation at interest.

Good business if you can get it.

Good business if any sovereign nation is foolish enough to give it to you.

When the commercial banks create money, as they do when they acquire government bonds, they levy a tax on every person in the United States. This is so because every new dollar that is created makes every dollar previously in existence worth somewhat less than it was worth before. This is the very heart of inflation.

It is also taxation without representation with a vengeance.

Until this system is changed our debt will continue to skyrocket without limit, and the fixing of debt limits by the Congress will continue to be an exercise in utter futility. And unless there is inflation to reduce the debt burden, it will

become insupportable by the economy much sooner than would otherwise be the case.

What ought to be done?

Eventually, no doubt, banks should be required to actually have in their vaults a real dollar for every dollar their depositors think they have in the bank. This is called 100 percent reserves. But such a reform could not and should not be accomplished quickly. It could and should be realized by a gradual increase in reserve requirements for *demand* deposits (but not for savings deposits) over a period of years. Such increases in reserve requirements should be geared to the flow of money in the economy, as brought about by the creation of credits on the nation's books through a true national bank of issue.

Once this reform were instituted we, the people, would have to—and should—pay our banks honestly and fully for the very real service they render in servicing our accounts. But that would be a cheap price to pay for the establishment of a livable monetary system, in which the nation's supply of money would no longer be they can create roughly another $9 of demand deposits and lend them into circulation at interest.

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Once this reform were instituted we, the people, would have to—and should—pay our banks honestly and fully for the very real service they render in servicing our accounts. But that would be a cheap price to pay for the establishment of a livable monetary system, in which the nation's supply of money would no longer be dependent upon ever-increasing debt.

Banks should lend existing money. But, as the Constitution clearly requires, the money (or credit) of the nation should never be created by any private agency, but by an agency of the nation itself. It is the duty of Congress to provide for this by a carefully drawn statute.

The stock in Federal Reserve Banks should be purchased by the government from their present private bank owners. The Federal Reserve should then become our national bank of issue. It should create Reserve Bank Credit as it does now. But that credit should be *credited* to the United States Treasury, not charged against it and the people as debt. As much such new credit *should* be created each year as is needed to keep our economy running at or near capacity—and no more than that. A stable price level could result.

Then and only then can we expect to overcome recessions, to put our people to work, and to do this without the danger of—indeed necessity for—the inflation, or the ever-increasing debt which are inescapable under the present monetary system.

BERNARD F. ZUCCARDY, ECONOMIC CONSULTANT

THE NATION'S LARGEST INDUSTRY AND PHASE II

All American Consumers have reason to be hopeful that their largest industry—construction—will be building products and providing services at much *less* inflationary costs in the future.

The action taken by President Nixon last August, freezing prices, rents, wages, and salaries, brought encouraging, long-overdue relief from the sky-rocketing costs that have plagued the construction industry—and for which *all* consumers have paid a very heavy price. The 90-day freeze has been not only a sobering experience for everyone—businessmen, consumers, government officials, and labor unions—but it has provided the Cost of Living Council that was established by the President, the time to devise new anti-inflation Phase II policies and procedures that will commence in mid-November.

The central dilemma for government officials groping with Phase II considerations—and for all Americans—is how to realize in combination the economic and political benefits of freedom inherent in a system of free competitive markets, with a government-imposed system of constraints in those markets where the pricing mechanism in terms of *supply* factors is ineffectual. Among these supply factors, the most dominant in terms of both economic cost and availability is the one of skilled and semi-skilled labor.

Nowhere in the nation's economy have the forces of competition relative to both economic cost and labor supply been less effectual in giving consumers minimal prices, than in the construction industry. And, nowhere in the nation's economy have the forces of wage-cost inflation been more rampant.

Knowledgeable analysts have characterized the labor cost-inflation problem in construction with terms such as "chaos", "wage madness", and "formula for disaster". Even President Nixon has been compelled to identify wage and price inflation in the construction industry in terms of "dangerous consequences". While these are very strong words, unfortunately they are extremely accurate in identifying the utterly irrational wage "demands" that labor unions have obtained in past years—and, indeed, were still obtaining right up to August 15, of this year.

The reason why the construction industry requires special scrutiny now and in the years ahead, is because of its enormous size and pervasiveness. It is no exaggeration to say that every consumer and every other industry in the United States are profoundly affected by the construction sector. Last year, total construction activity amounted to nearly 13 percent of the nation's entire gross product of $974.1 billion. In 1971, new construction and maintenance and repair will amount to an estimated $135 billion—larger than the automotive and steel industries combined. Indeed, the construction industry is the largest market for the giant steel industry, accounting directly and indirectly, for over 30 percent of steel's total sales and output. In 1970, the construction industry accounted for—

$64.8 billion, almost *one-half* of the nation's gross fixed capital formation of $132.2 billion;

About $36 billion, or over *16* percent of total government (national, state & local) purchases of goods and services of $221 billion;

About $31 billion, or *26* percent of state and local government purchases of goods and services of $121 billion.

