658

CURRENT ASSESSMENT OF THE ECONOMY

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-THIRD CONGRESS

SECOND SESSION

MAY 10, 1974

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
38-864 WASHINGTON : 1974

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 70 cents
Stock Number 5270-02608

850

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

WRIGHT PATMAN, Texas, *Chairman*
WILLIAM PROXMIRE, Wisconsin, *Vice Chairman*

HOUSE OF REPRESENTATIVES

RICHARD BOLLING, Missouri
HENRY S. REUSS, Wisconsin
MARTHA W. GRIFFITHS, Michigan
WILLIAM S. MOORHEAD, Pennsylvania
HUGH L. CAREY, New York
WILLIAM B. WIDNALL, New Jersey
BARBER B. CONABLE, Jr., New York
CLARENCE J. BROWN, Ohio
BEN B. BLACKBURN, Georgia

SENATE

JOHN SPARKMAN, Alabama
J. W. FULBRIGHT, Arkansas
ABRAHAM RIBICOFF, Connecticut
HUBERT H. HUMPHREY, Minnesota
LLOYD M. BENTSEN, Jr., Texas
JACOB K. JAVITS, New York
CHARLES H. PERCY, Illinois
JAMES B. PEARSON, Kansas
RICHARD S. SCHWEIKER, Pennsylvania

JOHN R. STARK, *Executive Director*
LOUGHLIN F. MCHUGH, *Senior Economist*
RICHARD F. KAUFMAN, *General Counsel*

ECONOMISTS

WILLIAM A. COX
JERRY J. JASINOWSKI
LUCY A. FALCONE
JOHN R. KARLIK
SARAH JACKSON
L. DOUGLAS LEE
COURTENAY M. SLATER
LARRY YUSPEH

MINORITY

LESLIE J. BANDER
GEORGE D. KRUMBHAAR, Jr. (Counsel)
WALTER B. LAESSIG (Counsel)

SUBCOMMITTEE ON CONSUMER ECONOMICS

HUBERT H. HUMPHREY, Minnesota, *Chairman*

SENATE

WILLIAM PROXMIRE, Wisconsin
ABRAHAM RIBICOFF, Connecticut
JACOB K. JAVITS, New York
CHARLES H. PERCY, Illinois

HOUSE OF REPRESENTATIVES

WILLIAM S. MOORHEAD, Pennsylvania
MARTHA W. GRIFFITHS, Michigan
HENRY S. REUSS, Wisconsin
HUGH L. CAREY, New York
WILLIAM B. WIDNALL, New Jersey
CLARENCE J. BROWN, Ohio

CONTENTS

WITNESSES AND STATEMENTS

FRIDAY, MAY 10, 1974

SUBMISSIONS FOR THE RECORD

FRIDAY MAY 10, 1974

CURRENT ASSESSMENT OF THE ECONOMY

FRIDAY, MAY 10, 1974

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON CONSUMER ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 318, Russell Senate Office Building, Hon. Hubert H. Humphrey (chairman of the subcommittee) presiding.

Present: Senators Humphrey and Proxmire.

Also present: Loughlin F. McHugh, senior economist; William A. Cox and Jerry J. Jasinowski, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Welcome, Mr. Stein and your associates of the Council. We appreciate your cooperation in coming here this morning.

Mr. Stein, last May you testified before this subcommittee, and I am sure you recall that in my opening statement I gave a long list of what I thought was wrong with the economy and was also quite critical of the administration's economic policies.

As a matter of fact, I want to say for the record that our little interchange produced a bet, and Mr. Stein is a man of his word. He honored that wager, and within the last 6 weeks or couple of months, Mr. Stein, myself and Mrs. Humphrey had dinner together. He paid the bet. We were betting on what was the rate of inflation, and I want to express my thanks to him, and I thoroughly enjoyed the evening.

At the time of our last discussion here in May, I said, for example, that prices were likely to be four times the administration's prediction of 2.5 percent, and I believe they were.

My opening statement upset you that day, and I believe you characterized it as one of "the most one-sided and misleading and dangerous descriptions of the state of the American economy" that you had ever heard. Unfortunately, events have made my predictions far more accurate than yours. We are now in at least the beginning of a recession, and inflation appears to be out of control. I could go on with another laundry list of what I believe is wrong with the economy, but what is needed are solutions, not merely a recitation of problems.

I want to confess quite honestly that I do not presume to have all of the answers, but I believe that we can and we must do better. The country is desperate for better leadership in economic affairs. It is in that spirit that we open today's hearings.

As a matter of fact, I have said publicly several times that I doubt any of us really know what to do with this inflation. I would hope that somewhere along the line that we could bring together the people from different walks of life and different professional disciplines without a note of partisanship to see if we could not find some answers, because it is quite obvious that what we are getting now are some arguments.

There are two major questions that you will address in presenting the administration's case, or the thinking and the economic policy of the administration. First, what is the current state of the economy, and what we can expect in the months ahead?

Are there significant signs that an economic recovery is developing to pull us out of the first quarter recession?

When can we expect any significant improvement in the rate of inflation?

Mr. Stein, now more than ever we need a thorough and objective appraisal of the state of the economy. If we are in for continued hard times, we need to know that.

The second question I hope you will address is, are present Government policies and tools adequate to deal with our economic problems? If not, what does the Council, or you and your associates, propose? What mix of fiscal, monetary, and anti-inflation policies?

As you might guess, I have some suggestions that I will elaborate on in the discussion period.

Following Mr. Stein and other members of the Council of Economic Advisers today, the subcommittee will hear from Mr. Gerard Adams, who will present the current Wharton economic outlook. For that reason, I propose that the subcommittee complete its interrogation of Mr. Stein and his associates by 11:30.

I know that you have other things to do, and I think in the next hour and 15 minutes, we can go quite a ways. I will say nothing more.

Bill, do you have anything?

Senator PROXMIRE. No, Senator.

Chairman HUMPHREY. Please proceed, Mr. Stein.

STATEMENT OF HON. HERBERT STEIN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY WILLIAM J. FELLNER AND GARY L. SEEVERS, MEMBERS

Mr. STEIN. Mr. Chairman, Senator Proxmire, I appreciate the spirit of your opening statement and hope that we can contribute to answering at least the factual questions that you have asked and discuss with some of the more speculative ones.

I would like to read a statement; it is a brief statement. Perhaps if I stick to my prepared text, I will not be tempted into any further bets, however much I enjoyed the dinner that we had the other night. I would rather have the occasion voluntary.

We are please to appear before you today to present our views on economic developments thus far during 1974 and our expectations for the balance of the year.

I should have pointed out at the outset what is clear to everybody here, but it may not be clear in the text, that the whole Council is here, Mr. Seevers, Mr. Fellner, and I, who will all participate in answering the questions.

Despite the obvious economic difficulties that we have been passing through, output and employment in the American economy have held up well in the face of last winter's energy crisis. It is true that during the first quarter of 1974 we suffered from a sharp decline in total production, that unemployment is now higher than it was at the end of last summer, and that some of the effects of the needed adjustments to our changed energy situation are still to be felt. But we believe that by the middle of the year overall production will once again be on the rise.

Although real GNP declined by 1.5 percent or at an annual rate of 6 percent in the first quarter of this year, the decline was a reflection of the energy crisis, particularly as it affected the motor vehicle industry. Automobile production as measured in the national accounts fell by 29 percent from the fourth-quarter level and by itself accounted for almost all of the decline in total GNP.

In addition, consumers reduced their real spending on electricity, natural gas, fuel oil and gasoline, as well as for tires, auto accessories, recreational vehicles and the like. If we make allowance for these and reduced business outlays for such things as trucks, we more than account for the first quarter decline in real GNP.

This is shown in the attached table which I will not read but would like to have in the record.

[The table referred to follows:]

CHANGE IN REAL GNP (IN 1958 PRICES) AND IN SELECTED COMPONENTS OF GNP AFFECTED BY THE ENERGY CRISIS

[In billions of dollars]

	1973 IV	1974 I	Difference
Total real GNP	844.6	832.0	−12.6
Auto GNP	41.3	29.3	−12.0
Trucks and buses	14.8	13.2	−1.6
Auto accessories including recreational vehicles [1]	12.6	11.6	−1.0
Consumer energy outlays:			
Gasoline and fuel oil	27.9	24.8	[2] −.9
Electricity and gas	15.2	14.1	−1.1
Total selected energy items			−16.6

[1] Includes mobile homes.
[2] The decrease in gasoline and fuel oil shown here is smaller than actually occurred in order to make allowance for the reduction in imports. Calculations by CEA.

Source: Basic data from Department of Commerce.

Mr. STEIN. Of course, not all of the first-quarter decrease in auto production was caused by the crisis, since prior to last fall there was a common expectation of a moderate decline in auto demand and output in 1974. But as an offset against this, one should also take account of the reduced spending of laid-off automobile workers, automobile salesmen, filling station attendants and others who lost their jobs because of the embargo.

I do not mean to suggest that aside from energy-related production the economy was robust. Indeed, before the onset of the energy crisis we foresaw very slow growth in the economy in the first half of 1974 reflecting some reduction in demand as well as limitations on supply. In the early part of 1973, amidst a process of very rapid expansion in demand, the economy encountered significant supply limitations so that as far back as a year ago some slowdown and readjustment was inevitable.

It is not surprising that the picture was mixed in the first quarter. Housing activity was in the midst of a pronounced decline. In contrast, demand in some sectors, like capital goods, was quite strong and shortages of basic materials were very common. Apart from energy-related items, real consumer spending showed a fairly good rise in the first quarter.

We do not foresee much change in overall production in the second quarter, since we see many cross-currents which are approximately offsetting. While we believe that we will wind up with a small plus, the change in real GNP could just as easily be a small minus, and let me emphasize that no significance should be attached to the difference between a small increase and a small decrease, especially between a small measured increase and a small measured decrease, because our measurements are not that precise.

In April we saw a good recovery in automobile production from the very depressed levels of the first quarter. Dealer sales of domestically-produced cars were running at a seasonally adjusted rate of 8 million units in April as compared to about 7⅔ million in the first quarter. Dealers' stocks are in fairly good shape. We should not be surprised to see some further decreases in automobile inventories in the current quarter, but not as much as occurred in the first quarter.

We expect a good recovery of the economy in the second half of 1974 and a resumption of the rise in real consumer spending that came to a halt late last year. We believe that the improvement in gasoline supplies will bring back into the market increasing numbers of purchasers of large cars who held back from buying last winter. Also buyers of smaller cars should find greater supplies of such cars because of increased production capacity. The reduction in auto inventories should come to a halt. All told, we are projecting moderate increases in auto production from the April level.

The capital goods sector is the strongest sector of the economy at present, and we expect it to remain strong for the rest of the year. Although the rate of capacity utilization in manufacturing has edged down, it is still very high by historical standards. Capacity is inadequate to satisfy demand in many industries producing basic materials. Backlogs are very high, and waiting times for many types of capital goods are very long. The Commerce Department survey of anticipated plant and equipment expenditures published in early March—which was essentially confirmed by the McGraw-Hill survey published in early May—points to rising outlays for new plant and equipment through the year. A good-sized advance remains after allowance is made for higher prices for equipment and construction.

We do not expect changes in inventory demand to have much of an effect on changes in total production for the rest of 1974. Some industries have been accumulating stocks of raw materials which have been in short supply and inadequate to sustain current levels of output. There are also reports of hoarding of raw materials in anticipation of price increases, but we have no hard information on this activity. So far we have not seen a backing up of finished goods inventories in the hands of manufacturers and trade firms. Relative to GNP the physical volume of total nonfarm inventories in the first quarter of 1974 does not appear high even though this ratio, based on constant dollar figures, has risen somewhat from the very low ratio of 1973.

The sharp decline in housing starts that began in early 1973 seems to have come to a halt in the first quarter of this year. That decrease was influenced mainly by the tightness in mortgage markets that developed last summer, although the extent of the decline was also affected by some earlier overbuilding of single-family homes and by last winter's energy crisis.

The greater availability of mortgage funds late last year and early this year has provided the groundwork for a recovery in housing. However, the sharp rise in interest rates that began in March has slowed down the flow of funds into thrift institutions, which are the main source of funds for mortgage lending, and indeed threatens a repetition of last summer's disintermediation.

Because we consider a continued recovery in housing to be important for itself as well as for the overall recovery of the economy, the administration is taking steps to insure a recovery in housing starts. We considered the possibility of asking the Federal Reserve System to pursue an easier money policy, but we do not consider that to be appropriate during this period when prices are rising so rapidly. Since we believe that a monetary policy of moderate restraint is now called for, the administration is taking steps to support the housing market. These steps will be announced later today, I believe at 11:00 o'clock.

In the year preceding the onset of the energy crisis—from October of 1972 to October of 1973—employment as measured in the survey of households had strong and nearly continuous upsurge. Civilian employment had increased by 3¼ million persons, an annual rate of growth of 3.9 percent, while the number of unemployed persons decreased by 770,000 to 4.1 million. The unemployment rate declined from 5.6 to 4.6 percent. The rate decreased sharply for all demographic groups and reached a low of 2.1 percent for married men whose wives were present. An unprecedented labor force participation rate of 61.8 percent was attained.

We knew last fall that these trends could not continue, nor was it desirable that they should. The labor market was tight. The high labor force participation and the low unemployment rate meant that the scope for further employment increases was limited. Large increases in demand and output would mean similar increases in the demand for labor, and under the conditions of last fall this could only intensify pressures on wages. In fact, we expected a tapering off in the rise in economic activity and labor demand, bringing with it a leveling off or a period of slow growth in employment and probably a slight upward tilt in unemployment. The oil embargo changed these earlier anticipations.

38-864—74——2

The impact of the oil embargo began to appear in November and increased in severity over the next 2 months, at a time when labor force participation rates continued to edge up. From October to January, the number of persons employed rose by 600,000 on a seasonally adjusted basis, while the unemployment rate rose to 5.2 percent. Over the same period, total civilian employment increased by 160,000 persons, seasonally adjusted, because the demand for labor was still growing outside of the energy-affected sectors.

An examination of payroll employment shows that nonagricultural jobs grew by 160,000, seasonally adjusted, from October to January. Important employment increases were experienced by the Government, the services, and the mining sectors of the economy. Employment declines were large in a few sectors, particularly transportation equipment, 105,000; retail trade, 95,000; and to a lesser extent contract construction.

The softening in the demand for labor over this period was also reflected in a shortening of the workweek. From October to January, the average workweek of private nonfarm payroll workers decreased by 0.3 hour to 36.7 hours. Although the declines were widespread, they were particularly large in transportation equipment, primary and fabricated metal industries, and contract construction. Except for contract construction, where homebuilding was declining, the large declines in hours worked appear to be primarily a consequence of the decline in the production of motor vehicles.

Since January of 1974 the unemployment rate measured in household surveys has been essentially on a plateau averaging 5.1 percent. Total civilian employment has hovered around 85.8 million. The levels of employment and unemployment of adults taken as a whole have changed little. The April decline of 0.2 percentage points in the labor force participation rate and the dip in the unemployment rate to 5.0 appear to reflect largely a sharp decrease in teenage employment and unemployment. The teenage data are very erratic, and the April dip could be due to an imperfect seasonal adjustment for April, inasmuch as the survey was taken during the week containing Good Friday. The fact that the total civilian labor force showed a slight dip from January to April may be primarily a reaction to the extremely sharp rise from last October to January.

The payroll series gives a somewhat different employment picture, showing a seasonally adjusted rise of 385,000 from January to April. The April figures is now 230,000 above last November. Manufacturing employment fell in February and March but rose in April, while outside of manufacturing, employment showed a strong increase over the 3-month period.

The average number of hours worked per week by private nonfarm payroll workers fluctuated around 36.8 hours from January to March. The decline to 36.6 hours in April appears to be related in part to the incomplete seasonal adjustment for a survey week containing Good Friday.

We believe that the continuing high level of employment since last fall attests to the fact that there is still considerable strength in the U.S. economy. Although we look forward to rising demand and output in the second half of this year, we will probably see some further increases in unemployment as the labor force once again begins to grow.

