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THE 1973 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS BEFORE THE JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES NINETY-THIRD CONGRESS FIRST SESSION

PART 1

FEBRUARY 6, 7, 8, AND 12, 1973

Printed for the use of the Joint Economic Committee



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1973

93-142

For sale by the Superintendent of Documents
U.S. Government Printing Office, Washington, D.C. 20402
Price \$1.85 domestic postpaid or \$1.50 GPO Bookstore
Stock Number 5270-01816

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CONTENTS

WITNESSES AND STATEMENTS

TUESDAY, FEBRUARY 6, 1973

Patman, Hon. Wright, chairman of the Joint Economic Committee: Opening statement.....	Page 1
Proxmire, Hon. William, vice chairman of the Joint Economic Committee: Opening statement.....	2
Widnall, Hon. William B., member of the Joint Economic Committee: Opening statement.....	4
Stein, Hon. Herbert, Chairman, Council of Economic Advisers, accompanied by Ezra Solomon, member; and Marina Whitman, member.....	5

WEDNESDAY, FEBRUARY 7, 1973

Patman, Hon. Wright, chairman of the Joint Economic Committee: Opening statement.....	29
Shultz, Hon. George P., Secretary of the Treasury, accompanied by Paul A. Volcker, Under Secretary for Monetary Affairs; and John T. Dunlop, Director, Cost of Living Council.....	31

THURSDAY, FEBRUARY 8, 1973

Patman, Hon. Wright, chairman of the Joint Economic Committee: Opening statement.....	67
Ash, Hon. Roy L., Director, Office of Management and Budget, accompanied by Samuel M. Cohn, Assistant Director; William A. Morrill, Assistant Director; Jack Carlson, Assistant to the Director for Planning and Economic Affairs; and Paul H. O'Neill, Assistant Director.....	70

MONDAY, FEBRUARY 12, 1973

Patman, Hon. Wright, chairman of the Joint Economic Committee: Opening statement.....	215
Stein, Hon. Herbert, Chairman, Council of Economic Advisers, accompanied by Ezra Solomon, member; and Marina Whitman, member.....	216

SUBMISSIONS FOR THE RECORD

THURSDAY, FEBRUARY 8, 1973

Ash, Hon. Roy L., et al.: Tables: Summary of congressional action on President's budget proposals.....	70
Distribution of budget outlays by purpose, fiscal years 1969 and 1974.....	74
Response to Representative Moorhead's request to supply for the record a breakdown of what defense procurement programs were affected by the impoundment.....	102
Response to Representative Reuss' request to supply a chart on foreign and international holdings of public debt securities as a percent of GNP.....	115
Response to Senator Humphrey's and Senator Proxmire's request to supply for the record program reductions and terminations from the budget.....	124

IV

	Page
Ash, Hon. Roy L.—Continued	
Response to Senator Proxmire's query regarding the S-3A program	187
Response to Senator Proxmire's request to supply corrections and and comments regarding the committee's chart entitled "Budget Trends"-----	193
Response to Senator Proxmire's request to supply for the record Federal outlays for benefits to low-income persons for fiscal years 1972, 1973, and 1974-----	198
Response to Senator Proxmire's request to supply for the record the criteria for future reductions or eliminations of funds for Federal programs-----	202
Response to Senator Humphrey's query regarding the amount of money in the budget for South Vietnam for service-funded mili- tary assistance-----	205
Patman, Hon. Wright:	
Tables:	
Totals of regular annual supplemental, and deficiency appropria- tion bills, as enacted, and comparison with estimates considered, 83d through 92d Congresses-----	69
Interest rates-----	69
Money market rates-----	69
Proxmire, Hon. William:	
Letter to Hon. Caspar Weinberger, Deputy Director, Office of Management and Budget, dated September 5, 1972, regarding a special analysis on cash subsidies and a special analysis covering tax subsidies and/or expenditures-----	99
Reuss, Hon. Henry S.:	
"The Rich Get Richer," speech from the Congressional Record, January 23, 1973-----	116

MONDAY, FEBRUARY 12, 1973

Patman, Hon. Wright:	
Letter to Hon. Herbert Stein, Chairman, Council of Economic Advisers, from Chairman Patman, dated February 21, 1973, requesting the Council to supply for the record estimates of receipts and expenditures on a national income account basis by half years, both actual and full employment, for fiscal years 1973 and 1974; and also enclosing written questions of committee members-----	266
Stein, Hon. Herbert, et al.:	
Supplement to Marina Whitman's statement in response to questions of Representative Widnall-----	229
Response to Senator Proxmire's request to supply for the record the interest rates charged on selected types of bank loans-----	243
Supplement of Hon. Herbert Stein in response to questions of Repre- sentative Brown-----	250
Response to Representative Brown's request to supply for the record comments on how to determine effectively what a full employment rate is-----	252
Clarification of colloquy with Senator Proxmire regarding the funding of the National Commission on Productivity-----	262
Letter to Chairman Patman, dated March 16, 1973, enclosing the Council of Economic Advisers' estimates of actual and full-employ- ment receipts and expenditures on a national income account basis by half years for fiscal 1973 and 1974-----	266
Response of Hon. Herbert Stein to additional written questions posed by Committee members-----	267

THE 1973 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 6, 1973

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

The committee met, pursuant to notice, at 10:10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman, Reuss, Griffiths, Moorhead, Carey, Widnall, Brown, and Blackburn; and Senators Proxmire, Humphrey, and Bentsen.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Michael J. Runde, administrative assistant; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Khumbhaar, Jr., minority counsel; Walter B. Laessig, minority counsel; and Leslie J. Bander, minority economist.

OPENING STATEMENT OF CHAIRMAN PATMAN

Chairman PATMAN. The committee will please come to order.

This morning the Joint Economic Committee begins its annual hearings on the President's economic program. As you know, it is the duty of this committee, after considering the program, to advise the Congress as to every one of its recommendations.

I note that the administration has praised itself considerably for the improved situation in our economy. I must say, however, that I cannot share this optimism nor can any of my colleagues. Our economy is troubled by a number of serious problems:

First, unemployment is still much too high. The objectives of the Employment Act are not being served when there are 4 million people out of work in this country.

Second, high interest rates, directly connected as they are with unemployment and poverty, are being permitted to go still higher despite the fact that the President has the authority to roll back the cost of money to a reasonable level.

Third, the wage-price program, weak as it was, had been much further weakened by recent administration action so that the danger of inflation is facing the country.

Fourth, the heartless budget policies of the Nixon administration are destroying the social programs that were built up through hard work over many years.

Fifth, our tax system is riddled with loopholes that benefit the rich at the expense of the moderate and lower income people.

Sixth, the national debt could be instantly reduced by \$70 billion and interest totaling \$4 billion a year could be eliminated if the paid up Federal bonds held by the Federal Reserve were canceled, as they should be. The Federal Reserve in turn would then be financed through the appropriation process and thus made to answer to the people of the Nation.

Finally, the administration is conducting a charade when it purports to hold itself out as the guardian of fiscal responsibility. The fact of the matter is that Congress, more than the administration, has fulfilled this role. Congress has cut the Nixon administration budget every year it has been in existence. It has cut some \$20 billion from the budgets of every President for the past 26 years.

We will be exploring these problems and many others in the days ahead. I can think of no more important goal for this Congress than to press for improvement in our economy, reduction in employment, and a fair break for the little fellow.

On behalf of the committee I wish to welcome Chairman Herbert Stein and his fellow members of the Council of Economic Advisers, Ezra Solomon and Marina Whitman. It is a pleasure to see you here. You may begin your testimony as you see fit, Mr. Stein, but first Senator Proxmire wanted to be heard briefly, and Senator Proxmire is recognized for that purpose.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Thank you.

One line is italicized by the President in his economic report. It is this: "Only by holding the line on Federal spending will we be able to reduce the inflation rate further in 1973."

Now, I think that the statement is correct. It makes good common-sense and good economic sense. It is right. I'm delighted the President underlined or italicized it.

But in doing so the President has succeeded in getting away with one of the boldest and most deceptive "snow jobs" this country has seen in a long time.

The President's statement has been zoomed into every home in America with one clear message. That message is this: President Nixon proposes to hold the line against increased spending.

The American people now believe that.

But is it true?

Is it true?

Is the President proposing to hold the line on spending?

The answer is "No." President Nixon is proposing one of the biggest increases in spending in the coming fiscal year in the history of this country.

Rarely has any President ever proposed such a whopping increase as has President Nixon for this coming year except when we have been facing a huge wartime buildup.

It is a pathetic reflection on what has happened to our sense of thrift and prudence that Members of the Congress and the press should accept the myth of an embattled President fighting to hold down spending when he proposed to increase spending by a fat \$22 billion over his request last year—for the current fiscal year.

His request is about \$19 billion over the amount we will spend this year—\$19 billion—that's a 7½-percent increase in 1 year. If we attain your 2½ percent inflation rate by December of this year and average 2½ percent in fiscal 1974 that will represent an increase in real Federal spending of 5 percent.

In a year of boom and expansion that is hardly restraining. In my view it is too much. It is inflationary.

To me Congress is worse in some respects. We may or may not come up with a lower ceiling. I will fight for one but the performance in the past week of passing a vetoed extravagant public works bill and adding \$120 million for a vetoed airport bill. I don't know.

The President's program is inflationary. Congress may be worse—press and public may figure that in the world of the blind the one-eyed man is king—this is not good enough. Look at the disarray of our anti-inflation fight.

1. Virtually all economic forecasts exceed the CEA's estimate of inflation in 1973 and indicate inflation will be worse and not better than last year.

2. The stock market has nosedived in spite of peace with the persistent explanation that investors don't believe phase 3 will do the job and fear that the President and the Congress will not sufficiently restrain Federal spending.

3. The dollar is sinking rapidly in foreign countries. It is now weaker than it has been in many years. Just today a massive selling wave hit the dollar.

4. The latest wholesale price increases have been the greatest in 20 years and foretell sharp increases in consumer prices in coming months.

5. Earliest indications on the wage bargaining front indicate a drive for big and expensive fringe increases as well as wage increases that seem likely to shatter the 5½ percent guideline.

6. Phase 3 is a feeble, ineffective program. It is softer than phase 2 which did little to restrain inflation in the following ways:

(a) The profit margin test has been weakened in that it will permit bigger price increases in a series of industries.

(b) No advance approval of wage or price increases will be required and any action by the Cost of Living Council will not require a refund of prices of guidelines so that there is no incentive for business to hold the line.

(c) The already weak and inadequate enforcement staff which was incapable of doing an adequate job in phase 2 has been cut in half.

7. Whether the President wins or loses on the spending front, another huge increase in Federal spending and another fat deficit is sure.

8. Last year marked a big and steady increase in the money supply at an inflationary 8.3 percent rate and a preliminary estimate of a whopping 13 percent increase in the money supply in December. In view of the lags involved between increases in the money supply and ensuing economic stimulation and price rises should spell increasing inflation trouble for 1973.

9. The administration is refusing to propose any kind of fiscal restraint through taxation. All the stimulating tax measures that made sense in a depressed 1970 are still at work—going full blast and

inflating the economy at a time when spending is leaping by at least 7½ percent and the money supply increase is breaking all records.

10. There are no significant structural reforms recommended to do anything significant in the long run about inflation. A rhetorical bone is thrown to productivity but no staff is provided, no plan, no program. Nothing that would measure up to the urging of this committee and the Chairman of the Federal Reserve Board. The deplorable economic prejudice against women is documented—and well documented in the report, but not a word of recommendation as to how we can better use this neglected source of manpower—the same source of neglect applies to the appalling continued high unemployment of blacks.

This is so, Mr. Chairman, I hope that these hearings will give us some hard answers and some solid input to improve this weak and ineffective economic program.

Chairman PATMAN. Thank you, sir.

I wonder if the ranking minority member, Mr. Widnall, would like to make a comment?

OPENING STATEMENT OF REPRESENTATIVE WIDNALL

Representative WIDNALL. Thank you, Mr. Chairman.

Briefly I would like to say that I hope that at these hearings we are going to get the facts because we are going to hear pointedly from our witnesses, and that we are not going to be indulging in a lot of political rhetoric because the conditions are such for our country that we desperately need to do something urgently to hold things in check.

I would like to just make this comment.

Yesterday the chairman announced that he would introduce legislation providing an automatic trigger for the reimposition of mandatory wage and price controls. According to the press, the legislation would require the President to reimpose mandatory wage and price controls whenever the Consumer Price Index rose to an annual rate of 3 percent or more in any 3-month period, or whenever the rate of inflation was higher than 2½ percent for any 12-month period. If such legislation became law at this time, I ask would it not immediately require the reimposition of mandatory wage and price controls.

In other words, the chairman's proposal is merely an indirect, roundabout way of saying that the Congress directs the President to immediately reimpose mandatory wage and price controls.

Although I've not seen the chairman's proposal, the news account said nothing about a trigger requiring the lifting of controls. Why just have a one-way street? If we are going to have a trigger into controls, don't you think we should have a trigger out of mandatory controls if we were to adopt such a proposal?

Chairman PATMAN. Mr. Stein, you may proceed, sir, in your own way.

**STATEMENT OF HON. HERBERT STEIN, CHAIRMAN, COUNCIL OF
ECONOMIC ADVISERS, ACCOMPANIED BY EZRA SOLOMON, MEM-
BER, AND MARINA WHITMAN, MEMBER**

Mr. STEIN. Thank you, Mr. Chairman. On behalf of my colleagues and myself I would like to welcome you back to the chairmanship of this committee, not that the vice chairman and I have not had some entertaining times in the last 2 years, but we think it is desirable this pleasure should be circulated. Also I would like to thank the vice chairman for repeating his support for our efforts to hold down government spending.

We are pleased to appear once more before the Joint Economic Committee to give our views on the state and prospect of the American economy. It is less than a week since we published our Economic Report, which you have all had, and we shall not therefore go into great length in these opening remarks. We shall, however, summarize the main points made in our report.

If there is one theme that runs through the report it is the theme of balance. In a sense this is the theme of all economics; that is, the economic problem is to achieve balance among conflicting objectives. But it seems at this present moment that the call for balance is particularly conspicuous because our economic situation is not now dominated by one overwhelming need which requires, at least temporarily, the subordination of other interests.

As we look at 1973, we see the problem of balancing rapid expansion which would most promptly reduce the rate of unemployment with the need for steadiness in growth which will help us to achieve continued reduction in the rate of inflation and a more sustainable prosperity for many years in the future. Similarly we see the need to achieve balance in the reliance on overall measures, such as budget policy, and in the reliance on more direct control of prices and wages. Within the price and wage control system we have the need for an effective balance between the degree of voluntarism and the degree to which the system is mandatory, in order to achieve the best possible combination of the effect on the overall behavior of prices with the productivity, efficiency and freedom of the economic system. Also as we look at our budget, we see the need to balance the generally shared desire to provide more adequately for the needs of the people through the budget with the also widely shared desire of the people who earn incomes in this country to retain the income for use in the manner of their own choosing rather than pay it out in taxes.

As we look at our external economic relations, of course, the need for balance is quite obvious in the very literal sense of achieving a better balance between our payments abroad and our receipts from abroad. But also in a more subtle sense we have problems of balancing the interests of producers on the one hand and consumers on the other in our international economic dealings, and of balancing our need to effect improvement in our international financial position with a desire to achieve a more efficient and liberal world trade system.

Now none of these balances is easy to achieve. We come forward with a set of recommendations which reflect the sincere efforts of this administration, including this Council, to achieve the balances that are best from the standpoint of our long-run national interests. However, we do not approach these problems with any pride of divine revelation about our answers, and as always we welcome the suggestions from this committee.

It is helpful to start our discussion of future policy with a look at what has happened in the American economy in the last year or so. Certainly 1972 was a year of great progress toward the goals of the Employment Act—that is, toward maximum employment, production and purchasing power. Between 1971 and 1972 total civilian employment increased by about 2.3 million, which is the largest year-to-year increase in 25 years. The most recent unemployment figures, which relate to the second week of January, showed an unemployment rate of 5 percent.

Our forecast that we would end 1972 with the unemployment rate in the neighborhood of 5 percent turned out to be correct. This is a gratifying decline from the 6.0 percent unemployment rate which prevailed at the end of 1971. The rise in employment and the decline in unemployment, of course, reflect the very large increase in total output that occurred during the year. Between 1971 and 1972 real GNP increased by 6½ percent, which was somewhat larger than we had forecast, and from the end of 1971 to the end of 1972 the increase was 7.7 percent, one of the largest increases of the postwar period. Other measures of economic activity such as the index of industrial production also showed outstanding gains.

As we show in our report, the rise in real output which occurred during this recovery, which includes 1972, was greater than in any of the previous recoveries of the postwar period and the rise of civilian employment also was exceptionally great. It is also interesting to note that we have had a decline of interest rates during the 2 years of this recovery, which is contrary to the usual recovery experience.

The strong expansion of the economy during 1972 was supported by increases in almost all sectors of demand. Business investment in plant and equipment increased by about 14 percent over the preceding year. New housing increased sharply to an all-time record of almost 2.4 million starts. We began to get some increase of inventories as sales increased. And consumer expenditures were very strong.

The expansion was also assisted by a stimulative fiscal policy. A year ago we had said that it was our objective to increase expenditures rapidly on the early part of the year and then to slow them down in order to keep the economy from rising too fast and to keep the budget from getting on to an inflationary path. While the Federal budget in calendar 1972 did not follow in every respect the course that had been laid out for it at the beginning of the year, nevertheless it was generally quite expansionary early and this contributed to the strength of the economy in 1972. Monetary policy also was conducive to the strong rise of the economy.

Alongside the expansion in output and employment we did get in 1972 a significant slowing down in the rate of inflation. This is clearest, of course, in the nonfood sectors of the economy. Food prices were a continuing problem through 1972 as they still are. However, the rate

of inflation, as measured by the GNP deflator, from 1971 to 1972 was only about 3 percent, compared with about 5½ percent in 1970. As measured by the Consumer Price Index, the rate of inflation in the latter part of 1972 was also 3 percent, compared with a little over 6 percent during 1969, and 3.8 percent in the early part of 1971 before price control was introduced. The reduction in the rate of price increase reflected in considerable measure a reduction in the rate of increase of money wages accompanied by a very sharp increase in productivity. Although the rate of increase of money wages slowed down somewhat the rate of increase of real wages accelerated in 1972 and was at one of its highest levels of the postwar period.

The question naturally arises whether and how much the price and wage control system of phase 1 and phase 2 contributed to the abatement of inflation. Our view is that the control system did make a valuable contribution. The rate of inflation had been declining before the controls were adopted and we believe that the rate of inflation would have continued to decline even in the absence of controls. However, we believe that the degree of slowdown in the inflation rate was enhanced by the operation of the controls, the risk of an acceleration was greatly reduced, and, perhaps most important, that the controls made a valuable contribution to confidence in the progress that would be made toward checking inflation. This confidence in turn set the stage for further reductions in the rate of inflation and at the same time was an important factor in bringing about the expansion of the economy that we had during 1972. It seemed to be a fact that in 1971, despite the progress that had been made to reduce inflation, the degree of anxiety about the prospect of prices was so great as to inhibit both private behavior and public policy that would have brought about a more rapid expansion. Paradoxically, the main contribution of the control system may have been to the expansion rather than to the slowdown of the inflation rate, although the expansion in turn probably contributed to reducing inflation.

Also, in appraising the performance of phase 2 we came to the conclusion that the system had had very few of the costs that many had feared it would produce. There was no great wave of strikes against the system, the effects on productivity and investment were probably rather small, and the system generated no major distortions or inequities. Nevertheless, as we observed the system and the reaction to it, it did seem to us that problems were building up which would call for a change. The kind of tolerance of rough and ready procedures which we had enjoyed during 1971 and 1972 seemed to be fading away. There would be more redtape, more litigation, more demands for formal and time-consuming procedures. There would be more firms running up against their profit margin limits and encountering situations in which they had very little incentive to increase productivity. There would be more cases, as the economy approached its potential, in which the maintenance of rigid ceilings would cause shortages of either goods or labor. Therefore, although we were greatly pleased at the extent to which the possible adverse consequences of price and wage controls had been avoided during 1972, we did believe that circumstances were developing in which a change in the nature of the program would be required. We did not think that the prospect for inflation and the fear of inflation had been so firmly

subdued that we could yet afford to remove the controls, however devoted we might be to finally living without them.

It was against this background that the economic policy problems for 1973 were faced. The economy was rising strongly and was much closer to its potential than a year earlier. On the whole the prospective forces for expansion in the private economy seemed more powerful than in 1972. The danger of inflation was diminished but still very much alive. The controls system was serving a useful purpose but required modification.

The situation called for major policy efforts in three fields:

First, a fiscal and monetary policy that, when imposed on the strong expansive forces in the private sector, would yield an overall rate of economic advance that would not defeat the price-stability objective.

Second, a general, direct price and wage restraint program—namely, phase 3—which would not excessively or unnecessarily interfere with efficient and equitable economic performance.

Third, steps to hold down the rise of food prices, both because food prices are themselves important and because they may have an especially great effect on the rate of wage increases.

With respect to the first and most important of these efforts, it would, of course, be arrogant to say that one is sure precisely what the optimum rate of economic expansion in 1973 is. Still, there seems a great deal of commonsense in the idea that an expansion which reduces unemployment to about 4½ percent at the end of 1973 represents about the maximum safe speed. At least, a faster expansion than that in the mid-1960's had been accompanied by an outbreak of inflation, and we were not then as inflation-sensitive as we are now.

An expansion of this pace, coupled with some further decline of inflation, would call for a slower rise of GNP—in money terms—during 1973 than during 1972. In our judgment we would want an increase of about 9 percent in the GNP from the end of 1972 to the end of 1973, compared with the actual increase of 11 percent during 1972. To get this moderate slowdown in the increase of money GNP, while private expansionary forces are stronger, requires a change of fiscal and monetary policy. Fiscal policy should move somewhat in the direction of restraint and the rate of expansion of money and credit should be somewhat reduced. If this is not achieved, we fear that inflation will speed up again, despite the retention of price and wage controls.

It is because of the importance of avoiding a revival of excess demand that the President's recommendations on the budget are the keystone of 1973 economic policy. These recommendations would restore the unified budget to a position in which full-employment receipts would cover full-employment expenditures. The rate of spending would be rising steadily, by about \$19 billion a year. The main achievement of the President's budget is to keep these increases from being much larger, as they would be if a resolute decision had not been made to hold spending down.

The administration has announced a revised price-wage control system which is, in our opinion, well adapted to the requirements of 1973. The new system reduces the burden of prenotification and recordkeeping. It revises the standards to create more incentive for raising productivity. But still it sets forth precise standards for wage and price behavior consistent with the goal of a lower rate of inflation,

and it maintains the ability of the Government to compel compliance where voluntary behavior would be inconsistent with that goal. As happened when phase 1 and phase 2 were announced there is a good deal of complaining that the system is unclear and inadequate. We think this will be found to be untrue of phase 3 as it was of the earlier phases.

The administration has taken strong measures to increase the supply of food and therefore to restrain the rise of food prices. Some of these are described in our report. Others have been taken even since the report came out. We believe, on the basis of what has now been done, that food prices at the farm will be no higher in December 1973 than they were in December 1972.

This combination of measures will, in our opinion, bring us out to the end of 1973 with the rate of inflation at $2\frac{1}{2}$ percent or less and with the unemployment rate in the neighborhood of $4\frac{1}{2}$ percent. Moreover, we will be in a situation where with continued sound policy we can have a prolonged period of growth, high employment, and reasonable price stability.

In the international economy, despite the progress that has been made in certain respects, major problems remain. Our balance of payments on the official settlement basis improved from a deficit of about \$30 billion in 1971 to a deficit rate of about \$10 billion in 1972, although the remaining deficit was large. Between the 2 years our balance of trade worsened substantially, although we believe for transitory reasons, and there were some slight signs of improvement during the year. We look forward to further improvement in both accounts as the year advances, as a result of the effect still to come of earlier exchange rate realignment and the relatively good U.S. price performance. Nevertheless it cannot be denied that the slowness of the U.S. improvement is a source of anxiety, at home and abroad.

Our recent and continuing experience emphasizes the importance of reform of the international monetary system to improve the process of achieving and maintaining international equilibrium. The United States made a major contribution to reaching such reform by submitting a fundamental proposal in September, which is not the subject of international discussion. We are hopeful that progress will be made in this field as rapidly as its complexity permits. We also believe that changes in the rules governing international trade are necessary to permit the United States to pay for its growing imports by exporting the things it produces most efficiently.

The Economic Report this year contains, for the first time, a chapter on the economic role of women. The chapter is essentially factual and descriptive and is not easily summarized, except to say that it is evidence that the national goals of maximum employment, production, and purchasing power will not be achieved without more attention to the female half of the population. We expect to continue work in this field and hope that future councils will have more to contribute both to understanding of the problems and to policies for dealing with them.

Thank you.

Chairman PATMAN. Thank you, Mr. Stein.

We will be under the 5-minute rule. I will take 5 minutes and yield to the ranking minority member and then to Senator Proxmire. We will go around that way and after the 5-minute rule we will have plenty of time.

Mr. Stein, I would like to ask you a question about the \$70 billion that the Federal Reserve open market committee holds in government bonds that are paying no interest in the New York City Federal Reserve Bank: these bonds were acquired, as you know, by the payment of government money, what some people call printing press money. It is good money. It is put out by the Bureau of Engraving and Printing. It is legal tender for all debts. I don't believe you could have better money than that. So the Open Market Committee of the Federal Reserve has traded \$70 billion of our money for \$70 billion of their bonds and now the bonds are paid. Mr. William McChesney Martin, former Chairman of the Federal Reserve Board, in answer to my question said they had been paid for once.

Another official of the Federal Reserve has indicated and testified to the same thing.

Now, then, why should we compel taxpayers to pay \$4 billion a year on bonds that have been paid for once and they are 200 percent inflationary because when you buy the bonds and then do not cancel them you have not only the bonds outstanding but the \$70 billion in money, too. So that is doubly inflationary.

Don't you think that those bonds should be canceled and the national debt reduced by \$70 billion as the first step that we should make? What do you think about that, Mr. Stein?

Mr. STEIN. Well, Mr. Chairman, I think that the cancellation of that debt would be a bookkeeping transaction without any practical significance.

Chairman PATMAN. It would reduce the national debt.

Mr. STEIN. It would reduce the statistics we show in the report but it would not affect the debt which is held by the public. The fact is that the interest earned on that debt, of course, is interest received by the Federal Reserve and inasfar as it exceeds the necessary expenses of carrying on the business of the Federal Reserve is returned to the Treasury, so there is no net cost to the Treasury.

Chairman PATMAN. Well, now, this is only part of it, Mr. Stein. The Federal Reserve could buy \$100 billion. It could buy the entire national debt, according to the policies it has in effect right now. It could buy the entire national debt and then the people would have to be working to pay the interest on that debt.

Mr. STEIN. Well, if they bought the entire national debt then this interest on the debt would be returned to the Treasury, but in any case I won't want to assume the Federal Reserve is going to go mad. The Federal Reserve buys debt in process of adding reserves to the banking system as they think is necessary for the purpose of maintaining an adequate rate of growth in the money supply, and, of course, they operate subject to the review of the Congress. I think it is essential that the Federal Reserve should have some salable assets because the way in which it can reduce the reserves outstanding, if it desires to do so, if monetary policy requires them to reduce the reserves outstanding, is to sell some asset and if it doesn't hold any interest-bearing asset it won't be able to mop up reserves.

Chairman PATMAN. Well, about reserves, in effect the banks get those bonds free because they get a change of reserve requirements that enables them to buy them without further cost.

In 1970-71 the banks manufactured or created \$25 billion in money each year. I had it calculated by the staff. The reserves were created on the basis of 22 to 1. That bothered me. I never heard of a ratio like that. So I had the calculation itemized and I discovered for the first time that instead of using the 7 or 8 or 10 to 1 reserves on demand deposits or $33\frac{1}{3}$ to 1 reserves on time deposits, they had commingled these reserves and issued the money on a basis that for every \$1 they had they loaned \$22 more.

Now, that happened 2 years, I know, and it is happening right now. And, of course, these reserves are something that nobody knows too much about because the Federal Reserve operates in secrecy and we don't get their papers and know what they are doing and we don't have any audit.

The Federal Reserve has never been audited, and they handle as much as \$2 billion a day for a whole year in buying and selling government bonds without any audit. And the 20 dealers who have been selected by the Federal Reserve in New York City offices made as high as 90 percent a year before last on their investment.

I got the audit of these dealers and I was astounded. I was shocked to think that they would make that much money on, you might say, no risk at all. So, I turned that over to the Federal Reserve and I haven't got any reply from them yet.

My time is up. We must respect this time, I will ask the members of the committee, so as to give all members an equal chance.

All right, Mr. Widnall, you are recognized.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Stein and your colleagues, we appreciate your coming here before the committee today and I am sure we will find your testimony very valuable.

Mr. Stein, could you summarize for us briefly what is involved in the phase III system of controls. There has been a great deal of public confusion on this issue, many people thinking that the controls have been entirely eliminated.

In the same vein, could you describe for us the "strong measures to increase the supply of food and thereby to restrain the rise of food prices," as you put it in your oral statement. You say that, "Food prices at the farm will be no higher in December 1973 than they were in December 1972."

What about prices at the retail level?

Mr. STEIN. Well, I think it would be desirable to try once more to explain what phase III is about. As I said in my testimony both at the time of the freeze and at the time of phase II, in the early days we went through a period in which there was a common complaint of inability to understand the system but this passed and I am sure this will pass in the case of phase III.

The situation with respect to phase III is this: There are three sectors of the economy which are under mandatory control right now, and they are food processing and distribution, the health services industry, and the construction industry.

With respect to the rest of the economy, we have set forth very precise standards of wage behavior and price behavior to which we expect unions and employees to conform. These are essentially the standards that existed in phase II and all the regulations for ex-

plaining these standards, for defining what is a cost, what is a wage, what is a price increase, and so on and so on, this whole book of regulations which was developed during phase II applies to behavior in phase III.

We have changed the standards, the price standards, in relatively minor respects, to which I will return. We have not changed the pay standards.

We have set up a labor management advisory committee which can advise the Cost of Living Council about suggestions for changing the pay standards, if they wish to do so.

Now, we are saying to all the rest of the economy outside these three areas that I listed, we expect you to abide by these standards, you know what the standards are, you have lived with them, we are calling upon you to abide by these standards, we are not asking you to notify us in advance, we are asking the larger corporations and unions to supply us with reports of their activities, we are asking medium size groups to retain records specifically relating to these standards which we can survey, and for the rest of the economy we will be watching through such general information as is available and the usual accounts that are maintained by businesses.

We have said that if we observe that any firm or union or industry is behaving or in our opinion is about to behave in a way which is not reasonably consistent with the standards we have laid down or with the goals we have set for the system, then the Federal Government will intervene, and we have maintained a staff for this purpose and we are asking you to extend the authority so that we will be able to intervene after April 30. This intervention could take a number of forms but the simplest thing to say is that the Cost of Living Council, which will be exercising this authority, can say to anyone stop, can say do not raise this price, it can say reduce this price, it can say your ceiling on this price is "x" or say the ceiling on this wage is "y." And, once the Cost of Living Council has said that, that order is mandatory, it has the force of law, and all of the penalties which are contained in the Economic Stabilization Act would then apply to any violation of that order.

The Cost of Living Council, we would think in the normal circumstances would hold some hearings, collect some information. We don't expect to be arbitrary in the use of this authority, but that is what is commonly described as the club in the closet.

Although we have reduced the staff of the administrative agencies in Washington and in the field we will have a staff which is adequate to this purpose because we have eliminated rent control which turns out to absorb an enormous amount of administrative capacity for very little effect on the cost of living and we have eliminated requirements for prenotification which had produced a great deal of paperwork.

So, that we are confident of our ability to observe the major cases to determine the reasonableness of behavior in the major cases and to stop excessive increases where they have occurred or seem about to occur.

That is the essence of the phase III program.

It is as we say, self-administering because we now have a system and set of standards which can be well understood just as we have understood the income tax to be a self-administration system. We

don't go into everybody's office, or study, or kitchen table and tell him how to fill out his income tax and what he should pay. We have set out certain rules. We expect them to be observed and where we detect violations we bring about a correction.

Now, on the food side. I think it is correct to say that what has been done there has not been very well appreciated, although I think probably in the agricultural segments of the country it is. We have for one thing eliminated restrictions on the acreage that can be planted to wheat. We have introduced a new system for determining the set-asides from the production of feed grains and soybeans which we believe will substantially increase the production of corn and soybeans.

We have established a procedure under which land diverted from crop production can be used for the grazing of cattle.

We have taken steps to empty the Government-owned bins of food commodities, grains, except for a very minimum reserve.

We have taken steps to encourage farmers who own stocks of crops under loan to dispose of those stocks.

We have eliminated the few remaining subsidies on the export of food from the United States.

We have completely suspended the limitation on the import of meat from abroad.

We have increased the permissible import of dried skim milk in the United States.

We have established a procedure under which actions by Government agencies which affect the supply or price of food, which would be notably the actions of the Department of Agriculture, will be reviewed by a committee of the Cost of Living Council from the standpoint of their consistency with the economic stabilization program. And one further point, we will, of course, as I said earlier, we are maintaining mandatory control on processing and distribution of food and we are setting up an advisory committee on the food industry to promote—

Chairman PATMAN. Mr. Stein, your time expired 3 minutes ago.

Mr. STEIN. Maybe on my next turn I will complete this.

Chairman PATMAN. We will go ahead down the line and you will have an opportunity before it is over to say anything you want to say.

Senator PROXMIRE, you may proceed.

Senator PROXMIRE. I might say, Mr. Stein, despite the critical flavor of my opening statement, I hold you in great respect, as well as Mr. Solomon and Mrs. Whitman. I think you are fine economists, and I greatly respect you.

I would like to get your response to my opening statement. Let me try to break it down and get the responses consistent to each element.

No. 1, the indications are that the public just doesn't believe that you have an effective anti-inflation program. The stock market has been dropping. All of the explanations are the market is discounting a substantial inflation which will upset the economic situation and require us to go into a recession a little later.

There is a disastrous collapse of the dollar which, as you know, just today there were huge sales of the dollar abroad.

We have had a soaring wholesale price increase. Food is the biggest element but certainly wasn't the only element. There are other disturbing aspects of the wholesale price increase that will be reflected in consumer prices.

Under these circumstances how do you justify such an expansive fiscal policy with a 7½-percent increase in Federal spending combined with a monetary policy involving an 8-percent money supply expansion last year, 13 percent in December, and a wage and price control system which seems to me like putting Truman Capote in the ring with George Foreman. It has the force of a butterfly's hiccup, there just is no real muscle here compared to the wheat programs you had in phase II.

Under these circumstances how can you convince us and the country you have an effective anti-inflationary program?

Mr. STEIN. Well, I have tried to indicate I think the skepticism about phase II is unjustified and it is no more justified than what the earlier—

Senator PROXMIRE. Let's look at the weaknesses in phase III, you have the—

Mr. STEIN. What?

Senator PROXMIRE. The profit margin rule is relaxed.

Mr. STEIN. The profit margin rule has been relaxed.

Senator PROXMIRE. It would be easier to increase prices in a number of industries.

Mr. STEIN. Right.

Senator PROXMIRE. No. 2, you don't require advance approval of a price or wage increase.

Mr. STEIN. That is right.

Senator PROXMIRE. Furthermore, if you don't approve them when they are made there is no penalty in the way of refunds that are made to consumers that paid too much, you can keep the excess profit. That incentive is gone; is that correct?

Mr. STEIN. That is right.

Senator PROXMIRE. Then, No. 3, the control program eliminates about 90 percent of the economy and concentrates in a few areas and then doesn't take advantage of the staff you had by reducing the size of the staff, cutting it in half; is that right? The staff is half as big as it was to enforce under phase II?

Mr. STEIN. Right.

Senator PROXMIRE. How can you say that this is an effective answer when we have the kind of inflationary expectations reflected in the stock market and elsewhere.

Mr. STEIN. Well, as I have indicated, we have a staff which is quite capable of observing the major movements in the economy and the behavior of the major economic units in the economy and I had thought it was one of your principal recommendations that we should trim the system down to concentrate on the major units.

Senator PROXMIRE. It was indeed, and to use the staff to do that, but you have knocked out half your staff.

Mr. STEIN. We have the staff. We haven't gone as far as you had suggested, I believe, in trimming the thing down. We have a system which still applies generally to the economy. Our belief is that we had achieved, and I think the statistics will show that in the nonfarm sector of the economy we had achieved, a very great slowdown in the rate of inflation. In the corporate nonfinancial sector the rate of inflation last year was only about 1½ percent. The big problem here was maintaining a degree of voluntary cooperation, including on the wage side, which would perpetuate that excellent performance.

Senator PROXMIRE. Let me move quickly. Are you satisfied with the monetary policy that we had last year and the effect it is going to have this year, in view of the lags involved?

Mr. STEIN. I am satisfied with the monetary policy we had last year. I would not want to see continuation of that monetary policy in 1973.

Senator PROXMIRE. Are we going to pay the price in higher prices?

Mr. STEIN. I don't expect we are going to have continuation of that rate of monetary expansion this year. I used to consider myself a monetarist at one stage but the emphasis that people who never were monetarists are now placing on the behavior of the money supply in 2 or 3 weeks is quite extraordinary.

Senator PROXMIRE. Do you claim our fiscal policy is restraining inflation in any significant way with the enormous increase in Federal spending, a \$19 billion increase, 7½ percent, 5 percent in real terms. Is that restraining?

Mr. STEIN. I certainly do.

Senator PROXMIRE. How?

Mr. STEIN. Well, because we have a very substantial increase in revenues.

As you know, the actual deficit will decline, will be cut approximately in half, because the revenues are rising even faster than the increase of expenditures, partly by the natural forces of the growth of the economy, partly by virtue of the increase in social security taxes which goes into effect this year.

Chairman PATMAN. The time of the gentleman has expired.

Mr. STEIN. Mr. Chairman, is the 5 minutes divided between me and the questioner or does he get 5 minutes?

Chairman PATMAN. Five minutes. The time you are talking you are using his time.

Mr. STEIN. The time he is talking he is using my time?

Chairman PATMAN. That is right.

Mr. Blackburn.

Representative BLACKBURN. In your oral statement you say that you believe the substantial worsening in our balance of trade between 1971 and 1972 was for transitory reasons.

I wonder if you would review briefly what you consider the reasons to be and why they are transitory.

You can use all of the time you like; just help yourself.

Mrs. WHITMAN. As far as we can tell there are two reasons why the balance of trade worsened on a year over year basis. Although it improved slightly over the course of the year, frankly that improvement was not as much as everybody, including us had hoped.

Probably the most important reason is the cyclical relationship between this country and other countries. That is, this country was growing very rapidly during 1972, in real terms and a number of other countries, particularly countries who are major customers of our, were having somewhat more sluggish rate of expansion than is their wont. This tended to accelerate the rate of increase of our imports because of the very rapid growth here, and the more sluggish growth in many countries abroad tended to slow down the rate at which they bought exports from us. Every indication is that the rate of growth is picking up and will continue to pick up in those countries in 1973, and we expect slightly less rapid real growth in this country during 1973. It is

for this reason we call that cyclical phenomenon, which was very important in 1972, transitory. These cyclical relationships do change over time.

The other factor, of course, is that the first impact of devaluation is perverse, it is in the wrong direction. The prices of the devaluing country's imports go up and for that reason the dollar value of our imports increases. Later, there is a change in real flows; the growth in the volume of imports is reduced, and the increase in the volume of exports is accelerated. But this takes time. We have seen this happening over the course of the year.

When we look at real exports and imports, we see that the trade balance improved considerably more over the course of the year than it did in nominal terms. But the fact is the initial impact of a devaluation is in the wrong direction and is only slowly overcome. History tells us that the lags here are considerable, so for this reason, too, we expect some substantial improvement in the future.

Representative BLACKBURN. Are you anticipating that with the dollar under attack—as it is at the present—we will probably undergo some further devaluation of the dollar and that this adverse influence on dollar value of imports will be reflected? Then, over the long term, will we see an improvement in our trade position?

Mrs. WHITMAN. The United States has been and is continuing to support the Smithsonian system and the exchange rate structure that was worked out there. Of course, the fact is that the exchange rates of other countries have been changing. There have been a number of small changes and this, of course, affects the relationship between the dollar and other currencies. The latest one is that the Swiss floated their currency recently and it went up somewhat. The Italians have floated and there it went a little bit in the other direction. One can't be sure, of course, what other countries will do, and at any given moment in time we have to stop and figure out what the net effect is on the dollar.

The pound has sunk over the last few months. Now, the Swiss franc has risen. So there is a net effect in terms of the value of the dollar.

One other point which I think is very important is that the United States had a much better price performance in 1972 than any other major country. This again will affect our trade balance favorably but, again, it takes a certain amount of time for this to have an impact on the consciousness of exporters and importers and for them to change their behavior patterns accordingly.

Representative BLACKBURN. I appreciate your answers and I think they are quite encouraging to all of us.

Has the Council of Economic Advisers given any thought to the potential hazard of the accumulation of vast reserves by the oil producing countries?

I see my 5 minutes have just expired.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Mr. Stein, I continue to oppose what I consider to be the administration's Rip Van Winkle attitude on international money. Here we have had a frightful balance-of-payments deficit last year, \$10 billion scattered between trade and tourism and foreign investment, and foreign military operations, just about everything you can think of; and another one coming up.

When Mr. Nixon took office, we owed in foreign liquid claims about \$40 billion. It has been more than doubled to \$82 billion today, another billion up the flue yesterday to the Bundesbank. These aren't just amounts that can be laughed off as Americans owing it to each other; these debts will have to be repaid abroad with interest.

We see crisis after crisis. While Secretary Shultz made a good statement last September to the IMF about the vital need for quick reform, I now find that diluted and attenuated, and a generally languid attitude. For example, on page 123 of your report you talk about the Committee of Twenty and say:

The first meeting of this new group was held at the annual session of the IMF in September 1972; this was followed by several meetings of deputies, who expect to prepare a draft outline of the main reform proposals in time for the 1973 annual meeting of the International Monetary Fund.

We are all going to be dead at this rate. I suggest that (1) our Government performance is much too languid in view of the nature of the problem involved, and (2) that the President ought to take over, convene the heads of state, put it to them that there must be a prompt reform, or that otherwise the United States is simply going to get rid of the Smithsonian, let currencies float, and as to those countries which dirty the float by archaic methods, or by accumulating unnecessary dollars, that we are going to respond by a surcharge on imports or some other device so that we can protect ourselves from living forever with a dollar whose foreign fate we in no way control.

Would you defend, if you can, the administration's very business-as-usual position? I don't understand it.

Mr. STEIN. I don't think it is accurate to describe the position as languid or business as usual. We had put forward a very far-reaching, very fundamental, and very innovative—

Representative REUSS. Excellent proposal, but since then nothing but doodling.

Mr. STEIN. This proposal, of course, can only become effective if it is agreed to by a large number of other countries.

Representative REUSS. Won't they agree much faster, Mr. Stein, if we let them know that we are wise to the fact that they are very largely prisoners of their own export industries, and that we intend to make honest men of them, and come to their aid by putting a surcharge on their export industries? I can't think of anything that would bring them to their senses with greater celerity.

Mr. STEIN. Well, I guess I won't like to pursue this, really not like to pursue this further except to say we are fully aware of the seriousness of the situation, that we are pushing in both domestic and international matters as vigorously as we can, quite vigorously, and have confidence that we will arrive at a solution.

We certainly are not complacent about the attitudes of other countries with respect to this problem. We do regard it as their problem as much as ours but also recognize that we will have to take our own action if agreements and cooperative measures are not taken. We share that view. I don't think I can really go into the details of that further.

Representative REUSS. I remind you that for months before August 15, 1971, this committee urged the administration to do something, which it didn't do until finally along came August 15 and as a result of

the dawdling we lost several billion dollars because of abortive attempts to sustain the dollar, and I hope we won't have another repetition.

Let's turn to the domestic side, then.

I will be back.

Chairman PATMAN. The time of the gentleman has expired.

Mr. Brown.

Representative BROWN. Mr. Stein, you note in your comments and your report notes a number of records in this recovery period. The 7.7 percent of the gross national product increase, employment growth of 2.3 million, housing starts of 2.4 million, and real wage increase of 4.3 percent, which is a record since World War II except for the 1955 recovery when it was 4.6 percent in 1 year. All of these would indicate a record recovery underway.

Now, if I recall my college economics, the theory of Keynes was that during the time of the recovery Federal spending would be held back or reduced so as to limit the size of the expansion with the hope of bailing out the economic cycle.

Is that the theory on which you are operating and the objective of what you call in your oral statement the keystone of the 1973 economic policy that the President recommends on the budget? Is that what we are aiming at?

Mr. STEIN. Well, in a way I suppose we are half Keynesians and we are aiming for a steady rate of increase of expenditures. We are projecting an increase of \$18 billion in fiscal 1973, \$19 billion in fiscal 1974, \$20 billion in fiscal 1975, which is essentially a constant rate of increase, but we would have a considerable deficit reduction, we would have a considerable deficit reduction on the actual bases because receipts would be rising so much. On a full-employment basis we would have a shift from a small surplus to balance as a consequence of the increase in social security tax rates.

So that we are not following a policy of trying to increase and reduce expenditures as was the 1930 kind of thought. When you start with the budget which has built-in increases of \$15 to \$20 billion a year, it is practically impossible to operate on the assumption you are going to have some years of decrease. We are trying to hold the increase down in a period when the private economy is rising very strongly and get a little restraint from the fact that the revenues are rising so strongly.

Representative BROWN. Is it fair to say that as a result of this you are distributing through the economy the opportunity to make economic decisions rather than having them all being made, possibly not all of them, but being dominated by the Federal Government? I would assume that the result would be that the economy has some of its own checks and balances in it rather than having to have it manipulated as extensively by Uncle Sam; and we will still have something left if the economy should start to slip, so that we can inject back into the Federal economy from the Federal level.

Mr. STEIN. That is right.

Representative BROWN. I am concerned about whether or not the benefits of this economic growth have been well distributed throughout the economy or whether or not they are concentrated in certain parts of it.

Is or isn't this boom that we are in or this recovery period that we are in distributed throughout all, sectors of our population?

Mr. STEIN. Well, we believe as far as any evidence we have can show that this prosperity is very well distributed. We don't have all of the information that we will sometimes have about the distribution of income in 1972, but we do know for one thing, of course, that total employment, total wage income has increased very substantially and that is the source of income of the great majority of the American people.

On the business side we see that failures of small business have fallen off very rapidly, that the incorporation or the establishment of new small business has increased very rapidly. We believe that on the farm side also the general, two things on the farm side. The increase of farm prices has benefitted farmers of all sizes but the increase of nonfarm employment opportunities has been of special advantage to the smaller farmer who tends to get a larger part of his income from employment of the farm.

So that we do think that the benefits of this recovery have been widely shared and, as President Kennedy once said, "A rising tide lifts all of the boats" and all the boats seem to be rising.

Representative BROWN. Thank you.

Chairman PATMAN. Mrs. Griffiths.

Representative GRIFFITHS. Thank you very much, Mr. Chairman.

Forty-two percent of the proposed budget reductions would be in the open appropriations for public assistance, medicare, and similar programs. Now, of course, that requires legislation. The legislation should be enacted immediately. Is the President going to ask that the tax increase be stopped and that we begin work on the medicare reduction legislation or will he push it ahead of trade?

Mr. STEIN. I can't answer that question. I don't know the answer.

Representative GRIFFITHS. Can you really say you are serious about these reductions unless this comes in immediately?

Mr. STEIN. Well, the fact that I can't answer the question doesn't mean that someone can't answer it. I just can't answer it.

Representative GRIFFITHS. You would agree if it is to be enacted then the cut must be enacted immediately; is that right?

Mr. STEIN. You will have the Secretary of Treasury tomorrow. Yes; some of these cuts require legislation.

Representative GRIFFITHS. If you are to have this cut we should really stop the tax hearing right now and begin work on it.

You also suggest that you are going to recover \$600 million from the welfare program, through a regulation that is already under attack in HEW. Do you seriously believe that you are going to recover \$600 million of overpayment or fraudulent payments to welfare people?

Mr. STEIN. Well, Mrs. Griffiths, I am sorry that I am not the witness to answer that kind of question. If you ask are we serious, I will assure you that we are serious.

Representative GRIFFITHS. Did you help propose these figures? You must have known. There has been practically no recovery in the entire United States of either fraudulent payments or overpayments so that it is absolutely unrealistic to suggest that through a program already under attack you are going to recover \$600 million.

Now, I would like to point out that the 1974 budget really is different. For the first time in the history of the United States the income security expenditures of \$82 billion makes it the largest single governmental function. Payroll taxes flowing into social insurance trust funds account for over 30 percent of all Federal revenues.

Could you comment on the economic implications of these taxing and spending trends?

Mr. STEIN. Well, I will give a personal opinion about this matter.

I am not a great admirer of the payroll tax and I think we have pushed it pretty far and that we should be very cautious about pushing it any further. I think it is unfortunate that this has proved to be such an easy way to raise money. I think it has distorted both the tax system and the expenditure side of the budget.

Representative GRIFFITHS. I hope that Mrs. Whitman speaks up a little on behalf of who is being taxed most heavily, because, of course, it is women who are paying these bills. It is the working family, a wife who is paying a large part of the bills in social security for which she gets not the return that everyone else is receiving.

I might say also that, while I appreciate the fact that you have a little bit here on women, I think it is going too far to put lawyers and judges into the same category. Even the President pointed out that there are so few women judges in this country, but with four appointments he couldn't find one woman qualified to make a Supreme Court Judge. The idea of putting editors and reporters in the same group is also ridiculous. I would suggest if you are going to show honest figures that you show the figures as they apply to a particular group.

Mr. STEIN. May I explain that the Census collects these data and does not go to the infinite degree of refinement which might be possible.

Representative GRIFFITHS. Why don't you suggest to the Census that for women they better do it differently. I will bet not one one-hundredth of 1 percent of the judges in this country are women. It must be such an infinitesimal number that it really doesn't work out.

Chairman PATMAN. Thank you, madam.

Mr. Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman. I would like to welcome all three of you to the committee but a special welcome, of course, to Mrs. Whitman who came here from the congressional district I have the honor of representing.

I hate to digress even to an infinitesimal part of my colleague from Michigan, but I do believe that the innovative thing about this report, while it might have some defect, at least you addressed yourself to the problem of the economic role of women, it may not be perfect but it is the first time it has been done, and I for one commend you and hope that this section will be continued and improved in the future.

Mr. Stein, you have made some predictions which are always the most dangerous part of your job, predictions on the gross national product, unemployment rate at the end of the year, rate of inflation, even the prices of food at the farm, but I see no prediction about interest rates.

If I read the economic report and your testimony you say that interest rates have been declining and I come away with the feeling

that if you are making a prediction you would be making the prediction there would be further declines, but you don't come out and say that. Of course, since the publication of the economic report there has been a general increase in the prime rate.

Can you give us any predictions on interest rates?

Mr. STEIN. Mr. Solomon.

Mr. SOLOMON. That is always the hardest to forecast and it is particularly difficult at this time.

The behavior of interest rates in this recovery has been completely different than in any former recovery. Generally, when the economy expands, interest rates rise and they rise sharply. In this case we did not have any rise in the case of some rates but an actual decline. What we have, apparently for the first time in many decades, is a conflict between two separate forces, the forces of recovery, with increased demand for credit, pushing interest rates up, which is normal, on the other hand, and a gradual abatement of inflationary expectations, which tends to push nominal interest rates down, on the other.

By 1969 and 1970, interest rates had got built into them a very large component, in the form of a premium for expected inflation. We think that component has been abating with the better price performance of the economy and we see a struggle between these two forces and it is hard to measure them. I would imagine that in 1973 that interest rates would move upward by and large but gradually because of the effect of these two forces.

Representative MOORHEAD. You said that interest rates have declined in the past year. If we take a look at 3 months' Treasury bills, we started 1972 at a 3.4-percent rate and we closed 1972 with a 5-percent rate.

Mr. SOLOMON. I was speaking of the recovery as a whole. If you will take the eight quarters that have passed from the trough of the recovery to eight quarters after the recovery, which is the latest quarterly figure we have, here are the figures.

For 3 months' Treasury bills, in the recovery of 1948, they had risen 54 percent. In the recovery of 1954 they rose 199 percent. In the recovery of 1958 they rose 204 percent. In the recovery of 1960 they rose 22 percent. In the current recovery they have declined 9 percent. An amazingly different performance.

Now, the same is true by and large for the other rates. Bank rates on short-term business loans, Treasury bond yields, and FHA mortgages.

It is true that over the past 12 months there has been an increase in short-term rates. But, there has been a fall in long-term rates and a very minor increase in mortgage rates given the fact that housing starts have broken all, not just records, but dreams of records.

Representative MOORHEAD. Mr. Stein, I find in the Economic Report of the President no analysis about the defense spending, the inflationary effect thereof.

As I understand the budget, the expenditures for defense spending will go up \$4.2 billion, whereas the cuts will come all in the social spending such as housing, and it seems to me defense expenditure, which satisfies no civilian demand, is more inflationary than, say, expenditures for housing which do satisfy a civilian demand.

Why isn't this analyzed in the Economic Report?

Mr. STEIN. Well, we have been over this many times. We have not found that there is a difference in the inflationary effect of one kind of spending over another.

As a matter of fact, if we were to take that particular issue, I would think that the housing expenditure could probably be more inflationary because in the case of the housing the Government puts up a little subsidy which generates expenditure out in the private sector which may be much larger than the amount of the subsidy. So that it is by no means clear from any work that we have done that there is any significant difference. We think the important thing is to keep this total rate of expenditure from rising too rapidly.

Representative MOORHEAD. Thank you.

Chairman PATMAN. Senator Humphrey is next and then Senator Bentsen.

Senator HUMPHREY. Mr. Chairman, Mr. Stein, I have just a few questions.

Back in 1971, I believe it was, the administration gave us recommendations through the Council of Economic Advisers for the stimulation of the economy by a number of tax cuts, some of those such as the investment tax credit, the repeal of excise taxes, and, of course, just within the last year a number of tax reductions that related to the business area; that is, to the corporate area of our economy.

This year the budget makes a number of cuts in programs and the Economic Report is totally lacking in any subject matter relating to tax reform.

Mr. Stein, as I recall, in the past the report of the Council of Economic Advisers laid out policy recommendations, tax recommendations, tax adjustment recommendations. As I see it now the stress in the budget and in the report is on spending cuts.

I won't go into the arguments about the defense matters that have been discussed here.

Why did this administration put all of the effort into figuring out just what to take away from the poor, the sick, the elderly, the rural people, and didn't produce one proposal for closing what are recognized, at least in an election year, were recognized by the administration as glaring loopholes, gross inequities in the tax structure, which enable some of the rich and the well off to avoid paying their fair share of taxes?

Why did you opt for spending cuts instead of tax reform?

Mr. STEIN. Well, Mr. Senator, of course, that is not the choice. The choice is between spending cuts and tax increases and we opted to avoid tax increases. We have not proposed a package of tax reforms here because it is not the role of the Council of Economic Advisers to propose tax reforms independently of the decisions of the administration and the administration is still in the process of considering and developing a package of tax reforms. We have by no means given up the idea that it would be desirable, or at least that we have an obligation to examine these alleged loopholes and/or escapes and to see whether we can improve the tax system by correcting them. It is our intention, however, that if we do come forward with a package of tax proposals it will be a balanced package redistributing the tax burden in some ways but not an increase in the tax burden. We have said, the President made it quite—I hesitate to when I come to the

word "clear"—the President made it very clear last year that he was opposed to a tax increase. Everybody in the country knew he was opposed to the tax increase. That was one of the main points of the platform on which he ran and he seemed to find considerable support in the country for this view and we have not found anybody who ran and won on a platform of being for a tax increase.

So we think we represent the views of the American people on that matter.

Senator HUMPHREY. Mr. Stein, we are not talking about a tax increase, we are talking about a tax reform. You know very well that the administration last summer stated publicly that it would present to the Congress of the United States promptly a tax reform proposal when all of this was being discussed by the number of people in the political arena, including the gentleman that is asking you the question.

Now, that was a commitment by the administration.

What is so magic about spending cuts on the poor, on welfare, on medicare, on rural housing, on rural environmental assistance programs, on REA loans. What is so magic about that that supersedes just some simple equity in the tax laws? We are not talking about a general tax-rate increase, we are talking about fairness in the tax laws. The CEA, the Council of Economic Advisers, on two other occasions did not hesitate to recommend tax reductions as a stimulus for the economy. This has been the pattern in the past.

Why haven't you recommended tax reform as at least an alternative to spending cuts?

Mr. STEIN. The point I am trying to make is that tax reform is an alternative to spending cuts only if it is a tax increase. If it doesn't give you any more revenue it is not an alternative to spending cuts, and we don't think this country needs or wants a tax increase. There may be readjustments that are required in the distribution of the burden, but as we look at taxation in the United States, at the total burden of government spending and total burden of taxation in the United States in the past 20 years, we think it has risen at a very rapid rate. I think it is quite unfair to say that we have turned our attention exclusively to cutting out programs for the lame, the halt, and the blind, or whatever that list was that you read to me.

Senator HUMPHREY. I like your description better.

Mr. STEIN. At least it is more classical.

But because you will see, if you look at the budget, that we have made a lot of cuts from proposals, our total budget for next year, as the Senator from Wisconsin has pointed out, is \$19 billion higher than this year's expenditures. About \$14 billion of that is in the nondefense category. We have radically changed the proportion in which the budget is distributed between defense and what are generally called human resource programs.

We are spending more for most of these programs in the total than we ever had before. Obviously there are some programs reduced. Everything that was started 8 years ago or 4 years ago was not a great success and deserved to be perpetuated and expanded with the passage of time, so some things are being reduced, some things are not being allowed to proceed.

Chairman PATMAN. Time has expired. We will try to arrange for a special day for those of you who would like to have more time. We will try to arrange it with Mr. Stein before it is over.

Senator Bentsen.

Senator BENTSEN. Yes—

Representative REUSS. May I address a question to the Chair—aren't we going to continue on?

Chairman PATMAN. Well, you see, it will soon be time to go to the floor. We have a special time over there for eulogizing former Presidents and that will start soon after 12 and I know some of the members here on this panel would like to be heard. In fact, many of us have a special interest in that and I felt after we got through with the 5-minute rule we will try to agree with Mr. Stein about a special date for those who would like to be heard further.

Representative REUSS. I hope later on today.

Senator BENTSEN. Mr. Chairman, I assume that 5 seconds don't come out of my 5 minutes?

Chairman PATMAN. No, no.

Senator BENTSEN. Mrs. Whitman, I would like to comment on the use of the word "transitory," because I think it is much more than that which we are facing in our foreign trade imbalance.

In 1971 we had the first deficit we have had in 100 years, in 1972 we had a substantial increase. If we had chosen not to use the fob figures but what most nations use we would find it even greater.

As I look at the January figures, I don't see any marked reduction in that problem. I think what we are facing is a problem of nontariff barriers that are being imposed by a number of nations. We are looking at nations like Japan that are the most protectionist in the world as far as their local industries but great expansionists in the exports of their goods. I hope that that administration is going to be entering into some very hardnosed negotiations to try to rectify some of these inequities we accepted at the end of World War II as we tried to make the economies of these nations viable again.

On this question that Senator Humphrey was discussing, the question of taxes. Mr. Stein, in the 1971 act we put in some incentives for business to try to help them recover and help the economy. I thought that was good. We wanted to create jobs. We wanted plant investment. We wanted machine tools purchased. We have seen a 14-percent increase in that category. Isn't it time now that we take a look at accelerated depreciation range and take a look at the investment tax credit. For example, if the investment tax credit for 1974 was halved and your acceleration depreciation range was removed, you would receive a \$4.7 billion increase in taxes. Some of that could be spent on health and some of it could be spent on education and it won't have the multiplier effect you have when you make plant investments. It won't have the effect on inflation that these capital investments have. Could we not be giving some consideration to the removal of some incentives that were put on for a purpose that is now being accomplished?

Mr. STEIN. Well, these incentives were not put on simply to stimulate the economy. As you may remember, we, the administration, advanced the program which would have provided a temporary very strong incentive in the 10 and 5 thing we proposed, a 10 percent

investment credit followed by 5 percent, and it was the Congress who decided they wanted this to be a permanent thing. They were not interested even primarily in promoting the recovery but in promoting the increased rate of investment and increased rate of productive growth in the United States over the longer term. And, of course, that was the reason for revising the depreciation system. Of course, this is a matter to be considered and I think one has to decide whether he thinks that the American people will be better off by having a more rapid rate of investment, a more rapid rate of economic growth, a more rapid rate of increase in output per man-hour and therefore income per man-hour, as contrasted with some of the programs that have been proposed or that we have had.

We think that the American people are better served in this manner, but it is a matter of judgment.

Mrs. WHITMAN. When I talked about the factors which affect the trade balance in 1972 and suggested that we expect some improvement in 1973, as indeed we do, this by no means suggested that we think we will be able to get back into a balanced position—by balance I mean a balance in our overall payments position which implies, obviously, very substantial improvement in our trade and current accounts—without some action on the part of other countries as well as ourselves. We have been taking actions along those lines and some of them I described.

There is no question that in the monetary negotiations that are already underway we are pushing very strongly for an adjustment mechanism which will make it possible for us to restore balance to our payments position.

Senator BENTSEN. You are treating the symptoms with the monetary negotiations rather than the cause.

Mrs. WHITMAN. On the contrary, our view is that the U.S. proposals in the monetary negotiations avoid only treating the symptom and get at the fundamentals. At the same time, on the trade side, we expect indeed to enter into multilateral negotiations later this year in which, again, it will be very important to press for reform of the trading system which will make it possible for us to earn our way, to pay for the imports that we buy with exports of American goods.

Senator BENTSEN. You will receive very strong support from me in that regard because I think it is absolutely essential.

Chairman PATMAN. Thank you, Senator Bentsen.

The gentleman's time has expired.

May I suggest this? That each member may have a right to extend his remarks. Is there objection? The Chair hears none.

Now, Mr. Stein, I wonder if we could induce you to be here to answer questions February 20?

Representative BROWN. May I ask a question?

Chairman PATMAN. Just a moment. Now some of us feel like—

Representative BROWN. A parliamentary inquiry.

Chairman PATMAN. Not at this moment.

Representative BROWN. A parliamentary inquiry is always in order.

Chairman PATMAN. I am asking you as a matter of courtesy to let me tell you what the rule is. We have to make a report March 7.

Representative BROWN. Mr. Chairman, this is a matter of courtesy. May I push my parliamentary inquiry?

Chairman PATMAN. You may ask it.

Representative BROWN. Is this committee going to persist in holding hearings and inviting witnesses at the time when we are in recess from regular sessions of the Congress? Now, during the period from the 9th to the 19th the Congress will be in recess for the normal Lincoln, Jackson, and Jefferson Day period, and some of us may have plans to be in our district to try to serve in that capacity as Members of Congress, and to be present for certain events that we have scheduled at this point.

Now, are we to continue to have this pattern that we have had unfortunately in this committee in the past and as to which I have raised objections privately to you and to others member of the committee; that we meet on the day after Christmas or Christmas Eve or New Year's Day or some other silly times of the year? Are we going to continue that, and is that the pattern that you are establishing by inviting Mr. Stein back? If it is, it is my request of Mr. Stein that he refuse to come because I won't be able to be here and I imagine many other members won't.

That is my parliamentary inquiry.

Chairman PATMAN. In my opinion we should leave that up to the committee; if the committee by majority vote does not want to meet during this period we will not meet. Under the law we must make a report by March 7.

Representative BLACKBURN. Mr. Chairman, a point of order. It is my understanding the report has to be filed by the end of March. I would like to continue this morning. In the past, the chairman has surrendered the chair to the vice chairman when the chairman had to leave.

Chairman PATMAN. Application has been made to extend the time but it has not been granted. Like it is now, March 7 is the final day and if the committee doesn't want to meet, the Chair would be bound by a majority of this committee. If anyone wants to make a motion they are privileged to do it.

Representative BROWN. How do we get the vote on whether or not we are going to meet when the Congress is in recess?

Chairman PATMAN. We will just do that by agreement of the members. We have done that in the past.

Representative BROWN. Can you advise me when you intend to schedule a vote on whether or not we should have a meeting of the committee during the recess?

Chairman PATMAN. If the committee votes not to have hearings during the recess we won't have any.

Representative BROWN. How do we get that vote?

Chairman PATMAN. By making a motion.

Representative BLACKBURN. Mr. Chairman, I believe that the chairman received a letter from eight Republicans objecting to hearings next week on the grounds we do have scheduled appearances.

Chairman PATMAN. We will leave it to the vote.

Representative BLACKBURN. What sort of sympathy did we get from the chairman on that? The hearings are still scheduled.

Do you read our letters?

Chairman PATMAN. I am telling you now if you want to make a motion you can do it. If you don't we will have the hearings.

Representative BROWN. I so move.

Chairman PATMAN. That we not have any hearings during the time when the Congress is in recess? You mean just for this period of time or for all times?

Representative BLACKBURN. Forever and ever and ever.

Chairman PATMAN. I don't think it would be fair to the absentees to make it permanent but on this one I would entertain the motion right now.

As many as favor the motion not having any hearings during this recess extending to the 20th of February—

Representative BROWN. A point of order. The motion is made but I don't know that we can take a vote on it since we don't have a quorum present this morning when Congress is in session.

Chairman PATMAN. Well, anyway, if you want to push it we are ready to vote.

Representative BROWN. I would like to push it when the committee can get a quorum.

Chairman PATMAN. You make a point of order there is no quorum?

Representative BROWN. I make a point of order we cannot have a—

Chairman PATMAN. There is no requirement that a quorum be present for this vote.

As many as favor not having the hearings—

Representative BROWN. I make a point of order.

Chairman PATMAN [continuing]. On February 20—let it be known by saying aye. [No response.] All opposed, no. [Chorus of "no."]

All right, by the uplifting of hands. All in favor of dispensing with the hearings during this holiday let it be known by uplifting of hands.

Representative BLACKBURN. How about lack of quorum?

Chairman PATMAN. We don't have to have a quorum for this. All opposed, no. [Chorus of "no."]

The noes have it and the motion carried and we would like to have you Thursday a week, Mr. Stein, if we may.

Mr. STEIN. I can't be here.

Chairman PATMAN. When can you be here?

Mr. STEIN. I can be here on February 12.

Chairman PATMAN. I didn't understand you.

Mr. STEIN. February 12.

Chairman PATMAN. That is on Monday?

Mr. STEIN. Yes, sir.

Representative REUSS. Let us accommodate ourselves.

Chairman PATMAN. By agreement we will meet on the 12th and have Mr. Stein.

Mr. STEIN. I have to poll my committee.

Chairman PATMAN. You can be here.

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

[Whereupon, at 11:45 a.m., the committee recessed, to reconvene at 10 a.m., Wednesday, February 7, 1973.]

THE 1973 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 7, 1973

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

The committee met, pursuant to recess, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman, Reuss, Widnall, and Conable; and Senator Proxmire.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Michael J. Runde, administrative assistant; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Khrumbhaar, Jr., minority counsel; Walter B. Laessig, minority counsel; and Leslie J. Bander, minority economist.

OPENING STATEMENT OF CHAIRMAN PATMAN

Chairman PATMAN. Mr. Shultz, we welcome you to the Joint Economic Committee. We are glad to have you. We are looking forward to your testimony.

This morning marks the second day of hearings on the administration's economic policies—policies which I consider to be a retreat from and abandonment of urgent national priority needs.

The administration has set forth an economic policy marked by climbing interest rates and the widely held expectation that the Nation is headed toward another disastrous credit crunch before the year is out.

Since April the prime rate has increased 20 to 25 percent and is expected to increase by the same amount again and reach a level well above 7 percent before the year is out.

By the same token, business loan rates, which average at least one point more than the prime, have followed the same pattern.

Effective residential mortgage interest rates, which stood at 7.51 percent for conventional home loans in April, have risen to 7¾ percent and are anticipated to reach 8 percent in the months ahead.

But one thing that is shocking to me, Mr. Shultz, is the fact that the poor person today who is buying a \$20,000 home must obligate himself to pay twice as much in interest and such charges than the home cost him.

In other words, he pays for three \$20,000 homes in order to get title to one, and I think that is clearly against conscience. We can never have environmental quality, the way I see it, in this country as long as we have such terrific rates as that.

Left unchecked, as the administration apparently intends, current circumstances will once more create a credit crisis for small business and industry, State and local governments and moderate and middle-income home buyers.

Aside from rising residential mortgage interest rates, the administration has made it perfectly clear that it has abandoned the national housing goals and those goals apply to low- and moderate-income families, the people most in need of decent shelter. The cancellation of federally assisted housing programs amounts to nothing less than this since no other way has been provided to finance the 600,000 units a year needed by low- and moderate-income families.

Along with the housing goals, the administration has also abandoned the full employment goal of 4 percent and has replaced it with a goal of 4.5 percent, a difference of nearly half a million people. Moreover, the current 5-percent unemployment rate fails to realistically indicate the full scope of our employment problem.

The Economic Report of the President shows that there were a total of nearly 8 million families and unrelated individuals with incomes at or below the poverty level during 1971. Add that total to the 4.4 million persons currently unemployed, plus the number of persons who have dropped out of the job market and are no longer statistically listed, and the real unemployment rate would be shown to be well over 10 percent.

The administration's indifference to the social needs of the Nation has also resulted in cutbacks in programs dealing with urban and rural development, health care and aid to education, among others.

I do not mean to imply that all Federal assistance programs are without fault. I do mean to emphasize that amputation is no solution for problems characterized by financial starvation and inadequate administration. At the very least, I would ask that the administration show the same concern for the people of this Nation that it has repeatedly demonstrated for such corporate giants as the Penn Central, Lockheed Aircraft, and the big banks.

Perhaps the most galling example of the administration's attitude was given to this committee yesterday when the Council of Economic Advisers in effect declared that tax reform is not desirable because it could mean tax increases. In my view, this is saying that we cannot have tax equity because it will mean that large corporations and wealthy individuals may have to shoulder their fair share of the tax burden.

It goes without saying that there are better ways of approaching crucial national problems. Hopefully, Treasury Secretary George P. Shultz, this morning's witness, will provide a more helpful outlook.

Welcome to the committee, Mr. Shultz. You may proceed with your statement.

Let's see, Mr. Widnall, would you like to say anything?

Representative WIDNALL. No, Mr. Chairman. We would just like to welcome you, all three of you witnesses this morning. We feel you can be very helpful in giving us the answers that you will provide for us.

Chairman PATMAN. I will reserve my time this morning in the beginning and I will yield to Mr. Widnall to have his 5 minutes, and then I will yield to Mr. Proxmire. I think we can afford to start on

10 minutes this morning, because we have a small number of committee members present.

Mr. Shultz, suppose you deliver your statement first, then I will yield to Mr. Widnall and Mr. Proxmire.

STATEMENT OF HON. GEORGE P. SHULTZ, SECRETARY OF THE TREASURY, ACCOMPANIED BY PAUL A. VOLCKER, UNDER SECRETARY FOR MONETARY AFFAIRS; AND JOHN T. DUNLOP, DIRECTOR, COST OF LIVING COUNCIL

Secretary SHULTZ. Thank you, Mr. [Chairman and members of the committee.

The Nation's basic economic goal is to achieve prosperity for all our citizens, without war and without inflation. We made considerable progress toward that goal in 1972: Employment and output advanced sharply, unemployment and inflation declined, and we saw the start of a major change in our international economic relationships. I expect that we will make further progress in all of these areas in 1973.

Economic growth is now under a full head of steam that will carry forward through the year ahead. This momentum is coming primarily from the private sector of the economy, but the Federal budget is also contributing to the expansion. As is appropriate, this fiscal stimulus will be reduced as the economy continues to expand and enters the zone of full resource utilization.

As we approach 1974, we must be on guard against either a burst of economic growth that would carry us through the upper bounds of the full employment zone, as occurred in 1967, or a marked slowdown in growth that would leave us short of full employment, as in 1959-60. Our present course will, I believe, put us on the path of steady growth at full employment and minimize the risk of straying off the path to one side or the other.

At the same time and on the assumption that fiscal and monetary discipline will be maintained, we will make further progress in the fight against inflation. The stabilization program contributed to the slowing of price and wage increases in 1972, and we expect it to make a contribution again in 1973. The program has been modified so that in much of the economy the rules are now self-administered; nevertheless, a comprehensive system of restraints over prices and wages remains in force. I might say "self-administered" in the same sense that our income tax system is self-administered.