Based on input-output relationships in the U.S. economy, the total construction sector, new and maintenance and repair, last year purchased about $69.7 billion of the products and services of other industries, and added $52.6 billion in value (and costs) at construction sites—which were distributed among employees, owners of business and other capital suppliers, and government. For *each* dollar of the $122.3 billion total construction expenditures in 1970, about *$.57* (cents) in sales was yielded to the many industries selling to the construction sector.

Gross private fixed investment, or capital formation, amounted to $132.2 billion in 1970, comprised of $67.4 billion of producers durable equipment, and $64.8 billion of residential and nonresidential structures. Between 1958 and 1970, the wage-price inflation incurred to build these structures increased *140 percent more per year* than the cost increases incurred to manufacture producers durable equipment. When one examines the relationships between wage rates and

earnings in construction with those in durable goods manufacturing, the reason for this inordinately excessive wage-cost inflation in construction becomes very evident.

In 1958, all contract construction workers averaged $2.82 per hour, 25 percent more than workers in durable goods manufacturing—or, $103.78 per week, 16 percent more. By 1970, however, average hourly earnings of contract construction workers had increased by 85 percent to $5.22, *vs* a 58 percent increase for durable goods manufacturing workers, and were then 47 percent more—an acceleration of 88 percent. Moreover, average *weekly* earnings of contract construction workers increased by 88 percent to $195.23 in 1970, *vs* a 61 percent increase for durable goods manufacturing workers, and were then 37 percent more—an acceleration of *131* percent! These increased *weekly* earnings of construction workers were realized notwithstanding the fact that they worked *2.7 less* hours per week in 1958, and *2.9 fewer* hours per week in 1970, than workers in durable goods manufacturing. These facts should put to rest the false rationale that inordinately higher hourly earnings of construction workers are justified because of the seasonality problem in construction work.

It is highly significant to realize that the index of wholesale prices of *all materials* used in construction increased by only 18.1 percent—about 1.5 percent per year—between 1958 and 1970. Productivity in terms of output per man-hour—the real basis for a country's economic advancement—rose at the rate of 2.5 percent per year for all private nonfarm industries, while productivity in the construction sector actually declined relatively, during these years. If the negative effect of productivity in the construction sector is omitted, the rate of increase in productivity in the private nonfarm economy is significantly greater.

In terms of *real* net spendable earnings, after adjustment for federal income and social security taxes and inflation, the take-home pay of contract construction workers with 3 dependents, increased *10* percent between 1965 and 1970, while the take-home pay for *all* other private nonfarm workers *declined* 1.1 percent.

A higher percentage of the gross product of the contract construction industry is allocated for "employee compensation" than in any other industry sector of the U.S. private economy. In 1970, employee compensation amounted to $451.9 billion, or *56* percent of the total gross product of the private sector of the economy of $814 billion, exclusive of contract construction. However, employee compensation in the contract construction industry amounted to $35.6 billion, or *78* percent of its $45.8 billion gross product last year for new construction. In other words, the labor component in contract construction is about *40* percent greater per dollar of gross product, than the labor component in the total private sector of the economy, exclusive of contract construction.

Because contract construction is such a labor-intensive industry, increases in the *rate* of costs of employees generates a higher leverage on total costs of its products and services than in any other industry. Hence, the inflationary element in construction emanating from labor costs is higher than in any other industry not only because of the alarmingly higher annual rates of increase evident in hourly costs for wages and benefits relative to other industries and to productivity, but also because of the much higher percentage that employee costs represent in the industry's total gross product.

These compounding effects in terms of inflation generated, should be recognized by the leadership of the industry and should be dealt with accordingly by the government agency that administers the Phase II stabilization program.

TABLE 1.—WAGE DECISIONS, ANNUAL PERIODS

	Average (mean) yearly percent change in decisions during 4 quarters ending—									
	1969				1970				1971	
	March	June	September	December	March	June	September	December	March	June
1st year adjustment:										
Construction	8.7	11.8	12.9	13.1	13.8	16.5	17.3	17.6	18.1	19.6
Manufacturing	7.0	7.1	7.5	7.9	8.4	8.4	8.3	8.1	8.1	8.0
Over life of construction:										
Construction	8.6	12.1	13.1	13.1	13.4	13.9	14.0	14.9	15.3	15.2
Manufacturing	5.3	5.4	5.8	6.0	6.2	6.3	6.2	6.0	6.1	5.9

Source: Bureau of Labor Statistics, U.S. Department of Labor.