In our view, the rate of price increase in the U.S. economy peaked in the first quarter of 1974, and we expect improvement from here on out. But we must recognize that improvement is relative—in this instance relative to the first quarter increase of 12.2 percent at an annual rate in the CPI and of 10.8 percent in the GNP deflator. As we said in our lastest Annual Report, "Whoever undertakes now to fight inflation must be prepared to stay the long course." But it is encouraging, when pursuing such a long-run goal, to see some results quickly. And this we expect.

Retail food price increases, which accounted for about one-third of the 12.2 percent rise in the CPI for the first quarter, should slow substantially in the April-June period and contribute importantly to a slower rate of rise in the CPI.

Increases in prices of refined petroleum products will diminish. This will be reflected in smaller increases in prices of fuels purchased directly by consumers; in the first quarter such increases accounted for another third of the entire CPI rise. Of course, the lagged effect of the rise in crude oil prices on substitute fuels, electricity generation costs and petrochemical based products will continue to be felt, but the impact will be smaller.

The behavior of the prices of goods and services other than food and directly purchased fuels will be central to the future course of inflation. Prices of these nonfood commodities and services other than fuels in the CPI rose at an annual rate of 6.1 percent in the first quarter and accounted for the remaining third of the CPI increase.

Prices of the nonfood commodities are influenced by developments in the industrial commodities component of the Wholesale Price Index. As is well known, prices of these commodities have risen at a rapid pace in the past several months through April and are likely to continue to advance rapidly for another couple of months. These increases in turn reflect the large rises in prices of raw industrial commodities and of unit labor costs. The latter are influenced by the rate of wage increase and the slowdown and decline in the first quarter of the year in output per manhour.

Given the likely pattern of developments with respect to the factors determining the prices of goods and services other than food and fuel, it is likely that prices of these items will accelerate during the year from the 6.1 percent rate of the first quarter of 1974. Most of the acceleration will occur in the fall when new goods come to market. But food and fuel prices are likely to be rising much less rapidly at that time than they are now and will provide some offset to the acceleration in prices of the rest of the consumer's market basket. Thus, on balance we should see a rate of inflation substantially below recent rates.

While such an outcome will indeed be encouraging, we will still have considerable distance to go to achieve acceptable price behavior. This underscores the need to maintain proper policies of demand management. In a setting of rapid price increases, continued shortages of many items, and the prospective recovery from the first quarter decline of output induced by the energy crisis, we do not think that policy should turn in a more expansive direction. To do so would jeopardize the improvement in prices that we expect during the balance of this year. It should be our goal to slow price increases further in 1975, and continued prudent fiscal and monetary policies will be required to achieve that.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Stein.

Do Mr. Seevers or Mr. Fellner have any comments that you would like to add at this time?

Mr. FELLNER. No, Mr. Chairman. This is a joint statement, and as as we are concerned, we go along with it.

Chairman HUMPHREY. Thank you.

We have some questions. I will stick with the rules that we divide up the time, Senator Proxmire.

Will the staff notify us when we come to the 10 minute limit?

Mr. Stein, I guess my question is simply put, but I want to elaborate a bit. The question is, do we have a recession, and where is the economic recovery?

Your position is that the worst of the economic slowdown is over, and you "expect a good recovery of the economy in the second half of 1974." I have already said publicly that I do not see the signs of good economic recovery in the second half. Now, of course, the word "good" I think is subject to several definitions; although the business sector, as you indicated, in the capital investment seems strong, the rest of the economy looks extremely weak to me and to many economists as well.

This morning I listened to the radio report of the "Business Council," I believe, at Hot Springs, and it was not too encouraging.

First, I am curious about what you mean by a good recovery. Both Wharton and Chase Economic Forecasts show weak real growth in the GNP in the second half, about 2 percent, and an actual decline in real GNP for 1974 as a whole. To me that is not a good economic performance, and not a recovery.

What do you precisely have in mind when you say there will be a good recovery in the second half?

Mr. STEIN. We have in mind a rate of increase of real output at approximately our normal rate of growth. We see the rate of increase rising as we go through the second half from 3 to 4 percent. We think the second half will be in the 3 to 4 percent annual rate range.

Chairman HUMPHREY. As compared with the estimates made by Chase and Wharton at around 2 percent?

Mr. STEIN. Yes. I have not seen the Chase, but I accept that if that is what they said.

Chairman HUMPHREY. They see an actual decline in real GNP for 1974 as a whole.

Do you buy that?

Mr. STEIN. Our numbers add up to a small increase in the neighborhood of 1 percent.

Chairman HUMPHREY. I believe you said it could either be a small increase or a small——

Mr. STEIN. That was referring to the second quarter?

Chairman HUMPHREY. Second quarter; yes.

Now, on the consumers, we have had to go around on occasion on this. In listening to and looking over your statement—and we thank you for getting it to us on time so that we could do that—you skim over what has happened to consistently weaken the economic viability of the consumer over the last year, and I happen to think that this is one of the weaknesses in the economy. It used to be that when I would tell you how hard hit the consumers had been by the recent inflation, that you would respond by telling me that we were using the wrong statistics, and in fact real per capita income had continued rising.

As you know, the nature of consumer well-being declined at a 7 percent annual rate in the first quarter, and I do not see much that indicates that it will be any better, or much better, and it looks like it will decline for the year.

What hard evidence do you have that there is economic strength among the consumers? In other words, what hard evidence do you have that you can turn it around from the decline in the per capita income and get it on somewhat of a more even or steady base?

Mr. STEIN. Well, of course, the real incomes of consumers are a reflection of the other things that are going on in the economy so that this is really a question about whether the other elements in the forecast are correct. But if, as we expect, real output is rising, and I could return to the reasons for thinking that, real output will be rising, employment will be rising, wages will be rising, as I suppose everybody recognizes the wage rates will be rising, and the rate of inflation will be diminishing very substantially, then this result will be achieved. After all, in the first quarter we had a consumer price index rising at the rate of 12.2 percent per annum, and this, given the fact that employment was not rising, ate into the real disposable incomes of consumers.

The turnaround will also be a mutually reinforcing process, the reduction in inflation rate will contribute to the increase in the real income of the consumers and the increase in employment will contribute to the increase of the real income of the consumers.

Chairman HUMPHREY. What do you think the annual rate of inflation will be for 1974? What is your prediction. Mr. Stein, recognizing that predictions are always subject to modifications.

Mr. STEIN. Yes.

We have said, as measured by the GNP deflator, we said earlier in the year that we thought it would be about 7 percent from 1973 to 1974. We would since the first quarter was a little more than we expected, we would probably edge that up a little bit, but not very much.

Chairman HUMPHREY. 7 percent you say?

Mr. STEIN. Yes.

Chairman HUMPHREY. What is the rate right now?

Mr. STEIN. Well, this is a problem that we ran into last year by distinguishing between quarterly rates and the comparison of the average of the year of calendar years. The CPI increase in the first quarter was 12.2 percent annual rate.

Chairman HUMPHREY. Where have I heard these figures, that the inflation rate was running around 14 percent?

Mr. STEIN. The December to March annual rate of the Consumer Price Index was 14 percent.

Chairman HUMPHREY. And you really think that is going to come down enough to get you on an annual rate of 7 percent inflation?

Mr. STEIN. I am not saying that the rate will be 7 percent from December to December. I am saying from the average of 1973 to the average of 1974 will be about 7 percent.

Perhaps I could describe our forecast a little more understandably since we get into this semantic problem, is that we expect this rate of increase of the CPI, which was about 12.2 percent in the first quarter, to get down to about 6 percent in the fourth quarter.

Chairman HUMPHREY. Down to about 6 percent?

Mr. STEIN. Yes.

Chairman HUMPHREY. Well, despite the fact that you see wages rising, despite the fact that you see commodities going up, there is no indication that commodity prices—metals, are going to go down.

Mr. STEIN. As we pointed out, one third of the increase in consumer prices in the first quarter was an increase in food prices.

Now, we do have evidence that wholesale food prices have declined. There is no question about that.

Chairman HUMPHREY. Not a great deal.

Mr. STEIN. That is quite right, but as I listen to the Senators from your part of the country, it seems to be quite a lot.

Chairman HUMPHREY. Well, the price of agricultural products has declined. We are going to have some hearings on that, but the relationship between what a farmer gets for an egg and what we pay for it in Washington is like the relationship between a grain of sand and the Sahara Desert.

Mr. STEIN. Yes, well——

Chairman HUMPHREY. By the time the people get through handling the egg, you wonder whether the hen was necessary.

What I really guess I am concerned about is when I see the Ford Motor Co. going to increase its prices, when I see, for example, the Wholesale Price Index—what is it this morning? It is running at 0.7 of 1 percent?

Mr. STEIN. Yes.

Chairman HUMPHREY. It ran at 1.2 percent, was it not, just a few weeks ago or a few months ago, the first quarter?

Mr. STEIN. Well, something like that, 1.3.

Chairman HUMPHREY. These Wholesale Price Index figures have got to translate themselves ultimately into retail prices, if I know anything about merchandising.

Mr. STEIN. Well, these estimates that we have made are based on taking what has happened to the wholesale prices and translating them in the future into retail prices, recognizing this obvious factor to which you have referred, and we have said in our statement we think we will have some acceleration in the retail prices, in the nonfood, nonfuel categories, but the behavior of retail prices has been so dominated in the last year and a quarter or so by food and fuel prices that we think that this relief there will more than offset the acceleration of the nonfood, nonfuel prices.

Now, of course, we are not expecting that the declines in wholesale prices of food will be translated proportionately to the declines of retail prices. What we are saying is that if we get—when we get 50 percent declines in the price of wheat and corn and cattle and 30 percent hogs—Mr. Seevers knows these numbers much better than I do—but we are in those ranges, when we get these large declines at wholesale, we will get at least a very marked reduction in the rise at retail.

Chairman HUMPHREY. I agree with that. I agree with that. But I want to just say quickly that I met with some textile people here not long ago, and they told me that what is going to happen to textiles should not happen to a dead dog, that it is just going to go right out of the roof, the shortage of cotton, wool is just unbelievable, and that we can expect—and as the man said to me, if you need some shirts, Senator, buy them now. Get a whole lot of them because he said you can go on the open market later on and make a killing. I do not know whether—this is one of the larger shirt manufacturers in the United States, as a matter of fact, that was talking about it, and I said, well, what about other apparel, and he said, right out through the roof.

And this is one of the largest apparel manufacturers in the United States.

Now, it is those things, plus what I read about electrical energy all over the United States, people are asking for rate increases for the electricity——

Mr. STEIN. We are not presenting, it seems to me, a very rosy picture of the course of inflation. The rate of inflation that we foresee, even with our expectations about food and fuel prices, is still a disturbingly high rate of inflation. We think this is the major problem before the country. That is why we take the stands we do about the budget and the fiscal policy.

Of course we ask for a rather, it would seem to us, a very moderate and reasonable continuation of the Cost of Living Council which, even without mandatory controls, can serve a useful function here. So far we do not have that, but we hope that issue is not dead.

Chairman HUMPHREY. I supported you vigorously on that.

Mr. STEIN. I appreciate that.

Mr. FELLNER. Mr. Chairman, I am sorry I have to leave because of a speaking engagement, may I just say one thing?

Chairman HUMPHREY. Yes.

Mr. FELLNER. I think, Senator, that the question whether the people who speak of these price explosions will actually get to those prices, will depend very largely on our demand management policies, and that is the reason why I think we should use reasonable restraint in that regard. That kind of reasoning, that it's obvious prices will explode, has some implication as to whether our policies will accommodate those prices. I think that it is very important that our monetary and fiscal policy should not accommodate that kind of a process.

Chairman HUMPHREY. The thing that worried me when I heard about textiles is that this is such a basic—a mother that goes in to buy a pair of children's shoes today is shocked—I realize that you can slow down, you do not have to buy as many shoes, and that, of course, is what will happen. When you go in to buy children's clothes, it is very expensive. I mean if you buy at what we call the discount houses.

Now, there again I agree with you that the demand factor can change it.

I want to stay within the 10-minute rule, and we understand, too, Mr. Fellner, that you have to leave. Do not feel any restraint at all. Go ahead.

Mr. FELLNER. Well, I would like to stay for a few minutes and listen.

Chairman HUMPHREY. Senator Proxmire?

Senator PROXMIRE. Mr. Stein, you are more optimistic than many of those who estimated the level of unemployment, average unemployment during 1974. You estimated 5.6 percent, as I recall, and most of them were higher than that average during the year. It seems on the basis of the record to date that you may be more accurate than others, that the unemployment has averaged in the first 4 months, as you say, about 5.1 percent.

While, as you say, unemployment is likely to get a little worse later on, the fact is that we are over the energy crunch, and it may well be that it might not get as bad as even you estimated.

Would you tend to revise that estimate, or would you stand by the 5.6 percent?

Mr. STEIN. We said a little over 5.5 percent and it would not exceed 6 percent, and we are inclined to feel even more confident that it would not exceed 6 percent, but I do not think that we would change that particular number.

Senator PROXMIRE. Now, in light of the contrasting outlook for unemployment on the one hand and as you depicted in your statement this morning, an inflation on the other, how would you view a tax cut of $5 billion passed by the Congress?

Mr. STEIN. We think that would be very dangerous, very inappropriate, and we are very much against it, as I and, I am sure, Secretary Shultz and other representatives of the administration, have said, it would be highly inflationary and just the wrong time to do that.

Senator PROXMIRE. Supposing it was a tax cut that was balanced, a tax cut with respect to consumption, an increase in the allowable deductions for dependents, for example, combined with an increase in other sectors of the tax code, such as investment credit and oil depletion and so forth, so that you would have a balanced overall effect on revenues, but you would have a different distribution between the impact of the taxes on consumption and investment?

Mr. STEIN. Well, I guess there are two things to be said about that, that a balanced overall effect on revenues may not have a balanced overall effect on the total economy, that is, the total—the reduction of the tax designed to stimulate consumption may have a larger or smaller effect on the economy than an equal number of dollars of revenue designed to strain expenditure.

But let's pass that over and assume that the tax change is neutral, both with respect to revenues, and with respect to the total economic effect. It seems to me that we are in a situation where the demand for—or the country's need for a higher rate of investment is very great, and that we should think very carefully about any tax measures which would reduce the rate of investment. We think that an increase to a higher rate of investment is one of the things which, if it does not at the time contribute to an excess of total demand, will by bringing forth more output later, tend to solve the inflation problem, and at the very least, to increase real incomes.

So, it seems to me very doubtful that we would want to move in the direction of that trade-off at this time.

Senator PROXMIRE. Well, you see, I think what bothers a lot of people is the fact that the typical consumer has been hit hard, as Senator Humphrey pointed out, with a drop in his real income, and one positive action that Congress could take would be to reduce his personal income taxes. At the same time you have this almost explosion of investment in plant and equipment. McGraw-Hill's estimate goes up to a huge 19 percent increase this year, very strong.

It would seem to me to be doubtful that a modest change in taxes would dampen that very much. It might provide some relief.

My question to you is, if this is the case, do you think that that kind of tax reduction would have inflationary consequences?

Mr. STEIN. Well, again going back to the initial proposition, assuming that it was both balanced and neutral with respect to revenue and with respect to its short run effect on total demand, I would say it would not have inflationary consequences. I think there would be other objections to it from the standpoint of the long run welfare of the American people.

Senator PROXMIRE. All right.

Now, let me ask you this. Yesterday the Senate passed an amendment that I introduced to set a ceiling on spending, on outlay of $295 billion. The bill to which that ceiling was attached was then killed. That ceiling would have been $9 billion below the President's estimate. A short time ago Senator McClellan issued the compilation of what the various subcommittee chairmen of the Appropriations Committees in the Senate expected to be able to do with their budget, and they estimated a reduction of about—in actual outlays of about $2.2 billion, or about 1.2 percent. Both of these reductions would be below the President's budget, one by quite a limited amount, one by a sharper amount.

What effect do you think this would have on inflation and employment? Do you think it would be desirable?