In some ways, the economy and Federal spending now stand at roughly the same place they did in 1964 or 1965. At that time, the economic recovery was well underway, inflation was still near a minimum, and the unemployment rate was dropping rapidly. Fiscal policy was stimulative, supported by the 1964-65 tax cuts, but the Federal budget was in approximate balance on a full employment basis. However, as domestic spending continued to increase, and as military spending for our growing involvement in Southeast Asia soared, our fiscal and monetary policies became irresponsibly stimulative and pushed the Nation into an inflationary boom from which we are still recovering.

This committee became increasingly vocal during the mid-1960's in expressing grave concern about that course of events. In 1968, the Congress and the executive branch together achieved a major reversal of fiscal policy, by regaining control over the Federal budget. This effort was carried out by two Presidents and by Members of the Congress on both sides of the aisle.

Since 1968, the Federal budget has generally remained under control. Severe restraint on military spending has provided room for an enormous expansion of spending for human resources and for large tax cuts.

I might note that I know you have copies of these budget books. The chart on page 16 of the budget book clearly brings out the point that in 1968, just before the President took office, we were spending roughly 33 percent of the Federal budget on human resource programs and about 47 percent of it on defense programs. As we project the 1974 budget, the defense programs have moved down from 47 percent to about 30 percent, and the human resources programs, by contrast, have moved up from around 33 percent to about 47 percent. So we have had an exact reversal in emphasis within the budget.

At present, however, all of the demands for increased Federal spending cannot be met. While there is room in the 1973 and 1974 budgets for an increase of \$37 billion in total outlays—mostly for human resources and general revenue sharing—it is vital that we cut back decisively those programs that are not worth the expenditure.

Thus, it is again critical that we have close cooperation between the Congress and the executive branch. Failing such cooperation, Federal spending will again rise at a pace that would generate an unacceptable rate of inflation in future years.

INTERNATIONAL DEVELOPMENTS

The focus of the administration's efforts with respect to the international economy is clear. First, we must continue our efforts to bring our external trade and payments position into a sustainable position. Second, we must press ahead with the urgent work of international monetary and trade reform to build an international economic order within which all nations are treated fairly and can grow and prosper.

These goals are interrelated. Without a stronger dollar and trade position, the prospects for monetary stability and an open trading order will dim. Without an agreed framework for the monetary and trading systems, unilateral defensive actions by one country or another can frustrate the restoration of an acceptable balance in our payments.

Last year, the overall U.S. balance-of-payments position showed a reduced, but still very substantial, deficit. However, the improvement can be traced entirely to some lessening of speculative pressures and smaller capital outflows. Meanwhile, our trade deficit was larger in 1972 than in 1971, although the deteriorating trend was arrested in the second half of the year.

The larger trade deficit last year is explicable in terms of cyclical factors and the initial, inevitably perverse effects of the exchange rate realignment. Looking ahead, we can foresee some improvement.

Nevertheless, I must emphasize the hard fact that we have a long way to go to achieve the trade surplus we need to bring our overall payments into sustainable equilibrium. We have learned that process

will take time. I believe the exchange rate realignment is beginning to help. So is our relatively good performance toward restoring price stability at home. Yet, there can be no room for complacency. The stark fact of our large deficit is plain for all to see.

Sporadic speculative disturbances in exchange markets reflect the underlying uncertainties. We must do what we can to speed the process of adjustment.

In particular, we need to recognize the favorable effects of exchange rate realignment will be undermined if we fail to manage our domestic economy effectively. Our domestic and international objectives coincide in demanding that we resist inflationary increases in costs and prices. Over the past 2 years, U.S. price performance has compared favorably with that of our competitors. We are resolved to do still better. The President's budget, the wage-price program, and the full range of our economic policies reflect our determination to do so.

For the longer term, we seek a major strengthening of the international economy through further elimination of trade barriers and through thorough reform of the international economic system.

Negotiations on reform of the international monetary and trading system are already in full progress, mainly under the auspices of the Committee of Twenty created last year. The United States played a leading role in establishing that forum, representative of worldwide interests, and has advanced a series of specific reform proposals to stimulate the discussions.

These discussions are dealing with fundamental issues of deep concern to individual nations. It is understandable—indeed it may be essential—that conclusions be deferred in one area of discussions until the pattern of the whole can be more clearly foreseen. Moreover, seeming agreement on such broad generalities as an improved adjustment process or convertibility can hardly be meaningful until those generalities are fleshed out more with concrete approaches, incentives, and obligations. I believe the negotiation process has achieved a better understanding of these issues and more specifically the proposals which we and others have submitted. In short, the committee is laying the intellectual basis for ultimate decisionmaking.

We all recognize there are deep-seated and fundamental differences on many aspects of reform, and I have no illusions about an easy solution. But I am encouraged that there is at least a common view of the broad objectives, and a general willingness to try to resolve our differences.

I continue to hope that the main outlines of a new system can be agreed by the next IMF meeting in Nairobi, and I assure you the United States will do its best to help meet that target.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Shultz.

We appreciate the testimony that you have given and it will be given very careful consideration by us.

Senator Proxmire was called out on a very urgent matter to a committee on the other side. He will be back in a few minutes and we will reserve time for him.

The newspapers referred to a phrase, economic czar, when you were selected by the President, Mr. Shultz. The President did not say it. But the newspapers did. You, of course, noticed that they called you an economic czar. Does that mean that you have—

Secretary SHULTZ. The newspapers have called me lots of things, Mr. Chairman, along with that characterization.

Chairman PATMAN. I have had some experience along that line, too, Mr. Shultz.

Really, you do have authority over all the economic matters in the United States, do you not—

Secretary SHULTZ. Well—

Chairman PATMAN [continuing]. Relating to wages, price controls, and the economy generally, that will affect the policies of the President?

Secretary SHULTZ. Well, I have the responsibilities of the Secretary of the Treasury and I have the responsibility for helping to coordinate the efforts of others through the Government so that we can bring to the President as coherent a set of recommendations as possible.

In that role I do not tell people what to do but try to help coordinate and help get as complete a story and analysis to the President as possible and where we can move forward on the basis of our own internal consultations, that we do so on a coordinated basis.

Chairman PATMAN. I assume that carries with it the power to reject or accept certain programs or suggest that others be substituted instead.

In other words, you have overall authority to coordinate the programs, I assume. That is correct, is it?

Secretary SHULTZ. Well, I do that on behalf of the President and, of course—

Chairman PATMAN. I understand that.

Secretary SHULTZ. When things are important they go to the President. He is the authority in the executive branch.

Chairman PATMAN. How does that affect other agencies of the Government like the Federal Reserve System? Would you have power over the Federal Reserve?

Secretary SHULTZ. No, sir.

Chairman PATMAN. None at all?

Secretary SHULTZ. Well, in the field of domestic monetary matters the Federal Reserve, of course, is an independent agency responsible to the Congress and we have no authority over the Federal Reserve.

Naturally, since the Treasury and the Federal Reserve have many matters of common interest, we try to inform each other and work in a cooperative manner, but they are independent and behave as such.

On international matters, of course, like all others, we are one nation abroad and we coordinate our activities there under the President's direction.

Chairman PATMAN. I know it's generally said that the Federal Reserve is independent but I wonder where you get your reasoning for that. The Federal Reserve Act is a law just like any other law passed by Congress and approved by the President. There is nothing in there that says it's independent. There is nothing in the Federal Reserve discussions, in the House and Senate, that says it is independent and the law certainly does not mention the word "independence" at all. How do you claim that it is independent?

Secretary SHULTZ. Well, it has certainly been the tradition and experience and expectation that we would have a monetary authority

that could operate with respect to the money supply and other major monetary variables as an agency looking at the economy and the impact of those changes on the economy in a fashion of independence.

Chairman PATMAN. On a broad question like that I shall certainly not take your time in an important hearing like this to discuss the independence of the Federal Reserve but I want you to know I do not agree it is independent and I know a lot of other people who do not agree it is independent. I think the Federal Reserve has been claiming otherwise over a long period of time to make the people believe it was independent. I do not think everyone accepts their reasoning, but for this hearing we will let that part go.

The question of interest rates, though, is one of the most important subjects we have and you cannot deal with interest rates very well unless you have the cooperation of the Federal Reserve.

Don't you agree with that, Mr. Shultz?

Secretary SHULTZ. Yes, sir.

Chairman PATMAN. You have to have the cooperation of the Federal Reserve. Well, do you get the cooperation now?

Secretary SHULTZ. We have within the stabilization program, as you know, a Committee on Interest and Dividends. The chairman of that committee is the Chairman of the Federal Reserve.

The Secretary of the Treasury is a member and there are other members of financial organizations in the Government, and we try to work together to help achieve the objectives of the stabilization program generally insofar as they are reflected in that sector of the economy. We have been particularly active recently with respect to recent increases in the prime rate.

Chairman PATMAN. The members of the Wage and Price Control Board, how many are there, including the Dividends and Interest Division?

Secretary SHULTZ. Well, I would have to look that up to be sure, Mr. Chairman, but the Cost of Living Council includes several Cabinet members. It includes the President's Consumer Adviser, it includes the Counselor to the President, Mrs. Armstrong, it includes the Director of the Cost of Living Council, of course, so I think that we have—

Chairman PATMAN. Does it include—

Secretary SHULTZ [continuing.] About 10 or 12 members of the Cost of Living Council.

Chairman PATMAN. Are all of them connected with the Government in some way?

Secretary SHULTZ. Yes; they are all full-time Government employees on the Cost of Living Council and the same is true of the Committee on Interest and Dividends.

Chairman PATMAN. Well, if you say that the Federal Reserve is independent, how could you consider Mr. Burns an employee?

Secretary SHULTZ. He is an employee of the Government just as the Chief Justice of the United States is an employee of the Government.

Chairman PATMAN. He is what?

Secretary SHULTZ. I say he is an employee of the Government just as the Chief Justice of the United States is an employee of the Government.

Chairman PATMAN. He wears two hats, one, Chairman of the Federal Reserve Board, and one as Chairman of the Interest and Dividends Division. They have not had a meeting, have they?

Secretary SHULTZ. They have had many meetings.

Chairman PATMAN. I have never seen any evidence of any meetings or at least any decisions. I am unaware that any decisions were issued.

Secretary SHULTZ. Well, I am sure we could get for the record, if you would like, a listing of the dates of meetings. There have been several statements issued by the committee and, of course, there are meetings of committee members and consultations apart from formal meetings, and there was a statement issued last Sunday, appearing in the papers on Monday, by the Committee on Interest and Dividends. That is the most recent action I know of.

Chairman PATMAN. I could not understand why they were proceeding in such a half-hearted way or in such a feeble way in fixing interest rates.

You know the House Banking and Currency Committee initiated a bill to give the President power a few years ago to roll back interest rates and he has the power now to roll back interest rates, so why would you, just by a statement and releases, try to get the bank to go easy on the prime rate when you have the power to fix the prime rate?

You certainly get no cooperation from the banks as a whole on having a satisfactory prime rate and, besides, do you not think the prime rate is almost a fake inasmuch as banks can and are making loans to prime customers at rates above the prime. The prime rate is a fraud—a sham. I have been told the banks are shooting for something like that 7½ percent on business loans to prime rate customers. This in turn will mean higher rates for practically all loans. I do not see any relief for the people under these circumstances. I am convinced that there is coercion between the banks in setting the prime rate. It is not in writing, it is not agreed in conversation, it is one of these unconversational understandings, but I do not think they would be held responsible under the antitrust laws for it, although they should be.

Do you think they would, if they were to get a rate that was—although high and burdensome and not justified—do you think the antitrust laws would still apply to them?

Secretary SHULTZ. Well, I do not have an offhand answer to that, Mr. Chairman. The movements in the prime rate do not seem, so far as I know, to be a result of discussions among the banks themselves about what they are going to do; that is, I do not know that there is any evidence of price fixing in that sense.

Chairman PATMAN. But now some will go up and some will go down but they finally arrive at a rate that they are all willing to accept and they all just accept it and they have no conversation about it and nothing in writing about it. I do not see how you can reach it in violation of the antitrust laws, since the Government has been a party to the juggling.

Secretary SHULTZ. We have asked them to be conscious of the goals of the stabilization program and to observe their own costs, their own practices and to show restraint and moderation just as others are being asked to show restraint and moderation.

Chairman PATMAN. What do you think would be a fair prime rate, Mr. Shultz?

Secretary SHULTZ. Well, I do not think you can just define that as a number unrelated to other things in general. The market produces rates of interests for general categories of prospective borrowings and it depends on the circumstances what the appropriate rate is.

Chairman PATMAN. So far as I have been able to ascertain, the prime rate customers are unknown, there has never been a list made by any bank of prime rate customers, they just accept certain people as entitled to the best rate without any understanding of any kind.

Now the prime rate, of course, cannot be enforced. If you were on the prime list and you noticed the prime rate had gone down and you wanted to get a loan and you went into the bank and to say to them, I am a prime customer and I want to borrow some money on the new prime rate, there is nothing to keep the bank from instantly raising the rate. They could lower it or they could raise it, but no one has anything to do with the rate except the bank itself, have they, Mr. Shultz?

Secretary SHULTZ. The bank, of course, must operate in competition with other banks, and I think a bank that raised its prime rate above the levels that were maintained by other banks would find itself losing customers after a while and it would tend to be forced down. Competition does tend to keep general equality of rates as among competing banks. So I think that, as an administrative act, a bank can decide what to set as its prime rate, just as it can decide as an administrative act whether or not to make a given loan when somebody comes in and says, "I need money and I want to borrow it." The bank has an administrative decision to make about whether to grant that loan and what are appropriate terms. Nevertheless, just because that is an administrative act does not mean that the bank's activities are not conditioned by the competition they receive from other banks. So I think it is misleading to think just because they can take that administrative step that they can act as though they are in isolation.

Chairman PATMAN. The big banks are the only ones affected by this. I do not think the smaller banks are affected.

If the banks should establish a prime rate of 8 percent, what could the Government do on a rate like that, what action could you take?

Secretary SHULTZ. I think, Mr. Chairman, it is noteworthy that interest rates generally are at a lower level than they were on August 15, 1971, when the President instituted his new economic policy. As a general proposition, the better job we do in controlling the budget and in making the best and most effective use we can of the wage and price control system and of maintaining discipline in our monetary policy, the more successful we will be in controlling inflation. When the rate of inflation is low and falling and when the expectations are that the rate of inflation will continue to be moderate, then we see that reflected in interest rates. That is the basic way in which we have to get at it, although we can, at the same time, expect the banking community to show the same restraint and moderation that we are asking others in the economy to do. And I think we are entitled to expect them to behave that way.

Chairman PATMAN. Suppose they would ignore you and the prime rate it is 8 percent, what could you do about it?

You do not know what rate they are going to arrive at because they are still juggling, still offering different rates, some high and some low. Suppose they should finally agree on a rate that is too high, and you know it is against the interest of the country, and it is inflationary, say 8 percent, what could you do or what would you do about it?

Secretary SHULTZ. One of the things that we are doing is asking the four banks that raised their prime rate last week to come in and submit their cost information and show us how they arrived at that decision.

Now, as of this morning, I believe three of the four banks have decided to take back the increase that they announced. I have not heard anything about the fourth bank.

At any rate, we have established a unit that will be prepared to examine costs and to look for justification of the interest rate behavior.

Chairman PATMAN. But the fact remains you are not doing anything that you have a right to do under the law to roll interest rates back.

I think we are in a terrible plight in this country when a person must agree to pay \$40,000 interest on a \$20,000 home, pay \$60,000 in order to get a \$20,000 home, when people are paying generally all over the Nation 18 and 24 percent interest and 42 percent interest and up to 240 percent interest. It occurs to me if there ever was an opportunity for the Government through you gentlemen to do something that is decisive and conclusive and right, you could take a hand in that and roll back those interest rates. That is terrible, that is against conscience.

Secretary SHULTZ. Mr. Chairman.

Chairman PATMAN. No one wants rates like that and they are going on all over the Nation today, and how can we go through a pretense of fighting inflation when we are allowing people to be charged that much interest?

Secretary SHULTZ. Mr. Chairman, one of the few prices in the economy—if you want to consider interest rates as a price, as I think you properly can—that has been generally lower during the stabilization program than it was at the start is interest rates. So in a sense, the stabilization program has brought about a rollback, if you want to think of it that way, but in a manner that is workable; that is, it is a reflection of the fact that both inflation and the expectations of inflation have receded somewhat, and it is up to us, I think, to work hard to continue the fight against inflation. This fight is reflected in the budget policy of the President and in the decisions about phase 3 and the request that you extend the Economic Stabilization Act. All of those things are part of the continuing effort to control inflation, and I believe that this is ultimately the way to have interest rates be lower.

Chairman PATMAN. Well, I do not see it that way at all. This jaw-boning may be generally persuasive but I doubt the banks will respect it.

About the changes in interest rates, may I invite your attention to the fact that within 5 months after Mr. Nixon went in the first term, interest rates have been raised three times and raised substantially, and the last time it went to 8½ percent, June 9, 1969. That is the highest prime rate in the history of this country.

I do not think the administration is dealing with this problem in a way that people can expect relief from high interest rates.

When you have to pay \$40,000 interest on a \$20,000 home, somebody is wrong and our country will be ruined with such interest rates as that. People now are charged 18 and 24 percent interest and yet you are doing nothing about it, nothing, and that is bound to be inflationary. Whenever you raise the price of interest, why, you raise the price of everything, even the goods on the shelves that are offered for sale.

Everything goes up with interest rates. And interest rates cause inflation, if they are excessive. We are dealing with the major problems here, inflation and, of course, price increases, and we are dealing with poverty because high interest, excessive, exorbitant interest, causes poverty. The higher the interest, the more poverty we have.

So we are failing to fight two of the most, two of the greatest, evils we have, inflation and poverty.

Representative WIDNALL. Will the chairman yield?

Chairman PATMAN. I yield to the gentleman.

Representative WIDNALL. I was under the understanding that we were operating under the 10-minute rule.

Chairman PATMAN. We were. Mr. Proxmire left and changed it a little bit.

If you want to be recognized now, it will be a pleasure to do it, Mr. Widnall.

Representative WIDNALL. I would like to know how many minutes you have because I know you ran substantially over the 10 minutes.

Chairman PATMAN. Well, you will get the same amount of time.

Representative WIDNALL. That is not it. If we have rules, we should abide by them, Mr. Chairman.

Chairman PATMAN. We do not have many members here this morning and we usually become realistic and judge our time by—

Representative WIDNALL. That is true, but we still should alternate.

Chairman PATMAN. You are recognized for the same time I used.

Representative WIDNALL. How much was that?

Chairman PATMAN. About 12 minutes or 14. [Laughter.]

Representative CONABLE. I have been here for 20 minutes.

Chairman PATMAN. All right, make it 20 minutes.

Secretary SHULTZ. Mr. Chairman, I remember particularly my formal student days. I like to think I have been a student all the time since then, but particularly when people like Professor Dunlop and his colleagues would examine me, the best technique for the student always was to get the professors arguing with each other.

So we are sitting here and you people just go right ahead, a tried and true student technique.

Is that right, Professor Dunlop?

Representative WIDNALL. Mr. Secretary, what provisions are being made to exempt food, medical care, construction costs, and interest and dividends from the more rigid enforcement which they are subject to under phase 3, if price fluctuations in these areas are consistent with the stabilization effort?

Secretary SHULTZ. Well, we, of course, continue to examine the structure of phase 3 as we go along. We expect that the basic structure is there for 1973 and we think that the pattern of mandatory controls

in the areas that you have mentioned—particularly the first three—are going to be needed and are needed and we will work with them through the year 1973.

Representative WIDNALL. A lot of pain is being felt with respect to medical care and hospital help where price decisions have not been made and appeals have been taken in connection with price structures. It seems to me that people are entitled to prompt decisions so that adequate planning can be done in these particular areas.

Are you familiar with the time lag that is taking place in a number of areas?

Secretary SHULTZ. I agree with the important need for prompt action on cases, and we are working to clean up the backlog of cases that were pending in the Price Commission and the Pay Board at the time phase 3 was announced.

Of course the pattern of self-administration in many sectors of the economy does not mean that people are operating outside the rules. We expect, rather, that they can self-administer within the rules and, thereby, we will not have the same bureaucratic problem that you are suggesting.

Representative WIDNALL. I know a number of instances where they just are hanging on the ropes in their operations because no decision has been made; they cannot adequately finance the deficits that are taking place and arrange for future commitments and future obligations because of the failure to act. I think it is extremely important that those who are administering the program be impressed with that and make some prompt decisions.

Secretary SHULTZ. I agree with that and, if there are troublesome cases that will help us to dig into this subject, I would be glad to have them and know about them.

Representative WIDNALL. The announcement of phase III states that, and I quote:

Procedures will be established which will permit the Government to see whether [wage and price] conduct is reasonably consistent with the voluntary standards

In the Economic Report of the President the point is made that the Government will step in with regard to action that is "unreasonably inconsistent" with the standards.

Does this mean that the phase III standards need not be adhered to exactly? How is a firm or union to know whether its conduct is reasonably consistent or unreasonably inconsistent with the phase III standards?

Secretary SHULTZ. The reason for using the word "reasonable" is that we found in our examination of phase II and as we consulted with people about what was going on—and we consulted quite widely and consulted people here, among others—that there were many anomalies creeping into the system as a result of the kind of mechanical application of certain rules. Uneconomic behavior of one kind or another began to develop, in which firms began to see an incentive in the system to let their costs expand; for example, in response to the tightness of the profit margin rule and, therefore, encourage uneconomic behavior. We want to stay away from that by having people do things that are reasonable under the circumstances, but we expect that they will adhere to these basic standards that are put forward. They are there in considerable detail, far more detail

than ever before with a program of this general nature. So I think while there is some uncertainty in people's minds, they basically have the phase II rules, with some modifications, to look at. They have come to understand those rules and those are the ones that are in effect.

Representative WIDNALL. The administration has stated that an unemployment rate of 4½ percent by the end of 1973 is consistent with the goals of stable economic growth and reduction of inflation.

Does this mean that the administration has abandoned all hopes of reducing unemployment below the 4½-percent level?

Secretary SHULTZ. No, sir. That is an estimate of where we think the unemployment rate as presently computed is likely to be by the end of the year. It is expected to be in that neighborhood just as, at this time last year, our estimate was that the unemployment rate would decline from roughly 6 percent to the neighborhood of 5 percent by the end of 1972.

That is what we said at the beginning of last year, and now we are saying it is going to continue its decline and we think that it will reach the neighborhood of 4½ percent by the end of the year.

That is simply our estimate of where the policy path that we are on is likely to take us in the year ahead. Obviously, there are many uncertainties involved in that. The economy is moving forward very strongly.

Now, a 4½-percent unemployment rate is not an ultimate goal. The ultimate goal, I believe, should be thought of more in human terms than in statistical terms. The statistics can be very misleading, because they do not describe consistently a similar picture when the composition of unemployment changes drastically as it has over the last 10 years.

But, in human terms, what we want is a situation where everybody who wants a job, and who is willing to look for one and take a job that is reasonably consistent with what they can do, can get a job. That is the kind of situation we want.

Representative WIDNALL. Mr. Secretary, I notice in your answer you said, "as presently computed." Is there a difference in computation to take effect sometime in the near future?

Secretary SHULTZ. No, I was just referring to the standard way in which the Bureau of Labor Statistics puts out its unemployment calculation and as you know there are many other people put out different kinds of calculations. The chairman mentioned a different way of computing it and there are all sorts of variations on this theme that people have used, but I wanted to make reference to that method used by the BLS. That is what I was referring to.

Representative WIDNALL. A rather important question, I think, Mr. Secretary, is how will the end of the war in Vietnam affect the economy in 1973? Or has the economy basically adjusted with the winding down of the war?

Secretary SHULTZ. In terms of the basic economic magnitudes of spending and employment and so forth, we have, of course, already seen the winding down of the war. Again referring to these budget books that you have, there is a chart here on defense-related employment which shows that in fiscal year 1968, we had about 8 million people employed in defense-related areas. That is in the military and DOD civilian and in defense-related industries.

By this time, that 8 million has declined to about 5.2 million, so we have had a very large decline in defense-related employment already. We expect that that picture will level out now, and the problem of absorbing these very large numbers which we have been undertaking over the past 4 years is now behind us, and we look forward to more stability in this employment picture.

Now, I don't believe that is the end of the matter by any means, because, it seems to me, the coming of peace to our country is one of the greatest things that we can have. It is bound to have an impact on the outlook and the sense of security that people feel, a sense of certainty and predictability about our life. I think the winding down of the war in these past 4 years has contributed to the settling down of our society, and the peace agreement and its establishment will continue to make that same contribution. So I think that we can look forward to the next 4 years with a new and fresh spirit that will affect our society throughout and will have an impact on the economy, even though in purely quantitative terms you won't find it. That affect has already been seen.

Representative WIDNALL. It is quite apparent from the figures and from the comparisons as to the slice of the pie taken by defense and by other operations of the Government that the defense part has gone down substantially from what at the top was about 65 to 70 percent of the budget, to a point now where it is 30-odd percent. Is that not right?

Secretary SHULTZ. That is correct; if you go back to the 1940's you will find that high percentage right after World War II.

Representative WIDNALL. And actually this has been done despite the fact that the military are increasing the amount of pay and wages and benefits that are obtained by those who are part of the military and a very substantial addition has been made to our budget through the action of Congress in granting those things to our service people.

Is it possible to isolate the effect which (1) the liberalized depreciation regulations, (2) the job development tax credit, and (3) the excise tax cuts on motor vehicles have had on our economic expansion?

Secretary SHULTZ. Well, in a general way it is possible, and I suppose that as we get more and more information we can pin it down with some more precision. But it is quite apparent that commitments for capital spending on new plant and equipment have moved forward very strongly since the 1971 Tax Act was completed and that certainly suggests a connection. One would expect there would be an effect in providing for a greater rate of return on capital investment. You would expect that to stimulate investment and it has. It's been one of the main contributing factors to the rise in investment. By the same token, the repeal of the excise tax has tended to let car prices, other things equal, be a little less expensive for the consumer and, therefore, stimulates the demand we have had—not entirely due to that, but I am sure it has made some contribution toward a tremendous year now—in automobile buying and production, and that has been a real contributor to the economy.

Representative WIDNALL. Is the administration still considering a value-added tax?

Secretary SHULTZ. No, we don't have that under strong consideration at this time. You may know that the idea of a combined value

added tax and a reduction of the property tax, and provision for a flow of money for education spending, was put to the Advisory Committee on Intergovernmental Relations last year. The President asked for their advice on that combination and their advice was basically negative. The President has not made final decisions on his own recommendations in the tax area as yet, but the value added tax is not up there as one of the front runners by a long shot.

Representative WIDNALL. I would like to ask one question of Mr. Volcker. Incidentally, Paul, I am delighted that you are staying on and will be part of the administration during the years ahead.

Secretary SHULTZ. I share that sentiment.

Representative WIDNALL. The question I have is this: The dollar is under very severe attack overseas. Is there any imminent meeting that is going to be held with foreign nations in an effort to reach some kind of agreement in the monetary field?

Mr. VOLCKER. I know of no general meeting, Mr. Widnall, none planned and don't expect any.

Secretary SHULTZ. There are, of course, the continuing efforts that we have been pushing of the Committee of Twenty and in the deputies of the Committee of Twenty, where Mr. Volcker is the U.S. representative, to push forward on general international monetary reform. I believe the next meeting of the deputies is scheduled for early March. We expect there to be a meeting of the ministers sometime in late March or so following the three meetings that have now been held or will be held of the deputies.

Mr. VOLCKER. We have continuing bilateral contacts. We are in fairly steady contact as you would expect.

Representative WIDNALL. That is all. Thank you.

Chairman PATMAN. All right, let's see, Mr. Conable, would you like to be recognized?

Representative CONABLE. Thank you, Mr. Chairman.

Chairman PATMAN. We will get back on the 10-minute rule if you want to and we will start around again. Will that be OK?

Representative CONABLE. Fine, yes, Mr. Chairman.

Mr. Secretary, welcome before our committee again. We are happy to have you here and we all share your concern about economic policy and want to understand as much about it as we can.

What is the desirability of maintaining the present parity level of the dollar and what are the prospects for achieving it? We have noticed what is going on in Europe and realize you may be under some constraint as to what you can say about it.

Secretary SHULTZ. So far as I know, this morning the exchange rate, exchange markets are relatively quiet and one of the things we do seek to avoid is to make statements that rightly or wrongly are interpreted in some way that stirs things up, so—

Representative CONABLE. All right.

Secretary SHULTZ. So we prefer not to stir things up if we can help it.

Representative CONABLE. I would like to ask Mr. Volcker, I think, what can be done about the Japanese and Canadian trade imbalances which make up the major deficit item on our trade contract. I realize that these are part of a total problem and that we can't look at them on a purely bilateral basis.

What do you anticipate the probable course of discussions to try to resolve this problem will be?

Mr. VOLCKER. Well, I think you put your finger on an important element in the problem without question, Mr. Conable. The Secretary spoke of our deficit, the need for time to deal with this matter, but the urgency of pressing ahead. Our deficit, of course, is matched by other's surpluses and you have indeed put your finger on a focal point of disequilibrium where there has been continuing discussion and effort. I think some measures have been taken, apart from the measures that we ourselves took quite vigorously a year or two ago. There have been some continuing efforts in Japan. The results have been slow to come, frankly, and I think apart from the necessary lags in this process there can be room for perhaps some impatience.

Now you say what kind of efforts? I think in the end this does take some restructuring, some shifting of resources in economies. That doesn't happen overnight. I think the broad lines of the Japanese intentions there have been made clear in a number of areas. One important thing to do, I think, is to act upon those intentions in a very vigorous way with dispatch.

Representative CONABLE. The Japanese are very good at forecasting intentions.

What specifically have the Japanese done up to this point? There's a difference between forecasting and doing, obviously.

Mr. VOLCKER. There have been measures—

Representative CONABLE. We have been reading, for instance, in the paper yesterday and today the focus is shifting to Japan at this point following the dollar flurry in Germany.

Mr. VOLCKER. There have been measures to liberalize import restrictions of which there were a good many. There have been some limited actions on the tariff side, all on the side of opening that market to imports, and I think that that is vitally important in the longer run. There have been some actions to restrain exports. There has been talk about more action to restrain exports. They have a voluntary textile agreement, a voluntary steel agreement, specifically with us. But there has been more general action talked about at least in terms of restraining exports.

There was an exchange rate change some time ago, as you know. Now, fundamentally I think the intentions of the Japanese Government has been expressed in terms in redirecting their resources more toward internal needs and they have a lot of internal needs in improving the standard of living, the housing needs, and antipollution requirements in Japan.

In the end I think this kind of restructuring is clearly in the interest of the Japanese people. I think they believe it is in the interest of the Japanese people. They obviously do. In the end that is going to show through on the external side. I think the imperative thing is you move on a variety of fronts forcefully because this problem is very serious and it is very serious today and there is no hiding it.

Representative CONABLE. Are the Japanese making any progress in opening up European markets?

Mr. VOLCKER. Well, that is another dimension of the problem. I think there has been certainly some increase in Japanese exports to Europe from a very low level. There are a number of restrictions in

those markets that they have run into and I think we do live in a multilateral world and one of the problems and objectives in achieving a better balance in the world is certainly one side of it is that the European markets should certainly be more fully open to the Japanese. I don't think there is any question about that.

Representative CONABLE. Mr. Secretary, I have just come from the Ways and Means Committee where we are working on tax reform. We have noted the departure, unfortunately, of some of your very fine Treasury people in the tax area. Who will be speaking for the administration with respect to any tax reform legislation that evolves in our committee?

Secretary SHULTZ. Well the same person that was handling it before. Fred Hickman is the Assistant Secretary for Tax Policy and he will continue to do that. Eddie Cohen, as you know, has decided to return to private life. He is still on the Treasury staff. He has not as yet resigned and, of course, has been extremely helpful to us in this area. But the burden in operating as Assistant Secretary is Mr. Fred Hickman who has been Assistant Secretary since last July and was in the Treasury, I think, for about a year before that.

Representative CONABLE. Will the administration's recommendations in this field be made known before the completion of our hearings on tax reform?

Secretary SHULTZ. Well I am not certain just what the timing of the President's decisions will be. Certain things are clear—

Representative CONABLE. Are studies in progress now with respect to this?

Secretary SHULTZ. There are always studies in progress in the Treasury on this subject and we have been working on the subject intensively over quite a period now. Among the things that we have been trying to do is to assess the impact of the very major tax reforms that were instituted in 1969 and 1971, and what do these changes mean. And, of course, since they affect subsequent tax years then you wait for the tax returns, then you analyze the tax returns. The amount of information for analysis is still limited. But we are trying hard to understand and get that analysis together, among other things.

Representative CONABLE. Up here on the Hill we have noted your appointment as Adviser to the President as well as Secretary of the Treasury and we wonder what impact this has had on the functioning of the Troika and the Quadriad; are they still meeting regularly; are they functioning in much the same way they had previously under other Secretaries of the Treasury?

Secretary SHULTZ. Yes; the Secretariat, you might say, of the Troika is the Council of Economic Advisers and, as a matter of fact, we met with the President the day before yesterday as a Troika. You might consider that as sort of a subcategory of the work of the Economic Council.

Representative CONABLE. Well, has your special status with respect to the President changed the functioning of the Treasury in any way that would have an impact ultimately on economic policy? How do you view that special status?

Secretary SHULTZ. Well, it makes me even more thankful to have able people like Paul Volcker and our new Deputy Secretary of the Treasury. We had an able deputy in Charls Walker and we have

been fortunate to replace him with a very able person in Bill Simon and the many other people of extraordinary ability throughout the Treasury. It is important to have people of very high caliber in those slots.

Representative CONABLE. Is the answer then you don't expect any major change in the processes for formulation of economic policy or in your relationship to the Council of Economic Advisers? I would like to understand any possible functional differences in the way the Treasury will be operating.

Secretary SHULTZ. What has been evolving, and the present arrangement is a further evolution, is greater and greater effort on the part of the President to see to it that matters of similar nature are coordinated effectively among those who know about the subject and whose work is going to be affected by the subject. They are coordinated effectively as they come to him for decision, and as people are making operating decisions of one kind or another they are effectively working together. So the economic group has been asked to use me as a coordinator, and we hope that on the whole we will be able to have the left hand know what the right hand is doing better than we have in the past.

Representative CONABLE. Will the Secretary of the Treasury have a different relationship to trade than he has had previously? What are the lines of authority in the trade field?

Secretary SHULTZ. Well, we have, of course, put forward our position, and we put it forward in writing in our IMF presentation, which I made on behalf of the United States, that trade and money and aid and military spending and investment spending, and so on, are all linked together and conceptually can't be separated. Then as we study these questions, we should have some sort of grouping of people that represent our best thinking in those fields and talk about them in a coordinated way and we are doing that.

The Council on International Economic Policy is a primary vehicle for doing that within the executive branch, and the Treasury has played and will continue to play a strong role in this along with other departments and agencies that are involved.

Representative CONABLE. My time is up, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

I want to take 5 minutes and then yield to Mr. Proxmire. Then at that time Mr. Reuss will be back.

I didn't ask you awhile ago, Mr. Widnall wanted to use some time, and I was glad for him to use it, but I didn't ask you the important question. The important question involves \$71 billion.

Secretary SHULTZ. Involves what?

Chairman PATMAN. \$71 billion.

Secretary SHULTZ. That is always an important question if it involves that much money.

Chairman PATMAN. Yes, sir. Now the facts are that the Federal Reserve Bank of New York as agent of the open market committee of the Federal Reserve System have accumulated \$71 billion over the years and I insist that money has been paid for once. Now my authority originally on that was William McChesney Martin. In interrogating him I kept asking who had paid for those bonds. It was \$25 billion in bonds then, and he said they had been paid for once. Other officials of the Federal Reserve System have said the same thing. Since

that time the Treasury bond portfolio has increased to \$71 billion and the Federal Reserve open market committee is receiving \$4 billion a year interest on those bonds. The bad part about it is people are paying interest on a debt that has already been paid.

Now, of course, the Fed tries to justify it by saying that, the balance of it after the Fed's expenses—there is no limit to expenses they can take out of it—goes over into the Treasury. That is correct, but why should any of it go any other place except the Treasury? It should not be collected anyway because the debt has been paid once.

This debt was paid to the Federal Reserve as the fiscal agent of the Government. It takes our money, our bills that they print over at the Bureau of Engraving and Printing, and it is all good money, legal tender, every bill. Legal tender, of course, means if you owe a debt.

Now in this case the Federal Reserve has taken this money and it has bought these bonds with it. That is using one Government obligation to buy another Government obligation. The bonds should be canceled because they have been paid for. Why should the taxpayers be required to pay \$4 billion a year interest on bonds that have been paid for?

These bonds amount to 18 percent of the entire national debt.

Now, if we recognize that and condone it, accept it, the Federal Reserve can acquire the whole national debt that way. Whenever you acquire \$71 billion in bonds by issuing \$71 billion in money to pay for the bonds, you have 200 percent inflation because you have the bonds outstanding and you have the money outstanding. Both of them. And neither one has been canceled. So I insist, Mr. Shultz, that those bonds should be canceled and the national debt reduced by \$71 billion, then we would at least have available \$71 billion for housing, we would have money for poverty, we would have money for many things that we do not have the money for now. That \$71 billion has been paid and should be canceled. We owe \$71 billion less. What do you say about that?

Secretary SHULTZ. Well, the Federal Reserve use Government bonds as a principal method of affecting the money supply, and they not only buy them but they sell them. That is one of their principal instruments of policy for carrying out the responsibilities that the Congress has given to them by statute.

Chairman PATMAN. But they never handle \$71 billion.

Secretary SHULTZ. That is in the nature of their operations.

As far as the burden of the debt is concerned, that is the amount of interest cost that the taxpayers pay. As the payments are, in effect, returned to the Treasury, the burden of that debt is canceled out.

Chairman PATMAN. I didn't hear the last part.

Secretary SHULTZ. The burden of that debt, to the extent that the interest that is paid is returned to the Treasury after the Federal Reserve's expenses are taken out, is, in effect canceled as far as the taxpayer is concerned.

Chairman PATMAN. Part of it is, but why should people be required to pay interest on bonds that have been paid for once?

Secretary SHULTZ. Well, it is the Treasury that pays and then the Treasury gets back, and in the process the Federal Reserve maintains—

Chairman PATMAN. Part of it.

Secretary SHULTZ [continuing]. Its ability to exercise policy direction over the money supply and this is one of its child policy instruments.

Chairman PATMAN. Well, that doesn't make too much sense to me. I know you are sincere and honest and know more about this than I do and I am not challenging your statement. In 1959 the Federal Reserve wanted to deliver \$15 billion to the commercial banks under the Federal Reserve System, which, of course, cost the commercial banks nothing. The Federal Reserve testified it would never need more than \$10 billion to buy and sell Government bonds. Now it is \$71 billion. According to their own account they don't need it and they are holding this money and it is a charge on our national debt. It is burdensome on our taxpayers to pay interest on bonds already paid for. I shall not pursue it further right at this time because Mr. Proxmire, I think, it entitled to time. But I do want to go into it further with you when we get through with the other members.

Mr. Proxmire.

Senator PROXMIRE. Mr. Secretary, the principal clash now, of course, on the economic front between the Congress and the President is over the budget.

Secretary SHULTZ. Well I would say—

Senator PROXMIRE. Let me say before you answer my question, it is over the budget. The President is trying to hold the budget to \$268.7 billion, as I understand it. I think he has made that very, very clear and I think Congress understands it. Now, let us suppose, as you know Congress, a number of Members of Congress, 35 of us who met yesterday and decided that we would recommend to the Congress a ceiling on spending, a ceiling, maybe below or above it, but a ceiling. Let us assume that the Congress does recommend a ceiling at or below the President's level, let us assume that the Congress abides by that ceiling. Let us further assume that the Congress changes the priorities. In other words, the Congress, for example, would reduce the President's military spending proposals as they have in every one of the last 5 years; this year, say, by \$5 billion. Say the Congress reduces the foreign aid recommendations, as they have in every year in the last 20, below what the President has recommended by a substantial amount. Say then they use some of that money, not all of it, but some of the money to restore some of the programs that the President has cut—housing, farm disaster loans, some of the other areas in which they think the priorities should be higher.

Under those circumstances, No. 1, would the President accept the decision of the Congress that would require a resolution by the Congress to limit outlays by the President? No. 2, would the President permit a higher level of spending in these areas if the overall level was within a ceiling at or below what he recommended?

Secretary SHULTZ. Well, first of all, the President cannot spend money that isn't appropriated or put in his hands to spend.

Senator PROXMIRE. Well, he has enormous unobligated balances for past years.

Secretary SHULTZ. Although those tend to be pretty firmly committed and you have, for example, a large sum in the trust fund for social security payments, and those flow as a result of the way the statute reads and that is not a discretionary—

Senator PROXMIRE. He has \$40 billion of such funds in the defense area which he can spend.

Secretary SHULTZ. Those are, by and large, funds that are in a flow. But, at any rate, the point is that authorizations—and the appropriations that go with them—to the extent that they are reduced, have an impact inevitably on the President's power to spend. He cannot spend money that is not given him to spend.

Now, suppose you have some ceiling—let's say that we all agree to some number, whatever it is, and you reduce over here, and add over here, and you are at the same number. Under those circumstances, one would not argue that you should refrain from spending the additional amount because of the necessity to maintain fiscal discipline. That argument would not be a usable argument under those circumstances.

But what the President's view would be on particular programs, and what he would think about them and the proper way of spending and so on, would depend upon the particular program and his analysis of it.

Senator PROXMIRE. That is helpful.

Secretary SHULTZ. Presidents over the years have always reserved the right to disagree and to withhold funds.

Senator PROXMIRE. As you may know, I warmly share the President's position on impoundment. I am one of the few northern Democrats that does. I think he is right. I think he has to impound funds. I favored Presidents doing it in the past and I continue to do so. I think it makes sense.

My question is if you move into an area like low- and moderate-income housing and water and sewer grants and the entire program is ended perhaps for a year and a half, at least that is the indication, it may be for a year and a half, under those circumstances, if more funds become available, and it is in the law, and the Presidents in the past have signed that law, under those circumstances would the President still feel impelled to impound funds if we can assume the President would agree that this is not a wasteful or extravagant program and one that is desirable in the public interest to have, and I am sure he would agree with that on water and sewer grants, for instance.

Secretary SHULTZ. Where the President thinks a given program is desirable and spending of the money seems also compatible with our economic objectives, certainly he is not going to decline to spend the money.

Senator PROXMIRE. Well—

Secretary SHULTZ. The question is whether he thinks that it is desirable.

Senator PROXMIRE. Let me say that assume that he may not think it is the best way to spend the money but this is something that is in the law, we provide for water and sewer grants, they are mandated from the law in the past, he is not exceeding the overall ceiling in releasing the funds, under those circumstances would he still withhold them?

Secretary SHULTZ. Well, you picked two interesting examples, the housing and the water and sewer grants. Those do happen to be cases where, whatever you do with current obligations, you have a long

pipeline and you continue to get a sustained rate of spending for awhile just because of the operation of that pipeline. But I would point out on the water and sewer grants that, I believe, the last three Presidents have all had their doubts about those expenditures and have felt that running a sewer line through a locality, if anything, is the sort of thing the locality ought to do. That is an example of one. And so there has been that running argument between the Congress and the Executive.

Senator PROXMIRE. He said he might have a quarrel on the housing programs, those are held up because they have to be looked at and maybe changed. Maybe they are not wise but he doesn't make any argument on water and sewer. He said those programs may be sound but the President wants to stay within the ceiling.

Let me ask you a question that is a little more generalized but I feel very strongly about it. I don't want to be dogmatic about it. But I don't want to seem too partisan. I don't know how I can avoid it under the situation.

Secretary SHULTZ. I have been testifying almost continuously for the last 4 days, so I have become accustomed to a certain amount of partisanship.

Senator PROXMIRE. Doesn't President Nixon have to assume far more responsibility for the sky high level of spending than he is assuming? He came into office not as a naive novice. He came in as a former Congressman, Senator, Vice President, candidate for President and one of the leading figures in the Federal scene for 20 years before he was elected. He was as seasoned and knowledgeable about Federal spending as any President we have had. He wasn't like President Eisenhower, new to the political scene. He has had 4 years as President now. It was his budget in 1971, his budget in 1972, his budget in 1973; the new 1974 budget is his budget. He has always had ability to veto bills and impound them. After all of that we have in the 1974 Nixon budget a huge \$73 billion increase over the spending of the last Johnson budget of 1970. This administration is responsible for a 37½ percent increase in Federal spending in 4 years. This is the biggest dollar increase any administration ever imposed on the American people except in wartime. When this increase is corrected for price increases it is still a 24-percent real spending increase by the Federal Government. It means under the Nixon administration, under strictly Nixon budgets the Federal Government has grown by 6 percent in real terms a year as compared to a long term growth of the economy of 3 percent. So 4 years of your administration management has resulted in the Federal Government growing literally twice as fast as the private economy has grown in the long pull.

What makes all of this even more appalling is the fact the Federal Government has been getting out of a war. It is good they are getting out of the war but the Government has been enjoying the decreasing spending burden of waging a war during this period so that whereas the 1970 budget included more than 10 percent of the unified budget for the war, the 1974 budget includes nothing for the war.

Now if you compare Nixon levels of spending with the Vietnam war left out, the administration has increased spending by a total amount of \$93 billion or 52 percent, and allowing for inflation, a mammoth increase of almost 10 percent in Federal spending each

year—these figures may not be exactly precise but they are roughly accurate. With that background how can you defend increased spending over \$19 billion or 7½ percent this year, a year of serious inflationary pressure with the dollar under grave international attack, with the past year of more than 8 percent expansion in the money supply? Isn't your budget a formula for inflation?

Secretary SHULTZ. Well, I agree that it is important to exercise fiscal discipline. The President has consistently been trying to do that. He has vetoed quite a few spending bills over the first 4 years of his term, and we do have the appalling picture that, if the President simply had done what Congress more or less indicated that he should do, in fiscal 1973 we would be spending something on the order of \$261 billion—not the \$250 that we expect to be able to hold it to. The consequences of that in fiscal 1974 would be \$288 billion, rather than the \$269 billion that the President has recommended, and by 1975 that would bring us up to \$312 billion rather than \$288 billion.

Senator PROXMIRE. You are saying it could be a lot worse, and I agree.

Secretary SHULTZ. The President is waging a very strong battle here and, having spent the last 2 days testifying before the House Appropriations Committee, I would say that he is winning the battle. People are apparently becoming aware of the fact that these numbers are big and they are high enough and we have got to figure out how to live within them, although I don't believe people have quite faced up to the fact that, in order to live within them, there are some tough decisions that have to be made and everybody can't have everything that they like.

Senator PROXMIRE. What you are saying is the situation could be a lot worse, and I agree. You are saying there are some forces in the Congress that would make it worse, and I agree with that, including forces in my party. What I am saying, even the recommendations that you suggest under present circumstances are inflationary, they provide for a bigger Federal Government in relationship to the size of our economy, consistently bigger in every year of the Nixon administration.

Secretary SHULTZ. I don't think that is quite true, Senator. If you take the Federal budget as a percentage of the GNP, it has been running roughly at 20 percent over the last 10 years and is a little bit less now than it was at the height of the war in 1968.

Senator PROXMIRE. We have had an enormous expansion.

Secretary SHULTZ. Nevertheless, I agree with you that government in total is big enough and it would be desirable if it were a little smaller. We now, between the Federal Government, State governments and local governments, take some 35 percent or so of the earnings of our taxpayers. That seems like a pretty high percentage and it would be desirable if we could reduce it.

Senator PROXMIRE. My time is just about up. Let me ask you one more question because it relates to all of this.

In view of the fact we have a fiscal policy which it seems that the world as well as the stock market construes as loose, a monetary policy which last year was highly expansive, 8.3 percent by any definition is expansive policy, isn't phase III a pretty weak pussycat to keep control of this expansive economy?

Secretary SHULTZ. I would say that you called it a peashooter under the pillow the last time.

Senator PROXMIRE. I was overstating its force then.

Secretary SHULTZ. I don't know whether that now shows you think it better or worse than last week.

Senator PROXMIRE. The more I study it the less confidence I have and it seems the Germans, the Japanese, the Europeans, as well as the investors, share that view.

Secretary SHULTZ. Well, I think that, in general, people were skeptical about phase 1 and they were skeptical about phase 2. Any time you do something different, people have to get adjusted to it a little bit. I think that process of adjustment is well underway. People are taking the program very seriously. We have taken a number of fundamental steps that we think will be of great benefit in the program, including persuading John Dunlop to serve as its director. However, I would agree with you that if you have a lack of attention to the fundamentals of monetary and fiscal policy, there is no wage and price stabilization program that can work. You must have attention to the fundamentals in order to be able to get the mileage that I think you can get from a wage and price control system. So the fundamentals are fundamentally important. We believe that the budget, as the President has put it into place for 1973, and proposed for 1974, and projected for 1975, is fundamentally consistent with continued growth of the economy and is consistent with reasonable stability of prices. And I know that Mr. Burns shares the concern over this program, and I am sure that as he addresses monetary policy and continues to address it he will also have this problem in mind. So I think we have all of the ingredients for continued good work on the fundamentals and, thereby, we can expect to get mileage out of phase 3.

Senator PROXMIRE. Mr. Burns indicated a few minutes ago when I questioned him in the Senate Banking Committee that he felt this means fiscal policy is too expansive. My time is up.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Mr. Secretary, right before August 15, 1971, the U.S. Government lost about a third of a billion dollars trying to support the dollar. This committee held a post mortem on that later on, and expressed great anguish about it, and was reassured by both the Treasury and the Federal Reserve in our hearings last year that this would not happen again, that intervention in support of the dollar would not be made except where there was no fundamental misalignment of the dollar and the other currency involved, and where the sums hazarded, therefore, could be expected to be returned very shortly.

I have an inkling, somehow or other, that despite those assurances to this committee, the U.S. Government very recently has been intervening in the market with respect to the dollar-deutsche mark rate.

Is this true and how can we stop it if it is?

Secretary SHULTZ. There has been some modest intervention.

Representative REUSS. Why? Are you asserting that the dollar-mark rate is properly aligned, and that the \$10 billion deficit which we suffered last year and from which we are currently suffering what looks like almost a repeat, are not really what they appear to be,

and that the German central bank is not gaining vast amounts of reserves?

Secretary SHULTZ. Intervention of a modest scale has made a contribution to maintaining some sense of stability in exchange markets. I think our intervention, the net intervention over the period since the Smithsonian agreement has been extremely small.

Representative REUSS. What was it last week and this week?

Secretary SHULTZ. Well, the exact amounts, I think, are not a good idea to disclose as we go along because that affects our ability to use them effectively.

Representative REUSS. Well, I am baffled, really. Is it the Treasury's view that the dollar and the deutsche mark are in good alignment, and that moneys spent defending that alignment are not going to be throwing good money after bad, and will shortly be returned?

Secretary SHULTZ. Well, I think we just have to say that the intervention speaks for itself, and we don't have any comment to add to that.

Representative REUSS. My comment would be that I believe you are embarking on the same disastrous course which attended U.S. monetary management right before the pre-August 15, 1971, fiasco, and I don't see why the American taxpayers should be compelled to shell out for adhering to outmoded ideas about defending the dollar. It would seem to me the best defense of the dollar one could make would be to do precisely what you have now said you didn't as Finance Minister Schmidt of the Federal Republic to do; namely, let the mark float.

What advantage is there to us to preserve an overvalued dollar and undervalued deutsche mark?

Mr. VOLCKER. I wonder whether in this concentration on deutsche mark we are not missing a conversation that I had earlier with Mr. Conable. There are imbalances in the world, Mr. Reuss, and we have had a major disequilibrium vis-a-vis Japan. I don't suggest what precisely the right remedy to that is. We reviewed a lot of measures. But I would say when you have an imbalance of this sort, whenever a major problem arises in this area, for instance, it tends to affect psychology in other areas. It spreads out psychologically and otherwise in other areas of the world. We have to identify where the major problems are and where the lesser problems are.

Representative REUSS. Isn't the major problem that we are running a ferocious deficit, affecting practically every item on the ledger? It affects tourism, it affects trade, it affects foreign investment, it affects foreign governmental operations. The Deputy Assistant Secretary of Commerce, Edward L. Allen, a member of your administration, said just the other day that the United States is likely to be running a \$1 billion annual balance of trade deficit even when the Smithsonian realignments reach their peak impact. He may be wrong. But even if he is, I don't see how we can laugh off the fact that we are running great deficits, the fact that Germany, Japan and other countries are gaining horrendously in their reserves. Both of those things, incidentally, are set forth in Secretary Shultz' excellent September IMF speech as indicative of a basic disequilibrium that ought to be changed by exchange rate changes. It seems to me they exist and here we go defending these outworn parodies.

Would you mind educating me as to why we do it?

Secretary SHULTZ. First, I would say as we look at the trade deficit figures and other figures that you have cited, there is very little laughter. I haven't noticed any tendency to laugh these off. These are real problems and we have said so in many instances, including the testimony that I just read and presented to this committee. They must be solved.

Now in the talk that I gave to the IMF that you mentioned, one of the themes was that when you have a situation that is out of balance, you should recognize that the surplus as well as the deficit countries have a contribution to make to this. A broad range of measures should be considered, and we have been pressing our trading partners to use a broad range of measures. Mr. Volcker talked about some of those ideas, in response to Mr. Conable's questions, particularly with respect to Japan. And at the same time we have been pressing hard to make as much progress as possible on the basic restructuring of the monetary system. Not only in offering a proposed plan but following up on it with more detailed position papers on every aspect of it, and so on.

Representative REUSS. Well—

Secretary SHULTZ. So I think we take it very seriously and we are working on it hard.

Representative REUSS. Is it not a fact that since Mr. Nixon took office, the amount of liquid short term debts owed by the United States abroad has doubled from \$40 billion or a little under that to more than \$80 billion, and is it not a further fact that that figure went up by another billion or two in the last week? I think those are right figures.

Mr. VOLCKER. That is true, the figures are large and growing and we have no disagreement that that is a very serious problem.

Representative REUSS. Can't I impress it upon you gentlemen that we here regard it very seriously? It is bad enough to have a domestic debt which is out of hand and which certainly bothers Senator Proxmire. There, however, it can be said truly, "Well, that is just Americans owing something to other Americans." But a foreign debt, the \$82 billion dollars, probably increasing another billion dollars while we talk here, that we are running up overseas, is a debt that we owe abroad and we have to repay that debt, principal and interest, and the interest rate now for Treasury bills, 5 or 6 percent, is very severe. We are going to get into a position where we are going to be in deficit on every item of the balance of payments shortly if we are going to have to pay \$4 or \$5 billion a year in interest on this debt. So I adjure you not to get the idea—I don't think you have it, but please don't get it—that all is well as long as foreign central banks are willing to absorb dollars. In my judgment, all is not well; all that indicates is that they have just fallen victim to their own export lobbies and are willing to acquire dollars endlessly. But even if we have no crisis, even if other countries don't go autarchic, the simple fact that we keep increasing our foreign held obligations I regard as very critical. And that is why I think, as I expressed yesterday, that we need immediate action—within the next few weeks—on the fundamental problem to which you addressed yourself last September, which is how can the United States have the same powers as other countries to alter the external value of its currency?

Has anything that I have said sound foolish to you, do you disagree with it?

Secretary SHULTZ. You never sound foolish.

We agree that there is a problem. We have no disagreement on that. We have said so, the President said so with considerable drama on August 15, 1971, and we have pounded away to bring that to people's attention throughout 1971. I must say as Secretary Connally pounded on that theme, he was criticized a great deal for being so single-minded about trying to draw the problem to people's attention. It seemed to me he did the country a great service in doing so, although I don't know that the point has really gotten home. We still continue to work at it and talk about it and to seek ways to rectify it not only in terms of a long-term rearrangement of the monetary system, but also in terms of more immediate efforts to bring about adjustments, particularly where we see our problems are very large and persistent, as in the case of our imbalance of trade with Japan. So we agree with the analysis that the problem is serious, that it is continuing, and that both immediate and longer-term actions need to be taken about it.

Representative REUSS. Turning to trade, wherever I go in Europe I find the Europeans saying that if the United States attempts to negotiate a trade round it will not be taken seriously unless it has prior congressional authorization, and I am inclined to think that that position makes sense.

There was testimony yesterday that the U.S. executive branch intends to start negotiating this summer. When are you going to send up the trade bill?

Secretary SHULTZ. Well, of course, we have been negotiating bilaterally all along and we continue to do that. As far as seeking authority, the prospect of considering that subject is well along and the President will make his views known when he considers it to be the appropriate time.

Representative REUSS. May I take it then, he being a rational man, that an appropriate time would be such time as would allow the Senate and House to give due consideration to the administration proposal, to go through its various legislative steps, take the matter to conference, and present the President with congressionally approved trade legislation well in advance of the starting date of those negotiations?

Secretary SHULTZ. Well, certainly we recognize that if the President is to have negotiating authority, it must be given by the Congress and can't be manufactured in the White House. So if he decides that he wants that, he will come and ask for it and we are conscious of the timing problem.

Chairman PATMAN. Mr. Shultz, I want to take a couple of minutes with you. I didn't ask you awhile ago when I was discussing the \$71 billion portfolio in bonds in the New York Federal Reserve Bank bought by Government money and not cancelled, I didn't ask you about auditing the Federal Reserve. You see, the Federal Reserve has resisted an audit by the General Accounting Office. We have attempted to get an audit by the General Accounting Office of the Federal Reserve System and all during the time of their existence they have refused it and they still refuse it.

Don't you think the Federal Reserve and all of its departments should be audited by the General Accounting Office?

Secretary SHULTZ. Well this sounds like a problem between the Congress and the Federal Reserve, and, since I have enough problems of my own, I think I would prefer to leave that between you.

Chairman PATMAN. You are the economic czar. Don't you think you could pass on something like that?

Secretary SHULTZ. No, sir; I don't regard myself in that position.

Chairman PATMAN. How do you personally feel about it? Do you feel it should be audited or not?

Secretary SHULTZ. As I understand it, there is a private audit made of the Federal Reserve.

Chairman PATMAN. What is that?

Secretary SHULTZ. As I understand it there is an audit.

Chairman PATMAN. Not private.

Secretary SHULTZ. Not by the General Accounting—

Chairman PATMAN. A self audit, that is the best they have come up with. They are not audited by the General Accounting Office. Wouldn't you favor that?

Secretary SHULTZ. As I say, I have enough problems of my own without getting into the discussion between you and the Federal Reserve.

Chairman PATMAN. You are the economic czar. This economic umbrella covers that.

Secretary SHULTZ. I don't assert jurisdiction, Mr. Chairman.

Chairman PATMAN. All right, how shall we proceed? I have got to go to the floor.

Senator PROXMIER. I can stay.

Chairman PATMAN. You can preside and go ahead awhile, say 12:30.

Just one other question. After we get through, if we were to want to ask you to come back a certain day, would it be desirable for you to come back, say, within the next week, Mr. Shultz?

Secretary SHULTZ. I am at your disposal, Mr. Chairman.

Chairman PATMAN. I think about the 19th would be a good time if we have to ask you to come back. The 19th is the day before Mr. Burns' testimony on February 20. That would be the 19th. Would that be desirable?

Secretary SHULTZ. I believe I am accustomed to working on Saturdays, Sundays, and holidays, but I believe that does happen to be a holiday. Maybe you work too, I don't know.

Chairman PATMAN. A holiday?

Mr. VOLCKER. Washington's Birthday under the new style calendar.

Chairman PATMAN. You mean the 19th of February is Washington's Birthday?

Mr. VOLCKER. Washington's Birthday is now always on Friday or Monday.

Secretary SHULTZ. That is Washington's Birthday by act of Congress.

Chairman PATMAN. Would you consider that sort of a pseudo-holiday and it would be all right to go ahead and work. If we have to ask you to come back that would be about the time and we hope you will be able to come. If not we will accommodate you by coming the Saturday before. Will that be all right?

All right, go ahead.

Representative WIDNALL. Mr. Chairman, I would just like to make one comment in connection with the proposed audit. The firm of Lybrand, Ross Bros. & Montgomery audits the Federal Reserve Board. A summary of that report is furnished to Representative Patman of Texas and Senator Sparkman of Alabama.

Chairman PATMAN. Will the gentleman yield?

Representative WIDNALL. I will yield.

Chairman PATMAN. Remember that only claims to be an audit of the Board of Governors. They don't handle much of the Federal Reserve System. The Board is a small cog in the financing wheel. But the 12 Federal Reserve banks handle the money and even the members of the Board couldn't get their salaries unless the banks allocated it and appropriated it for that purpose. They have little to do with the Federal Reserve System money.

Representative WIDNALL. I have been sitting on this committee for many, many years now alongside of you and this isn't the first time you have brought that up.

Chairman PATMAN. And it won't be the last.

Representative WIDNALL. Unfortunately, that is true.

Chairman PATMAN. Anyway, the General Accounting Office has not audited any part of the Federal Reserve System, not even the Board, and the Board is the least part about it.

Representative WIDNALL. I am going to ask a question that Senator Javits is interested in and unfortunately he can't be here today.

The present international monetary crisis again highlights the failure of the countries of the world to develop a workable "adjustment mechanism" for the major currencies of the world.

Can you give us any forecast as to when the negotiations on this key element, the reform of the international monetary system, will be concluded and in turn what difficulties are being encountered?

Secretary SHULTZ. Well, we covered that to some extent in the statement and in our discussions so far, but we have the following program. We have put forward a plan. We have put forward detailed discussion of various elements of the plan, incouding the so-called adjustment process that Senator Javits referred to, and I believe our paper on that was published as an appendix to the economic report, so it is generally available.

There have been three meetings of the deputies of the Committee of Twenty, one meeting of the ministers, and there are others scheduled.

There has been nothing conclusive about those meetings so that, in a sense, nothing much seems to have happened. On the other hand, there has been a good strong exchange of views, and we feel that there is at least a continuing concern to get the job done.

On the whole I think it is fair to say the United States has pushed and led and been among the most forceful of countries in trying to spur the work of the committee.

We have held up for ourselves the objective or having at least agreement on broad, general principles by the time of the IMF meeting in Nairobi in September, and we hope that we can make it. It is the sort of thing that is very difficult to forecast, and so I don't know how to put any precise probability on that. But we think there is a reasonable chance and we are certainly making every effort in good faith with others to bring that about.

Now I suppose the kinds of upsets in money markets that we have seen this past week or so, and that we saw last summer, tend to highlight the importance of getting on with this job, and, perhaps, this most recent episode that we are in will help do that.

Representative WIDNALL. Mr. Secretary, yesterday one member of the majority accused the administration of blithely forgetting about human needs when it composed this year's budget. In your testimony you say that in 1973 and 1974 there is room for a great increase in the amounts allotted to human resources and to revenue sharing.

You also state you cut out those programs which were not worth expenditures.

Perhaps you could tell us how you went about evaluating the programs contained in the budget, and those which were excluded as well.

Secretary SHULTZ. Well, the programs that are affected by the impoundments are listed in the budget—I think over a space of some eight or nine pages in detail—and the process of evaluation is a continuing one. The information that came to hand in the departments and in the Office of Management and Budget was accumulated and used in the assessment process, and, basically, what is sought is whether the objectives set forward for the programs are being effectively met. In other cases where there were objectives that had been met, this was reflected in the distinctions made in the funding of different programs. I don't know that there is anything especially mysterious about the process.

Representative WIDNALL. I think that is all, Mr. Chairman.

Senator PROXMIRE [presiding]. Mr. Secretary, I want to pursue the line that I was going along before, and I would like to see if we can determine the economic principles on which this budget and this fiscal policy is based, and whether they are sound now.

This year's budget places great stress on the full employment budget concept, and you know you and the President have accepted that for a number of years now, of course. That is based on the understanding, as I assume, that you would accept and expect a deficit this year, that the budget would come into balance sometime in the future, if we get to a 4-percent level of unemployment, because incomes would rise and, therefore, Federal revenues would rise, and there might be some diminution in expenditure because of less unemployment compensation, and so forth.

The phrase "full employment" occurs 18 times in the 11 pages of the President's budget message. In previous testimony before this committee, you stressed the full employment budget concept and the rule that expenditures should never exceed full employment revenues. The full employment budget concept is a useful analytical device but it seems to me even this device can be abused. Is a balanced full employment budget always the fiscal target at which we should aim, and, if so, how can we have any discretionary fiscal policy? Wouldn't it be better if we had a little more restrictive policy at a time like this when everything seems to be booming, when every analysis suggests that we are going to be moving ahead at a rate that most analysts feel is inflationary. Wouldn't it be better to have a real surplus in the full employment budget?

Secretary SHULTZ. I certainly think you can conceive of times when it would be desirable to have a surplus of the full employment budget, depending upon what is happening in other parts of the economy. On the whole, if there were any changes in the budget, I think it would be better to have it downward at this time, rather than upward. We do think that the economy, while it is expanding strongly, should not be subjected to the kind of fiscal crunch that would be involved in moving from a deficit of \$25 billion, say, to a zero deficit, or whatever full employment surplus you had in mind. That would be subjecting the economy to a terrific fiscal swing and might very well curtail the boom that we have underway more than we would like.

We try to see the economy expand and desire to have it expand in a steady manner, so we don't get inflation.

Senator PROXMIRE. You want it sustainable so you don't have to crack down later and have a recession develop.

Secretary SHULTZ. Exactly.

Senator PROXMIRE. Don't many economists at least analyze the fiscal impact of the budget by looking at the budget as it appears in the National Income Accounts, and wouldn't it be useful if you published estimates of the full employment budget made also on a national income accounts basis?

Secretary SHULTZ. You could do it that way. So much confusion seems to arise over the various budget concepts that I despair of introducing another one. We have the unified budget and we have the Federal funds budget and we tried to use the concept of the full employment budget, in concert with a concept that was brought out of the report of the Budget Commission back in 1967, I believe—

Senator PROXMIRE. I remember that well.

Secretary SHULTZ [continuing]. And to aline the concept so we didn't have too many budget concepts floating around. While, I think, the full employment concept does give you a chance to calculate in a manner that professionals can pretty much agree on, nevertheless, there is a little bit of range there—

Senator PROXMIRE. The reason I ask that, if we had those estimates by half years the calculations that I have seen suggest that we have a large deficit in the first half of calendar 1973, then a surplus in the second half, which seems to be exactly the wrong kind of prescription according to every prediction I have seen. Expectations are the first half will be highly expansionary, inflationary pressures will be maximized in the first half. There is considerable question whether the economic expansion will be sustained at this kind of level and that we might ease off quite a bit.

Under those circumstances, again if you break it down in this way, doesn't our fiscal policy seem counterproductive?

Secretary SHULTZ. Well, it is hard to imagine these flows quarter by quarter in precisely the way you would like. At the same time, I would say that that general direction is the general direction we seek. Since, as the economy gets closer and closer to full use of resources, you have got to bring the real rate of growth down to the natural rate of growth of the economy.

Senator PROXMIRE. That is one aspect of it, and the other aspect, of course, is you are racing along too rapidly in the first part and even if you are at a higher level of unemployment, if you move too fast, it can be inflationary. You have that element as well as whatever the level of unemployment is.

At any rate, a question that many people in the press and elsewhere are constantly asking, and I haven't heard any administration expert such as you really answer it before, is how can you justify having a full employment budget based on an unemployment of 4 percent when the administration seems to have argued that a 4-percent unemployment rate is inflationary.

Mr. Connally was very explicit in that saying we have never been anywhere near that except in a wartime period and around the wartime, that 4½ percent is probably the best we can expect. The aim or forecast seems to be 4½ percent unemployment and yet you are calculating the budget on the basis of a 4-percent full employment balance, which means that you are going to have a deficit at 4½ percent, and you don't get down to the 4 percent without inflationary pressures on the basis of administration analysis. So how do you justify the 4-percent level?

Secretary SHULTZ. Well, first of all, as background matter, I think the only reasonably sustained peacetime period when unemployment has been somewhere near 4 percent was in the middle Eisenhower years, and we did have a span of time in which we attained that objective. So I think it is something that is attainable, and I think one of the tragedies of economic policies was that we were on the verge of getting into that territory again in the middle-1960's and then, with the big blowup of the budget, we pretty well blew that opportunity.

Senator PROXMIRE. I am glad to hear you say that but it seems to me that contradicts the analysis made by Mr. Solomon and other administration spokesmen who say we have a change in the labor mix, there are more women and more young people and they have a more casual attitude toward employment and 4½ percent unemployment now is equivalent to about 4 percent 20 years ago.

Do you accept that or do you think it is wrong?

Secretary SHULTZ. As a technical matter—just taking the composition of the labor force and of unemployment, comparing them in two time periods and attributing the relatively high unemployment rates that certain sectors of the labor force tend to have—that comparison which you cited is well known and it is just a description of a calculation that can be made. What I would say is one point is a technical matter and another point is, let's say, a policy matter. As a technical matter, with this changed composition of unemployment, and as we move from, let's say, 4½ to 4 percent unemployed, we ask ourselves what would be the lift to full employment revenues as we move to 4 percent? The amount of lift that we would get would be less than, say, moving from 6 percent to 5½ percent because the new workers in the first example are less productive than the ones who were unemployed and who were being brought into employment in my second example. So, as a technical matter, I think as we get into that zone of 4 and 4½ percent unemployment, we won't see full employment revenues move around too much, just because of the nature of the people who would be employed as you move along.

Senator PROXMIRE. Doesn't that suggest that the 4½ percent unemployment level, then, as I understand it, that is pretty much of a clear arithmetic calculation of what is going to happen, increasing revenues between 4½ percent that—

Secretary SHULTZ. There will be an increase. My point is there won't be that much of an increase. But the rate of increase will decline because of the different composition of the labor force.

Senator PROXMIRE. Then you also get the fact, if you accept, which I don't, but if it is accepted that because of the increased number of women and young people in the work force, 4½ percent is about the best we can do, then the principle of basing the full employment concept on 4 percent is deception, it is wrong, you are always going to have a deficit. It's an inflationary principle, inflationary application, isn't that right?

Secretary SHULTZ. Well, I don't accept that and neither does the President and I don't know of anyone in the administration—

Senator PROXMIRE. Neither you nor the President accept the notion that 4 percent unemployment is inflationary, that we can't get down to that without inflationary impact.

Secretary SHULTZ. Let me try to get at that problem in two ways.

I think, as a policy matter, the changed composition of unemployment means that you have to be ready to shift your policies to deal with the changing problem you have. As an analytical matter, one should say it is one thing to be talking about unemployment of married men supporting families. Now that represents one kind of a problem, and certain policies can be adapted to that.

If you say, on the other hand, here is a teenager who wants part-time employment, that is also a problem, but it is a different problem from the first one.

The policies that we have with respect to the first may not work very well with respect to the second, and we have to be smart enough to figure out what alteration in policy is called for and to be trying to bring it forward.

I think there is that pattern in our policy that we should be trying to apply.

Senator PROXMIRE. See if I have a clear understanding. Is your position 4 percent unemployment can be achieved without unacceptable inflation?

Secretary SHULTZ. I would hope that we could achieve a lesser rate than 4 percent that is consistent with reasonably stable prices, but I think we have a lot of work to do before we get to that point in understanding what policies will work and in being able to implement them. That is what we ought to be striving to do. What we should be striving for is a situation where everybody who wants a job, and is willing to take a little trouble to look for one and accept one that is reasonably consistent with the skills that person has, should be able to get one.

Senator PROXMIRE. We all accept that. But there is this problem I think this committee has run into ever since your predecessor, Secretary Connally, indicated, and Mr. Solomon indicated the same thing, that if you get into 4½ percent you are moving into an inflationary area and this is lower than we should strive to achieve.

Do you take the position that 4 percent is something we can achieve now? You say there have to be some changes. How long will it take to achieve those changes, 10 years, 20 years, 5 years?

Secretary SHULTZ. I don't think that we do a very good job at all in this country of moving people from school into work. Other countries seem to do much better than we do. Unemployment rates among youths in this country are very high and it has been a matter of great distress to me for a long time that, even in periods of extraordinary high employment, such as 1968, when our unemployment rate overall was 3.5 percent or less, we had extremely high rates of unemployment among, say, black teenagers living in the central city. Those rates didn't seem to respond to what was going on in the economy as a whole. It was not true apparently that, as President Kennedy said, a rising tide lifts all of the boats. Those boats didn't get lifted.

Senator PROXMIRE. You are saying unless we change that situation, and we haven't changed it yet, we won't be able to get down to a 4-percent unemployment or much below 4½ percent without inflation, unacceptable inflation; is that correct?