Table 1 indicates that the average first-year wage costs in the construction industry, exclusive of fringe benefits, increased in the year ending June 1971, by an average of 19.6 percent—or, at a *19* percent faster rate than the 16.5 percent average increase in the year ending June, 1970, and at a *66* percent faster rate than in the year ending June, 1969 of 11.8 percent. When adjustment is made for the added cost of fringe benefits, total wage and benefit first-year costs increased by an average of *22.1* percent in the year ending June, 1971, compared with an 18.6 percent average increase in the year ending June, 1970.

Clearly, these alarmingly excessive average yearly rates of wage and benefit costs were accelerated by the enormous average yearly increases granted in the second, third and fourth quarters of 1970, of *20.6* percent, *25.0* percent and *24.0* percent, respectively.

Moreover, the average increase in construction wage costs alone, *over the life* of contracts—meaning usually a 3-year period—increased by *15.2* percent in the year ending June, 1971—over a 9 percent faster rate than the 13.9 percent average increase for the year ending June, 1970. Adjusted to include the cost of fringe benefits, total wage and benefit costs increased *over the life* of contracts by an average of *17.2* percent in the year ending June, 1971, compared with an average increase of *15.7* percent in the year ending June, 1970.

It has been reported in the press that the Phase II anti-inflation program should be modeled after the CISC—Construction Industry Stabilization Committee—that was established by President Nixon on March 29, of this year. Whatever small success may be attributed to the CISC, such as providing an additional focus for public attention to the inflation problem in the construction sector, its decisions, at best, were extremely marginal relative to mitigating the preponderant inflationary forces in the construction industry.

While the CISC focused on influencing a downward trend in first-year increases in wage and benefit costs under *new* agreements in 1971, these reduced rates of increases would have been a long time in significantly affecting the *yearly* advances in construction labor costs because they deal only with the "top of the inflationary-cost iceberg".

Based on wage and benefit costs of construction workers in 1970, and adjusted for first-year increases through June, 1971, of 22.1 percent, employee compensation of *1.7 million* construction workers covered under *deferred* increases amounts to about *$24.8* billion. Comparatively, only about 596,000 construction workers are covered under collective bargaining agreements expiring in 1971, for which new agreements are required. In 1970, wage and benefit costs of these workers were about $7.1 billion.

Assuming that workers under these new 1971 agreements had received wage and benefit increases amounting to 10.5 percent—based on the average one-year increase in contracts approved by the CISC through June 15, 1971—this, in combination with 1970 total costs, amounts to about $7.8 billion in 1971. Thus, in mid-1971, total wage and benefit combined costs of construction workers covered under deferred increases ($24.8 billion) and those that would have been covered under new CISC agreements ($7.8 billion) amount to about $32.6 billion.

Accordingly, the quantitative dollar relationship of total costs of construction workers covered under deferred increases relative to total costs of workers covered under new agreements is a ratio of 3.2 to 1. Expressed in percentage terms relative to the purpose of the CISC to stabilize construction costs, one must conclude that the *inaction* of the CISC on deferred increases resulted in a failure rate of *76* percent. Clearly, this could not have been identified as a

"success" in mitigating inflationary labor costs in the consruction industry.

It is contended that the reason why the CISC did not act on these inflationary deferred increases is because legal contracts had been made between construction contractors and the labor unions providing for these increases in wage and benefit payments. It is argued that had the CISC lived up to its responsibilities under President Nixon's executive order creating it, would have been to abrogate these contracts.

However, notwithstanding the propriety of the "legalities" called for in these contracts, if not the irrational economics, the CISC could have *required* that these contracts specifying unreasonable inflationary increases in deferred wage and benefit payments, be *re-opened*, and that new rates be decided by the CISC that were more in line with cost-of-living and production factors. Indeed, had the CISC assumed this commendable posture and acted forthrightly, it would have been doing nothing more than what it was, in fact, obliged to do under the terms of the executive order that stated:

"Section 3(b). Each board (and the Committee) shall also have the authority to *examine* collective bargaining agreements negotiated prior to the date of this order which contain wage or salary increases scheduled to take effect on or after such date to *determine* whether any increase is unreasonably inconsistent with the criteria established in section 6." [Italic added.]

If the language above were not clear enough, the CISC issued a statement entitled "Procedures of Construction Industry Stabilization Committee", dated April 30, 1971, which stated:

"The Executive Order also specifies (Section 3b) that craft boards and the Committee shall have the authority to examine wage and benefit increases provided for in collective bargaining agreements negotiated earlier, so-called deferred increases, to determine whether any increase is unreasonably inconsistent with the criteria provided in Section 6 of the Order . . . The Executive Order makes it clear that the authority to examine deferred increases may be exercised in those cases which provide for increases that are unreasonably inconsistent with the criteria of Section 6."