Mr. STEIN. Well, I think it would be desirable to have—if the Federal deficit for fiscal 1975 were lower than what now seems to be the prospect, therefore, I think it would be desirable if ways could be found to hold the expenditures below the $304 billion figure that we initially proposed.

Now, whether we could get to the number that you suggest without giving up programs of great importance, is something that would have to be considered very carefully. I guess I would think that the

$9 billion or $10 billion that you propose is too big, both from an economic standpoint and from the standpoint of the programs, but that some reduction would be beneficial. I think there would be two main benefits. One is that it would, by reducing the Federal Government's borrowing on the market, tend to relieve the strain on interest rates and permit housing to go forward more rapidly. And I think it would also have an anti-inflationary effect in both real and psychological terms.

Senator PROXMIRE. Well, that latter point seems to me to be very important. This is a concrete, specific action that Congress could take. The budget does represent about an 11-percent increase in spending. It is true that with inflation the real addition of resources is not nearly that great, but it is a substantial increase in both dollars and resources.

It would seem to me that it would be advantageous if we could cut it down to a 7.5-percent increase, which the $295 billion represents. However, I suppose with the controllable expenditures being as limited as they are, that would be extremely difficult to do.

Mr. STEIN. Well, as I understand it, the controllable expenditures are in the neighborhood of $110 billion, of which about $80 billion is in the defense program, and you know, there are many ways to ruin a country, inflation being one of them, but being inadequately defended is another one, and so I think we should be very cautious about that.

But I am really not prepared to go into detail into the possible reductions in the size of the budget. We have been talking about this. Mr. Ash will be up next Monday testifying about the debt limit, and he can be questioned further about that.

Senator PROXMIRE. Now, it is almost 11 a.m. I wonder if you could tell us whether or not the housing proposals by the President would result in additional net spending, or if they would not? I am not asking about the details of it. I am just asking about the economic consequences.

Mr. STEIN. Well, I guess I can tell you, as I understand it. That is a somewhat iffy question because one aspect of it involves a commitment of the Treasury to make loans to the Federal Home Loan Banks, and whether that commitment would have to be taken up would depend on the future course of interest rates, so that if interest rates came down the Treasury might not have to take up this commitment, and there would be no budgetary effect. If interest rates did not come down, the Treasury has to take up the commitment. There is a budgetary effect.

But I think that this kind of budgetary effect is somewhat different from other kinds of expenditures because what is involved is that the Treasury would borrow and funneling the money through the Federal Home Loan Banks, would come back into the credit market. So it is pretty much a wash transaction except that it may divert a certain amount of funds from other parts of the market into housing. But there would be part of the program that involves expansion or increase of the tandem plan, the Gennie Mae, Fannie Mae program, and this could have some budgetary consequences also.

Senator PROXMIRE. I will not question you further on these. Of course, we all have the statement before us, and it will be issued shortly.

Yesterday, as you said, the Senate did kill, and I think probably finally kill, the monitoring authority. Frankly, I voted for that, the controls had not worked well, and we should have ended them. At any rate, there was some discussion and debate and confusion and difference of opinion as to what monitoring authority you might be able to exert, and everyone agreed that the Council of Economic Advisors was the one agency, if there is an agency, that could monitor prices, give us information on developments with respect to prices throughout the economy, and do it in a way that would keep us informed to some extent.

What action can you take or do you plan to take to monitor the course of prices over the next few months?

Mr. STEIN. Well, of course, the Cost of Living Council will remain in being until June 30, in any case, under its present authorization and executive order. But monitoring is a rather elastic term, as used in this sense with respect to the Cost of Living Council. It does not mean simply looking at the statistics or looking at the prices or reporting the statistics of the prices. It involves certain kinds of activity which are not mandatory but may be significant. The Cost of Living Council as a council, and because of the interest it represented, has had a great deal of influence in the administration in getting policies of the various departments adapted to our interest in preventing inflation. I would say one of its most successful performances has been with respect to agricultural policy, to looking at all of these orders that the Department of Agriculture puts out, and asking what is this going to do to prices, what is this going to do to inflation, and do we really need to do this.

It has been concerned with some other agencies, Department of Transportation, for example, and I think that is an important function.

Also, it has—there is a kind of moralsuasion, jawboning, exercise of talking with labor leaders, with labor unions, with leaders of business, trying to persuade them of the virtues of moderate behavior. So there is some action involved here, although not mandatory, and I think we will have to decide what we do about this after June 30.

I hope that you are not correct in saying that it is all dead, because we would still like to push for it. The Council of Economic Advisors, as you know, is about 46 people—the Cost of Living Council is several hundred.

Senator PROXMIRE. Let me just interrupt. My time is just about up, Mr. Stein. To say that I think it is dead, and that the realistic appraisal is that it is, as I say, it failed in the Senate, the assumption was it would have a lot harder time in the House anyway, bitterly opposed by both labor and business, and for that reason I think its revival is most unlikely. But I think there is a strong sentiment in both the House and the Senate, and acceptable to labor and business to have a modest expansion of the Council of Economic Advisors with the capacity to do precisely what you told us, to work with the agencies and to do some discussion and negotiation with the labor unions and business, to communicate the views of the President that restraint is desirable.

Mr. STEIN. Well, that is one of the alternatives we will have to be considering in the next few weeks.

Senator PROXMIRE. My time is up.

Chairman HUMPHREY. Thank you.

Mr. Stein, let me see if I understood correctly your discussion with Senator Proxmire.

Is it your forecast that unemployment will range between 5.5 percent and 6 percent, is that your judgment?

Mr. STEIN. Yes.

Chairman HUMPHREY. For this calendar year?

Mr. STEIN. No. I am saying that—yes, but I am saying that it will rise from the 5.0 percent that we had in April into that area between 5.5 and 6 percent. I just point to a—we have the latest compilation by RCA of the consensus of economic forecasts of 1974 unemployment rate, and these come to 5.7 percent, which seems to us a reasonable——

Chairman HUMPHREY. What bothers me about that is not whether the statistical prediction is accurate or near accurate, but the fact that we are beginning to accept it. That is an incredibly high rate of unemployment, and the economic loss of that amount of unemployment runs into the billions of dollars. And I just do not believe that we ought to permit ourselves to think for a moment that it is an acceptable rate. In fact, to the contrary, that we ought to move heaven and Earth to bring it down. I do not know any way we can pay our bills or keep this economy in any kind of healthy condition with 5 to 6 percent of our work force unemployed.

But we have been edging it up. You know, it is sort of like getting accustomed to medications. You can keep taking larger doses. But I can tell you, there comes a break point where the toxic effect is overwhelming and overcomes any positive therapeutic effect, and that is what I am worried is happening in this unemployment figure, when it used to be that we were talking about a 3-percent rate, and then the Government had a standard that maybe a 4-percent rate was acceptable. Now we have moved it on up to not 4.5 or 5 percent, but we are talking now about that—well, between 5 and 6 percent. I mean, this is just a statement of my feelings about it. I feel that we have to design policies and hopefully encourage the economy to where it will do something better.

Mr. STEIN. May I just say——

Chairman HUMPHREY. Yes.

Mr. STEIN. We do not regard 5.5 to 6 percent as a goal of policy or as a desirable state for the economy. We are forecasting that this is a situation which we will pass through. We expect the rate will decline substantively, and we are confronted with the fact that of course we do not accept 12 percent inflation rate as acceptable, as a desirable state of the economy, and that we have to, we believe, grasp this nettle and accept some transitory difficulties in order to get down from there, or else we will never get down.

Chairman HUMPHREY. You see, my concern is, though, it is not transitory, and that we are not grabbing the nettle, so to speak. We are not biting the bullet. And I say "we." I do not think the Government anywhere is really doing it, Congress or the executive branch.

We have been going on this unemployment business for a long period of time. It was a temporary drop, but the prevailing rate over the last 3 years since 1972, the last 2½ years, has been in the area of around five plus, 5 percent or more.

Mr. STEIN. That is true.

Chairman HUMPHREY. We have been cutting up, the price freeze went on when inflation was a little over 4 percent, and now it is on up. I still do not know what it is, I mean 12 percent or 14 percent. But whatever, it is a double digit, that we know. And we are not getting better. We are actually having a slow erosion and deterioration.

Now, that may be due to international affairs. I understand the energy problem. All of these matters require reason and not passion. But the point is, and I do not see that we are coming up with design, with a program, with policy. The old cliches of the budget and all that sort of thing, it just does not add up.

Mr. STEIN. Well, I think the trouble with these old cliches, with the old religion, is that we have not abided by it, not that we have found it to be erroneous. And I think what we have found is that the new cliches and the new relations did not work, and we have to go back to the homey truths. The idea that for every problem there is some newly-invented solution which nobody thought of before which will enable you to come to the promised land without difficulty is just—you know, we know that that is not correct.

I do not say, or would not say that our interests should be confined to the told-time religion of fiscal and monetary policy. But I think we have to live by that a lot more prudently than we have in the past. There are things we want to do, we hope we can do about increasing production, about increasing productivity and so on. But the final solution, I believe, lies in this area of responsible demand management.

Chairman HUMPHREY. That may be the case, and I hope you are right. But there still is not the structural organization to really do what we are talking about, even on jaw-boning, even preaching moralsuasion to our respective segments of the economy.

My point is that I do not see that there is any concerted effort. I do not deny the fact that monetary policy has an influence on the economy. Of course it has. And I gather that the budget was presented which will be reduced by the Congress was a surplus budget in terms of full employment budget, is that not correct?

The budget for fiscal 1975?

Mr. STEIN. Well, we had so many measures of the full employment budget by the time we were through that I am most uncertain about the answer to that. But it was approximately in balance, I would say.

Chairman HUMPHREY. I understood it was an $8 billion surplus budget on the basis of what we call full employment, that new technique that we have. That is about $4 billion more than we had in 1974. You can have one of your men check that out. If I am wrong, I will correct the record.

I would like to talk just quickly in the time that I have about housing. We are going to release a study that we had done by the subcommittee through the research services of the Congressional Library and others showing that there will be a fall in housing starts in the second quarter to 1,500,000 units, and yet you indicate that the sharp decline in housing starts that began in early 1973 seems to have come to a halt in the first quarter of this year.

With interest rates where they are—and I have got to say once again that I think those interest rates are an open aggression upon mankind—I do not see how housing can recover. We are just pricing housing out of the reach of most families. I do not care how much mortgage money they can get.

Have you made any studies?

Do you have any evidence to support the claim that housing is about to recover?

Mr. STEIN. Well, what we said, in the first place, was that the decline of housing has come to an end, and your forecast of 1.5 million in the second quarter would not belie that. After all, we started with an annual rate of 2.4 million in the first quarter of 1973. We have come down to about 1.5 million. That is about where we are. And we have made some studies of the demand for housing, with some care, taking into account the stock of unoccupied houses, the number of families, their incomes, the cost of houses, the cost of mortgages and so on. And we believe on the basis of these studies that we will have a rise in housing.

But we do have a potentially very difficult, potentially dangerous situation, as a result of the rather peculiar character of the financial institutions that finance housing, that we could have a great flow of funds out of the thrift institutions, which would be, which could abort the recovery that we see. And so part of the financial measures that we are talking about are to prevent that and to make sure that all of our backstops are available to make sure that that does not happen.

Chairman HUMPHREY. Our study indicates that the housing starts will average out for the year at about 1.6 million.

What do your studies indicate?

Mr. STEIN. Our estimate is about one and two-thirds million units, it is a little higher.

Chairman HUMPHREY. Just a little bit, but about in the same range?

Mr. STEIN. Yes.

Chairman HUMPHREY. And both of those estimates, then, demonstrate conclusively that the housing needs, the minimum needs are not being met, the essential needs for housing are far beyond the 1.6 million or the 1.7 million, whatever the figure may be. And I really must say that I do not think we have come up with anything in Congress or the executive branch that meets these housing needs. I do not know any young couple can pay these interest rates and build a house at these building cost rates. And according to what I hear, from what I have heard, the prices of materials are going up, wages are going up, and interest rates are going up, and somewhere along the line—you know, I do not have enough staff to keep me informed on all of this. But I heard that about 60 and 70 percent of the American people are priced right out of housing. There is no way they can get it.

Mr. STEIN. Well, I want to answer that question. Of course, everybody is living somewhere, and the number of people living in inferior houses is very much smaller than it ever has before. So that the American people are better housed than they ever have been before. There is no doubt about that.

But with respect to these points, we think—we are very concerned about the interest rate problem, and we think that some of the measures announced today will do something about that. We think if we can take up a notch or two in the budget, that will help to do something about interest rates. I think that is the most useful thing we can do, aside from a third thing, which is to get the inflation under control, because it is basically the expectation of rapid inflation that gives us these high interest rates.

Now, with respect to other costs, we are concerned about wages in the construction industry. That was one of the things that we thought that the continuation of the Cost of Living Council might assist us with. But we cannot deny that problem. If labor costs in this industry just go on rising relative to labor incomes in other industries, then people in other industries, who are employed in other industries are going to have difficulty buying the houses, and in the end the labor in the construction industry is going to lose jobs.

Chairman HUMPHREY. They are out of jobs now. The carpenters are without jobs. You can get—building trades people have a high rate of unemployment in the areas. I mean, not universally, but in many areas, particularly in the housing area.

Mr. STEIN. They also have very high wage rates and high, rapidly rising wage rates.

Chairman HUMPHREY. My time is up. But I imagine every man is victimized by his own prejudices, and I am sure I am. But every time I hear a discussion of inflation it is that if a worker gets an increase it is inflation, but if management gets profits that is for investment. If the rate of investment is incredibly high, that is healthy. If a worker's income is high, that is dangerous. If interest rates go up, which makes bank profits soar, then that is good, too.

I do not know, I guess I am born for the wrong time. There is just something about all of this that just bugs me. The folks that really have to carry much of the burden of the country, the working families that always run behind whenever there is inflation, no matter how many wage increases they get, they never catch up. They play catchup all the time. They are like the man who ran for office with a deficit. He never gets caught up. And they are just in trouble.

But by golly, whenever we have these sessions—and I know how bright the economists are—they always prove in some way or another, when it is all through, if you just get those interest rates up that is good for you. It is like getting hit in the head with a hammer, it is good for you if you do not—if you forgot your own headache.

Mr. STEIN. I do not think I said that.

Chairman HUMPHREY. Well, you know, today when we talk about how do you control inflation, you say, well, monetary policy, fiscal policy, wage policy.

Now, what does it mean?

Monetary policy means higher rates. Fiscal policy means lower budgets in much of the budget except for defense, and the other part we are going to cut.

And what does it mean on wage policy, wage-price policy?

Well, you hold wages down. But I have not seen anybody hold any prices down. I have not seen this government scolding many people, and they are just going up. Every time I pick up the paper somebody has hijacked the prices.

Mr. STEIN. Well, I guess you are not on John Dunlop's mailing list, because he scolds a lot of people.

Chairman HUMPHREY. Who is that?

Mr. STEIN. John Dunlop. He just scolded Mr. Ford.

Chairman HUMPHREY. Well, he does not scold loud enough. Now, here is a great company, Ford Motor Co. I happen to have a high regard for Ford Motor Co. and their performance. But how in the name of commonsense, after all of these agreements that everybody arrived at about, you know, that we would take the controls off and they are going to behave. And all at once, bango, down comes the price increase, and they are going to do it all across the board.

You know you are living in a fool's paradise if you do not know what is going to happen. I mean, it is one thing, you know, to go around and complain. But it is another thing to know what is going to happen, and then complain. And we know what is going to happen. We do not have any doubt what is going to happen. Everybody is going to grab all they can get. They are all afraid that they are going to have price controls put back on them again, or they are going to have some kind of wage and price freeze, everybody. You just go out here in the street and talk to anybody that you want to talk to that is in management or labor, and they say, well, I am going to get in a position, they are not going to catch me this time. And so, bango, the only guy that is getting lower prices today is the farmer again. He got a little nip, you know, a couple of times there, put the cup to his lip and tasted the juice and got some higher prices. He thinks it is going to be great. Now what is happening to hogs and cattle, wheat, all these things down, down, down. He is going to end up with high costs. He has got that big old expensive tractor, the parts, he will never be able to pay for the parts. His land prices have gone up. His fertilizer is up 300 percent. And he is just having one big time, and all at once, bango, that wheat is going to be $2.70 a bushel.