Secretary SHULTZ. That problem is in proportion to your total problem and the need there is to figure out how to solve it. Just pumping up the economy apparently doesn't solve it.

Senator PROXMIRE. The manpower training programs which the administration recommends we cut by 17 percent—

Secretary SHULTZ. One of the distressing things is that in many cases those programs don't seem to have worked very well in solving that problem. I don't claim to sit here and know how to solve that problem. It is darn difficult. I have some thoughts about the subject and—

Senator PROXMIRE. Let me get to Mr. Dunlop. You have kind of been neglected this morning and you are such a brilliant and able man I don't want to permit that to continue.

This morning's New York Times in an editorial said that the most serious cause of the trouble with the dollar is lack of confidence abroad in phase III. They think phase III is a weak sister and isn't going to be able to do the job. I hope you can disabuse us on that as the man who will be in charge of phase III.

Let me just indicate the areas of phase III that I think are subject to the criticism.

Here is a program with a weaker profit margin rule and the analysis that I have seen, that I have here, show that a number of major industries will be able to increase their prices more than they could under phase II and still be in compliance with the law.

No advance approval is required. Advance approval was required in phase II.

If an increase in prices put into effect and found by you to be wrong, you will not require refunds, so there is no effective penalty. The shotgun will be firing blanks. And then the other element is that you have a smaller area to police but you have only half the staff that you had when we were operating phase II and rather than intensify controls with the smaller group you won't be able to do that, so there won't be any strengthening in that area.

What is your response?

Mr. DUNLOP. Well, Mr. Chairman, I believe phase 3 can work is we will make it work, and that means not only from my perspective but also to get appropriate legislation here relatively fast so there if no uncertainty about its future in the country generally. Also I agree that we need strong capacity to move in our stabilization agencies, but also we need a set of attitudes and cooperation in the labor management community which I think it is possible to develop. And it seems to me that the effectiveness of the program is not necessarily to be measured in terms of numbers of government employees or powers alone. There is on paper plenty of authority to do the job. That is certainly clear. Effectiveness also depends on selecting the key problems and concentrating on them and getting the kind of cooperation from the people involved as one moves, hopefully, from a period of firm controls to a freer wage and price system in the future.

Senator PROXMIRE. Secretary Shultz said in a speech in New York which I read that if people get out of line they are going to get clobbered. I was delighted to hear that. I think that was a good strong statement to make. What are you going to do if you can't require refunds, what are you going to hit them with? Are you going to change the regulations?

Mr. DUNLOP. Well, although I am not yet, sir, in the job and, therefore, would normally want to look more carefully at what one says one is going to do until he is there. The regulations make very clear that one can reimpose mandatory controls in the sense that people could not make changes in wages or prices without advance review. One can require various kinds of reports. Though I have not been into the question that you raised about refunds, it is very clear to me that the level you set for a future price can take into account a period of the past, at least as I have looked into it.

Senator PROXMIRE. That is good to hear. So if you had a firm that had increased, exceeded the price by a certain proportion, you would not as a matter of policy require refund but you might take that into account in requiring a somewhat lower price than they might otherwise might have if they had exceeded price guidelines for a substantial period; is that right?

Mr. DUNLOP. Without looking closely at the legal authority on that narrow point, that would be the attitude it seems to me with which one ought to approach it.

Senator PROXMIRE. Now there has been a lot of talk about rents. They have gone up sharply in many parts of the country since phase 3 was announced. I showed one the other day where there was a 100-percent increase. Since then I have heard of a great many increases in the area of 20 to 35 percent, and what is the situation on that, is there pretty much of an irrevocable decision that has been made that rents are not going to be included in phase III?

Secretary SHULTZ. All of the areas will be kept under surveillance and if we see that we have a major problem, a continuing problem in the rent area, we will certainly reconsider.

Senator PROXMIRE. Can you do that geographically?

Secretary SHULTZ. We don't expect to see that.

I would appreciate very much if I could have that example of the 100-percent rent increase and some of the other indications that you have, if you could make them available to me.

Senator PROXMIRE. An increase from \$235 a month to \$470 a month and we have the receipts.

Secretary SHULTZ. We will look into it.

Senator PROXMIRE. Senator Javits and Senator Case both testified before the Banking Committee they were very anxious to have this for their States. They wanted to do it on the basis of any area where rental vacancies had exceeded 6½ percent. Have you given any thought to that?

Secretary SHULTZ. We have examined vacancy rates and what has been happening to them, and we felt as we went along in the program that vacancy levels were such as to reasonably stabilize rent levels. As a matter of fact, at the end of phase 2, as you know, 70 percent of all rental units were free of controls, so that the controlled sector was really relatively small in proportion to the total, and that had seemed to work all right just as a matter of the operation of vacancy rates. I do think that the problem around New York has been one probably of too much rent control rather than too little. That is, the long period in New York of rent controls did have the effect of reducing the number and quality of rental units.

Senator PROXMIRE. I think you may very well be right. I am inclined to oppose rent controls except for one development that comes along that changes it and specially I feel if they need rent control in New York let the New York people put it into effect. They have opted out in the suburbs of New York and if they opt out I don't think the Federal Government should tell them they have to go under it, on the other hand the administration is recommending a moratorium on low- and moderate-income housing starts which is going to aggravate the housing shortage for people with low income as time goes on and their rents are likely to go up. So what would you think of tying a rent control proposal to the duration of the moratorium and a lag period of maybe 6 months after?

Secretary SHULTZ. I think it would probably be self-defeating.

Senator PROXMIRE. Why?

Secretary SHULTZ. In the sense that one of our problems is to raise the general quality of rental units and eliminate, insofar as we possibly can, the number of substandard units, and quite a lot of progress has been made on that. Again, I think we have a chart in here somewhere that shows that. I don't have those numbers right in my mind.

Senator PROXMIRE. Do you want to—

Secretary SHULTZ. Let me see if I can find that.

Senator PROXMIRE. You can supply that for the record.

Secretary SHULTZ. Here is the chart that I wanted. In looking at the question of occupied substandard housing, in 1950 we had 15.3 million housing units that were so classified as against 29.1 million units of standard housing.

By 1960, the standard housing had risen to 47.7 million and the substandard had declined to 9.0 million—from 15.3 to 9.0—and by 1970, the estimate is, that while the standard housing goes up to 62.5 million units, the substandard is down to 4.1 million. I think what we need is to make continuing progress in that area, and I would be afraid that too much rent control would lead to too little elimination of substandard units.

Senator PROXMIRE. Well, isn't it true that No. 1, the Census Bureau changed the definition which made these not comparable and—

Secretary SHULTZ. That is not my impression.

Senator PROXMIRE. That is what the staff tells me.

No. 2, the Douglas Commission that made a study of it found out as late as 1968 there were 11 million substandard and overcrowded housing units. What the Census Bureau did was drop the overcrowded criteria. Overcrowded, it seems to me, is the best index of need for new housing.

Well let me ask you this, Mr. Secretary. You are the top tax man of the administration and I will be as brief as I can, I know the hour is late. I will take a few minutes on these questions.

When Under Secretary Cohen testified before this committee last summer he told us the Treasury was conducting a thorough review of the tax law in preparation for tax reform legislation President Nixon promised to submit to Congress before the end of last year. We requested this review be made available with the President's recommendations. Thus far we haven't seen either the tax reform proposals or the Treasury review.

Does the administration intend to submit any substantive tax reform proposals to this Congress and, if so, when?

Secretary SHULTZ. Well, we will have the answer to those questions when the President makes his decision.

Senator PROXMIRE. You don't have anybody in the administration who can tell us? There is no higher authority on taxes than you are.

Secretary SHULTZ. I call tell you that the review of the tax system has been going on in the Treasury very intensively and different possibilities have been examined. The matter has been discussed a number of times with the President and he has not yet made a general decision.

Senator PROXMIRE. Will we get that by the end of the fiscal year?

Secretary SHULTZ. One thing I have learned in my 4 years here is that I wait for the boss to decide.

Senator PROXMIRE. And there won't be any until the President has made his recommendations? There won't be any Treasury review of any kind?

Secretary SHULTZ. Well, the Treasury will testify before the Ways and Means Committee as their hearings progress.

Senator PROXMIRE. One other question. In view of what I have been hearing about the Penn Central Railroad lately, I gather that it will be coming to the Government for another bailout. Figures run as high as \$800 million.

I understand labor demands are severe and if the company trustees agree to them there will be a big increased cash need on top of an existing cash shortage. This isn't just a Penn Central problem, there are other major railroads in effective bankrupt status. How does the administration feel about bailing out this industry?

Secretary SHULTZ. We think it is not a good idea.

Senator PROXMIRE. You are opposed to it?

Secretary SHULTZ. Yes, sir.

Senator PROXMIRE. Well, that is good to hear. I certainly support that position and I am delighted you have said that and I am hopeful that you will be able to stand by it.

Secretary SHULTZ. We think there are things that the railroad and its employees deserve from the Government. They deserve much stronger action from the ICC and elsewhere in reviewing the problem that this railroad like others has; namely, they have some trackage, roughly half of it, that is quite economic and a good workable proposition, but they are required to operate over other trackage which is not workable economically. If they could get some speed and help in getting rid of what is just not economic, it would be extremely helpful.

Senator PROXMIRE. You as former Secretary of Labor and Mr. Dunlop as one of the outstanding labor management experts and arbitrators in the country are two of the real experts in this area. Do you think Congress should now intervene in the labor management situation with respect to Penn Central to assure continuing operations of the railroad? Do you have any advice on that?

Secretary SHULTZ. Well, I am not posted on developments this morning. They are coming down to their deadline and, as I understand it, the probabilities have been heavily toward a strike. I think there are some genuine counterpressures in the situation. We have tried to communicate to the parties the lack of willingness of the administration to provide \$100 million or so to bail them out, so they won't be operating under any illusion there. And I do think that if we could manage to get some motion on the slow bureaucratic processes of working through these cases of abandonment of uneconomic lines that that would be very helpful. But as to the particular question of whether Congress should act on that strike, I don't have a recommendation at this point. That is, I don't know about this morning's developments.

Senator PROXMIRE. Well, thank you, gentlemen, very, very much. The committee will stand in recess until tomorrow morning at 10 o'clock.

[Whereupon, at 12:35 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, February 8, 1973.]

THE 1973 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 8, 1973

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

The committee met, pursuant to recess, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman, Reuss, Moorhead, and Widnall; and Senators Proxmire, Humphrey, and Percy.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Michael J. Runde, administrative assistant; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Khrumphaar, Jr., minority counsel; Walter B. Laessig, minority counsel; and Leslie J. Bander, minority economist.

OPENING STATEMENT OF CHAIRMAN PATMAN

Chairman PATMAN. The committee will please come to order.

We have as our witness this morning Mr. Ash, the new head of the Office of Management and Budget. I would like to make a short statement first.

For the past 2 days the Joint Economic Committee has listened to assertions from administration witnesses to the effect that interest rates in general have been going down under the President's economic stabilization program.

The facts of the matter indicate that the reverse is true and has been true for the past 10 months. Not only has the prime rate increased by 20 percent during this period, but even greater increases have been requested by short-term Federal securities.

The interest rate on 3 months' Treasury bills has increased 47 percent. Six-month Treasury bill interest rates have increased 25 percent. Prime commercial paper rates have gone up 36 percent. Three- to 6-month finance company paper has gone up 28 percent. Increases have also occurred for Federal funds for business loans and for both conventional and FHA residential mortgages.

I am not impressed with the present effort of the Committee on Interest and Dividends to roll back the quarter point increase in the prime rate reported by four New York and Philadelphia banks. It is clear that large commercial banks are using the prime rate as a sham.

The effort of the Committee on Interest and Dividends to retain the 6-percent prime rate is an empty gesture since large banks are quietly raising the effective interest rate on the loans they are now making to

prime rate customers beyond the 6-percent level. This isn't surprising in view of a report in the New York Times indicating that bankers have been given assurance that no punitive action will be taken if they exceed the 6-percent prime rate level. If bankers are allowed to escape the standards of the economic stabilization program then there is little hope that costs will be held down in other areas.

The irony of the situation is made all the sharper by an administration which allows banks to deceive the public while eliminating or drastically curtailing a large number of vital social welfare programs designed to meet the needs of millions of poor people throughout urban and rural America.

There can be no conceivable excuse for such action. Aside from other considerations, the present situation provides a sufficiently strong argument for requiring the director of the Office of Management and Budget to be confirmed by the Senate. This is nothing personal in this, I would say the same thing regardless of who was up here in this particular place and under these conditions. This position, perhaps more than any other in the administration, has the strongest influence in determining how and when funds appropriated by Congress will be spent. It is one of the most powerful positions in the Federal Government.

With this in mind, I wish to welcome on behalf of the committee, the appearance this morning of Roy Ash, Director of the Office of Management and Budget. You may begin your statement, Mr. Ash.

Representative WIDNALL. Mr. Chairman, I would just like to ask this question pertaining to your opening statement. Is it your intention to request the reporter from the New York Times to come before this committee to testify who it is gave the bankers assurance that they will be able to raise these rates?

Chairman PATMAN. We will look into that.

Representative WIDNALL. That is all.

Chairman PATMAN. We have plenty of time to look into it.

First, Mr. Ash, I would like to place in the record a table. Much that has been said by the President to justify cut backs in congressionally authorized expenditures. But I have here figures on administration budgets for the last 20 years starting with the 83d Congress, 1952. In each case the Congress appropriated less than the President recommended.

Commencing in 1952 it was \$12 billion less. The second session, \$2 billion less. Then in the 84th Congress it was \$1 billion less the 1st session and \$244 million less the 2d session. And the 85th Congress, 1st session, \$5 billion less, and the 2d session \$619 million less, and the 86th Congress, \$1.8 billion less, and the 2d session \$211 million less, and the 87th Congress, \$4.9 billion less, and the 2d session \$4.5 billion less. The next Congress, the 88th, \$6.4 billion less, and the 2d session, \$4.1 billion less. The 89th Congress, \$2.4 billion less, \$833 million less the 2d session. The 90th Congress, \$5 billion less, \$3.9 billion less the 1st session and the 2d session \$14.5 million less.

The 91st Congress it was \$8.2 billion less, and the 2d session, \$3.4 billion less. 92d Congress, \$2.6 billion less, and the 2d session, \$6.4 billion less.

That shows that the Congress every year for the last 20 years has reduced the recommended budget of the President of the United States, whether Democratic or Republican, and I would like to insert

the exact figures reiterated above and tables on interest and money market rates at this point in the record.

Is there objection?

Without objection so ordered.

[The information referred to above follows:]

TOTALS OF REGULAR ANNUAL SUPPLEMENTAL, AND DEFICIENCY APPROPRIATION BILLS, AS ENACTED, AND COMPARISON WITH ESTIMATES CONSIDERED, 83d THROUGH 92d CONGRESSES

Session of Congress	Estimates considered	Amounts enacted	Change
83d:			
1st.....	\$66,568,694,363	\$54,539,342,491	—\$12,029,351,852
2d.....	50,257,460,935	47,642,131,205	—2,615,359,780
84th:			
1st.....	55,044,333,729	53,124,821,215	—1,919,512,514
2d.....	60,892,420,237	60,647,917,500	—244,502,647
85th:			
1st.....	64,638,110,610	59,589,731,631	—5,048,378,979
2d.....	73,272,859,573	72,653,475,248	—619,333,325
86th:			
1st.....	74,859,472,045	72,977,957,952	—1,881,514,093
2d.....	73,845,974,460	73,634,335,992	—211,638,498
87th:			
1st.....	91,597,448,053	86,606,437,273	—4,990,960,780
2d.....	96,803,292,115	92,260,154,659	—4,543,137,456
88th:			
1st.....	98,964,155,135	92,432,923,132	—6,471,232,004
2d.....	98,297,358,556	94,162,918,995	—4,134,439,560
89th:			
1st.....	109,448,074,896	107,037,565,895	—2,410,508,000
2d.....	131,164,926,586	130,281,568,430	—883,358,106
90th:			
1st.....	147,804,557,929	141,872,346,684	—5,932,211,265
2d.....	147,908,612,996	133,389,868,734	—14,568,744,262
91st:			
1st.....	142,701,346,215	134,431,463,135	—8,269,883,080
2d.....	147,766,358,434	144,273,528,504	—3,491,829,930
92d:			
1st.....	167,874,624,937	165,225,661,865	—2,648,963,072
2d.....	185,429,804,562	178,958,106,864	—6,471,697,688

INTEREST RATES

	Current rates	As of April 1972
Prime rate charged by banks: Prime rate.....	6-6¼	5
Rates on business loans of banks:		
Short.....	5.84	5.52
Revolving.....	5.83	5.24
Long.....	6.31	5.64
Mortgage interest rates:		
Conventional.....	7.65	7.51
FHA.....	7.70	7.60

MONEY MARKET RATES

Period	Prime commercial paper, 4-6 months	Finance company paper placed directly 3-6 months	Prime bankers' acceptance 90 days	Federal funds rates			
Current.....	5.90	5.38	5.25	5.34			
April 1972.....	4.33	4.20	4.13	5.09			
	3-month bills		6-month bills		9-12 month bills		
	Rate on new issue	Market yield	Rate on new issue	Market issue	1-yr. bill market yield	Other	3-5 year issue
U.S. Government securities:							
Current.....	5.689	5.13	5.313	5.35	5.39	5.55	6.38
April 1972.....	3.849	3.82	4.354	4.36	4.67	4.89	5.92

Chairman PATMAN. Mr. Ash, you may proceed, sir.

STATEMENT OF HON. ROY L. ASH, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY SAMUEL M. COHN, ASSISTANT DIRECTOR; WILLIAM A. MORRILL, ASSISTANT DIRECTOR; JACK CARLSON, ASSISTANT TO THE DIRECTOR FOR PLANNING AND ECONOMIC AFFAIRS; AND PAUL H. O'NEILL, ASSISTANT DIRECTOR

Mr. ASH. Mr. Chairman and members of the committee, before my statement and given the statement that you have just placed into the record, Mr. Sam Cohn would like to augment that with a few comments. Then I will get to my statement.

Chairman PATMAN. Yes, sir; pull your microphone up closer so we can hear you, please, and you may identify your associates who are with you at the table.

Mr. ASH. Mr. Sam Cohn on my right, Assistant Director, Office of Management and Budget, Mr. Bill Morrill next to him, Assistant Director, Mr. Jack Carlson, Assistant to the Director for Planning and Economic Affairs, to the right of him, Mr. Paul O'Neill on my left, also Assistant Director, Office of Management and Budget.

Mr. COHN. Mr. Chairman, related to the statement you just inserted in the record, I have no quarrel with the figures. I think the record does show that the Congress has reduced the appropriation estimates forwarded by the President. I think that in recent years particularly the appropriation requests are not the full story. In fact, the Congressional Joint Committee on Expenditures in recent years has tried to give a more complete story that covers spending in bills other than those that go through the Appropriations Committee.

With your permission I would like to insert in the record something from these other reports.

Chairman PATMAN. Without objection, so ordered.

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

SUMMARY OF CONGRESSIONAL ACTION ON PRESIDENT'S BUDGET PROPOSALS

[In billions of dollars]

	Outlays		
	Appropriation bills	All other actions and inactions	Total congressional changes
1970.....	-2.9	+3.2	+0.3
1971.....	-0.1	+2.9	+2.8
1972.....	+0.1	+0.5	+0.6
1973.....	-1.6	+7.8	+6.3
Total 1970-72.....	-4.5	+14.4	+10.0

Mr. ASH. Mr. Chairman, members of this committee, I have a 12- to 15-minute statement that I would like to make and then augment it with a very brief discussion using some charts. The charts will provide a broad perspective and overview of the budget as presented for the

year 1974 and some of the particular aspects of that that we believe should be kept in mind as the Congress sets about to consider the recommendations in that budget.

Chairman PATMAN. You may proceed as you desire, sir.

Mr. ASH. The opening paragraphs of the President's budget message summarize the objectives of the 1974 budget:

—to hold down Federal spending so that there will be no need for a tax increase;

—to move the Nation's economy toward the goal of a high employment prosperity without inflation and without war;

—to help bring about the change demanded by the great majority of the American people by ending the inexorable flow of power to Washington, increasing the reliance on State and local governments to carry out what are primarily State and local responsibilities, and providing greater freedom for the American people to decide for themselves what is best for them; and

—to assure the taxpayers that their money is used wisely and efficiently by Government.

The 1974 budget is a blend of sensible economic policy and sensible government. It proposes a fiscal policy that is appropriate both for the present and for the longer run. And it carries out the mandate of the American people for a responsive and responsible government—one that adjusts its activities to changing national needs and squarely faces the harsh necessity of sound fiscal policy by terminating ineffective and outmoded activities and by reducing those programs that are less desirable than others.

BUDGET POLICY

In July 1970, the administration adopted the full-employment budget principle in order to make the budget a tool to promote orderly economic expansion.

The full-employment budget principle permits fiscal stimulation when stimulation is appropriate and calls for restraint when restraint is appropriate. It is not self-enforcing. It tells us the course to steer, but it requires that we take the actions necessary to keep on course.

During the past 2 years, with the economy operating below capacity and the threat of inflation receding, the Federal budget provided fiscal stimulus that helped move the economy toward full employment. The 1974 budget recognizes the Federal Government's continuing obligation to help create and maintain—through sound monetary and fiscal policies—the conditions in which the national economy will prosper and new job opportunities will be developed.

As we look ahead, with the economy on the upswing, the full-employment budget principle—and common sense—prescribe a shift away from fiscal stimulus and toward smaller budget deficits. Now, the budget must help us guard against inflation.

The 1974 budget proposes to hold 1973 spending to \$250 billion and to hold 1974 and 1975 spending to no more than revenue would be at full employment. Doing so will not be easy. Reduction of some activities and termination of others are necessary and are proposed in the budget. As the budget outlay totals—\$250 billion in 1973, \$269 billion in 1974, and \$288 billion in 1975—indicate, however, significant increases are provided for many important programs.

SPENDING CEILING

If we had not budgeted with firm restraint, 1973 outlays would be \$261 billion, and spending in both 1974 and 1975 would be far beyond full-employment revenues. As a result, the present legal limit on the national debt would have been exceeded, and we would have faced the need for higher taxes or the threat of huge, inflationary deficits.

Achieving effective control over Federal spending so that we can avoid inflation or higher taxes or both requires two complementary actions:

—vigorous and determined efforts to weed out existing programs that do not justify the taxes to pay for them, and

—establishment by the Congress, before it acts on any spending bill, of a rigid ceiling on total spending, limiting total 1974 outlays to the \$269 billion level recommended in the 1974 budget.

In the absence of such restraint by the Congress, the seeds sown in individual authorization and appropriation actions will produce a bitter harvest of excessive Federal spending not only in the coming fiscal year but in the years beyond. This is not a partisan judgment; it is a simple fact of life.

RESPONSIVE, RESPONSIBLE GOVERNMENT

Higher Federal tax rates are not needed now, nor in the years ahead, to assure adequate resources for properly responsive government—if the business of government is managed well. While new programs are often required to meet emerging problems, some existing programs prove to be ineffective or become obsolete or outmoded. Unless vigorous and determined efforts are made to restructure, reduce, or terminate programs that no longer justify their cost, these programs continue, and even grow. In so doing, they prevent even the most efficient of governments from operating within the limits of sound fiscal policy.

The 1974 budget incorporates the results of an intensive effort to identify programs that should be reduced or terminated because they do not justify the taxes required to pay for their continuation. It proposes reducing or eliminating programs that do not meet this criterion.

There is no responsible alternative to such reductions and terminations. Unchecked spending would result in large, inflationary deficits this year, and for years beyond, and the opportunity to gain effective control over Federal spending would fade away. Pruning back and eliminating ineffective or outmoded programs would, on the other hand, free resources for use in solutions of more urgent national problems.

Recognizing this, the President directed, in the fall of 1972, that a fresh review of the 1973 budget be undertaken and that an urgent search be made to uncover every possible way in which a prospective surge in spending could be controlled. The results are presented in the 1974 budget.

If the administration had let spending go unchecked and accepted a \$261 billion level for 1973 and had allowed this program momentum to proceed on course, then the unconstrained total of outlays would

have been \$288 billion—rather than \$269 billion—in 1974 and \$312 billion—instead of \$288 billion—in 1975. Thus, the actions taken and proposed to reduce spending in fiscal year 1973, when combined with the 1974 budget proposals, will reduce Federal outlays by \$11 billion in 1973, \$19 billion in 1974, and \$24 billion in 1975.

Totals of the size of the unconstrained outlays are simply inconsistent with the effective management or control of Federal spending and would invariably lead to serious inflation, higher interest rates, higher taxes, or all three. In fact, maintenance of a full-employment balance with these unconstrained outlay totals would require an across-the-board personal income tax surcharge of at least 15 percent or its equivalent in other tax increases.

This administration opposes all three of these alternatives. With a firm rein on spending, none of them will be necessary.

PROJECTIONS FOR 1975 IN THE 1974 BUDGET

This year's budget presents, for the first time, a detailed preview of next year's. This step was taken to demonstrate that if we stay within the 1974 and 1975 estimated outlays presented in this budget, we will prevent a tax increase—and to demonstrate that the 1974 budget is a sound program for the longer range, not simply for today. This innovation in budget presentation is a blueprint for avoiding inflation, higher interest rates, and tax increases, while framing more responsive instruments of government and maintaining prosperity.

Careful consideration of the longer range implications of budget decisions is essential if we are to insure a reasonable degree of continuity of policy from one year to the next, avoid becoming prisoners of the unintended consequences of past decisions, and maintain consistency between fiscal and other policies in the longer run. We must plan ahead if we are to keep the budget under control. We must have the capability to anticipate and prepare for foreseeable difficulties if we are to avoid painting ourselves into a corner.

The exercise of such foresight provides a welcome corrective to the temptations of expediency which could lead to cumulative program increases that the Nation can ill afford. The program reductions and terminations taken and proposed in the 1974 budget illustrate the administration's determination to exercise this foresight. They will result in more significant savings in 1975 and later years than in 1973 and 1974. We know that the Federal spending pipeline is a very long one in most cases. And we know that the sooner we start reducing costs, the better for the Nation.

The estimated 1975 outlays for the various Federal agencies are, of course, tentative. The outlay total, however, is the approximate amount that will represent appropriate Federal spending in 1975 if we are to avoid new taxes and inflation. As program priorities change and require increases in some areas, offsetting decreases must be found in others. As the projections indicate, this is necessary for both 1974 and 1975.

This sober examination of the budgetary realities we will face in 1975 is advance notice to all concerned as to the general direction programs must take—the constraints within which they must operate. Unrealistic expectations and aspirations of advocates of special interests must be set aside if the overriding public interest in a non-inflationary prosperity and stable tax rates is to prevail.

CHANGING PRIORITIES

Over the years, this committee has maintained a deep interest in the priorities that are reflected in the Federal budget and has been a strong advocate of greater emphasis on civilian programs—especially those in the human resources area—and a declining share of the budget for national defense. The committee's preferences have been realized during this administration's tenure.

Outlays for human resources are expected to double between 1969 and 1974, while national defense outlays are at roughly the same level in 1974 as in 1969. As a result, defense outlays will decline from 44 percent of total Federal spending in 1969 to 30 percent in 1974; outlays for human resources will rise from 34 percent of the budget in 1969 to 47 percent in 1974. Outlays for pollution control in 1974 will be seven times the 1969 level, and low-and moderate-income housing aids will more than double between 1969 and 1974.

These changes reflect the shift in national priorities toward peacetime domestic concerns that has been underway since this administration took office. The 1975 estimates published in the current budget show a continuation of this shift in relative priorities. Here a table will be inserted in the record containing the data supporting these statements.

[The table referred to follows:]

DISTRIBUTION OF BUDGET OUTLAYS BY PURPOSE, FISCAL YEARS 1969 AND 1974

	Billions of dollars		Percent of total outlays	
	1969	1974	1969	1974
Grants to State and local governments.....	20.3	44.8	11.0	16.7
(Grants to urban areas).....	(14.0)	(31.4)	(7.5)	(12.3)
Major retirement and social insurance benefit payments, excluding retired military pay.....	44.3	87.1	24.0	32.4
National defense.....	81.2	81.1	44.0	30.2
Retired military pay).....	(2.4)	(4.7)	(1.3)	(1.7)
All other.....	38.8	55.7	21.0	20.7
Total.....	184.5	268.7	100.0	100.0
Human resources.....	63.5	125.5	34.4	46.7

Mr. ASH. Grants to State and local governments will more than double between 1969 and 1974 and will, in 1974, account for one-sixth of the total Federal budget. The percentage increase in direct benefit payments to individuals has been almost as great. These payments, under the major retirement and social insurance programs—but excluding military retired pay—will grow from one-quarter of the

budget in 1969 to one-third in 1974. Together, these grants and transfer payments will increase from 35 percent of the budget in 1969 to almost 50 percent in 1974.

The projections demonstrate that we can afford to continue worthwhile ongoing programs and to increase spending for the most important while staying within the constraints of sound fiscal policy. We can maintain the military strength that is needed to support our negotiations for a lasting peace. At the same time, we can permit high-priority domestic programs to grow.

To make this possible, however, we must persist—vigorously and with great determination—in our efforts to reduce or eliminate ineffective and lower priority programs.

CONCLUSION

The 1974 budget is based on the common sense judgments that: Government cannot make a habit of living beyond its means; we must set an overall spending ceiling that is consistent with sound fiscal policy and affix the responsibility for staying within this ceiling; we must not abuse our economic system by suffocating the productive members of the society with excessive tax rates; and it is more important to save tax dollars by abandoning programs that have failed and shifting resources to more productive uses than to delude ourselves—and waste money—by pretending that these programs are working.

While it is hard to argue with these judgments, it is just as hard to put them into action. The administration is determined to put them into action, and has presented a budget that will move us firmly toward this goal.

If you will permit, Mr. Chairman, I would like to just briefly go through and graphically demonstrate what I have been saying.

Chairman PATMAN. All right.

Mr. ASH. First, on chart 1 is a view of 3 years of budget expenditures and budget receipts showing that there has been a growth—a restrained growth but, nevertheless, a growth—in expenditures from the 1972 level through 1973 and into 1974 of roughly \$18 million a year. So even though the budget may be characterized as one with substantial cuts in total, it is a budget that still has a fair amount of increase—approximately 8 percent per year. Had those increases not been restrained, 1973 would have been not 8 percent but 12 percent, and 1974 would have been the same—12 percent.

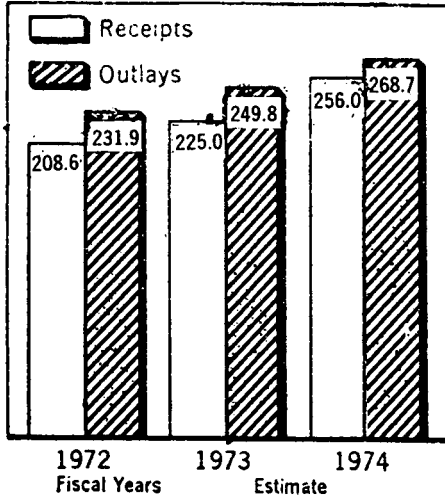
Virtually all of those increases shown from prior years are increases for social programs and general revenue sharing, not defense programs.

On the right-hand side of the chart is another very significant presentation, showing that over the years since 1964, Federal budget outlays have been approximately 20 percent of gross national product. [Chart 1 follows:]

Chart 1

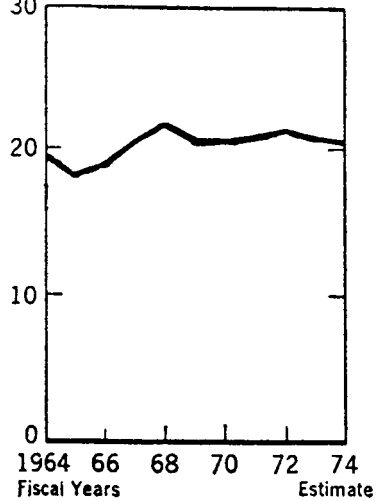
Budget Totals Since 1972

\$ Billions



Outlays as a Percent of GNP

Percent



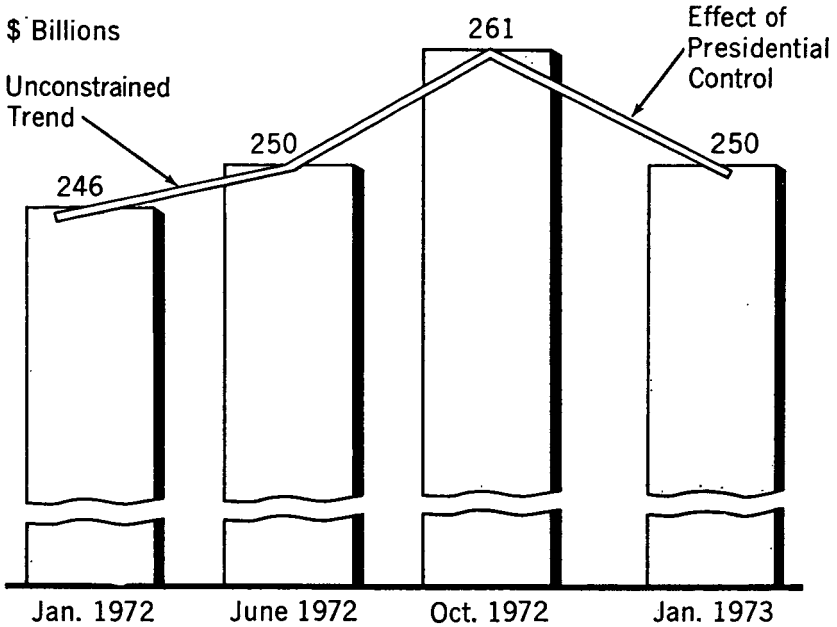
Mr. ASH. Not shown on the chart, but significant as well, is that over these same years the outlays of State and city and local governments have caused the total costs for governments at all levels to be about one-third of the total of gross national product. That is, added on top of the 20 percent of gross national product that is spent at the Federal level is another 13 or so percent spent at the State and local level. Thus, the total cost of running our governments is about one-third of all of our gross national product. That number was approximately 25 percent at the beginning year 1964 of this chart.

Chart 4 shows somewhat dramatically what has been going on this fiscal year.

[Chart 4 follows:]

Chart 4

The Result of Controlling Outlays - FY 1973



Mr. ASH. On October 27, 1972, the appropriations and all other laws calling for expenditures at that time would have caused 1973 outlays to be \$261 billion. The very difficult efforts that have been applied since that time have been able to bring the total down to \$250 billion, a number that many thought was not achievable, and programs to achieve this total have been submitted to the Congress.

You will note that that \$250 billion now expected to be spent in fiscal 1973 is approximately that in the President's budget as submitted 1 year ago last month.

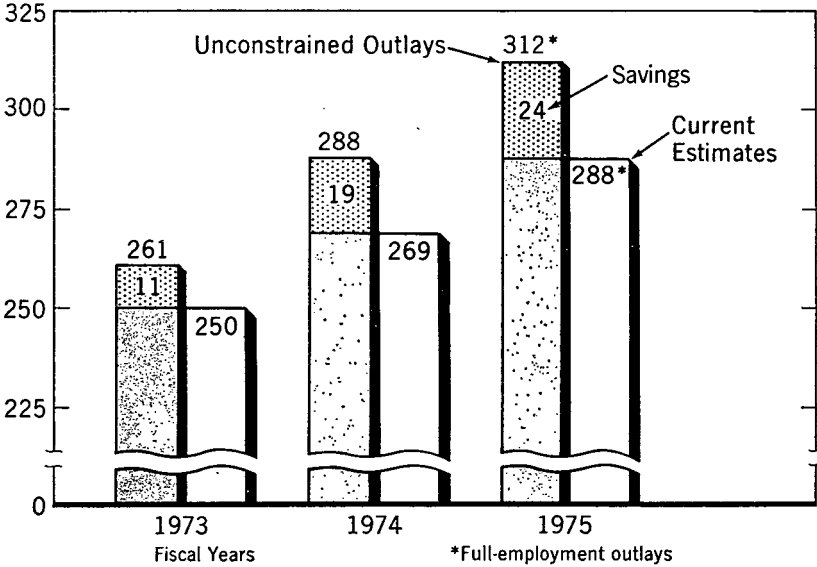
Another way of looking at what has been happening is to show the difference between constrained outlays and unconstrained outlays as shown in chart 5.

[Chart 5 follows:]

Chart 5

Restraining Outlays

\$ Billions



Mr. ASH. In this year, 1973, by the efforts that I have just described and that are further enumerated in the budget, \$11 billion was reduced from what might have been spent. Those same programs carried forward to years 1974 and 1975 would have given rise to increments to each of those years of \$19 billion and \$24 billion, respectively, demonstrating that once a program is set in motion it itself has a tendency to grow and add to the totals of expenditures and to mortgage the future.

By having constrained this year those programs that would have been given rise to \$54 billion of additional spending in future years, we have moved to budget positions that will be in full-employment balance in those 2 years. In contrast, substantial taxes would have been called for or inflationary pressures and high interest rates might well have resulted had these constraints not taken place.

Here in chart 7 is the reflection of these programs on the full employment budget. You will note that in the years 1966 through 1968 we were running at very substantial full employment deficits. This gave rise to the inflationary pressures that had to be corrected immediately in 1969 and thereafter if we were not to have a much greater catastrophe which we were headed toward, than the problems that did arise from correcting the excesses of 1966 through 1968. As a result, you will see that in the years 1969 projected all the way through 1975 we have roughly a full employment budget balance for the period as a whole. We believe that this policy is one that provides the correct

discipline to the economy—making use of the deficits only in measured amounts when they do serve the purpose of developing greater economic strength, and clearly constraining deficits as we move toward full employment.

A significant factor, which maybe not everybody realizes, is the effect of taxes on the total of the fiscal position of the Government as is shown in chart 8.

[Charts 7 and 8 follow:]

Chart 7

Comparison of Full Employment Budgets

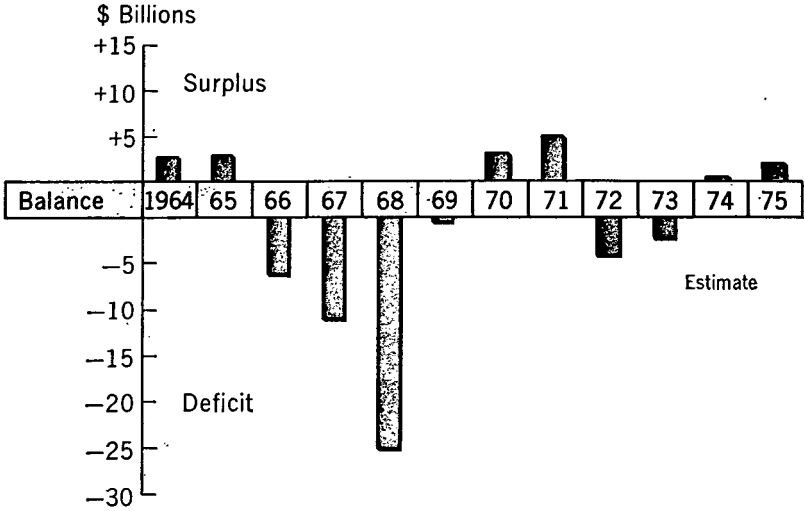
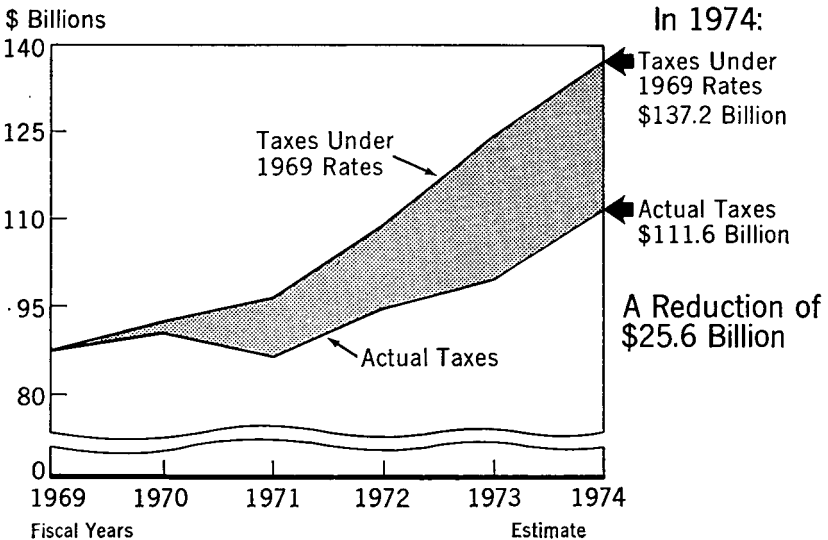


Chart 8

Individual Income Taxes - 1969 vs 1974



Mr. ASH. Individual income taxes have been substantially changed by the tax bills enacted in 1969 and thereafter. In fact, the effect of those bills today provides a reduction in individual income taxes of almost \$26 billion below what they otherwise would have been. We would have had revenues of \$137 billion from individual income taxes in 1974, as we can best estimate, had the 1969 taxes prevailed. We will now be able to count on revenues of approximately \$112 billion instead.

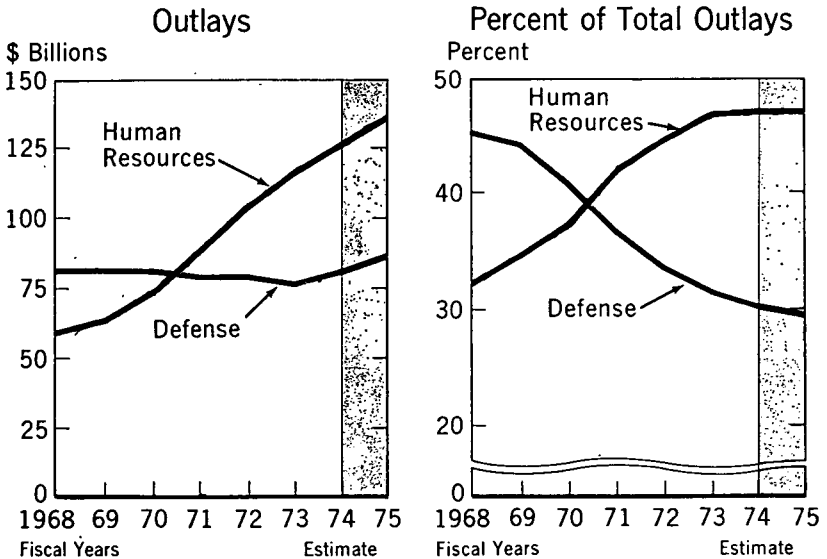
As a result of those changes in individual income taxes, we have left in the pockets of individual taxpayers \$25½ billion that might otherwise not have been there. Those moneys, which would otherwise be spent by Government for what Government thought was best can now be spent by individuals for what they choose.

One further chart, chart 10, to show quite dramatically a point that I made earlier: there has been a substantial change of priorities. It is not just talk, it is a matter of fact.

[Chart 10 follows:]

Chart 10

Changing Priorities



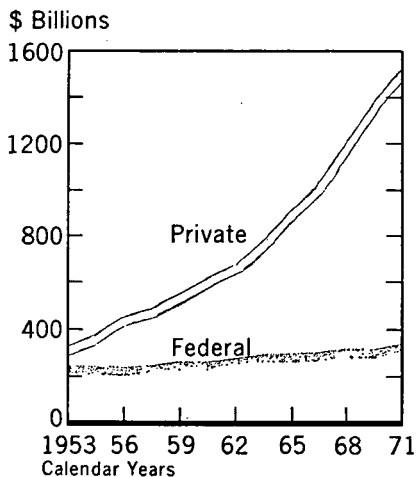
Mr. ASH. This administration has reordered priorities. You will see that defense expenditures, running above the \$75 billion line on the chart, have been approximately flat over all of these years since 1968, even with substantial pay increases and increases in the costs of material. Human resources programs, on the other hand, have gone from under \$60 billion in 1968 to \$135 billion in 1975. The right side of the chart shows that defense expenditures as a percentage of total outlays have gone in just the opposite direction from expenditures for human resources programs, to the point that it is clearly obvious to anybody that priorities have been reordered—it is not just a matter of talk.

A matter of which I am sure, you, Mr. Chairman are always interested, is that having to do with debt levels. Going all the way back to 1953, the Federal debt level has, in absolute terms grown a bit, and the private debt level has grown very substantially, as shown on the left side of chart 11.

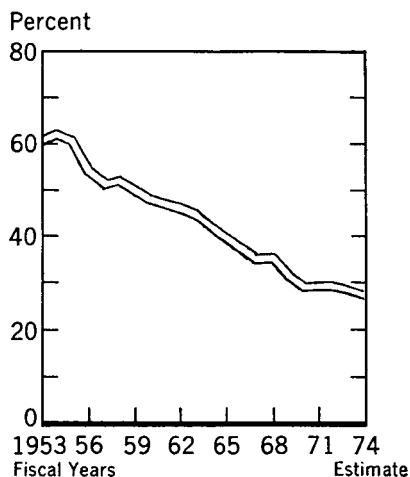
[Chart 11 follows:]

Chart 11

Federal vs Private Debt



Federal Debt as a Percent of GNP



Federal debt: debt held by the public

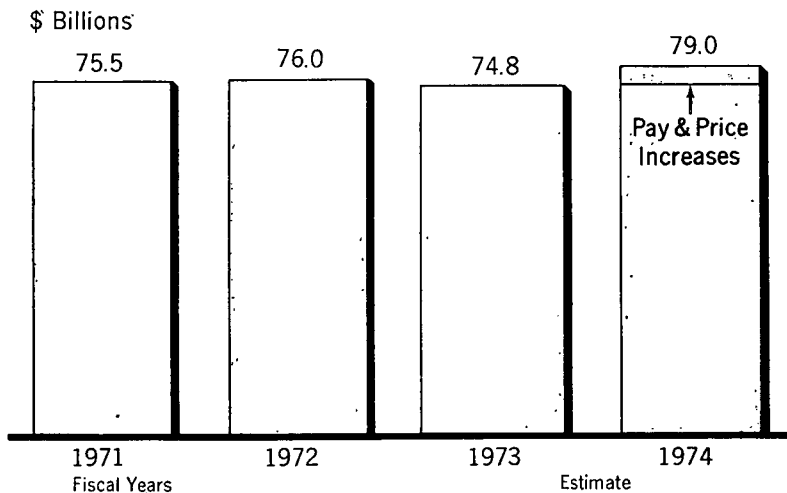
Mr. ASH. Federal debt as a percentage of gross national product has come down from over 60 percent in 1953 to less than 30 percent today. This is a move in the direction of fiscal responsibility in this and earlier administrations. It is true none of us like debts in absolute amounts, nevertheless, if there is to be debt and if debt in some occasions serves a purpose, we and previous administrations have been following policies that are in the right direction. I think we would find it to be catastrophic today if Federal debt as percentage of annual gross national product would be going in the other direction.

The next chart, chart 12, illustrates a point I made earlier. Department of Defense outlays are virtually flat during the years 1971, 1972, and 1973. The small increase in 1974 is made up almost completely of pay and price increases during this particular year.

[Chart 12 follows:]

Chart 12

Total Department of Defense Outlays*



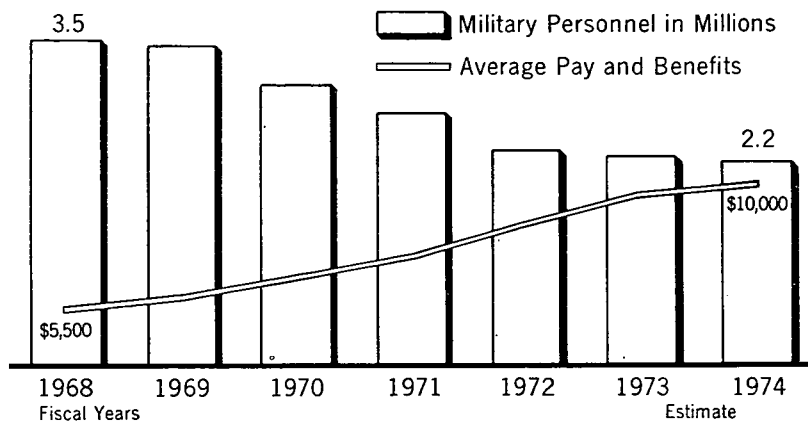
*Department of Defense military functions and military assistance programs

Mr. ASH. The next chart, chart 15, illustrates further the main contribution of personnel costs to increased defense expenditures this year. While the number of military personnel has been going down from 3.5 million in 1968 to 2.2 million in 1974, a substantial reduction

in numbers of military personnel, the average pay of military personnel in the same period has been going from \$5,500 a year to \$10,000 a year. [Chart 15 follows:]

Chart 15

Military Personnel & Average Active Pay & Benefits



Planned manpower has been reduced 37% but average pay and related benefits are about double the 1968 average

Mr. ASH. We are moving toward an all-volunteer force. We are able to compete in the market and pay the amounts that those in the military truly deserve for the value of their services.

Chairman PATMAN. Mr. Ash, I assume you would like to have those charts in the record?

Mr. ASH. Yes, sir.

Chairman PATMAN. About how many more do you have?

Mr. ASH. I think we can go to chart 50, and we will be finished.

Chairman PATMAN. Go right ahead.

Without objection, they will be inserted in the record at the point of reference in your statement.

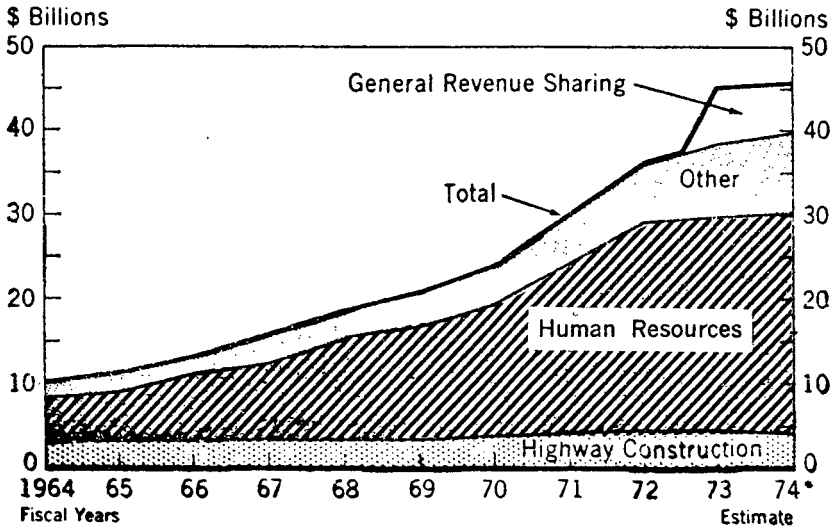
Mr. ASH. This chart, chart 50, provides an overview that may be contrary to what many have been saying, particularly here in Washington. Since 1964, as you can see, Federal grants to State and local governments have been going up year by year. In contrast to the complaints that the Federal Government is now by program reductions taking money away from State and local governments, quite the contrary is the case. I won't go into the detail of the makeup of

that chart but only suggest that in looking at the top line, the total line, you can see that over the years there has been a substantial shift in the direction of putting money into the hands of States and local governments and bringing closer to the real problems and real solution the opportunities to spend those dollars in the most effective ways.

[Chart 50 follows:]

Chart 50

Federal Grants to State and Local Governments



*For comparability with prior years, includes \$1.1 billion for payments to the adult assistance categories which became a direct Federal program on January 1, 1974

Mr. ASH. Mr. Chairman, that completes my statement and the further elaboration provided through these charts.

Thank you very much.

Chairman PATMAN. Thank you very much, and we will study the charts and I am sure we will receive valuable information from them and we appreciate your testimony.

Representative WIDNALL. Mr. Chairman.

Chairman PATMAN. For what purpose do you wish to be recognized?

Representative WIDNALL. Might I make this suggestion? That in connection with furnishing copies of the charts for the record, in view of the fact that the record probably won't be reproduced for a short time, could, in the interim, the members of the committee be furnished with copies of those charts?

Chairman PATMAN. For those members requesting copies, you will be in a position to furnish them, will you, Mr. Ash?

Mr. ASH. Yes, sir; I believe you each have received supplies in the mail at your offices the charts that go along with this year's budget in a booklet entitled "Budget Highlights, Fiscal Year 1974." It includes these and many more besides.

Chairman PATMAN. Will that suffice?

Representative WIDNALL. Yes.

Chairman PATMAN. Thank you, sir. Without objection we will proceed on the first go-around, 10-minute rule.

Mr. Ash, you devote a large part of your statement to stressing the need to curtail Government spending where possible. As you may know, the Federal Reserve has a portfolio of Treasury bonds totaling \$71 billion. These bonds are all paid up yet, the Treasury continues to require taxpayers to pay interest amounting to \$4 billion a year on these bonds to the Federal Reserve. Don't you think that for the sake of saving the taxpayer money we could cancel these bonds and thereby reduce the national debt by \$71 billion and eliminate annual interest payment of \$4 billion.

Mr. ASH. I understand that the Secretary of the Treasury met with you and I believe I would defer to his judgment on that matter. This is a matter under his purview and one that has, as I am sure we all know, a number of technicalities along with just economics to it.

Chairman PATMAN. Well, I think it is in your purview, too. You hold a mighty big job.

Mr. ASH. At this moment I have no judgment of my own on that subject, but guided by your comments, I will make sure to have one and soon.

Chairman PATMAN. All right, let me ask you another one. By the same token, since monetary policy has a direct effect on Government's cost of money, don't you think it would be sound management to require the Federal Reserve to rely on congressional appropriations for financing its operations and thus be answerable for monetary policy to both the Congress and the administration?

Mr. ASH. Well, sir, it is my understanding that in the creation of the Federal Reserve System there was considerable debate about the degree of independence it would have—

Chairman PATMAN. Aren't you mistaken about that? There was no debate about the independence of Federal Reserve. You read the proceedings and there is nothing in the law that says they are independent.

Mr. ASH. Well, I am sure there was debate about the subject. I think I am sure. Maybe a better way to say that is that it was determined that a degree of independence would be very healthy for the economic stability of this country. I recommend that the Federal Reserve continue to have that very same degree of independence that it has always had.

Chairman PATMAN. It puts the money lenders in a very healthy position.

The Federal Reserve has never been audited. Now, all other agencies of Government are audited by the General Accounting Office. Don't you think the Federal Reserve should be audited?

Mr. ASH. It is a subject about which I know very little at the moment. I don't believe I have a judgment as to whether it should or shouldn't be. I don't know of any instance over any time in the past where it not having been audited gave rise to a problem of any sort.

Chairman PATMAN. You mean in the Federal Reserve?

Mr. ASH. Sir.

Chairman PATMAN. You are talking about the Federal Reserve now?

Mr. ASH. Yes; by the GAO. Having internal auditing capability of its own, I don't know of any instances where that hasn't served the full purpose intended.

Chairman PATMAN. One time I sent the auditors to New York to go through the Federal Reserve Bank of New York. That is where all of the real business is done. The Federal Reserve Act was passed to get the monetary matters out of New York, get them back to Washington. It is going back to New York and the Federal Reserve Bank of New York is handling all of the main transactions and they are proposing, now to build a \$50 million building over there, additional, right away, that will come out of Government funds, too, if they get it. They haven't gotten it yet.

Anyway, you wouldn't oppose auditing the Federal Reserve; would you?

Mr. ASH. At this moment not knowing any reason to subject it to audit, I would assume that it is operating well and is effectively audited to the satisfaction of the Board of Governors of the Federal Reserve bank and to the satisfaction of the Congress. I do not know otherwise and would, therefore, presume this would be the business of the—

Chairman PATMAN. Try this on for size to see if you don't think it warrants further examination by an audit.

Those \$71 billion in bonds were purchased by the Federal Reserve Open Market Committee, a fiscal agent of the U.S. Government. They take our money from the printing press over here at the Bureau of Engraving and Printing that has the same dignity, prestige, and standing and value as the U.S. Government's bonds except the interest and they trade this money, \$71 billion, for \$71 billion in Government bonds drawing interest.

Now, then, if they cancel the bonds that would be all right. You know if the obligor and obligee becomes the same person the debt is canceled in all commercial transactions, but they don't cancel these bonds, they leave them outstanding and they sell some of them back and forth. Everyday they sell about \$2 billion worth of bonds, buying and selling everyday, sometimes.

The taxpayers are having to pay \$4 billion a year interest on bonds that have been paid for once.

Now, if you want to ask a good witness on that subject you ask Mr. William McChesney Martin. He testified before this committee in answer to my questions that when the money went to pay for the bonds the bonds were paid for.

Now, then, if something is not done about canceling them we will have to pay for them again and we will have to raise taxes to pay for them again.

Don't you think they ought to be canceled under those conditions?

Mr. ASH. Mr. Chairman, I know I am facing the world's expert on this subject and, therefore, I should heed every statement he makes. I will heed what you have said and learn a little more on the subject so that the next time maybe I can give you a fuller response.

Chairman PATMAN. We will be glad to give you an opportunity. We have a few days, I think, that we could do that right after the recess or maybe before the recess is over.

You are not taking a recess, are you?

Mr. ASH. I am afraid I am not.

Chairman PATMAN. We are not either, so we are all right.

Mr. ASH. I will stay with you.

Chairman PATMAN. On the impoundment of funds, I want to ask you a few questions. The water and sewer contracts on pollution and health education and rural rehabilitation, and what is know as REAP, they are all seriously affected by the impoundment of funds. Now, that is not done by you, but by your predecessor, by your office.

About how much has been impounded, about \$12 billion?

Mr. ASH. Sir, a report was submitted earlier this week——

Chairman PATMAN. Just approximately, please.

Mr. ASH [continuing]. And that number was \$8.7 billion. The items were set forth in detail.

Chairman PATMAN. I want to send you an up-to-date copy of the Constitution and I want you to point out in the Constitution where the President or you have the authority to impound those funds.

Mr. ASH. Yes, sir; I can quote it from Article II right now without needing the Constitution.

Chairman PATMAN. Just go ahead and quote it, please.

Mr. ASH. I have been testifying on this subject for the last few days before another committee.

The Constitution provides that the President take care to see that the laws of the country are faithfully executed. There are a number of laws of the country that exist simultaneously. Sometimes they are not all in concert. Sometimes one has called for him to take an opposite position than others. In this particular case, the President responded to several laws, including the debt ceiling, under which the President is obligated not to incur greater debt than provided for him by the Congress, and the Anti-Deficiency Act, which was further amplified by the Omnibus Appropriations Act of 1950. All these acts provide the basis for the actions that the President took and reported in the 1974 budget.

Chairman PATMAN. You think that is an answer to the question? What part were you going to read?

Mr. ASH. I quoted it without reading.

Chairman PATMAN. Read it if you please.

Mr. ASH. Section 3 of article II. And I will merely take out the piece.

Chairman PATMAN. Just read the text, if you please.

Mr. ASH. "He shall"—and then there are many words that follow, but this verb continues right on to this: "*** take care that the laws be faithfully executed."

Chairman PATMAN. Yes, sir, that is right. The Congress passes the laws and the President executes them. But we passed some laws, sent them to the President, and he vetoed those laws, and then the House and Senate by two-thirds vote, as required by the Constitution, passed them over his veto, and if you read that Constitution it says they shall become the law when that is done.

Now, then, it is the law because the President was overridden. What right do you have to impound funds under a law that has been vetoed and then overridden? The Constitution says it becomes a law.

Mr. ASH. Because there are also other laws. Let's take one without referring——

Chairman PATMAN. You mean laws that would repeal the Constitution?

Mr. ASH. Sir, I didn't say that. I indicated that he must live with the laws of the Congress. If those laws are inconsistent, it is impossible for him to live with all of them at the same time.

Chairman PATMAN. They are not inconsistent. It says if the House and Senate override the President's veto it shall become a law. A bill has been vetoed, there is no doubt about, no ifs, ands, or buts about it.

Mr. ASH. The House and Senate together established a debt ceiling, which debt ceiling—

Chairman PATMAN. The last act of Congress is the debt ceiling. If Congress fixes a debt ceiling then they subsequently pass that law that violates it, the last law would prevail.

Mr. ASH. My understanding is—

Chairman PATMAN. That is a fiction.

Mr. ASH. It is my understanding the President cannot write out a check that will cause the Treasury to pay out more money than it is entitled to incur in the way of debt.

Chairman PATMAN. Well, my time is up. I will have to get back to you.

Mr. Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Ash, you have stated repeatedly in your testimony that in preparing this budget an effort was made to examine Government programs and to weed out the ones which were ineffective or outmoded.

First, could you tell us how you went about this, since I believe this was a direct function of OMB? And second, can you tell me what other programs we might see come under careful scrutiny in coming budget years?

Mr. ASH. I will answer the last part first. I can give a shorter answer.

All programs will come under careful scrutiny for the coming years. That is one of the responsibilities imposed by the President upon the Office of Management and Budget and we expect to continue to keep all programs under careful scrutiny.

The first part of the question related to how these judgments were made. They were made, first, by observing the applicable laws and, second, looking at each of the programs in relation to them. In addition, as described in the report made earlier this week of reserves that were established by the Office of Management and Budget, there were approximately 13 different reasons, one or more of which accounted for each of the amounts that were reserved. Each program was subjected to all of those reasons and they are shown opposite each amount that is so reserved and set forth in the report.

Representative WIDNALL. Some of the Federal subsidy programs are under attack as meeting the criterion of being outmoded. Would you comment on these?

Mr. ASH. Yes. The Anti-Deficiency Act does require the President—it does not just authorize but places on him the responsibility to spend money efficiently and not be wasteful with Federal moneys. In looking at all of these programs, it was clear that in some cases the money wasn't being spent as efficiently as others.

Now, we would be the first to acknowledge that we are not drawing a line between all good programs on the one hand and all bad programs on the other. Given the constraints imposed in total upon the amounts available for outlay this year, it was necessary also to look at programs that did have some merit, but did not have as much merit as did other programs.

Representative WIDNALL. I realize fully that yours is not the most popular position in Government and that you are not to be an individual at all, as you are the person just like a parent who has to say "no" now and then, and that is never popular.

But I do find that in the enforcement of the budget edicts or budget pronouncements, that it seems to fan down into areas where it really hurts and it seems that manpower should not be eliminated. I can give you a simple example of that. Today in many commissaries they have been eliminating checkers in connection with the food markets to the point where people now are standing in line an hour and a half or 2 hours in order to check out the items. It is all given in the name of economy; this is a budgetary edict. It seems to me this is rather poor economy when it is being practiced to that *n*th degree.

Mr. ASH. I am sure cutting back any program hurts somebody, if only those Government employees who have been charged with administering that program. We are not saying that everybody is happy about these reductions. Clearly, there are some people who find that the reductions bear upon them, but I would observe two things: first, it was absolutely impossible to reduce the total from \$261 to \$250 billion without some hardships; and second, even with the cuts or reductions, we are talking about the increase in social programs plus revenue sharing—but largely the social programs—accounts completely for the increase of \$18 billion in total spending of 1973 over 1972.

The real question is the difference between \$18 billion and \$29 billion. We are talking about the hurt that is measured by not having increased the \$18 to \$29 billion. The \$18 billion increase is still there—a very significant increase.

Representative WIDNALL. You have spoken on several occasions of so-called "unrestrained outlay totals" of \$250 billion in fiscal 1973, \$261 billion in fiscal 1974, and \$288 billion in fiscal 1975.

Would you explain how OMB arrived at these figures?

Mr. ASH. Yes, sir. We took those programs that in the budget are listed on pages 50 and following and projected ahead the most likely expectation of outlay levels that those programs would cause in the years ahead.

Representative WIDNALL. Would you relate this approach to the zero based budgeting concept?

Mr. ASH. The OMB view of budgets is one that does attempt to look at every program on a zero-based starting line. As we know, this is very difficult to do and many people would not want to look at it this way. However, one of the charges upon OMB is to look not only to increments but, at the same time, continue to reexamine all programs on a zero-based start.

Representative WIDNALL. Now, there has been considerable criticism of the increase in the military budget. However, excluding pay increases and increased retirement benefits, would you say that military spending has been greatly increased?

Mr. ASH. No, sir; quite the contrary. Military spending, as you can see, has been almost flat in absolute dollars even while the unit price per man-hour or man-day of those in the services, plus the unit price of materials, have been affected by economic policies of earlier years that gave rise to some of our inflationary pressures.

Representative WIDNALL. There has been a marked drop in the percentage of the tax money that is being spent for military purposes as against other purposes by the Government. Isn't that so?

Mr. ASH. Yes, sir; I think in this area there has been a contribution by the Congress as well as by the President. Together we have provided an effective military force and at the same time brought the relative proportion of the military costs way down from what they were 4 years ago.

Representative WIDNALL. What role does the Office of OMB play in phase 3 of the economic stabilization program?

Mr. ASH. I didn't hear part of that.

Representative WIDNALL. What role does your office, OMB, play in phase 3 of the economic stabilization program?

Mr. ASH. Well, the Director of OMB is a member of the Cost of Living Council and reflects the viewpoint that OMB has in total policy deliberations that take place in the Council. OMB also has considerable economic and other factual information that is brought to bear in the judgments that are made at the Cost of Living Council.

Representative WIDNALL. I understand my time is up.

Chairman PATMAN. Yes, sir. Senator Proxmire.

Senator PROXMIRE. You were until a few weeks ago, Mr. Ash, the chief executive officer of one of the Nation's principle defense contractors, the Litton Corp. Litton has hundreds of millions of dollars in contracts with the Navy, as you know, right now. Those contracts are subject to bitter dispute between the Navy and Litton.

Doesn't your appointment as head of the Office of Budget and Management, an office in which you may have decisive influence over the funds the Navy gets—doesn't this appointment constitute a direct and palpable conflict of interest?

Mr. ASH. No; and I will answer that in a more amplified fashion.

First, I am not sure it would be said by Litton or by the Navy that there is a bitter dispute.

Senator PROXMIRE. It is a lot less bitter since you got the power you have today.

Mr. ASH. Second, I would like to say that my knowledge about Litton ended on December 9, therefore, I will only speak from what I know, which ended on that day. Third, I would like to explain why there is absolutely no conflict of interest between my present responsibilities and those that I previously had. I have severed all connections with not only Litton Industries but all other affiliations that I have had outside of Government—more I believe than even the law requires that I do. Nevertheless, I have done it. As an example, the chairman may find it interesting to know that I have also severed all connections with the Bank of America, where I had been a member of its board of directors, executive committee and trust committee.

I have put all of my stock holdings in Litton and other companies in a blind trust and have instructed them to sell all of those stock holdings so that I will have no financial interest of any kind in Litton.

Senator PROXMIRE. How long will it take them to liquidate your Litton stock?

Mr. ASH. The direction is to have them all sold by March 9. I have made sure and I continue to make sure that I do not even know of any Government information bearing on Litton until all of those shares have been sold. I have made sure not to even know that information.

Finally—or not even finally, because I have got more than one more point to make—the Office of Management and Budget has no part in contractual matters between agencies of the Government and their contractors. When I left Litton the only issues that existed between Litton and the Government dealt with contract matters—concerning the meaning and effect of contract terms, the rights and responsibilities both of Litton and the Navy under contracts—and I am sure that we all know that the Office of Management and Budget is not a party to any matters that deal with resolution—

Senator PROXMIRE. Mr. Ash, you know perfectly well your office has a profound effect on Navy contracts because you influence the amount of money the Navy has with which to contract for procurement. It has a profound effect on what Litton can get and any other defense contractor; isn't that true?

Mr. ASH. Senator, the issues that exist are the interpretations of contract clauses and meanings and authorities and responsibilities that both parties have—rights and responsibilities that both parties have—under contracts. The OMB does not take any role in interpreting contract rights and responsibilities of parties in the Government and outside of the Government—

Senator PROXMIRE. I know you have more to say. Let me spell out what I am getting at.

A few weeks ago in hearings before this committee I asked Mr. Gordon Rule, the Navy procurement official who has handled most major claims for the Navy, whether you should be appointed head of Management and Budget. He said no. He said in effect that your appointment constituted an insufferable conflict of interest—as he put—the formation of a military-industrial-executive department complex—precisely the kind of influence against which President Eisenhower warned.

The Navy has lost no time in proving Mr. Rule right. They got the message of the implications of your appointment loud and clear.

In fact the Navy was so sensitive to your new power that within 24 hours—with the direct concurrence of Navy Secretary Warner, Mr. Rule was told to resign: to get out.

Now, on the basis of this record do you think the Congress and the public can believe that your presence as the “Lord High Executioner” of all budgets, including the Navy’s, won’t considerably soften the Navy’s posture on the Litton claims?

Your accession to this position of power was opposed by Mr. Rule, because caving in to Litton on claims would set a precedent that would seriously endanger the Navy on other contracts such as Grumman’s contract on the F-14.

Your presence as the top budget man could be just the factor that would mean a cave-in to defense contractors all along the line.

Now let me be specific:

Last June 16 you met with several high ranking Navy officials to discuss some of these matters. You were then president of Litton and you were also serving as the head of the panel for Government reorganization set up by the President. Don't you believe in retrospect that your meeting with Navy officials at that time could reasonably have been interpreted as an attempt to apply political pressure to force the Navy to settle your claims or terms favorable to Litton?

Mr. ASH. Senator Proxmire, I will first complete the answer that I was in the process of giving and hadn't yet completed, which I think might well have dealt with the point that you just made, and then I will go on to the meetings in June, if you wish.

In addition to the points that I have made, pointing out that there is no conflict of interest, you may be assured that if any matter arises where I or the President believe, because of past business responsibilities, it is inappropriate for me to participate in any decision, I will remove myself from consideration or decision.

I will make one further point. I took an oath of office for my present job. I believe in oaths of office. One never does take them lightly. I did not take mine lightly. I intend to serve the interests of this Government and will do so. I believe I will go as far as anyone has ever gone before in attempting to serve a governmental interest.

Senator PROXMIRE. Don't you see, Mr. Ash, you can remove yourself from particular decisions but everybody in the Department and everybody in the various agencies knows that you have this kind of power.

I am sure you had nothing to do with the request of Mr. Rule to resign or his being banished to Anacostia, too, and yet in spite of that he was banished because of your power. So there is no way that in view of your background and in view of your associations, in view of your interests, in view of what you have been trying to do, you can escape from that.

Mr. ASH. Let me make one more observation that I think you might find useful as you talk to others who are witnesses here.

Anybody in my job or many other jobs in the Government has to come from someplace, unless he was born in Government, and sometimes when I see the seniority of some people, I have to wonder if they were. There is no place today, given the pervasive influence of Government, that is not affected importantly by Government activities. Whether he be an educator out of a university that looks more and more to Government for funding, whether he be a farmer—and certainly around this city today there is criticism coming from farmers about actions taken by the Director of Office of Management and Budget—whether he comes out of labor, whether he is a lawyer that has represented, tax clients or anybody else, whether he has come out of State government, there is a potential conflict. Virtually everybody today has before he arrived in Government—unless he was born here—come from someplace and that someplace has been affected importantly by Government.

Senator PROXMIRE. Here we have one of the most celebrated and one of the most difficult and conspicuous conflicts that I have seen in the 15 years I have been here.

You suggested in that meeting that the Navy present the Litton and other shipyards problems to Congress with a request for a policy change that would cost from \$1 to \$2 billion. Can you tell us what you had in mind by way of a new program?

Now, could you tell us what you had in mind by way of a new program?

Mr. ASH. I surely can, and I think it was a very constructive suggestion. It is up to the Navy to decide what to do with it. Whether they liked it or not, I don't know. But I made the suggestion in the most constructive way, and I believe it was, even while at the same time I was the president of Litton, of potential great service to the people of the country and to the Government.

Senator PROXMIRE. It would cost the taxpayer a whale of a lot of money and enrich the Litton Corp. and their stockholders.

Mr. ASH. It probably would save the taxpayers a considerable amount of money. I will, if you wish, describe the particular thoughts that I had at the time. You can judge for yourself whether you believe, as I believed then, that this would be of great benefit to the U.S. Government and to the taxpayers and to the people of this country.

Senator PROXMIRE. Let me say the \$1 to \$2 billion program would mean additional payments by the Federal Government to the Litton Corp. of which you were at that time the chief executive officer; would it not?

Mr. ASH. No, sir.

Senator PROXMIRE. What would it have done?

Mr. ASH. If you wish I will elaborate on my proposal so we won't have to speculate about what it was. Do you wish me to use the time?

Senator PROXMIRE. I don't want you to use more time. I only have a very few minutes. Give it to me as concisely as possible.