The criteria specified in the executive order stated:

"Section 6. The following criteria shall be aplied in determining whether any wage or salary increase is acceptable:

(a) Acceptable economic adjustments in labor contracts negotiated on or after the date of this order will be those normally considered supportable by productivity improvement and cost of living trends, but *not in excess of the average* of the *median increases* in wages and benefits over the life of the contract negotiated in major construction settlements in the *period 1961 to 1968.*"

It should be noted that the average median increase in wages and benefits in the construction industry in the period 1961–68, was about *4.5* percent. However, in the face of this fact, the CISC still did not see fit to challenge numerous contracts containing deferred annual increases of *25* percent and more that were presented to it by contractor associations.

In testimony before the U.S. Congress last summer, the Chairman of the Board of Governors of the Federal Reserve System, stated:

"The problem of ***cost-push inflation,*** in which escalating wages lead to escalating prices in a never-ending cycle, ***is the most difficult economic issue*** of our time. . . .

Wage increases . . . in automobile, can, aluminum, and AT & T settlements, amount to *12* percent or more for the first year."

In this regard, considerable public attention was given to the inflationary settlement in the steel industry in July. It is estimated that wage and benefit cost increases of $650 million will amount to nearly 15 percent in the first year. However, in terms of *direct* economic effects, first year increased costs in the steel industry will amount to only about *10.5* percent of the *$6.2* billion in increased wage-benefit costs of construction workers in 1971 over 1970. In other words, the added inflationary costs of construction workers in the *past year* (as of July, 1971) were over *9½ times* what the increased direct costs will amount to in the steel industry in the coming year. When consideration is given to the much higher rate of productivity in the steel industry relative to the construction industry, the inflationary effects of labor costs in construction have been most severe. Moreover, it should be recognized that while in the case of the steel industry, its products and services can be (and are) imported from less costly foreign producers, the more inflationary products and services of the construction industry can not be so imported, unfortunately.

In view of the foregoing, what can be said about the Phase II stabilization program and its ingredients?

It seems clear that the prospects for either (1) doing nothing at the end of the 90-day period, or (2) instituting across the board wage-price controls, are the two extremes that would not be tolerated by the American people under present conditions. Rather, it seems probable that a government board, commission or some such agency will implement the Phase II stabilization program. More important is the question of establishing guidelines or criteria under which wages and prices would be administered by such an agency, the industries to be covered, and the members who would constitute such a board or commission.

There is wide agreement among most economists that if price stability—interpreted as a 2 percent or less increase per year in consumer prices—is to be achieved, then increases in wages must be limited to productivity increases in the private nonfarm industries, plus an incremental amount not to exceed 2 percent. For example, in the ten-year period, 1960-1970, productivity in the private nonfarm industries increased at the average annual rate of 2.6 percent, compounded. Accordingly, if the objective is to limit consumer prices to 2 percent per year, then wages should not increase more than 4.6 percent per year.

Some illustrations:

In industries with no productivity improvement, wages and prices would be limited to a 4.6 percent increase;

In industries with a productivity improvement of 1.6 percent, wages could increase by only 1 percent;

In industries with a productivity factor exceeding 4.6 percent, wages could be increased by 4.6 percent, but prices would be *reduced* by the percentage which that industry's productivity exceeds 4.6 percent.

Relative to the industries that would be covered under Phase II, it seems reasonable to assume that the heavily unionized industries almost certainly will be covered. This, of course, would include a very large chunk of the private labor force, in addition to employees at the national, state and local levels of government. While it is to be expected that the Phase II program will be administered with impartiality, it also must be recognized that some equity adjustments will be required for those workers who did not "get in under the wire" thirty days prior to last August 15.

On the matter of the members who would constitute a proposed Wage-Price Board, most suggestions advanced by members of the Congress and others is to set up a tripartite group made up of representatives from labor, management and the public. The primary reasoning of the tripartite advocates seems to be that it worked during former emergencies though under somewhat different arrangements than what is envisaged currently. And they also point to the establishment by President Nixon this year of the CISC—a group of twelve persons, four each representing labor, management and the public.

While the tripartite grouping seems highly plausible in that it is constituted by members representing 3 major segments of our national economic life, it is very questionable whether it is the most effective way to administer a wage-price stabilization program. Rather, there is much to commend that the Phase II program should be administered strictly by government officials and personnel, with an Advisory Committee or Council composed of representatives of labor, management and the public. Such an Advisory Committee or Council could be sub-divided into as many Industry Advisory Subcommittees as may be required. Surely, such an arrangement whereby both labor and management are removed from the final decision-making of the proposed Wage-Price Board would minimize the kind of continuing conflict that is virtually inherent in a tripartite arrangement.

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