Would you not say that, Mr. Seevers?

I just thought I would get you in the act here.

Mr. SEEVERS. Thank you, you are very kind. I am glad you are on the public record with a price forecast.

Can I take that as a forecast, $2.70 a bushel?

Chairman HUMPHREY. Yes, by the time they get the harvest in, and then afterwards the price will bet jacked up after farmers get rid of it, just as soon as my name is Hubert Horatio Humphrey. I have not lived 62 years in rural America and not found out what has happened. I know when they are doing it to you. You know, I can feel it.

Mr. SEEVERS. Farmers are pretty smart guys, though. You know, some of them hold onto that grain.

Chairman HUMPHREY. They do not have any more control over the market than I have, as I say, over the weather.

Mr. SEEVERS. Well, I think that wheat prices could come down a lot. I do not know whether they will come down that——

Chairman HUMPHREY. What are they now?

Mr. SEEVERS. Around $3.25 to $3.50.

Chairman HUMPHREY. About $3.10 or $3.02 in Minnesota, and in northern Minnesota about $2.98. You know, it is what the farmer—not what he gets down in Chicago, what does he get in that elevator right out there. He cannot go to Chicago. What is more is, he would have to carry it piggyback. There are not any railroads.

We will get to you on that one after a while, but I am upset on that.

Mr. SEEVERS. That is the subject of a different hearing, I understand.

Chairman HUMPHREY. Yes, sir.

Senator PROXMIRE. I have the details of the housing program right here, and it suggests about a $10 billion—$10.3 billion influx of funds into housing, which might make quite a change in the number of housing starts in 1974. I certainly hope so.

No. 1, which would provide about 100,000 additional starts, is $3.3 billion for tandem FHA–VA mortgages at 8 percent. They have been 7.75 percent.

No. 2, up to $3 billion of new mortgage commitments for conventionals.

Chairman HUMPHREY. Wait a minute, wait a minute. Is that 8 percent without points, Senator.

Senator PROXMIRE. Yes, sir.

Chairman HUMPHREY. That is pure?

Senator PROXMIRE. That is right.

Is that not right?

Mr. STEIN. Eight percent would be the rate, and then the points would be——

Chairman HUMPHREY. We have got lots of ways to skin cats around this town.

Senator PROXMIRE. Up to $4 billion by below-market rate advances to thrift institutions. And in addition, they would raise the FHA1 VA rates, which I think they have to do, because it is a fact of life. The market is above it, and that would help reduce the points, because that would reduce 8.5 to 8.75 percent.

New FHA mobile homes, also going to 11.25 percent. It is true that it is hard to determine the effect of this, but I would think that by putting the additional $10 billion or $10.2 billion into housing, it would have some of the following effects:

No. 1, you probably would get more housing starts. I think maybe as much as 200,000 or 300,000 more housing starts in 1974. You probably—you are obviously going to get higher interest rates. It is acknowledged in the housing area. Because resources will flow into housing and because the Federal Reserve Board has indicated that they are going to attempt to adopt, to follow a policy of monetary restraint. I would think that the effect of this would mean higher interest rates elsewhere.

Mr. Stein. Well——

Senator Proxmire. But $10 billion in housing is no free lunch. There is no way of avoiding that unless you are going to have an inflationary effect of that $10 billion.

Mr. Stein. Well, I guess there is no free lunch. The main method in which this will operate will be to divert funds from other parts of the capital market into housing. It should change the relative interest rates between mortgages and, say, business borrowing, to the advantage of mortgages, to get mortgage rates lower than they would otherwise have been. There is some increase in mortgage rates announced here, but as you say, these are just reflections of what has already occurred in the market. This proposal here does not raise the mortgage interest rates. It just recognizes that at the previous rates no one is going to go in, very little money was going to go into the mortgage markets.

We believe—I think everybody recognizes that the net additional inflow of money into housing coming from this program is not $10 billion. That is, if the Federal Home Loan Bank, for example, goes out and borrows $3 or $4 billion to make advances to their thrift institutions, that $3 or $4 billion has got to come out of somewhere. Some of it will probably come out of deposits in thrift institutions by people who will now decide to hand FHLB deposits or certificates of savings and loans. Or similarly, if the Treasury goes out and borrows $3 billion to put into mortgages, that $3 billion has to come out somewhere, so that the net, I think everybody recognizes; is not $10 billion and still add considerable to housing starts.

Senator Proxmire. Well, the point is, however, that most economic analysts argue that the high interest rates and continued high rates and the prospect that interest rates will continue as high as they are, maybe go up some, but not moderate very much, will worsen our economic situation. You do not seem to address that in your statement to us this morning, that this will be a deteriorating factor even if it does not discourage housing. If we can somehow permit housing to escape, it is going to have an adverse effect on State and local borrowing. It is going to have an adverse effect in the business sector or wherever.

Mr. Stein. Well, I think the average level of interest rates that we have in the country is appropriate to the situation in the country, and what we are trying to do by these housing measures is to shelter housing a little from being the primary victim—it is a common word —of the high interest rates, that is to spread the consequences of high interest rates around the economy in a way which is not so harmful to housing or the housing industry.

But I think that given a situation in which inflation, as we have all ben saying, has been running at 10, 12, 14 percent, where there is uncertainty about whether it is going to decline, where the demand for business investment is very high, or the Federal Government is running deficits, you have to have, you must have high interest rates. My professor said, if you will not pay higher taxes or high interest rates, you pay even higher prices than we are now paying. I think that is a basic truth. Now, we will get interest rates down when we correct these conditions that are causing it.

The most important of those being the rapid rate of inflation. Well, I think all experience shows—well, I am sure you know this. I do not need to go through this—if you try to get the interest rates down by pumping up money, you just generate more inflation and more inflationary anticipations at higher interest rates. So that the fruitful approach to doing something about interest rates, is to do something on the budget side as we have tried in 1974, to try to reduce the budget deficit and try to reduce the Government's competition in absorbing funds out of the capital market, and then to do something about inflation.

Senator PROXMIRE. Do you have any estimates as to when short-term interest rates will drop?

The Wharton people estimate 9- to 10-percent interest rates for some time to come.

Mr. STEIN. Well, among all forecasts that is a very, an especially chancy one. But we think we will see it in the second half of this year.

Senator PROXMIRE. Mr. Stein, in your statement you say, and I would like to ask Mr. Seever to comment as an expert on agricultural prices, you say that you expect food prices to moderate in the fall. I have heard contrary opinions voiced by highly competent people who say they think food prices are likely to rise in the fall.

What do you base this conclusion on?

Mr. SEEVERS. We have tried never to say that food prices are going to be declining over an extended period. We do not expect that. The fall——

Senator PROXMIRE. Why not?

The food prices at the farm level have been declining.

Mr. SEEVERS. Yes; they have been declining. But I think that they are likely to flatten out this summer.

Senator PROXMIRE. I see.

Mr. SEEVERS. Maybe even rise some for meats.

Senator PROXMIRE. So number one, you do not see any prospect of a decline at any time during the year of any significance in food prices for the consumer?

Mr. SEEVERS. No, I think the period when there is the best chance for a temporary decline is right now. In fact, I suspect we have had some declines in overall food prices in the last few weeks. We have obviously had some declines for fresh foods, poultry, eggs, and meats. So as far as a decline, I think yes; we may be having a decline right now.

But our basic pattern for the rest of the year is a much more moderate rate of increase of food prices than we had in the first quarter, when they went up at about a 20-percent rate.

Senator PROXMIRE. Why?

Mr. SEEVERS. Because we are now having expanded supplies of livestock.

Senator PROXMIRE. Yes, but in the fall you are assuming a good crop year.

Mr. SEEVERS. Yes; we are assuming a good crop year.

Senator PROXMIRE. Here and abroad, because we are exporting freely without any restraint.

Mr. SEEVERS. When we give a specific forecast of what food prices are going to do, everybody knows there is a lot of uncertainty in that.

and the biggest uncertainties are whether crops, looking at the world as a whole, are normal.

Senator PROXMIRE. Is it not true that we have a very, very thin carryover of wheat, for example?

Mr. SEEVERS. Yes.

Senator PROXMIRE. The thinnest we have had, perhaps—well, in a generation?

Mr. SEEVERS. Who do you mean by "we" in this case? The United States or the world?

Senator PROXMIRE. The United States.

Mr. SEEVERS. Yes; it is true that this country's grain stocks are the lowest in many years.

Senator PROXMIRE. And we had during the 1960's about 1 billion bushel carryover. Last year 500 million, this year only 140 million bushels. So that it is so thin it is only a matter of months that any kind of failure in Russia, in Europe, in Canada, in this country, could have pretty catastrophic results on food prices in the fall.

Is that not right?

Mr. SEEVERS. No; I think you have got it a little bit mixed up. We are going to have a very low carryover at the end of this wheat crop year. But this wheat crop year is virtually over. It is certain that we are going to have an enormous wheat crop. So as far as our stocks are concerned, we are beyond the danger point for this period when stocks are lower than they have been for many years.

Now, we expect in the year when the new crops will be utilized——

Senator PROXMIRE. How about corn?

Mr. SEEVERS. Let me finish wheat first.

Senator PROXMIRE. All right.

Mr. SEEVERS. We expect some buildup in wheat stocks during that period. That does assume a certain level of exports. It assumes exports slightly below what we are exporting this year. We think that is a reasonable and probable expectation.

But if there were major crop failures in the world that are not now on the horizon, then the export picture would change.

Senator PROXMIRE. Now, how about corn; in view of the fertilizer problem, especially the shortage of nitrogen?

Mr. SEEVERS. First, we are putting in a lot more corn acreage. The analysis we have from the Department of Agriculture is that there will be as much fertilizer put on per acre as there was last year.

The problem is that with corn prices so attractive farmers would like to put on more fertilizer. There are some areas where there are some critical problems. I understand in some parts of Iowa, there just is less fertilizer to go around.

Senator PROXMIRE. Wisconsin has problems, too.

Mr. SEEVERS. But I think partly these problems have been exaggerated, because even at the high price of fertilizer, given the price of grains, it has been profitable for farmers to want to put on more fertilizer, and so that in some sense there has been a great shift in the demand for fertilizer, and that is why there appears to be a shortage and there is a shortage in that sense, but not in the sense the that appearance of the shortage does not mean that we are going to have some kind of crop failure because we are not putting on fertilizer.

We can still have a high level of fertilizer application and have a condition where farmers would like to put on more fertilizer.

Senator PROXMIRE. My time is up, but I cannot resist pointing out that yesterday in New York in the United Nations, Senator Humphrey made a very significant address in which he called for a world food reserve program. This seems to me to be something we just must start, and he proposed that we start it now.

Now, would that be possible in your view, in view of the wheat carryover and all of the other problems that we have?

Mr. SEEVERS. Well, I think now is the time to think about a world reserve program.

Senator PROXMIRE. How about acting?

Mr. SEEVERS. We are thinking carefully about it. We are getting ready for the world conference and other negotiations where this can be considered along with other countries. I think now is a terrible time to start building reserves, with reserves thin and prices where they are, even though they are lower than they were a couple of months ago. It seems to me it is the wrong time to literally start building reserves. It is a good time to plan on what is a good world food security system, but it is not the time to start building reserves in my judgment.

Chairman HUMPHREY. We will come back to you on another occasion on that one. We have a little modest disagreement on that. I think I am right, and I am going to make a little bet. I bet you we will have a good carryover of wheat that we will want to put in reserve by October.

Would you like to bet? [Laughter.]

Mr. STEIN. Be careful.

Mr. SEEVERS. On the advice of the Chairman——

Chairman HUMPHREY. How about, let us say we will have about 400 million bushels?

What would you say about that?

Mr. SEEVERS. Oh, we expect that.

Chairman HUMPHREY. 450: how would you go for 450 million?

Mr. SEEVERS. In September?

Chairman HUMPHREY. How would you go for 450 million?

Mr. SEEVERS. How about 600 million?

Chairman HUMPHREY. Now, wait a minute. That is not a carryover; that is a massive surplus.

Mr. SEEVERS. In September we will have——

Chairman HUMPHREY. No: I said October. I will give you even a little more time.

Mr. SEEVERS. We will have even more stocks than 600 million in October. You mean the end of the new crop year?

Chairman HUMPHREY. Why do you and I not just have a little fun? Why do we not put it down here for about the end of next crop year? What would you like?

I will see you after the meeting. I will have a little wager with you, because we are going to do better than you predict on that.

I know that time has run, but I have got two or three questions on investment, Mr. Stein, and we can do it in 5 minutes.

We have some disagreement about tax cut, and a few of us Senators are submitting to our colleagues a proposal along the lines Senator Proxmire indicated with a modest cut in low and middle income groups, with a pickup of revenue that would relate to restricting the minimum tax, repeal of the DISC program—Domestic International Sales Corporation—repeal of asset depreciation range, and repeal of oil depletion allowance.

Now, do you think that those prospective actions, without regard now to the tax reduction for low and middle income, which I understand that you have already expressed yourselves on—what do you think would happen if we would repeal DISC?

Do you think this would have any adverse effect on the economy?

Mr. STEIN. Well, I am reluctant to get into details of a tax structure, because it is our general position that we try to avoid that kind of legislative matter. But I did say a few words about DISC yesterday, and I will say them here again today.

Chairman HUMPHREY. Why do I not just submit questions to you for the record?

Would you do that?

Mr. STEIN. All right. That would be better.

Chairman HUMPHREY. Because I know you have other things to do here today.

[The following questions and answers were subsequently supplied for the record in an exchange of letters between Chairman Humphrey and Mr. Stein:]

RESPONSE OF HON. HERBERT STEIN TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN HUMPHREY

MAY 20, 1974.

Hon. HERBERT STEIN,
Chairman,
Council of Economic Advisers,
Executive Office Building,
Washington, D.C.

DEAR DR. STEIN: When you recently testified, I said that there would be two follow-up questions for the record. You agreed to do the best you could to answer these questions for the Subcommittee.

First, I would like your views on four tax reform proposals that will soon be considered by the Senate in conjunction with tax-cut legislation. I believe that reform ought to be an integral part of the tax-cut effort and will fight to see that it is incorporated. Attached is a Dear Colleague letter and information sheets about the tax reform proposals.

What is your economic evaluation of the implementation of each of the proposed tax reforms?

Assuming that some reasonable package of tax reform is included with a tax cut, principally transferring income to low and moderate income consumers, would you be any more favorably disposed toward a tax cut at this time?

The second question has to do with the accuracy of our Federal expenditure estimates. The April issue of the Survey of Current Business warned that the rate of total Federal expenditures would be significantly below the path implied in the Administration's budget document. On May 13, 1974, OMB Director, Roy L. Ash, confirmed that this way so, saying that fiscal 1974 outlays would be about $5 billion less than they had originally been estimated in the budget. I find it hard to see how we can make responsible fiscal policy decisions when we do not know the facts about the budget. It now appears that the budget is a bit more restrictive than the official estimates. Would you tell the Subcommittee why these expenditures estimates are so far off, what is being done to correct such errors, and how you see this error affecting the fiscal policy outlook?

Dr. Stein, I want to thank you again for your appearance before the Subcommittee and your efforts to cooperate on these and other questions. Although our policy differences are wide, your willingness to cooperate has always been generous and it is appreciated.

Sincerely,

HUBERT H. HUMPHREY, *Chairman,*
Subcommittee on Consumer Economics.

THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
Washington, D.C., June 11, 1974.

Hon. HUBERT HUMPHREY,
U.S. Senate, Washington, D.C.

DEAR SENATOR HUMPHREY: I appreciated your cordial letter of May 20 and am happy to submit some personal observations on your questions and the supplementary material that you enclosed.

The Council of Economic Advisers has opposed the adoption of DISC from the start and is now hoping that it can be eliminated in the context of elimination of similar subvention by our trading partners. The goals should be to phase out the DISC whose permanent retention cannot be justified in a world of floating exchange rates, in our view.