Mr. ASH. I looked through the hearings that took place last year about Navy contracts. I had never read such hearings before. It was very interesting. But I saw a compilation there of claims against the Government made by many shipbuilders of this country. Virtually all of them had very substantial claims against the Government arising out of shipbuilding work. I didn't know that. I also didn't see any such claims or at least nowhere near that amount for contracts that dealt with Air Force programs or Army programs. I, as a doctor looking at symptoms, would say there must be some common symptom that lies behind the fact that virtually every Navy contractor has a claim but nobody else seems to have them. If there is a common symptom it suggests there might be a common problem. So I attempted to deduce from Litton's experiences what the common problem was.

I concluded that the common problem was that the method of contracting that has been used probably itself had some deficiencies in it because it seemed to always give rise to claims at the end of or during the course of performing these contracts.

The claims themselves, as I saw them from the point of view of Litton, and the contractual shortcomings as I saw them, gave rise to considerable cost to the Government which probably could be avoided by better contracting in the first place.

Furthermore, the claims gave rise to considerable diversions of the time of important Government people and important industrial people who had to deal with the legal matters of claims rather than dealing with what really was important——

Senator PROXMIRE. I am afraid you are losing me. Are you saying because there are costs for Litton Corp., for example, and some of these other shipbuilders, that exceed the original contracts, there were overruns, therefore, there must be claims, therefore, the Federal Government must be wrong, therefore, \$1-\$2 billion to wipe out the claim to take care of the overruns in the case of shipbuilders would take care of the problem?

Mr. ASH. I will pick out one of your points. You have made a number.

Existence of a claim does not prove the Federal Government is wrong but it doesn't prove it is right either. Claims, as you know, go before the Board of Contract Appeals and are resolved in a proper judicial fashion. The Government and the contractors accept that determination although it is subject to appeal by either party and both the Government—

Senator PROXMIRE. The reason for your meeting on June 16 was exactly to get around this judicial settlement. You wanted them settled by the Navy without reference to the Board of Contract Appeals. That was the whole purpose of your meeting.

Mr. ASH. One of the numbers of purposes of that meeting—and if you wish I can even go into other ones—was to propose that the Navy find a settlement, working with the Congress. The interesting thing of my proposal was that I suggested it be put in front of the Congress for consideration; a means of dealing with all accumulated claims, not by paying them one amount or any other amount but—

Senator PROXMIRE. You say you would like it settled politically by the Congress rather than settled by the Board of Contract Appeals?

Mr. ASH. At the present stage they are all going the route of Board of Contract Appeals. I suggested there was a better way to go and that they bring it before Congress to see whether there isn't a way to deal with them short of those interminable processes that take place before the Board of—

Senator PROXMIRE. I have as much respect for Congress as anybody, but I must say there are political pressures in the Congress to settle these claims very favorably for defense contractors.

Let me follow up a little further. Prior to your June 16 meeting you had discussed Litton's problems with then Secretary of the Treasury, John Connally, and he had apparently suggested the new \$1-\$2, billion program.

Can you tell us the dates and places of your meetings with Mr. Connally and whether you have spoken with him about it since your appointment to your new job?

Mr. ASH. I have not spoken to him since my appointment to this job. I did speak to him, and I don't know on which date, at the time when he was Secretary of the Treasury, at a time that I knew he did have knowledge and interest in Government finances and Government management in total. I don't know which particular date but I am sure it is someplace in my calendar.

Senator PROXMIRE. Why did you speak with the Secretary of the Treasury?

Mr. ASH. Because I had been told, or I came to know through some route or other, that the Secretary of the Treasury was a party to whatever program was worked out with the Lockheed Aircraft Corp., and, therefore, that he had been assigned, as I discussed, some responsibilities to deal with problems—

Senator PROXMIRE. Connally bailed out Lockheed and maybe Connally could bail out Litton?

Mr. ASH. In fact, may I add this one statement. One of the first specific things that I said to Secretary Connally—and I certainly want to put this one in the record—I said, “I am explicitly asking you to do absolutely nothing. I merely want you to know the status of these programs.” He will confirm this, I am absolutely sure. I know it is a matter of fact that when I did talk to him I said, “I want you to understand that I am asking you to do nothing.” I think that Litton’s history and my history of leaning over backward to avoid conflict of interest are as good, and probably better, than most any other—

Senator PROXMIRE. That leads me to the final question on this round.

There has been some speculation that you intend to help Litton obtain a favorable settlement of its claims against the Navy from your present position. Now, Mr. Ash, I want you to listen carefully to what I am about to say, and think about your response. You have been reported to say that you would not necessarily rule yourself out of any budgetary decision relating to Litton’s shipbuilding contracts.

Can you tell us exactly what your position is with respect to claims by your former company against the Navy?

Mr. ASH. Sure. You are quoting from a recent publication in one of the local newspapers.

Senator PROXMIRE. Washington Star.

Mr. ASH. What that says is a very neatly extracted part of my total discussion with that reporter, as so often seems to be the case.

Senator PROXMIRE. Then you concede the accuracy of this statement but it is in the wrong context?

Mr. ASH. It is absolutely in the wrong context. I will place it in the proper context and I think you will understand it more clearly.

I said to that reporter just what I said here a few minutes ago, “Everybody coming into Government has to come from someplace. Because of Government’s pervasive influence on everything, whatever he does in the Government probably someplace touches what he previously had done.” And I gave the reporter the example of the educator, the farmer, the lawyer, and the one from State government. We were talking on the subject of whether the budget should be \$261 billion or \$250 billion. I said that if we were to allow that number to be \$261 billion rather than \$250, the inflation thereby created would bear upon Litton and would bear upon everybody in this country. I am not going to disassociate myself from the decision to operate the Government at \$250 billion rather than \$261 just because Litton will be a beneficiary of that decision. So will 200 million other people be a beneficiary of that decision. I will continue to work for the benefit of all of the people.

All of the people include a number of people that are dependent upon Litton for their pay, for their lives, and I will continue to work for them. But as I have said to you here, I will make sure that I will absent myself from any decisions or considerations where either I or the President believe there is any possibility of conflict with the interest of Litton. In addition, I have taken all of these other steps that I have enumerated including an oath of office, which I believe very strongly.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Thank you, Mr. Chairman, and in spite of the rigor of the cross-examination that you have been getting, welcome to you Mr. Ash. I want to commend you for doing something which no Democratic Budget Director ever seemed to be able to do. You have cut out, as I understand it, all funds for the Subversive Activities Control Board. As far as I am concerned, somebody who does that can't be all bad. [Laughter.]

I think I can promise you the support of my brothers Proxmire and Moorhead at least, in going all the way to protect that budget cut.

Mr. ASH. I would appreciate their support on that and maybe even a few other things that surround it.

Representative REUSS. I am with you on that item.

Now, as to the other items, I do have a few questions.

Would you turn to this large book called Special Analysis and turn to Special Analysis K on page 156. I would like to have you check my reading of that table because I think it is very significant. You there expose to public view the tax transfers made to various groups. You show the tax transfer benefits to four groups: to the aged, to veterans, to welfare recipients and working mothers, and to the disabled. You set it forth very clearly. For instance, you show that in fiscal 1972 those welfare recipients and working mothers mooched at the trough \$95 million in tax transfers. Now, will you show me where in this enormous book you set forth the tax transfers to the large oil companies, the banks, the giant corporations, the holders of tax-exempt bonds, the receivers of capital gains, the other loophole beneficiaries?

Can you direct me to that information?

Mr. ASH. Until you added the term "loophole beneficiaries" I was tracking right along with everything you said because one man's loophole is another man's equity.

Representative REUSS. Would you show me where in this volume you show the millions transferred by the oil depletion allowance, the intangible drilling expenses, capital gains, tax favors to banks, tax-exempt bonds, et cetera?

I looked through all of its 249 pages without finding any such a table, and I just wonder whether you haven't written a little table here that will give great comfort to rotund gentlemen in their club lounges this afternoon as they read about the aged, the veterans, the working mothers, and the disabled getting by with a few million, but have said nothing about what the rotund gentlemen are getting by with, which is in the billions.

Could you straighten me out on that?

Mr. ASH. I can give you two sides to that.

Representative REUSS. Refer me to the page on which such information appears.

Mr. ASH. There is no page that makes that particular cross cut and aggregates together the many various matters that you have described.

Representative REUSS. Would you get out promptly a supplement to Special Analysis K which we can paste in there which tells us how much big oil and big banking and big industry, big tax-exempt bondholders and the whole list of them get from Uncle Sam?

I will buy you a splendid new shirt if it isn't many times what those welfare recipients and working mothers are getting.

Mr. ASH. Well, I know it is less by a long ways than what you would suggest it is.

Representative REUSS. Well, I haven't suggested anything yet. I have just said it is more than the Office of Management and Budget takes great delight in exposing as the widow's mite received by the welfare recipient and working mothers.

Mr. ASH. Given my rate of pay in the Government I don't need a new shirt right now. On the other hand, Mr. Cohn, who is very expert on this subject, can respond to that question.

Representative REUSS. Tell me where in the book this information is set forth and, if not, I would like you promise to product it promptly and submit it for the record so we can see both sides.

Mr. COHN. Mr. Reuss, you won't find it anywhere in this book. As I am sure you know, and I want to make clear, Mr. Ash is no way responsible for its not being here.

Representative REUSS. He is exonerated. It is Mr. Nixon. But lets get Mr. Nixon's version.

Mr. COHN. Please, Mr. Reuss.

It is my understanding that the Treasury Department has been providing this committee with studies from time to time of the different so-called tax expenditures as they have been providing them to us.

Representative REUSS. Let's have them from you, too, so we can compare the tax transfers. I am using your rubric—to the old folks and the vets and the working mothers and the disabled. Let's have you set forth what the people in the upper 5 percent of income brackets got.

Mr. COHN. Well, let me see what we can get from the Treasury since they do this work. We have no capability here and I am sorry—

Representative REUSS. They had a great capability to show what the little fellow was getting. How about showing us what Mr. Connolly's clientele, as someone expressed it, is getting.

Mr. COHN. I thought they did provide it.

Representative REUSS. We would like it from you. You are the Office of Management and Budget, and we would like it in a form so that people can see who is getting what from our tax system.

Mr. COHN. Mr. Reuss, we have no particular capability to produce these figures.

Representative REUSS. I will ask the Director.

Are you or are you not, Mr. Ash, going to provide this committee with a fair and full report on who gets the benefits of these tax transfers, which will transcend the pitiful headings of the aged, the veterans, the working mothers, and the disabled? I think that is a rather heartless display. I would like to see you tell us the whole story.

Why can't you do that?

Mr. ASH. As I discussed in another context, but there is an analogy, the President had the responsibility of determining how to conform with two inconsistent laws. It is our understanding that the Ways and Means Committee has said they do not want this kind of data exhibited in the budget.

Representative REUSS. The Joint Economic Committee is telling you that it very much wants it, that it thinks special analysis K is a put-on.

Now, are you or are you not going to furnish this committee, not the Ways and Means Committee if they don't want it, but this committee, with a breakdown of the tax transfers to all groups in society?

Mr. ASH. What do you wish different than what the Treasury already submits? The Treasury submits to this committee—

Representative REUSS. For one thing, the Treasury hasn't submitted anything in the last 6 months. I would like to have you submit an extension of your tax transfer table that I have just read which treats all the beneficiaries of tax transfers, the holders of a tax-exempt bond, equally with a working mother.

Now, are you going to do that or aren't you?

Mr. ASH. We will attempt to get from the Treasury their latest report on the subject. There is, furthermore, as you know, a very difficult problem defining what you want.

Representative REUSS. You seemed to be able to solve the problem in the use of the working mother.

Mr. ASH. Let me ask a question to get an instruction back that might help us.

The deductability of interest by homeowners, is that considered by your definition a transfer?

Representative REUSS. Right.

Mr. ASH. Even though most of that money goes to the very people that are considered the middle- and low-income groups?

Representative REUSS. Right. And a lot goes to the owners of third homes and condominiums and so on.

Do the best you can, so that this committee can make some judgments.¹

Senator PROXMIRE. Will you yield for 30 seconds?

Representative REUSS. For 30 seconds.

Senator PROXMIRE. On September 5 I wrote your predecessor, Casper Weinberger, and I said discussions you and I have had before the Joint Economic Committee, we have agreed on the need for greater scrutiny and analysis of Federal subsidy programs. The budget squeeze we face makes this even more imperative. As you know, the committee has made a considerable effort recently to throw some light on this area—but much more needs to be done.

Along these lines, it would be a great help to Congress to have the Office of Management and Budget develop a special analysis on cash subsidies. What I have in mind is a brief conceptual discussion and a factual display, explaining what a subsidy is, what general objectives they may have, how they effect the private market, identification of their budgetary costs, who are the direct beneficiaries, and so on.

I would also suggest that your office, in conjunction with the Department of Treasury, establish a special analysis covering tax subsidies and/or expenditures.

That was 5 months ago and we are still waiting for the answer and Congressman Reuss' questions are right down the line with what we have been asking for.

Representative REUSS. If you have any conceptual or methodological doubts along the way, I want what you have got.

Mr. ASH. We will make our best judgment given the sense of your question and try to come as close as we can to what we believe you have in mind. I believe Senator Proxmire's letter is probably in some unattended mail I should get back to.

¹ No material was received in response to this request.

Senator PROXMIRE. I ask you unanimous consent this letter be placed in the record.

Chairman PATMAN. Without objection, so ordered.
[The letter referred to follows:]

SEPTEMBER 5, 1972:

HON. CASPAR WEINBERGER,
*Deputy Director, Office of Management and Budget,
Executive Office Building, Washington, D.C.*

DEAR MR. WEINBERGER: In discussions you and I have had before the Joint Economic Committee, we have agreed on the need for greater scrutiny and analysis of Federal subsidy programs. The budget squeeze we face makes this even more imperative. As you know, the Committee has made a considerable effort recently to throw some light on this area—but much more needs to be done.

Along these lines, it would be a great help to Congress to have the Office of Management and Budget develop a special analysis on cash subsidies. What I have in mind is a brief conceptual discussion and a factual display, explaining what a subsidy is, what general objectives they may have, how they effect the private market, identification of their budgetary costs, who are the direct beneficiaries, and so on.

I would also suggest that your office, in conjunction with the Department of Treasury, establish a special analysis covering tax subsidies and/or expenditures.

If you feel the Joint Economic Committee can be of assistance in establishing these special analyses, I suggest your staff contact Mr. Jerry J. Jasinowski of our staff.

With best wishes,
Sincerely,

WILLIAM PROXMIRE,
Chairman, Joint Economic Committee.

Representative REUSS. Let's assume, Mr. Ash, that that budget deficit of \$13 billion or so is a valid outer limit. I am almost ready to go along with you in that.

Now let's look at how you arrive at an actual budget which will yield that deficit. As I view the budget, it shows great tenderness for the armaments and the space industries. SST has actually been added on to the expenditure side. Shipbuilding subsidies, corporate aviation subsidies, go on pretty much unchecked. Then you cut about \$10 billion from the average person's share of the Government, and that of the poor and underprivileged, a billion and a half for welfare, a billion and a half for medicare and housing, a billion for health, education, and poverty, a billion in pensions, a billion for the environment, a billion and a half for agriculture, half a billion for water.

Then the budget totally disregards the pledge that was made to bring in some loophole plugging tax reform, a field which many of us estimate could yield at least \$9 billion a year by plugging loopholes enjoyed by the oil industry, tax-exempt bonds, capital gains, and so on. The only rationale that I can see to this whole budgetary outlook is that President Nixon's campaign contributors have been favored at the expense of the other 95 percent of the people.

What would be a good answer if somebody should ask that question?

Mr. ASH. Probably President Nixon's supporters and campaign contributors include most everybody these days and I would think that—

Representative REUSS. Those days. I am not sure these days.

Mr. ASH. I will stay with my statement "these days."

Representative REUSS. Try to answer the charge that is made that the budget basically aids the arms industry, the space industry, the maritime industry, corporate aviation, cuts the heart out of people programs, and doesn't lay a glove on the great loophole enjoyers.

Mr. ASH. I think it is a wrong conclusion from the data. The data show that the biggest single part of the increment goes to social programs of one kind or other. This is where the increased money is going in 1974 over 1973, as was the case for the increase in 1973 over 1972.

To pick a number, human resources programs go from outlays of \$116 billion in 1973 to \$125½ billion in 1974.

Thus, \$9½ billion of the increase goes to human resources programs.

Representative REUSS. That would be your answer?

Mr. ASH. Yes; the thrust of this budget continues the policies of the administration during the last 4 years; that is, to move in the direction of spending bigger and bigger proportions of total Federal outlays for social programs of many and varied kinds.

Representative REUSS. My time is up. Mr. Chairman.

Chairman PATMAN. All right, Mr. Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Ash, when was this budget prepared?

Mr. ASH. It started almost a year ago and it gradually evolved over time, with many discussions taking place, until it finally went to press just a very few days before it was distributed. It was distributed, as you know, on January 29.

Representative MOORHEAD. But the decisions were made prior to the cease-fire arrangement in Southeast Asia, is that correct?

Mr. ASH. Yes, sir.

Representative MOORHEAD. Now that we do have such a cease-fire arrangement, are you in a position to make any recommended changes, particularly I am thinking in the military budget resulting from the fact that we apparently will not be fighting in Southeast Asia?

Mr. ASH. There are no specific changes that reflect the subsequent events. Clearly a function now to be performed is to consider changing circumstances, but I must say that the budget for the fiscal year 1974 is based on the premise that there will be no war in Southeast Asia.

Representative MOORHEAD. This budget is based on that presumption, therefore, there can be in your view no reduction in the military expenditures; is that correct?

Mr. ASH. Most of those reductions have taken place from the peak years of 1968 and 1969 down to the present. With respect to a peace dividend, we have realized it by the substantial efforts that have already reduced billions of dollars per year from the levels spent at the 1968 and 1969 peak.

Representative MOORHEAD. One of your predecessors, Mr. Charles Shultze, testified before this committee on the fact that at least during his regime and before the manner with which the Department of Defense dealt with then the Bureau of Budget, was different from other departments and agencies.

Does that condition still exist today under the Office of Management and Budget?

Mr. ASH. No. As I understand from looking at the experiences of my predecessors, there was a time during previous administrations when the Defense Department had a more dominant role as to its own budget vis-a-vis the Office of Management and Budget, then the Bureau of the Budget. Today the Defense Department is dealt with as are all other departments.

Representative MOORHEAD. At that time Mr. Shultz said that whereas other departments came to the Bureau of the Budget, the Bureau of the Budget sent its people to the Pentagon. Is that still in existence?

Mr. ASH. If he is talking just about travel, that is one thing, but I am not sure which meaning he had. Clearly it is essential that the Office of Management and Budget people not just sit in their offices. They go to all agencies, including the Defense Department. I think what he meant—and maybe I shouldn't put words into his mouth—but I think what he had reference to was the order in which each took their positions about the budget numbers. He will have to explain his own comments and I can only make that one point.

Representative MOORHEAD. Well, I am pleased that your testimony is that you are going to treat Defense just as tough as you treat other departments and agencies although from the figures that Congressman Reuss read it doesn't quite appear that way and I think that what is of concern to a great many Members of Congress, as you have said, everybody has to come from someplace, but this committee and a great many Members of Congress have believed that the Office of Management and Budget and its predecessor was not tough enough on the Defense Department, and it does seem, we do raise the question, not talking about your honesty, but the fact that you did come from the defense contracting industry gives us pause to wonder. Will you be as tough on your former conferees, I am not talking about Litton, I am talking about the whole supreme truck, as somebody who came from someplace else.

Mr. ASH. There are two parts to the answer that I would like to make. First, I would hope that you would join with me in observing that during the first 4 years of this administration, the administration has been very tough on Defense, holding it to about the 1968 level, while social programs have more than doubled. In terms of the experience right up to this moment, I think that we should all join in congratulating the administration's view of defense and what it has done about defense and in the meantime concluding a war in the best possible way. I would hope that we would look at how full the cup is, even as we bring up the question of how empty it might be.

Let me go to how empty it might be or your criticism of my position.

Litton has been very successful in innovating and creating new products—products that were very valuable to this country's defense and probably contributed significantly to the results achieved. I am proud of the fact that Litton did that. Nobody else did the things that Litton did. That gave rise to about 25 percent of Litton's business being defense.

When one continues to characterize Litton as a defense contractor, I think this perspective is lost. Litton is a defense contractor in about the same degree as are General Electric and many other companies. You may not know that. I think many do not know that, because of Litton's great success in developing products of a high technological nature that have served this country. The defense part of Litton's business is more or less the same as the defense part of the business of many important companies of this country.

So I say my having come from Litton is not really different than having come from A.T. & T. General Electric, but maybe even DuPont—I don't know the numbers on DuPont—General Motors, and many other such companies.

I think one should put in perspective that view of Litton when these kinds of conclusions are being drawn.

I have not come from the defense industry. I have come from a business firm of this country three-quarters of which is engaged in programs other than defense—almost as much as the percentage that we show for Government outlays. I believe, therefore, that in any view of me that you might have, view me as having come from all industry, not the defense industry.

Representative MOORHEAD. Mr. Ash, I am not trying to criticize you personally, I am just saying that because I think 25 percent of the big industry being in business, that you may subconsciously not be as hard on defense contractors as somebody else, and I caution you against that. I hope a year from now you will come before us and say, well, I slapped down this bunch and I cut back this program and I have really held their feet to the fire.

For example, I noticed that in the impounding of funds there is about \$1.8 million for the military.

Did any of that adversely affect any defense contractor?

Mr. ASH. \$2.7 billion of reductions shows on page 52 of the budget. You may have in mind the report submitted earlier this week under different definitions, but \$2.7 billion is the reduction and termination figure for defense for each of 1974 and 1975.

Representative MOORHEAD. I am referring to the report submitted.

Mr. ASH. \$18 billion.

Representative MOORHEAD. The hearing in the Congressional Record.

Mr. ASH. The same answer goes to each. As I said to Senator Proxmire, I have made sure that I do not know what is in this budget, and the details that are behind it, pertaining to Litton. At this moment I don't even know whether any of these programs relate to Litton and I have made—

Representative MOORHEAD. I didn't say just Litton, I said any defense contractor.

Mr. ASH. Defense expenditures, unless they are for the services themselves, relate to defense contractors. I can assure you that I will have no trouble at all being intellectually honest on this subject.

Representative MOORHEAD. Could you then supply, using let's say, the statement appearing on February 5, in the Congressional Record, a breakdown on what defense procurement programs were affected by the impoundment?

Mr. ASH. We sure can, but if it includes any that Litton is involved in I will instruct the staff not to tell me.

Representative MOORHEAD. It is going to be difficult to do. My time has expired.

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

Apportionment reserves are established at the level of the individual appropriation. The specific procurement programs for which apportionment reserves were established as of January 26, 1973, are:

Aircraft procurement, Army (1972-74)-----	\$2, 825, 000
Other procurement, Army (1972-74)-----	21, 726, 000
Shipbuilding and conversion, Navy (1971-75)-----	145, 672, 302
Shipbuilding and conversion, Navy (1972-76)-----	427, 211, 537
Shipbuilding and conversion, Navy (1973-77)-----	777, 100, 000

Total----- 1, 374, 534, 839

These reserves were established pending subsequent apportionment. The funds will be released when needed.

Chairman PATMAN. As I indicated in my opening statement, Mr. Ash, interest rates on short-term Federal obligations have increased substantially in recent months. It would seem to me that phases 2 and 3 of the economic stabilization program have failed to serve the Government very well in this respect. Since you have indicated an overriding desire to prevent unnecessary expenditures, don't you think the economic stabilization program should step in to halt the rise in interest rates; if not, order a rollback. Remember, the President has the power under the law that his committee sponsored some time ago to roll back interest rates himself.

Mr. ASH. Mr. Chairman, as you may know, just this very week three banks did decide to take heed.

Chairman PATMAN. One-quarter of 1 percent.

Mr. ASH. Well, its the right direction and a quarter of 1 percent on the amount of money that banks lend is a big amount.

Chairman PATMAN. Don't you think it is a rather feeble effort? There is no justification for uniform interest rates?

Mr. ASH. The second part of the answer to that question is that one of the best contributions to low interest rates is through responsible fiscal policy.

I am sure you will be talking to those dealing with the monetary policy of this Government, but in terms of my responsibilities, which is for fiscal policy, I think we have presented here a route which can make the best possible contribution to low interest rates and available money.

Chairman PATMAN. Mr. Ash, I have heard that a long time and its just an excuse and no reason. Interest rates have been going up, up, and up; in 1969, when Mr. Nixon came in, within 6 months residential mortgage interest rates had gone up from 6 percent to 8½ percent. The highest rate in all history. Then they say they came down. They came down within that 7½ to 8½ but not below the 7½. It has ranged right along there and usually it is near 8½ percent. So interest rates have not come down substantially and what you are saying now is said by all of the officials, but it is just an excuse and it is not backed up by facts.

Mr. ASH. Knowing your expertise on the subject, which is much greater than mine, I do think most economists would agree that had the President not taken the actions that he took in the first part of his administration, we would be seeing not the interest rates that we are seeing today, but an absolute financial catastrophe that we would all be trying to dig ourselves out of.

Chairman PATMAN. The financial catastrophe is not unlikely yet if you don't do something about these interest rates. The people are paying \$150 billion a year on interest alone. Now that much is taken out of the budget of the people of America every year and more. Its getting to be very, very serious and I urge to you to give further consideration to it.

Mr. Ash, you assert that budget outlays for low- and moderate-income housing will more than double between 1969 and 1974. That may seem impressive but these outlays have, nevertheless, failed to help achieve meeting the national housing goals for low- and moderate-income people during this period.

Hasn't the administration in effect abandoned the housing goals for low- and moderate-income families through termination of federally assisted housing programs?

Mr. ASH. Sir, the goals are still there. The mechanism that was put in place to achieve those goals—

Chairman PATMAN. The source of funds is gone.

Mr. ASH. The mechanism that was first put into place to achieve the goals, subsidized low-cost housing, didn't work. It resulted in subsidized housing but it was not even good housing and certainly not low cost. What has happened is that those programs are for the moment suspended, pending a determination of how best to achieve the very goal that you state. I am sure that in the process of determining how to achieve a goal that previous programs were not able to achieve, there will be considerable discussion with the Congress, and with others who have knowledge and interest, on how better to fashion programs to supplant the ones that really didn't meet the goal.

Chairman PATMAN. There is nothing wrong with housing that a source of funds will not cure. You have no source of funds for federally assisted housing and you are not trying to get any. I think we would be justified in making the Federal Reserve furnish a source of funds or provide it in some other way. The Federal Reserve has plenty of money to furnish for gambling casinos on speculation, for high-interest-rate lenders, and similar purposes. Our central bank is the only one in the world that doesn't acknowledge a social responsibility to the people. It is the only one. Little Mexico, across the Rio Grande, requires the central bank to make at least 30 percent of its loans for low- and moderate-income housing and they have plenty of housing down there. Other countries do the same thing. Every country except our own acknowledged a social responsibility to their people. Ours don't acknowledge anything but trying to keep \$71 billion free of charge and claim that it owns it. That is their contribution.

Mr. ASH. Sir, I seem always to have two part answers, and I would like to make two points now. I don't think any of us would want to provide a source of financing for housing programs or any other kind of programs, if we felt there was a good likelihood that those moneys would be misspent or fall far short of achieving the goals.

Chairman PATMAN. We haven't got to that yet. Let's get to the money.

Mr. ASH. Secondly, in the chart book, chart 41, which I did not show you, shows very vividly what has been happening to housing over the years. In 1950, 15,300,000 houses were defined as substandard.

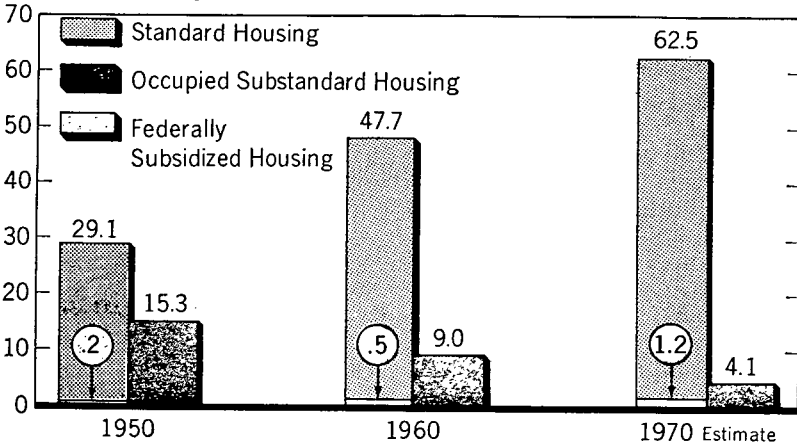
Today that number is down to 4,100,000 houses, while standard housing has more than doubled.

[Chart 41 follows:]

Chart 41

The Improvement in Housing Conditions, 1950-1970

Millions of Housing Units



Basic economic forces have provided the major stimulus for the dramatic improvement in housing conditions since 1950

Chairman PATMAN. We will study your charts. In your statement you set forth a comparison of certain expenditures for the years 1969 and 1974, and make the point that grants to State and local governments will have increased from 11 percent of total outlays in 1969 to 16.7 percent in 1974.

What percentage of the budget outlays for those years is represented by interest payments on the national debt? It is nearly \$25 billion this year, isn't it? Will you give us a comparison in your figures.

Mr. ASH. Total interest payments on the national debt are about 10 percent of total outlays. Interest payments on debt held by the public are about 7 1/2 percent of total outlays. Just to put it in another perspective, as we have been sitting here, interest has been paid at the rate of \$50,000 a minute.

Chairman PATMAN. Well, of course, you can do something about that, you can roll interest rates back. Why don't you start now?

Mr. ASH. We have a program—

Chairman PATMAN. We have given you the power.

Mr. ASH [continuing]. That goes in that direction.

Chairman PATMAN. How does that compare with outlays for grants to State and local governments?

Mr. ASH. Well, the amount of aid to State and local governments is the very number that you were referring to.

Chairman PATMAN. All right, just let it go.

What recommendations would you make to reduce interest rates to the lowest level possible and hold them there so that a far greater percentage of the funds available to the Government could be channeled to human resources needs?

Mr. ASH. The recommendations that I would make are ones that have been made are the ones that, in the aggregate, comprise the budget that is being now presented to the Congress for its consideration for fiscal year 1974.

Chairman PATMAN. Thank you, sir.

Now, I note, Mr. Ash, that there is no mention anywhere in your statement of President Nixon's commitments to provide aid to both North and South Vietnam in the event that a satisfactory peace is achieved and maintained there.

If peace is achieved, where will the funds for this purpose come from? Will funds for this purpose require further cutbacks in domestic social welfare programs?

Mr. ASH. There is in the military budget an item for continuing Southeast Asia activities, but there has been no specific provision for the possibility that moneys would at any time go into North Vietnam. As you know, there is a long road between here and there. Many discussions will have to take place, agreements will have to be reached as to the amount of aid; and a determination will have to be made by many countries of this world as to the degree to which they might participate. The net effect is that the decisions are in front of us, and all these issues will have to be dealt with when the facts begin to unfold.

Chairman PATMAN. It will be necessary that I be on the floor at 12 noon and for a little while. I will ask the vice chairman of the Joint Economic Committee to preside.

Senator PROXMIRE [presiding]. Thank you. It is your turn, Senator Percy. Do you want me to go ahead?

Senator PERCY. I understand you have a speech that you have to make.

Senator PROXMIRE. I'd appreciate it if I could go ahead.

Senator PERCY. Go right ahead.

Senator PROXMIRE. What you said to Congressman Moorhead earlier is more revealing about the attitude of the new Budget Director than what anybody has said today. You said the Nixon administration has been very tough on defense spending. The fact is the administration takes credit for getting us out of the Vietnam war. They should have gotten us out earlier. The fact is we were spending \$22 billion from an incremental standpoint on Vietnam that wouldn't have been spent without the war. The war is now over. We are now increasing defense spending about \$4.2 billion. So we have lost all of the peace dividend, all of the \$22 billion, some of which we thought we would be able to conserve one way or another. In addition to that we are increasing defense spending by \$4.2 billion and you call that being tough on defense?

Mr. ASH. You said we have lost the peace dividend. Quite the contrary, we have spent the peace dividend for social programs.

Senator PROXMIRE. Your chart shows we haven't cut defense spending at all when the activities in Vietnam were declining.

Mr. Ash. The chart also shows that the level of defense spending has gone down considerably relative to total spending. Real defense spending in terms of 1968 or any other base year's dollars has gone down. The average cost of paying military personnel will go from \$5,500 per year in 1968 to \$10,000 per year in 1974. The cost of materials is going up, largely because of the inflationary pressures that were put in force from 1965 to 1968, which still carry over to a degree, but which are being restrained by the President. Since total defense spending is about the same as earlier, these inflationary pressures have caused the real dollars spent on defense, measured by any base period, to go down.

[The following supplementary note was subsequently supplied for the record by Mr. Ash:]

When adjusted for pay and price increases, defense spending in 1974 will be about the same as in 1973 and about one-third *below* 1968. During this same period when real defense spending has been reduced one-third and current dollar defense spending remains roughly level, nondefense outlays have grown by 91% or \$90 billion. This is four times the peak incremental Southeast Asia support costs, estimated by the Department of Defense to have been \$21.5 billion in 1969. The scaling down of the war has released billions of dollars into other programs and helped make possible the \$90 billion increase in nondefense programs between 1968 and 1974.

Senator PROXMIRE. The fact is in spite of spending billions less on the Vietnam war as your chart showed in 1970, 1971, 1972, 1973, and more for 1974. Here is the reason. Part of it is lost because of inflation. That is true. Part of it is used up in extra pay. That is true, no question about it. But that is only part of it. We have analyzed this carefully and we find a substantial amount of this increased non-Vietnam military spending is because of excessive procurement costs, paying for much more than we are getting to firms such as Litton.

The Litton ship claims alone amount to about \$450 million. As a semiprivate citizen you fought like a tiger to get them, saying you would take it to the White House. Now, in the budget we have put a freeze on all new public housing units for 18 months. It costs roughly \$800 per unit for the annual contributions for public housing (1972 actual was 940,000 units and about \$744 million for outlays equals just less than \$800 per unit per year). That's the subsidy per unit.

The Litton claims alone—just the Litton claims—would pay for public housing for 1 year for 562,500 units—more than half a million units. This would house 2 to 2½ million poor people for 1 year. What's it going to be, Mr. Ash, claims for Litton or housing for the poor?

Mr. Ash. I think the answer to the question is a very simple one.

[The following supplementary note was subsequently supplied for the record by Mr. Ash:]

Taking the annual Department of Defense procurement program in total, since 1968 program reductions have more than offset program increases. *Despite* general price growth between 1968 and 1974 of over 26%, which would require a procurement increase of almost \$6 billion in order to provide the same level of resources in 1974 as in 1968, the defense procurement program has actually been *reduced* by \$3.7 billion from \$22.6 billion total obligational authority in 1968 to \$18.8 billion in 1974. All procurement claims, cost growth, and inflation have been absorbed within this lower total. Thus, the declining procurement program levels have reduced defense outlays between 1968 and 1974. If it were not for reductions such as these in the procurement program, the defense budget would be billions higher today than it is.

Senator PROXMIRE. Claims for Litton?

Mr. ASH. I think you would like to have me fight like a tiger on behalf of the people of this country and that is what I believe I am doing. Secondly, I am sure you know as well as I that the fact that there is a claim from either party against any other party in a contractual matter doesn't predetermine the rightness or wrongness of the parties' positions. That is yet to be determined. Litton will abide by and I am sure the Government will abide by the ultimate determination made as to who owes whom how much. When I left Litton, and I presume it is still the case, Litton was asking for absolutely nothing that was not provided for in the contract that it had with the Government. It was only asking for one thing, that the Government perform its obligations under the contract——

Senator PROXMIRE. The Navy looked at it differently. The difference was almost half a billion dollars.

Let me ask this.

Mr. ASH. Which was provided in the contract, incidentally, and audited by the GAO.

Senator PROXMIRE. In view of all these problems, the current controversies with the Navy over Litton's landing helicopter assault ship and other shipbuilding contracts, the problems that are building up on the DD 963 destroyer program, the many other military contrasts that Litton holds and the question of your allegiance to your former company, the fact that Litton's shipbuilding operation under your leadership has been shown to be one of the most inefficient and mismanaged shipyards in America, and in view of the tremendous power you will wield as Director of OMB, why shouldn't your appointment be subject to Senate confirmation? Do you oppose the proposal that your appointment be conditioned on Senate confirmation?

Mr. ASH. I do. You have made a lot of whereases I would find unacceptable as statements of fact, or at least total statements of fact. There was considerable contrary testimony, too, as to the effectiveness of the shipbuilding operation that Litton has, or at least had, and the benefits that will accrue to the Government from it. So the testimony, if one wants to be selective, I am sure, can say a number of things. I think to make this record complete, it should also state that there is much testimony that says that a great national asset of this country is the shipbuilding facility and management that Litton has.

Senator PROXMIRE. We have the Navy experts, labor people, a number of others, who testified to Litton's incredible inefficiency and mismanagement.

Mr. ASH. I have in front of me some of the testimony given before this committee and find substantial parts of it, particularly that of the Government's representative and, more particularly, that of the General Accounting Office's representatives, which runs in a different direction, but I am not going to reintroduce——

Senator PROXMIRE. How about the Senate confirmation, would you oppose that?

Mr. ASH. Yes, sir; I would.

Senator PROXMIRE. Why.

Mr. ASH. I will tell you why: The Director of the Office of Management and Budget is an integral part of the President's office, just as your staff people are in integral part of your office. They are there to help the President carry out his functions and his responsibilities.

They have only the authorities and responsibilities that have been assigned to them, or may be assigned to them from time to time, by the President, just as your assistants only have the authorities and responsibilities that you assign to them from time to time. They are a part of, and an integral part of, the President's office. As such, they should be no more subject to confirmation than if I asked you to bring your staff people up in front of me to see whether I found them acceptable.

Senator PROXMIRE. Don't you realize that in the 50 years since the budget and accounting office was created that the job you have has evolved and changed enormously, that you have a great, great power, you are not like Mr. Haldeman and Mr. Ehrlichman, simply subject to the whims of the President. You serve in a separate category with 600 employees, something of that kind. You have an immense power over everybody's budget that comes before you. The Senate has voted by a 4-to-1 vote margin, including Republicans, who I am sure greatly respect you and want to be loyal to the President. Under these circumstances, wouldn't you agree that the Senate should have some participation in determining who is going to have this great power? Every time we introduce a bill, it goes to your office for evaluation. We are told whether or not the Office of Management and Budget favors or opposes that legislation. I think that is good. I favor that strongly. But this gives you enormous influence and we don't have any advice at all in saying who should be the man who has this authority.

Mr. ASH. The point you have just made I think further supports the fact that it should not be subject to confirmation. When bills are submitted they also have the concurrence of the Office of Management and Budget, which is in fact the concurrence of the President. This means that the position in each bill reflects the position of the President. It has no independent standing.

Senator PROXMIRE. That is true of everybody in the Executive Branch. Nobody in the Executive Branch unless he wants to resign is going to operate in conflict with the President of the United States. Every Cabinet officer, every assistant Cabinet officer. When I went in the Army I took an oath that I would support whatever the President told me to do and that is what everybody else does.

Mr. ASH. I wish it would always work that way.

Senator PROXMIRE. I am sure you don't want me to be a rubber stamp for my President.

Mr. ASH. Since a favorite subject of yours is overrun, we have 660 people in the Office of Management and Budget as approved by the Congress.

Senator PROXMIRE. Isn't it correct that the Administration has not recommended in this year's budget request a suspension or termination of a single ongoing military program, not one? You have pages of terminations of domestic programs, not one military program—name one.

Mr. ASH. In fact, there are six items set forth specifically for reduction or termination, including the second safeguard site, a significant military program, proposed for termination.

Senator PROXMIRE. Those are the wish list, what the admirals and generals say they would like to have, these aren't the kind of reductions you have with ongoing programs that are terminated as you have with domestic programs.

Mr. ASH. This is what the President proposes to the Congress, a reduction from what otherwise was already in process under the programs that had existed in earlier years under the Safeguard and under other programs.

Senator PROXMIRE. My staff must be in direct conflict with you and your staff. They assure me that that just isn't the case, that the reductions or elimination or terminations are those programs that the military would like to have, as they always do, but you have to say no to some of them.

Mr. ASH. I may list some others that may be of interest to you. The Sea Control Ship was deferred. The S-3A and other aircraft budget levels were reduced. AWACS procurement was deferred. Sparrow and Sidewinder missile procurement quantities were reduced. These are specific actions that are in this budget.

Senator PROXMIRE. Well, it is exactly what I indicated, these were the wish list that they asked for and that you cut down.

My time is up. I will be back.

Senator Percy.

Senator PERCY. Mr. Ash, this is, I think, the third time that I have heard testimony from you in the last week on both sides of the Capitol and I do begin to wonder when you are going to be able to do your work. I know it is when you go back to the office at night. But I am sympathetic with the problem that anyone in the Administration faces in being continually called before Congress and I hope that your early appearances here will finish our questioning of you so that you can get back to your very important work. Your testimony has been extremely valuable.

Mr. ASH. I am enjoying every bit of it.

Senator PERCY. You know you and I differ very sharply on whether your position should be subject to confirmation. I feel it should be. But I think we also agree on many things.

I would like to have a better understanding of the memorandum from John Ehrlichman to the President dated February 6, which Senator Scott has sent me a copy of. That shows that funds held in reserve in the 1973 fiscal year budget were \$8.7 billion for 3.5 percent of the total unified budget outlay.

Does the \$8.7 billion include impounded funds for water pollution?

Mr. ASH. They are not in there because under the act itself, those funds aren't reserved, or to use the congressional term, "impounded." They do not fall within that definition because they are not yet allocated to States. The law itself provides that those funds would become available only as they were allocated to the States by the head of EPA. Since they have not been allocated, there is nothing to reserve.

Senator PERCY. My understanding is that the water pollution funds impounded represent about \$6 billion now. The President intends to spend about \$5 billion out of \$11 billion that had been appropriated, so when we add the \$6 billion to the 8.7 we come up

with impoundments of over \$14 billion, which would be about six percent then of the total unified budget outlay. This is on the high side, not the low side of the average, in recent years going back through 1962.

Mr. ASH. I don't intend to quibble with you about definitions, but the law is very explicit. The way that this particular program works does not give rise to any class of action that could be considered impoundment. I am sure we can add many figures together for any purpose we want, and I will confirm your addition. However, I will at the same time say that the numbers don't relate to the EPA law itself or to the request for impoundment information.

Senator PERCY. Mr. Ash, you have talked a great deal about the Administration's commitment to return power to the States and local communities, a principle that I certainly agree with, and in essence to let them choose their own priorities.

Can you discuss in more detail some of the areas other than the general revenue sharing in which this will occur?

Mr. ASH. Yes, sir there are proposed in this budget four special revenue sharing programs: one for manpower training, one for urban community development, one for law enforcement and one for education. Together, they add up to about \$7 billion in the first full year. In the aggregate, this is more or less equal to the various categorical programs that are proposed to be supplanted. Thus, we are giving back to the cities and States the right to determine how best to spend that money. I am sure that they may want to spend it differently than the narrow categorical Federal programs require. The categorical programs require standardization across the whole country, which may or may not fit individual communities, and may lead to wasteful and completely misapplied expenditures of dollars.

Senator PERCY. I was a strong advocate and supporter of revenue sharing and have been ever since I have been in the Senate. I am in the midst now of trying to determine what effect revenue sharing has had in the State of Illinois in all of our municipalities. Has the Office of Management and Budget made any survey of what impact revenue sharing has now had? I know it's very popular amongst the mayors and city councils. What impact has it had, has it meant holding lines on taxes or actually reducing taxes or providing better services? Is there any generalization that can be made?

Mr. ASH. Your question clearly is a threshold one with which we all will be concerned. It is still somewhat too soon to be able to derive any meaningful feedback on the effect of revenue sharing, but I can assure you that under the heading of management, the Office of Management and Budget will be giving considerable attention to this question and we will be greatly interested in it.

Senator PERCY. Are you continuing a survey of your own now?

Mr. ASH. We intend to develop the kind of understanding that, I am sure, will serve your purposes and our own as to the effectiveness of revenue sharing expenditures.

Senator PERCY. I think it would be most useful and I think many of us would be very interested because I think you are capable of making a much better survey than we shall be able to with our limited facilities.

Mr. Ash. Mr. Cohn advises me the Brookings Institute is making such a study on its own and without Federal moneys. We can all become beneficiaries of that expenditure, and it will not come out of our respective budgets.

Senator Percy. The Domestic Council, if we can get into an organizational matter, was a creation of the Ash Commission. Could you describe for us what the relationship is between the President and the members of the Council as distinguished between the President and the various Cabinet officials? How does the Domestic Council actually function now?

Mr. Ash. The best way to portray it quickly is by considering the analogy to the National Security Council. Putting aside functional differences, each of them has a role advisory to the President. Each is charged with considering policy level matters that are broader than those of any one department or agency, thus allowing a greater focus to be placed across a broad spectrum of governmental activities. The Domestic Council synthesizes and provides analyses that cross domestic governmental activities and works with the department heads attempting to resolve positions for recommendation to the President.

Senator Percy. I think the experiments of the administration in reorganizing the Cabinet and creating some supercabinet officials that will really supervise the functions of government is a very good thing. It is a very useful way to reorganize, considering how glacially slow we in Congress are moving on reorganization plans.

I am somewhat confused about the role of the Secretary of the Treasury as an adviser now, almost an economic czar, to the President. What does that do to the functioning to the Council of Economic Advisers. We deal very extensively here with the Council, which has been very useful. What changing roles will the Council have now as the Secretary of the Treasury assumes a separate function and has a separate office in the Executive Office Building, and so forth?

Mr. Ash. The Council of Economic Advisers continues to perform exactly the same role that it has performed. Its output goes not only to the President, but it is also a participant in the Troika and the Quadriad, which as you know brings together points of view on economic matters across the Government. The Council's advice, however, can be better made use of now because the Secretary of the Treasury has been given an assignment to view matters across a broad economic front rather than just the narrow ones of Treasury. Thus, information professionally provided by the Council of Economic Advisers can be brought to bear in operational ways that would have been more difficult otherwise.

Senator Percy. Lastly, if I could go back to the subject of the last week that we have been discussing, the impoundment of funds, do you feel that the President has the power to impound funds simply because he does not like a particular program? Let's say that the debt limit will not be exceeded, the ceiling he placed on the budget will not be broken, and yet he simply doesn't like a program that has been set up by Congress.

Mr. ASH. Probably the answer to that is again best expressed in an analogy. "Does not like" has a highly subjective tone. The President, as the Members of the Congress, has the right to make his judgments based upon what he believes is in the national interest. I wouldn't characterize it as "like" or "not like." The President is obligated to spend funds in efficient ways. This year in particular, because of the debt ceiling, he is further obligated to find some areas to spend less money. He makes his best judgments as to which expenditures are best in the national interest and which are not. I wouldn't characterize him as liking or not liking, any more than I would characterize your position on any program of liking it or not. You use your best judgment. The President used his best judgment and that is what he has done for 1973 and the proposed budget for 1974.

Senator PERCY. Thank you.

Senator PROXMIRE. Mr. REUSS.

Representative REUSS. Thank you, Mr. Chairman. I would be glad to yield to Senator Humphrey.

Senator HUMPHREY. Go ahead for a minute.

Representative REUSS. Mr. Ash, you pointed out to Senator Proxmire and Mr. Moorhead that Litton Industries is by no means exclusively a defense contractor, that about 75 percent of its business is in nondefense activities. Those activities include ship construction, do they not?

Mr. ASH. That is within the 25 percent.

Representative REUSS. That is within the 25 percent?

Mr. ASH. The military ship construction is within the 25. The 25 probably for the period since I left Litton might go up a few percentage points. When I did leave it was ranging around the 25 to 28 percent.

Representative REUSS. Litton Industries constructs cargo vessels and tankers and so on, does it not, at its Pascagoula shipyards?

Mr. ASH. When I left it was finishing up the construction of some commercial cargo vessels, which were scheduled to be finished relatively soon so as to make available the full facility for defense construction. My knowledge is, however, outdated.

Representative REUSS. It also has constructed tankers in the past, has it not?

Mr. ASH. I don't believe it has constructed tankers, at least in the last 10 years.

Representative REUSS. Is it not a fact that Litton Industries is doing some work on the supersonic transport?

Mr. ASH. I do not know whether it is or is not doing any work on the supersonic transport.

Representative REUSS. Have you read your latest annual report of Litton Industries?

Mr. ASH. Litton's latest annual report? I participated in writing the latest annual report, meaning the one that came back out last July 31.

Representative REUSS. Yes. Now that I refresh your recollection, isn't it a fact that Litton is doing some work on a supersonic transport?

Mr. ASH. I don't know whether it is now or not. It was in July.

Representative REUSS. It was in July?

Mr. ASH. I believe it was in July. But I don't know whether it is doing any now or not.

Representative RÆUSS. But it was doing some in July?

Mr. ASH. I believe it was.

Representative RÆUSS. I now call your attention to two of the budget items of, first of all, Federal subsidies for ship construction. I quote from page 109 of the budget document: "Federal subsidies for ship construction in 1974 will maintain the current program momentum. Outlays for federal maritime programs will increase by \$66 million to \$502 million." That is half a billion dollars.

I further call your attention to the fact that funds for supersonic transport research in the budget have been increased. But you would say that your prior connection with Litton Industries is pure coincidence, and has nothing to do with the rather remarkable increase in those items which Litton just happened, only recently, to be involved in?

Mr. ASH. To repeat the old saw, "I am glad you asked that question." First, to my knowledge, Litton is not bidding on, has no bids for, and in no way will be the beneficiary of any of the moneys set forth here for ship subsidies. The commercial ships that I last knew that Litton was working on were ones contracted for a number of years ago. No actions to my knowledge are going on where Litton will have any participation in those moneys.

Second, let's get down to supersonic transport.

The research and development that is continuing on the supersonic transport has nothing to do with Litton's very small participation in that program. Litton provided navigation equipment for that program. Navigation equipment is not one of the research areas that is being continued in this year's budget. I am glad you asked the question because the answer is zero in both cases.

Representative RÆUSS. Right. On the SST, from the result of the substantial increase in SST research in the proposed 1974 budget, if that increase should be voted and if that helps bring about in the future a SST, Litton then would be presumably in a position to sell some SST navigational equipment to whoever was making it, would it not?

Mr. ASH. Any number of companies would be in a position to do so. It is a matter of best bid. I would hope that the contractor would take that best bid, whoever it is. I will not be a shareholder of Litton at that time and have absolutely no interest in it. I can see no way to remove myself from that or many other things this Government does. To pick another example, the Government may vote funds for elementary education. Litton has in the past years been a participant in the elementary education marketplace. Litton has been, as many other companies in many, many marketplaces, affected by many, many economic and other decisions. I can't think of a better way to separate myself from those than I have done.

Representative RÆUSS. Let me now turn to chart 11 of your presentation, which shows the Federal debt as a percentage of GNP and shows a very heartening and encouraging trend of the curve downwards.

Is it not a fact, however, that if one were to construct a chart of the foreign held Federal debt as a percentage of GNP it would show a horrendous curve upward, practically off the chart?

Isn't it a fact that when Mr. Nixon took office in 1968 and 1969 that the foreign held portion of our national debt was something like \$38 billion, and that today it is something like \$83 or \$84 billion, more than double. Since it is the foreign held debt that presents the problem—debt that we have to pay off in real resources—shouldn't, for fuller understanding of the problems we are up against, your chart book contain a chart on that?

Mr. ASH. There is no chart on that. I don't happen to have at my fingertips the information to confirm it. I will presume that you are correct and if not we will answer for the record.

[The following supplementary note was subsequently supplied for the record by Mr. Ash:]

In December 1968, about \$14½ billion of public debt securities was held by foreign and international investors. In November 1972, these investors held about \$56 billion.

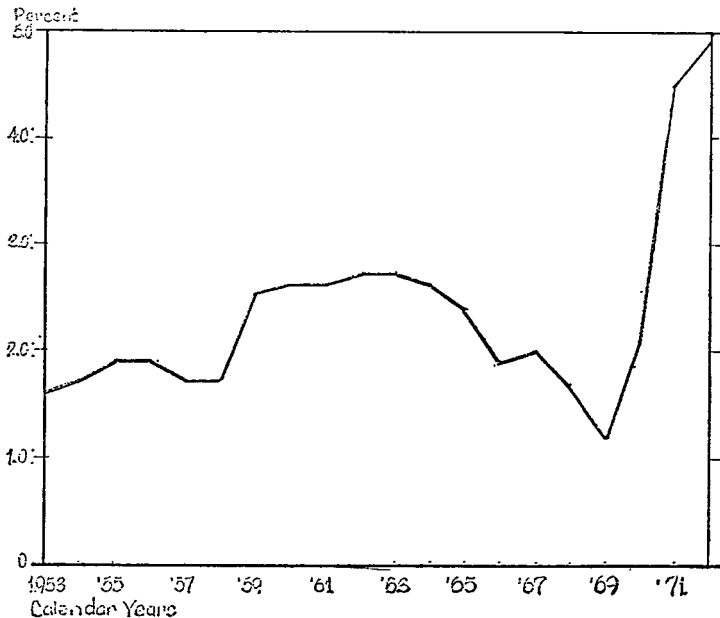
Representative REUSS. Well, I appreciate that. Would you construct, it's easy to do, a little chart using the same format as that in which your Federal debt is presented, a GNP chart on the foreign held portion of that, because that seems to be what is really significant and I hope you will do it because it may serve to awaken us all to the real bind we are getting into there.

Mr. ASH. I agree with you about the importance of the very point that you are bringing up. It is one that concerns me in my capacity as a part of the Troika on economic management of this Council. I will join you in the concern that I am sure you are expressing.

Representative REUSS. I will appreciate the chart.

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

Foreign and International Holdings of Public Debt Securities as a Percent of GNP



Representative REUSS. I have just one more question. Recently the Bureau of the Census published its figures on who is gaining and who is losing in America, dividing Americans into the top fifth, next fifth, middle fifth and so on, in terms of income.

Many of us were very disturbed to find that, reversing a 30-year trend, income shares for the top 20 percent and particularly for the top 5 percent of American families have been increasing their percentage of the total at the expense, of course, of the people in the middle and the people on the lower end.

At this time I ask unanimous consent to include in the record a speech I made in the House on January 23, which shows these dismal figures whereby for the first time in 30 years the——

Senator PROXMIRE. Without objection.

[The speech referred to follows:]

[From the Congressional Record, Jan. 23, 1973]

THE RICH GET RICHER

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Wisconsin (Mr. REUSS) is recognized for 30 minutes.

Mr. REUSS. Mr. Speaker, the Census Bureau's recent report, called "Money Income in 1971 of Families and Persons in the United States," contains some revealing data on changes in the distribution of income in this country in the past 4 years. The administration has not publicized the charts prepared by the Census Bureau showing changes in the percentage shares of U.S. income enjoyed by low-, middle-, and high-income families. These charts show the top fifth of American families increasing their share dramatically under President Nixon—from 40.6 percent in 1968 to 41.6 percent in 1971—at the expense of the lower three-fifths, whose shares decreased over that period:

PERCENTAGE SHARE OF AGGREGATE INCOME IN 1947, 1950, AND 1959 TO 1971, RECEIVED BY EACH 1/5 OF FAMILIES AND UNRELATED INDIVIDUALS, RANKED BY INCOME, BY RACE OF HEAD

Income rank	1971	1970	1969	1968	1967	1966	1965	1964	1963	1962	1961	1960	1959	1950	1947
Families total (percent).....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Lowest 1/5.....	5.5	5.5	5.6	5.7	5.4	5.5	5.3	5.2	5.1	5.1	4.8	4.9	5.0	4.5	5.0
Second 1/5.....	11.9	12.0	12.3	12.4	12.2	12.4	12.1	12.0	12.0	12.0	11.7	12.0	12.1	12.0	11.8
Third 1/5.....	17.4	17.4	17.6	17.7	17.5	17.7	17.7	17.7	17.6	17.5	17.4	17.6	17.7	17.4	17.0
Fourth 1/5.....	23.7	23.5	23.5	23.7	23.7	23.7	23.7	24.0	23.9	23.7	23.6	23.6	23.7	23.5	23.1
Highest 1/5.....	41.6	41.6	41.0	40.6	41.2	40.7	41.3	41.1	41.4	41.7	42.6	42.0	41.4	42.6	43.0
Top 5 percent.....	(1)	14.4	14.0	14.0	15.3	14.8	15.8	15.7	16.0	16.3	17.1	16.8	16.3	17.0	17.2

¹ See text below.

And for the real shocker, let us look at the percentage share of the richest 5 percent of American families over the years. In 1947, these few families were receiving 17.2 percent of total income. By 1968, the figure had shrunk to 0.14 percent. But the first 2 Nixon years—1969 and 1970—reversed this trend: the share of the top 5 percent grew to 14.4 percent. Then, in 1971, instead of a percentage the Census Bureau reports a footnote, excusing the absence of information as follows:

The percentage shares of aggregate income for the top 5 percent of families for income year 1971 and also for other years are being computed using revised procedures. Because of their income level for this fractile falling into broader income intervals than those previously utilized, use of earlier techniques would result in inconsistent and erroneous estimates, primarily because of interpolation errors. Revised data will be included in income reports to be published in 1973. For more detailed explanation of this problem, see page 12 of the text.

However, a Census Bureau official informed me that if calculated according to previous procedures, the 1971 figure would have shown a jump to 16.2 percent—the largest increase for this group in 25 years. It is a curious coincidence that the Census Bureau should be overcome by statistical scruples at the very point where the direct income shifting effect of the last 3 years—heightened unemployment and increased tax breaks for well-to-do tax avoiders—would have been most clearly.

The text of a January 11, 1973, article by Harry B. Ellis in the *Christian Science Monitor* on the subject of income shares follows:

REUSS FINDS WIDENING OF RICH-POOR GAP

The old adage that the rich get richer and the poor get poorer was never truer than right now, according to Rep. Henry S. Reuss (D) of Wisconsin.

Latest census figures, he says, show that President Nixon's administration is helping the 20 percent of top-income Americans increase their share of national wealth "at the expense of the rest of society."

In 1968 the highest one-fifth of the population enjoyed 40.6 percent of the nation's income. In 1970, according to Census Bureau figures quoted by Mr. Reuss, the share had grown to 41.6 percent.

This meant that Americans on lower rungs of the income ladder were dividing smaller shares of the pie—that the income gap between rich and other Americans grew during Mr. Nixon's first administration.

"But wait," adds Mr. Reuss, member of the House Committee on Banking and Currency and of the Joint Economic Committee of Congress. "Mr. Nixon's Robin Hood in reverse . . . appears in most striking form when you look at the share enjoyed by the richest 5 percent of American families."

This top 5 percent, he notes, enjoyed 17 percent of total U.S. income in 1950, but slipped to 14 percent between 1950 and 1968.

Under Presidents Truman, Eisenhower, Kennedy and Johnson, in other words, "the poor, and particularly the fellow in the middle, greatly improved their position" vis-a-vis the rich.

This trend reversed itself as soon as President Nixon took office. By 1970 the share of the top 5 percent of earners was up to 14.4 percent.

"And for 1971," declares Mr. Reuss, "we find the Census Bureau reporting not a figure but a gobbledygook-full footnote, stating that the Census Bureau hopes to have this figure in a year or so."

"However," adds the Wisconsin lawmaker, "a Census Bureau official, who preferred not to be named, informed us that the true figure would show the top 5 percent with a staggering 16.2 percent of the total, a 15 percent gain for them since 1968."

Mr. Reuss is a highly respected expert on economic affairs, a man not given to hyperbole. He is also one of many prominent Democratic lawmakers in both houses disturbed by what they regard as the tilt of Mr. Nixon's administration toward the affluent.

INCOME GAP WIDENED

In his early White House years the President gave tax breaks to business, in an effort to stimulate the U.S. economy. This worked, but a side effect, according to Census Bureau figures, was to widen the income gap between top and bottom.

White House spokesmen stress that, after years of stagnation, real take-home earnings of American workers—after the deduction of taxes and inflation—have risen during the Nixon years.

This also is true. Between 1964 and 1970, according to the Department of Commerce, real spendable income scarcely rose at all, when corrected for the cost of living rise and taxes.

Real income actually declined in the 1970 period, when a business slowdown coincided with inflation increases close to 6 percent.

Put another way, low- and middle-income people may have been narrowing the gap slightly between themselves and the rich, but they were not gaining in real income.

Then, on Aug. 15, 1971, Mr. Nixon introduced his new economic policy, characterized by a 90-day wage-and-price freeze, followed by still-existing controls. The President will shortly ask Congress to extend the controls program beyond April 30.

"Since August, 1971," says the Department of Commerce, "real spendable earnings for the average worker and his family have risen at an annual rate of 4.3 percent." The average American, in other words, now is beating inflation.

Nixon officials and Mr. Reuss appear to be looking at two sides of the same coin. The average American is earning more, but his income is not rising as quickly as that of the top 5 percent of money earners.

Both sides agree that dark spots exist in this picture of general, though mixed, affluence, notably that 16 percent of all teenagers and 9.6 percent of blacks cannot get work.

The Department of Labor urges Congress to consider adoption of a wage differential for American youth, allowing young people to be hired at less than the adult minimum wage.

An increase in the federal minimum wage without a youth differential, says Michael H. Moskow, Assistant Secretary of Labor for Policy, Evaluation, and Research, "might price some young people right out of the market."

ADULT OVER YOUTH?

An employer offering a minimum wage job tends to give it to an adult worker rather than to an inexperienced youth. If he could hire the teen-ager for less money, the employer might choose the youngster.

Cumulatively, this might put thousands of teenagers to work, reducing their soaring unemployment rate.

Representative Reuss has just introduced a "jobs now" bill aimed at creating 500,000 federally financed public service jobs, designed particularly to absorb the hard-core unemployed.

Object of the Reuss bill, cosponsored by 79 Democrats and Republicans, is to provide jobs—in recreation, child care, health care, antipollution, and other fields—at state and local levels.

A White House goal in 1973 is to cut nationwide unemployment, currently 5.2 percent of the labor force, below 5 percent. The Democratic leadership of House and Senate believes the target should be lower.

Both agree that, whatever happens to the white adult employment level, special steps must be taken to help disadvantaged Americans, handicapped by age, education, poverty, or color.

Representative REUSS [continuing]. Well-to-do people at the top are increasing their share and everybody else is decreasing theirs.

My question is a simple one: Won't the Nixon 1974 budget simply make matters worse?

Mr. ASH. I don't have the numbers in front of me. I don't think they will. I personally am trying to set a good example by moving from one part of that spectrum to the other, and maybe I am at least contributing something to the objectives that you have in mind.

Representative REUSS. Well, you are indeed because it is the middle spectrum that has been hurting, and, in your own small way, there is just so much one man can do.

Mr. ASH. I am doing all I can.

Senator PROXMIRE. Before I yield, have you finished?

Representative REUSS. Yes, sir.

Senator PROXMIRE. Before I call on Senator Humphrey, we have a vote on the floor of the Senate at 12:30 p.m. I am going to go the floor and come back. I have some other questions you will be delighted to hear and while Senator Humphrey is proceeding I will come back and if Senator Humphrey wants to come back he can come back from the floor after he votes. Meanwhile Congressman Reuss will preside.

Senator HUMPHREY. The vote of the Senate may be helpful to both of us here, Mr. Ash. I would hope to return.

First of all, I want to express as one member of this committee a welcome to you to appear before this committee and I hope that you will see fit to do it as often as we ask you.

Mr. ASH. I will. I certainly will.

Senator HUMPHREY. Thank you, sir.

I noticed that in your statement the following words:

The 1974 budget incorporates the results of an intensive effort to identify programs that should be reduced or terminated because they do not justify the taxes required to pay for their consideration. It proposes reducing, eliminating programs that do not meet this criteria.

It was my understanding as a legislator and even during the time I served as mayor of a city that if you terminated a program, you must ask for the termination, that the executive did not supersede the legislative authority and surely his agents do not supersede the legislative authority.

What justification do you give to the Congress of the United States, Mr. Ash, as a spokesman for the executive branch, for the summary termination of programs that have been duly authorized legislatively and funded by the Congress of the United States? I am not talking about reduction, I said termination.

Mr. ASH. Reduction and termination are much alike.

Senator HUMPHREY. No they are not, my friend. There is a lot of difference between being sick and being dead.

Mr. ASH. It is a matter of degree. One could reduce each of these programs to \$10 and I suppose that technically that wouldn't be a termination. So that there isn't as great a distinction as I believe you see.

I have earlier stated and will be glad to restate the reasons that the actions were taken. The President was confronted with the necessity of responding to inconsistent laws imposed upon him. He did have to make those judgments. The Congress adjourned without themselves making judgments to reduce particular programs. Nevertheless, when they did adjourn they established a debt ceiling—

Senator HUMPHREY. Who established a debt ceiling?

Mr. ASH. The Congress voted on a debt ceiling of \$400—

Senator HUMPHREY. Not a spending ceiling but debt ceiling.

Mr. ASH. Yes, sir; of \$465 billion. In the process of doing so it considered or acknowledged to hold the debt ceiling to \$465 billion, it would be required to hold spending to \$250 billion.

Senator HUMPHREY. Would you give me the arithmetic on that? My simple arithmetic doesn't add up to that.

How much was the budget expansion of the proposed debt ceiling of the President?

Mr. ASH. Approximately—

Senator HUMPHREY. The opposed ceiling?

Mr. ASH. Approximately \$11 billion.

Senator HUMPHREY. I know that. How much was the debt ceiling?

Mr. ASH. You will see that the debt that is expected to result at the end of this fiscal year is just barely below the \$465 billion.

Senator HUMPHREY. That was with the \$261 billion of outlays of the Congress?

Mr. ASH. No, sir, with \$250 billion. It required a reduction to \$250 billion in order to live within the congressionally established debt ceiling of \$465 billion. Those data are set out in considerable detail in the budget and show the route by which the President can meet the obligations of law imposed upon him.

Senator HUMPHREY. My question is what authority did you have on behalf of the Executive to terminate a program? The debt ceiling is always subject to revision, in fact it was revised two times last year, as you know.

Mr. ASH. The authority to spend is only for spending that is within the debt ceiling. In spending only within the debt ceiling to consider every program, and in considering every program, we keep in mind the Anti-Deficiency Act and its further amplifications in subsequent years.

Senator HUMPHREY. The Anti-Deficiency Act does not apply itself to programs, the 1906 amendment, there is no authority to terminate programs.

Mr. ASH. There is no mandate not to terminate.

Senator HUMPHREY. That is not the question. There is no authority to terminate programs. What constitutional legal authority do you have to terminate a program? There were other ways to stay within the debt ceiling. There were substantial sums of money that could have been reduced in other programs, if it is your justification that you had to stay within the debt ceiling. I happen to believe you could have come back and asked for an increase in the debt ceiling, if need be. You haven't hesitated to do it in this administration and previous administrations. What is your legal authority to exercise the power of veto over legislation when you had no such power in the Constitution?

Mr. ASH. The first part of the answer, and I don't intend to be facetious, is that if you would like to have each of them reinstated at \$10 so as to not have them technically terminated, I suppose we can do so without really breaking the budget. I mean it is a matter of degree, and zero is just another degree.

Now the second part of the answer is that the President is obligated not only to stay within the debt ceiling because it is the debt ceiling, but he is obligated to manage the economy in a way that avoids the kinds of near catastrophic problems that we had from 1965 through 1968 when the level of debt was rising and unemployment was lower than it is now.

Senator HUMPHREY. The overall deficit during those periods of time, I don't want to argue the politics of, were slightly less than they are now.

Mr. ASH. They were incurred in exactly the wrong time and under exactly the wrong circumstances. They fed great fuel to the inflationary fires.

Senator HUMPHREY. Let's not worry about that for a moment. I will accept your argument for purposes of getting on with this little discussion.

The Constitution calls upon the President of the United States to faithfully execute and administer the laws of this land.

What authority did you have to terminate, for example, a program which the House of Representatives has just acted upon called rural environmental assistance program? What authority did you have?

Mr. ASH. The aggregate of the Economic Stabilization Act, which requires that he act to promote the economic stability of this country, the Anti-Deficiency Act, and the requirement to live within the debt ceiling in the authority. These laws call upon the President to use his best judgment in the national interest as to how best to spend the money available to him. He concluded that that money could be best spent in the national interest on the programs that it was spent on and best not spent on the programs that he proposes to terminate.

I will have to add here that the President did not just choose between good programs and bad programs. There was forced upon him another kind of decision, a decision between good programs and better programs.

Senator HUMPHREY. Let's stop for a minute there because some of this is bureaucratic poppycock and I want to label it what it is. Good programs and bad programs, when did we decide that the President of the United States, after the Congress has legislated, was to stand as the great judge as to what is a good program and a bad program? I thought that is what this Congress was for. We have to make those decisions, sir.

Mr. ASH. And the President recommends very strongly, and did so in this budget, that the Congress assume that responsibility rather than leaving it to him.

Senator HUMPHREY. I don't recall getting any recommendation as a committee member of the Committee on Agriculture and Forestry for the termination of 2 percent REA loans. I don't recall getting any recommendation for the ending of the rural housing program. I recall that the President signed those programs. I recall that he went to the country in Oklahoma and talked about how great those programs were.

When did you come to the decision that these programs were all so bad. Was it just after the November election or was it before?

Mr. ASH. Some were announced before. You received no recommendations on the individual programs. In the budget that is now before you, you are receiving a very strong recommendation that the Congress first establish a total budget ceiling before it acts on individual bills; then, within that ceiling, determine what it believes the proper priorities are to spend that amount of money.

Senator HUMPHREY. Mr. Director, we appreciate your advice and that is what a budget is for, it is not holy writ. It is a document of advice and counsel to the Congress of the United States. There is a great deal of difference between parental advice and dictatorial edict. May I say that this advice that we get in the budget we will gladly survey and analyze, and much of it I would hope that we might accept. But you weren't giving us any advice when you cut off, for example,

the program that the House of Representatives just ordered you to reinstate, the rural environmental assistance program, which surely didn't affect the inflation of this country. You didn't give us any advice, you gave the people an order, and I submit you violated the law.

Let me show you another law you are not living up to.

When you terminate a program, if you do, which is illegal, the action of termination, there is no legal justification for termination, not in any law of this land—none.

There is no legal constitutional statutory provision for termination of a program by the President. There can be by the act of Congress but not by the President.

Now under the Reorganization Act of 1970, section 203, it says:

On request of any committee of either House, or of any joint committee of the two Houses, the Secretary of the Treasury and the Director of Office of Management and Budget shall furnish to such committee or joint committee information as to location and nature of data available in the various Federal agencies with respect to programs, activities, receipts and expenditures of such agencies, and to the extent feasible prepare for such committee or joint committee summary tables of such data.

And it goes on to say, that you are supposed to present to us at our request the justifications for cuts, presenting to us cost-benefit relationship.

Have you presented any justifications to the Congress of the United States except that you just thought the program was not any good, which is a very subjective judgment as to what has been done in these programs?

Mr. ASH. First, there was submitted last week, in response to a request of the Congress, information and reasons why a number of program reserves were set up.

Second—

Senator HUMPHREY. To whom did you furnish that?

Mr. ASH. It went to the President of the Senate.

Senator HUMPHREY. Pardon?

Mr. ASH. It went to the President of the Senate and to all—

Senator HUMPHREY. That is the information on impoundment, an amendment which I attached to the debt ceiling.

Mr. ASH. It is the Humphrey amendment that we are responding to.

Senator HUMPHREY. May I say I will come to it at a later time because the inadequacies of that information is second only to some of the inadequate information we get on certain contracts.

I happen to believe that you have not provided the information and I am hereby asking for the Joint Economic Committee that you provide for this committee a full detailed explanation, justification of cost-benefit impact, cost-benefit relationship of every single cut that you have made in every program in the 1973 fiscal operation and projected 1974. That is an official request from a member of this committee and the law requires that you fulfill it.

Mr. ASH. As the law requires, we now receive that request and will respond to it.

Senator HUMPHREY. As promptly as possible?

Mr. ASH. We certainly will.

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

TABLE OF CONTENTS—INFORMATION FILED ACCORDING TO BUDGET ORDER BY AGENCY
OUTLAY SAVINGS FROM PROGRAM REDUCTIONS AND TERMINATIONS, 1973-75

[Fiscal years. In millions]

Agency and program	Outlay savings		
	1973	1974	1975
PROPOSED ACTIONS REQUIRING SUBSTANTIVE LEGISLATION			
Department of Health, Education, and Welfare:			
1. Eliminate certain optional payment procedures under OASDI.....		310	310
2. Eliminate Federal financing for low-priority Medicaid services to adults.....		75	100
3. Reform Medicare cost-sharing and implement effective utilization review.....		616	1,300
4. Improve structure of public assistance programs.....		158	158
Total, Department of Health, Education, and Welfare.....		1,159	1,868
Veterans' Administration:			
5. Eliminate duplicate burial benefits.....		54	54
6. Bring pensions into closer alignment with need.....		223	227
Total, Veterans' Administration.....		277	281
Total, proposed actions requiring substantive legislation.....		1,436	2,149
ITEMS NOT REQUIRING SUBSTANTIVE LEGISLATION			
Funds Appropriated to the President			
Foreign economic assistance:			
7. Reduce programs of the Agency for International Development below levels previously budgeted.....		62	170
8. Arrange for return of amounts advanced previously.....	242		
Total, foreign economic assistance.....	242	62	170
Office of Economic Opportunity:			
9. Reassign OEO activities and discontinue direct Federal funding of community action organizations leaving support to local decision.....	62	328	390
Department of Agriculture:			
10. Reduce the cost of farm price support programs consistent with rising farm income prospects and achievement of foreign sales agreements:			
Reducing direct payment to farmers.....			
Stopping export subsidies.....			
Increasing crop loan interest.....			
Terminating old crop loans.....			
Tightening storage facility loan eligibility.....			
11. Terminate rural water systems and waste disposal grants which are replaced by loans, or to extent consistent with Water Pollution Control Act, EPA financing.....	50	100	150
12. Substitute regular loan assistance for emergency loans.....	365		
13. Decrease the large interest subsidy by the Rural Electrification Administration through use of Rural Development Act 5-percent insured loans vice 2-percent direct loans.....	84	373	695
14. Eliminate cost-sharing for installation of soil and water management practices on private lands and make corresponding reductions in technical assistance given through conservation programs.....	41	258	259
15. Limit the special milk subsidy to institutions not receiving subsidized milk through free and reduced price child feeding programs.....		59	77
16. Achieve economies in the Forest Service through tightened management, reduced State forestry support, and shifting construction of forest roads to timber purchasers.....	39	94	106
17. Curtail anticipated growth in Agriculture extension programs and reduce Federal support for agricultural research of primarily local benefit and low-national priority.....	13	34	34
Total, Department of Agriculture.....	1,248	2,137	2,555
Department of Commerce:			
18. Phase out Economic Development Administration programs in favor of more focused and consolidated efforts to stimulate economic development.....	5	35	56
19. Redirect or defer selected R. & D. programs of the National Oceanic and Atmospheric Administration which are not directly focused on national objectives or not critical now.....	26	41	
20. Limit planned expansion of selected science and technology programs of National Bureau of Standards which could be delayed without significant adverse impact.....	17	10	7
21. Modify planned expansion of minority business enterprise program due to recent rapid growth in program and need to evaluate effectiveness.....	6		
22. Adjust maritime ship operating subsidies due to delays in Russian grain shipments.....	17		

See footnotes at end of table.

TABLE OF CONTENTS—INFORMATION FILED ACCORDING TO BUDGET ORDER BY AGENCY OUTLAY SAVINGS FROM PROGRAM REDUCTIONS AND TERMINATIONS, 1973—Continued

[Fiscal years. In millions]

Agency and program	Outlay savings		
	1973	1974	1975
ITEMS NOT REQUIRING SUBSTANTIVE LEGISLATION—Continued			
Funds Appropriated to the President—Continued			
Department of Commerce—Continued			
23. Provide planning funds directly to States for support of regional commissions and eliminate Federal participation.....		27	44
Total, Department of Commerce.....	71	113	107
Department of Defense—Military:			
24. Reduce military and civilian personnel and other operations costs.....		1,200	400
25. Reduce procurement of Safeguard, aircraft, missiles, and ships.....		650	1,300
26. Limit growth in research, development, test, and evaluation programs.....		200	200
27. Reduce construction associated with Safeguard deployment, bachelor housing, and family housing.....		50	200
28. Limit new spending for all-volunteer force and other legislation.....		400	500
29. Tighten operations of revolving and management funds.....		200	100
Total, Department of Defense.....		2,700	2,700
Department of Defense—Civil: Corps of Engineers:			
30. Slow scheduling of less critical navigation and flood control projects while meeting essential flood control, power, and water supply demands.....	102	471	650
Department of Health, Education, and Welfare—Health:			
31. Strengthen medicare cost controls and eliminate unnecessary advance payments for hospitals.....	342	277	431
32. Strengthen medicaid management.....	101	175	200
33. Rely on Federal health financing mechanisms to pay depreciation charges in place of medical facilities grant program, and achieve quality care objectives through the professional standards review in place of the regional medical program.....	35	189	206
34. Phase out over an 8-year period, Federal financing for local mental health programs.....	18	63	75
35. Eliminate duplicative preventive health program grants.....	16	53	53
36. Phase out training grant over a 3-year period and control the level of new research grants selected in nonpriority areas.....	29	57	67
37. Focus health manpower training support on areas of special need.....	26	49	54
Education: Substitute education revenue sharing for the Federal funding component of certain education programs and discontinue the Federal role in some areas:			
38. Foreign language and area training programs.....		13	14
39. Land-grant college support.....	10	10	10
40. University community services.....	9	15	15
41. State departments of education.....	1	36	13
42. Payments to local school systems for certain federally related students.....		119	120
43. Public libraries and school library resources.....	2	49	135
43A. Certain narrowly focused categorical programs.....	1	53	76
44. Substitute private market mechanism for Federal capitalization of direct student loans.....	24	264	288
Income security:			
45. Limit outlays through the operation of the Administration-supported statutory ceiling on social services grants (already enacted by the Congress).....	2,343	2,700	4,700
46. Adjusted the growth rate for vocational rehabilitation program.....	6	31	26
47. Limit to 5 years Federal funding responsibility for Cuban refugees.....	12	58	98
48. Institute quality control for social services research.....	10	31	62
49. Eliminate overpayments and payments to ineligible recipients of public assistance and introduce management improvements.....	129	592	592
Total, Department of Health, Education, and Welfare ²	3,114	4,834	7,235
Department of Housing and Urban Development:			
50. Temporarily suspend new commitments under housing subsidy programs.....	59	305	612
Terminate categorical community development programs in favor of urban special revenue sharing:			
51. Model Cities.....			435
52. Urban renewal.....			180
53. All other.....		7	130
Total, Department of Housing and Urban Development ³	59	312	1,357
Department of the Interior:			
54. Reduce construction activity on some roads and other capital improvements of relatively low priority in national parks, public lands, and Indian areas to less than anticipated rates in 1973 and 1974.....	20	10	13

See footnotes at end of table.

TABLE OF CONTENTS—INFORMATION FILED ACCORDING TO BUDGET ORDER BY AGENCY OUTLAY SAVINGS FROM PROGRAM REDUCTIONS AND TERMINATIONS, 1973-75—Continued

[Fiscal years. In millions]

Agency and program	Outlay savings		
	1973	1974	1975
ITEMS NOT REQUIRING SUBSTANTIVE LEGISLATION—Continued			
Funds Appropriated to the President—Continued			
Department of the Interior—Continued			
55. Schedule water resources development construction by Bureau of Reclamation at less than anticipated rates except for hydropower and water supply projects	19	123	113
56. Reorient saline water program to emphasize research on new technologies and deemphasize construction of large-scale test plants of known technology	2	14	21
57. Constrain land purchases for Federal recreation and wildlife areas and grants to States for purchase of recreation areas in 1973 and 1974 below anticipated levels	42	61	46
58. Increase rate of lease sales on Outer Continental Shelf to increase domestic oil production thereby reducing outlays		1,010	510
59. Reduce other costs not accounted for in program reductions above	10	2	
Total, Department of the Interior	93	1,220	703
Department of Justice:			
60. Review prison construction program for its relationship to State and local facilities and impact of alternatives to incarceration on Federal prison population	8	28	
61. Return responsibility to functional agencies for community relations service technical assistance program		4	4
Total, Department of Justice	8	32	4
Department of Labor:			
62. Reform manpower training programs administratively to accomplish the purposes of manpower special revenue sharing	123	354	250
63. Phase down the emergency employment assistance program consistent with the increase in new jobs in the private sector		670	700
64. Increase efficiency of employment and unemployment insurance services	52	35	35
65. Tighten the operations and management in the Department of Labor	4	10	10
66. Allocate proper unemployment benefit costs to the Postal Service		26	26
Total Department of Labor	179	1,095	1,021
Department of Transportation:			
67. States are deferring highway projects because of a lack of legislative authority	100	83	
68. Defer lower priority Coast Guard construction and research contracts	29	14	10
69. Reschedule FAA equipment purchase and long-range research that are not essential to air safety	35	35	
70. Delay airport grants due to environmental and other problems	20		
71. Reorder high-speed rail research and development, placing greater emphasis on near-term needs and deferring projects where results are not required for several years	15	41	5
72. Reduce operating subsidies for Amtrak	10	27	
73. Focus UMTA research and development on immediate improvement programs and hold up contracts for software developments awaiting additional studies and evaluations	10	26	5
74. Rephase intermodal transport research and development focusing on immediate problems. Reduce selected research and development projects whose results are not required in the near term	10	7	6
75. Increase efficiencies of Coast Guard operations	28	10	3
76. Stretch out the termination payments on the SST	18		
77. Increase efficiencies of FAA operations	20	20	
Total Department of Transportation	295	263	29
Department of the Treasury:			
78. Delay construction of Federal Law Enforcement Training Center to assure resolution of environmental impact of problems	1	12	
79. Reduce personnel travel and related costs	3	9	9
Total Department of the Treasury	4	21	9
Atomic Energy Commission:			
80. Reduce Plowshare program to permit further economic and environmental study	3	3	3
81. Reduce space electric power and propulsion programs because of no current mission requirements	6	12	18
82. Defer selected lower priority projects in the nuclear materials, weapons, civilian reactor, and research programs	25	21	46
83. Reduce inventory and working capital requirements	56	-35	
Total, Atomic Energy Commission	90	1	67
Environmental Protection Agency:			
84. Actions related to Federal Water Pollution Control Act amendments of 1972	300	950	1,950

See footnotes at end of table.

TABLE OF CONTENTS—INFORMATION FILED ACCORDING TO BUDGET ORDER BY AGENCY OUTLAY SAVINGS FROM PROGRAM REDUCTIONS AND TERMINATIONS, 1973-75—Continued

[Fiscal years. In millions]

Agency and program	Outlay savings		
	1973	1974	1975
ITEMS NOT REQUIRING SUBSTANTIVE LEGISLATION—Continued			
Funds Appropriated to the President—Continued			
General Services Administration:			
85. Provide more efficient guard service in public buildings.....		3	3
86. Require more effective supply practices.....	15	25	
87. Reduce new computer procurements by improving utilization of existing equipment.....	7	9	
Total, General Services Administration.....	22	37	3
National Aeronautics and Space Administration:			
88. Delay the space shuttle to provide for a more orderly program buildup.....	18	45	75
89. Reduce other manned space flight.....	93	47	10
90. Defer the High-Energy Astronomy Observatory to allow NASA to study same program objectives at lower cost.....	7	68	56
91. Cancel Application Technology Satellite-G because research can be funded by industry without Government support.....	3	17	16
92. Reduce nuclear power and propulsion research since prospective applications are in the distant future.....	9	16	18
93. Cancel experimental STOL aircraft because of uncertainty on the timing of a commercial market.....	3	34	20
94. Reduce other technology and support consistent with the slower pace of the space program.....	28		
95. Reduce NASA personnel and administrative expenses consistent with program reductions.....	18	24	24
Total, National Aeronautics and Space Administration.....	179	251	219
Veterans' Administration:			
96. Reform veterans benefits administratively to align benefits and need.....		160	160
97. Reschedule construction activities.....		55	65
98. Restructure research in line with current needs.....	5	13	27
Total, Veterans' Administration.....	5	228	252
Civil Service Commission:			
99. Limit the level of the intergovernmental personnel assistance grant program pending evaluation.....		1	5
100. Allocate proper retirement costs to the Postal Service.....		285	105
Total, Civil Service Commission.....		286	110
Corporation for Public Broadcasting:			
101. Maintain previous years level of support.....	10		
National Science Foundation:			
102. Curtail lower priority institutional and also educational programs, pending development of plans to meet new program objectives.....	20		
103. Reductions due to effect of the above curtailment and other selective reductions.....		32	
Total, National Science Foundation.....	20	32	
Small Business Administration:			
104. Reduce direct business loan program of Small Business Administration as needs are met by increased participation of private banking community through SBA guaranteed loans.....	42	41	34
Subversive Activities Control Board:			
105. Terminate as a result of court decisions limiting workload.....		(*)	(*)
Tennessee Valley Authority:			
106. Slow scheduling of construction activity on projects underway and postpone increases in other programs.....	10	30	25
Washington Metropolitan Area Transit Authority:			
107. Use bond proceeds to even out level of Federal contribution to subway construction.....	80	13	
Pay raises for civilian agencies:			
108. Require absorption of most of January 1973 comparability increase.....	280		
Total, items not requiring substantive legislation ¹.....	6,515	15,457	19,591
Total, all savings ¹.....	6,515	16,803	21,793

¹ Excludes rural housing.

² Includes rural housing program of the Farmers Home Administration.

³ Includes savings accomplished by enactment of administration-supported limitation on open-end social service grant program.

⁴ \$400,000 in 1974 and 1975.

1. "ELIMINATE CERTAIN OPTIONAL PAYMENT PROCEDURES UNDER OASDI"

BACKGROUND

The OASDI program provides cash benefits, estimated at \$55.2 billion in 1974, for retirees, their survivors and the disabled. Benefits are based in general on the wage record of the worker up to the time of retirement or disability.

ACTION

The proposed legislation will eliminate an optional payment procedure which has previously applied. Under this procedure in certain circumstances, the beneficiary had the option of choosing a lump-sum retroactive benefit payment accompanied by a permanent reduction in the monthly benefit payment. The change will not decrease the amount of benefits received by the average beneficiary over his lifetime, but will insure that he receives the highest possible monthly income—the income many aged persons depend upon to meet their living expenses. The 1971 Social Security Advisory Council recommended this change.

2. "ELIMINATE FEDERAL FINANCING FOR LOW-PRIORITY MEDICAID SERVICES TO ADULTS"

BACKGROUND

Lack of dental care is seldom life threatening and is less critical for adults than for children.

Dental care is seldom covered in private health insurance plans and is not covered under Medicare.

ACTION

Legislation is proposed to terminate Federal matching of State funds for dental services provided to adults.

Federal matching for children's preventive dental care—the most important area of dental care—will be continued for Medicaid eligible children up to age 21.

States, at their discretion, may continue to finance dental care services for adults. The 35 States which now offer dental care are generally the States with higher per capita incomes.

3. "REFORM MEDICARE COST-SHARING AND IMPLEMENT EFFECTIVE UTILIZATION REVIEW"

BACKGROUND

Present *cost-sharing* provisions in hospital insurance impose excessive burdens on patients with lengthy hospitalization and provide little incentive for appropriate use of services. They impose cost-sharing of 25% of the inpatient deductible for the 61st to 90th day and 50% for the 91st to 105th day on patients who already have large medical expenses and are least able to afford these costs.

In the area of *utilization review*, Medicare program statistics indicate substantial variations in hospital admission rates, lengths of stay, and other utilization that cannot be justified by medical criteria.

ACTIONS

Legislative cost-sharing reforms will be proposed to reduce the financial burdens of lengthy hospitalization and to establish stronger economic incentives to curb unnecessary use of services in the hospital insurance program (HI) from the 2nd to 60th hospital day when most inappropriate use of services occurs. The proposals include an HI deductible equal to the room and board charge for the first day in the hospital and copayment of 10% of all subsequent charges. Reforms are also proposed to raise the supplementary medical insurance (SMI) deductible from \$60 to \$85—relating it to increases in social security cash benefits since 1966, and to increase the SMI coinsurance from 20% to 25%.

More intensive *utilization review* will be stressed to assure that the Medicare program pays for only those admissions, stays, and procedures that are medically warranted.

4. "IMPROVE THE STRUCTURE OF PUBLIC ASSISTANCE PROGRAMS"

BACKGROUND

The Public Assistance program covers the Federal share (averaging about 53% of the total) of the costs of providing cash assistance to needy families through State-administered welfare programs. Within the limits of broad Federal standards, the States have been free to set their own eligibility standards and payment levels. Federal costs have risen rapidly, reaching \$6.1 billion in 1972. Examination has revealed a number of defects in the present program. Some of these are being addressed through administrative regulations and are discussed separately. Two, however, require legislation. These are:

1. The inequities that result from unlimited deductions for work-related expenses.

2. The exaggeration of percentage disregards of income (for purposes of computing benefits) when these are taken against gross income, rather than after other eligible deductions have been taken.

These factors produce situations in which a family, once on welfare, may continue to receive benefits even after its income rises well above that of other families who are not eligible for benefits. This impact is clearly inequitable.

ACTION

Legislation will be proposed.

Instituting a limit on the amount of income which can be disregarded under the heading of "work-related expenses."

Requiring that percentage income disregards be taken on a net basis (after other valid deductions) rather than on a gross basis.

The vast majority of families receiving welfare benefits will not be significantly affected by these changes. In the longer run, changes such as this, eliminating clear inequities and abuses, are essential if public confidence in the welfare system is to be restored.

5. "ELIMINATE DUPLICATE BURIAL BENEFITS"

BACKGROUND

Annually VA pays over \$80 million to families of deceased veterans to help defray funeral costs. The VA payment of \$250 is made regardless of need and whether or not the death resulted from military service.

The original purpose of the payment, when first provided in 1917, was to assure destitute veterans would not be buried in the Potter's field.

Since that time, the Congress has enacted a number of programs which provide financial assistance to families of veterans and other Americans at the time of death—e.g., all persons covered by Social Security are entitled to a payment of up to \$255. Over 90 percent of all veterans are covered by this benefit. Other Federal payments are available from such programs as Federal Employees' Compensation, Railroad Retirement, Public Health Service personnel, etc. In addition, veterans are entitled to interment at Federal expense in national cemeteries and to low-cost VA insurance coverage.

ACTION

Legislation is proposed to end the present duplication of VA and other Federal payments. The proposal would limit the VA payment to the difference between the VA \$250 payment and any other similar-purpose payment by the U.S. Government. As a result, the program would become more equitable (no longer discriminating in favor of veterans who have Social Security and other federally-sponsored benefits), and would result in an annual budget saving, estimated at \$54 million in 1974.

6. BRING PENSIONS INTO CLOSER ALIGNMENT WITH NEED

BACKGROUND

The Veterans Administration spends about \$1.5 billion a year for veterans pensions to assist veterans whose incomes fall below certain levels prescribed by law.

The present pension program is deficient and inequitable. While it is intended to be a needs-based program, it does not generally recognize the family as a single economic unit and overlooks a substantial element of family income recognized by other Federal needs-tested income maintenance programs.

It prohibits against counting the working wife's earnings. Not only does this violate the needs principle, but leads to inequity among veteran pensioners. For example, if one veteran pensioner has a total family income of \$12,600, including \$10,000 of his wife's earnings, he will receive the same pension as another veteran pensioner who has a total family income of \$2,600 consisting solely of his own income.

ACTION

The President's budget proposal would:

Include all the wife's income in the computation of a veteran's income for determination of pension.

Continue the successful reform efforts of Congress and the Administration in enacting legislation which better relates VA pension to aggregate income.

Make VA pensions more equitable by applying the needs principle.

Result in annual budgetary savings estimated at \$223 million.

7. AGENCY FOR INTERNATIONAL DEVELOPMENT

BACKGROUND

The Agency for International Development administers programs of foreign economic assistance—development loans, technical assistance, supporting assistance, and voluntary contributions to international organizations. These programs form an important and integral part of U.S. foreign policy. The President's January 1973 budget requested for the Agency for International Development budget authority of \$2,185 million, with net outlays estimated at \$1,846 million. The Agency's request and OMB's analysis of the foreign assistance program for 1974 takes into account an increased concentration of that program against high priority foreign policy objectives and the growth in principal and interest reflows from prior year loans returning to the Agency. This comprehensive review of foreign economic assistance programs results in recommendations for budget authority of \$1,676 million for 1974 and \$1,595 million for 1975, with outlays of \$1,664 million for 1974.

ACTION

These lower budget authority levels produce outlay reductions in 1974 and 1975 of \$62 million and \$170 million, respectively.

8. RETURNS FROM THE EUROPEAN FUND

BACKGROUND

The Organization for Economic Cooperation and Development (OECD) terminated the European Monetary Agreement (EMA) on December 31, 1972. The EMA established in 1958 a European Fund out of which credits could be granted to member countries to help them overcome temporary balance of payments difficulties. As part of the EMA termination arrangements, the OECD agreed to return the original United States contribution (\$271.5M) to the Fund and a portion of the Fund's earnings—a total of \$355.5M composed of the following assets:

\$118M in cash

123.5M EMA claim against U.S. Treasury

114M thirty-year credit to Turkey

ACTION

The return of these assets has now been accomplished. The budget reflects the first two of the above items (\$241.5M) as a proprietary receipt off-setting 1973 foreign economic assistance budget authority and outlay. These receipts are available for general governmental purposes and are *not earmarked for foreign aid*. The Turkish credit has no impact on budget authority or outlays.

9. OFFICE OF ECONOMIC OPPORTUNITY

"Reassign OEO activities and discontinue direct Federal funding of Community Action organizations leaving support to local decision."

BACKGROUND

Funding for Community Action Operations currently includes direct Federal funding to 908 Community Action Agencies (CAA's), approximately 2,740 Neighborhood Centers, 1,000 limited purpose agencies, a special emphasis program for the elderly poor, and provides training and technical assistance funds to CAA's.

Since 1964 the Federal Government has spent over \$2.8 billion for Community Action Operations.

There is no conclusive evidence that the Community Action program has moved significant numbers of people out of poverty on a self-sustaining basis.

The Community Action program has identified the need for and demonstrated the value of participation in service development programs by the people being served. With Community Action concepts now incorporated into ongoing programs, the continued existence of this program as a direct Federal responsibility is no longer necessary.

After more than seven years of existence, Community Action has had an adequate opportunity to demonstrate its value to local communities. In addition to private funds, State and local governments may, of course, choose to use their own funds to continue providing support to their local community action agencies.

ACTION

Effective July 1, 1973, new funding for programs supported under Community Action Operations will be at the discretion of local communities.

Responsibility for certain programs now funded through the Office of Economic Opportunity (OEO) will be assumed by other agencies, as follows: the migrant program will be delegated to the Department of Labor; Indian programs will be assumed by HEW; Community Economic Development program grantees will be funded by the Office of Minority Business Enterprise in Commerce; health projects will be transferred to HEW; research and development functions will be transferred to the agencies which have statutory responsibility in the fields of current OEO activity. In addition, legislation will be submitted to establish a Legal Services Corporation.

Having provided for the support of those OEO programs which have proved their value and having determined that there is no conclusive evidence that the Community Action Program is an effective means of moving people out of poverty, there is no longer any need to continue the Office of Economic Opportunity as a separate Federal agency.

10. FARM PRICE SUPPORTS

BACKGROUND

Net farm income in 1972 (CY) was a record high \$19.2 B, and should remain high in 1973 with continuing strong domestic and export demand. The time is opportune to structure farm programs in such a way as to provide farmers with the opportunity to maximize farm income from the marketplace. Total direct payments of \$4 B in 1972 was equivalent to one-fifth of net farm income. With strong domestic and export demand projected for next year, the opportunity exists for increasing the farm income share generated in the private marketplace. Thus, the 1973 set-aside programs are designed to return idled cropland to crop production and enable farmers to capitalize on their farming skills to meet market demands. Use of such previously idled acreage to produce crops in demand in the domestic and world marketplace can simultaneously strengthen farm income and lower program costs to taxpayers. Consumers also benefit from increased production and farm prices lower than the current high levels.

ACTION

Reduced direct payments under 1973-crop feed grain and cotton set-aside programs.

Reduced set-aside requirements under 1973-crop feed grain and cotton programs to allow farmers to bring back into production some of the acreage idled in 1972.

Increased interest rate from 3.5 percent per annum to 5.5 percent on commodity loan advances to farmers beginning with 1973 crops. The higher rate reflects the borrowing cost to the Treasury for comparable time periods.

Terminated CCC export payments on wheat, rice and tobacco with export demand strong and surpluses substantially reduced.

Announced resale (extended loan) would not be available for 1972 crop wheat or soybeans and resale of all old grain crops would not be extended beyond maturity dates in the spring of 1973, stimulating sale of on-farm stored commodities to meet demand, and resultant repayments of Government loans to farmers.

Aggressively disposed of CCC-owned commodity inventories to help meet strong market demand.

Tightened loan eligibility on storage facility loan program, and increased interest rate from 5.5 percent per annum to 6 percent. The demand for farm storage space has eased with the rapid drawdown in grain supplies and due to the record pace of construction during the past several years. The higher interest rate reflects the borrowing cost to the Treasury for comparable time periods.

11. RURAL WATER AND SEWER SYSTEMS

BACKGROUND

The water and waste disposal grant programs were initiated to supplement the Department of Agriculture's loan program for the planning and development of public water and waste disposal projects in rural areas when funds were not available from other sources.

Other Federal programs have been created in recent years to assist communities in the development of waste disposal facilities through Environmental Protection Agency and the Environmental Financing Authority. At least one State (Vermont) has taken steps to provide easier access to private credit markets for local communities; other States could do likewise,

Under these grant and loan programs priority will be given to waste treatment facilities, but 75 percent grants are authorized for collection sewers in established communities needing both collection sewers and waste treatment facilities.

Project selections for EPA grants are determined largely by States who are in a better position than the Federal Government to select the highest priority projects for financial assistance.

ACTION

The Farmers Home Administration water and sewer grant program was terminated effective 1-1-73. All firm commitments prior to that date will be honored.

Loans (\$300 million) are being provided for water and waste facilities during the remainder of FY 1973.

Beginning in FY 1974, \$345 M in loans will be made available under the authorities of the Rural Development Act for a variety of community development facilities *including* water supply, but *excluding* waste disposal facilities.

A recap is shown on the following table:

[In millions of dollars]

Budget impact	Fiscal year—		
	1973	1974	1975
Grants:			
Outlay savings.....	50	100	150
Program level.....	42	30	-----
Loans (program level):			
Water and sewer.....	300	-----	-----
Community development.....	-----	345	345

12. FARM EMERGENCY LOANS

BACKGROUND

The liberal provisions of the Agnes Disaster Relief Act—\$5,000 principal forgiveness, 1 percent interest loans, no needs test or credit elsewhere test permitted—have resulted in an unprecedented demand for emergency loans in areas throughout the country.

The Disaster Bill as enacted made the benefit provisions available not only in other Presidential areas which suffered less widespread losses than in the Agnes/Rapid City areas, but also in areas designated by the Secretary of Agriculture.

In areas designated by the Secretary of Agriculture, most of the loans are for crop damage due to extreme or untimely weather conditions—drought, hail, excessive rain, etc.—and not to assist families suffering the loss of their homes and possessions as occurred in the Agnes/Rapid City areas.

Because crops are often grown in areas where weather conditions are not ideal, many of the same counties have been designated by the Secretaries of Agriculture year after year.

Examples:

(1) Counties Designated for Emergency Loans in Consecutive Years 1966 through 1971

Number of counties.....	3,072
Consecutive years:	
6.....	38
Percent.....	1.2
5.....	75
Percent.....	2.4
4.....	249
Percent.....	8.1
3.....	354
Percent.....	11.5
2.....	578
Percent.....	18.8

(2) Frequency with which Active Emergency Loan Borrowers in Selected Counties, as of 6-30-71, Received Loans during Fiscal Years 1966 through 1971

Active borrowers June 30, 1971 (13 counties).....	507
Received emergency loans in years shown:	
6.....	45
5.....	52
4.....	95
3.....	90
2.....	137
1.....	86

Under this Act FHA loans have been averaging about \$4,600 of which roughly 75 percent is a grant.

The above combination of factors makes this program not a disaster relief act, but a compulsory giveaway.

ACTION

No new applications are being accepted in designated areas after the 60-day designation period has expired.

All applications filed prior to the expiration of the 60-day designation period are being processed for approval.

An increased amount of Farm Operating Loans are being made available in these areas for eligible applicants who were unable to obtain emergency loans within the designation periods.

The Department of Agriculture is supporting prompt enactment of H.R. 1975 which will provide an interim basis for accepting and processing new emergency loan applications pending transmission and enactment of an administration comprehensive Disaster Relief proposal.

13. REA LOANS

BACKGROUND

REA has provided 2% direct electric loans since the mid 1930's—when Treasury borrowing costs were less than 2%—and 2% telephone loans since 1949. These loans are financed directly by the Treasury.

During FY 1972 there were 1094 active REA electric borrowers with \$4.7 billion in outstanding loans, and 867 telephone borrowers with \$1.4 billion in outstanding loans.

The annual Federal subsidy on these outstanding loans is approximately \$240 million.

Heavy Federal costs limited the total amount of credit that could be made available through REA, though demand was high.

REA financed electric consumers served have changed dramatically from 1950 to 1971.

80% of all 1950 electric connections were for farms.

By the end of 1971, only about 19% of all electric connections were for farms.

Percent of total KWH sales for farms were 13.6%.

Percentages of other electric consumers and their use of power are as follows:

	KWH sales (percent)	Connection (percent)
Nonfarm residential.....	51.0	71.6
Commercial and industrial.....	29.1	6.6
Irrigation.....	3.0	1.3
Other (churches, schools, small shopping centers, military bases, recreation complexes, etc.).....	3.3	1.4

The recent Rural Development Act provides for insured and guaranteed loans at higher interest rates for electric and telephone borrowers. Such loans would be financed by private lenders.

ACTION

REA discontinued making new 2% direct loans effective 1/1/73.

Insured and guaranteed loans will be made to cooperative borrowers at 5% interest. Private company borrowers will pay interest at approximately market rates.

Loans will be available under the Rural Development Act authorities for new electric and telephone applicants as well as existing REA borrowers.

Since Federal costs will be lower, total REA loans for electric and telephone will be \$200 million larger than earlier planned by the President for both 1973 and 1974—loans will total about \$760 million.

Effect on lending at higher rates, as estimated by REA, is to raise the average monthly electric bill by 50 cents in five years; perhaps by \$1.00 in ten years.

14. AGRICULTURAL CONSERVATION PROGRAMS

BACKGROUND

Many of these land and water conservation programs were initiated in the 1930's to supplement farmers' incomes and to stimulate the use of conservation farming. Original objectives have largely been achieved.

Supplementary income provided through the programs has become of little significance, with net farm income reaching an all-time high of nearly \$19 billion in 1972.

Total cost share payments for the Rural Environmental Assistance program (REAP) were \$135 million in 1971.

The average REAP payment was \$239 in 1971.

The benefits of these conservation measures have been demonstrated to a whole generation of farmers through high school and college vocational education, and through technical and cost-sharing assistance programs for over 30 years.

About one million farms participated in the program for each of the past 20 years. Participation reached 3 or 4 million farms in earlier years.

Cumulative REAP cost-share assistance is approximately \$7 billion.

There are over 2.2 million cooperators of conservation districts.

Technical assistance is provided by the Soil Conservation Service to approximately 1 million landowners and other recipients annually.

Rural Environmental Assistance Program (REAP)

The following quote from the GAO report of February 16, 1972, on the program provides an appropriate summary of the case against REAP:

"Although significant soil and water conservation benefits have been realized under the program, substantial amounts of funds have been spent on practices that have not produced any appreciable conservation benefits, that have stimulated agricultural production, or that are otherwise questionable."

REAP is based on the concept that assistance would be provided for measures which would not otherwise be undertaken. Many of the practices included in the program are generally accepted good farming practices or are profitable to the individual farmer to undertake on his own. For example:

Application of lime has yielded returns of 5 to 10 percent. Yet in 1964, the last year for which lime purchases were a regular practice and reported separately;

19.2% of total program cost-sharing or \$37.6 million was for lime;

51% of total program cost-sharing or \$101 million was for practices incorporating substantial use of lime, fertilizers, other minerals and seed. (These amounts include the \$37.6 million for lime above.)

In 1971, 39% of total program cost-sharing or \$52 million was for practices incorporating substantial use of lime, fertilizers, other minerals and seeds.

Drainage and irrigation practices can be highly profitable. For example, tile drainage has produced returns of 30 percent.

\$19 million was utilized for drainage and irrigation practices in 1971.

Since 1940 assistance for drainage was provided on over 50 million acres.

Since 1959 assistance for irrigation was provided on over 30 million acres. (There are 40-50 million irrigated acres in the nation.)

Assistance for contour farming and strip cropping since the program began was provided on well over 100 million acres each.

Cost-sharing has been provided beyond the point where the value of the practice has been demonstrated.

According to a sample in one area, 26 percent of the farmers receiving payments were obtaining them at least 3 out of 4 years for the same practices.

While only 300 to 400 million acres are cultivated and diverted, assistance for the establishment of all types of vegetative cover from 1936 to 1970 was provided on over 800 million acres, and for "enduring vegetable cover" on over 315 million acres.

Regarding financial assistance for pollution control and abatement measures under REAP, the general policy in other areas is that the polluter must pay for correcting the polluting practice.

Direct grants to private industry for effluent treatment are not made.

Further, under the Federal Water Pollution Control Act, as amended, municipalities receiving Federal grants for water treatment facilities must establish a fee structure which will recoup the cost of facilities which are related to treatment of industrial wastes:

According to the last (1964) study by the USDA of the distribution of program payments:

While the participating farms of under 180 acres comprised 58.4% of the total, these farms received only 38.6% of the total assistance provided even though their assistance per acre was higher than farms over 180 acres, \$1.41 vis. \$.38.

Further, farms under 180 acres represented 73.5% of the total farms, but only 58.4% participated in the program, while farms of over 180 acres represented 26.5% of total farms and 41.6% participated in the program.

Only 2.6% of the farms under 180 acres received payments of over \$500, but 13.3% of the farms over 180 acres did so.

Allocation of REAP funds is not consistent with National needs. According to the General Accounting Office report on REAP on February 16, 1972:

Estimated conservation needs "include costs for practices which do not provide appreciable conservation benefits or which are production oriented. For example, of the \$3.4 billion estimate of needs used in allocating the 1971 funds, \$1.1 billion was for temporary practices alone.

Adjustments in allocations of funds between States has been limited by law to 15%, but by practice to 1% since 1952.

The following are examples from the report of the General Accounting Office:

"An ASCS county office paid a farmer \$420 toward clearing 30 acres of woodland."

\$400 was paid to plant shrubs "around a house that appeared to be newly constructed and relatively expensive".

"The benefits to the farmer from temporary practices are relatively immediate.

For example, a farmer told us (GAO) that he grew a temporary grass cover on his land to build up the soil and increase production rather than to control erosion because he did not have an erosion problem."

A farmer received a cost share for fertilizing a 20-acre tract annually and he assumed the total cost of fertilizing the remaining 80 acres of his 100-acre tract. Consequently, ASCS shared in the cost of fertilizing all of the tract on a rotating basis. Federal cost shares from 1966 through 1969—\$903.

The Water Bank Program largely duplicates the migratory waterfowl land acquisition program administered by the Department of the Interior. The programs operate in some of the same counties.

Under the Water Bank program, farmers and other landowners agree not to drain, fill, burn or otherwise damage wetlands which are used for nesting or breeding areas by migratory waterfowl.

Agreements are for 10 years and annual payments are made by the Secretary of Agriculture to the landowner.

The Department of Interior purchases land and permanent easements for waterfowl production areas from landowners to preserve the wetlands.

From 1962 to 1972 fights to over 1.1 million acres were acquired.

The Department of the Interior also administers programs for the purchase and operation of Federal wildlife refuges as well as grants to the States which may be used for land acquisition or other wildlife project activities, including operations.

ACTION

Elimination of the Rural Environmental Assistance Program (REAP) after December 22, 1972.

Elimination of the Water Bank Program after December 22, 1972.

Reserve of appropriations above the 1973 budget request for conservation technical assistance, and continuation of that program level in 1974.

Slowdown of watershed construction and resource conservation and development activities in 1973 and 1974, including reserve of congressional add-ons.

15. SPECIAL MILK PROGRAM

BACKGROUND

The special milk program was initiated in 1954 primarily for the purpose of alleviating milk surpluses through increased consumption. It provides subsidized milk to children in participating schools and child service institutions. The current program is redundant in subsidizing milk for children who attend schools and other child service institutions which receive Federal subsidies for meals which must include milk. In addition, the food stamp and commodity distribution programs are intended to supply adequate assistance to the needy to meet nutrition requirements.

The dramatic increase in participation and Federal assistance for the other food assistance programs including the child nutrition programs reduces the priority of the subsidized milk program:

	1969	1973	1974
Federal funding for all child nutrition programs excluding special milk (in millions of dollars).....	517	1,413	1,493
Special Assistance for free and reduced price lunches (in millions of dollars).....	42	620	663
Participation (million children daily):			
Total, school lunches served including milk.....	18.7	23.6	24.2
Needy children served free and reduced price lunches which include milk.....	2.8	8.1	8.6
Commodity distribution to needy families (millions of dollars).....	274	264	240
Participation—average (million people).....	3.6	3.0	2.6
Food stamps (in millions of dollars).....	250	2-193	2,19
Participation—peak month (million people).....	3.2	12.4	12.4

The special milk subsidy program has been considered low priority for several years as the broader programs for feeding the needy have expanded. Termination of this program was recommended to Congress by the President in the FY 1971 budget and in his February 26, 1970, message on reduction, termination, and restructuring of 57 obsolete or low priority programs and again in the FY 1972 budget.

President Johnson also viewed the milk program as low in priority. His 1967 budget proposed to limit this program to needy children and to children in schools not participating in the lunch program and in FY 1970 he recommended its termination.

Fluid milk consumption is not expected to decline appreciably, if at all. The number of meals served with Federal subsidies in schools and other child service institutions and which must include milk are expected to increase. Moreover, nonparticipants in available food service programs, in almost all cases, are from families whose incomes are such to allow purchasing milk without a subsidy. It is further expected that the subsidized milk now consumed will continue to be provided in the institution or brought from home.

ACTION

Subsidies for milk will be terminated for schools and other child service institutions which participate in other child nutrition programs effective July 1, 1973.

16. FORESTRY PROGRAMS

BACKGROUND

National Forest Development Roads are funded in three ways:

By the Forest Service with appropriated funds prior to scheduled timber sales;
By the purchaser of timber offered for sale (under Forest Service supervision) with allowance made for road costs; or

By the purchaser (under Forest Service supervision) supplemented by appropriated funds provided by the Forest Service.

The Cooperative Forest Fire Control Program provides technical assistance and grants to States for fire control on State and private lands. Although fire control on State and private land is primarily a non-Federal responsibility, the Federal role has been to provide some incentive and support to the State fire control programs.

ACTION

More forest road construction funding from direct Federal to purchaser construction enabling outlay reductions without materially reducing needed timber access road construction.

Reduce the Cooperative Forest Fire Control Program from an appropriation level of \$25 M in FY 1973 to a \$16 M level for FY 1973 through FY 1975. The savings achieved are being used to help fund the cost of fighting forest fires on National Forest System Lands in FY 1973.

Delete certain construction items and use congressional increases in FY 1973 for fighting forest fires on National Forest System Lands instead of for Forest Land Management and Forest Research.

17. AGRICULTURAL RESEARCH AND EXTENSION PROGRAMS

BACKGROUND

The USDA research program is a dual system conducted through universities and in "inhouse" research agencies. The organizations included in this system include:

The 54 State Agricultural Experiment Stations.

The Extension programs of the States, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands.

The 16 Land Grant Schools of 1890 and Tuskegee Institute at 63 schools of forestry.

The Agricultural Research Service (ARS) with operations at about 210 field locations involving over 3,000 scientists.

Several other research and action agencies of the Department.

Costs of extension and research in the States are shared with State and local government, other cooperators, and USDA.

Work undertaken by this community includes basic, applied and developmental research in such fields as:

- Livestock
- Plant sciences
- Entomology
- Soil and water conservation
- Agricultural engineering
- Nutrition and consumer use
- Rural development
- Commodity utilization and marketing
- Forestry and environmental problems

Technology transfer of research results is the primary responsibility of cooperative extension.

Program coordination is obtained through the Cooperative State Research Service, Extension Service, and various planning groups.

Some research is found to be inefficient and duplicative and not directed to highest priority problems. Size of complex and fragmentation of resources often in small isolated locations are contributing factors.

ACTION

Selective reductions in USDA in-house research (ARS) and in payments to States for agricultural and forestry research.

An additional \$5 M is proposed to encourage State experiment stations, extension, and others to assist local and State governments in the identification and resolution of rural problems.

Extensive reorganization of the ARS and implementation of new management systems to increase the responsiveness of the Service to national problems and to encourage better utilization of scientific talent and facilities.

Emphasis is being placed on improved regional and national research planning by USDA research agencies, the State experiment stations, and users of technology to improve the manner by which research resources are allocated.

Support for the developing research and extension programs at the land grant schools will continue at about the 1973 level. This is part of a strategy to increase the availability of research and extension services to all potential users on the basis of need and in accordance with law. This will necessitate some degree of program reorientation.

18. ECONOMIC DEVELOPMENT PROGRAMS

BACKGROUND

The Federal Government has been operating a maze of economic development programs, including those of the Economic Development Administration, the Small Business Administration, the Department of Agriculture, and the Department of Housing and Urban Development.

Some of these programs started as experimental efforts, but they have grown into large programs, with much overlap and duplication, and with relatively little effort to develop more effective means of accomplishing the objectives of stimulating desirable economic growth, and reducing persistent unemployment.

The Economic Development Administration, started in 1965 as an experimental effort, has provided public works grants, business loans, and technical and management assistance, with annual costs of about \$300 million.

The EDA funds have been widely dispersed, so while they have been helpful in individual cases, they have done little to overcome the problems of any community. The EDA program has not proven as successful as originally hoped in creating employment opportunities, and on many projects only a small portion of the job opportunities created have gone to the previously unemployed.

Over half of the public works projects funded by EDA have been for water and sewer systems, even though there is no basis to conclude that such water and sewer grants are a highly effective means of stimulating economic development and employment opportunities.

A March 21, 1972, report by the General Accounting Office, titled "More Effective Use Could Be Made of Program Resources To Alleviate Unemployment," describes some of the problems created by the duplication of Federal activities, and cites several EDA projects which had little or no impact on the unemployed or underemployed.

As a Federal program directly selecting and funding local projects, EDA's program is inconsistent with the goal of restoring responsibilities and decision-making powers to States and local governments, to reverse the trend of increased Federal direction of state and local affairs.

ACTION

EDA programs will be phased out by the end of 1973, in favor of more focused and consolidated programs to stimulate economic development. Most of the 1973 funds appropriated for EDA will be available for funding project proposals which have already been reviewed by EDA and are in an advanced stage of processing.

Although the President's Budget for 1974 provides for termination of the EDA programs, it proposes to initiate or expand alternative programs to stimulate economic development, with less direct Federal involvement. The Budget provides an increase of \$348 million to initiate or expand programs under the new Rural Development Act passed by Congress last session. This includes \$200 million in loans for commercial and industrial development, up to \$110 million for grants and loans to smaller communities for community facilities, and an additional \$45 million in loans for water systems and other community facilities. This program will permit State and local officials greater control in project decisions.

The Environmental Protection Agency has already made available \$5 billion to communities for construction of sewage collection systems and waste treatment facilities, under the Water Pollution Control Act of 1972. This funding will remove the need for many of the EDA projects.

Business loans by the Small Business Administration will increase by 30% (or by over \$600 million) to encourage private investment in economic development. Also, \$110 million is provided to assist State and local economic development companies in their efforts to stimulate local or regional development.

The President also is requesting over \$2 billion in special revenue sharing funds for urban community development, to permit both large and small communities to make their own development decisions.

19. NATIONAL OCEANIC AND ATMOSPHERIC ADMINISTRATION

BACKGROUND

The President's Budget for fiscal year 1973 proposed an increase of \$58 million in funding for the National Oceanic and Atmospheric Administration, from \$341 million in 1972 to \$399 million in 1973. Congressional appropriations, including transfers from other accounts, provided the full amount requested.

The planned increase for 1973 would have permitted NOAA to expand nearly all of its programs, including several lower priority and long-range research activities, and some programs for which clear objectives have not yet been finally determined.

Some of the proposed expansions were in program areas in which several other agencies were already involved, with potential duplication in functions. The originally planned expansion would have complicated further the Administration's efforts to consolidate program responsibilities, reduce overlap and duplication, and improve program effectiveness.

ACTION

In fiscal year 1973, obligations by NOAA will be expanded to \$364 million, compared to \$341 M in 1972. Although this expansion is smaller than previously planned, the efforts by NOAA to improve its operations and reduce or defer lower priority programs will permit substantial improvements in the weather monitoring, prediction and warning program, as well as continued expansion of atmospheric research. In fiscal year 1974, program obligations will increase by \$21 million, to \$385 million, primarily for continued improvement in weather prediction and warnings, preparing for a major hurricane modification research effort in the Pacific, expanded research on marine ecosystems to help determine the effects of ocean dumping, and increased research to protect marine mammals.

The revised budget for 1973 will provide an increase of nearly \$7 million for the environmental satellite program for continuation of the polar orbiting satellite system as well as implementation of a two geostationary satellite system. The latter system will provide near continuous picture coverage of the 48 contiguous states and surrounding oceans for warnings of hurricanes and other severe weather conditions. Other improvements related to disaster warnings include automation of meteorological observation stations, expanded flash flood warning services, and accelerated research on tornadoes and severe storms.

Installation of a fifth generation computer at NOAA's Geophysical Fluid Dynamics Laboratory will, for the first time, allow comprehensive mathematical modeling of the oceans and atmosphere as a complete fluid system which will serve as a basis for extending the time range of weather and ocean forecasts, and provide a means for assessing the global environmental impact of man's pollution.

A marine ecosystems analysis project will be conducted in the New York Bight to provide vital scientific and technological information necessary to understand the nature and effects of ocean pollutants as a step toward rational management of our marine resources. NOAA will also initiate research on the population and behavior of marine mammals, develop fishing gear to prevent accidental landings of porpoises, and begin increased enforcement activities required by the new Marine Mammals Protection Act. The Sea Grant program, which has provided valuable information on the Nation's marine resource and engineering problems, will be increased from \$17.7 million to \$19.5 million in FY 1973 to maintain the vitality of its contributions.

Some of the program increases which were originally planned for fiscal year 1973 will be carried out in 1974. The principal example is equipping the NOAA research aircraft for hurricane modification research.

Important program redirections begun in 1973 and to be completed in 1974 will permit a more integrated and comprehensive Federal attack on selected problems. For example, NOAA will curtail or terminate its programs in earthquake research and precipitation enhancement and the Department of the Interior will assume principal Federal responsibility for these programs. Since Interior has been conducting the largest Federal programs in these areas, this action will permit a consolidation of effort and reduce unnecessary overlap. Responsibility for engineering seismology will be assumed by the National Science Foundation.

The data buoy and manned underseas science and technology programs are being redirected to concentrate on meeting the requirements of NOAA's operating and research programs. NOAA will eliminate its marine geophysical mapping program, since these activities are being performed adequately by private industry. Also, the vast improvement in data collection capabilities resulting from the satellite systems permits phase-out of older, less effective observation programs.

With these program redirections and the increases in total funding in 1973 and 1974, NOAA will be able to continue to improve its services to the public.

20. COMMERCE TECHNOLOGY DEVELOPMENT AND UTILIZATION

BACKGROUND

The President's Budget for FY 1973 proposed a \$26 million increase for the National Bureau of Standards to permit initiation or expansion of programs to stimulate the development and utilization of technology in solving domestic problems. The Congress appropriated an increase of \$23 million, from \$54 million in 1972 to \$77 million in 1973.

The largest single initiative is the experimental technology incentives program which will focus on finding effective Federal actions to stimulate technological innovation to improve productivity and enhance the international competitive position of U.S. industry. Congress appropriated \$10.8 million for this new program, with the funds to remain available until expended. Since this is an entirely new and experimental program, it requires extensive planning and program development to assure effective use of the funds. Planning has proceeded more slowly than anticipated, and the agency is not ready to effectively use all of these funds.

NBS also planned to expand its fire research and safety program from \$1 million in 1972 to \$6 million in 1973; increase its program to improve the reliability of pollution measurement instrumentation; and make small expansions in several other technology programs.

ACTION

The total increase for National Bureau of Standards programs will be limited to \$12 million in 1973 (from \$54 million in 1972 to \$66 million in 1973). This increase of 22% in 1973, along with a further increase of \$6 million in 1974, will permit NBS to proceed with these important program initiatives in a responsible and effective manner.

A total of \$15 million is provided in 1973 and 1974 for the experimental technology incentives program. The fire research and safety program will be expanded, with \$3 million available in 1973 and an additional \$5 million in 1974, including construction of an experimental fire research facility. The effort to improve reliability of pollution measurements will increase by 100% in 1973, from \$1 million to \$2 million.

An energy conservation program will be initiated in 1974, with emphasis on increasing the efficiency of the use of energy in buildings and reducing the demand for energy. In addition to these initiatives, NBS will continue to maintain a strong basic measurements program.

21. MINORITY BUSINESS DEVELOPMENT

BACKGROUND

The Office of Minority Business Enterprise (OMBE) was established in 1969, with the principal objective of coordinating all Federal programs which contribute to minority business development. Its funding was \$2 million in fiscal year 1971.

In December 1971, OMBE received \$40 million to begin its own program of management and technical assistance to minority businessmen. This program is conducted primarily by supporting business development organizations, which in turn provide a variety of assistance to help create, improve, and expand minority businesses.

At the time this new \$40 million program was just getting underway, it was necessary to submit the President's Budget request for fiscal year 1973. In anticipation that the program would be successful in achieving its goals, the Budget proposed to increase funding for OMBE to \$64 million.

OMBE's evaluation of the new program after about one year of operation showed that its achievements did not meet expectations, and that there was a need to improve program effectiveness before making further expansion.

ACTION

In 1973, the program will be increased by \$2 million, to \$46 million, rather than increased to \$64 million as earlier planned. This program level will permit OMBE to continue to fund the business development organizations established in FY 1972, as well as support several new organizations. This will provide for at least one business development organization in each urbanized area of the country with a minority population of 25,000 or more. OMBE will be able to focus increased effort on improving the effectiveness of its program, rather than directing its resources to managing a large program expansion.

In 1974, this OMBE program will be expanded by \$6 million over the 1973 level. OMBE also will assume responsibility for the Community Development Corporation program formerly funded by the Office of Economic Opportunity.

Although the OMBE program is not expanding as rapidly as previously planned, total Federal assistance for minority business development will increase sharply from \$692 million in FY 1972 to an estimated \$990 million in FY 1973 and \$1,185 million in FY 1974. These increases include a large expansion of loans and loan guarantees to minority businesses by the Small Business Administration.

Federal assistance for minority business development will increase to \$1,100 million in 1974 (\$700 million in 1972 and \$200 million in 1969). Loans will go to over 11,500 minority firms in 1974 (9,000 in 1972 and 4,700 in 1969) and management assistance will be provided to over 18,000 minority firms.

Included in the \$1,100 million of Federal assistance in 1974 is the following:

- \$110 M in direct Federal loans by SBA;
- \$450 M in guaranteed loans by SBA;
- \$200 M in procurement assistance provided through the 8a program of SBA;
- \$87 M in lease and surety bond guarantees provided by SBA;
- \$91 M of direct and indirect management and technical assistance provided by the Office of Minority Business Enterprise;
- \$45 M in farm ownership loans; and
- \$110 M in grants, advisory services, and other assistance by several agencies.

22. SHIPPING SUBSIDIES FOR RUSSIAN GRAIN

BACKGROUND

The Shipping Agreement with the Russians concluded by Secretary Peterson in December of 1972 provided that at least one-third of the grain purchased would be reserved for carriage in U.S.-flag ships. To accomplish this, the United States subsidizes the difference between the negotiated rate and the operating costs of U.S. ship operators. This difference was originally estimated at \$10.16 per ton. The negotiated rate paid by the Russians is \$10.35 per ton which was roughly \$2.00 per ton more than the world rate when the agreement was consummated.

ACTION

Due to more profitable employment elsewhere, (i.e., P.L. 480 Grain program, fuel oil shortage), the 1973 outlay reduction of \$17 million has been due primarily to reductions in the volume and cost of the 1973 subsidized Russian grain carriage program and the slippage of the bulk of U.S.-flag participation until the latter part of FY 1973.

	Volume (tons)	Rate	Cost	1973 outlays
Original estimate.....	6,000,000	\$10.16	\$63,244,000	\$44,800,000
Revised estimate.....	5,689,000	9.69	55,127,000	27,800,000
1973 outlay reduction.....				-17,000,000

It is possible that even further reductions may be made in the 1973 outlay program for operating-differential subsidy as experience indicates that U.S. operators may not be able to carry the full volume of grain set aside for U.S.-flag ships.

23. REGIONAL ACTION PLANNING COMMISSIONS

BACKGROUND

The Regional Action Planning Commissions were created to provide a formal mechanism for joint State-Federal decision-making on the economic development needs of particular regions of the country. In accordance with Title V of the Public Works and Economic Development Act, the regional commissions have had a Federal Co-chairman and received direct appropriations of Federal funds.

The Federal Co-chairmen had veto power over the use of the Federal funds. A Federal staff and commission staff participated in formulating programs for the use of the funds, and the Federal member, as well as the State members of a Commission, have had to agree to those programs or projects which would be implemented. Funds provided for the Regional Commission program could not be used for any other purpose.

This ever-present Federal involvement in the operations of the regional commissions was indicative of the past reluctance of the Federal government to give up any of its vast decision-making powers to State and local leaders.

In fiscal year 1973 the seven Regional Commissions are receiving a total of about \$40 million in direct Federal appropriations, including about \$10 million for planning and management assistance, and \$30 million for supplementary grants for public works.

ACTION

The action proposed in the 1974 budget will remove the Federal Government from a decision-making role in activities of regional commissions. Rather than have funds appropriated directly for regional commissions, with Federal involvement in how these funds will be used, \$10 million is being requested to be provided to all States for their use, if they wish, in supporting planning and management activities of regional commissions. The \$10 million is being requested as part of the Planning and Management Assistance program of the Department of Housing and Urban Development.

If the States' leaders wish to retain the current regional commissions, the States will decide the budgets for the commissions and determine how the funds are to be used, without interference from a Federal staff. Those States which are not in commissions may decide to establish commissions. In fiscal year 1974 it is expected that each State will receive approximately \$200,000 in additional Federal funds which can be used for supporting commissions. This will provide the financial assistance needed to permit all States to join or form regional commissions, if desired, as they were invited to do by the Vice President last year.

The current direct funding for the regional commissions will be continued through the end of fiscal year 1973. There will be no reduction of any grants, contracts or other awards made by the commissions in 1973 or previous years.

The 1974 Budget does not include funds for supplementary grants for public works and related projects previously funded by the commissions. In addition to the \$200,000 available to each State, other planning and management assistance funds, and revenue sharing funds, could be used to fund regional commission activities. Also, as the continuing or new regional commissions establish plans for specific development projects, they will be able to apply for assistance from continuing Federal categorical programs. For example, the 1974 Budget provides an increase of \$378 million for grants and loans under the new Rural Development Act, including funds for commercial and industrial development and community facilities.

These actions do not affect the Appalachian Regional Commission, which will continue to operate under separate legislation.

24. MILITARY AND CIVILIAN PERSONNEL

BACKGROUND

The high costs of raising pay and benefit levels sufficient to achieve an All Volunteer Force and to comply with legislation requiring that military and civilian pay levels be kept comparable to those in the private sector increased the proportion of the Department of Defense budget required for pay and related personnel costs from 42% in 1968 to 56% in 1973.

1974 ACTION

Stabilized the proportion of military outlays required for pay and related costs in 1974 at the 1973 level of 56% by:

Reducing military and civilian end strengths 106,000 from proposed levels for 1974.

Reduced proposed activity rates for real property maintenance, material depot maintenance, operating force support and supply operations.

RIVERS AMENDMENT

BACKGROUND

Current law provides that the basic pay and allowances of military personnel be increased whenever civilian pay is adjusted. The law also requires that the entire increase for both pay and allowances be added to basic pay only. This peculiarity results in overstating the basic pay base for computing military retired pay and understating individual allowances for quarters and subsistence.

ACTION

Legislation will be proposed to permit military pay raises to be supplied separately to basic pay and allowances for estimated savings of \$100 million in 1974 and \$200 million in 1975.

{Applies to Action No. 24 and 28.}

25. PROCUREMENT

BACKGROUND

Procurement programs are budgeted at \$18.8 billion in 1974. When adjusted for general price inflation of about 3%, the 1974 procurement program is actually about \$360 million below the 1973 level.

ACTIONS

Decreased planned 1974 procurement programs for:

Sea control ship

Minuteman III modernization

Aircraft modifications

A-X aircraft

F-4J aircraft

F-14 aircraft

S-3A aircraft

Defense support program

Close-In Weapons System (phalanx)

M60A1 tank

Gun improvement program

Without these reductions, the 1974 program would have been substantially higher than budgeted.

26. RDT&E REDUCTIONS

BACKGROUND

Activities funded under the RDT&E appropriation range from basic and applied research of military relevance to the development and testing of major weapons systems. RDT&E programs are budgeted at \$8,658 million total obligational authority in 1974.

ACTIONS

Reduced 1974 program levels. These reductions have the effect, in some cases, of slowing down the pace of development and, in other cases, of deferring program initiation. Examples of programs affected by these reductions include Trident, AWACS, advanced attack helicopter, cruise missile, surface effects ship.

27. CONSTRUCTION

BACKGROUND

The construction and family housing programs increased from a level of between 1.7 and 2.0 in 1967 thru 1973 to 2.2 in partial recognition of the need to provide improved barracks, family housing, and other types of facilities required in the context of an All Volunteer Force and for modern weapons requirements. Reductions from the request totalled over one-half billion dollars.

ACTION

Despite a backlog of current program requirements, 1974 program proposals were reduced for family housing and bachelor housing construction.

Reduced or deferred projects such as
 Defense Office Building
 Hospital and medical projects
 Satellite basing facilities for strategic bombers.

28. ALL VOLUNTEER FORCE

BACKGROUND

Planning for an All Volunteer Force has been accomplished in the context of a \$3.5 billion annual program requirement. Initial recruiting experience during 1972 and 1973 lowered program levels from \$3.5 billion to \$3.2 billion in 1974, for programs designed to attract and retain sufficient volunteers to meet manpower goals.

ACTION

Reduced All Volunteer Programs \$300 million in 1974 and 1975 as a consequence of lower accession requirements due to reductions in military end strengths, and more effective recruiting and retention efforts.

[See Action No. 24.]

29. TIGHTEN OPERATIONS OF REVOLVING AND MANAGEMENT FUNDS

BACKGROUND

Stock funds are revolving-type accounts that finance the acquisition of inventories of consumable (non-repairable) items for resale to the military services and other authorized customers world-wide. During periods of high levels of customer activity, such as the recent war in Indochina, sales of stock fund type material increase. As sales increase, inventories are built up to provide safe levels protection against unforeseen demands and to finance higher levels of procurement. When customers' activity rates decrease, sales of consumable times by the stock funds decrease. Inventories can be reduced without endangering the effectiveness of supply support to the customer.

ACTION

Reduce inventories through sale of stock fund items to customers without replacement on a one-for-one basis. Hold outlays for replacement of stock fund inventory to lower levels in 1974 and 1975 for estimated savings of \$200 million and \$100 million respectively.

March 6, 1973

30. CORPS OF ENGINEERS—WATER RESOURCES CONSTRUCTION

BACKGROUND

Corps program will require \$8 billion to complete projects now under construction.

An increasing number of projects are experiencing delays because of environmental considerations. Most of the projects now under construction were authorized before enactment of the National Environment Policy Act of 1969.

Some projects raise questions of possible conflicts among national objectives, e.g., major Federal investments to bring land into agricultural production through agricultural flood protection and drainage at the same time that payments are being made to set aside presently arable land in order to stabilize farm income.

ACTION

1974 budget outlays of \$1,579 million for the Corps-water program represent savings of \$471 million based on program level that would have prevailed if budgetary action was not taken in 1973 and 1974 to apply reasonable constraints to program.

In order to avoid unmanageable construction backlog, projects originally scheduled to start in 1973 have been rescheduled for initiation over a 15-month period beginning in the last quarter of 1973 and only five new starts are budgeted for 1974.

Some delays will be incurred for projects designed to meet long range or less urgent water demands for such purposes as agricultural flood control.

Schedules for hydropower developments will generally be maintained.

31. "STRENGTHEN MEDICARE COST CONTROLS AND ELIMINATE UNNECESSARY ADVANCE PAYMENTS FOR HOSPITALS"

BACKGROUND

During Phase II the inflation of medical care prices was reduced to about half the rate of increase before the Economic Stabilization Program. Nevertheless, strong inflationary pressures continue to exist in the health sector, particularly in hospital costs.

With respect to *unnecessary advance payments*:

When the Medicare program was established, a system of working capital advances was adopted to assure sufficient funds in advance of billing for cash flow requirements of hospitals and other health care providers.

This reimbursement method has resulted in outstanding interest-free advances in excess of \$325 million.

These advances are no longer necessary since processing of bills is timely and other early payment methods are available to Medicare providers on the basis of demonstrated financial need.

ACTIONS

Extension of Economic Stabilization Program authorities is proposed to continue controls on providers of health services. Improved regulations for the hospital sector are now under consideration by the Cost of Living Council.

Terminate this system of providing working capital advance payments in 1973, with a budgetary savings of \$300 million. Other advance payment arrangements based on demonstrated financial need are available to assist institutions in the event of cash flow difficulties.

32. "STRENGTHEN MEDICAID MANAGEMENT"

BACKGROUND

Opportunities for improving management of the Medicaid program at the Federal and State level have been identified. Examples of these include:

Identification and elimination of payments to ineligible recipients of public assistance;

Termination of Federal matching payments for services incorrectly paid under Medicaid;

More intensive financial review to ascertain the existence of Federal overpayments to States.

ACTION

Incentives are being provided for States to terminate payments to ineligible recipients.

Field guidelines and instructions for the use of Federal personnel will be distributed to assist in identifying program overpayments and in conducting intensive financial reviews. These guidelines and instructions are currently being field tested prior to their use.

33. "RELY ON FEDERAL HEALTH FINANCING MECHANISMS TO PAY DEPRECIATION CHARGES IN PLACE OF MEDICAL FACILITIES GRANTS PROGRAM, AND ACHIEVE QUALITY CARE OBJECTIVES THROUGH THE PROFESSIONAL STANDARDS REVIEW IN PLACE OF THE REGIONAL MEDICAL PROGRAM"

BACKGROUND

The Medical Facilities Construction or "Hill-Burton" program assists in the construction of public and private nonprofit hospitals and other health facilities. Through the provision of about \$1 of Federal matching money for each \$3 of State and local money, the program has been a major force in carrying out better than 10,000 medical facility construction projects.

Regional Medical Programs (RMP) began in 1965 as a mechanism to link the expertise of medical centers with practicing physicians and community hospitals, with special emphasis on heart, cancer, stroke, and, later, kidney diseases. This linkage was mainly in the form of education and training programs for health care practitioners, on the one hand, and development of specialized resources, such as intensive care units. The purpose of these activities was to improve the quality of care available for heart, cancer, stroke, kidney and related diseases. There are currently 56 RMP's which vary in size from single cities to combinations of several States.

From 1947 to 1971 Hill-Burton expenditures amounted to just over \$3.7 billion, or 29% of the \$12.8 billion expended on the projects supported by the program. From 1966 through 1972 the Federal Government obligated in excess of \$512 million for the RMP.

Termination of the Hill-Burton program is warranted since:

Today an overall national *oversupply* of hospital beds exists. The average occupancy rate in the Nation's community hospitals has been declining since 1969, and now is down to about 73%. In some areas—particularly non-metropolitan areas in the Midwest and West—the average occupancy rate is below 70%. Large numbers of unoccupied beds are a major factor in driving up the cost of hospital care.

Hill-Burton expenditures, as a percentage of total national expenditures for construction of health care facilities, have declined over the past decade. In 1972, Hill-Burton expenditures represented only about 5% of the total national medical facility construction expenditures, compared to 13% in 1963.

The vast bulk of spending for medical care facilities has been made available through the private sector.

Termination of the RMP is warranted since:

The greatest expenditure of RMP funds has been in the area of continuing education and upgrading training of health personnel. It is not an appropriate use of Federal funds to finance continuing education for professionals generally capable of financing their own education to improve professional competence. Training programs supported by RMP's have been short-term in nature. In FY 1971, 60 percent of the people receiving training by RMP attended a project lasting one day or less. Another 27 percent attended one lasting no more than 5 days, and only 13 percent attended projects lasting more than 5 days.

As a result of various legislative and administrative decisions in recent years, several activities for improving the quality of care previously assigned to RMP are now being supported by other HEW organizations, such as the special NIH cancer and heart initiatives, and the system of Professional Standards Review Organizations being set up under the Medicare authorities.

ACTION

The President's Budget begins the phaseout of these programs in 1973, and requests no funds for them in 1974. The appropriation authorizations for both programs will be permitted to expire at the end of 1973.

With respect to medical facilities construction, the growing coverage of health insurance plans, including Medicare and Medicaid, which provide reimbursements to cover costs of capital improvements, provides a growing source of assistance for the financing of essential construction from revenues. Enactment of national health insurance legislation will further assist in such financing. Other Federal programs—such as HUD's mortgage insurance program—will continue in 1974 to assist in the construction of community health facilities.

With regard to RMP, those activities involving provision of care should become self-sufficient through reimbursements from health insurance plans. States and localities are in a position, of course, to support any RMP activities that are of high priority.

34. "PHASEOUT, OVER AN 8-YEAR PERIOD, FEDERAL FINANCING FOR LOCAL MENTAL HEALTH PROGRAMS."

BACKGROUND

Federal grants for mental health services were originally established to provide "seed" money for the initial hiring of staff for mental health centers.

Presently most of these grants require an 8-year Federal commitment.

The selective nature of these programs is inequitable to the nation as a whole because relatively few communities receive Federal funds. Less than 25% of the population are in catchment areas served by these centers which place little emphasis on the medically disadvantaged.

ACTION

Authorizations for new grants which expire in 1973 will not be extended.

Sufficient budget authority is requested for 1974 for all currently committed continuation costs until the expiration of the grant periods.

With the momentum of this initial effort and with resources from State and local tax revenues, and increasing third party coverage of mental illness, State and local governments should now be able to continue the expansion of community mental health centers.

Essential mental health benefits will be included in the Administration's national health insurance proposal.

35. "ELIMINATE DUPLICATE HEALTH PROGRAM GRANTS"

BACKGROUND

A number of activities in Preventive Health Services are duplicative. Other activities have accomplished their original goal of demonstrating a methodology and are more appropriately continued by State and localities. These activities include:

Injury control programs which have reached a stage of research and demonstration that allows communities and States to put into practice tested methods or preventing injuries;

A data gathering system—Neighborhood Environmental Evaluation and Decision System (NEEDS)—already in operation in 22 cities—which has demonstrated the efficacy of this method as a planning tool and can easily be replicated in communities without special categorical Federal technical assistance;

An Arctic Health Center limited to the environmental impact of special conditions on the Alaskan population in which a continuing Federal role is not justified.

Nutrition activities which have examined a number of nutrition problems and demonstrated control measures which States and localities can duplicate; and Immunization activities that have supported State personnel costs and which are no longer necessary.

ACTION

Termination of the injury control, NEEDS planning tool, Arctic Health Center, and nutrition activities and reduced support for immunization activities and certain Center for Disease Control direct operations.

Other Federal resources are available for these activities. For example,

Funds for injury control and NEEDS are available from HUD, other HEW programs and the Environmental Protection Agency;

Activities supported by the Arctic Health Center can be supported by the Environmental Protection Agency and other HEW research funds;

Nutrition programs can be supported through the Department of Agriculture and other HEW programs; and

Immunizations can be financed by Medicaid and the proposed national health insurance as well as other HEW programs.

36 AND 37. "FOCUS HEALTH MANPOWER TRAINING SUPPORT ON AREAS OF SPECIAL NEED"

BACKGROUND

Since 1963 the Federal Government has supported programs that single out for special assistance schools that educate and train workers in the health professions.

These programs, initiated largely in response to a perceived undersupply of physicians, have over the years grown to encompass virtually the entire spectrum of health professionals and workers allied with those professionals. The President's Budget represents a judgment as to which of these many activities are of higher priority and deserving of continued Federal support, and those for which categorical Federal support should be terminated. These latter activities—and the essential rationale behind the terminations—are described on the attached four sheets.

From 1963 through 1972 the Federal Government obligated approximately \$2.3 billion for the support of health manpower education.

ACTION

The President's Budget reduces the funding of the following health manpower activities in 1973, and eliminates their funding in 1974:

Categorical Allied Health Support

Categorical Public Health Support

Capitation Support for Schools of Veterinary Medicine, Optometry, Podiatry, and Pharmacy ("VOPP's")

Capitation Support for Schools of Nursing.

Support for selective funding for those activities which clearly serve national needs or objectives will continue through special project grant assistance, rather than through categorical or formula assistance to all institutions.

Many States have expressed interest in encouraging further growth in the supply of health manpower, and can be expected to provide additional support to institutions that need assistance.

"Categorical Allied Health Support"

Program description

The allied health manpower program supports improvements in the preparation and utilization of allied health workers. Grants have been provided to those allied health training centers with the best potential for increasing enrollments in established curriculums, for planning and establishing new programs, for coordinating programs to make more effective use of faculty and facilities, for developing and demonstrating or evaluating interdisciplinary training programs, new teaching methods, new types of health manpower, and for special programs to reach special groups such as returning veterans.

Reasons for termination

Federal support for selective funding of allied health activities which clearly serve national needs will continue through special project grant assistance under the flexible educational initiative awards authorities of the Comprehensive Health Manpower Act.

Student assistance is available through alternative sources, e.g., the programs administered by the Office of Education that are generally available to all students, including loan programs. The salary levels of trained health workers generally are adequate for students to repay any loans which may have been obtained.

Federal funding has not been a crucial factor in the substantial growth in the allied health field. Federal support has been small in relation to State, local, and private spending in this field.

"Categorical Public Health Support"

Program description

The purpose of the Federal program in public health has been to expand and improve the opportunities for health personnel to undertake graduate or specialized training in public health. Institutional support, through both formula and project grants, has been provided to schools or public health to assist them in providing training, consultation services and technical assistance in public health and in the administration of State and local public health programs. Traineeships grants have been provided to support students taking graduate or specialized training in public health.

Reasons for termination

The majority of the Nation's 18 public health schools are public institutions that can turn to State and local governments for such additional general support as may be required.

Federal support for public health educational activities clearly serving a national need, e.g., demonstration of innovative educational techniques and curriculum reform, will continue through special project grants assistance, under

the educational initiative awards authorities of the Comprehensive Health Manpower Act. The schools also will continue to receive special purpose funds from other Federal programs.

Student assistance is available through alternative sources, e.g., the programs that are generally available to all students administered by the Office of Education, including loan programs. The salary levels of trained public health workers are adequate for students to repay any loans which may have been obtained.

Federal institutional support for the schools of public health amounted, on the average, to less than one-fifth of the institutions' total expenditures during the 1970-1971 academic year.

"Capitation Support for Schools of Veterinary Medicine, Optometry, Podiatry, and Pharmacy (VOPP)"

Program Description

The VOPP capitation grants provided by the Comprehensive Health Manpower Training Act of 1971 replaced the institutional grants of basic support to educational programs authorized under the Health Professions Education Assistance Act of 1963 and its subsequent amendments. The capitation formula is based on enrollment and provides incentives for expanding enrollments and for shortening periods of training. Awards to 109 VOPP schools under capitation in FY 1972 totaled \$25,200,000.

Reasons for Termination

The need for Federal support programs for these institutions rests not so much on production of trained professionals as on improving their training and accelerating changes in programs to relate them more closely to changing patterns of health care delivery. Such activities in the VOPP schools will be supported under special project grants and Health Manpower Educational Initiative Awards.

Student assistance is available through alternative sources, e.g., the programs administered by the Office of Education that are generally available to all students, including loan programs. The salary levels of trained health professionals are adequate for students to repay any loans which they might obtain.