We do not agree with your staff's assessment of the ADR system under current inflationary conditions, even though we deplore any large-company bias. This bias seems implicit in all sophisticated tax liberalization options provided in the internal revenue code because small businesses are slow to spot and to use them. However, this is an argument for simplification, not for removal of the ADR.

While much of the economic analysis in your background sheet is unexceptionable, you should know that Robert Eisner is very much on one side of the issue of accelerated depreciation and of the shortening of service lives for depreciation. What *is* clear from studies published in the *Survey of Current Business* is that the benefits of acceleration have been outweighed by the effects of inflation in recent years. Consequently even accelerated depreciation based upon historical costs has increasingly tended to fall short of economic depreciation in terms of replacement costs. Scrapping the ADR system now would probably move us away from achieving closer equality of economic depreciation and the depreciation allowances actually claimed by business. The President has asked the CEA to take the lead in a study of U.S. capital requirements and we expect to go into this question deeply.

Our position regarding the minimum tax is basically the same as in the Administration's original proposal of April 1973. It is not clear to us why the minimum taxable income should be taxed at a flat rate and we should prefer progressive taxation at normal rates of a minimum taxable income equal to at least 50 percent of adjusted gross income (plus some tax preference items).

It seems to me that all of us, including some who have not been friends of percentage depletion for oil and gas in the past, have to reconsider our position on that subject in the light of the new world energy situation. I believe that we are probably going to want to produce more energy in the United States than would be naturally forthcoming at world prices. Therefore I believe we are going to want some special supportive measures. I would not argue that percentage depletion is the best supportive measure, partly because it tends to prevent the true economic costs from being reflected in market prices. But I don't think one can reasonably be against percentage depletion, in favor of price controls on oil when it is in short supply, and in favor of open markets when the world supply is abundant.

I have been around Washington long enough to regard the balanced tax package—equal revenue gains and losses—as a Purple Cow. I have never seen one. I have seen many such packages proposed. We always end up with most of the tax cuts and few of the increases. But even if the improbable were to happen and we were to get a balanced tax package, I would want to look at it closely. I would be concerned about two possibilities. One is that while the package is balanced in revenue effects it may not be balanced in overall economic effects. That is, the tax cuts may stimulate spending but the tax increases may be of a kind which depress asset values but do not cut spending, at least not at the same time. The other possibility, more serious in the long run and inherent in the proposals now circulating, is that the balanced package may cause a shift of resources from investment to consumption which would be undesirable in the present state of the U.S. economy.

Sincerely,

HERBERT STEIN.

Chairman HUMPHREY. One other thing I would like to have you prepare for us for the record, the survey of current business, the April issue of the Department of Commerce publication states:

The rate of total Federal expenditures is significantly below the path implied in the administration's budget document. Unless an increase of a very unlikely size occurs in the second quarter, the national income product measure of Federal expenditures for the fiscal year ending in June will be far below that projected in the budget.

Mr. Stein, I would appreciate it if you could give us some accurate estimates of the Federal budget for the current fiscal year. It was apparent when the budget was presented last February that spending could not possibly reach the levels projected in that document.

That was pointed out by this committee in its annual report, and now it has been confirmed by the analysts of the Commerce Department. The staff informs me that fiscal 1974 spending will be at least $5 billion short of the official budget estimates and possibly twice that much.

How can we make responsible fiscal policy decisions unless we know the facts about the budget?

The budget is a good bit more restrictive than the official estimates, and if this fact were realized, it would influence our judgments about the economic outlook. It might even increase the support for a tax cut, which I happen to think we need.

Therefore, I am going to ask you to update the budget facts, if you will please.

Mr. STEIN. Yes, I would be happy to do that.

[The following information was subsequently supplied for the record:]

We agree with the assessment published on page 3 of the April 1974 *Survey of Current Business* that the rate of total NIA expenditures is currently below the path implied in the Administration's official budget published in February. Revisions in the FY 1974 NIA estimates since that time—consistent with the revised unified budget estimates presented to the Ways and Means Committee on May 13—are itemized in the table below, and are followed by a brief explanation of the major changes.

While estimated NIA expenditures have been reduced by about $6 billion, estimated NIA receipts have declined by $2 billion, causing a reduction in the estimated NIA deficit of about $4 billion. We now expect the NIA federal sector for FY 1974 to be almost balanced, while the full-employment surplus is estimated to be somewhat in excess of $10 billion. We continue to believe that it is desirable to maintain the moderately restrictive fiscal policies implied by these figures.

Direct federal purchases of goods and services have been revised downward by $1.7 billion. The largest part of the shortfall is in nondefense agencies, although defense purchases are also lower than estimated in February.

The estimate of FY 1974 foreign transfer payments was reduced by $2.1 billion due to a recent decision by the Department of Commerce not to include the write-off of Indian rupees in NIA federal expenditures. Since this rupee transaction will have no economic impact, it was ultimately decided not to include it in the NIA figures. In addition, lower expenditures for medicare have reduced domestic transfers by $0.6 billion from the February estimate.

FEDERAL GOVERNMENT EXPENDITURES AND RECEIPTS, NATIONAL INCOME ACCOUNTS BASIS, FISCAL YEARS 1973 AND 1974

[In billions of dollars]

	1973 actual	1974 February	1974 May	Change in estimate
Federal Government expenditures	255.1	285.2	278.8	−6.4
Purchases of goods and services	104.5	111.5	109.8	−1.7
Transfer payments	89.4	107.2	104.5	−2.7
Grants-in-Aid to State and local governments	40.4	44.1	42.6	−1.5
Other expenditures	20.8	22.4	21.9	−.5
Federal Government receipts	243.3	280.5	278.2	−2.3
Surplus or deficit (−)	−11.8	−4.7	−.6	+4.1

Note.—Grants are now estimated to be $1,500,000,000 billion lower in fiscal 1974 largely because of lower than anticipated spending for medicaid, education, and public assistance.

Other expenditures are down by $500,000,000, largely due to a lower estimate of net interest.

It should be emphasized that changes in employment conditions and in the rate of inflation, legislative changes, and changes in the leads and lags of expenditures compared to earlier estimates invariably cause the actual outcomes to differ from the best forecast estimates. Moreover, the shift toward greater restraint implied by these figures at constant unemployment rates is appropriate given the higher-than-expected rates of inflation during the 1st months of 1974.

Senator HUMPHREY. Do you have anything else you want to say, Mr. Stein?

Mr. STEIN. No; I think you will get some revision of the budget figures when Mr. Ash testifies on Monday about the debt limit. As far as the unified budget figures are concerned, it is nothing like what is suggested there.

Chairman HUMPHREY. I am also going to include in the record at this point the letter that we circulated to our colleagues in the Senate as of May 8, a letter that was signed by seven U.S. Senators, Bayh, Clark, Hart, Humphrey, Kennedy, Mondale, and Muskie, along with supporting data pertaining to our tax proposals, both of the cut and readjustment.

[The letter and supporting data follow:]

U.S. SENATE,
Washington, D.C., May 8, 1974.

DEAR COLLEAGUE: When H.R. 8217, the vessel repair tariff bill, reaches the Senate floor, we intend to propose a joint amendment that will raise substantial new revenues by making four reforms in the Internal Revenue Code.

This tax reform amendment will be offered in conjunction with the $6.6 billion anti-recession tax cut amendment for 1974 that is being proposed by Senators Kennedy, Mondale and Long. The tax cut amendment will give taxpayers the option of taking either a $190 tax credit or an $825 personal exemption for themselves and each dependent, and it will also include Senator Long's "Work Bonus" proposal to give low income workers with children a refundable tax credit, in order to provide relief for the lowest income groups from the increasing burden of the Social Security payroll tax.

The tax reform amendment is designed to offset the long-term revenue loss from the tax cut amendment, while preserving the anti-recession aspect of the tax cut in the current year. Thus, the proposed reforms will generate new revenues of $4 billion in 1974, and $7 billion in the fifth year. In addition, these reforms will help to insure that every American pays his fair share of taxes, and will eliminate several ineffective tax subsidies.

The amendment will contain the following reforms, which are described in more detail in the attached fact sheets and which have been thoroughly reviewed and debated by the Senate in recent years.

(1) Repeal of the oil depletion allowances, effective January 1, 1974 ($2.0 billion revenue gain in 1st year, $2.6 billion in 3d year; $3.3 billion in 5th year).

(2) Repeal of the Asset Depreciation Range (ADR) system of accelerated depreciation, effective for plant and equipment placed in service as of this letter's date ($250 million revenue gain in 1st year; $1.5 billion in 3rd year; $2.0 billion in 5th year).

(3) Repeal of the Domestic International Sales Corporation (DISC) system of tax incentives for exports, effective January 1, 1974 ($815 million revenue gain).

(4) Strengthening the Minimum Tax by reducing the current exclusion from $30,000 to $10,000 and by eliminating the current deduction for taxes paid, effective January 1, 1974. This provision was passed 47–32 by the Senate on January 24, 1974 ($860 million revenue gain).

If you would like to cosponsor this revenue-raising tax reform amendment, please let us know or ask your staff to contact one of our offices.

Sincerely,

BIRCH BAYH,
DICK CLARK,
PHILIP A. HART,
HUBERT H. HUMPHREY,
EDWARD M. KENNEDY,
WALTER F. MONDALE,
EDMUND S. MUSKIE.

[Article from the St. Paul (Minn.) Pioneer Press and Dispatch, Apr. 4, 1974]

HELLER BACKS TAX CUTS FOR LOWER INCOMES

(By Ann Baker, Staff Writer)

The idea of tax cuts for moderate-income to poor families was endorsed by economist Walter Heller Wednesday.

"And we should take Social Security taxes off the poor, and we ought to do it tomorrow," he said.

"It simply makes no sense not to have a differential. It would help the poor, it would redress the grievances and I think it would help a flagging economy."

Heller spoke at the closing session of the 81st Minnesota Welfare Conference in Minneapolis, which drew some 3,200 persons in three days.

He said "I'd go along with" the tax exemption proposed by Sen. Walter Mondale, D-Minn. A bill Mondale says he will introduce soon would allow a $200 deduction per person to be taken from the final tax bill, instead of the $750 exemption now made before the tax is calculated. It would save low-income persons considerably more than the affluent.

"The so-called welfare explosion, which increased the number of AFDC recipients from 4.4 million in 1965 to 11 million in 1973, has been used as a club against welfare in Washington," Heller said.

Nixon administration members, he said, "talk about the welfare mess, bums and loafers and cheaters," but, he said, they ignore the population explosion which played a part in the increase.

And, he said, they ignore the fact that liberalized social service and community action programs of the 1960s "for the first time reached many people entitled to assistance.

"If you think of welfare as relieving dependency, the policies of the '60s were simply achieving their purpose. The planners were frustrated, but the poor were better off."

Heller said government planners are "sometimes addicted" to simplistic solutions and that no one measure will solve the welfare problem.

He termed "ominous" President Nixon's announcement last Saturday that he will ask Congress to trim $800,000 from current welfare appropriations, particularly, said Heller, because Nixon was vague about which programs he wants to cut.

Federal expenditures, said Heller, have remained a steady 20 to 21 per cent of the gross national product over several years.

"The federal government has feasted on five income tax cuts, while states have had thousands of increases. The federal budget for 1975 has an apparent deficit," he said, "but it is actually tighter, not looser. . . .

"There's no lack of fiscal capacity, if the programs are what we want. It's a question of priorities."

Contrary to "every cliche," said Heller, "normally, inflation does not hurt the poor. The same conditions and policies that produce inflation raise the rate of employment and the income of the poor, except those on fixed incomes. This past year has been totally different. . . . A family of four with $6,000 spends 40 per cent of its income on food, and if you do that you've lost 10 per cent of your real income in the last year. Add the fuel explosion. . . ."

Heller said it is difficult and confusing to try analyzing federal spending policies, which have a now-you-see-it-now-you-don't quality.

Broadened categories of federal aid, originally called "special revenue sharing," he said, "are not tide down to specific purposes that will help the dispossessed. . . . You and I might applaud the effort to cut red tape. . . . But remember the poor and the black and disadvantaged want to know who's getting the damn money.

"They have to move their lobbying from Washington to 50 state legislatures where they know they have even less clout. Gulliver unbound looks like a giant who will step on them."

Heller urged his audience not to blame cuts in social service funds on general revenue sharing (an idea that he fathered back in 1957). It was accidental, he said, that the two measures were linked in an act passed in December 1972.

Revenue sharing, he said, "has been used by the administration as an excuse for cutbacks in other areas. I think they'd have made the cuts anyway."

In any event, he said, revenue sharing was designed not to take the place of federal welfare and social service expenditures, rather as "direct support to state and local government as such . . . to produce public services . . . like garbage collection, police and fire protection, parks. At the state level the great bulk is going into education. There's no reason welfare interests shouldn't try to get their fair share . . . but it was designed for the functions that don't have much federal support."

Chairman HUMPHREY. We thank you very much, Mr. Stein and Mr. Seevers, and I hope to see you at another one of our hearings on agriculture, my pet project.

Thank you very much.

We now have as our other witness Mr. Gerard Adams. Mr. Adams is the chief economist for the Wharton economic forecast or outlook.

We welcome you, and I appreciate your patience in waiting this morning for us.

Would you proceed?

Do you have a prepared statement?

Mr. ADAMS. I do have a prepared statement.

Senator HUMPHREY. Yes; it is here. I had misplaced it.

Thank you very much.

Now, do as you wish. I have the time, and I am greatly interested in what you have to say.

But I want to observe something here. I want it in the record, because sometimes historians look at the record. And I want to observe it with a note of both anger and, may I say, disbelief, almost. The Government witnesses have been here testifying; the press was here. There are two members of the press here, for which I am very grateful. I want to thank them for staying.

But this is why the American people do not get the facts. One side of the story is told, and one side of the story is reported. And I think it is time that somebody blew the whistle on it, and I intend to do it. I am not running for anything, so I do not have to care, you know. And I am fed up with coming to these hearings and hearing Government witnesses testify and seeing the press—and ordinarily there is television—and the minute that somebody comes up that may not be a Government witness, and particularly may have a different point of view, out everybody goes.

This happens on every committee on which I serve. If there is a Government witness from the State Department or CIA, or USIA, they are there. The minute somebody comes in from the outside, unless he is some former official of the Government that they think is going to be cantankerous and make accusations, why they are gone.

This has happened in this committee repeatedly. And I want to say that I think a man of your stature deserves coverage. So, my friends of the fourth estate can put this wherever they want to. I think it is time that the American media understood that there are other points of view besides just the Government's; or maybe they are bending over so bad because of what has happened in this Government that they are trying to equalize it by ignoring other people.

Go ahead.

STATEMENT OF F. GERARD ADAMS, PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA, AND SECRETARY-TREASURER, WHARTON ECONOMETRIC FORECASTING ASSOCIATES, INC.

Mr. ADAMS. Thank you, Senator. I appreciate that, and I appreciate the opportunity the subcommittee has given me to present our analysis of the economic outlook.

Due to the lateness of the hour, what I will try to do is to abbreviate this statement somewhat.

The latest Wharton Quarterly Forecast continues to show the U.S. economy in what we might term a recessionary period, but moderate recovery is now clearly in prospect, perhaps already underway. After the sharp decline in real output in the first quarter, the economy will be essentially flat in the second quarter.

The resurgence of economic activity will take place at a fairly modest pace. Further increases in unemployment can be expected.

Senator HUMPHREY. What was that "further"?

Mr. ADAMS. Further increases in unemployment can be expected——

Chairman HUMPHREY. Increases in unemployment?

Mr. ADAMS [continuing]. As output expands at less than the normal potential growth rate of near 4 percent. Real GNP can be expected to increase at an annual rate of approximately 2 percent during the next four quarters, while unemployment will approach 6 percent in 1975. The recent tightening of monetary policy will limit the stimulus expected from residential construction.

Chairman HUMPHREY. Are you taking into account now the prospects of the President's proposals on housing?

Mr. ADAMS. Well, of course, we have not fully taken them into account, because we have not known them.

Chairman HUMPHREY. Yes.

Mr. ADAMS. I suspect to some extent these contributions to the housing market will offset other funds which are being withdrawn by the disintermediation process. Moreover, I think I should stress that the housing market does not respond very quickly, that really the impact of many policy actions we take now will not be until very late this year or early next year. We do, indeed, show growth of the housing market at that time.

The inflation rate will continue at above 10 percent annual rate in the current quarter as price controls are lifted. Later in the year inflation will ease somewhat, but the price increases during 1974 will be 9 percent annually, and in 1975 prices will continue to rise at annual rates near 7 percent, as measured by the GNP deflator.

I know your interest was in consumer prices, and the approximate number there, I believe, will be above 8 percent annual rate as we move into 1975.

Chairman HUMPHREY. The discussions of rates of inflation are very intriguing to me, because there are so many ways to look at them. When you talk about the annual rate, that is the annual rate on top of the last annual rate?

Mr. ADAMS. Oh, yes.

Chairman HUMPHREY. You know, it is—when you get a wage increase, you generally talk about what your total wages are going to be. And I just sort of thought when we talk of inflation, we ought to talk about—really what we are talking about is it is going to be—how much would you predict it might be at the annual rate next year?

Mr. ADAMS. Eight percent on the CPI, 7 percent on the GNP deflator.

Chairman HUMPHREY. So that would be on top of what we have already got for 1974?

Mr. ADAMS. It would be—the absolute increment in the level of prices in 1975 will be on average 7 or 8 percent above 1974.

Chairman HUMPHREY. So, really, what we are talking about, if you had a base period, if you could say—let us take the period of 1970 as the base period, or whatever year you want, then you could really talk about what our inflation has been, not the rate, but what has the inflation been. There is a difference between the rate of inflation and the degree of inflation.

Mr. ADAMS. That is right.

Chairman HUMPHREY. And I think those are very important differences.

Mr. ADAMS. From the point of view of demand, recent economic trends present a paradox. This is a most atypical economic slowdown. As Mr. Stein has said, there is considerable strength in investment. Business fixed investment is being held in check largely by capacity limitations, and this makes it most unlikely that expansion plans reported in recent business investment anticipation surveys will be met.

On the other hand, as we know, consumer demand has been weak. Real per capita purchasing power has been declining. The decline between 1973 and 1974 will be approximatelay 0.5 percent compared to normal growth of about 2.5 percent.

Inflationary pressures will remain at a very high level, despite some easing of agricultural prices in expectation of a plentiful harvest. The rate of inflation is being augmented by a flurry of price increases as the dismantling of price controls becomes effective throughout the entire economy. It is not clear at this time how many firms may use this opportunity to scale up their prices, but we expect to see perceptible increases during the next two quarters in several sectors.

Chairman HUMPHREY. You are going to be right.

Mr. ADAMS. Moreover, labor agreements in major industries such as steel have substantially outstripped wage guidelines. It is difficult to place a value on complex labor agreements, but most of them call for price escalator clauses, at least 3 percent annual productivity increases, and substantially liberalized pension benefits. In the light of recent consumer price trends, the expected wage increases are in excess of last year's experience and will surely call for higher product prices.

In view of the sluggish economy, there will not be substantial offset from improvements in productivity. Unit labor costs will be rising sharply. Inflationary forces are shifting from demand pull to cost push. In the absence of an effective system of price and wage controls, the wage-price spiral accounts for continuation of inflation at rates of over 7 percent annually in 1975, despite the expected easing of demand pressures.

The current economic situation for the United States poses some serious policy issues. Important policy alternatives have been precluded by decisions made in recent weeks. The rapid dismantling of price and wage controls will have a perceptible impact on the pace of inflation over the course of the next few months. The lack of significant counter-inflationary policy was no doubt a major factor in the decision of the Federal Reserve Board to tighten monetary policy. But this tightening will maintain high interest rates and will hamper economic expansion. The real economic cost of stern one-sided policy measures can be very high.

Now, we must recognize realistically that many of our present economic problems stem from earlier miscalculations and from factors which were beyond our control. No manner of policy manipulation in 1974 can resolve all of these difficulties. but this is not an excuse for simply throwing up our hands in despair.

Many of us are disenchanted with the operation of detailed price-wage controls. This is not a time once again to establish open season for price increases. There is basis for broad guidelines for wages and prices. The key to such proposals must be balance. Wage earners can be expected to limit their wage demands only so long as they can be sure that prices will not rise out of hand and that excessive profits are prevented. Continuation of the Cost of Living Council or of an equivalent independent agency—and I stress the word "independent" here—remains a high priority. The agency should have broad authority to establish equitable price and wage targets. to measure the pace of inflation. to call the Nation's attention to those price and wage decisions which are inflationary.

I think at this time moderate stimulus may be appropriate on the side of demand, particularly in housing and consumption where there is ample capacity. One proposal discussed in recent weeks has been a tax cut to offset the recent decline in consumer purchasing power. Personal income tax reduction, amounting to perhaps $6 billion, could be coupled with a revision of the withholding schedules to eliminate some of the large overwithholding.

We have assumed a $6 billion cut in personal income taxes at the lower end, and a revision of withholding schedules to bring in another $6 billion of disposable income. An alternative run of the Wharton Model which incorporates these tax reductions shows that such action would provide a moderate stimulus to real economic activity when it is most needed in the second half of 1974 and in early 1975. It would create only moderate inflationary pressure.

The committee has the details on that particular solution.

Finally, since the consumer and the small saver are least able to protect themselves against inflation, we must move full speed ahead to develop new means to protect consumer savings and income from the onslaught of inflation.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you, Mr. Adams.

[The prepared statement of Mr. Adams follows:]

PREPARED STATEMENT OF F. GERARD ADAMS

The latest Wharton Quarterly Model Forecast continues to show the United States economy in a recessionary period though moderate recovery is clearly in prospect. After the very sharp decline in real output in the first quarter (at a 5.8% annual rate), the economy will be essentially flat in the second quarter. The end of the oil embargo has lifted the threat of further significant downward movement. It is immaterial whether we formally call this period a recession. There may not be two consecutive quarters of absolute decline in real GNP, but output has fallen substantially below potential.

The resurgence of economy activity will take place at a fairly modest pace. Further increases in unemployment can be expected as output expands at less than the long run potential growth rate of near 4% per year. Real GNP can be expected to increase at an annual rate of approximately 2% during the next four quarters while unemployment will approach 6%, and capacity utilization will decline to 89% (Wharton index). The recent tightening of monetary policy will limit the stimulus expected from residential construction.

Inflation will continue at above a 10% annual rate in the current quarter as price controls are lifted. Later in the year inflation will ease somewhat, but the price increase during 1974 will be over 9 percent and in 1975 prices will continue to rise at annual rates near seven percent, as measured by the GNP deflator. Profits are well maintained, but in large part this represents continued high levels of inventory profits attributable to rapid inflation.

From the point of view of demand, recent economic trends present a paradox. This is a most atypical economic slowdown. There is considerable strength in investment. Business fixed investment is held in check largely by capacity limitations and this makes it most unlikely that expansion plans reported in recent business investment anticipation surveys will be met. On the other hand, consumer demand has been weak. While automobiles sales have improved somewhat recently, we cannot expect a stimulus to demand from the consumer. Surveys indicate very low levels of consumer sentiment. Unfortunately, the growth of prices has outstripped wages. Householders have been squeezed. Real per capita purchasing power (disposable income) has been declining (the decline between 1973 and 1974 will be approximately one-half percent compared to normal growth of 2.5%.

Housing has, of course, been another element of weakness. The probable resurgence in this area is now threatened by the sharp change in the Federal Reserve's monetary posture. Since the lags in the housing area are fairly long, the impact of tighter money will be principally in delaying and slowing the expansion of residential construction. The extent of the impact of the change in policy depends on how tight money will be and how long this posture will be maintained. On the assumption of monetary growth of just over six percent per year (a figure which should be compared with projected growth of current dollar GNP of 9 to 10 percent) short term interest rates will remain near current high levels for several months. They decline somewhat late in the year as the post-freeze inflation bulge subsides, and as monetary policy eases slightly. With seven percent inflation, however, any dramatic drop in interest rates appears unlikely.

Inflationary pressures remain at a very high level, despite some easing of agricultural prices in recent weeks in expectation of a plentiful harvest. The rate of inflation is being augmented by a flurry of price increases as the dismantling of price controls becomes effective throughout the entire economy. It is not clear at this time how many firms may use this opportunity to scale up their prices, but we expect to see perceptible increases during the next two quarters in several sectors. Moreover, labor agreements in major industries—such as steel for example—have substantially outstripped wage guidelines. It has been difficult recently to place a value on complex labor agreements. Most of them call for price escalator clauses, at least 3% annual productivity increases and substantially liberalized pension benefits. In the light of recent consumer price trends these wage increases are in excess of last year's experience and will surely call for higher product prices. In spite of the anticipated rise in unemployment, wages of low income workers will also be marked up as a result of the May 1 increase of 40 cents per hour in the minimum wage. On balance, compensation per hour for the non-farm private economy is expected to increase at 8.5% to 9% annual rates during the next two years. In view of the sluggish economy, there will not be substantial offset from improvements in productivity. Unit labor costs will be rising sharply. Inflationary forces are shifting from demand pull to cost push! In the absence of an effective system of price and wage controls, the wage-price spiral accounts for continuation of inflation at rates of over 7% annually in 1975 despite the expected easing of demand pressures.

The foreign balance is another area of concern. In current prices, the trade balance is beginning to be significantly affected by the increase in world petroleum prices. Moreover, the value of the dollar has declined sharply in recent months—some five percent on a trade weighted basis from January to April—and this too has an unfavorable impact on the trade balance in the short run. We are experiencing a sharp turnaround of the trade balance from the heartening surpluses of the past few quarters to a substantial deficit position. By 1975 the deficit on trade may be of the order of $7 billion. Real trade flows are not as seriously affected, though the resumption of oil shipments and the general slowdown of world markets will tend to reduce the real trade surplus.

The current economic situation for the United States poses some serious policy issues. Important policy alternatives have been precluded by decisions made in recent weeks. The rapid dismantling of the wage and price controls will have a perceptible impact on the pace of inflation over the course of the next few months. The lack of significant counter-inflationary policy was no doubt a major factor in the decision of the Federal Reserve Board to tighten monetary policy. But this tightening will maintain high interest rates and will hamper economic expansion. The real economic cost of stern one-sided policy measures can be very high.

Realistically, we must recognize that many of our economic problems stem from earlier miscalculations and from factors which were beyond our control. No manner of policy manipulation in 1974 can resolve many of these difficulties! But this is no excuse for simply throwing up our hands in despair!

Many of us are disenchanted with the operation of detailed price and wage controls. Yet this is not the time once again to establish "open season" for price increases, particularly since inflation is originating increasingly from the cost push side. There is ample basis for guidelines for wages and prices. The key to such proposals must be balance. Wage earners can be expected to limit their wage demands only so long as they can be sure that prices will not rise out of hand and that excessive profits are prevented. Continuation of the Cost of Living Council remains a high priority. The Council should have broad authority to establish equitable price and wage targets, to measure the pace of inflation, and to call the nation's attention to those price and wage decisions which are inflationary.

Moderate stimulus may be appropriate on the side of demand, particularly in housing and consumption where there is ample capacity. One proposal discussed in recent weeks has been a tax cut to offset the recent decline in consumer purchasing power. Personal income tax reduction, amounting to perhaps $6 billion, could be coupled with revision of the withholding schedules to eliminate some of the large overwithholding. An alternative run of the Wharton Model which incorporates these tax reductions shows that such action would provide a moderate stimulus to real economic activity when it is most needed in the second half of 1974 and early 1975. It would create only moderate additional inflationary pressure.

Finally, since the consumer and the small saver is least able to protect himself against inflation, we must move full-speed ahead to develop new means to protect consumer saving and income from the onslaught of inflation.

WHARTON MARK III QUARTERLY MODEL—MAY 1, 1974: PREMEETING CONTROL SOLUTION

TABLE 1.—SELECTED MAJOR ECONOMIC INDICATORS

Item	Lagged 1974.1	1974.2	1974.3	1974.4	1975.1	1975.2	1975.3	1975.4	Annual 1973	Annual 1974	Annual 1975
Gross national product	1,351.8	1,387.2	1,420.0	1,457.1	1,491.1	1,524.8	1,561.5	1,603.3	1,289.1	1,404.0	1,545.2
Percent change: Gross national product	4.4	10.9	9.8	10.9	9.7	9.3	10.0	11.1	11.6	8.9	10.0
Real gross national product	832.0	832.9	835.7	840.9	845.0	849.4	855.7	863.7	837.4	835.4	853.5
Percent change: Real gross national product	−5.8	.4	1.4	2.5	2.0	2.1	3.0	3.8	5.9	−.2	2.2
Implicit price deflator—GNP	1.6	1.7	1.7	1.7	1.8	1.8	1.8	1.9	1.5	1.7	1.8
Percent change: Implicit GNP deflator	10.8	10.4	8.3	8.1	7.5	7.1	6.8	7.1	5.4	9.2	7.7
Percent change real private output per manhour	−3.4	1.4	.5	1.3	.9	.9	1.5	1.6	3.0	−.7	1.1
Percent change private compensation per manhour	7.9	8.3	8.6	8.8	9.3	8.8	8.6	8.5	7.4	7.8	8.8
Unemployment rate (percent)	5.2	5.4	5.6	5.8	5.9	6.0	6.0	6.0	4.9	5.5	6.0
Capacity utilization: Manufacturing and mining	.9	.9	.9	.9	.9	.9	.9	.9	1.0	.9	.9
Personal savings rate (percent)	6.5	5.9	5.8	5.6	5.4	5.4	5.7	6.0	6.2	5.9	5.6
Percent change in money supply	5.8	6.0	6.0	6.3	6.2	6.2	6.3	6.4	7.4	5.6	6.2
4-6-month commercial paper rate	8.3	10.1	10.0	9.7	9.4	9.2	9.2	9.3	8.2	9.5	9.3
Moody's total corporate bond rate	8.2	8.5	8.7	8.8	8.8	8.8	8.8	8.8	7.8	8.5	8.8
Corporate profits before tax	138.5	148.5	145.2	144.9	145.6	146.4	149.8	155.3	126.3	144.3	149.3
Federal surplus, NIA basis	4.9	−9.0	−4.8	−5.7	−3.9	−3.4	−6.7	−7.0	−.9	−3.7	−5.2

Chairman HUMPHREY. Just very quickly before it slips my mind, your support for the continuation of the Cost of Living Council, of course, is what some of us felt very strongly about here. But, as was indicated by Senator Proxmire, both labor and business strongly opposed this, as they did standby controls.

The labor movement primarily opposed it because they felt that the Council and the actions of the administration were weighted against the wage-earner. They exercised considerable restraint in wage demands—I think that is a matter of public record—while prices were going up rather rapidly.

If you come down for the idea of an independent body, which, again, appeals to me, the only problem I have is who appoints them? And the fact of the matter is that it would have to be the President, but, of course, we could have it by confirmation. That would give us some safeguards. I say that respectfully, because I think the President intends to appoint people that basically agree with his philosophy, as any President does. This is not to be picking on this President per se.

But I would appreciate any further suggestions that you have on the independent type of monitoring agency. That is really what you are asking for, is it not?

Mr. ADAMS. That is right.

Chairman HUMPHREY. Is it possible for the Bureau of Labor Statistics to do this sort of thing?

Mr. ADAMS. Perhaps so. One of the reasons for my suggestion that it be an independent agency is the problem that such an agency has to pick and choose. It is not simply sufficient to monitor and publish statistics every month. It is really necessary to recognize that same wage or price increase may be way out of bounds, and to give it the appropriate publicity, and perhaps call it to the attention of the Congress, whereas other wage agreements fall into a normal or relatively noninflationary pattern.

I am afraid that an agency which is too closely tied to the Executive Office of the President is really not in a position to do this independently. That is why I did not say let the Council of Economic Advisers do it.

On the other hand, an agency that is too distinctly statistical, like the Bureau of Labor Statistics, again, is not in a position to raise these issues. So that presumably it would have to be an independent organism which, perhaps, might be appointed by the President, although perhaps with bipartisan membership, and perhaps with the approval of the Senate.