"Capitation Support for Schools of Nursing"

Program Description

Formula payments to diploma programs were authorized under the Nurse Training Act of 1964. Under the Health Manpower Act of 1968, formula grants for all types of nurse training programs were authorized but never funded. The Nurse Training Act of 1971 authorized capitation grants to support educational programs in nursing schools of all types with extra amounts to encourage expansion of enrollment and the training of nurse practitioners. The program was subsequently funded in FY 1972 and awards totaling \$31.5 million were made in June of last year.

Reasons for Termination

Federal support for programs to improve the use of nurses and to develop expanded roles for nurses in the delivery of health care will be supported in 1974 through special project grants.

The ability of nursing schools to expand prior to the availability of capitation support is evidence that this Federal support for this particular health profession is not essential.

Traditionally, the largest percentage of nursing schools, i.e., hospital-based institutions, have been financed through patient care costs. No convincing case has been made that limited Federal resources should be used to replace the traditional sources of financial support for such training.

The average annual cost of educating a nurse has been estimated at \$2,000 to \$3,000. Since the level of capitation support has been about \$300, capitation represents an insignificant portion of the cost of nurse training.

Of 1,400 nurse training schools throughout the country, only 950 applied last year for the capitation grant. As this number increases, the per capita level of support will decrease further.

38. FOREIGN LANGUAGE AND AREA PROGRAMS

BACKGROUND

Federal funding for this program was initiated in 1958 and since then \$149 million has been spent for Foreign Language and Area Studies.

Under this program funds have been provided to over 100 foreign area studies centers in American higher education to help develop a pool of foreign area specialists.

The funds provided by this program are not necessary as an incentive to draw graduate students to the subject fields.

Program has developed to a point where the centers rely on NDEA VI funds for only 10% of their annual budgets.

Centers are now established and should be able to continue their programs in foreign languages and areas without direct Federal institutional assistance.

ACTION

The President's 1974 budget requests no funds for new initiatives.

This action reflects the shift in Federal support from categorical institutional aid to student assistance.

An adequate cadre of specialists has been built to produce a self-sustaining supply of future generations of similar specialists.

Federal agencies in the international and national security fields which have needs for specialists in these fields directly finance the training of their personnel at centers such as these.

Federal funds will still flow to the centers from direct training support and through students receiving expanded student assistance who go there.

39. LAND GRANT COLLEGE AID (BANKHEAD-JONES ACT)

BACKGROUND

Since enactment of the Bankhead-Jones Act in 1936 and through 1972, \$186 million has been spent for land grant colleges.

This annual appropriation of \$10 million is divided equally among the states and territories for assistance to land grant colleges.

There is no justification for continuing a Federal subsidy for this marginal amount of support for general operations because (a) it is not targeted on needy students, (b) it is not addressing a special problem or need which requires Federal action, (c) it is only a small portion of the vast bulk of support for land grant colleges, which is a State responsibility and (d) Federal priorities in higher education are being shifted to students according to need rather than to institutions according to formula.

ACTION

Termination of this program is proposed for FY 1973 and 1974.

40. UNIVERSITY COMMUNITY SERVICES PROGRAMS

BACKGROUND

Since its enactment in 1965 and up to the fiscal year of 1972, \$68 million has been spent for University Community Services programs. This funding was provided to assist universities develop programs to support students in need of special assistance. Funds are provided on a formula grant basis to States and territories. A State agency designated by the governor decides which projects to fund.

The impact of this program is negligible because the assistance is so scattered and is not distributed on the basis of need. The program is inconsistent with the shift in Federal higher education priorities away from categorical assistance for the general support of institutions and toward student assistance.

ACTION

The termination of this program is proposed in the President's FY 1974 budget.

41. STATE DEPARTMENTS OF EDUCATION

BACKGROUND

Since this program was authorized in 1965, \$191 million has been provided at an annual level of up to \$38 million to help State Departments of Education purchase additional staff services for basic administration and for long-range planning.

It is not an appropriate Federal role over the long run to finance general State administrative efforts in the field of education through categorical programs unrelated to special needs.

States may, if they choose, use education special revenue sharing funds to augment their capacity to administer educational programs.

ACTION

The President's 1974 budget proposes to terminate this program.

42. IMPACT AID

BACKGROUND

Since 1950, the Federal Government has provided over \$7.2 billion for Impact Aid. These funds are generally distributed to local school districts on the basis of:

The numbers of children in attendance whose parents both work *and* live on Federal property ("A" children).

The numbers of children in attendance whose parents work in Federal facilities but, in most cases, live on taxable non-Federal property ("B" children).

ACTION

The President's Budget proposes:

Continued funding in behalf of children whose parents both work and live on Federal property (Category "A"), and who make little or no contribution to support the schools their children attend. Funds for the Category "A" students would be made available through Educational Revenue Sharing in 1974.

No funding in behalf of children whose parents live in the local community and pay full property, sales, and other local taxes just like any other private citizen.

In FY 1972, the following districts, among the highest average *per capita* income in the Nation, received the following amounts:

Montgomery County.....	\$6, 080, 950
Fairfax County.....	10, 711, 020
Prince Georges County.....	9, 507, 880

Most of the children of Federal employees who attend the schools in these counties are from families who own property which is taxable in the affected jurisdictions.

43. PUBLIC LIBRARIES AND SCHOOL LIBRARY RESOURCES

COLLEGE LIBRARIES

BACKGROUND

Since 1966 the Federal Government has spent over \$162 million in support of college libraries, librarian training and library demonstration programs.

The 1973 Supplemental Appropriation Act included \$18 million for these three programs:

1. College library resources—a basic grant of \$5,000 to every eligible institution.
2. Librarian training—program to train professional and paraprofessional librarians.
3. Library demonstrations—to develop model programs.

The basic grant program is not in line with Administration policy on support of higher education because:

Basic grants go to all institutions regardless of need.

Basic grants focus higher education dollars on institutions rather than students. The average grants to institutions are in such small amounts that for most schools they have little if any effect on the overall quality of their library programs. Student assistance programs should provide general aid based on need without regard to career choice.

High priority research and demonstration activities can be carried on by the National Institute of Education and the program for postsecondary innovation.

ACTION

The President's 1974 budget proposes to rescind \$3 million of the 1973 appropriation to maintain the program at the 1972 level and to terminate the program in 1974.

PUBLIC LIBRARIES

BACKGROUND

Since 1957 the Federal Government has spent over \$340 million for Public Library Services.

The President's budget provides \$32.7 million for this program in 1973.

Through this program Federal funds have acted as a stimulus to attract State and local funds for the general improvement of public library services.

Federal support has accomplished the role of catalyst on State and local funding for public libraries.

From 1960 to 1970 State and local support for libraries has more than doubled.

ACTION

The President's 1974 budget proposes to terminate this program.

BACKGROUND

SCHOOL LIBRARY RESOURCES (ESEA, TITLE II)

Since 1966 the Federal Government has spent over \$563 million to provide library resources and other instructional materials to elementary and secondary schools through a State formula grant program.

The program has provided up to \$90 million a year spread over nearly 17,000 school districts.

The individual grants to school districts within States are so minimal that resources are dissipated with no significant program impact.

The basic law does not allow for targeting funds on the basis of economic need.

ACTION

The President's 1974 budget would terminate this program.

Education Revenue Sharing funds can be used to purchase the same resources.

43A. CERTAIN NARROWLY FOCUSED CATEGORICAL PROGRAMS

DROPOUT PREVENTION

BACKGROUND

Since 1969 the Federal government has spent \$30 million in support of this demonstration program to develop methods and techniques for encouraging potential dropouts to stay in school.

The President's budget provides \$8.5 million for Dropout Prevention in 1973.

The program is scheduled to be phased out as the 5-year experimental projects are completed and the results compiled.

As projects are completed, the Office of Education will disseminate the results so that local school districts can make use of them.

ACTION

The President's 1974 budget includes \$4 million for Dropout Prevention, a decrease of \$4.5 million below 1973.

UNDERGRADUATE INSTRUCTIONAL EQUIPMENT (HEA VI)

BACKGROUND

Since 1966 the Federal government has spent over \$78 million in grants to institutions of higher education for the acquisition of instructional equipment.

No funds were provided for this program in the President's 1973 budget.

This program is inconsistent with administration policy to concentrate higher education dollars on students rather than institutions.

ACTION

This program was terminated in the 1973 President's budget.

EDUCATION PROFESSIONS DEVELOPMENT

BACKGROUND

Since 1959 the Federal government has spent over \$799 million under National Defense Education Act and later under the Education Professions Development Act to support a wide variety of teacher training activities.

The President's 1974 budget includes \$107 million to support teacher training in 1973.

Supporting teacher training is not an appropriate Federal role except where there is an urgent national need directed toward areas of critical shortage.

Colleges and universities are currently turning out many more future teachers than there are new teaching jobs available.

ACTION

The 1974 budget provides \$74 million for Education Professions Development, a decrease of \$33 million below the 1973 level and terminates the narrow categorical programs under this authority.

The more broadly based programs—Teacher Corps, Career Opportunities, Urban-rural—will be continued.

Funds are included in the 1974 budget to continue support of people already in the college teacher fellowship program, but no new fellowships will be awarded.

ENVIRONMENTAL EDUCATION

BACKGROUND

The Federal government has spent a total of \$5 million in support of this demonstration program to develop innovative ways of teaching students about the relationship between man and his environment.

The President's budget provides \$3.2 million for this program in 1973.

The primary purpose of this program was to alert school systems to the need to include "the environment" in their curricula. This has been accomplished.

A separate federally funded demonstration can no longer be justified; now local communities may put the results of this program into use as they perceive the need.

ACTION

No funds are requested for this program in the President's 1974 budget.

NUTRITION AND HEALTH

BACKGROUND

The Federal government has spent over \$4 million in support of this demonstration program to coordinate the delivery of nutrition and health services to children through the schools.

The President's budget includes \$2 million for this program in 1973.

This was an experimental program which was not intended to go on indefinitely; it has achieved its objective.

We now need to evaluate and disseminate the results of the program so that local communities can make use of them.

Federal funding should come from less categorical programs such as Education Revenue Sharing.

Continuation of these programs beyond the experimental phase would be unnecessary and inequitable as it would only benefit a very small percentage of the nation's students.

ACTION

No funds are provided for this program in the President's 1974 budget; it is scheduled for termination.

PURCHASE OF EQUIPMENT OR MINOR REMODELING (NDEA III)

BACKGROUND

Since 1959 the Federal government has spent over \$890 million to provide funds through this formula grant program for the purchase of special equipment such as laboratory or audiovisual equipment and for minor remodeling in school buildings.

The President's 1973 budget proposed the termination of this program.

This was a narrow categorical program the purposes of which can be supported under similar authority such as Title I and Title III.

At its inception there were no other programs to provide for such needs; now there are broader programs which enable schools to purchase special equipment as well as other services to meet their individual needs.

ACTION

This program was terminated in the President's 1973 budget.

FOLLOW THROUGH

BACKGROUND

Since 1967 the Federal government has spent over \$239 million for this demonstration program to develop and test new ways to educate disadvantaged children in the early primary grades. This program was transferred from OEO to HEW in 1972.

The 1973 President's budget includes \$57.7 million for this program.

The program has been a demonstration effort for seven years; it has accomplished its intended objective.

Results may now be applied by local communities; Federal financial assistance may be derived from less categorical programs, such as Education Revenue Sharing as a matter of local choice.

To continue the program beyond its experimental phase would be unnecessary and inequitable—i.e. only those students in areas served would benefit from programs supported by all Federal taxpayers.

ACTION

The President's 1974 budget would begin to reduce funding for this program at a level of \$41 million, \$16.7 million below 1973.

44. NATIONAL DIRECT STUDENT LOANS

BACKGROUND

The National Direct Student Loan Program (NDSL), formerly National Defense Student Loan Program, has provided Federal capital contributions to revolving funds at higher education institutions since 1958. The Federal government provided 90%, and schools contributed 10% of total funds. These revolving funds make loans to students which they are expected to repay at 3% interest) following graduation. Certain forgiveness provisions apply for teaching, military service, etc.

Federal capital contributions over the years have resulted in an NDSL revolving fund estimated at \$2.2 billion; repayments on past loans which are available to make new loans are estimated at \$150 million in 1973 and \$160 million in 1974.

ACTION

The 1974 budget continues the NDSL program as a revolving fund. There will be no additional Federal capital contribution.

The NDSL program has served the purpose for which it was created: to make

funds available to students who needed them to attend school. At present, loan volume under the NDSL program (circa \$450 million annually) has been surpassed by the newer Guaranteed Student Loan program whose volume is estimated in excess of \$1.3 billion a year.

Under the 1974 budget schools will make new loans under the NDSL program using funds repaid by previous borrowers. The major demand for new loans will be met by the Guaranteed Student Loan program whose expansion is provided for in budget estimates. Under this program, most students will receive their loans from financial institutions. But schools which wish to make Guaranteed Student Loans themselves will be able to apply for an 80% advance for such loans from the new Student Loan Marketing Association. Thus, from the schools' standpoint, the major part of loan capital requirements can still be met from outside their own resources.

45. "LIMIT OUTLAYS THROUGH THE OPERATION OF THE ADMINISTRATION-SUPPORTED STATUTORY CEILING ON SOCIAL SERVICES GRANTS (ALREADY ENACTED BY THE CONGRESS)"

BACKGROUND

The program heretofore covered a very wide variety of activities under the undefined heading of "social services." These activities—for which the Federal taxpayers financed 75% of the costs—ranged from child care to prisons. States had discovered that they could refinance a huge share of their entire budgets with Federal money under the heading "social services."

It had been clear for several years that funding requirements for this program were growing out of control. The history of the last several years is as follows (in millions of dollars of program cost):

1969-----	354
1970-----	522
1971-----	690
1972-----	1,598

ACTION

Without some measure of control, costs were expected to reach \$4.7 billion in 1973 and \$5.2 billion in 1974. The statutory ceiling of \$2.5 billion (imposed under the State and Local Fiscal Assistance Act of 1972, which also provided General Revenue Sharing) still represents massive growth—\$900 million over the 1972 level and more than seven times the level of 1969.

The next step, to be taken through regulations now being prepared by HEW, is to assure that within this ceiling, the funds are used effectively, providing services of real value to those who need them.

46. "ADJUST THE GROWTH RATE FOR THE VOCATIONAL REHABILITATION PROGRAM"

BACKGROUND

The program provides grants to States to finance services to the mentally and physically handicapped. The objective is to help them prepare for and engage in remunerative employment in order that they may become self-sufficient.

ACTION

The "reduction" amounts to an adjustment in the rate of growth, rather than an absolute reduction. The program continues to grow, from \$618 million in 1972, to \$640 million in 1973 and \$650 million in 1974. The downward adjustment in the rate of growth reflects the fact that additional sources of funding are becoming available to support vocational rehabilitation activities. For example, the new Supplemental Security Income program (Adult Welfare under H.R. 1) is expected to purchase about \$40 million of VR services for beneficiaries in 1974, with another \$66 million coming from the Disability Insurance Trust Fund.

47. "LIMIT TO 5 YEARS FEDERAL FUNDING RESPONSIBILITY FOR CUBAN REFUGEES"

BACKGROUND

The program is intended to assist refugees from Cuba in adjusting to living in the United States. Since 1962, the Federal Government has provided 100%

reimbursement to State and local welfare agencies for financial and medical assistance rendered to needy Cuban refugees. The program also provides for resettlement and education services, as well as for the cost of the airlift from Cuba. An appropriation of \$139 million was provided in 1972.

ACTION

The policy of reimbursing States and localities is being changed to limit, in general, the Federal responsibility to the first five years of the refugees' residence in the U.S. This provides sufficient time for the refugee to have become a U.S. citizen and to have overcome the most serious aspects of adjustment to this country. It is quite appropriate to have such a time limit for most States, since Cuban refugees constitute such a small portion of the total caseload. Adjustments in this general policy will be made, however, to recognize unique situations such as the high concentration of Cuban refugees in Florida. A second major reason for this reduction is that the airlift from Cuba has been restricted by the Cuban Government. The States will, of course, continue to receive support for covering these costs, particularly including the Public Assistance program.

48. "INSTITUTE QUALITY CONTROL FOR SOCIAL SERVICES RESEARCH AND TRAINING"

This involves reductions in two programs: SRS Research and SRS Training Grants.

The background and reasons for the reductions differ somewhat between the two programs. Accordingly, they are discussed separately in the attached papers.

SRS RESEARCH

BACKGROUND

The SRS research program is intended to develop knowledge relevant to the solution of problems of the dependent and disadvantaged, which may enable the programs of SRS to help solve those problems. The program was funded at \$64 million in 1972.

An examination of this program revealed that there were several cases where funds were being used to support nonproductive or duplicative activities and to support activities for which there was no evidence of near-term payoff.

ACTION

The level of the program is being reduced to \$52 million in 1973 and \$47 million in 1974. The reduction will involve eliminating these activities, while continuing a substantial level of support for high priority projects and those which seem likely to produce near-term payoff.

Examples of low-priority activities planned for termination

Three Vocational Rehabilitation Research Training Centers are being eliminated because they have demonstrated relatively low productivity and their core areas of research have been duplicative of other centers. (Annual cost \$1,580,000).

Two Regional Research Institutes are being discontinued. In one case, termination is based on failure to provide adequate technical assistance to the Regional Office and poor quality output in general. For the other Institute, discontinuation is based on slow progress in reaching stated objectives and duplication of efforts involving another Institute. (Annual cost \$200,000).

Certain evaluation projects are being discontinued because of their duplication with the efforts of the new SRS Rehabilitation Engineering Centers. (Annual cost of \$300,000). This will strengthen the Rehabilitation Engineering Program by consolidating research efforts formerly performed by individual researchers.

Speech and audiology rehabilitation research past efforts have emphasized both long and short term studies. Plans now are to discontinue long term studies and emphasize only those projects which are expected to provide near-term payoffs.

Included in discontinuations are projects that have demonstrated low cost-benefits from their efforts. One project attempted to demonstrate the effectiveness of training unemployed and underemployed handicapped residents of Appalachia to profitably market regional crafts. This effort did not result in viable business ventures.

SRS TRAINING GRANTS

BACKGROUND

Under various legislative authorities, the Social and Rehabilitation Service has made grants to institutions of higher learning to support both students and faculty in social work and related fields. Assistance has been made available at both undergraduate and graduate levels of study. The stated objective has been to assure the availability of adequate numbers of trained personnel in rehabilitation, social work and aging. The program was funded at \$37 million in 1972 and \$47 million in 1973. Specialized training programs conflict with a policy of placing principal reliance on general programs of student assistance based on need.

ACTION

The program will be phased-out at the end of 1974. Funding in 1974 will be at \$17 million, sufficient to continue support for those who are already in school under this program. No new grant commitments will be made. Federally-funded programs of general student aid are now available to assure that students are not deprived of higher education for lack of funds. These programs include scholarship assistance for needy students at the undergraduate level and guaranteed loans for other undergraduate students and for graduate study. In view of the availability of these more general forms of assistance, specialized programs such as SRS training grants are duplicative and unnecessary. That is, a student who wishes to pursue an education in social work can receive the assistance he needs from the general programs, thus rendering the specialized program unnecessary.

In addition, the normal operation of the job market will tend to induce an appropriate number of students to pursue this area of training and thereby avoid the imbalances which the specialized training programs engender in the supply of trained personnel.

49. "ELIMINATE OVERPAYMENTS AND PAYMENTS TO INELIGIBLE RECIPIENTS OF PUBLIC ASSISTANCE AND INTRODUCE MANAGEMENT IMPROVEMENTS"

BACKGROUND

Since 1936, the Federal Government has spent more than \$80 billion under the public assistance program. Outlays have risen to an annual level of \$6.6 billion in 1972 and, even with substantial cost-saving reforms, will be \$6.0 billion in 1973.

Recent surveys have established beyond doubt that inequities, inefficiencies and abuses have crept into the administration of the program. In a March 1972 sample of cases, it was revealed that *of every 100 welfare cases being paid:*

- 7 should not have been receiving *any* benefits.
- 14 were being overpaid; and
- 8 were being underpaid.

It is unreasonable to expect taxpayers at any level of government to tolerate this situation, which not only means wasted tax money, but further loss of public confidence in the welfare system and in government's ability to function in the interest of all the people.

ACTION

Steps are being taken to simplify the present Federal regulations to make it as easy as possible for States and localities to administer the program fairly and efficiently.

Incentives are being provided for States to clean up the caseload, eliminating ineligible recipients and overpayments.

The Administration is determined that the Federal taxpayer will not be asked to carry this unjustified burden.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

50. "TEMPORARILY SUSPEND NEW COMMITMENTS UNDER HOUSING SUBSIDY PROGRAMS"

DIRECT SUBSIDY HOUSING PROGRAMS

BACKGROUND

Four major HUD programs provide in-kind Federal housing assistance for lower income families: Low-rent Public Housing; Rent Supplement; Home-ownership Assistance (Section 235); and Rental Housing Assistance (Section 236).

Commitments now outstanding are expected to cost the Federal taxpayer in the range of \$57 billion to \$82 billion in direct subsidy payments over the life of the projects as well as additional sums for tax subsidies.

Program deficiencies

1. The programs have not produced results commensurate with the costs to the taxpayer. Instead, the programs have:
 - Provided a fortunate few with new housing while comparable families pay more for unsubsidized housing that is not new;
 - Placed some families in homes which they cannot afford to maintain;
 - Provided inordinate financial gains for intermediaries who are not poor;
 - Inflated the cost of housing;
 - Had limited effect on National housing production and housing substandardness both of which have been most responsive to monetary and fiscal policies.
2. Additional tax dollars cannot be committed to ineffective programs which impose a heavy burden on future budgets; if continued without suspension, new production commitments in 1973 and 1974 would have obligated the Federal Government to an additional \$15 to \$27 billion over the next 40 years.

ACTION

New commitments for subsidized housing production were suspended effective January 5, pending the reevaluation of these programs. The President's Budget assumes the suspension will continue for 18 months through FY 1974.

Existing commitments under these programs will be honored and Public Housing Operating Subsidies will be provided under the terms of the interim policy announced by HUD on December 1, 1972. These commitments will sustain HUD subsidized housing production at approximately a 250,000 annual rate through FY 1974.

The Federal Government will continue to assist low- and moderate-income families to satisfy their housing needs by insuring low downpayment mortgages and enforcing laws against discrimination in housing.

NON-PROFIT SPONSOR ASSISTANCE

BACKGROUND

This two-part program provides loans and grants to assist non-profit sponsors of subsidized housing constructed under HUD housing programs. Under the loan program (Section 106(b)), interest free loans are provided from a revolving fund to cover preconstruction expenses which are repaid from proceeds of the HUD insured mortgage. The \$1 million annual grant program (Section 106(a)) was first funded by Congress in 1972.

Program deficiencies

1. *Grants.*—The program is an ineffective and unnecessary use of Federal dollars to provide assistance that is already available from a number of State governments and private organizations.
2. *Loans.*—Suspension is consistent with the suspension of additional subsidized housing commitments. This action will permit reevaluation of the Federal responsibility for assisting non-profit sponsors.

ACTION

Grants.—Terminated the grant program effective June 30, 1972.

Loans.—Suspended additional loan commitments effective January 5, 1973, pending the reevaluation of the direct subsidy housing programs which are also suspended.

COLLEGE HOUSING PROGRAM ¹

BACKGROUND

This program provides long term interest subsidy grants to colleges and universities to help finance the construction of housing, student unions and related facilities. If a college is unable to borrow on reasonable terms in the private market, HUD will lend Federal funds directly to the college at 3%. Since inception in 1950, approximately 40% (900,000 units) of all existing campus residential space has been financed through this program. In 1973, congressional action reduced the program level from \$300 to \$250 million.

¹ This program was included in this category even though it will be terminated.

Program deficiencies

1. *Fails to provide assistance based on need.*—This program contradicts the policy of focusing higher educational assistance on individual students based on need, as stated in the President's Education Message of 1970. The benefits are passed uniformly to assist all resident students, regardless of income. Even when available, the indirect assistance (\$100–\$200) does little to reduce the financial barrier to the education of the low-income student.

2. *Does not recognize student preferences.*—New residences are being provided at a time when students are fleeing existing dormitories because of the availability of off campus housing. (Colleges seeking forbearance for projects in default have increased from 13 projects in 1971 to 59 in 1972.)

3. *Discourages cost savings.*—By subsidizing the difference between the private market rate and 3%, the interest subsidy gives the college no incentive to seek the best possible financing terms from a lender. In fact, there may be some incentive to seek a *bad* bargain in order to qualify for a 3% direct Federal loan.

ACTION

Terminated the program on January 5, 1973.

51. "MODEL CITIES"

BACKGROUND

The Model Cities program was initiated to help a limited number of cities develop and carry out programs containing new and imaginative proposals for improving urban living conditions. Federal assistance is provided in the form of technical support, planning grants, and supplementary grants to underwrite part of the cost of local model city programs.

The program was first funded in FY 1967. By June 30, 1973, \$2.3 billion will have been provided to the cities (150 originally; 147 at present) participating in the program.

Program deficiencies

1. *Failure to achieve statutory objectives.*—

(a) The program has not produced enough "new and imaginative proposals to rebuild or revitalize large slum and blighted areas . . . (etc.) Instead, supplementary grants have tended to support fairly conventional types of activities, lacking any "demonstration" value.

(b) The program has not had a significant enough impact on social and economic problems and has not done enough "to improve living conditions for the people who live in [Model City] areas" to justify continuation as a separate program.

(c) A categorical grant program involving Federal approval of individual activities in a limited area within individual cities does not promote "the most effective and economical concentration and coordination of Federal, State, and local public and private efforts to improve the quality of urban life."

2. *Leads to inequities among cities.*—Given the program's lack of success as a demonstration, it is unfair to subsidize 147 cities when nearly every city confronts similar kinds of urban problems.

3. *Fragments local community development strategies.*—A separate Model Cities program weakens comprehensive, city-wide programs aimed at promoting better community development.

4. *Undermines local responsibility.*—By requiring Federal review and approval of local plans, the Model Cities statute tends to weaken the responsibility of local officials.

ACTION

The Model Cities program will be terminated on June 30, 1973.

Participating cities may continue local Model City program activities using their own funds or, beginning July 1, 1974, using Urban community development shared revenues.

52. "URBAN RENEWAL"

BACKGROUND

The Urban Renewal program provides two-thirds (in some cases, three-fourths) grant and loan assistance to support local physical redevelopment projects, including rehabilitation, or acquisition, clearance and redevelopment of slum areas.

The program was authorized in 1949, and will have provided \$13 billion for renewal projects by the end of fiscal year 1973. The current funding level is \$1 billion plus \$450 million for disaster areas.

Program deficiencies:

1. The program has not been effective in improving urban living conditions:

Secretary George Romney has publicly described the performance of this and other HUD physical development programs as follows: "These categorical programs are no longer adequately responsive to the crisis of our central cities. We have poured billions into these programs with little result. To continue would mean throwing more billions of the taxpayers' money away. Larger infusions of money have not served to solve the problems. Something else is needed."

2. *Urban renewal grants deal only with the manifestations of social problems, not with the basic causes.*

Secretary Romney has said: "The forces that cause abandonment and the decline of large neighborhoods are *not* primarily physical, but are primarily human, social, and governmental."

3. *Urban renewal tends to drive up land prices in urban areas, thereby discouraging private investment in these areas.*

The process of land acquisition under the renewal program causes land *prices* to remain considerably higher than land *values* (as determined by appraisals).

Secretary Romney has said: "There are people who are identifying areas of coming blight and going out and picking up the property at low prices and holding it until they can sell it for urban renewal at high prices . . . I am saying that we have a totally new set of situations here as a result of programs that are operating quite differently than intended. I think the intentions are wonderful, but the results are not."

4. *Benefits are not based on need*

Physical redevelopment assistance is not tied to individual need, and much of the Federal subsidy is wasted on persons who do not need the subsidy.

A substantial part of the Federal subsidy goes to land speculators who can unload land at several times its value. In one eastern city, for example, local officials documented at least 20 instances in which the urban renewal agency purchased land at more than *double* its appraised value. Moreover, the price paid for parcels exceeded the appraised value by more than:

- 500% in *nine* instances
- 1000% in *five* instances
- 1500% in *three* instances
- 2000% in *one* instance

5. *Undermines local responsibility*

The competition for renewal funds puts a premium on developing projects which reflect the priorities of the Federal official reviewing the application rather than the community itself.

6. *Fragments local community development strategies*

By providing Federal assistance on a project-by-project basis, the program inhibits community-wide development strategies.

7. *Voluminous regulations make the program too cumbersome to deal effectively with local problems*

A participating locality must observe over 1800 pages of Federal regulations in carrying out its project. Hence much of the time and talent of local officials is directed toward staying within (or circumventing) regulations, rather than toward solving basic community problems.

ACTION

New project approvals will be discontinued after June 30, 1973. In FY 1974, \$137.5 million will be provided to close out on-going renewal projects as a prelude to terminating the program.

Beginning July 1, 1974 localities may choose to support physical redevelopment projects with funds provided under Urban Community Development Revenue Sharing.

"ALL OTHER"

53. REHABILITATION LOANS

BACKGROUND

The Rehabilitation loan program provides 3%/20 year direct loans to individual owners and tenants to promote rehabilitation of property located in urban renewal areas.

The program was initially funded in 1965, and by June 30, 1973, will have provided \$263 million in subsidized loans.

Program deficiencies

1. The program treats only the manifestations, not the causes, of neighborhood deterioration.

A 3% Federal loan for rehabilitation does nothing to correct the problems causing serviceable dwellings to require major rehabilitation in the first place. These problems, including insufficient income, inadequate public services, and crime, can quickly undo the benefits of rehabilitation.

2. *Results in an inequity to the Federal taxpayer*

Every structure will deteriorate unless it receives periodic maintenance and renovation. The rehabilitation loan program forces the average taxpayer to carry a *double burden*: he must take care of his own rehabilitation needs and subsidize the rehabilitation of 14,000 other housing units (out of a stock of 70, million!).

Well over half of these subsidized loans go to persons with incomes *above* the median in their area, including nearly 500 persons earning more than \$20,000.

Contrary to what many believe, most of the funds provided under this program do *not* finance rehabilitation up to minimum housing codes. Most of the units receiving the loans already meet these codes; the rehabilitation provides additional improvement.

3. *Negligible impact on housing conditions*

On the average, this program increased the standard housing stock by only 19 units per participating city in 1972, or just a little over 5,000 units nationwide.

4. *The program is costly to administer*

In some localities, overhead or administrative expenses have accounted for 50% of program costs.

5. *The program is ripe for abuses*

Major scandals under the program have been uncovered in several cities.

ACTION

The program will be terminated on June 30, 1973.

Beginning July 1, 1974, localities may choose to support the rehabilitation of properties using funds provided under Urban Community Development Revenue Sharing.

FEDERALLY ASSISTED CODE ENFORCEMENT GRANTS

BACKGROUND

Code Enforcement grants are provided under HUD's Urban Renewal program. These grants cover two-thirds (in some cases, three-fourths) of eligible costs, including salaries of local code enforcers, other administrative costs, and public improvements. The program also fully funds grants for rehabilitation.

The program was originally funded in 1966, and has provided \$345 million for the enforcement of local codes.

*Program deficiencies:*1. *Not an appropriate use of scarce Federal tax dollars*

The Federal Government does not set housing codes. These codes are developed *locally*, promulgated *locally*, and enforced for the benefit of the individual community's residents. Housing codes are no different from other municipal ordinances, such as local traffic codes. Federal categorical funding is inconsistent with the local nature of these codes.

2. *Results in an inequity to the Federal taxpayer*

Since *all* localities have an equal obligation to enforce local codes governing housing, it is unfair to require taxpayers in all 18,000 municipalities to subsidize the enforcement of codes in 157 fortunate cities.

3. *The Federal code enforcement program has been misused*

The General Accounting Office has uncovered a number of deficiencies in the results achieved by federally aided code enforcement.

4. *Distorts local priorities and fragments community development strategies*

Providing a subsidy for code enforcement within specified project areas approved by Federal officials makes it difficult for cities to undertake a comprehensive, city-wide code program, or to devote Federal aid to where it is needed most.

ACTION

The program was terminated on June 30, 1972.

Under Urban Community Development Revenue Sharing, localities will have the option of supporting local code enforcement activities, beginning on July 1, 1974.

GRANTS FOR NEIGHBORHOOD FACILITIES

BACKGROUND

The Neighborhood facilities program supports the *construction* of multipurpose neighborhood centers with grants for two-thirds of eligible project development costs.

The program was initially funded in 1966, and will have supplied \$254 million for neighborhood centers by the end of 1973.

Program deficiencies:

1. *Low priority use of scarce Federal tax dollars.*

As its name implies, the neighborhood facilities program primarily benefits those persons in the immediate vicinity of the assisted project—usually persons within a single jurisdiction. Hence, localities have all the necessary incentives to provide these facilities; Federal inducements are not necessary or appropriate.

2. *Fragments local development strategies and distorts local priorities.*

The Neighborhood facilities program fragments local community development strategies and distorts local priorities by providing assistance on narrowly-circumscribed, project-by-project bases.

3. *Failure to achieve statutory objectives.*

Many facilities have not been used to carry out "a program of health, recreational, social or similar community service," as documented by the General Accounting Office.

ACTION

The program will be terminated on June 30, 1973.

Localities will have the option to use Urban community development revenue sharing funds to finance neighborhood facilities, beginning July 1, 1974.

PUBLIC FACILITY LOANS

BACKGROUND

The Public Facility Loan program provides direct loans to small towns for public facilities construction when credit is not otherwise available on terms equal to those offered by HUD.

The program was initiated in 1955, and over \$650 million has been committed to date.

Program deficiencies:

1. *Helping small towns gain access to the private credit market is a natural—and very appropriate—role for the States to play; Federal financing in this area is neither necessary nor appropriate.*

States have the necessary resources—good credit ratings and the wherewithal to guarantee local borrowings—to help their political subdivisions finance public facilities. Moreover, States have a much more direct interest in and responsibility for helping these localities.

2. *This program is unfair to those States which have met their responsibilities in this area.*

To date, 50% of the loans have gone to just six States (having only 15% of the total U.S. population). There is no apparent reason why these States cannot meet their responsibilities as the other 44 States have.

3. *Direct Federal assistance discourages rational intrastate growth policies.*

The Federal Government is in no position to ration credit among small towns (80% of the borrowers have populations less than 5,000). The States should do this in conformance with State-wide growth plans.

ACTION

The Public facility loan program was terminated on January 5, 1973.

Localities will have the option to support public facilities construction with funds provided under Urban community development revenue sharing, beginning July 1, 1974.

GRANTS FOR BASIC WATER AND SEWER FACILITIES

BACKGROUND

The water and sewer grant program provides *half* the cost of constructing local water facilities and sewer lines. Waste treatment and other anti-pollution facilities are *not* eligible for support under the basic statute.

The program was initially funded in 1966, and has provided over \$1.1 billion for water and sewer facilities.

Program deficiencies:

1. *Not an appropriate use of scarce Federal dollars*

The provision of water and sewer services has always been regarded as strictly a local government responsibility—just like fire protection.

The benefits from these facilities accrue almost exclusively to those persons and businesses served by them; the average taxpayer gets no benefit from them.

Prior to 1966, water and sewer facilities were financed *entirely* with local resources as a matter of course.

2. *Federal inducements to water and sewer lines construction are not necessary*

Since benefits from water and sewer facilities are enjoyed by those persons served by the facilities, adequate incentive to provide them already exists at the local level, as any local official knows; *Federal* inducements are not needed.

This is underscored by HUD statistics showing that, of those projects rejected for funding, only 20% are dropped by the locality.

In fact, the mere presence of a Federal water and sewer grant program probably *delays* the construction of these facilities, since localities, which otherwise would finance the costs on their own, chose to wait in line for a Federal grant.

3. *Federal financing is not necessary.*

Water and sewer facilities can finance themselves through user charges just like municipal parking lots; a Federal subsidy is not necessary.

In fact, the International City Management Association has found that, nation-wide, sewer systems *yield a profit* to the municipalities operating them.

4. *The Federal subsidy is an ineffective means of helping the poor.*

A federally aided water or sewer system provides equal benefits to *all* persons served by it—rich and poor alike; hence, part of the benefits goes to persons who do not warrant Federal subsidy.

5. *The program is unfair to the taxpayer.*

The average taxpayer must carry a double burden: not only must he pay his share of the water and sewer facilities serving his own needs; he must also pay part of the cost—through his Federal taxes—of someone else's facilities.

ACTION

The water and sewer grant program was terminated on January 5, 1973.

Under Urban community development revenue sharing localities will have the option to support water and sewer projects, beginning July 1, 1974.

OPEN SPACE LAND PROGRAMS

BACKGROUND

The Open Space program provides grants to assist public bodies in preserving and creating open space. The program was intended to encourage the protection of lands having scenic, recreation, conservation or historic value. Grants normally cover up to 50% of total project costs. The program has been active since 1962, and will have provided nearly \$600 million for open space projects by June 30, 1973.

Program deficiencies:

1. *Distorts local priorities*

Open space is one of several community development programs which tends to distort local priorities by providing assistance on a narrow project-by-project basis.

2. *Local responsibility*

Benefits accrue primarily to residents served by the parks and should be financed from local resources including general shared revenues.

ACTION

The Open Space program was terminated on January 5, 1973. Local communities may continue to provide public open space using Urban Community Development revenue sharing funds beginning July 1, 1974.

NEW COMMUNITY ASSISTANCE GRANTS

BACKGROUND

The New Community Assistance Grants program provides grants of up to twenty percent of project costs to supplement assistance received under any one of 13 specified Federal grant programs. By June 30, 1973, \$25 million will have been made available since the program began in FY 1970.

Program deficiencies:

1. *Inequitable benefits.* Supplementary grants provide assistance to relatively well-off residents of new communities above that available to other communities. There is no reason to continue this inequitable situation.

2. *Supplementary grants not necessary.* These grants are not essential to the development of new communities facilities. Development of projects assisted under this program can continue under other Federal programs including the New Communities Fund.

ACTION

The New Community Assistance Grants program will terminate on June 30, 1973. (The New Communities Fund providing guarantee assistance will be continued.)

COMMUNITY DEVELOPMENT TRAINING AND URBAN FELLOWSHIP PROGRAMS

BACKGROUND

Community Development Training and Urban Fellowship programs provide: (1) 50% grants to States for preservice and inservice training of technical and professional people employed by State or local government or nonprofit corporations conducting community development programs; and (2) Fellowships for graduate level education of students intending to pursue careers in urban public service.

Program deficiencies:

1. *Primary program objective has been achieved in the training program.* The training program has essentially achieved its primary objective of building State training capability. Today 45 States have community development training programs, whereas when the program began in FY 1968, only a few States were organized to provide training.

2. *Minimal impact.* The fellowship program has had little impact on increasing the supply of urban professionals in public service jobs. From FY 1967 through FY 1972, only 469 students have been assisted.

3. *Low Federal priority.* Specialized training grants and fellowships are low priority uses of Federal resources when other Federal and private programs may be used to provide assistance for training and education.

ACTION

The Community Development Training and Urban Fellowship programs will terminate on June 30, 1973.

DEPARTMENT OF THE INTERIOR

54. REDUCE CONSTRUCTION ACTIVITY

BACKGROUND

Indian buildings and irrigation construction

Capacity of existing or nearly completed Indian schools is sufficient to accommodate all Indian students for the next year or two. Deferral of planning, design or construction of additional schools in order to achieve a reduction in outlays will not mean that any Indian child is denied access to a safe school.

About \$10 million of the deferred amounts was appropriated for six dormitories in Alaska which were to be constructed in conjunction with a State regional high

school plan. The State Board of Education has indicated that the regional high school plan will not be followed and that small high schools close to the homes of the students will be adopted. Therefore, construction of these dormitories has been deferred pending review of the new State plan.

During the first half of the fiscal year, the rescheduling for several projects has slipped and this will necessarily delay issuance of contracts until late in the fiscal year. A further deferment of one to two months to help achieve budgetary goals will not severely handicap the ultimate completion of these projects.

Indian roads construction

Projects selected for obligation late in FY 1973 will be those on which significant construction progress could not be accomplished due to climatic condition of the area.

Park development

The reduced level in 1973 is a temporary measure made necessary to meet overall budget targets. Most of the projects involved are also moving slowly because of delays in completing review of environmental impact statements. There are no Bicentennial projects involved in this reduction list.

ACTION

Indian buildings and irrigation construction

The 1974 budget reflects delay or deferment from FY 1973 into FY 1974 of \$31.5 million in general construction obligations. After the deferment, the FY 1973 program will be \$45 million, an increase of \$5 million over FY 1972.

Indian roads

The 1974 budget reveals a level of outlays for FY 1973 that is the same as was budgeted in FY 1973.

In FY 1973, obligations will be incurred later in the year than anticipated in September and outlays will be reduced by \$10 million from what they otherwise would have been.

In FY 1974, the obligation program is lower than it otherwise would have been to compensate for the \$10-million surge in outlays resulting from late obligations in FY 1973.

The program level of \$55 million in FY 1973 is an increase of \$16 million over the FY 1972 level.

The reduction for park development will be applied across-the-board to non-bicentennial planning and construction projects.

55. WATER RESOURCES CONSTRUCTION

BACKGROUND

Reclamation program will require \$4.5 billion to complete projects now under construction even if no other projects are started.

An increasing number of projects are experiencing delays because of environmental considerations. Most of the projects now under construction were authorized before enactment of the National Environment Policy Act of 1969.

Some projects raise questions of possible conflicts among national objectives, e.g., major Federal investments to bring additional land into agricultural production through irrigation at the same time that payments are being made to set aside presently arable land in order to stabilize farm income.

ACTION

1974 budget outlays of \$437 million for the Reclamation program represent savings of \$123 million based on program level that would have prevailed if budgetary action was not taken in 1973 and 1974 to apply reasonable constraints to program.

In order to avoid unmanageable construction backlog, projects originally scheduled to start in 1973 have been rescheduled for initiation over a 15-month period beginning in the last quarter of 1973 and no additional new Reclamation starts are budgeted for 1974.

Some delays will be incurred for projects designed to meet long range water demands for such purposes as irrigation of additional lands.

Schedules for municipal water supply and hydropower developments will generally be maintained.

56. SALINE WATER RESEARCH

BACKGROUND

The Federal desalting program has spent over \$200 million since its inception. Only a small percentage of these funds has been used for research on new processes.

The demonstration plants and modules constructed under this program have not succeeded in producing water at a cost much less than \$1 per thousand gallons. Large plants (50 to 100 times the size of any constructed) are projected to produce water at a cost of about 25 cents per thousand gallons.

Except for very few specific cases, water at these prices cannot be sold in the U.S. without heavy subsidies.

Technology of some desalting processes such as distillation has been advanced by the Federal program to the stage that private industry or users should assume such future investments to meet any market demands.

ACTION

Beginning in 1973, research and development on the distillation and brackish water membrane processes will be phased out, including shutdown of facilities for testing these processes.

The program will be directed toward research on promising processes such as seawater membranes for which technology has not been tested. Further development or construction of test facilities will be undertaken only when new processes show promise of marketability.

Budget outlays of \$13.6 million in 1974 reflect savings of \$14 million from re-direction of desalting program.

57. CONSTRAIN LAND PURCHASES

Land and Water Conservation Fund (LWCF)

BACKGROUND

The Land and Water Conservation Fund finances:

Land purchases for Federal recreation uses, national parks, wildlife refuges and forests, and

Grants to States for 50% matching of their funds for outdoor recreation development and land purchases.

In the absence of careful management of fund balances and new budget authority, outlays would sharply increase in 1974 and 1975 well above the \$300 million "full funding" program level.

ACTION

Manage new commitments and outlays to stabilize the program in future years at about the \$300-million level.

Outlays (\$ in millions):

1969	-----	122
1971	-----	193
1972	-----	184
1973	-----	230
1974	-----	240
1975	-----	300

The plan will be financed largely from unused balances of prior appropriations and therefore:

Only \$50 million in new appropriations are needed for State grants in 1974;

No new appropriations are required for Federal purchases in 1974.

Migratory Waterfowl

ACTION

Obligations and outlays will be reduced \$3 million and \$2 million respectively in 1973 for the migratory waterfowl land acquisition program. In 1974, there is no request for a Treasury advance (loan) to the Migratory Bird Conservation Fund, which will continue to be financed from sales of Federal duck stamps.

58. OUTER CONTINENTAL SHELF (OCS) ACCELERATED LEASING PROGRAM

BACKGROUND

1973—actual sale of offshore leases in December made it clear that OCS receipts in fiscal year 1973 would be \$1 billion in excess of previous expectations—thus reducing 1973 outlays by a like amount.

1974 and 1975—increase in rate of lease sales on the Outer Continental Shelf to increase domestic oil and gas production was judged a desirable course of action. 1974 budget assumes three large general sales that offer a total of about three million acres per year in 1974 and 1975.

ACTION

As a result of the analysis, receipts which offset outlays were increased about \$1 billion in 1973 and 1974 and about one-half billion in 1975 over previous estimates.

59. REDUCE OTHER COSTS

ACTION

Interior is reducing outlays for travel from appropriated level of \$52 million down to \$45 million in 1973 and \$50 million in 1974. The reduced level established for 1973 can be accomplished on a temporary basis without unduly hindering program capability. Considering Interior's widespread field operations, reduction could not be efficiently sustained over a longer period. Thus, the program level is restored by 1975.

A portion of the increased funds budgeted in FY 1973 for earthquake research is temporarily held back pending completion of a detailed program formulation study. The budget anticipates resolution of the study and resumption of the higher level of research effort in 1974.

60. JUSTICE

BACKGROUND

The Bureau of Prisons has underway a long-range construction program designed to eliminate overcrowded conditions and provide a better institutional environment for offender rehabilitation activities. This program has been slowed down to permit a review of (1) the possibility and feasibility of entering into cooperative arrangements with State correction agencies for the housing and rehabilitation of prisoners, (2) the possibility of acquiring surplus State facilities suitable for meeting Federal corrections requirements as is being done in Wisconsin, and (3) the extent to which expanded use of Bureau of Prison Community Treatment Centers may affect requirements for correctional facilities.

ACTION

In 1973, construction of two Metropolitan Correctional Centers is being deferred, and an arrangement with the State of California is being sought in place of constructing a Youth Facility in Ventura County. No funds are being requested in 1974 for construction of 3 facilities for which site and design funds are currently available. These actions reduce outlays \$8 million in 1973 and \$28 million in 1974.

DEPARTMENT OF JUSTICE

61. COMMUNITY RELATIONS SERVICE

BACKGROUND

The Community Relations Service of the Department of Justice was established by title X of the Civil Rights Act of 1964 to reduce and prevent racial tensions.

ACTION

In the coming year, at a savings of \$4.0 million, the Service will be able to discontinue its technical assistance program, which primarily aided community groups in securing Federal assistance in areas such as housing, economic development, education, and administration of justice. This savings can be realized,

without programmatic damage, due to the continued streamlining of Federal administrative processes through grant simplification and other management improvements, to the better coordination of Federal activities through Federal regional councils and decentralization of decisionmaking authority to State and local governments, and to strengthened monitoring of Federal civil rights activities by the executive branch. This responsibility for assuring that all community groups have equal opportunities to benefit from Federal assistance rests with the programmatic agencies rather than the community.

In 1974, the Service will spend \$2.6 million to reduce racial tensions. This will permit an expansion in crisis resolution and State liaison activities of 41% over 1972 levels.

62. REFORM MANPOWER TRAINING PROGRAMS ADMINISTRATIVELY TO ACCOMPLISH THE PURPOSES OF MANPOWER SPECIAL REVENUE SHARING

BACKGROUND

In 1962, the Manpower Development and Training Act was enacted with the primary purpose of alleviating the problem of skill obsolescence caused by automation. The Economic Opportunity Act of 1964 expanded the scope of manpower training to address the broader problems of chronic unemployment and poverty.

Under the authority of these acts, categorical manpower programs were instituted including Institutional Training, Neighborhood Youth Corps (In-School, Out-of-School, and Summer), Public Service Careers (including New Careers), Operation Mainstream, JOBS, JOBS Optional, and the Concentrated Employment Program. Through grants and contracts with private and public employers, these programs provide varying kinds of assistance (counseling, testing, training, support service, placement, and follow-up) to the unemployed and underemployed with special emphasis on the disadvantaged.

Between 1962 and 1972, about \$9 billion was expended on MDTA and EOA manpower programs. The growth of expenditures has been substantial: From \$50 million in 1963 to \$1.2 billion in 1968 to \$1.7 billion in 1972.

The effort to coordinate the vast array of discrete categorical programs has required complex and cumbersome administrative machinery. This complexity has, in itself, hampered program operations, for even where effective coordination has been achieved, the vital element of flexibility to meet changing manpower needs at the local level has suffered. Under the current system, State and local officials cannot adjust nationally established funding levels of various categorical program components, even though changing local needs may render them obsolete.

The many evaluations of manpower projects and programs have not demonstrated that they have been fully effective as presently operated.

ACTION

Manpower Revenue Sharing will be implemented, beginning in 1974, under a renewal of present authorizing legislation. Revenue Sharing will enhance the role of local officials in providing a comprehensive range of program activities and services without the restraints of nationally defined categorical programs. The Congress has indicated its support for comprehensive manpower programs at the local level in recent reports accompanying House and Senate Subcommittee appropriations bills for the Department of Labor.

Initiation of new pilot comprehensive manpower programs, advocated by the Subcommittees, will proceed in FY 1973 to pave the way of nationwide Manpower Revenue Sharing in FY 1974.

In view of the uncertainty surrounding the effectiveness of present programs, and the pending conversion to a more efficient Manpower Revenue Sharing program, and tight budgetary constraints, the President's Budget includes reduced levels of budget authority in 1973 and 1974. In order to provide a better base on which to build, reduced budget authority in 1973 will accelerate the process of weeding out poor program performances and reducing ineffective administrative mechanisms. In this way the 1974 funds can be programmed more efficiently and more funds made available for serving people and less for unproductive overhead.

Specific national funding of the Neighborhood Youth Corps Summer Program will be eliminated by allocating substantial Emergency Employment Act funds to finance summer work opportunities. This program in the past has been mainly income support and only marginally related to the central goals of manpower programs. Evaluation of the summer program has indicated short term benefits

such as reducing summer youth unemployment, but that it is ineffective in affecting such long-term goals as school dropout rates or the lifetime earnings potential of the participants. The use of EEA funds for this purpose this year should lead to creative programming for youth in developing work opportunities offering more substantive experiences in the public service. Next year, under the MRS process, elected officials will be able to capitalize on this summer's learning to structure meaningful manpower programs for youth.

63. "PHASE DOWN THE EMERGENCY EMPLOYMENT ASSISTANCE PROGRAM CONSISTENT WITH THE INCREASE IN THE NEW JOBS THE PRIVATE SECTOR"

BACKGROUND

In FY 1972 and 1973, \$2.25 billion has been available for transitional Emergency Public Employment.

When the program began in 1971:

Unemployment was around 6%.

States and localities had public service needs which they could not finance.

Now:

The annual average number of employees on non-agricultural private sector payrolls between 1970 and 1972 has increased by 1.4 million.

The unemployment rate is expected to be down to 4.5% by the end of this calendar year.

The remaining unemployed are mostly in need of assistance which this program cannot provide.

State and local fiscal situation has improved and will continue to do so with the receipt of general revenue sharing funds.

ACTION

The program will be phased out gradually through end of FY 1974, to provide time to place those employed under this program in permanent employment.

The advent of local Comprehensive Manpower Programs under Manpower Revenue Sharing during 1974 will permit those States and localities who so desire to use manpower funds for this kind of public employment. General revenue sharing funds are also available to create jobs.

64. "INCREASE EFFICIENCY OF EMPLOYMENT AND UNEMPLOYMENT INSURANCE SERVICES"

BACKGROUND

Since the enactment of the Wagner-Peyser Act of 1933 and the Social Security Act of 1935, the Federal Government has been making grants to States to support the Federal/State Unemployment Insurance and Employment Services. These grants cover 100% of the cost of the Services.

The Services operate 2300 local offices. Unemployment insurance activities include payment of unemployment compensation to private sector workers, ex-Federal employees and former servicemen. State agencies collect State Unemployment Insurance taxes from covered employers. The Employment Service provides outreach, interviewing, testing, counseling, and referral to employment or training opportunities.

Federal grants for these services has been climbing steadily: From \$405 million in 1962, to \$521 million in 1967, to \$816 million in 1972. Congressional actions contemplated grants of \$907 million in 1973.

Unemployment insurance claims are averaging 20% less than 1972 experience. A long range program to automate many unemployment insurance and employment service activities is beginning to produce personnel savings.

The existing Employment Service placement capability exceeds the present and projected placement rates. For example, in 1962 with a substantially smaller staff the Employment Service placed 4.5 million job seekers in permanent positions, (more than 3 days). In 1972, only 2.7 million workers were similarly placed although the labor force and the total number of jobs in the economy had increased.

ACTION

The revised 1973 budget request will provide \$855 million, 5% more than the 1972 program but \$52 million less than the contemplated Congressional action.

The 1974 budget request will provide \$882 million, including funds for Job

Banks which will be funded in 1973 from the Manpower Training Services appropriation at a \$25 million level.

The Department of Labor has reviewed the allocation of funds to the various States, and in some cases within States, to assure that the 1973 funds are available for processing unemployment insurance claims and other priority activities. The reviews were conducted against stringent standards.

65. "TIGHTEN THE OPERATIONS AND MANAGEMENT IN THE DEPARTMENT OF LABOR"

BACKGROUND

The Manpower Administration, the Labor-Management Services Administration, and offices reporting directly to the Secretary of Labor provided Federal administration of:

- (1) Manpower progress authorized by the Manpower Development and Training Act and the Economic Opportunity Act.
- (2) Employment and Unemployment Insurance Services.
- (3) Labor-Management Reporting and Disclosure Act.
- (4) Welfare and Pension Plan Disclosure Act.
- (5) Labor relations in the Federal Government.
- (6) Central departmental legal services, administration, and management.

Salaries and expenses appropriations for these units totaled \$142.3 million in 1972, and \$148.4 million had been requested for 1973. In addition, the supervision of the United Mine Workers' election, which was unbudgeted, would have required a supplemental of at least \$1.2 million.

Full time permanent employment in these areas totaled almost 6250 at the end of 1972 and could reach over 6500 by the end of 1973.

During the 1974 budget review, it was determined that personnel totals could be reduced by (a) elimination of detailed review and supervision of State and local manpower projects, (b) more selective and efficient handling of reports under the Labor-Management Reporting and Pension Plan Disclosure Acts, and (c) tightening up overhead operations.

ACTION

The 1973 budget request has been reduced to \$145.1 million, and \$138.1 million has been requested for 1974.

Full time permanent personnel levels are expected to be reduced to around 6000 by the end of 1974.

66. "ALLOCATE PROPER UNEMPLOYMENT BENEFIT COST TO THE POSTAL SERVICE"

BACKGROUND

Ex-Federal employees (including ex-Postal Service employees) and ex-service-men can receive unemployment benefits if they meet the eligibility requirements of State law. The Federal Government pays the State the costs of these benefits.

At the beginning of fiscal year 1972, the Postal Service were established as a self-supporting operation, except for costs which the law specifies should be paid by the Federal Government.

Despite this self-supporting principle, the Federal Government has paid the States the costs of unemployment benefits for former Postal Service employees, estimated at \$30 million in 1972 and \$29 million in 1973.

ACTION

Starting in 1974, the Postal Service will reimburse the Federal Government for unemployment benefits paid to former Postal Service employees.

Unemployment Compensation

Allocate proper unemployment benefit costs to the Postal Service

BACKGROUND

Postal Service employees are entitled by law to receive Federal unemployment compensation benefits (5 U.S.C. 8501, 39 U.S.C. 1005(f)). An estimated \$50 million of Federal funds has been paid to former Postal Service employees since July 1971 when the Postal Service became independent.

The Postal Reorganization Act provided the Postal Service with complete independence to conduct its operations within the financing limitations of mail

revenues, borrowing, and a Federal subsidy. The Act intends that eventually mail users should bear the full cost of postal operations. In view of the general thrust of the Act, it is appropriate that the Postal Service should finance the cost of unemployment compensation from mail revenues.

ACTION

The Budget provides for reimbursement by the Postal Service for unemployment compensation benefits paid to former postal employees since the Postal Service became independent. The Postal Reorganization Act authorizes changes to be made to the Postal Service budget as it is presented in the President's Budget and thus the estimated cost of \$50 million is reflected in the Postal Service chapter for 1974 (Annexed Budgets And Other Material, in the Budget Appendix).

The language of the Federal Unemployment Benefits and Allowances appropriation provides for payment by the Postal Service of an amount of unemployment compensation to be determined by the Secretary of Labor. Only the reimbursement for 1974 is reflected in the Federal Unemployment Benefits and Allowances account. Federal outlays are reduced because the reimbursement from the off-budget Postal Service Fund offsets payments to former postal employees from the account.

67. FEDERAL-AID HIGHWAY PROGRAM, 1973 OUTLAY SAVINGS OF \$100 MILLION

BACKGROUND

The Federal-aid Highway program operates with contract authority provided by the Congress in advance of an appropriation of cash to reimburse the States as work is put in place. This contract authority is usually enacted by the Congress in biennial Highway Acts. The biennial Highway Act of 1972 was not enacted by the Congress.

The States expected to receive eight categories of 1974 contract authority before January 1, 1973. When highway legislation was not passed, many States were forced to delay obligations while they reconsidered their program plan. This delay was necessary since the States had to defer projects in categories of contract authority in which they had run out and then replace these projects with projects in other categories. For example, some States replaced Interstate projects with primary or secondary highway projects.

In addition, up to nine States will be forced to defer projects in all categories until they receive additional contract authority from the Congress.

ACTION

Project delays from the lack of legislation will reduce payout requirements by approximately \$100M in FY 73 and \$83M in FY 74, but it is presently planned that the original 1973 budget program level of \$4.4 billion will be fully utilized by the States by June 30, 1973. The 1974 effect results from the long lead-time between project obligations and outlay of funds to reimburse the States.

68. DEFER COAST GUARD CONSTRUCTION, 1973 OUTLAY SAVINGS OF \$29 MILLION

BACKGROUND

Coast Guard construction and research programs are funded on a project-by-project basis. As such, while all were determined necessary, it will be possible to delay the initiation of certain lower priority projects for up to six months. Construction projects selected to be deferred will:

- Not curtail essential public services

- Be achieved without fiscal year penalties

- Or unacceptable losses in operating capabilities.

Present plans do not contemplate discontinuation of any research projects now underway which will result in future cost reductions and manpower savings; for example, automation of navigation aids.

ACTION

Present plans assume that construction and research projects selected for six months deferral to achieve outlay savings in 1973 and 1974 will be initiated in future years. All work is expected to be completed before essential services to the public would be adversely impacted.

69. RESCHEDULING FAA EQUIPMENT PURCHASES AND LONG-RANGE RESEARCH,
1973 OUTLAY SAVINGS OF \$35 MILLION

BACKGROUND

The Airport and Airway Development Act of 1970 provided for the expansion and modernization of the airway system through a ten year, \$250 million annual facilities and equipment program, and an expanded research and development program. FAA in 1973 prepared a plan to accelerate the facilities and equipment procurement program and to fund research and development at substantially above the \$50 million special allocation in the Development Act.

ACTION

Unanticipated procurement delays have resulted in some slippage in the FAA accelerated commissioning program. In addition, selected lower priority activities, such as the back-up engine generator procurements, have been delayed to meet fiscal objectives. Obligations in 1973 will exceed the \$250 million level specified in the act and in 1974 will be consistent with this amount. FAA will continue programs providing for installation of new instrument landing systems, airport towers and airport radars. Programs which are designed to reduce operating and maintenance costs will also be emphasized. No projects have been cancelled.

In the Engineering and Development program, there has been some rescheduling of lower priority and longer term research projects. For example, the discreet address beacon system program will be slipped, and the very long-range, advanced air traffic management system study, will be curtailed.

70. AIRPORT GRANTS, 1973 OUTLAY SAVINGS OF \$20 MILLION

BACKGROUND

Throughout the 1960's the airport grant program level was about \$70 million. The Airport and Airway Development Act of 1970 increased that amount fourfold (\$280 million). The 1973 budget assumed that airport projects for about \$70 million would be approved each quarter. This assumption has proved to be incorrect since environmental considerations have slowed the approval of projects. Another reason for delay is that many potential grantees held back submitting projects awaiting the outcome of pending legislation before the last Congress. This legislation would have decreased the local matching share for many communities.

ACTION

No decrease in program level of \$280 million is planned. Obligation of funds to improve airports is proceeding at the anticipated rate in the ten year plan.

71. HIGH SPEED GROUND RESEARCH AND DEVELOPMENT, 1973 OUTLAY
SAVINGS OF \$15 MILLION

BACKGROUND

The High Speed Ground Research and Development program in the Federal¹ Railroad Administration is directed toward two major objectives:

Research, development and demonstrations for conducting near-term demonstrations of improved, intercity rail passenger systems to determine the contributions that can be made to be more efficient and economical service; and

Research and development of new or advanced technology rail systems for potential use in the late 1970s or 1980s.

The major demonstrations projects involve the Metroliner, Turbotrain and funding for an Improved Passenger Train (IPT) which will be increased in 1974. The major objective of the demonstration programs are to assist AMTRAK in revitalizing rail service.

The major advanced technology projects involve tracked levitated vehicles to develop potential 1980s high speed, low polluting vehicles (electrically or magnetically propelled).

ACTION

To meet first needs first—the provision of concentrated assistance to revitalizing rail passenger service in the decade of the 1970s, the Metroliner and Turbotrain demonstrations are receiving major attention.

Non-time sensitive projects, such as the tracked levitated vehicles (whose potential application is in the 1980s), are being rephased to permit reassessment of new technological approaches to avoid unnecessary and expensive hardware development. These delays will not affect the overall objective of the advanced technology program to assess new systems for future use.

72. AMTRAK, 1973 OUTLAY SAVINGS OF \$10 MILLION

BACKGROUND

The \$10M reduction for AMTRAK in 1973 consists mainly of a \$9.1 million supplemental appropriation being held in reserve which Congress had appropriated in addition to the Administration's request.

Of the \$9.1 million supplemental appropriation, \$4.5 million was provided for the continuation of several experimental routes and the initiation of international service to Mexico and Canada. AMTRAK is providing this service within its existing resources and without the necessity to use any portion of the \$9.1 million. The remaining \$4.6 million of the \$9.1 million was for the initiation of new experimental service in Arkansas and California. This service has not been initiated since insufficient time existed for testing the market potential of the proposed routes before the termination of the two-year experimental period on June 30, 1973. Additionally, because AMTRAK and the Department of Transportation have not finalized their comprehensive route system recommendations for the March 15, 1973, Report to Congress it was difficult to assess the relationship of the new routes to an overall rail network.

ACTION

The Federal Government will provide \$103 million in 1973 and \$93 million in 1974 for operating subsidies for AMTRAK. In addition \$100 million in Federal loan guarantees are to be made available to AMTRAK in 1974 for it to achieve more economical and rider-attracting service through procurement and refurbishment of rolling stock. The \$100 million reflects an increase over prior year capital investment loan guarantees which were \$100 million total for both 1972 and 1973.

73. URBAN MASS TRANSPORTATION RESEARCH AND DEVELOPMENT, 1973 OUTLAY SAVINGS OF \$10 MILLION

BACKGROUND

Since 1970, the Urban Mass Transportation Administration (UMTA) research, development and demonstration program has increased from \$16.3 million to an authorized level of \$93.0 million in 1973. The rapid increase was predicated on the necessity to insure sufficient funding to undertake projects with both immediate and longer term assistance to the urban transit problem. While substantial progress has been made, the application of technology to the development of "new systems" has proven more difficult than anticipated—in part, because new and unanticipated technological advances have occurred to alter existing projects and in part because technology is only one segment of the broad urban transit problem.

ACTION

Since certain project target dates were not achieved and planned decision points have slipped, the mass transit R&D program in 1973 is being reduced from \$93 million in obligations to \$73 million, with a \$10 million outlay savings. The obligational deferred savings will be used in 1974.

74. REPHASE INTERMODAL RESEARCH AND DEVELOPMENT, 1973 OUTLAY SAVINGS OF \$10 MILLION

BACKGROUND

Intermodal R&D and policy analyses are conducted by the Office of the Secretary of Transportation to facilitate long-range departmental planning and to provide options for R&D to be subsequently conducted by modal administrations or the transportation industry. Shifting workload demands and delays in initiating certain contractual activities have occurred during fiscal 1973. This situation combined with the availability of some fiscal 1972 funds carried over into fiscal 1973 have reduced current funding requirements. In addition, some longer range work of a non-time sensitive nature can be deferred for accomplishment at a later date.

ACTION

Funds originally intended for obligation during the second half of fiscal 1973 are being deferred and will be applied to comparable program activities in fiscal 1974. Interruption of on-going activities is being held to a minimum. The areas affected in fiscal 1973 include policy studies, contracts with universities on interdisciplinary transportation problems, deferral of contract initiation on fundamental analysis of the causes of jet engine and surface vehicle noise, and the development of statistical information on transportation.

75. EFFICIENCIES IN COAST GUARD OPERATIONS, 1973 OUTLAY SAVINGS OF \$28 MILLION

BACKGROUND

The Department of Transportation and Coast Guard have been continuously evaluating various Coast Guard programs to insure that current programs are essential and are managed efficiently and economically. Based on established Coast Guard standards (e.g., optimum station locations, workload) for evaluating the overall Search and Rescue system, it was determined that:

Selected Search and Rescue (SAR) units where workload and risk factor is low or where the workload could be handled efficiently and economically by adjoining or adjacent units could be terminated.

With the improvements of aircraft design (e.g., communication and navigational aid) and the advancements and developments of satellites and buoys, a decision was made to:

Terminate the Ocean Station Vessel program and decommission some of the vessels (i.e., 25 years or older). Other vessels and personnel will be reassigned to high priority areas such as law enforcement for fishing treaties and environmental protection.

The Department of Transportation's National Plan for Navigation publication and the advancement of other operational long-range aids to Navigation systems provided the basis for:

Phasing out LORAN-A in areas where dual coverage exists since the system is no longer technologically capable of meetings stated and anticipated navigation requirement.

In the case of the above programs selected for termination or phase-down, normal maintenance will be deferred where safety permits.

Moreover, CG is making a concerned effort to attract and recruit veterans with needed skills in the selected reserve, therefore, eliminating the need for some of the initial and advanced training required for a new recruit. This will have a telescoping effect which will eliminate some overhead personnel, require less reservists and enhance management.

ACTION

Selected SAR units workloads will be handled by adjoining or adjacent units; Satellites and Buoys will eliminate the need for an international Ocean Station Vessel program;

Operational Long-range system such as LORAN-C and OMEGA should meet stated and anticipated Navigational requirements with minimum economic impact to current LORAN-A users while providing them longer ranged, more reliable service, eliminating in the process, undesired overlap and duplication at reduced cost to the Federal Government.

76. STRETCH OUT SST TERMINATION PAYMENTS, 1973 OUTLAY SAVINGS OF \$1 MILLION

BACKGROUND

When the supersonic transport development program was terminated in March, 1971, there were substantial financial obligations that had been incurred during the development effort. In addition, substantial costs were incurred in terminating the program. These obligations include settlement of contractor claims and reimbursement of air carrier payments. Completion of selected technology efforts that were of special benefit to the Government and private industry were also specifically authorized.

ACTION

Negotiations to settle these claims have proceeded more slowly than originally anticipated. FAA has provided revised outlay requirements, based on a reassessment of the negotiating progress. Continuing effort will be made to secure equitable settlements that fairly reflect the Federal liability.

77. INCREASE EFFICIENCY OF FAA OPERATIONS, 1973 OUTLAY SAVINGS OF \$21 MILLION

BACKGROUND

FAA operations and maintenance activities are financed by a \$1.2 billion dollar appropriation. This appropriation includes funds for the operation and maintenance of the air traffic control and navigation systems, safety regulation, airport program management, and administration and direction of the agency. In addition, funds are included for procurement of selected equipment, and certain research and development programs.

ACTION

A belt-tightening program, which is consistent with the safe and efficient operation of the national airway system, has been instituted. Reductions in anticipated new employment, contractual studies, travel and training will provide the major portion of these savings. FAA will continue, however, to expand personnel in Air Traffic Control. Other expenditures not directly affecting the operation and maintenance of the traffic control system will be curtailed with emphasis on deferral of engineering and development support contracts, overtime reductions, communication expense savings, and curtailment of aircraft rental and equipment procurement.

78. LAW ENFORCEMENT TRAINING CENTER CONSTRUCTION DELAY

BACKGROUND

Construction of a consolidated Federal Law Enforcement Training Center was authorized, and initial appropriation made, in FY 1970. Appropriations through FY 1973 will have totaled \$27 million, but only \$5.5 million in costs will have been incurred. These costs have been for planning and construction of first phase and planning and design of the main Center facilities. Further construction of the Center is being delayed pending final resolution of sewage treatment problems. Prince Georges County officials have expressed concern over the environmental impact of the Center. As part of its general embargo on new sewage tie-ins, the Washington Suburban Sanitary Commission has withdrawn its approval of a sewage hookup for the Center to its Parkland treatment plant. The Center's present facilities, used only by the Secret Service, are tied to a Department of Agriculture sewage treatment plant, which needs to be expanded if the completed Center is to use it. Further construction at the Center is being deferred until a sewage connection is assured.

ACTION

Delay further construction, which will reduce planned outlays by \$1.0 million in FY 1973 and \$11.5 million in FY 1974.

79. TREASURY, REDUCTION OF PERSONNEL, TRAVEL, AND RELATED COSTS

BACKGROUND

Review of original estimates for travel, communications and equipment in the U.S. Secret Service for FY 1973 indicated that outlays for these purposes could be reduced by \$2.2 million.

Simplifying the control of legal liquor in the Bureau of Alcohol, Tobacco and Firearms by relying to a greater extent on frequent inspections rather than on-site supervision reduced outlays in FY 1973 by \$1.0 millions. This change, along with the decreasing production of illegal liquor and the elimination of the expansion of the firearms and explosives program, has allowed reductions of \$8.6 million in FY 1974.

ACTION

Reduction in outlays for Alcohol, Tobacco and Firearms of \$1.0 million in FY 1973, and \$8.6 million in FY 1974 and 1975; reduction of 702 in positions.

Reduction in outlays in U.S. Secret Service of \$2.2 million in FY 1973.

80. PLOWSHARE PROGRAM REDUCTIONS

BACKGROUND

The Plowshare (civilian applications of nuclear explosives) program has recently concentrated on the development of an underground nuclear explosive technology principally to recover natural gas from tight geological formations.

Two cooperative gas stimulation experiments have been conducted and another is planned for the spring of 1973.

The practical development of this technology, which would require thousands of individual explosions, requires additional study of major problem areas, particularly environmental (radioactivity and ground motion) and economic considerations.

AEC has also explored the feasibility of using underground nuclear explosives for the recovery of other natural resources. Further examination of promising applications will be made on a limited basis.

ACTION

Savings of \$2.7 M for gas stimulation activities reflects a postponement of the testing and a slowdown in the development of an advanced nuclear explosive system while environmental economic considerations are further studied. Some device design and engineering work will be continued, but at reduced levels.

AEC will not initiate a program to recover and use geothermal energy via underground nuclear explosives. FY 1973 savings are \$.5 M.

Actions have been taken so that these savings will be accomplished in FY 1973.

81. SPACE PROGRAM REDUCTIONS

BACKGROUND

AEC's space nuclear programs support NASA and DOD missions and comprise two development programs:

Space electric power systems ("SNAP" units for on-board needs).

Space propulsion systems ("nuclear rocket").

Space electric power systems using radioisotope energy sources have been developed and are now operational on a number of NASA and DOD missions. For higher electric power requirements, AEC has been developing systems powered by nuclear reactors.

Development of a nuclear rocket propulsion system was recently reoriented to a technology effort while NASA conducted advanced propulsion systems studies.

ACTION

Because future missions requiring either space electric power reactor systems or nuclear rockets are in the very distant future, these programs are being terminated in FY 1973 and are expected to result in savings of \$1.9 M and \$4.0 M, respectively. The space electric power radioisotope systems program will continue.

82. MISCELLANEOUS PROGRAM REDUCTIONS

BACKGROUND

FY 1973 savings are possible in four major AEC programs:

Nuclear materials production

Nuclear weapons development, testing, and production

Civilian reactor development

Basic and applied research

Nuclear materials program savings are due to increased operating efficiencies and to waste management planning modifications.

Weapons program savings reflect changes in operating plans resulting from FY 1974 budget decisions and increased operating efficiencies.

Civilian reactor development reductions are from the deferral of some lower priority projects and from the need to develop plans for advanced reactor programs.