Chairman HUMPHREY. Yes; I surely tend to agree with you on the necessity of an independent body. I would ask your opinion of this.

Some of us have felt that in light of the dismantling of what you could call the anti-inflationary machinery, at least in part, that we maybe ought to set up sort of a special commission made up of public and private members to—well, to do more than just monitor the present economy, but to take a look down the road as to what policy proposals might be effective in bringing about a more healthy economy.

Senator Roth of Delaware made such a proposal. I listened to his presentation in the Senate. I thought it was very good.

Without putting you on the spot on that today, I would like to have us send to you some of the suggestions that were made in Senate debate. And would you be kind enough to give us your evaluation?

Mr. ADAMS. I would welcome that opportunity.

Chairman HUMPHREY. And any suggestions on it, because some of us are still interested in that. I just do not believe we can just go willy-nilly down the road and kind of pretend that just by leaving things to the forces of the marketplace that it is all going to work out just jolly well, simply for one reason, above all, the international conditions affect us so much. The market forces, domestically at least, are not answerable to these international conditions.

[The following information was subsequently supplied for the record:]

UNIVERSITY OF PENNSYLVANIA,
Philadelphia, Pa., May 31, 1974.

Senator HUBERT H. HUMPHREY,
Chairman, Subcommittee on Consumer Economics, Joint Economic Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR HUMPHREY: I am pleased to reply to you on the question of managing inflation.

We have only limited power to influence inflationary processes in any case. To the extent that inflation represents the interaction of supply and demand in freely operating markets direct action on prices is of no avail. Commodity inflation such as we have had recently is almost impossible to control. The best we can do is to stimulate supply or to limit demand.

On the other hand there is room to influence inflationary processes when we are working with industries which have market power or with labor unions. Surely we cannot and would not want to prevent normal price or wage adjustments. For that matter we would not want to limit one sector of the economy at a time when all others are making gains. We cannot expect labor to hold back its wage demands when profits are running very high. But, action may be appropriate, particularly in periods of cost-push inflation, and the threat of action may be surprisingly effective. I remember in the early years of the present Administration when the president of one of the major airlines came running to the Council of Economic Advisers saying that he wanted to resist the wage claim of the mechanics and hoped for the CEA to take some action to back him up. The CEA was then taking a position of non-intervention and the airline mechanics obtained the full wage increase they demanded.

Any price-wage agency needs to have two characteristics—balance and the power to act. By balance I mean sufficient independence from the executive and balanced representation or perhaps independence like the Federal Reserve Board. By power to act we need to give this agency if possible more than the power to impose sanctions and to do without prior Congressional approval. It should be a continuous agency with other duties as well. The problem is that the CEA is part of the executive office of the President and consequently entirely dependent on Presidential decisions and short term political considerations.

I would support what you have termed as the third proposal. A permanent agency, perhaps derived from the Cost of Living Council with greater independence, however, from the Executive. Almost inevitably appointment of its members would be by the President with confirmation by the Senate. Ideally the members of this Council would have terms which are fairly long and would thus be quasi independent of the administration in power. They might represent both parties. They would generally confine their activities to analysis and appraisal of wages and prices and related issues, such as productivity. They would set a broad standard for non inflationary wage and price policy and call the nation's attention to violations of these standards. Ideally the new Council would have stand-by authority to limit price and wage decisions but would use these powers only in exceptional situations.

Yours sincerely,

F. GERARD ADAMS,
Director, Economics Research Unit.

Chairman HUMPHREY. Now, Mr. Adams, I want to go over just a few high points of your findings.

Your projections on real economic output show essentially a recession in the first half of the year. Is that correct?

Mr. ADAMS. Yes; I think that by now most of us have learned not to worry too much about the terminology of the word "recession."

Chairman HUMPHREY. Yes; a slowdown.

Mr. ADAMS. In fact, the rate of growth has been substantially below 4–4.5 percent ever since sometime last year. Definitely, we would say that is distinctly an economic slowdown below the full potential of the economy.

Chairman HUMPHREY. And that is to be followed, according to your projection, by a low rate of growth of about 2 percent in the second half of the year, with an overall output for 1974 showing an actual decline.

Is that your analysis?

Mr. ADAMS. Yes; I would say the overall output for the year coming out very close to the zero mark in terms of the previous year.

Chairman HUMPHREY. Without getting into the semantics of it, or what we call a recession, the technical aspects of it, how would you characterize the economic performance relative to the Nation's historical trend?

Mr. ADAMS. Of course, it has been a terrible performance in a sense, partly as the result of the fuel crisis, in the sense of a slow economy with a fantastic inflation rate. We, of course, all had hoped that we would see a bounce back of the economy, and I think there is fairly general agreement that the economy will begin to recover. But the basic difference of opinion is whether this recovery will be rapid and will be simply a matter of turning off the oil faucet and then turning it on again, or whether this will be a fairly modest recovery with continued slack and continued buildup in unemployment. We come out clearly on the latter side.

Chairman HUMPHREY. Your analysis shows unemployment rising to 6 percent by the end of 1974?

Mr. ADAMS. By 1975, mid-1975.

Chairman HUMPHREY. By 1975. And staying at that level during 1975?

Mr. ADAMS. Yes. It is a bit early to predict what will happen in the end of 1975 and into 1976. Some of our evidence has been fairly optimistic on that, but that far in the future I would not put a great deal of faith.

Chairman HUMPHREY. Of course, the 6-percent level of unemployment brings with it not only economic repercussions but social problems, as you know. I think this is sometimes often forgotten in our discussions here, what happens to the lives of people, what happens to communities, because a 6–percent level sometimes means that some communities are way up with high rates and some industries with very high rates of unemployment.

People do not shift this quickly, as we sometimes indicate in these peripheral discussions that we have. They are trapped, so to speak, with their home, with their background, their skills, their family. Everything holds people at times to certain jobs and certain localities.

First of all, why are your unemployment forecasts higher and seem to be more prolonged at a higher rate than the Council of Economic Advisers? To what do you attribute this.

Mr. ADAMS. Well, I think the basic consideration is, clearly, that we have a less buoyant real economy. The economy simply does not resurge as quickly as the CEA's estimate.

Another side in all of these calculations is, of course, that the unemployment rate depends on employment on the one side, and it depends on the labor force participation on the other. The phenomenon that we have seen recently, which accounts for the minimal decline in the unemployment rate in the last couple of quarters, has been that the labor force simply has not grown the way it usually does.

To some extent this lack of growth of the labor force simply reflects the fact that when there are fewer jobs available, people withdraw from the labor force. That does not necessarily mean that they really would not rather have jobs. So in a sense it is a hidden unemployment, and certainly that has been one of the aspects of the picture we see now. It may well be that in the course of the coming year, these people will again want to find a job. And even if they do not join the labor force they will not be working.

Chairman HUMPHREY. The hidden unemployment factor is one that many of the Senators, you know, talk about. We are a little bit closer, may I say, to some of the economic realities of our respective areas.

Now, it is difficult for those of us that represent a particular geographic jurisdiction sometimes to have a feeling of the whole country. But I know that in our own State, for example, that in certain parts of the State we could get a much larger labor force available if they thought they had a chance to get a job.

Mr. ADAMS. That is right.

Chairman HUMPHREY. But the idea of having two or three members of a family searching for a job has now been cut back to, well, if we can have two at work, that is good, and one has really withdrawn from the labor force as such, but is there as a residual labor force if needed, but not listed as unemployed.

Mr. ADAMS. That is correct.

Chairman HUMPHREY. It is interesting how these unemployment statistics can really deceive one.

What actions do you think the Federal Government should undertake to reduce this increase in unemployment? I gather you think it ought to be reduced.

Mr. ADAMS. Well, from Wharton, of course, we have come out in favor of a moderate tax cut that would make some difference, not a very large difference. There is clearly room for an expansion of various kinds of Government employment programs, a view of Government employment in some sense as an employer of last resort. There is much possibility there, and in training program and various other what I would term microactivities that would focus on the problem of the pockets of unemployment where they are most severe, on the problems of the specific socioeconomic groups which are, of course, most affected by lack of demand for labor.

Chairman HUMPHREY. Well, I surely am one that believes that the Government ought to be the employer of last resort. We have talked about that a great deal. We have not done much about it. I have some old-fashioned ideas about this. I believe that rather than paying a man unemployment compensation, you ought to maybe double his pay and see that he has a job. We have got things to do in this country, a tremendous amount of things to do. Surely we ought to find constructive work for people. And I gather your proposals from Wharton have included that sort of seeking?

Mr. ADAMS. Yes.

Chairman HUMPHREY. Now, on this inflation business, Mr. Adams, I think your treatment of it is more sophisticated than you generally hear in Washington. There is a tendency here to explain these complex problems with increasingly simple proposals, and I think the administration has done a great disservice by brainwashing the city that our inflation has been caused primarily from execessive Federal spending. That is a kick they have been on for a long time. I do not think they have ever been able to justify it.

It is sort of kind of what I call political witchcraft. They just keep at it.

Turning to your actual forecast, do you see inflation increasing about 9 percent on an average, I guess, in 1974?

Mr. ADAMS. Yes; the price level in 1974 will average 9 percent higher than the price level for 1973.

Chairman HUMPHREY. And continuing to rise at an annual rate for about 7 percent in 1975?

Mr. ADAMS. That is right.

Chairman HUMPHREY. I want to say, first of all, I think it is going to be higher in 1974. I think you are a very generous man, very kind.

Mr. ADAMS. I would not dispute that particularly.

Chairman HUMPHREY. I think it is going to be higher. I think there is going to be a tremendous amount of price increases in the next several months as a result of the removal of the price control mechanism, the abandonment of the Cost of Living Council, and the reliance of the Government primarily upon the Federal Reserve System to save the whole situation. I am not critical of the Federal Reserve. I think we are just asking it to do too much. And I also believe that if we keep it up we are going to get people down on the banks again as we did once before in this country.

We need a banking structure in which we can have faith and trust. And because the Federal Government has relied almost entirely upon monetary policy as a means of abating inflation, you are going to have people just looking at bankers as though they are our number one enemy when it is not their fault.

Now, in your policy recommendations—well, I guess your proposal or your evaluation on inflation is more pessimistic than the Administration's, and also your forecast on price is slightly more pessimistic.

Mr. ADAMS. Yes.

Chairman HUMPHREY. How do you get these forecasts?

You know, you come here and you are a respected economist.

What is the system that you have?

Do you use the same figures the Government does?

Mr. ADAMS. No. I am not sure that our formal methodology is entirely different, but we obtain these calculations through a formal econometric model. I might stress that while we use a formal econometric model, there are substantial inputs, informational inputs, for instance on prospects of farm prices and import prices, which are outside this formal computerized mathematical structure.

Also, this is true to some extent of the determination of wages. But all of these elements feed into a simultaneous system, and the numbers that are derived essentially are what our structure tells us is consistent with the rest of the economy, with the level of pressures on the wages, with the prospective developments in the farm prices, with the import prices, which of course, particularly in the situation as at present with the high reaches in the oil prices, of course, something that was totally unpredictable——

Chairman HUMPHREY. And still is.

Mr. ADAMS. And still is, I think.

Chairman HUMPHREY. Still very much unpredictable.

Mr. ADAMS. Yes.

Chairman HUMPHREY. Would you say that the basic information with which you make your computations and your predictions is a broader mix than the Council has?

Mr. ADAMS. I am not sure that I can say that. I think they, too, take many things into consideration. It is a somewhat different methodology, and of course, judgmental inputs surely are different.

Chairman HUMPHREY. You mentioned their support for the Cost of Living Council continuity, and then if not that, the independent agencies.

What characteristics do you think, what are the essentials that you feel such an agency ought to have?

What kind of criteria should it have?

What should it be doing?

What should it be looking for?

Could you spell it out somewhat?

Mr. ADAMS. Well, to me, one of the essentials of such an agency is the ability to gain support, both on the side of labor and management. This is not an easy, this is not an easy thing. But it is quite clear that if you want to prevent the price-wage spiral from operating, then you must make it clear to labor that in the long run prices simply will not continue simply out of hand. And certainly, you cannot allow a situation where you have excess profits.

Now that, I think, really does mean a somewhat bipartisan commission, which I think would tend to set some sort of a broad guidelines for what is a sensible price and wage policy where both labor and management would have to give something, and then at the minimum, call the attention of Congress and of the public to those sectors or those parts of the economy which are significantly in violation.

Now, these guidelines, I am not optimistic that this will reduce the rate of inflation very quickly to nothing. But I think our experience suggests that in the past it has tended to moderate the growth of inflation and tended to moderate the wage-price spiral phenomenon.

Chairman HUMPHREY. Well, it is my feeling, you see, that while those of us in public life would like to please everybody, sometimes cannot. And I have had very strenuous arguments of late with supporters of mine, particularly in the labor movement, about the whole subject of anti-inflation policy. I do believe in wage-price guidelines, and I can understand labor's resistance to wage-price controls as they have been administered. I think the labor people really took a beating on this. I do not think there is any doubt about it.

But it is my judgment that we do need some mechanism, we have to have some structure. We cannot just rely on good will and good works to moderate the inflationary forces, and somewhere to blow the bugle on excessive increases, whatever it may be, wages or prices. We saw what happened in the building industry in 1970, 1971, was that?

I think right to the first year of the Nixon administration, tremendous increases in both prices and in wages, and it threw the whole economy out of balance. And I can remember talking to some of the prominent labor leaders who were just up in arms about it, because they themselves found their workers disenchanted and disgruntled because they did not get the same kind of treatment. And of course, it soon had its impact all through the whole economy.

Now, on the matter of the consumer spending outlook, and I have just got a few points here. One of the big unknowns for the rest of 1974 is what will consumers do in reaction to the increasingly tight squeeze they have been put into. In the last quarter, consumers had to draw down their savings in order to maintain their standards of living. This obviously cannot go on very long.

Could you give us any, or more details on how you see consumer behavior during the balance of 1974, given the rest of your economic outlook?

Mr. Adams. Well, as Mr. Stein pointed out, consumer income, of course, depends to a substantial extent to what happens to economic activity, employment and so on. Our view is a more sluggish one in this regard. We have a fairly high rate of wage increases, about 8.5 percent increase, annual increase in compensation per man-hour.

We also have price increases which at least over the first half of the year exceed the growth of wages, so the consumer is getting squeezed. In fact, we see here the consumer spending a good deal of this income with a relatively moderate savings rate. The savings rate in the first quarter of this year was about 6.5 percent, and despite the consumer's discontent and the low marks that he is giving on the consumer sentiment indexes—the Michigan survey, for example—we see that savings rate dropping to approximately 5.5 percent, from 6.5 percent to 5.5 percent.

So the consumer, while he does not like to spend more, in a sense he is forced to by the rise in prices and the decline in income.

Chairman Humphrey. Yes.

Mr. Adams. And nevertheless, this does not provide sufficient stimulus to the economy from the consumer side to keep it going. So a good deal of the problem arises precisely in this squeeze that the consumer has had with regard to his real income.

Our numbers do incorporate some improvement in the auto market, some that we have already seen. But on the other hand, it is quite clear that consumer purchases in real terms of durable goods will be very much held in check. We do see some growth of nondurable goods. We see more growth of services. The consumer, in a sense, is reallocating his expenditures.

Chairman HUMPHREY. Inflation figures and income figures are to me very deceiving in terms, again, of people, and what really goes on. Let me give you just a little example of what I mean.

When I leave this committeeroom and finish this day, I am going home to Minnesota. I am going to go out into the countryside where I live, and the people that live near me are low to middle income people. It is a very small town. There are no well-to-do people there. Most of them are farm people. Some of them are wage-earners that drive into the metropolitan area with their jobs.

When I tell them, for example, that, you know, I heard Mr. Stein or I heard Mr. Adams or somebody else talk to me about inflation, I say, you know, they tell me that prices are going to go up about an average of 9 percent, they just look at me and say, you know, you have been down there too long. You do not know what is going on. Now, do not give me that 9 percent stuff.

If you want to know what prices are doing, just come around, come over and talk to my wife. You ought to see what I had to pay to get my tractor fixed. You ought to know what I had to pay to get the house repaired, or to get the barn fixed. I mean, it is two worlds, it is two separate worlds. I began to think that—you know, did you ever wake up thinking you are in a dream all of the time?

And really, what I hear in Washington as to what is happening, where people are out in the factories, in the farms and the shops—it is like it is two separate globes. It really does not even fit.

I have sons and a daughter. They have young friends, and we have them out to our home. And I sit around talking like we are talking, and they just look at me and say, but daddy, you do not know anything that is going on. You do not buy shoes anymore, you know. And if you do, you have got enough money, you do not care. You do not have to worry about what the doctor bills are. You go out to the Naval Medical Hospital. You do not know what is going on.

You ought to hear it. And this is really why I think that sometimes the Government ought to almost disestablish itself, take a sabbatical leave for a while, and go on out and see what is going on.

Do you ever get that feeling, you know, when you are up there in Wharton, that somehow—of course, it may be you are living in another world, or is your world not the real one?

Mr. ADAMS. I do not know. Living on a professor's salary——

Chairman HUMPHREY. That is right. But well, what I guess I am getting at is, you see, so many people in America—I had a little note here from one of my staff people showing that the—what is the number of people—just a minute here.

Yes, over half of the houses built, for example, in 1973 cost over $30,000. And you are supposed to take that out of a quarter of an income under $16,000 to handle your house and your payments. And only 25 percent of our people throughout the entire country earn over $16,000 a year.

Well, inflation for people over $16,000 is one thing. Inflation for people under $16,000 is another ballgame, and when you stop and think that in my State, for example, a substantial majority of the people earn under $12,000 a year, a vast majority, and families with incomes under $12,000 a year, large numbers, how do they pay for these things that they need for their lives?

They just do not. They go into debt, and all of this rate of savings or anything relates to people who have something to save.

I guess what I am trying to say is, generalized figures have so little relevance to the individual predicament, to the human predicament. And I have come down to the point now where I began to wonder if we really are able to utilize our statistical evidence in a way that is really meaningful in the lives of a vast number of our people.

Do you get what I am trying to drive at, or am I just wandering around here?

Mr. ADAMS. Well, it is certainly true that in an inflationary period this kind of a problem, the differential impact on different people, is particularly pronounced. The man whose income is flexible and rises as the price level rises, he is obviously not affected.

Chairman HUMPHREY. That is right.

Mr. ADAMS. Whereas the man whose income is relatively speaking fixed, who falls behind, he is the one who gets squeezed. And I think one very important aspect of this whole inflationary, the impact of inflation on welfare, is this drastic reshuffling that occurs where certain people in perhaps the construction industry where wages have risen are keeping pace.

Chairman HUMPHREY. If they had a job.

Mr. ADAMS. If they have jobs; yes. And others are falling behind.

Chairman HUMPHREY. Well, you know, just simple things. Everybody out our way, they say that what we have in Minnesota is, we have beautiful lakes. We have lots of good farmland. We have good sized families. And everybody wants a car and a boat. You know, you really do not quite qualify for citizenship unless you have a boat. And when you get out there in the afternoon, Friday afternoon—I remember some years ago, you hardly saw anybody on the road with their boat before 5 p.m. Now, you come on out and they are starting leaving their job and going somewhere around 10 a.m. By noon time, the road is pretty filled. Everybody is going up north to the lakes with their boat.

Well, I was going to buy a boat just a while ago. I am going to buy it anyway because I am one of the lucky ones, you know. I am frank to admit it. But I asked the fellow I was going to buy the boat from up there, around Annandale, Minn., I said say, you know, I bought one from you back, what was it, 1967 or something like that. I said, now I want to buy a boat almost identical, because I want to give the one I have got to one of my boys.

And I said, how much is it? Well, I want to tell you, if I had had the income that some people have, and that $16,000 one, I would have hoped I would have walked on water, because that is the only way I would have ever been out there, because the cost of a boat has just gone up unbelievably, for simply recreation. I am not talking about cruisers, and I am not talking about yachts. Forget those people. I mean people who make rowboats. And this is what I mean about inflation.

I mean, for the average person that has to be concerned about just what his house rent or housing payments, food, clothing, health care, and a modest amount of recreation, they do not have 9-percent inflation. Those folks have got 15 percent to 20–25-percent inflation. They are really getting it, because it has all leveled off all the way. They are not buying all of this big stuff, you know. They are not interested in capital goods. They are interested in kids' shoes. I cannot believe what people pay for children's shoes. I cannot possibly believe it. When I see, for example, what they have to pay for children's clothes at the discount stores, I do not think anybody—I guess the only ones in Washington that know about this are younger Congressmen. My children are all grown up. I know about it because of grandchildren.

But again, my family is more fortunate than others, and I do not believe in judging the well-being of other people on how lucky the Humphrey's are. I have got some that are not so lucky. But I got my money when my kids were gone. I know what it meant when the time was that we did not have any money and I had the kids. The whole world is upside down. The time that you need a good house is when you are young and when you have children. When do you get a good house? When you are old and gone, and the kids are gone.

I have got houses coming out of my ears and I do not even have time to live in them. But when I had my kids, I did not have any space, and I did not have any help, and my wife had to bring them up and we did not have anybody helping us. It is all screwed up and I am mad about it.

I have to go to lunch pretty quick, they tell me. OK, but I want to ask you another question. I am glad you are a patient listener. I need to get this off my chest this morning. It is therapy. It saves me from going downtown to talk to a doctor.

Let us talk about this housing business for a while. I am really interested in what the administration will come up with in housing. So far, thank God we know how to build teepees. You have a rather dismal outlook or a limited outlook on the recovery of the housing sector.

Is that correct?

Mr. Adams. Yes. It is not all that dismal in the sense——

Chairman Humphrey. Maybe that is the word. Your outlook is less favorable than Mr. Stein's.

Mr. Adams. Yes, that is correct, in the sense that we have just a little short of 1.6 million housing starts in the year 1974.

Chairman Humphrey. That is what our study—that is the Congressional Research study and the Joint Economic Committee study. We put together some technicians here and that is what our study came out with.

Mr. Adams. We are not far from that number, and we do see it rising. We do see it rising by mid-1975. We have it up to between 1.8 and 1.9 million starts. Now——

Chairman Humphrey. Now, pace that against need. I mean, how does that approach what we ought to be doing?

Mr. ADAMS. Well, we could be doing very much better, in the sense that the estimate was 2.4–2.5 million starts.

Chairman HUMPHREY. Mr. Barnacle, who is on my staff, we have been looking at the MIT-Harvard study on this, and they said we needed 23 million new housing starts by the end of this decade. That is for the decade.

Mr. ADAMS. Right.

Chairman HUMPHREY. We are surely not going to come anywhere near it, are we?

Mr. ADAMS. No, no.

Chairman HUMPHREY. And of course, this takes into consideration obsolescence, deterioration of old homes, new family units, number of new family units. So we are really running behind, are we not, considerably?

Mr. ADAMS. Yes. Oh, yes.

Chairman HUMPHREY. If this was an industry failing to replenish its plant equipment, there would be a big uproar in the country. They would say American industry is becoming obsolete.

Is that not right?

Mr. ADAMS. Well, of course, you know there is a great deal of flexibility in housing. In a sense, it is important to build new units and hopefully to build larger ones to accommodate families. But people do very often make do in the old house, and people are increasingly making do in multiple family dwellings and apartments. And this certainly significantly affects lifestyle.

I do not think we can say we must have a certain number of housing units in order to be able to live. We can probably get along on less. We will have fewer young people moving out of the family household, more old people staying with their families, and people in generally more cramped situations. This is particularly serious in terms of inner-city housing, because the opportunities for inner-city people are opportunities that are created as the people on the periphery move outward or move upward into better housing. So that it significantly affects our lifestyle.

And this is, as I see it, the critical problem. If we were significantly short of resources in the housing sector, I would say this is the way it has to be. In fact, we have a relatively weak housing sector at a time, you know, when we could stimulate this sector without significant inflationary effects elsewhere in the economy.

Chairman HUMPHREY. In the same general committee, in this same room, 2 days ago we had the mayor of one of the large cities in California representing the U.S. Conference of Mayors. Mayor Minetta, I believe that was his name, from San Jose, Calif. And his testimony was most revealing as to what has happened in terms of Federal Government policies on housing, how they actually had worked counter to the improvement of the inner city, how the emphasis had been upon the moving out, rathe rthan the developing within. And it seems to me that this is again, when we talk housing as you are mentioning here—we sometimes can make do. That is a sure thing. We had to do that in the war years and it can be done.

But again, we are talking about an optimum, so-to-speak, relationship as to how you get not only more housing units for a better life, or at least more space, but also what happens to the development of a community, how it develops. And this, I think, is partly what is being ignored.

Now, the final thing I want to ask you is on the tax cut. I am pleased that you have seen fit to support the modest tax cut. Assuming that we just get a $6 billion tax cut, the staff indicates that your analysis shows a 0.5 percentage point increase in real GNP as a result, by the fourth quarter of 1974, and no significant impact on inflation.

Is that a proper analysis?

Mr. ADAMS. That is a proper analysis. Over the course of 1975 we still see some real growth, and we do see a marginal—I do not know whether it is significant—buildup of inflation a little bit toward the end of 1975. But we are talking here about 0.2 percent in the inflation rate, and I would be very unsure how significant a number that it. What we do see is—and I think the thing that is most important here is that over this soft period of the economy—we do see a perceptible improvement in real output.

Chairman HUMPHREY. Now, you know the complaint against this proposed tax cut is that it would be very inflationary.

Do you agree with?

Mr. ADAMS. No; I do not agree with that.

Chairman HUMPHREY. I am going to ask the staff if you would be kind enough to respond to us to present to you some of the proposals that we have indicated for an offset. I happen to be one that believes that if we have the tax cut, and I have supported it and so did the majority of this Joint Economic Committee. It is not as if somebody had just come up with the idea. We have held hearings all year on the economy, and an overwhelming majority of the Joint Economic Committee supported the tax cut.

But I also believe we ought to possibly have some offset in revenue just simply for budgetary purposes. Some of the suggestions that we made in our letter that we are circulating to our colleagues is the repeal of the so-called DISC proposal, the repeal of percentage depletion for oil. Now, that is arguable whether we should do it in one or several stages. The repeal of asset deprecation range, the ADR, and the strengthening of the minimum tax.

We are supposed to have 10 percent minimum tax, and I think that the real fact is it is about to come out at about 2.5 percent by the time that you got all of the exclusions that you could use for deducts.

So we will ask you, if you care to right now, do you think that these modifications in the tax structure would in any way impede investment?

That is No. 1, necessary investment.

And second, do you think that they would be both economically and socially desirable, or do you not?

I do not want to put words in your mouth.

Would you like to comment now, or would you prefer that we just send you a communication.

Mr. ADAMS. I think it would be preferable if I could put an answer in writing on that at some later date.

Chairman HUMPHREY. Fine. Thank you very, very much. I appreciate your being with us. You have been most helpful. Thank you.

I wish to include at this point in our record a letter to the editor on the subject of the tax cut, which I proposed, which was published in the Minneapolis Tribune.

[The article follows:]

[From the Minneapolis (Minn.) Tribune, Apr. 30, 1974]

INFLATION AND THE NEED FOR A TAX CUT

(By Senator Hubert H. Humphrey)

In recent days there has been considerable criticism, including an editorial (April 23) in the Minneapolis Tribune, of the proposal that we cut income taxes for low- and moderate-income consumers. I have proposed this course of action, as have others, as a means of buttressing consumer purchasing power and in that way fighting the recession that is already upon us. I believe the arguments against a tax cut are based on a serious misreading of the current economic situation.

In the first place, the federal budget current provides no real stimulus to the economy. As President Nixon correctly said in his budget message, "The recommended budget totals continue (the) policy of fiscal restraint as part of a continuing anti-inflation program."

To be more precise, the unified budget is becoming more restrictive, rising from a full-employment surplus of $4 billion in fiscal 1974 to an $8-billion surplus in fiscal 1975. This means the $6-billion tax cut now being discussed would lower the full-employment budget surplus for fiscal 1975 to about the level of restraint in last year's budget. Even without any revenue-gaining measures, a $6-billion tax cut would not push the budget into an expansionary position.

In addition to misreading the current fiscal position of the federal budget, several critics of a tax cut have not looked at the fine print of the proposals. The proposal I prefer, and intend to fight for, is a tax cut coupled with revenue-gaining tax reform along the lines recommended by the Joint Economic Committee earlier this year. This would mean a tax cut for low- and moderate-income consumers, largely offset by a package of tax reform focusing on percentage depletion, intangible drilling expenses, foreign tax preferences and and strengthening of the minimum income tax.

With major oil companies reporting first-quarter profit increases as high as 123 percent, while the real spendable earnings of consumers declined 3 percent during the same quarter, tax reform is essential to restoring consumer confidence in the fundamental fairness of our economic system.

Second, those who oppose a tax cut usually misunderstand the nature of the present inflation. Rather than being the result of excessive federal stimulus, the pressure on prices has come from other sources. The inflation of 1973 was primarily the result of food and fuel-supply problems that had their origin in specific policy errors and market disruptions.

A secondary source of inflation was the world-wide boom in commodity prices. These previous price increases are this year working their way through the production cycle as well as stimulating a sharp rise in labor costs. And inflation this year will get a further jolt as business and labor seek to get "ahead" of inflation after all formal controls end this week.

In other words, inflation in 1974 has a life of its own outside of the conventional macro-economic framework. It is now nourished by a variety of cost factors that unfortunately were injected into the system last year, and which now lie beyond the impact and grasp of ordinary fiscal policy.

I would take this point even further, arguing that those who believe that the current inflation is the result of excessive fiscal stimulus, or that it can be dealt with by conventional policies of aggregate restraint, do real harm to the formulation of an effective anti-inflationary policy.

While I don't pretend to have a neat package of solutions to the problem of inflation, it is obvious to me that we need to develop new techniques in this battle to complement our present economic tools. It is my judgment that the federal government must establish a permanent institution to focus on the problem of inflation. In addition to developing an information system that identifies price problems before they become crises, such an institution should have the power to hold hearings, postpone public and private decisions that could seriously undermine price stability, make recommendations to the executive and Congress to improve price stability and have limited power to impose legal sanctions.

Just as they have misread the nature of the current inflation, many of those who oppose a tax cut also fail to read the unmistakable signs of the serious recession that is upon us. The huge drop in real gross national product in the first quarter is, after all, the worst decline in economic output since 1958, and much worse than the administration's February forecast that the economy would probably only decline a little in the first quarter. More important, the recent statistics do not reveal any sectors of the economy with sufficient strength to bring about recovery.

Consumption spending has been weak for the last six months and cannot be expected to lead any recovery.

Residential construction expenditures in the first quarter dropped 8 percent and have fallen 16 percent in the last six months. In view of the recent sharp rise in interest rates, and the incredible announcement by Federal Reserve Board Chairman Arthur Burns that money will stay tight no matter what it does to housing, there is currently no hope that homebuilding will experience the turnaround forecast by the administration earlier this year.

Business spending on plant and equipment, which has always been offered as the backbone of a recovery in the second half of 1974, only increased at a 7-percent annual rate in the first quarter.

Finally, net exports declined $8.3 billion in the first quarter of this year, compared to an increase of $5.2 billion in the fourth quarter.

Because the current inflation is not significantly due to excessive budget stimulus, and because the recession is upon us with no signs of recovery, it seems to me that the case for a tax cut is made. This conclusion is not reached, as some commentators have inferred, because I regard unemployment as more serious than inflation. On the contrary, I regard both inflation and unemployment as harmful to the economic and social fabric. But it is my belief that a modest tax cut, coupled with tax reform, will not increase inflation, but will express itself in higher output, jobs and income.

Chairman HUMPHREY. Thank you, Mr. Adams.

The subcommittee will stand adjourned.

[Whereupon, at 12:35 p.m., the subcommittee adjourned, subject to the call of the Chair.]

O