Research program savings are due to the early phasedown of some lower priority accelerator activities reflecting FY 1974 budget decisions and to increased operating efficiencies in the controlled thermonuclear fusion and biomedical and environmental research programs.

ACTION

AEC is now taking action to accomplish FY 1973 savings in these areas, as follows:

	Millions
Nuclear materials production.....	\$5
Nuclear weapons.....	10
Civilian reactor development.....	5
Basic and applied research.....	5
Total.....	25

83. REDUCE WORKING CAPITAL AND INVENTORY REQUIREMENTS

BACKGROUND

These reductions are made possible through more management attention and control of the working capital and inventory requirements of AEC and its contractors.

ACTION

AEC has taken action to accomplish \$56 M of savings in FY 1973.

ENVIRONMENTAL PROTECTION AGENCY

84. WATER POLLUTION CONTROL

BACKGROUND

The Federal Water Pollution Control Act Amendments of 1972 provided \$18 billion in contract authority over three years for the construction of wastewater treatment facilities. Other authorizations were provided for planning activities, broad research functions and demonstration programs, bringing aggregate authorizations to a total of \$24.6 billion.

The Amendments provided contract authority not to exceed \$5 billion in 1973 and \$6 billion in 1974. These amounts would add to inflationary tendencies in the construction industry. In addition they would cause some construction to be initiated prior to the completion of plans, resulting in inefficient applications of Federal resources, examples of which were documented by the General Accounting Office in their 1969 report on the municipal grants program.

Similar concerns existed for other programs authorized at higher levels than proposed by the Administration. In addition, the Amendments included some duplicated authorities which would detract from the coordinated implementation of the total water pollution control program.

ACTION

Within the maximum amounts, allotments of contract authority for construction grants were provided at levels of \$2 billion for 1973 and \$3 billion for 1974. At these levels, outlays for construction grants will be \$1.6 billion in fiscal year 1974, more than double the current estimate for 1973 and almost twelve times the level in 1969.

In addition, funding at levels lower than maximum authorizations for other program areas is intended to reduce the use of duplicated authorities, provide adequate time for planning and implementation, avoid windfall payments for past actions and minimize special direct and categorical grant and assistance programs.

Outlays savings indicated in the budget represent the difference between estimated outlays for current and requested appropriations and outlays which would result from allocation of the maximum contract authority and full funding of all sections of the Act.

GENERAL SERVICES ADMINISTRATION

85. PROTECTION OF PUBLIC BUILDINGS

BACKGROUND

In fiscal 1971 and 1972 the GSA protective force—for standard level guarding—was increased by more than 754 to provide added security for U.S. courthouses and other Federal buildings. This increase was occasioned by high incidents of violent activity and militant demonstrations, and was considered a short-term requirement which would be phased out as soon as conditions warranted. Since 1970 GSA standard level protection costs have increased from \$15.1 million to \$34.4 million for 1972. Even after allowing for pay increase costs, adjusted expenses have nearly doubled. During this same period average square feet decreased from 105 M in 1970 to 100 M in 1972.

Comparison of eight month period January through August (earliest available data) indicates reduced level of militant activity at Federal buildings:

	Demonstrations	Bomb threats	Evacuations	Bombings	Arson
1971.....	593	483	118	24	13
1972.....	671	284	54	13	11

While common crime, theft of employee property, etc. continues to be a problem, this should not require the same degree of intensive protection to combat incidents of violent activity. Protection programs should emphasize (a) installation of mechanized security devices, (b) mobility of manpower, (c) intelligence to permit increased coverage when trouble is anticipated at selected locations or for specific events, and (d) where economic, greater use of service contracts.

ACTION

In view of decrease in threats of violence, begin selected reduction in level of protection and improve efficiency in protection services by use of increased mobility, service contracts where more economic, and selected emphasis on security devices.

86. SUPPLY WAREHOUSING

BACKGROUND

About 75% (\$1.2 B) of GSA supply procurement is through direct shipment from vendor to agencies. The remaining 25% (\$0.5 B) of sales are distributed through GSA system of 25 warehouses. The warehouse system has a total annual overall economic cost of about \$140 million, which includes \$75 million budgeted cost and \$65 million in other economic costs for investment in warehouses and inventories. Inventories available for issue were \$168 million on June 30, 1972, with an average stock-turn ratio for the year of 2.6 compared to average goal of three inventory replacements per year. Based on sales forecast of \$490 million per year (before adjustments for shifts in method of supply), inventories could drop to about \$163 million thus reducing requirement for supply replenishment.

A recent OMB sample test of 200 supply items, considering total Government resources including capital investment and indirect economic costs such local property taxes foregone, indicates a substantial number of items should be shifted out of the warehouse sales program. Items (including some special support goods for DOD and other agencies) should be supplied by direct shipment arrangements.

ACTION

Improve ratio of warehouse sales to supply inventory, shift a large number of items to a direct shipment method of procurement, and critically examine requirements for maintaining special support items which—for reasons other than cost—have been warehoused over the years even though economic analysis indicates other means of supply should be used. Total inventory levels of \$228 million for 1973 and \$203 million for 1974 would lead to outlay reductions of \$15 million and \$25 million respectively. Actions consistent with findings of Commission on Government Procurement.

87. ADP FUND EQUIPMENT PURCHASES

BACKGROUND

One of the major functions of the ADP Fund is to purchase computers and lease them to other agencies. The Fund is used primarily to purchase equipment when manufacturers offer special opportunity buys and agencies do not have available funds to make purchases of needed equipment. When GSA purchases the equipment it is then leased to various agencies over a period of years. Present ADP equipment in this Fund is valued at about \$16 million of which \$11 million was purchased in 1972.

The Fund assets for 1972, including GSA's own equipment, consist of about \$50 million—including a \$20 million 1971 supplemental appropriation. The \$20 million was planned primarily for opportunity purchases of IRS equipment, most of which was later purchased directly by IRS. Thus, these and other balances are still available for other opportunity buys. However, there are several factors which warrant a program re-examination and reduced levels of new computer procurements at this time:

OMB is undertaking a government-wide review of ADP activities based on an indication that (a) there are further opportunities for improving the utilization of the current Federal inventory of about 5,800 computer systems operated at an annual cost of over \$2.4 billion, and (b) a more stringent review of new acquisitions should be required.

Policy guidelines in Circular A-54 concerning the most economical method of ADP procurement (lease vs. purchase) is being re-evaluated in light of other OMB guidelines for making capital investment decisions.

GSA is proposing legislation permitting development and implementation of a firm term multi-year leasing program. Upon enactment of such legislation, program proposals will need to be developed.

Recent OMB policy clarification requires agencies to provide for opportunity buys by first reprogramming funds from within their own appropriations wherever possible. Program agencies should bear the primary financial responsibility for realizing computer savings and increasing the efficiency of their own resources. (In the past, about 50% of the opportunity buys in the GSA fund have been for defense agencies.)

ACTION

In view of above considerations, GSA obligations for purchase of ADP equipment has been reduced to \$3.0 million for 1973 and \$1.4 million for 1974 compared to \$10 million and \$20 million respectively which otherwise could have been expected. Resultant outlay reductions are \$7 million for 1973 and \$9 million for 1974.

88. SPACE SHUTTLE, 1973 OUTLAY SAVINGS OF \$18 MILLION

BACKGROUND

Because it will reduce the cost of space operations in the 1980's, the Space Shuttle transportation system remains the key to the U.S. future in space.

However, a relatively slight delay in the development of the Shuttle was considered acceptable so that the Shuttle would not require an inordinate share of available resources in FY 1973 and FY 1974.

The reduced level of funding for the Shuttle will permit a more orderly buildup in manpower and spending levels.

ACTION

Slow down the manpower and spending buildup on the Space Shuttle with a resulting delay of about nine months in the Shuttle's first manned orbital flight (to late CY 1978).

89. OTHER MANNED SPACE FLIGHT PROGRAMS, 1973 OUTLAY SAVINGS OF \$93 MILLION

BACKGROUND

The number of support contractor personnel at NASA's Manned Space Flight Centers can be reduced because of the scheduled phasedown in manned space flight activity following the completion of Apollo and the launch of the Skylab experimental space station. After the launch of Skylab in CY 1973, the only other manned flight until the Shuttle is developed (late CY 1978) will be a rendezvous and docking mission with the Soviets in CY 1975.

NASA spending on advanced development projects not related to near-term missions or not required until the Shuttle becomes operational can be reduced.

NASA research on the sortie laboratory can be reduced because the Europeans plan to fund development.

Research on a reusable space tug can be reduced because, with little modification, existing stages such as Agena and Centaur could be used as expendable upper stages.

Research on Life Sciences can be decreased because potential long-duration space missions (such as required by a space station) have been deferred in current planning.

ACTION

The number of support service contractor personnel has been reduced by 17% in FY 1973 and 44% in FY 1974 (relative to FY 1972 levels).

Outlays for advanced manned space flight projects and Life Sciences have been reduced by \$13 M in FY 1973 and \$19 M in FY 1974.

The outlay estimate for the Skylab experimental space station was reduced by \$16 M in FY 1973 without any direct impact on its scheduled launch date.

90. HIGH ENERGY ASTRONOMY OBSERVATORY (HEAO), 1973 OUTLAY SAVINGS OF \$7 MILLION

BACKGROUND

Although much is to be learned by observing the Universe in the high energy ranges, it is not essential to proceed at any specific pace.

Since HEAO is just now getting underway, it is possible to suspend work on this project without a great deal of wasted investment.

The two HEAO spacecraft, which were designed to conduct observations from earth orbit, are very large and expensive (development cost about \$300 M). The HEAO spacecraft is nearly five times (22,000 pounds versus 4,700 pounds) as large as NASA's largest orbiting stellar observatory (the Orbiting Astronomical Observatory—OAO).

During the period of suspension, which is expected to last at least one year, NASA will develop plans to achieve some of HEAO's higher priority objectives using less expensive spacecraft. In the interim, some high energy observations will continue with small spacecraft already in operation and under development.

ACTION

Suspend development of HEAO for a period of at least one year pending further study of lower cost alternatives.

91. APPLICATIONS TECHNOLOGY SATELLITE-G, 1973 OUTLAY SAVINGS OF \$3 MILLION

BACKGROUND

In the past NASA has been a catalyst for the development of communications satellite technology. However, a commercially viable U.S. communications satellite industry now exists.

Applications Technology Satellites F&G were planned to conduct experiments on the use of communications satellites for a variety of purposes (e.g. broadcasting educational programs to less-developed areas).

ATS-G (which would have been essentially a carbon copy of ATS-F) can be cancelled because further advances in satellite communications research and development can be accomplished by industry without Government stimulation.

ACTION

Cancel ATS-G but proceed with the launch of ATS-F in 1974. Retain a small core of in-house NASA personnel able to provide technical advice when the need arises.

92. NUCLEAR POWER AND PROPULSION, 1973 OUTLAY SAVINGS OF \$9 MILLION

BACKGROUND

Development of nuclear propulsion technology and large-scale nuclear power sources is being brought to a close because all prospective applications are in the very distant future.

The U.S. has no current plans to send men to Mars, to establish a manned lunar base, or to place large space stations and space bases in orbit. As a result, it would be premature at this time to continue nuclear technology work related to such potential long-term missions.

The near-term needs of the space program in this area are for relatively small radioisotopic power sources for approved unmanned planetary missions.

ACTION

Terminate development of nuclear propulsion technology and large-scale space nuclear power sources.

Continue development of radioisotopic power sources for approved planetary missions.

93. SHORT TAKE-OFF AND LANDING (QUESTOL) AIRCRAFT, 1973 OUTLAY SAVINGS OF \$3 MILLION

BACKGROUND

Because of uncertainties in the timing of the need for commercial STOL aircraft in the 1980's, the QUESTOL project is not required at the present time.

A study conducted by DOT has concluded that a Reduced Take-Off and Landing (RTOL) aircraft could be utilized rather than STOL aircraft to reduce airport congestion. An RTOL would require relatively little technological advance and could be developed with private funds.

DOD will proceed with development of the Advanced Medium STOL Transportation prototype which could later be modified to be a first generation civil STOL transport, if a market arises.

ACTION

Cancel the QUESTOL project.

In order to keep options open for the 1980's, continue NASA work on a quiet STOL engine and research and technology applicable to STOL aircraft.

94. OTHER NASA TECHNOLOGY AND SUPPORT, 1973 OUTLAY SAVINGS OF \$28 MILLION

BACKGROUND

In order to achieve FY 1973 outlay reductions, NASA's other programs in such areas as tracking networks, planetary, astronomy, applications, and advanced research and technology have been reduced. These reductions are consistent with the overall slowdown in the pace of the space program.

ACTION

Reduce estimates for other NASA technology and support programs by \$28 M in FY 1973.

95. NASA PERSONNEL EXPENSES, 1973 OUTLAY SAVINGS OF \$18 MILLION

BACKGROUND

Because of the scheduled phasedown in manned space flight activity and decreases in other NASA programs, the number of NASA Civil Service personnel can be reduced.

In addition, related savings in travel, administrative, and facility support expenses can be achieved consistent with the revised NASA program.

ACTION

During FY 1974, reduce NASA Civil Service personnel by 1,880 positions.

The largest personnel reduction will be achieved at Lewis Research Center (Ohio) including the closedown of the Plum Brook Station which is primarily related to the cancellation of work on large-scale space nuclear power sources (-660 positions).

Another large reduction will be applied at the Marshall Space Flight Center (Alabama) because of the completion of the Apollo program and the impending completion of the Skylab experimental space station program (-650 positions).

Consistent with NASA program decreases, other personnel reductions will be taken at Goddard Space Flight Center (Maryland) (-158 positions); NASA headquarters (-150 positions); Kennedy Space Flight Center (Florida) (-100 positions); and other centers (-162 positions).

96. "REFORM VETERANS BENEFITS ADMINISTRATIVELY TO ALIGN BENEFITS AND NEED" (VETERANS COMPENSATION)

BACKGROUND

The statutory objective of the veterans compensation program is to compensate veterans for loss or impairment of earnings ability resulting from service-connected injury. Compensation benefits are based on a statutory ten-level disability rating scale ranging from 10% disability to 100% disability. Within this scale, VA publishes a "Rating Schedule", which prescribes the percentage of impairment for a whole series of disabilities (e.g., emphysema, various psychoses, arm or leg injuries, etc.). The amount of compensation paid each veteran depends upon the percentage of earnings impairment ("disability rating") for his particular disability, determined from the Rating Schedule.

The annual volume of veterans compensation payments runs approximately at a \$3 billion level, covering veterans of conflicts since the Spanish American War and peacetime veterans.

VA studies indicate that the Rating Schedule, substantially unchanged since 1945, needs to be updated to meet its objective.

ACTION

VA will develop a new Compensation Rating Schedule, based upon data from a comprehensive study of the actual earnings impairment of compensation recipients. The new Schedule will benefit many veteran recipients by bringing compensation payments more closely in line with actual impairment of earnings and will correct inequities between recipients. While the total number of veterans on the compensation rolls will remain at about the same level, the number of Vietnam-Era veterans benefited will rise from 331 thousand to 354 thousand.

97. "RESCHEDULE CONSTRUCTION ACTIVITIES"

BACKGROUND

The VA construction program maintains, upgrades, and/or expands the VA system of 170 hospitals, 85 nursing homes, and 213 outpatient clinics. The program has been funded at \$100M to \$180M over the last three years. Prior to that, funding had been rather erratic.

The construction appropriations finance a great variety and number of projects which at any given time are in different stages of development, from planning and design through on-site construction. The projects differ greatly in purpose and size—ranging from those involving millions of dollars to those less than \$50,000; from those involving direct patient care to those ancillary projects such as medical education and research.

ACTION

Inevitably, in a program of this size, involving projects which are estimated by completion to cost almost \$1.5 billion, a tight re-evaluation of project schedules will reveal opportunities for closer tailoring of planning and execution to fit local conditions and experienced rates of unforeseen delays and "slippage."

The cited reduction in outlays is a product of improvements in agency capability to plan and monitor a large number of construction projects, taking due advantage of several decades of construction experience. The re-evaluation of project schedules conducted by VA generally will not result in elimination of projects originally estimated to be initiated in 1974; rather, the rescheduling reflects a re-assessment of timing, resulting in shifts of various project stages from one part of the fiscal year to another.

98. "RESTRUCTURE RESEARCH IN LINE WITH CURRENT NEEDS"

BACKGROUND

VA funds biomedical research in an attempt to provide new knowledge that can be used in the diagnosis, treatment, prevention, and further understanding of disease. It also uses the funds as a staff recruitment and retention device.

Outlays in the programs have increased steadily over the years from \$32M in 1964 to \$75M in 1974.

ACTION

Resources available to VA in 1973 and 1974 have been held to the levels necessary to maintain its existing research projects pending an evaluation of the VA program. This action will retain the flexibility to implement recommendations coming from such an evaluation. Although the number of projects will be held constant, outlays will increase from year to year because projects which were funded on a half-year basis in 1973 will be funded for a full year in 1974.

CIVIL SERVICE COMMISSION

99. INTERGOVERNMENTAL PERSONNEL ASSISTANCE GRANT PROGRAM

BACKGROUND

The Intergovernmental Personnel Act (P.L. 91-648, January 5, 1971) authorized, among other things, a program of grants-in-aid to State and local governments as one tool to strengthen their personnel administration capabilities. The first grants under this authority were awarded in fiscal year 1972 from a \$12.5 million appropriation. An additional \$15 million was appropriated for fiscal 1973. Now that some experience is available within the program, results should be compared with expectation to ascertain its cost-effectiveness.

ACTION

For fiscal 1974 the Budget calls for a \$5 million reduction in the appropriation for this activity (\$1 million outlay reduction) pending an evaluation of completed projects which have been funded under the program. That evaluation could lead to recommendations to terminate the program, enlarge the program, or maintain it at the minimum level recommended for 1974.

RETIREMENT FUND PAYMENTS BY POSTAL SERVICE

100. ALLOCATE PROPER RETIREMENT COSTS TO THE POSTAL SERVICE

BACKGROUND

The Civil Service Retirement and Disability Fund is owed \$285 million in installment payments required to amortize the future cost of retirement benefits provided postal employees through pay raised negotiated between the Postal Service and its unions. The Postal Reorganization Act of 1970 authorized postal employees to participate in the Civil Service Retirement program but does not require Postal Service to reimburse the Retirement Fund.

An appropriation of \$63 million was requested in the 1973 Budget to finance installment payments which had accrued due to increases in the unfunded liability of the Retirement Fund since the Postal Service became independent in 1971. However, consideration by Congress of the request was suspended without prejudice pending deliberations over H.R. 10484 which would have amended the Postal Reorganization Act to require Postal Service to fund the installment payments. H.R. 10484 was not enacted but a similar bill, H.R. 29, has been introduced in the 93rd Congress.

The Reorganization Act provides the Postal Service with complete independence from executive branch control and the ability to finance its operations almost entirely from mail revenues and borrowings. The Act intends that eventually the Postal Service should operate without Federal subsidy and that all costs should be paid by the mail users. Consistent with the principal of managerial responsibility enunciated in the Act, the cost of retirement benefits for postal employees which is determined as a result of Postal Service-employee bargaining should, as with other postal costs, be financed from mail revenues.

ACTION

The Postal Reorganization Act authorizes changes to be made to the Postal Service budget as it is presented in the President's Budget, The 1974 Budget reflects in the Postal Service chapter the cost of installment payments resulting from increases in the unfunded liability of the Retirement Fund due to postal pay raises negotiated since the Postal Service became independent.

In order to clarify the source of financing the cost of postal employees retirement benefits, the appropriation language of the Retirement Fund provides for payment of \$285 million by Postal Service to the Fund. Outlays of the Civil Service Commission are reduced by \$285 million because the reimbursement from Postal Service nets against total expenditures of the Civil Service Commission.

The outlay of \$285 million by Postal Service is not included in Federal outlay totals because postal operations in 1974 are no longer included in the Budget but are reflected instead in the Annexed section of the Budget Appendix. This treatment is consistent with the independence provided by the Postal Reorganization Act.

101. CORPORATION FOR PUBLIC BROADCASTING

Maintain previous year's level of support

BACKGROUND

The 1973 appropriation request of \$45 million for the Corporation for Public Broadcasting has yet to be enacted into law. As a result, Federal financing of the CPB has been restricted to the 1972 appropriation level of \$35 million by continuing resolution which expires February 28, 1973.

ACTION

The 1974 Budget proposes an amendment to the 1973 CPB appropriation request. The amendment would reduce the \$45 million request to \$35 million and thus provide for continuation throughout 1973 of the current level of Federal funding. This action is taken only in regard to the stringent financial conditions which affect the Federal Budget. It is neither intended nor expected to inhibit CPB activities. In fact, it might serve to stimulate CPB efforts to increase the proportion of its financing from non-Federal sources.

102. AND 103. NATIONAL SCIENCE FOUNDATION

BACKGROUND

Institutional and educational programs

Following Sputnik (1957) special Federal efforts were initiated to produce more scientists through building up the capacity and capabilities of graduate schools and through a variety of programs to encourage young people to become researchers.

The need for such special efforts is no longer evident. There is no general or projected shortage of scientists and engineers. There is adequate capacity in universities to provide for the education of new scientists and engineers of the types, numbers and skill levels required.

A recent report summarizing the findings of numerous manpower studies projects in many fields an increasing oversupply of Ph.D.'s trained for research careers, "Many will have to find positions as practitioners of science and engineering . . ." ¹ and will be overeducated for these positions.

In 1971, 229 universities granted Ph.D.'s in science as compared with only 155 institutions in 1962.

Expanded Federal support of research will continue to support graduate students particularly in the fields of primary national concern.

To the extent that future demand for scientists or engineers rises above that presently projected, the availability of jobs should act as sufficient incentive.

The Experimental R&D Incentives program

This program was initiated to explore ways to increase non-Federal investment in R&D and to improve the application of R&D results to the economy and society. Additional time is needed in 1973 to complete planning studies before experimental projects are actually funded.

¹ Wolfe, Dael and Kidd, Charles V., "The Future Market for Ph. D.'s," *Science*, Vol. 173, 27 August 1971, pp. 784-793.

The University research management grants program

This program—designed to improve the effectiveness of university management of Federal research funds—requires a more extensive planning effort in 1973 to assure the maximum return from the dollars invested.

Other selected reductions have been made, largely of a deferral nature, in light of overall fiscal constraint and availability of other resources to achieve general program objectives.

ACTION

(The savings in outlays for the National Science Foundation of \$20 million in 1973 and of \$32 million in 1974 result from the reservation of \$62 million (in obligations) from the 1973 appropriation. Because many NSF programs are forward funded, the outlay savings due to the reduction in 1973 obligations is greater in 1974 than in 1973.)

Eliminate graduate student support and defer institutional grant programs added by the Congress in the 1973 budget.

Curtail science education program during period of transition from old objective of encouraging research careers in science to new objectives related to scientific literacy of general student population.

Defer portions of the Experimental R&D incentives and the research management grants programs pending completion of program plans in 1973.

Defer construction of new oceanographic ship.

Lay-up *Ellanin* Antarctic research vessel.

104. FINANCIAL ASSISTANCE TO SMALL BUSINESSES

BACKGROUND

In developing the 1973 Budget, the Small Business Administration planned to use about \$275 million for direct loans. This would have been an increase of \$43 million over the 1972 level of \$232 million.

Prior to finalizing its loan program plans for FY 1973, it was determined that the planned increase in direct loans was not necessary. This change was due to the greatly increased participation by private lending institutions in providing loans to small businesses under a guarantee by the Small Business Administration. Therefore, it was possible to assure increased financing to small businesses, while decreasing direct Federal involvement.

The SBA had conducted a successful campaign with private lending institutions to encourage them to participate in the SBA guaranteed loan program. Over two-thirds of the Nation's banks are now participating in the SBA programs, compared with only 10% in 1968. Also, the improved economic outlook increased the willingness of private institutions to finance small businesses.

ACTION

Direct loans by SBA will total about \$225 million in 1973, rather than be expanded to \$275 million. At the same time, the value of small business loans guaranteed by SBA will increase by 45% (or \$528 million) in 1973, and by an additional 37% in 1974. Therefore, total financial assistance to small businesses under SBA loans and loan guarantees will increase by 37% in 1973 and by an additional 33% in 1974.

105. SUBVERSIVE ACTIVITIES CONTROL BOARD

BACKGROUND

The Subversive Activities Control Board was established by the Subversive Activities Control Act of 1950 to protect the national security by disclosing the names, purposes, and objectives of organizations determined to meet criteria specified by Congress. As the result of a series of unfavorable court decisions, activities of the Board have been restricted to conducting adversary hearings on organizations believed to be communist-affiliated to determine if they are indeed "communist-action," "communist-front," or "communist-infiltrated." In the past seven years only three organization cases have been referred to the Board by the Department of Justice, and the Department does not expect to refer any cases

during the next year. Last year's Congressional appropriation provided \$350,000 for FY 1973, as compared to a Presidential request of \$706,000 and a prior year appropriation of \$450,000. Furthermore, the appropriation act specified that none of the funds should be used to carry out the provisions of Executive Order 11605, which directed the Board to expand its activities by updating the Attorney General's list of subversive organizations. At present there are only two confirmed members seated on the five-man Board, as the Senate did not act in the last session on two nominations for the remaining three seats.

ACTION

Restriction of the Board's functions has led to a decision not to request funding for FY 1974. The Board has been asked to terminate its activities with the \$350,000 appropriated for the current year.

TENNESSEE VALLEY AUTHORITY

106. RESOURCE DEVELOPMENT

BACKGROUND

Completion of TVA's water resources projects is less critical than development of additional generating facilities to meet anticipated power demands in the region.

The two principal projects under construction, Tellico and Duck River projects in Tennessee, have experienced delays due to environmental considerations.

ACTION

The 1973 and 1974 savings of \$10 million and \$30 million, respectively result from water project delays due to environmental problems. Funds so saved will be available for use in future years.

1974 program level of \$380 million meets power load growth and continues regional planning and other non-power programs.

107. FEDERAL CONTRIBUTION FOR METRO TRANSIT SYSTEM CONSTRUCTION

BACKGROUND

The enactment of P.L. 92-349 provides for a Federal guarantee of METRO revenue bonds. As a result of this guaranty, the marketability of the bonds was greatly enhanced. The decision to use the bond revenues at an earlier time than originally planned allows revision of previous financial scheduling which resulted in lower Federal outlay estimates in FY 1973 and FY 1974.

ACTION

The original Federal outlay estimates were \$155M in FY 1973 and \$163.3M in FY 1974. The revised schedule requires \$75M in Federal outlays in FY 1973 and \$150M in Federal outlays in 1974. The outlay savings resulting are \$80.2M in FY 1973 and \$13.3M in FY 1974.

108. PAY RAISES FOR CIVILIAN AGENCIES

(LAST ITEM, PAGE 57 OF PART 2, 1974 BUDGET)

The total 1973 cost of the January 1973 pay raise is about \$305 million for the civilian agencies. The President directed all the large civilian agencies to seek additional economies in FY 1973 to offset (or absorb) this cost, and made the lifting of the hiring-promotion freeze for each such agency contingent on this being done.

Approximately \$280 million of the cost is expected to be offset in this way. To facilitate such absorption, general transfer authority was requested in Title II of Part III of the 1974 Budget Appendix. Full absorption for the small agencies may not be practicable, and \$25 million is budgeted to meet the unabsorbed costs.

Senator HUMPHREY. I will have to come back. I have to go vote on one of your compatriots, but I want to talk to you after voting because I don't want to leave you out.

Mr. ASH. I hope you vote right.

Senator HUMPHREY. We will be back.

Senator PROXMIRE. Mr. Ash, you have testified that you will shortly own no shares of stock in Litton or any other interest in this company. Our experience shows former corporate officials return from Government service to their old companies. So as to remove any doubts, let me say remove any doubts about your potential conflict of interest, will you give us a commitment today that you will not return to Litton when and if you leave the Government?

Mr. ASH. I am not sure such a commitment is required. I can say that I have no commitments, understandings, agreements, requests, or any other possible basis for returning to Litton, and I will conduct my Government business without any possible potential further relationship with Litton. But I do not believe it is a fair request to single out one company any more than any other company because I will be as disengaged from that company as I will be from IBM. To say that I hereby commit not to go join that company or to go back into law practice or to become a Governor of a State or to do any such thing, I think it is an unfair thing.

Senator PROXMIRE. What you say is that you have made no commitments to go back, but you will not make a commitment that you will not go back. You may go back or you may not?

Mr. ASH. I think it is an unfair request because to single out Litton is no different than singling out any other possible future employment and to preclude one's possible future employment isn't exactly a fair request.

Senator PROXMIRE. I think your position is clear.

The fact is that the defense cuts in your budget are phony cuts. Now, that's a very serious charge and I want to back it up by illustrating just how phony your defense cuts are. You claim \$650 million in outlay savings for procurement in fiscal year 1974 and \$1.3 billion in savings for fiscal year 1975. Isn't it correct that one of the weapons you are claiming reductions for is the S-3 aircraft?

Mr. ASH. I am not quarreling to your data, I am not able to find it.

Senator PROXMIRE. In fiscal year 1972, the Navy purchased 13 S-3's; in fiscal year 1973 it bought 35 S-3's; and in 1974 it is buying 45 S-3's. Procurement of this aircraft has gone up steadily in the past 2 years and it is going up substantially next year. Where's the savings? Where's the cut?

Mr. ASH. I guess of all of the people I brought along to assist I unfortunately don't have much assistance in answering that one. Can anybody join in doing so?

[The following response was subsequently supplied for the record by Mr. Ash:]

The S-3A program was reduced over \$100 million from the level that would have been funded had there not been the constraint to reduce 1973, 1974, and 1975 to the full employment expenditure level. If it were not for the \$2.7 billion military reductions, the defense budget would have been that much higher and total Federal outlays would have been in full employment deficit rather than balance.

Senator PROXMIRE. That was one of the cuts which you indicated to me earlier when I asked you to indicate the reductions you had in defense, you mentioned the S-3. Isn't it correct that Litton is one of the principal contractors for the S-3? Isn't Litton supplying the inertial navigation system for this aircraft?

Mr. ASH. I really don't know whether it is or isn't.

Senator PROXMIRE. Well, can you tell us how much Litton is being paid for its work on the S-3 and whether there have been any cost-overruns or schedule slippages on the navigation system?

Mr. ASH. First, I am not here to speak for Litton and have no right to provide Litton information.

Senator PROXMIRE. That has been in your annual statement for the last several years. You indicated you took part in writing the statement.

Mr. ASH. I have no knowledge of whether Litton has any participation in the S-3. I am afraid I must say that even if Litton did, with the many, many other things that were going on in Litton, I don't recall that particular one.

Senator PROXMIRE. Don't you read your own annual statement? If it is important enough to put it in the statement you as chief executive officer would know about it.

Mr. ASH. With 115,000 employees, Litton was doing many, many things. There were a lot of them that escaped my personal attention.

Senator PROXMIRE. Well, as I say, it is in your statement, you earlier referred to it, you singled it out. Isn't it true that almost all the so-called defense cuts are S-3 type cuts, that is reductions from the requests of the Air Force, Navy, and Army? Haven't you just trimmed the military wish list and called it a budget cut, and isn't this entirely different from the kinds of slashes that have been ordered in housing, health, manpower, and community action programs?

Mr. ASH. I am not sure the word "request" is exactly the right one. It was the program course that each had been on as a result of prior actions and prior program plans.

Senator PROXMIRE. It wasn't in last year's budget. You had 13 S-3's in 1972, 35 in 1973, and 45 in 1974, so you call that a reduction? I am sure the housing people wish they could get that kind of reduction.

Mr. ASH. In fact, housing expenditures are going up, even while these reductions are taking place. In fact, one of the interesting things about the list of reductions is that the list of social program reductions is very small. Expenditures on social programs in total, as I indicated earlier, are going up.

Senator PROXMIRE. I want to get to that because I completely disagree with you on that and I think we can prove you are plain wrong. In fact, haven't you merely decided to stretch out or defer purchases of military hardware and aren't you simply postponing expenditures that will be made in the next few years anyway? When you stretch out the procurement of a weapon doesn't this automatically increase its total cost?

Mr. ASH. It may increase its total absolute cost, it may not increase its total equivalent present value cost.

Senator PROXMIRE. Well in most cases you have had a lot of experience in this as a defense contractor. In most cases of your experience hasn't it resulted in higher cost?

Mr. ASH. There is an opportunity cost that has to be judged. In the case of the Department of Defense, certainly we could buy all of our needed armaments from now through the year 2000 today and probably at less unit price, if we guessed the right ones, and if they still were good by the time the year 2000 came.

Senator PROXMIRE. I am not talking about theory. Every single weapons systems I have seen, when they stretch them out they cost more. For example, if the S-3 is stretched out, wouldn't this increase the total cost and unit cost for the program? Doesn't that mean that the cost of Litton's work will also increase?

Mr. ASH. Sure, programs performed at a later year tend to cost more than in the present year because of the same factors that bear upon the difference between present value and future value.

Senator PROXMIRE. What kind of cut is this? The taxpayer is going to have to pay more for it.

Mr. ASH. The savings in interest payments may offset increased costs.

Senator PROXMIRE. You aren't canceling the program, you aren't ending it, killing it, you terminated community action programs and some of the other programs within community action, I should say. This is a program you are going to continue but you are going to stretch it out and it is going to cost the taxpayers more.

Mr. ASH. The present plan is to continue the program, keep the money in the Treasury to avoid paying all of that interest, and to use those interest savings to offset any cost increases that will come from inflation.

Senator PROXMIRE. In view of your connections with Litton I am frankly concerned over the conflict of interests that could occur in decisions you will be called upon to make with respect to other programs in which Litton is involved. Doesn't Litton also supply electronic systems for the B-1 bomber, the F-14 aircraft, the F-15 aircraft, and the Air Force's subsonic cruise decoy missile? Isn't Litton also the prime contractor on the Army's Tacfire system?

Mr. ASH. As of my knowledge I can identify all of those except one, but let's for the moment even include that one. Litton is one of this country's most contributing defense contractors. It also does a considerable amount of commercial work. I am sure that many decisions that I will make will bear upon Litton as well as many, many other companies. However, as I indicated to you this morning, I am so severing myself from Litton and have taken such a binding oath to this Government, that I have no relationship to Litton, any more than I have to any other company, any other activity in Government, in educational institutions, or elsewhere.

Senator PROXMIRE. Let's take one example and see how it works. There is already a major cost overrun on Tacfire. It started out to be a \$124 million program. Now it is estimated that it will cost \$206 million to complete it. We spent \$3 million on this system in fiscal year 1972, \$4 million in fiscal year 1973, and you're requesting \$41 million in fiscal year 1974. Tell us how you plan to review this program and how you intend to handle the Army's request for fiscal year 1975? How will you separate your roles as Director of OMB and former president and major stockholder of Litton? Won't it be harder for you to maintain complete objectivity when it comes to requests in which Litton has a direct interest than other kinds of budget requests?

Mr. ASH. You say I am requesting \$41 million for this coming year?

Senator PROXMIRE. Well, the administration is and you are their principal budget officer.

Mr. ASH. I have already indicated I have made sure not to know anything that bears upon Litton until I have completely had all of my shares of stock sold. I am learning this for the first time from you. Now that is my first knowledge on that subject.

Senator PROXMIRE. Then how would you plan to review this program for 1975?

Mr. ASH. As I have said before, if any matter arises where either I or the President believe that there is any possible conflict of interest, you may be assured that I will separate myself from that decision and judgment.

Senator PROXMIRE. So that your position is that up until March 9 you will have nothing to do with any Litton contract, and when you are sure your shares of stock are sold you will feel that Litton is no different than any other defense contractor.

Mr. ASH. I didn't say that. That is characterizing my statement different than it actually was.

Senator PROXMIRE. Correct me. That is why I asked the question.

Mr. ASH. I said you may be assured that if ever the President or I believe that there is a conflict of interest between any decision I might make or if my involvement in any consideration leading to a decision I might make, would have any conflict of interest, I will separate myself from that consideration.

Senator PROXMIRE. How do you make that decision if it involves Litton?

Mr. ASH. It will depend upon each issue as it comes up.

Senator PROXMIRE. This isn't very comforting for those of us who feel we are wasting a whale of a lot of money in defense contracts.

Mr. ASH. You must realize I have an oath of office to my present office. I have never in my life had any trouble being honest and being able to face any situation with complete objectivity, separate from my personal interest, and I will continue to carry out that position on any issue. There are going to be many that will involve Litton and involve every person in this country. For example, it is of very great importance to all of us that we operate with a budget of \$250 billion and not \$261 billion in 1973. Everybody will benefit from this, including Litton and every employee of Litton.

Senator PROXMIRE. Well, Mr. Ash, I think we will just have to let that statement stand on its own. Frankly, as a Senator I just couldn't accept that.

Mr. ASH. What would you have me do besides everything that I have said I would do?

Senator PROXMIRE. I would have you resign from your present position. I think it is a mistake to take somebody as deeply involved as head of a major defense contractor and put him in when that firm has so many matters that are going to be pending for years, the years when you are in this position of great power. I think that there are many other offices that you could very ably fill, but I think this particular office is not one. I don't think you should be Secretary of Defense either.

Mr. ASH. I have been a trustee of the California Institute of Technology, a major educational beneficiary, if you would call it beneficiary, of governmental funds. In fact, the Government probably has been the major beneficiary from my relationships with both Cal Tech and with Litton. I see no reason why the president of Cal Tech could not come back and once again be the Secretary of Air Force, as he was before he became president of Cal Tech.

Senator PROXMIRE. Let me get into the other area which I have indicated. I think we can have a very clear dispute that may help enlighten both of us.

The budget contains an analysis this year, as it has in previous years, of total expenditures divided into the categories of human resources, physical resources, national defense, interest, and other. This is a useful breakdown for some purposes. However, it is an awkward grouping in many ways. Human resources combines social security and retirement trust funds with discretionary expenditures for education, manpower, and so forth. Housing, which many people might instinctively think of as human resource spending, is included in the physical resource category.

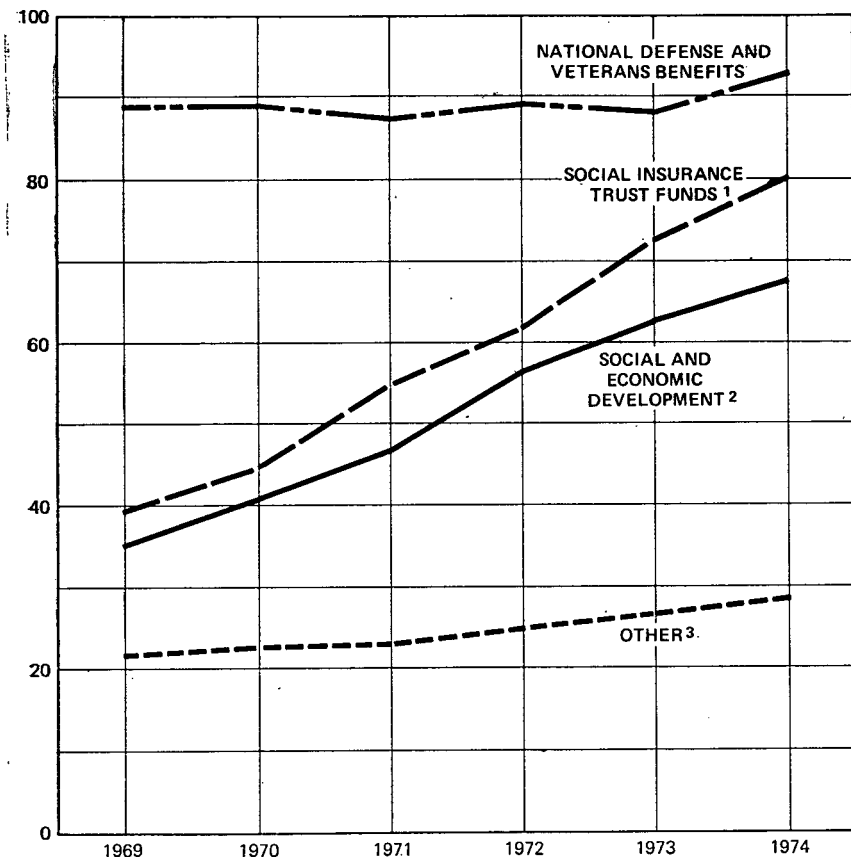
The committee staff has grouped total expenditures by a somewhat different functional breakdown. I would like to show you the chart they have made and get your reaction. This chart shows the trend over time for four categories of spending: Defense (including veterans' services), social and economic development, major trust funds (social security, Medicare, and civil service retirement), and others. Grouped this way it is apparent that defense represents the largest single category. Major trust funds are a rapidly growing category—because of increases in social security benefits. Social and economic development spending has been rising more gradually—if we put this on a per capita basis, it may not have risen at all in the last few years.

The staff has developed the numbers on which this chart is based from the budget table on spending by function. They have done a careful job, but there are a number of technical problems, such as the treatment of intergovernmental transactions, which are difficult to handle. I would like to ask you to have your staff check our computations on this, and submit any corrections you think should be made.

[The chart referred to above follows:]

BUDGET TRENDS

BILLIONS OF DOLLARS



1 - Social Insurance Trust Funds includes, Retirement, Social Security, Medicare and Unemployment benefits.

2 - Social and Economic Development includes education and manpower; health (excluding Medicare); agriculture and rural development; natural resources and environment; commerce and transportation; community development and housing; public assistance and services; general revenue sharing, and allowances for civilian pay raises and contingencies.

3 - Other includes international affairs and finance; space research and technology; interest; general government

SOURCE: Budget of the U.S. Government, 1974.

NOTE.—In view of the comments made by OMB, this chart has been amended slightly to include an allowance for civilian pay raises and contingencies in the social and economic development category. Other categories have been given names which reflect their content.

Mr. ASH. Yes, sir. May we also submit along with the validation of what I presume to be correct numerical data any comments that we feel are appropriate about the definitions that are used?

• Senator PROXMIRE. Fine.

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

Although they might be appropriate for other uses, we believe that the two main features of the groupings of budget outlays chosen by the Joint Economic Committee are not appropriate for a *functional* classification.

(1) Outlays for veterans benefits and services should not be merged with defense spending. The purposes of veterans outlays are almost entirely income security, education and manpower training, and health benefits or services for this group of beneficiaries. We believe, therefore, that they should be grouped with other outlays for income security, education and manpower training, and health.

(2) The social and economic development category should not be divided between trust fund outlays and Federal funds outlays. Distinguishing between medical care financed from Federal funds (such as Medicaid) and that financed from trust funds (such as Medicare) or between special benefits for coal miners and social security benefits serves no useful purpose in this context. In many cases, such as the ones just cited, there is—contrary to the Committee's assumption—no significant difference between these outlays insofar as controllability is concerned.

Our first preference is for the groupings that have been used in the budget for the past several years: national defense, human resources, physical resources, interest, and other. A different grouping that we would prefer to the one the Committee chose would consist of three categories: (1) National defense, international affairs and space; (2) net interest; and (3) domestic programs. Such a grouping would show the following information for the years covered in the Committee's chart.

	1969	1970	1971	1972	1973	1974
A. In billions of dollars:						
National defense, international affairs, and space research.....	89.3	87.6	84.1	85.5	82.8	88.0
Net interest.....	12.7	14.4	14.8	15.5	17.4	18.7
Domestic programs.....	82.6	94.6	112.4	130.9	149.6	161.9
Total.....	184.5	196.6	211.4	231.9	249.8	268.7
B. Percent of total:						
National defense, international affairs, and space research.....	48.4	44.6	39.8	36.9	33.2	32.8
Net interest.....	6.9	7.3	7.0	6.7	7.0	7.0
Domestic programs.....	44.8	48.1	53.2	56.5	59.9	60.3
Total.....	100.0	100.0	100.0	100.0	100.0	100.0

The marked shift in priorities that has occurred during the years shown above is obvious in table B.

TECHNICAL COMMENTS ON THE COMMITTEE'S GROUPINGS

Defense Department and veterans benefits.—The figures shown for this group are the correct sum of outlays for the national defense and veterans benefits and services functions. "National defense" is not the same as "Defense Department", so the Committee's title for this group is incorrect.

Major trust funds.—This group is the sum of the Medicare trust fund and the subfunction: retirement and social insurance. Because this subfunction includes both trust funds and Federal funds and excludes the highway and airport and airways trust funds, the title "major trust funds" is incorrect.

Social and economic development.—Because this group includes the overwhelming bulk of the nondefense budget, allowances for civilian agency pay raises and for contingencies should be included with it.

Other.—This is a residual category, which includes the interest function. Largely for this reason, intergovernmental transactions (almost 2/3's of which are interest received by trust funds) can appropriately be included here.

If the Committee wants to use a grouping of outlays for social and economic development programs, we suggest that it include in that grouping all outlays for the following functions: agriculture and rural development; natural resources and environment; commerce and transportation; community development and housing; education and manpower; health; income security; and general revenue sharing, plus the allowances for civilian agency pay raises and for contingencies. For the reasons noted above, we would not show trust funds separately, but if the Committee wanted to show them separately, its table on budget priorities should be as follows:

	1969	1970	1971	1972	1973	1974
A. In billions of dollars:						
National defense and veterans benefits.....	88.9	89.0	87.4	89.1	88.2	92.8
Social and economic development.....	74.1	85.0	101.3	118.0	135.1	147.3
Trust funds.....	(43.0)	(48.6)	(59.0)	(66.7)	(75.9)	(84.1)
Other funds.....	(31.1)	(36.4)	(42.3)	(51.3)	(59.2)	(63.2)
Other.....	21.6	22.6	22.7	24.8	26.5	28.5
Total.....	184.5	196.6	211.4	231.9	248.8	268.7
B. Percent of total:						
National defense and veterans benefits.....	48.2	45.3	41.4	38.4	35.3	34.5
Social and economic development.....	40.2	43.2	47.9	50.9	54.1	54.8
Trust funds.....	(23.3)	(24.7)	(27.9)	(28.7)	(30.4)	(31.3)
Other funds.....	(16.9)	(18.5)	(20.0)	(22.2)	(23.7)	(23.5)
Other.....	11.7	11.5	10.7	10.7	10.6	10.6
Total.....	100.0	100.0	100.0	100.0	100.0	100.0

Note: This grouping shows a marked shift in priorities away from national defense and veterans benefits to social and economic development.

Senator PROXMIRE. Would you make any comments on the fact that social and economic development is flattened out?

Mr. ASH. Mr. O'Neill, who is quite expert on the subject, I can assure can enlighten us all on that.

Mr. O'NEILL. I would like to ask a question, if I may.

Senator PROXMIRE. Yes.

Mr. O'NEILL. Did I understand you rightly, that the \$12 billion worth of veterans spending for education, medical, and pension benefits are not included in the social and economic activities?

Senator PROXMIRE. They are included in defense. We think that they are a cost of the war. We didn't include other things in the defense that are a cost such as interest and others. We did include that. The administration has always put that category of veterans into human programs, and of course, this is a matter of dispute. It could go either way. But we feel that is a better category.

Mr. O'NEILL. Well, sir, with a difference in definitions, one can probably construct a table that will show whatever you desire.

Senator PROXMIRE. That is exactly the point I am trying to make, exactly. That is just what you have done here.

Mr. O'NEILL. What we are trying to do when we show human resources spending is to show the number of dollars that are transferred from Federal taxpayers, for example, in the area of income security, from one set of taxpayers to another.

Senator PROXMIRE. What I am trying to do is develop some kind of a chart, some kind of understanding of the money that is going into high-priority human programs trying to solve the problems we have: The education problems, the poverty problems, the housing problems. We have a transfer in social security. There has been a huge increase. Congress, every election hiked it up, maybe too much. That doesn't answer what you are really doing to solve the musturgent problems of the country.

Mr. O'NEILL. Senator, the 20-percent increase that was provided for social security last year, as you may know, contributed to putting a substantial number of older people above the poverty line. In our classification of expenditures we do not distinguish between social security trust fund benefit payments and benefit payments to veterans who are poor. We think that we give a proper reflection of the kind of social priorities that are reflected in the budget.

Senator PROXMIRE. I wouldn't dispute it, you can make a strong case social security should have been increased. I voted for the increase. The Nixon administration fought it tooth and toenail. The President wanted the increase to be 5 percent. We increased it 20 percent and they say now this is what we have done on human resources. No. 1, they opposed the 20 percent interest. No. 2, it seems to me it's in a different category than trying to solve our fundamental social problems, although I would agree with you it does help to some degree, but it isn't the same as the problem I am coming to now.

Mr. Ash, there is no discussion in the budget of the problem of poverty in our society. How serious is poverty in our society, and what is the administration program to deal with it?

Mr. ASH. There is considerable discussion of poverty in the budget, and many different aspects of it are included in the reference to each of these programs.

Senator PROXMIRE. Where in the budget, what pages?

Mr. ASH. You mean are they all congregated together in one place or—

Senator PROXMIRE. Tell us one place.

Mr. ASH. Under social security. The social security payments clearly go partly to people who you would put under the definition of poverty. There is the food program. You saw the food stamp program.

Senator PROXMIRE. What I am talking about, I apologize for interrupting—what I am talking about we have a fundamental problem of poverty in our country that is getting worse, not better, and I would like to have you try and dispute that, that the poverty problem isn't getting worse in terms of more people who are poor on the basis of the Government, the administration's own definition now, than last year, and there has been a steady increase since 1969.

Mr. ASH. Mr. O'Neill has some useful information.

Mr. O'NEILL. I think when the latest statistics are available—

Senator PROXMIRE. You are the Director, Mr. Ash, and I would like to hear what you know about poverty. I think that is very important. You know a great deal about defense. What do you know about the poverty problem?

Mr. ASH. You are asking for statistical information I don't happen to have.

Senator PROXMIRE. Give me any understanding you have of the poverty problem.

Mr. ASH. That is what I was in the process of doing. The budget and particularly the charts that I brought, but did not use, show a great number of programs that are clearly aimed toward persons that would be defined as in poverty. I would have to put these charts up for further discussion this morning.

Senator PROXMIRE. I don't want the charts, what I want to know is if you know the number of people who are poor in the country. I want to know if you know how to define poverty. I want to know if you can give me responses to what you are doing about it.

Mr. ASH. On page 153 of the Special Analysis on Federal Health Programs there is a list of health care outlays for indigent persons and nonindigent persons, in 1972, 1973, and 1974, showing the dollars going for those groups of people.

Senator PROXMIRE. But not the number of people?

Mr. ASH. Dollars going to them. The Federal dollars going to indigent persons age 65 and over for health programs, including medicaid, which is clearly for those in poverty, are going up from \$9.3 billion in 1972 to \$10.2 billion in 1973 to almost \$11 billion in 1974. Outlays for children and youth are about the same in each year, and outlays for other adults, that is those 19 to 64, go up almost double. Data are also there for nonindigent persons. This is one for major program area—health. It does not include food stamps, I am sure you will agree that food stamps largely go to those we consider in poverty.

Senator PROXMIRE. You are reading the wrong line. That is for the total.

Mr. ASH. Then the indigent one.

Senator PROXMIRE. The indigent one is going down.

Mr. ASH. Health outlays for the indigent age 65 and over goes down partly because social security for those same people are going up by many times that amount by which this goes down. That is particularly the fact that pertains—

Senator PROXMIRE. I didn't realize the budget recommendations were this bad. Nonindigent persons, the nonpoor, will get an increase, \$7 billion in 1972, \$8.4 billion in 1973, \$11 billion in 1974, but indigent persons, the poor, are suffering diminution.

Mr. ASH. The number of persons classified as indigent is substantially changed by the very existence of increased social security. The number of people classified as indigent goes down as social security brings them up.

[The following supplementary note was subsequently supplied for the record by Mr. Ash:]

Table J-23, which was the subject of the preceding discussion, was incorrect as published on page 153 of the Special Analyses Volume because it did not include Medicaid. The correct figures including Medicaid are:

TABLE J-23 (REVISED).—ESTIMATED FEDERAL HEALTH CARE OUTLAYS BY POPULATION AND INCOME GROUPS
[In millions of dollars]

	1972 actual	1973 estimate	1974 estimate
Total, all recipients.....	16,677	17,507	21,163
Aged.....	11,118	11,744	12,717
Other.....	4,261	4,494	6,929
Children.....	1,298	1,269	1,517
Indigent persons, total.....	7,994	7,707	8,109
Aged.....	3,799	3,410	2,774
Other.....	3,128	3,263	4,106
Children.....	1,068	1,034	1,229
Nonindigent persons, total.....	8,681	9,800	13,054
Aged.....	7,319	8,334	9,943
Other.....	1,133	1,231	2,823
Children.....	230	235	288

Note: The number of aged indigent persons declines because thousands of them are being lifted out of poverty by the social security benefit increases and liberalizations and other Federal benefit increases. These social security increases reduced the aged low-income population by 1,200,000 persons in calendar year 1973.

Senator PROXMIRE. I wish that were the case. The fact is we have been increasing social security every year and I have the figures here and the fact is that every year since 1969 the number of poor people

in this country has increased. It was 24.2 in 1969, 25.5 in 1970, and then 25.6 in 1971. During the time when the rest of us who are better off, our incomes are going up, the poor don't seem to be sharing in the improvement in our society at all, and the reason I do this, I don't mean to embarrass you at all, the reason I am doing this is because the administration proposes to gut the poverty programs that we have.

Mr. ASH. It's not that. When you look at the data it is not that.

Senator PROXMIRE. What are you doing here?

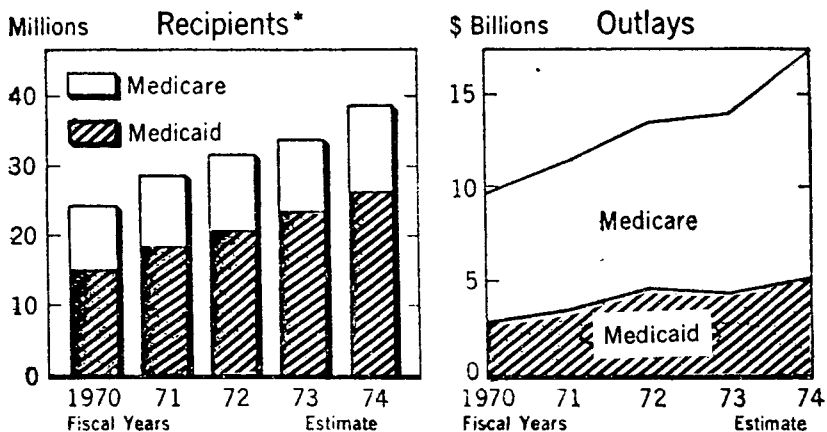
Mr. ASH. Well, again if we can get to the individual areas that I was going to comment on, food programs are substantially up. As you know, food stamps are aimed mostly at those that would be considered in poverty. I don't have the particular chart number but it is one of those that I had hoped to show.

Maybe in fact the thing to do is to refer to some of these charts to show what is happening. Here is a chart, chart 22, maybe you don't have the book, on medicare and medicaid. Medicaid recipients went from 15 million in 1970 to 27 million in 1974. Outlays went from under \$3 billion to over \$5 billion, almost double, just to pick one.

[Chart 22 follows:]

Chart 22

Medicare and Medicaid



Medicare and Medicaid provide protection against medical costs for the Nation's needy, aged, and disabled populations.

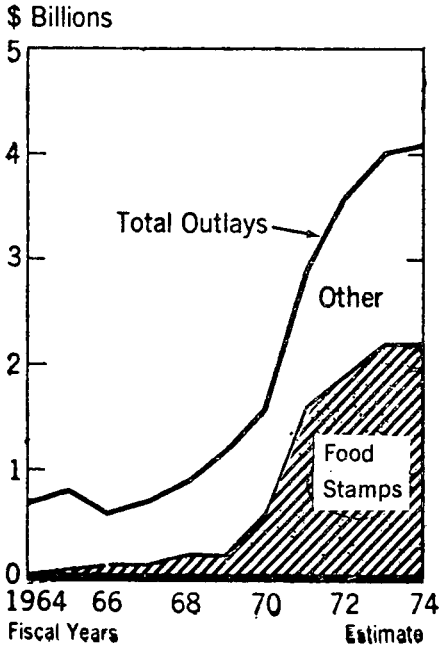
*Includes duplication because some persons receive both Medicare and Medicaid

Mr. ASH. Chart 19, on food programs, shows a very substantial increase particularly in food stamps. Outlays in 1968 for food stamps were about \$200 million, the detail is shown in the back of the chart book. In 1974, they will be \$2.2 billion.

[Chart 19 follows:]

Chart 19

Federal Outlays for Food Assistance



From 1969 to 1974:

- 200% increase in children receiving free or reduced price school lunches,
- 65% rise in areas participating in food stamp program.
- Food stamp recipients quadrupled.
- Average food stamp bonus per person more than doubled.

Senator PROXMIRE. Would you do this, Mr. Ash? Would you for the record give us for the last 3 years and including 1974, I am talking about fiscal years 1972, 1973, and 1974, all the programs for the poor and with the amounts involved so that we can have that as a matter of record and for reference?

Mr. ASH. We will certainly do that.

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

FEDERAL BENEFITS TO LOW-INCOME PERSONS

Estimated Federal outlays for benefits to the poor in FY 1974 will be \$30.3 billion. This is \$2.0 billion above the FY 1972 level. It is *very important* to note that this estimate is based on a concept which excludes Federal outlays for people who are not poor because they have received these benefits. For example, it is estimated that the social security increases enacted in 1972 will reduce the aged low-income population by 1.2 million persons in calendar year 1973. These persons will have received benefits totaling almost \$500 million. In 1959, the low-income population totaled 39.5 million; 22% of the population. By 1971, the low-income population had been reduced to 25.6 million; 12% of the population. This represents a reduction since 1959 of 13.9 million persons (35%).

Table I displays estimates of direct benefits to low-income persons through Federal expenditures and direct loan programs. The latest available demographic and program information was used to derive these estimates.

Cash payment programs are the largest single component of Federal benefits to low-income persons. These represent 43% of the total in 1974. The second largest component is health programs, primarily Medicaid and Medicare accounting for 23% of the total. The category with the greatest relative increase from 1972 and 1974 is income security/in-kind (food and housing subsidy programs). This is due to increases in housing assistance payments (for existing units) and, to a lesser extent, reflect the 1972-1973 increase in the food stamp program.

The slight 1973-1974 decrease in "Cash payments" reflects the projected decrease in the number of aged low-income persons as a result of social security increases enacted in calendar year 1972.

The 1972-1973 decrease in "Health" reflects the advance Medicaid payment for 1973, which was made to the States in June 1972, as well as Medicaid savings attributable to the Social Security Amendments of 1972 and to improved program management. Other factors influencing persons include reduced numbers of low-income persons and extension of Medicare benefits to the disabled. While all Medicare outlays will continue to rise in 1973, those recorded as spent in behalf of aged, low-income persons will decline because the number of aged-low-income was reduced.

Approximately half of the 1973-1974 decrease in "Manpower" is due to the phasing down of the Emergency Employment Assistance program. The remainder reflects the outlays decrease for Manpower Training Services.

TABLE I.—TOTAL FEDERAL BENEFITS TO LOW-INCOME PERSONS BY FUNCTIONAL PROGRAM AREAS
[Outlays in billions of dollars]

	Cash payments	Income security in kind	Education	Health	Manpower	Other	Total
1964 actual.....	6.6	0.4	0.2	0.4	0.1	0.2	7.9
1965 actual.....	6.6	.4	.2	.5	.3	.2	8.3
1966 actual.....	7.0	.4	.7	.8	.9	.5	10.2
1967 actual.....	7.1	.4	1.1	2.1	1.1	.7	12.4
1968 actual.....	7.6	.5	1.2	3.0	1.4	.9	14.7
1969 actual.....	8.2	.7	1.2	3.6	1.4	.9	16.1
1970 actual.....	8.9	1.2	1.5	4.1	1.5	1.1	18.3
1971 actual.....	11.1	2.6	1.8	4.8	1.9	1.4	23.6
1972 actual.....	12.2	3.2	2.0	6.2	2.4	2.3	28.3
1973 estimate.....	13.0	3.8	2.0	6.0	2.6	2.7	30.1
1974 request (estimate).....	12.9	4.0	2.1	6.9	2.2	2.3	30.3

Senator PROXMIRE. On February 6, I wrote you as Director of the Office of Management and Budget and I asked you this. I said:

To assist the committee in understanding the spending choices the administration has made for fiscal 1973 and 1974, additional information on the cuts listed on pages 49-57 of the budget would be valuable. In conjunction with your testimony before the committee on February 8th, I would therefore ask you to bring a written explanation of these items that is more detailed than that available in the budget. In particular, we need brief statements of: (a) Why each cut was made, and (b) the specific nature of each cut.

Do you have that material with you?

Mr. ASH. The letter was hand-delivered last night.

Senator PROXMIRE. Night before last, I am told by the people that delivered it.

Mr. ASH. I saw it last night. I don't have the information with me. It asks for a lot in almost no time. It probably overlaps with what Senator Humphrey has just requested, but certainly it is our intention to respond to your request.

Senator PROXMIRE. What I don't understand, Mr. Ash, is how can you make these cuts if that information wasn't available? It is not a matter of having to dig up something and have a lot of investigation, put somebody on it.

Mr. ASH. Absolutely, it is just a matter of compiling it, and typing and addressing it, and putting it in an envelope. That is pretty short time.

Senator PROXMIRE. You have 600 people over there, you ought to be able to get the information you have available. People responsible for recommending these reductions should have known.

Mr. ASH. They do know. It is a matter of writing it down in a way that makes sure you get all you asked for. You have asked for a special compilation. To put it together in a way that you have asked for, does require a little amount of work.

Senator PROXMIRE. How long will it take you to get that?

Mr. O'NEILL. It depends in part on how much detail you want.

Senator PROXMIRE. What was that again?

Mr. O'NEILL. It depends in part on how much detail you desire.

Senator PROXMIRE. You have got my letter and what I want is the information that you have available and just give us a response in whatever you think would be appropriate. You can Xerox the material you have got, if you can.

Mr. ASH. If it overlaps——

Senator PROXMIRE. Within a week?

Mr. ASH. If it overlaps with what Senator Humphrey asked for shall we attempt to merge the two, or would you like to have two separate even if redundant reports?

Senator PROXMIRE. Senator Humphrey asked for something I was going to ask for, specific cost-benefit studies which are required by law. I am asking for the details, not just the numbers—the details.

Mr. ASH. We will respond to both of the requests and do it.¹

Senator PROXMIRE. My last question is this: I understand in the event that Congress should make reductions in the military budget and should make reductions in foreign aid, should make reductions in some of the other areas, and then pass legislation that would require increased spending in some of the areas where you have made cuts, might you then go ahead and restore some of these reductions; is that right?

Mr. ASH. Well——

Senator PROXMIRE. I am talking about an overall reduction below the President's ceiling or President's overall ceiling. I think he is right in the ceiling. In fact he is too high. It ought to be about \$4 billion less. So my question is if we comply with the fiscal requirements here, have a responsible congressional action overall in spending, and reduce spending to \$268.7 billion or below, will you then respect congressional priorities?

Mr. ASH. Certainly the President will apply the kind of judgments that is called for by law. He will under the Anti-Deficiency Act make sure that he spends the money efficiently and will conform to the law of all kinds as he must do. This is his job and he will do so.

Senator PROXMIRE. That doesn't answer my question.

Mr. ASH. It is hard to answer a hypothetical question as to any particular program. The President as all Presidents before him, has attempted to do his very best to comply with the many and different laws he has to comply with.

¹ See Mr. Ash's response beginning on p. 198.

Senator PROXMIRE. Let me be specific, not hypothetical. The House, I think, yesterday acted on the REAP program. Say the Senate passes that program and say we also provide legislation for community action programs, the antipoverty area, and provide, say, a half billion in the two programs, then we cut \$1 billion elsewhere. Under those circumstances would the President go ahead with those two programs?

Mr. ASH. There you have posed, I think, the central question. What the Congress does is, of course, its business. If, as the President has recommended, the Congress establishes a total spending level before individual bills come before the President and he can be assured that the total of those bills will stay within that level, then I am sure he would be very gratified. If, on the other hand, an individual bill comes before him without any assurance we will have total fiscal responsibility, I will forecast a veto of those bills that are considered not appropriate for spending and would give rise to a tax increase. The President is committed to no tax increase.

Senator PROXMIRE. Would he impound funds if the Congress is within the \$268.7 billion ceiling? Will he continue to impound if we made cuts in these areas I have suggested and then restored some of the human programs that we think should proceed—will he impound funds for the human programs even if the fiscal argument evaporates?

Mr. ASH. If the fiscal argument evaporates I am sure there will be quite a different reaction. He, like all Presidents before him, has continued to reserve appropriated funds for very good and very justifiable reasons. There is no reason to believe that it won't be proper for this President to continue to do what all Presidents have done when they have had before them appropriations that they believed could not be spent lawfully and properly under the various laws that guided them.

Senator PROXMIRE. Can you give any examples at all for justification under those circumstances?

Mr. ASH. It is hypothetical. Again, there is no need of my hypothesizing one particular one, any more than trying to answer a hypothetical question of yours.

Senator PROXMIRE. Just one other question before I yield to Senator Humphrey: The President may ask for funds for North Vietnam. He may ask for funds for some other programs. Many things change in the course of a year. We always have supplementals of one kind or another. The President may decide it is a good idea to go ahead with some program. I understand you have a little black book, kind of like in Gilbert and Sullivan of programs you will cut, the heads that will roll in the event a program comes along which you would fund.

Do you have a book of this kind of priorities where you would make reductions in the event that you find that you have programs that you and the President feel are desirable and should be funded as conditions change?

Mr. ASH. I am sure your intelligence system is better than mine, I have never seen such a black book.

Senator PROXMIRE. Maybe it is blue.

Mr. ASH. I have never seen a book of any color that has such information in it. It probably would be a good idea to assess all programs at all times and to have a view of their relative priorities, but—

Senator PROXMIRE. Some members of the staff of this committee have seen that book; there is such a book.

Mr. ASH. Your system is better than mine. Should I find it?

Senator PROXMIRE. Well, I suggest you find out what it is so you can let us share in the information. The reason I asked that question, I think that—

Mr. O'NEILL. May I respond to that?

Senator PROXMIRE. You know about the book?

Mr. O'NEILL. I am Assistant Director of the Office of Management and Budget. I have been in the organization since when Senator Humphrey was Vice President down the hall from my office. I have never seen such a book.

Senator PROXMIRE. I understand the book we are talking about is one associated with the cuts you made this year. It was a book that obviously had to have in it more than just barely enough to make these cuts possible and, therefore, you have a residual list of projects.

Mr. O'NEILL. Senator, in preparing analyses for the President we certainly do put together a lot of books indicating where programs could be changed, where they could be reduced, and where they might be increased. We pool together information from the agencies of the Government, from the testimony before your committees, from the academic community, and we certainly do try to give the President some indication of priorities among those things. That is part of our responsibility.

Senator PROXMIRE. That is what I want.

Mr. O'NEILL. We try to—

Senator PROXMIRE. One, I want to know your criteria. I want to know the basis on which you are going to make the future cuts. It would help our judgment on future programs.

Mr. O'NEILL. We have agreed to supply what you have asked for for the record.

Senator PROXMIRE. Fine; very helpful.

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

A decision to reduce or eliminate funds for an existing Federal program follows from the application of several criteria, which may be summarized as follows:

Does the need which brought about the enactment of the Federal program still exist? The needs of the Nation change continually, and with them the needs for specific Federal programs. In some cases the needs are transitory, and pass; in others, Federal programs intended to fulfill a specific need become redundant when these needs are met with new, broader programs. We are continually called upon to identify and correct inequities created by providing excessive benefits to some by virtue of overlapping programs, and insufficient benefits to others because of funding limitations of the broader program.

Does the program achieve its intended goal? Many Federal programs, particularly those in the social welfare area, are essentially large-scale social experiments, for social legislation is rarely enacted which foresees fully the joint effects of the complex incentives of all the participants in these programs. As a consequence, some of the efforts simply fail to accomplish the objectives that they are intended to serve.

Is the program meeting its objectives in a reasonably efficient way? Many programs fulfill the intended objectives, but at costs that far outweigh the benefits likely to be derived from the program. In some instances, the "real" beneficiaries of the

programs are not the beneficiaries toward which the program was directed. Often, after programs have been on the books for many years, their principal beneficiaries change and are not the intended, nominal beneficiaries. Assuming equal desirability of objectives, less efficient programs are considered for elimination before more efficient ones.

These are the principal criteria which have been used in making decisions about reductions or eliminations of funds for Federal programs. In some instances, funds for programs have been reduced or eliminated because in the President's judgment the relative importance of the objective or the inefficiency of the solution places them at a point where, in light of limited resources, they seemed to rank lower than other programs. In other instances, funding has been adjusted because programs have, in the President's judgment, fulfilled needs which no longer exist or failed to fulfill their stated objectives.

Senator HUMPHREY. Mr. Ash, before we go much further, I thought you would like to know what my relationships have been basically with Budget Directors so you won't take offense to any of my questions.

When I was Vice President, Kermit Gordon was the Budget Director and after a Cabinet meeting he apparently spoke to President Johnson and said that he had the feeling that the Vice President was personally antagonistic toward him and the President called me and said: "I wish that you would have a talk with Mr. Gordon, he said he is very much concerned about your relationship with him." So I said I would be pleased to do so and Mr. Gordon was kind enough to come to my office. I think Mr. Gordon is a remarkable public servant, and as he came in to my office we sat down and sort of looked at each other for awhile and I said, "Mr. Gordon, Kermit, what is on your mind?" And he said quite honestly, "I am upset, I feel that you frankly just don't like me." I said, "Why do you feel that way?" I said, "I do like you, we need not discuss that. I have a great respect for you, I like you." He said, "It is the way you talk to me. It is the way that you converse with me. It is the things you say to me." Well, I said, "You just have to understand something. You are the Director of the Budget." I said, "I have never had a program in my life that I ever advocated in the Congress of the United States that anyone in the Bureau of the Budget ever approved. You have a negative attitude over there." And I said, "It is nothing personal, apparently it relates to the institution and the profession," So I said, "Kermit, let's get back on a good understanding. I am now the Vice President and I am supposed to love you," but I said, "As a Senator I want you to know that the programs that I proposed, I always used to get a letter back telling me they were not within the President's programs, and that is the reason for our relationship of the past."

Now I am a Senator again, Mr. Ash, and I just wanted you to know where I stand. It is not a matter of private relationship, it is public relationships that we are talking about, and I want to ask you, to follow up on Senator Proxmire, you have a budget ceiling proposed and let's get it clear, that is nothing more or less than the suggestion of the President of the United States. I don't want the President to think when he suggests something that it automatically becomes holy writ, it is not found in the old Dead Sea scrolls. The budget ceiling is a proposal; isn't that right?

Mr. ASH. That is correct.

Senator HUMPHREY. It has not been agreed to by the Congress?

Mr. ASH. It is a recommended action which is totally up to you.

Senator HUMPHREY. But it is the feeling that this is the maximum amount that we can have without an increase in taxes; is that right?

Mr. ASH. That is correct; not only the maximum amount but the right amount.

Senator HUMPHREY. Now, when he comes in for those funds for North Vietnam, because you always come in for a supplemental, not necessarily you, but its the tradition of the Government, there is no Senator around here that has ever had the experience of a full year without a supplemental. I doubt that anyway. Generally, we have one or more.

What are you going to do about the budget ceiling then, where are you going to take off that extra billion dollars or whatever else you are going to ask for the dear souls up in North Vietnam?

Mr. ASH. We believe that this budget number is the one that should not only a guide but should be adopted by the executive branch and by the Congress. It is up to you to decide, though, on your own behalf. If there is any need during the course of the year to spend any additional moneys, it is the intention of the President to look at all of the conditions and circumstances at that time and to spend those additional moneys within the ceiling that the recommended total represents.

Senator HUMPHREY. Do you have any plans that you know of, any specific plans for assistance, economic assistance to North Vietnam? Don't misunderstand me, I am not ruling it out, I want to keep an open mind on it, and I am not here to make any policy statement on my part. But, do you have any plans in the administration to offer suggestions and proposals for assistance to North Vietnam?

Mr. ASH. At this moment there is a long way between where we now stand and the prospect of such funds as you mention. There have to be discussions, negotiations, and agreements; these could well include other countries. The amounts if any, involved have yet to be determined. All of this, at this stage, is still future work and we have not yet anticipated what the outcome will be. When all that work takes place, I think it behooves us all to see where we are then, consider all of the factors that exist, and decide what is the best decision to make.

Senator HUMPHREY. You do not rule out the possibility of financial assistance to North Vietnam; is that correct?

Mr. ASH. I neither rule it out nor rule it in.

Senator HUMPHREY. Let's assume for the purposes of this budget ceiling that there is some aid to North Vietnam, which apparently from all of the chatter and talk and commentary that we hear, is possible, and again I want to say I am not sitting here to tell you that I would look with a negative attitude upon it. We will wait and see what the possibilities are, as you said what other nations do, et cetera. If that should be the case, and if \$268.7 billion is the spending ceiling, what programs are you going to reduce to accommodate the aid to North Vietnam? Who are you going to hit first?

Mr. ASH. That decision hasn't been made and probably shouldn't be made until we know more specifically when and how much expenditure, if any, would be required and what the status of all other programs are at that time.

Senator HUMPHREY. Do you feel that you will stick with the \$268.7 spending ceiling?

Mr. ASH. Yes, sir.

Senator HUMPHREY. In other words, then if additional funds come in because there is no money in this budget that is open, at least, there may be some disguised money, but as far as we are able to find out there is no money in the budget for North Vietnam, am I to understand if there is a request for funds for assistance to North Vietnam it means that it will have to come out of other programs that are included in this present budget?

Mr. ASH. That certainly is our intention and expectation precisely as you have described it.

Senator HUMPHREY. The Congress will be very interested in hearing that because there is considerable concern about the budget as it is now.

Service-funded military assistance is included in the budget, approximately 1973, according to our information from staff here. We had \$3,642,000. That included military assistance, security-supporting assistance, MAP, credit sales, et cetera. This according to what I hear from the staff is what was in the budget, there may be others, that is openly stated in the budget. How much money do you have in the budget this time for South Vietnam for service-funded military assistance?

Mr. ASH. Rather than guess, I think the best we can do is to put into the record that particular number. The data that we have, I believe, includes Southeast Asia, NATO, and other areas, so I think what we had better do is to provide for the record an answer to the particular question that you have asked.

Senator HUMPHREY. Well, we surely appreciate that.

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

Military Assistance, Service Funded for Southeast Asia is about \$2.7 billion total obligational authority in 1973 and \$1.9 billion in 1974. Military Assistance, Service Funded is just one component of the Support of Other Nations program. This program, as shown in the table on page 74 of the President's budget entitled "Summary of the Department of Defense Budget Program," includes support of NATO infrastructure, our military advisory groups, etc. The Support of Other Nations program is \$2.9 billion in 1973 and \$2.9 billion in 1974. If one then includes in the definition of Support of Other Nations, as does the Department of Defense, the Military Assistance and Foreign Military Sales programs, the total becomes \$3.8 billion for 1973 and \$4.1 billion for 1974.

Senator PROXMIRE. Did I understand it was \$2 billion last year? Do you know if it has gone up or down?

Mr. ASH. The Defense Department tends to be the source of the information in testifying on this.

Senator PROXMIRE. You are the Budget Director, this is \$2 billion.

Mr. ASH. You are asking about detail within the total and what it is for. We have been talking about definition here. The definition that we in OMB work from is a broad one and the Defense Department has more detail on those programs, as other agencies have for their programs.

Senator PROXMIRE. This is a pretty broad category, aid to South Vietnam.

Mr. ASH. I think your figure may include NATO and some other things. If we have it you can have it. If not, we will get it from the Defense Department.

Senator HUMPHREY. And as the chairman has indicated here, we are not talking about some little contribution to the Sisters, Little Sisters of the Poor, we are talking about \$2 billion, that figure or more, and I think it ought to be listed in the budget.

Mr. ASH. \$2.9 billion is the figure shown on page 74 of the budget as total obligational authority for support of other nations. As I indicated, that includes Southeast Asia plus some others besides.

Senator HUMPHREY. I think we ought to get a breakdown and we will ask for it and I am sure you will give it to us.

Mr. ASH. The MAP program is in there.

Senator PROXMIRE. It is all Southeast Asia?

Mr. ASH. Although we will get you the precise data, if you wish to carry forward from here on this subject, we can assume that the major part is Southeast Asia.

Senator HUMPHREY. I think we need that information.

Just a couple of other questions, Mr. Ash, because your position is a very important position in the Government. I considered it the second most important position in this Government and it is not one that is the private preserve of the President.

Are you held responsible for the preparation of the budget, for the overall preparation of the budget?

Mr. ASH. Yes, sir.

Senator HUMPHREY. Are you responsible for carrying out Presidential orders relating to the budget, such things as budget appropriations, impoundments, et cetera?

Mr. ASH. Yes, sir.

Senator HUMPHREY. In other words, do you do that at the President's direction?

Mr. ASH. At his direction.

Senator HUMPHREY. Do you consider this budget as having a very significant impact on the economy?

Mr. ASH. I think it is significant and I would like to think it is beneficial.

Senator HUMPHREY. You consider the budget a public document?

Mr. ASH. It certainly is a public document and we have made thousands and thousands of copies. I hope everybody has one.

Senator HUMPHREY. How would you feel about having a public document of this consequence and significance prepared more in the open before it gets to the Congress. Why is the budget process, not under your administration, any more than others, but let's talk about general budgeting practices, not open? Why does this information have to be such in-house secret? Why don't you listen to a Governor or a mayor or a legislator? Why don't you go to the field and take testimony? Why don't these distinguished men, and they are very able, I have a high regard for the personnel of the Office of Management and Budget, there is nothing personal toward any of them, I know many of them. They are competent people, but why is it that in the preparation of this document, which represents approximately a quarter of the GNP of this country, why don't you go out and have some field hearings before you come down to put this thing under the door in the middle of the night in a Senator's office?

Mr. ASH. The people in the Office of Management and Budget

solicit and get information from many, many sources, including Congressmen and Senators. In the process of putting the budget together, they attempt to synchronize all this information in a way that is meaningful for Presidential consideration.

They assimilate information of all kinds—past legislative actions, discussions, and interviews. This kind of information comes into the budget and then in turn is put forth in front of you, so that you can go from there and have even more public hearings on everything that is in it.

Senator HUMPHREY. After it comes to us?

Mr. ASH. It comes as a recommendation to you. At some point there has to be a recommendation. There is lots of discussion before the President works on the budget and makes his recommendations.

Would you suggest that the President have hearings in some formal nature in the process of doing his own deliberations?

Senator HUMPHREY. Yes; I would.

Mr. ASH. We have a system of Presidential hearings.

Senator HUMPHREY. Did you solicit information from the 50 Governors of the 50 States of this Nation as to what their needs were in terms of the Federal budget?

Mr. ASH. I am sure there was a considerable understanding of their views.

Senator HUMPHREY. I didn't ask that, I said did you solicit information?

Mr. ASH. Personally, I didn't solicit any information for this budget because I came in at a later time. I will defer to others who participated in preparing it as to how information did come to them from the Governors.

Senator HUMPHREY. I talk to a number of Governors and they apparently missed the State of Minnesota. You didn't get any information from the State of Minnesota.

Mr. O'NEILL. Every year, let me take an average case in the Department of Health, Education, and Welfare, in putting together the budget estimates for public assistance, social services, and food stamp benefits, there is a great deal of discussion with the individual State budget officers representing the Governors to see what they think the demands will be on the Federal budget in the ensuing fiscal year. This is done so that we can provide you, and the President as well, with the best possible estimates of the activities that will flow under existing and proposed statutes.

In addition, there are frequent opportunities and occasions when we meet with Governors and representatives of groups who have a special interest in how the Federal budget is put together. To give an example, this year one of the programs that we have recommended be phased down over the next 5 years is the research training program. You may have heard about this from people in your State. I personally have met with approximately 10 different groups of people to talk about that program. I asked them to supply me with information that I could pass on to the President and to you, justifying that Federal tax dollars should be used in the way that the dollars are being used in that program. Frankly, I was not able to get anything from the people who are urging that the taxpayers' dollars be spent in this way. That is an example of how we talk to people who have a basic interest in the formulation of the President's budget recommendations.

Senator HUMPHREY. When you have a budget request from the Department of Labor, you have a hearing officer, do you not?

Mr. O'NEILL. Yes, sir; we do.

Senator HUMPHREY. Do you have a hearing officer for the State legislative leaders of this country? There is an organization of legislative leaders, you have never called in those people before a hearing officer to find out what they believe as a result of their deliberations ought to go in this budget?

Mr. O'NEILL. We have an individual, as you may know, in the Office of Management and Budget who acts as a continuing liaison with the U.S. Conference of Mayors and with the National League of Cities.

Senator HUMPHREY. They don't listen to them very well, according to their last blast.

Mr. O'NEILL. I have read their document fairly carefully. I must say some parts of it are quite encouraging to me. The mayors are coming forward and saying, "Yes, we think the President's idea about urban special revenue-sharing is a good idea and one we should work on with the President and support. It is a better way to do business than the ways we have been doing in the past when the Federal Government told us that if we wanted any money for development, we had to take it from urban renewal or from some other specific categorical program." I think that they are saying that they like the mechanism for providing funds to State and local governments, which we are proposing.

I am quite encouraged by the public response to our special revenue-sharing proposals.

Senator HUMPHREY. Let me suggest as one who has been interested for some time in the whole area of budget, you could set up a much more open procedure to procure information from the field.

I know you get information from your district offices, I know you get information from regional offices, I know they try to do the best. I don't recall that you have heard from a great organization, say, like the steelworkers or U.S. Chamber of Commerce. These organizations are not called in for the purpose of testifying prior to the preparation of this budget, prior to its being sent to the Congress. In other words, I like you and I trust you to a point, but I like to see it public. This, it has been said, is a very significant document and you know you say it is only a recommendation, but every day on the radio and television and in the press the President says there is a spending ceiling, there is a spending ceiling, and without it there will be a tax increase. It becomes like law just by repeating it. Of course, here in the confines of this room Mr. Ash tells us this is but a recommendation which, of course, it is, but that isn't the way it is interpreted because the \$250 billion spending ceiling has been talked about in recent commentary as if the Congress had legislated it, which led me to this:

Do you believe the budget preparation is a joint enterprise, Mr. Ash, with the executive and the legislative branches?

Mr. ASH. Well, I think that the process is as we have just been describing it. There is lots of interaction between the Office of Management and Budget and other groups in the process of preparing the budget. There comes a point, however, when the Office of Management and Budget has to discuss the budget with the President.

Senator HUMPHREY. Yes, sir.

Mr. ASH. Those discussions, I am sure you would agree, aren't exactly a joint operation.

Senator HUMPHREY. After the President has signed off, because it is his message that comes to us, do you feel that from there on out that there is a joint operation between the Executive and legislative?

Mr. ASH. Certainly. I think that even as we are here today, now that the budget is before you, you should elicit and we should be prepared to provide you with all the information that we have on the budget.

We propose the budget and you act upon it. We should, having proposed it, stand ready to engage in whatever kind of discussions you want and to respond with whatever kind of information you need for your deliberations. This, I think, is the essence of the joint effort.

Senator HUMPHREY. Do you feel that after this exercise of give and take, so to speak, on the budget taking place between the executive and the presentation of the budget and the congressional consideration, do you consider that when the Congress has finally worked its will on the budget that that is the law of the land?

Mr. ASH. It is one of the laws of the land, which along with other laws, gives the President the guidance and direction that he must have.

Senator HUMPHREY. You also believe then that the President is required under his oath of office to faithfully execute and administer the law of the land?

Mr. ASH. He certainly is.

Senator HUMPHREY. And the budget is the law of the land when the Congress finally approves it?

Mr. ASH. The law of the land is the aggregate of all laws. Those laws sometimes aren't consistent with each other. Certainly one looks to the President to apply good judgment, on behalf of the total national interest, in his carrying out his oath.

Senator HUMPHREY. But you are not going to try to tell me that the President picks and chooses which laws he wants to abide by?

Mr. ASH. I am saying that when he is confronted with conflicting laws he is made to pick and choose. If the laws do conflict, he must be guided by the most constraining law and the most constraining law in this particular case is the debt ceiling.

Senator HUMPHREY. He could come up and make a recommendation though, could he not, for any conflict of law that he sees, to correct that conflict?

Mr. ASH. He certainly could make a recommendation if he believed it were the wise thing to do. That is up to the President to decide.

Senator HUMPHREY. Mr. Ash, I just don't want this record to go without having noted on my part that I do not believe the President of the United States is empowered with any kind of unusual Godlike wisdom that he should decide which laws we obey and which ones we shouldn't. I listened to the President the other day on amnesty. He said these young men had violated the law. Some of the young men said they didn't believe in the law, it was a bad war, so they took off. I don't happen to be a proponent of general amnesty, but I want to say if the President can say, despite whether you believe in it or not, it is the law and you have to obey the law, might I suggest he apply the same standards to himself.

Mr. ASH. He does.

Senator HUMPHREY. I haven't noticed that, particularly in reference to some of the cutoffs I have seen.

Do you have statutory responsibility, Mr. Ash?

Mr. ASH. I have only those authorities and responsibilities that have been delegated to me by the President.

Senator HUMPHREY. Oh, no. Don't you have statutory responsibilities?

Mr. ASH. The Reorganization Plan No. 2 of 1970 transferred to the President, for him to redelegate, the authorities and the responsibilities that theretofore rested in the Bureau of the Budget.

Senator HUMPHREY. Is that right. I have title 2 of the Legislative Reorganization Act of 1970, fiscal controls, budgetary and fiscal information and data; I quote:

The Secretary of the Treasury and the Director of the Office of Management and Budget in cooperation with the Comptroller General of the United States shall develop, establish, maintain insofar as practicable for use by all Federal agencies, standardize information and data processing system for budgetary and fiscal care, and section 202, Secretary of the Treasury and the Director of Office of Management and Budget shall upon request of the Committee of either House or any Joint Committee of the two Houses, the Secretary of the Treasury and Director of Office of Management, furnish to such committee or joint committee information * * *.

Are you trying to tell me that you do not have statutory responsibilities?

Mr. ASH. I probably need a lawyer alongside to answer the technicalities. I was answering as to the substance, but clearly on the technicalities I need a legal answer, which I am not ready and able to provide here.

Senator HUMPHREY. Well, now, the President, of course, is the Chief Executive Officer whenever we pass legislation setting up departments of Government, the Department of Agriculture, or the Department of Commerce, the authorities vested in the President who in turn delegates it to the Secretary to carry out the law of the land.

But you can't deny the fact that you have—there are many statutes that call upon you to do certain things; isn't that a fact?

Mr. ASH. I think that the Reorganization Plan of 1970 did provide that those statutory authorities and responsibilities theretofore in the Bureau of Budget be transferred to the President for him to redelegate as he chose.

Now, I may have a misunderstanding. I will make sure to get a correct understanding and put it in the record.

[The following supplementary note was subsequently supplied for the record:]

The redelegation of functions to OMB was made by Executive Order 11541, dated July 1, 1970. The only permanent statutory assignments of functions to the Director of OMB since that date have been by Public Law 92-643, with respect to certain advisory committee management activities, by Sections 201-203 of the Act of October 26, 1970 (Public Law 91-510), relating to budgetary and fiscal data, and Section 102 of the Act of January 5, 1971 (Public Law 91-650), concerning review of the District of Columbia budget.

Senator HUMPHREY. I would think that we could not have too much trouble about that if we take a look at what the law says it is,

and I read you portions of the law and it didn't say a word there about the President, it says the Secretary of the Treasury and the Director of the Office of Management and Budget.

Mr. ASH. Was that law after the Reorganization Plan No. 2 of 1970?

Senator HUMPHREY. That is the legislative Reorganization Act of 1970.

Now, if that is the case, if you have statutory authority, or statutory responsibilities, don't you think that your position ought to be subject to Senate confirmation?

Mr. ASH. We are getting into a point that I think I can better answer with legal advice. Apparently it is a technical issue. It doesn't however, run counter to the fact that the Office of Management and Budget is an integral part of the President's office and, as such, should not be subject to Senate confirmation.

Senator HUMPHREY. There are many things that are subject to the President's office. My gracious, every Ambassador is the President's personal representative subject to confirmation by the Senate of the United States: Mr. Ehrlichman is not provided for by statute.

Mr. ASH. Nor Mr. Halderman.

Senator HUMPHREY. We understand that.

Mr. ASH. Mr. Kissinger.

Senator HUMPHREY. These are separate advisers.

Mr. ASH. And there are others.

Senator HUMPHREY. And there are others.

Mr. ASH. This tends to fall in that category.

Senator HUMPHREY. I think some of them should be required to be provided for by statute and subject to confirmation.

We passed a bill in the Senate relating to your office, not to you personally, but to your office and the Deputy Director. You have answered to me today that you consider this document called the budget as having a very significant impact on the economy. You have said that you are held responsible for the preparation of the budget. You are responsible for carrying out Presidential orders. You produce a public document in which there is public information and you at least from my point of view, as I read the law, and I think I read it correctly, you do have statutory responsibility. You are not just a personal adviser to the President, obviously you are not, because you tell us what to do. We get letters from you, signed by you, and I had a letter here the other day on the REA, over in the Committee on Agriculture, signed by you saying that my bill that orders and directs the Administrator of the Rural Electrification Administration to make available such loans from the funds provided for in the appropriations bill. You signed the letter that you didn't approve of that. You sent that. That wasn't advice to the President, that was advice to the Committee on Agriculture and Forestry.

Don't you believe you ought to be subject to confirmation by the Senate of the United States?

Mr. ASH. No.

Senator HUMPHREY. You believe that you ought to be above the statutory requirements?

Mr. ASH. No; I am not sure that this means being above the law. It could well mean below.

Senator HUMPHREY. I would hardly say that. A man that prepares a budget that is equal to one-fourth of the total gross national product of this country, a budget which the President says will determine whether or not we have more taxes or no taxes, have inflation or no inflation. Would you tell me we ought to have a man roving around this city that has that much authority and power and not even subject to the confirmation process of the Senate of the United States when we are called upon to confirm a captain or lieutenant in the Coast Guard, Marine Corps, or U.S. Army?

Mr. ASH. I have already stated the reasons why I think the Director of OMB should not be a subject to Senate confirmation.

Senator HUMPHREY. And yet you believe that the budget process should be cooperative and a partnership between the executive and the legislative. I understood you to answer it yes.

Mr. ASH. Yes, sir; I see no inconsistency.

Senator HUMPHREY. But you don't want to have the partner to have anything to—

Mr. ASH. You wouldn't want me to pass on who your chief assistants are.

Senator HUMPHREY. You pass on the laws, oh, my dear friend.

Mr. ASH. They do a—

Senator HUMPHREY. You cancel out more programs than we can pass.

Mr. ASH. The President does.

Senator HUMPHREY. You do it in his name.

Mr. ASH. OMB is assistant to the President. It is the President who makes these judgments and decisions.

Senator HUMPHREY. He doesn't have Mr. Halderman do it, he has you do it and the President canceled out the REA program but he did it through the Secretary of Agriculture.

Mr. ASH. He has to do it through somebody.

Senator HUMPHREY. I am simply saying if you have that much power, and you do have power, not you alone but the Director of this office, you mean to tell me that you feel deep down in your heart, to use an old phrase, that you ought to be above Senate confirmation or excluded from Senate confirmation, from scrutiny, in the Senate proceedings of advice and consent.

Mr. ASH. Well, I will accept the word "excluded," rather than "above." I think, as I am sure everybody here knows, that the Director of Office of Management and Budget testified before congressional committees with no reservation. I am sure that whether or not the job is subject to confirmation in no way relates to or affects his willingness to testify before any Senate committees.

I think that the Senate and the House both have full access to the Director of the Office of Management and Budget. The only remaining issue is whether they will also participate in determining who he should be.

Senator HUMPHREY. Yes.

Mr. ASH. That it is equivalent to the President or me or somebody else participating and determining who your chief assistants might be.

Senator HUMPHREY. No, that is different. That is entirely different.

Mr. ASH. I see it as very like.

Senator HUMPHREY. I want to say most respectfully that we confirmed Mr. Weinberger over here a little while ago.

Mr. ASH. Thank you.

Senator HUMPHREY. Mr. Weinberger takes orders from you and you take orders from the President. Now, we are confirming a man for all practical purposes that takes orders from you, when you in turn work with the President to prepare this budget and take orders from the President. The entire executive branch is under the general jurisdiction of the presidential office. We know that. The question here is whether or not in the budget process we should have not only cooperation such as you are extending today, as you will in days to come, but whether or not you should be subject to the confirmation process of the Senate. I think you have got your point of view. I disagree with it. I am sorry you feel that way. I frankly think a great deal could be done here to ease this situation if the confirmation process were adhered to.

Senator PROXMIRE. Thank you very much.

Mr. Ash, as I said, I think you should resign from your position but that doesn't mean that I don't have great admiration for your capacity, your good temper, the fine way you have conducted yourself this morning, and this is one of the longest hearings we have had, it is almost 4 hours, but I am going to impose on you to ask one more question and then make an observation and then we will go to lunch.

In a press briefing the day after the budget was released Defense Comptroller Robert Moot said that the fiscal year 1974 budget includes \$2.9 billion for the war in Vietnam. How much of this amount will you recommend be cut now that we have a cease-fire, and if it is cut, will the funds be available for domestic programs or will they go back to the Pentagon or something else?

Mr. ASH. I don't believe that that was what he said. He said that the Southeast Asia costs in our budget are \$2.9 billion. These are not the war costs. As we discussed earlier, the major portion—\$1.9 billion—of that is support of other nations. The Defense Department testified in the past, and I am sure will continue to do so, on what the actual costs have been.

Senator PROXMIRE. This is a sharp clear difference of opinion. The context of the Moot statement was that he was talking about the war in Vietnam, he wasn't talking about NATO, he wasn't talking about Israel, wasn't talking about Korea, he was talking about the war in Vietnam and wasn't talking about the service-funded economic aid that we give in the Defense budget, he was talking about the war in Vietnam. You take another look at that and see. Maybe I am wrong and maybe you are wrong.

Mr. ASH. We will see and if need be we will check with him to make sure that we have a complete understanding all the way around.

[The following supplementary note was subsequently supplied for the record by Mr. Ash:]

The Department of Defense has estimated that 1974 budget authority for Southeast Asia Support was \$2.9 billion. Of this amount, \$1.9 billion was for Military Assistance, Service Funded, Support of Other Nations programs. The remaining \$1.0 billion was for support of U.S. forces involved in the Southeast Asia situation, both naval and air. The estimate excluded any support for U.S. ground combat forces, as there are no U.S. ground combat forces engaged in South Vietnam.

Senator PROXMIRE. You know what really shocks me, to conclude, is that the Congress is held responsible as a wild-eyed spender and yet we get a budget document and we have the outstanding people in the administration, you and Sam Cohn and other very able people, we have here, and they can't tell us anywhere in the budget what the outlays will be for the Space Shuttle, which is about \$450 million, or where it is.

It is in the budget. The new aircraft carrier, which is another \$400 million. You have just been unable to tell us about the service-funded aid to Vietnam, you don't know how much it is. And that's a mere \$2 billion. You can't find it, and yet you assured us you were going to review the defense spending with the same degree of intensity as the human programs. And you can't find a little item or tell us how much that service-funded aid is, whether it is \$2 billion or \$2½ billion, it really seems to me, Mr. Director, that this is appalling.

Mr. ASH. Just because I can't find it doesn't mean it is not findable. I have only been in the job 5 days.

Senator PROXMIRE. You have at your right Sam Cohn, one of the ablest men in Government who has been there 20 years, 24 years.

Well, thank you very much, gentlemen.

Mr. ASH. Thank you.

Senator PROXMIRE. The committee will stand in recess until 10 o'clock on Monday morning when we hear once again from the Chairman of the Council of Economic Advisers.

[Whereupon, at 1:50 p.m., the committee recessed, to reconvene at 10 a.m., Monday, February 12, 1973.]

THE 1973 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 12, 1973

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

The committee met, pursuant to recess, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman of the committee) presiding.

Present: Representatives Patman, Reuss, Carey, Widnall, Brown, and Blackburn; and Senators Proxmire and Humphrey.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Michael J. Runde, administrative assistant; John R. Karlik and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Khumbhaar, Jr., minority counsel; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF CHAIRMAN PATMAN

Chairman PATMAN. Mr. Stein, are the Council of Economic Advisers ready?

Mr. STEIN. We are ready, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

The committee will please come to order.

What disturbs me a lot about this present situation is devaluation of gold and things of that nature. I remember less than 15 months ago, I think about 14 months ago, we had this same thing up resulting in laws being passed on devaluation of gold and we even asked you if you had anything else that you would like. We said we would give you everything you wanted, and you said, "No, we have everything it takes to do the job," and we thought the job had been done.

Now, it comes back to us and in a way that indicates it was not done, and I just wonder if the export of money hasn't caused a large part of this. I don't mean to say it caused it all. Up until 3 or 4 years ago my recollection is that in goods and services the United States for decades, had a good balance in goods and services, but then they commenced exporting money in huge amounts overseas. We even passed a law that gave the President the power to either stop the exports of large amounts of capital or to have supervision over it to make sure it was not excessive, and that law, to my knowledge, has never been used, has it been used, Mr. Stein?

TESTIMONY OF HON. HERBERT STEIN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY EZRA SOLOMON, MEMBER; AND MARINA WHITMAN, MEMBER

Mr. STEIN. Well, we do have certain controls on capital exports.

I would like to say one thing at the outset: This being the day it is, when there are important international negotiations going on in this field, we do not propose to get involved this morning in any exposition of this subject.

Chairman PATMAN. I told you—I am not hearing you, Mr. Stein. Will you repeat that please?

Mr. STEIN. Well, I said two things. First, we do have controls on the export of capital and in the second place—

Chairman PATMAN. Wait—on those controls, how much capital do you permit to go overseas without any restrictions or limitations, everything up to say \$1.2 million or do you have a limitation of \$1.2 million or \$5 million?

Mr. STEIN. Well, the controls apply to individual cases, one by one. We don't set an aggregate limit, but maybe Mrs. Whitman can explain. The more general point I wanted to make was that in view of the current state of affairs and the negotiations and discussions that are going on we do not think it would be appropriate for us to enter into any discussion of the present international monetary situation.

Chairman PATMAN. Well, you put your finger on something that I think goes into it, secrecy. We don't know anything about what goes on. The Federal Reserve officials travel all over the world, talk to all the high officials in every country in the world, don't make any report to us at all and we can't get anything out of them hardly. We send people down there and they say, "We will have to discuss these things with you in secrecy. We can't let this out," and we have had a very difficult matter of getting any information, and I think that contributes to this whole thing.

Now, less than 15 months ago, as I said we had the Smithsonian Agreement, we had the laws passed that you asked for, and we were assured that is all we need, that is all we need. We have it now. This will get the job done.

And now we find ourselves not only in an impasse but in a bad situation that is even worse than the one we had, if I am correct about it, and I think all during the years I have been trying to get information about these overseas banks, and I have have an awful lot of trouble getting it, I have gotten all kinds of evasive replies, some absolute refusals, and some saying, "We would like to give it to you but we have to negotiate on the secrecy of it," and I just wonder if that isn't one of the big factors in this.

Now, you take the 94 U.S. banks, the big banks have branches all over the world, as you know, and 91 U.S. banks that have five—let's have your attention, please, sir.

Representative BLACKBURN. I want to talk—

Chairman PATMAN. Mr. Blackburn, I will recognize you if you wish.

Representative BLACKBURN. This is completely unprecedented. You have not finished your speech yet.

Chairman PATMAN. I am calling it to your attention; there are 577 overseas branches in every major and minor country in the world. At the end of 1970 these branches had \$70 billion in assets. The total probably exceeds \$75 billion today.

Now, the American companies, big corporations, are also in on this deal, if my information is correct. They are furnishing part of this money to run down the value of our currency, and I think that we have been—we either did not get the truth before or we have been misled, and I hope that you will do something to justify our confidence in you. We want to help you but we want to be told what is going on.

What assurances can you give us that something is going to be worked out in a reasonable length of time in the future. Mr. Stein?

Mr. STEIN. Well, I can express my own confidence that this will occur, and you will be informed of what has been done at an appropriate moment.

Chairman PATMAN. At the appropriate moment?

Mr. STEIN. Yes.

Chairman PATMAN. You mean after it has been done?

Mr. STEIN. Well, at a moment that is appropriate for Congress to perform such functions as it may have in the matter.

Chairman PATMAN. In passing laws.

Mr. STEIN. I can't say that.

Chairman PATMAN. Do you admit now that the laws we passed before at your suggestion were not sufficient?

Mr. STEIN. We never said that any single step that had been taken was sufficient for all time.

Chairman PATMAN. I don't think you did either, but when we asked you at the end if there is anything else we could do regarding laws or anything else, we were assured by you gentlemen that you had been given all the power that you needed. You believed that the job could be done that way, and that was less than 15 months ago.

Mr. STEIN. We have no complaint about the activity of Congress in this field. We had good cooperation from you, and we hope that we will continue to have this cooperation.

Chairman PATMAN. Thank you, sir.

I would like Mr. Proxmire to use his time now. We will have 10 minutes each, without objection, and then Mr. Blackburn and then Mr. Reuss.

Mr. Proxmire.

Senator PROXMIRE. Mr. Stein, in late December you were interviewed by Elizabeth Drew. During the course of the interview Miss Drew asked you about our full employment goal of 4 percent. Your response was, "Of course, the goal, when the 4 percent has been put forward as the goal, people have never really meant that. It was more propaganda than guide to policy."

Mr. Stein, do you still stand by that statement?

Mr. STEIN. Yes.

Senator PROXMIRE. I find it hard to believe that this is the opinion of the Chairman of the Council of Economic Advisers. In fact, in this year's Economic Report, you said the exact opposite, "in the early 1960's * * * a 4-percent unemployment rate, was considered to be an 'interim' goal, which might be changed later as a result of improvements in labor markets or other developments. These judgments applied to conditions expected in the early 1960's. In retrospect, the standard they suggested seems to have been in the correct zone."

Now, which is it, Mr. Stein? Was the CEA merely doing a public relations job on us in the sixties or was 4-percent unemployment a guide to policy?

Mr. STEIN. Well, the 4-percent unemployment was a guide to policy, but in a very qualified way which we make clear in our report. In no year of this period, in the early 1960's did the administration then in office or the Council of Economic Advisers feel itself obliged to develop a program which, within the term of that year would yield 4 percent. This was a goal that was out there but it was not operationally determining the policy that was being proposed.

Senator PROXMIRE. When you say that 4 percent, a 4-percent goal is more propaganda than guide to policy, and you say it is out there somewhere, does this mean that you can't foresee the possibility of achieving 4-percent unemployment without unacceptable inflation.

Mr. STEIN. No, it does——

Senator PROXMIRE. In the reasonably near future, that is over the period of the next 2 or 3 years?

Mr. STEIN. It does not mean that at all.

Senator PROXMIRE. What does it mean?

Mr. STEIN. We are quite explicit about that in our report. In our report we say that we think an appropriate goal for this year is to get the rate of unemployment down to 4½ percent by the end of the year, and that we do not regard that as a floor either in the short run or in the long run, and that if we have certain other kinds of behavior from the private sector and in the Government sector we can get this rate down further. I wouldn't see any reason to say that 4 percent is terribly important, you know, we might get it to 3½ percent. We do try to specify the conditions which would be conducive to getting down below 4½ percent.

Senator PROXMIRE. Well, what are those conditions? What do you have to do in terms of structural changes to improve the makeup of the work force?

Mr. Solomon knows very well, we played that tape back, he has referred to the fact that there has been a change in the labor force and he is right. There has been a change. We have more women in the labor force, more young people in the labor force. We have a different attitude toward employment, perhaps a little more casual than married men.

What do we have to do in order to create a situation in which you think that 4 percent can be achieved. Are you simply talking about the course of time, adjusting to it, or are you talking about actual policy changes that have to be made?

Mr. STEIN. I am talking about two kinds of things, and I think this is an important point which has been overlooked for a long time: The achievement of a low rate of unemployment is a two-handed game in which the Government plays one hand but not all, and in which the behavior of people in the labor force is the other hand, and so that the Government has its responsibilities.

As we say, the Government's principal responsibility is "a steady increase of money demand at a rate consonant with the potential growth rate of the economy and reasonable price stability."

I am reading from page 73.

Again this would not imply that the unemployment rate of $4\frac{1}{2}$ percent assumed to have been reached by the end of 1973 will not decline further. If with $4\frac{1}{2}$ percent unemployment, there is the pressure of an excess supply of labor, the average rate of wage and price increase would be lower and the rise in employment relative to the labor force would be higher leading to a further reduction of the unemployment rate.

A further reduction of the unemployment rate in 1974 and beyond to even lower levels would be assisted by labor market policies, including manpower programs, which effectively reduce the relatively high level of frictional and structural unemployment that has typically been experienced in the United States.

So, we are pointing really to three kinds of conditions: First, that we need a steady, strong growth of the demand for output.

Second, we need reasonable adaptation of wage demands to the state of the economy. That is, I do not think we can——

Senator PROXMIRE. It is that later point I would like to ask you about, you refer to page 73 where you say, and I quote "what the outcome will be and shall be will depend on private behavior and the amounts of work that people want to do on realistically achievable terms as well as public policy."

Are you talking about the fact wages are too high or demands of organized labor are too unreasonable?

Mr. STEIN. I am not distinguishing between organized and unorganized labor.

Senator PROXMIRE. Forget about that.

Are you saying that the people are unwilling to work at the wages that are available?

Mr. STEIN. I am saying that if we reach a situation in which, say, the unemployment is x , but there are a lot of people who want to work, aside from certain structural and frictional conditions, that a reduction in the rate at which wage increases occur, given the previous proposition about the rise of demand, will bring more people into employment. I do not think we can divorce the possibility of employing people from the wage rates at which they are willing to work.

Senator PROXMIRE. Yes, what I am trying to get at is whether—the reason that unemployment is high, and it has continued high although it has improved considerably over the past few months, but the reason it is still high is because of inadequate skill on the part of people who want to work so that they can't qualify for the kind of jobs that we would accept, is that part of it?

Mr. STEIN. Well——

Senator PROXMIRE. Is that the reason that the increased number of women and the increased number of young people makes the unemployment rate higher than it would be if you had a different make-up of the labor force?

Mr. STEIN. The young people suffer from a number of difficulties, and the whole situation is a complicated one, but I think the fact that we prohibit young people from working below a certain wage specified by law is one of the difficulties.

Senator PROXMIRE. Then the minimum wage is one difficulty, is that right?

Mr. STEIN. Yes.

Senator PROXMIRE. To what extent do you think that this is responsible. If we modified the minimum wage to exempt teenagers, do you think then it would be possible to get down to 4 percent more readily and quickly with less inflation?

Mr. STEIN. Well, it would work in that direction, yes, sir.

Senator PROXMIRE. Does the Secretary of Labor agree with that. I understand he disagrees.

Mr. STEIN. Well, I haven't discussed it with him.

Senator PROXMIRE. You haven't what?

Mr. STEIN. I haven't discussed it with him.

Senator PROXMIRE. All right.

How do you explain the proposal by the administration to cut back on manpower training programs in the light of the apparent structural difficulties we have here? I take it that the main problem of teenagers and of women is that they don't perhaps have the skills that others have.

Mr. STEIN. No, that is not the main problem of teenagers and women. The main problem of teenagers and women is that a very large proportion of them at any moment are in the position of just having entered or reentered the labor force and, naturally, when they enter or reenter the labor force there is a certain period of search for employment during which they are considered to be unemployed. They don't stay unemployed very long. You have had testimony before your committee last year from a study that was done for you by Mr. Feldstein which showed that the young people, for example, find a lot of jobs and have a great deal of turnover. They are going through a process of adaptation, which involves finding jobs, leaving jobs, being unsatisfactory to their employers, or finding their employers unsatisfactory so they go through numerous spells of rather brief periods of unemployment.

Senator PROXMIRE. Let's assume, let's agree there is a problem of teenagers that makes it somewhat different with young people and women than it does with adult men. If this is the case do you subscribe to the notion that 4½ percent unemployment now is equivalent to, say, 4 percent unemployment 15, 20 years ago, when the makeup of the labor force was different and you had a smaller proportion of women and young people?

Mr. STEIN. No, I am really not sure of that because there are a number of changes in the composition of the labor force.

For one thing, while these factors work in that direction, the labor force does have a higher educational attainment than it did 15 or 20 years ago, and since lower unemployment rates are generally associated with higher educational attainments, this would tend to work in the other direction.

I am not trying to say what is the ideal unemployment rate in this country. My whole line of argument here and earlier has been to say that this is something that will be determined jointly by the operation of the Federal Government and by the operation of the private sector.

Senator PROXMIRE. All right, we have set forth or you set forth a goal, as I understand it, of inflation by the end of the year of two-and-a-half percent.

Mr. STEIN. Yes, sir.

Senator PROXMIRE. And there is no specific goal for unemployment set forth. It is very helpful for you to indicate that you think we can attain a 4½ percent level but that is not expressed, as I understand it, as a goal.

Mr. STEIN. No; it is.

Senator PROXMIRE. It is not, that is right.

Mr. STEIN. It is.

Senator PROXMIRE. It is expressed as a goal?

Mr. STEIN. As a goal and as a prediction.

Senator PROXMIRE. How would you feel about the 2½ percent inflation, which most people feel is ambitious, most people feel you can't but perhaps you can. How would you feel about a modification of the wage-price control law that Congress is now considering to provide for a goal of 4 percent unemployment by the termination of that act, that is April 30, 1974, that would give us more than a year to achieve the goal of 4 percent? It is true that that is a little more ambitious than you have indicated that you think we can achieve, but it is on the right track, it is in the right direction, it certainly is no less realistic than the 2½ percent inflation. It gives a balance, it would give a balance to the act. It would mean that we would work just as hard to expand the economy as to hold down prices.

What would be wrong with that kind of a goal?

Mr. STEIN. I think it would be unwise as I think that we really cannot see that far ahead. I think that the goals we have stated are reasonable ones, and achievable ones and ambitious ones, and as we come toward the end of 1973, we will be in a better position to judge where we should go next. I don't see what use, what function, would be served by this, or what kind of policy it would envisage as being called for.

Senator PROXMIRE. My time is up. I will be back.

Chairman PATMAN. The time of the gentleman has expired.

Mr. Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman.

I want to thank the Council for joining us on this holiday occasion. Of course it is a Republican holiday so you can be expected to go to work.

Mr. Stein, as I interpret your remarks, what you are saying is that it is a little unrealistic to take a figure out of the air and say we are going to achieve this figure, whether it is unemployment or inflation, irrespective of what other influences it might have on our economy.

Isn't that what you are saying? If we were to continue the expansionist policies that we followed for the last 2 or 3 years, couldn't it mean a disastrous inflation later on?

Mr. STEIN. Exactly.

Representative BLACKBURN. And so aren't we dealing with a constant evolution of policies? In effect, when we see certain figures that indicate the economy is moving ahead, and it is a healthy economy, then perhaps we should not continue expansionist policies even though we haven't achieved what might be considered a desirable goal of unemployment.

Mr. STEIN. Right. As we said in our initial statements, we are always, but particularly now, in a position of having to balance a number of objectives, and one thing we have to balance is the speed of this expansion with the desire not to revive the inflation. We think we are maintaining a reasonable balance.

Representative BLACKBURN. Well now, on the question of the composition of the labor force: I personally have been receiving reports from businessmen for the last several years that it is just impossible to hire day labor on a dependable basis. I am not talking at about \$1.60 an hour or \$1.80 an hour, I am talking about \$2.50 or \$3 an hour. They tell me you can hire a person and then they work 3 days, maybe 5 days and you may not see them again.

They also tell me that some people will work 3 weeks out of a month but they won't work the fourth because they might lose their food stamp benefits or they might lose their rent supplements or they might lose their 235 interest subsidy program for their homeownership.

Now, is it possible that Government policy in some ways is contributing to unemployment by making it undesirable for some people to be employed too much?

Mr. STEIN. I think you can put it that way or say that Government policy to some degree contributes to unemployment by making it fairly attractive to be unemployed.

Now, this is not necessarily a thing to bemoan. The Government and the community have to make decisions about how much pressure they want to subject unemployed people to, but I think there is no need to blink at the fact that there are a number of policies which diminish the pressure to seek work.

Representative BLACKBURN. Well, in short, what you are saying is people are not afraid of going hungry as they once were.

Mr. STEIN. That is right.

Representative BLACKBURN. And without that that impetus some people will not make the effort to go to work, isn't that true?

Mr. STEIN. Well, it is a very small proportion but certainly there are some.

Representative BLACKBURN. But through these policies then we have made a certain floor of comfort that we guarantee everyone whether they work or don't work?

Mr. STEIN. Well, we have made that decision and, as I indicated, I don't think it necessarily is an unwise decision but it does affect the unemployment rate.

Representative BLACKBURN. Well, the point I am making is that we cannot bemoan the fact that unemployment does not get down to 2½ percent when Government policies, which we, the Congress, have enacted, may well make it impossible to get unemployment below a certain figure no matter what we do as far as the broad economic structures are concerned.

Mr. STEIN. I agree with that.

Representative BLACKBURN. On this question that the chairman raised initially about the balance of trade and the balance of payments, isn't it true that again Government policies may have contributed to the balance-of-trade problem. The policies I am thinking about are the increased cost of doing business that we, the Congress, have posed on American businessmen, for instance, in the form of environmental protection devices. I am not deploring these things, but I am just saying that we have decided to impose these burdens on our businessmen, which have the result of increasing their cost of doing business.

We have added the Occupational Safety and Hazards Act, and, as I mentioned, the environmental concerns. We are not producing the

energy within our own continent that we did, say, 5 years ago. We are producing at the maximum rate right now, and yet Government policy is prohibiting the development of nuclear powerplants which may be a substitute for fossil fuels of our coast, and the result is we are having to import goods from abroad.

Now, aren't these Government policies having the effect of decreasing our balance of trade, making it more difficult for the businessman to compete when he tries to sell abroad, and yet we can't blame that on the Council of Economic Advisers, can we?

Mr. STEIN. I thank you for that. [Laughter.]

Well, certain Government policies operate in that direction. I would say that, on the whole—although I would like to repeat my desire to stay away from this area—but on the whole, of course, we do have in the past year or 18 months, an exceptionally good record as compared with the rest of the world in the increase in prices of our products despite some of these things that you have pointed to, and I expect we will continue to do that.

Representative BLACKBURN. Well, the key to that is increased productivity, isn't it? If we are going to maintain an increase in GNP while not increasing prices a great deal, and yet if we are going to impose these other concerns, these other cost-increasing devices on our businessman, the only answer is to increase productivity, isn't it?

Mr. STEIN. That is an important answer. Another aspect of the answer is not to revive another wave of inflationary demand here in this country, and that is one of the reasons why we made this prudent budget policy the keystone of our economic policy for this year.

I think one thing that would certainly contribute to confidence in the dollar would be assurance that this budget policy, which the President has recommended, will be implemented.

Representative BLACKBURN. Let me ask you this, Dr. Stein, after your testimony before this committee on February 6 there was considerable comment in the press, "We will have to take our own action if monetary agreements with U.S. trade partners are not forthcoming."

Do you feel free to elaborate on these other actions that you think we might have to take? Specifically, would you favor the imposition of an import surcharge in the event that the currency exchange rate values of our major industrial trading partners remain unrealistic?

Mr. STEIN. I wouldn't like to discuss that on this day, thank you.

Representative BLACKBURN. This is something that is being discussed now would we presume?

Mr. STEIN. It is a long way over there and I don't know just what. So, let's not go into that.

Representative BLACKBURN. What thought is being given by the Council of Economic Advisers to deal with this problem of the energy crisis? I have seen projections that we would be purchasing some \$20 to \$25 billion worth of petroleum products from the Middle East in the next 5 to 6 years.

Now, of course, this is going to create severe monetary problems with that amount of money being held by those two countries, and I can see some domestic serious problems if these countries take these dollars and buy into American business concerns perhaps or something of that sort.

Have you given any thought to that as to how we might deal with it?

Mr. STEIN. Mr. Solomon is very much involved with this and he can answer.

Mr. SOLOMON. There will, as you know, be an energy message coming up very shortly.

The fact is that we do have lots of energy in the United States. It is there under the ground. It is a question of providing the correct incentives and the ability to get it out. We have found the oil in Alaska and we have found the gas and it is there sitting. You can't use it up there.

We seem to prefer to buy it from the Middle East rather than to ship it across Alaska. This is a question of society's values. The bill is going to be high if we keep importing our energy in the form of oil, and we keep increasing our uses of energy at the rate that we have been increasing it.

Quite apart from the raw material problem, we do, also face refinery shortages. There is not a single refinery on the drawing boards in the United States today. Refinery capacity is now being used absolutely to the limit and if we start tomorrow it will be 5 years before we can get some new refinery capacity going here. This again is a matter of values.

Representative BLACKBURN. My time is up, Mr. Solomon. I may come back to that. Thank you.

Chairman PATMAN. Thank you, sir.

Mr. REUSS.

Representative REUSS. Thank you, Mr. Chairman.

Mr. Stein, you stated a moment ago that on this international monetary crisis matter, on which I do not propose to inquire of you, the administration would notify Congress, at such time as it thought proper, what it had done and that it would decide when that proper time was reached, with reference to the question of whether Congress had any function to perform or not. Let me remind you that Congress has a constitutional power and duty to coin money and regulate the value thereof, and, specifically, is charged by the Bretton Woods legislation with control over the foreign parity of the dollar, particularly as it relates to gold, and in that connection, I just want to serve notice now on you and the administration, that if the administration, out of the current monetary crisis, seeks to go back to another Smithsonian arrangement of fixed parities, forget it.

Congress has sat by and seen the attempt to fix parities in the Deutschmark in 1969, the French franc that same year, the Swiss franc in May 1971, and the Smithsonian in December 1971, and if I read the feelings of my colleagues correctly, we, having witnessed these less than successful operations, are of the view that the parity of the dollar should be fixed fundamentally, at least, by market forces rather than by the fiat of finance ministers and central bankers. We don't think they have done a good job at it.

We think they have hurt the United States, and I would adjure you to bear that in mind during whatever it is that is going on that you can't tell us about.

Now, turning to that part of the economy that you can tell us about, let's look at the domestic inflation-unemployment situation.

In your report to this committee a few days ago you said, "If there is one theme that runs through the report it is the theme of balance," and it is about balance that I want to inquire.

In the administration game plan, we find a continuation of very liberal incentives toward business investments—rapid depreciation, tax credits, and so on which, in your report, you say, is likely to yield another unprecedented 14 percent increase this year over last, in business fixed investment.

We also note that the budget continues to devote very large sums to armament procurement, to shipbuilding subsidies, to space, and that the major cuts have occurred in things like public service employment programs, which are to be cut completely out, and manpower programs which are phased down by about 17 percent, in OEO which is to be cut out, and model cities which is to be cut out.

My question is this: In heaping more coal on the arms industry, the space industry, shipbuilding, capital investments generally, and in easing up on job creating expenditures which relate to less skilled labor—public service employment, OEO, model cities—aren't you getting way out of balance? Aren't you producing more inflation in the most inflationary areas of labor shortage, and more unemployment in the greatest areas of employment difficulty, despite your best intentions?

Aren't you creating a hideous example of imbalance?

Mr. STEIN. Well, of course, we don't think so. And I would like to say something about this defense business partly in response to what you have just said and to what others say.

I don't understand how such errors persist, but the idea that we are heaping more coals on the defense industry just bears no relation to the facts.

The devotion of real resources to defense in the United States is now lower than it has been at any time since before the Korean war. The number of people in the Armed Forces is now lower than it has been at any time since before the Korean war.

Representative REUSS. I am not talking about GI's, I am talking about Lockheed.

Mr. STEIN. And the proportion of our defense expenditures that goes for personnel is now higher than it has been in a long, long time. Only 24 percent of the Defense budget goes for procurement, including construction, and research, testing, evaluation, and development, so that this is a shibboleth that is left over from some earlier debates which are long since dead. We are not—

Representative REUSS. Address yourself to the fact that you are keeping up these huge hyperthyroid business investment induces, which you say are going to produce another 14-percent increase in business fixed investments, at a time when you are cutting out public service employment, OEO, and model cities, just take those.

Mr. STEIN. Well, we think that a high rate—

Representative REUSS. Why is that balanced, when your great unemployment is in the less skilled and your great employment shortages are in the capital goods industries?

Aren't going at it 100 percent the wrong way?

Mr. STEIN. Well, maybe. We never do anything 100 percent. [Laughter.]

The tax reforms that we made for the sake of producing investment we think are in the continuing interest of the American people.

These should not be described as bonanzas for business. They are ways of providing some encouragement to investment in the United States, which is one of the main routes by which we get an increase of productivity and an increase of output per man-hour of real income per man-hour. That way, we all get better off, and the benefits of this are not confined to the corporations who are its initial recipients.

As far as the public service employment program is concerned, as you know, it was adopted at a time when the unemployment rate was 6 percent as an emergency measure. The unemployment rate has now come down substantially. We have learned that the kind of employment provided under the public service employment programs is essentially the same kind of employment that is provided by State and local governments generally. All we did was to provide them with a kind of revenue sharing which they could use to spend for whatever purposes they had in mind which employed labor, and we are now providing them with so much more money through general revenue sharing and other sources that it is totally unnecessary. The program does not get to the problem with which you are concerned and with which we are concerned.

Aside from that, if you leave that program out, our expenditures for manpower programs in the budget are not reduced. They are reduced in some categories but not in others, and we do propose, of course, that some of the previously existing programs should be folded into a new special manpower revenue sharing program, but we retain a very strong interest in this field.

Representative REUSS. A related question: by all this investment on incentives, increasing it by another 14 percent this year, aren't you merely borrowing from the future, and isn't there going to come a time, when business is going to say: "We have now got so much fixed investment in place that we can ease up for a few years. We overbuilt."

Aren't you, in short, starting another Herbert Hoover boom-and-bust cycle?

Mr. STEIN. Well——

Representative REUSS. Herbert Hoover.

Mr. STEIN. Well, we envisage an expansion of 14 percent, an increase of 14 percent, in business investment in an economy which will be growing by 10 percent, in money terms overall, after a period in which business investments had been rather low, and we don't think that we are in danger of producing any substantial unbalance by this action.

Representative REUSS. My time is up, Mr. Chairman.

Chairman PATMAN. Mr. Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Stein, in your statement you say that:

The decline in interest rates during the two years of current economic recovery is contrary to the usual recovery experience.

To what do you attribute this atypical behavior? Is most of the decline a result of the controls?

Mr. SOLOMON. Mr. Widnall, I tried to respond to that question last time by saying that interest rates are subject to two forces: One is what we call the real interest rate, which depends on the forces of basic supply and demand for credit, and the other is the inflationary premium which has come to be built into the interest rate.

As people anticipate inflation they add a little something for that anticipation to the rate they demand as lenders. What we have been seeing is an abatement of this inflationary premium. So, while in the normal course of a business recovery you would expect the real rate of interest to rise—we don't, of course, observe the real rate—the combination of the real rate and the inflationary premium has brought about an actual decline during a period of recovery. It is mainly that.

Representative WIDNALL. Mr. Solomon and Mr. Stein, you keep speaking about the decline in interest rates, yet the majority members of this committee keep talking about the increased interest rates. Now, what is the nub of the variance in interpretation?

Mr. SOLOMON. Well, the nub of it is that the way we have measured it is from the trough quarter from which all business recoveries patterns are dated. In this case it is the fourth quarter, or the third quarter of 1970. Interest rates are lower now than they were at the trough of the recession. They have risen in the past few months, especially at the short end. Long-term interest rates are still lower than they were at the trough. Short rates have now risen. It just depends on where you start.

Representative WIDNALL. You said, Mr. Stein, that the rate of increase in food prices will be less in 1973 than it was in 1972. Why?

Mr. STEIN. The food price situation in 1972 was very heavily influenced by a reduction in food supply. We had for the first time in a very long time a decline in the per capita domestic supply of food partly as a result of the bad weather and earlier high prices of feed which go back in a long cycle to the corn blight and so on.

We have now taken a number of steps, we expect a very massive increase in the supply of feed grains. We have taken steps to increase the acreage that can be planted to wheat, the acreage that can be planted to feed grains and soybeans, to increase the grazing of cattle, and so on. We have taken a number of important steps which will increase the supply of food during the year.

The main thing that has been moving the food prices has been meat. It takes time of course to produce meat but we expect that by the second half of this year the supplies will be much more ample, and then the rate of increase of food prices will taper off.

Well, that is the basic explanation.

Representative WIDNALL. Well, Mr. Stein, you speak about feed grains, yet how are you going to get a decrease in cost to the American consumer if we continue to sell substantial quantities overseas?

Mr. STEIN. We think that this year the supplies forthcoming are going to be so much larger than last year, and that despite these exports which are expected, the domestically available supplies will be very much larger. We are just going to produce a lot more.

Representative WIDNALL. You are quoted in the Daily Report of Executives, January 11, 1973, as denying the possibility of a post phase II rise or price bulge.

What changes do you foresee in the Consumer Price Index and in the GNP deflator over the next two or three quarters?

Mr. STEIN. Well, Mr. Congressman, if I denied the possibility, I was not speaking very carefully. I don't usually deny the possibility of anything. I did not foresee that we would have a bulge such as we had when we moved from the freeze into phase II.

We are going to have some bad months on the Consumer Price Index on the food side because we have recently had some very bad months on the food side at wholesale and this has got to come through in the retail prices. But that is not essentially a matter of the control system.

With respect to those things that are under the control system, I don't think we will have as much of a bulge as we did after the freeze ended because, of course, the freeze was a much more rigid system. Prices were being held further below their equilibrium or natural levels. We have a lot of prices which even under phase II were floating below their ceilings.

So, I didn't think that aside from the food side matter, which is not really due to the controls, we would have much of a bulge.

Representative WIDNALL. What, if any, provisions are being made to exempt food, medical care, construction costs and interest and dividends from the more rigid enforcements which they are subject to under phase 3 if price fluctuations in these areas are consistent with the stabilization effort.

Mr. STEIN. As far as food is concerned, as you know it is food processing and distribution which is under rigid controls. I must say that we are not at the moment preparing for any decontrol in this area because we think it is going to be an area of some problem, considerable problem, for some time.

You mentioned interest and dividends. Interest and dividends are now under a system of voluntary restraints. In general answer to your question, we would like to see a lot more performance before we think of decontrol in those areas. I will say another word about the health care matter. I think that prices and costs in the health care business are going to be matters of Government concern for a long time, although possibility not forever under the aegis of the Economic Stabilization Act. Since the Government is such a large financier of health care through medicare, medicaid and all other ways, it will have a continuing interest in charges in this field which, I think, will have to be reflected in some kind of policy but not necessarily the kind of controls that we now have.

Representative WIDNALL. You had a chapter concerning the role of women in the economy, and you discuss the various types and characteristics of women who work.

What approximate contribution to GNP do the women of the labor market make? What is apt to be their place in the future, Mrs. Whitman, if you would care to comment on that, too.

Mr. STEIN. We maintain the proposition that the economics of women are not the sole prerogative of women economists but, in this case Mrs. Whitman will answer. [Laughter.]

Mrs. WHITMAN. In answer, with respect to the first part of your question, the contribution of women to the GNP, I will have to check and let you know.

I can say, of course, that it has been rising very substantially because the participation of women in the labor force has been rising very substantially and, of course, the fact is that women's production in the home is not counted as part of the GNP.

When women are paid for work in the marketplace it becomes part of the GNP so any time women shift from one of these functions to the other, or take on the second in addition to the first, this represents an increase in the GNP.

I would anticipate that the share of GNP contributed by women is going to continue increasing in the future. I think so partly because there will probably be some further increase in the labor force participation of women. It is a trend that has been going on for some time now. Second, I would assume that as more and more women are in the labor force for more extended periods of time, as the pattern of moving in and out of the labor force perhaps becomes less dominant, then presumably the average contribution to the GNP of a female worker will also increase.

Representative WIDNALL. Mr. Chairman, I would like to ask permission for Mrs. Whitman to supplement the statement she just made if she would care to for the record.

Mrs. WHITMAN. We will be glad to provide it for the record.

Chairman PATMAN. Without objection, it is so ordered.

[The information referred to follows:]

SUPPLEMENT TO MARINA WHITMAN'S STATEMENT IN RESPONSE TO QUESTIONS
OF REPRESENTATIVE WIDNALL

There are several ways to approach the question of what women contribute to the GNP. One way is to calculate the share of aggregate earnings from labor and from capital received by women.

In 1971, which is the most recent year for which we have the information, women received 23 percent of all income from labor earnings; they received 34 percent of all income from capital investments (dividends, interest, net rental income, etc.). Weighing earnings from labor and from capital by what economists have estimated to be their respective shares of the net national product gives a rough estimate that women contribute about 26 percent to the net national product.

In interpreting this figure a number of caveats should be kept in mind. First I must again emphasize that what we measure in the national product excludes the value of the work produced at home, and women, of course, are the major contributors there. The value of this work is not trifling. One educated guess suggests that the value of women's work at home could well add about 30 percent to the net national product. There are innumerable problems in estimating the value of time spent working at home. But if we take the average wage women who work full-time in the market earn, and assume that figure to be the value of home-work, and use information on hours worked at home by full-time housewives as well as by working women (who also do work at home) then we come out with a total for 1971 \$295 billion (which would add 31 percent to actual NNP for that year).

Another difficulty in interpreting the share of national product received by women is that women may well contribute more than they earn. To the extent that women do not receive equal pay for equal work in the market, their contribution is underestimated by their earnings.

One technical point should be noted. When economists are asked to estimate the contribution of a factor of production to output we point out that all the factors of production work together to produce an output and the contribution of one is dependent on the contribution of the others. If any one factor was taken completely away, output would probably drop dramatically, at least in the short run. Economists therefore stress the contribution at the margin. The question may therefore be raised—by how much would national output change if women's input was reduced by one work-hour, all other inputs remaining the same, and by how much would national output change if men's input was reduced by one work-hour, all other inputs remaining the same? Economists usually identify these so-called "marginal products" of inputs with their hourly wage. In May, 1971, the hourly wage of full-time male workers was about \$3.70 and the hourly wage of full-time female workers was about \$2.50. However, it is again important to recognize that to some extent this wage differential reflects discrimination rather than true productivity differences.

The outlook for women

Most indicators point to a continuing increase in the market activity of women and therefore a continuing increase in women's share of the GNP. The labor force participation of women has been shown to be strongly related to the number of children they have and there are persuasive indications that completed family size will decline. There has been a downward trend in the fertility rate over the past 15 years—from a rate of 123 (births per 1,000 females 15 to 44 years of age in 1957), to a rate of 82.6 in 1971. Furthermore, surveys of the childbearing expectations of young wives give reason to believe that there will be a reduction in family size in the years to come. In 1955 the proportion of wives 18 to 24 years of age who expected to have two or fewer children was 34 percent; by 1972, this expectation had risen to 70 percent. Over the same period, the proportion of young married women expecting to have four or more children dropped from 38 percent to 9 percent. It is likely that to some extent these expectations themselves indicate that young women are planning more and more to have careers and that, therefore, they are planning to limit the size of their families. On the other hand, some women, those who may not have had access to modern birth control methods, and who may not have planned to work, may be induced to work when they discover that they can have the smaller families that they may have desired but could not count on having.

Besides influencing the amount of work women do outside the home, a decline in family size may ultimately affect what women will earn on the job. As women maintain more continuity in the labor force, they will have more of a chance to receive the training on the job that is so important in developing true careers and this should greatly enhance their future earnings.

We are also hopeful that the artificial barriers and prejudices that have kept women from maximizing their potential contribution will give way. Such a development would not only influence what women earn but should also motivate more women to seek serious careers outside the home.

The earnings that women (or men) will achieve in the market are of course influenced by many things that are difficult to predict. For example, exogenous changes in technology influence the demand for different kinds of skills. However, it seems likely that the basic forces that I have noted are of sufficient importance that they will dominate future trends. Thus women's contribution to the market output as measured in the national product accounts seems likely to increase both because of increased participation in the market and increased earnings relative to men.

Chairman PATMAN. Senator Humphrey is next.

Senator Humphrey is recognized for 10 minutes.

Senator HUMPHREY. Thank you.

Mr. Stein, I am sure some of the questions I am going to ask you might have been alluded to to which you have given response already and, if so, just indicate and we will save the time.

The weekend newspapers have obviously been filled with commentary concerning the dollar, the speculation on the dollar, the drop in the stock market, the overall consideration of the Federal budget and its impact on the economy. I tried to gather together a few things here that might be of some interest. I will read from the Times, I believe, of yesterday which says, "The cause of the crisis was a weakening of the dollar."

Speaking of the crisis particularly in the Western Nations, noting that:

President Nixon, British Prime Minister Heath, West German Chancellor Willy Brandt and French President Georges Pompidou conferred Friday by telephone in what was taken as an effort to keep the monetary crisis from ripping apart the fabric of western economic and political relations. And, to prevent the monetary upheaval from wrecking the Common Market, the finance ministers of the major European states met in Paris for urgent consultations.

Then it goes on to say:

The cause of the crisis was a weakening of the dollar, resulting from a combination of blows:

The news that the United States in 1972 suffered the worst trade deficit in its history—close to \$7 billion. The resulting excess supply of dollars to Europe tended to drive the price of the dollar down—just as any commodity, milk, for example, in excess on the market will be driven down in price.

Fears that the Smithsonian Agreement, hailed by President Nixon at the time as “the most significant monetary achievement in the history of the world,” had failed. By that agreement, the dollar was devalued and other currencies upvalued by varying amounts, yielding a net dollar devaluation of 11 to 12 percent. That “historic” devaluation was supposed to make American goods cheaper, foreign goods more expensive, and thus curb the outflow of dollars. Last week the markets abandoned that hope.

The concern by investors around the world that the American inflation was still not under control. Inflation weakens the dollar abroad because it makes American goods more expensive.

Then it goes on to point out:

Recent statements of Mr. Nixon, Secretary Shultz and other administration spokesmen that the program is really tough—speaking of phase III—have not yet remedied the initial impression that phase III was an untimely step toward phase zero.

Now, all of this is corroborated by a number of articles that have appeared all across the spectrum of journalism.

Do you think that phase III is part of the cause of the crisis related to the weakening of the dollar?

Mr. STEIN. Well, Mr. Senator, there are really two parts to that question. One is whether the interpretation commonly given of phase 3 is a correct one and, second, is whether this interpretation, whether correct or incorrect, had any effect on the dollar.

Now, I will comment on those two separately.

About the first, I think it is absolutely incorrect. The idea that the move to phase 3 was a premature abandonment of controls is totally fanciful and, as I guess I said last time, it merely repeats the kind of anxiety through which we have gone several times on the inflation front in the last couple of years, possibly under the leadership of people who write economic news as if they were writing Dante’s “Inferno.”

Anyway, the fact is that we have a very comprehensive and forceful control system here. We have set forth quite specific guides to behavior for the private sector. These are guides well understood by the private sector because they are essentially guides under which they worked in phase II. We have machinery to observe conformity to these standards, and we have the machinery and the legal authority, which we hope you will extend, and the determination to enforce compliance with the standards where we think failure to comply threatens the success of the system.

So that we think this interpretation of what we are doing is quite unjustified. And it is very ironic, you know, that until January 11 our performance with respect to prices had been the marvel of the rest of the world. People had never believed that we would do it or that if we did it that it would work and, finally, they were made believers.

Well, it is going to take a little while perhaps to make believers of them again but I am sure we will. Just as many people didn’t believe we would get the Federal budget under control, they couldn’t believe we would hold the budget to 250 or they believe we would hold next year’s budget to full employment balance. All the experts said it was impossible, because there was too much built-in pressure on the budget. But, with determination, the President has done his part of it, and I think this will contribute to resolution of this problem.

Senator HUMPHREY. I am very pleased with your response because I spent a couple of years of my time trying to encourage the administration to put on the wage and price controls which it ignominiously resisted for a considerable period of time, and now you say that they did work, and I appreciate that. It is very good for the whole spirit of this Government to confess sin, and to be admitted to the glory of righteous living.

But now I see that you are playing a little easy with this factor called confidence. The roles are kind of reversed these days. I never used to be too sure about that thing called confidence but I know all the economic writers are saying that confidence is a very fragile commodity in the financial world, and then they go on to point out there was this sudden induction on January 11 of phase III in the Economic stabilization program with its potentially inflationary overtones.

You know the trouble about politics, what is true is not always as important as what people think is true and apparently what some people think, phase III is going to be a bonanza for certain elements in our society and promote inflation or to unleash the forces of inflation. I hope that is not the case, and I am not at all sure that I would agree with that assumption.

On the budget I noticed that another report, you are familiar with, Mr. Joseph Slevin's commentary in the Washington Post, I don't know whether we take him as an authority or not, but he is a respected gentleman, it says, "Nudge most government and private economic forecasters and they will tell you the chief threat for 1973 to becalming Nixon's next year is that consumers and even more importantly businessmen may spend as if there were no tomorrow. They note that it is a tight budget. They note that there was considerable emphasis that was placed upon wages, price controls, profits, the role of women, and complex international monetary issues but that the economic message, the economic report," for which you are responsible, "has literally failed to mention the main economic threat facing the country; namely, that the budget starves the Government sector and inflates the private sector."

What is your comment about that?

I thought I would quote reputable authorities who are not necessarily Democrats or partisans.

Mr. STEIN. Have you started yet?

Senator HUMPHREY. These are people who are in your ball park. These are part of your professional community.

Mr. STEIN. Well, OK.

With respect to the question about influences determining the state of the economy in 1973, of course what determines the state of the economy and its rate of expansion is the combined effect of what is going on in the private sector and in the public sector. In our analysis of the outlook for 1973 we, in a way, add up business fixed investment, inventories, consumption, all the main sectors of the economy, and we come to the conclusion when you add these things all up, and combine them with the budget policy that we have recommended, we will have a rate of expansion which is appropriate to our circumstances.

We naturally focused attention on budget policy because that is the lever or one of the levers that we work with, and so our task—and I think if you look back to the history of the Employment Act you will see the task was described almost exactly this way—our task is to assure that we have a budget policy which when combined with the private forces that we see at work in the economy will give us the desirable overall behavior and we think we have done that.

Now, with respect to the other question about whether we are starving the public sector, and lavishing attention on the private sector, that is just absurd.

As we show in our report in the table on page 77, the proportion of the national output that goes through the government has increased very much over any period you want to choose. The table goes from 1955 to 1971, and I have some estimates for 1972. This is particularly true of the proportion of the national output that goes through Government for purposes other than defense.

In 1955, 14 percent of the national output, as it would have been at full employment, went for civilian government expenditures.

In 1972 the figure was about 24 percent.

Senator HUMPHREY. Does that include social security in 1955?

Mr. STEIN. It includes social security in both periods.

Senator HUMPHREY. Both periods?

Mr. STEIN. And, you know, this is another one of those leftover ideas that we are suffering from private opulence and public squalor. That is just not true any more. We have been through a decade of enormous increases in government spending, absolutely and relative to the GNP.

Senator HUMPHREY. Just let me say for myself I think the Nation is privately rich and publicly poor, and all I can say is you have to take a look at the transportation system which is a disgrace, the energy crisis which is a catastrophe in this country, the housing situation in central city which is without doubt one of the abominations of current civilization, and I don't think you can say we have poured it into the public sector so much.

Lots of goodies, lots of milky ways, candies, martinis, et cetera, but when you get down to the infrastructure, Mr. Stein, I think it is pretty badly operating, not operating too well unless you think Penn Central is working well.

Mr. STEIN. Can I get a word in? The transportation system is a model of the consequences of 80 years of Government regulation. We would like to do a little—

Senator HUMPHREY. And private exploitation. Let's put things in balance.

Mr. STEIN. This was—

Senator HUMPHREY. If you want a balanced situation.

Mr. STEIN. This was the first major venture of the Federal Government into managing the economy, transportation.

Chairman PATMAN. Have you finished?

Senator HUMPHREY. I finished my round, I will come back.

Chairman PATMAN. Mr. Brown.

Representative BROWN. Mr. Chairman, thank you very much.

I want to let you know how delighted I am to be here during this recess period and how pleased I am to see four of the eight democrats

who voted we ought to have this meeting here, and I want you to give my regards to Mrs. Griffiths, Mr. Moorhead, Mr. Carey and Senator Bentsen who all voted that way but couldn't be here today.

I am also pleased that all three of the Republicans who voted against the hearings were able to show up.

I would like to go back to the question that Senator Humphrey was asking, Mr. Stein, about the reasons for the dollar crisis. How much impact does the fact that we seem to have a Congress bent on forcing the administration to spend this impounded money have on the attitudes of people abroad about our economy?

MR. STEIN. Well, as I said, I guess before you came in, I am trying to avoid any deep penetration into this area, but with respect to that question, although I really cannot quantify it, I am sure it cannot be in a favorable direction. I am sure that concern about the revival of the inflation in the United States is part of the general concern, and concern that we may not succeed in achieving the degree of budget restraint that the President has proposed contributes to that.

I would say again that I think this concern, even with respect to the budget, is misplaced; that we believe that we are going to have cooperation from the Congress, and will keep the budget under adequate restraint.

Representative BROWN. We not only have guidelines for the private sector, in effect, through phase III, but we also have some guidelines for the public sector in terms of the request that we live within a certain budgetary limit, isn't that correct?

MR. STEIN. Yes, that is very important, and we think that is even more important than phase III.

Representative BROWN. Let me also ask you with reference to this gross national product figure that you gave, percentage of the gross national product devoted to public spending, is that a record?

MR. STEIN. Yes. Yes, the 1972 figure is a record, and in that field we make records almost every year.

Representative BROWN. As a percentage?

MR. STEIN. As a percentage, yes.

Representative BROWN. In that—

MR. STEIN. I would exclude World War II, of course.

Representative BROWN. How does it relate to World War II figure?

MR. STEIN. I don't have the World War II figures but, as I remember, we were spending something like 40 percent of the GNP during the war for government, and we are now up to about 31 percent.

Representative BROWN. So that we have now more than ever, control by the Federal Government of how the resources of our society, the economic resources, will be allocated?

MR. STEIN. Yes.

Representative BROWN. And the converse of that is that we have less individual economic freedom on how resources will be allocated, I would assume?

MR. STEIN. It means certainly that a larger proportion of the income that people earn is spent by governments, Federal, State and local. The Federal, of course, is about twice as large as the State and local.

Representative BROWN. And since the American people seem to have more direct control over their local governments in terms of

spending because such matters as tax levies and bond issues and so forth frequently are voted on by the community at large at the local level and sometimes even at the State level, presumably if there is an effort to force public spending out of the Federal sector and into the State and local sector, it will still give the average American citizen more decisionmaking power as to how his economic resources are going to be spent, isn't that right?

Mr. STEIN. That is right.

That is very fundamental to our thinking.

Representative BROWN. And that seems to be what moves the philosophy of this administration. That is as I understand it.

Mr. STEIN. Yes, sir, that is correct.

Representative BROWN. I heard the other evening on television some implied criticism, well, as a matter of fact, it wasn't television, it was radio, it was in a reprise to the President's economic message presented by the Speaker of the House, some implied criticism of the fact that our taxes to cover funds of the Federal Government now see 24 percent of those taxes paid by corporations and I think 74 percent or thereabouts paid by individual income taxes. Are those figures approximately correct?

Mr. STEIN. Well, I think that is approximately correct. Corporate profits taxes are more like 15 percent of Federal receipts. He might have been including some other payments by corporations, perhaps the corporate sector of the social security payments or certain excises. I don't know how he got to that number.

Representative BROWN. Let me ask, What is the impact of those corporate taxes? Are those, in effect, taxes that have no reflection in terms of the individual costs?

Mr. STEIN. That is one of the great unsettled questions of economics, that is, who pays the corporate profits tax. We do know it is not paid by some impersonal entity called a corporation. The question is whether the corporate profits tax is paid, in the end, by the stockholders—that is, by those who supply the capital to the corporation—or whether it is passed on and paid by the customers of the corporation. In either case—

Representative BROWN. Well, presumably even possibly money not paid to the people who work for the corporation because—

Mr. STEIN. It could be passed back and absorbed by the workers in lower wages than they might otherwise get.

In any case the distinction between taxes on corporations and taxes on people is a false one. Nobody pays taxes but people. So the question is which people pay the corporate profits tax, and what are the effects of it, and my own—well, as I say, the profession is very divided about this, but my own view is that the tax on corporations is, in the end, a tax on the suppliers of capital, not exclusively those who supply capital to corporations but those who supply capital in any form, because the tax gets transmitted through the market to all suppliers of capital.

Representative BROWN. Some of that capital being supplied by the price of the product.

Mr. STEIN. Yes, some of the capital being supplied out of the price and through the profits. But in a sense everybody who saves pays part of that tax.

Then there is the indirect consequence of the effect of that tax on the rate of investment, particularly on the rate of investment in business plant and equipment which tends to be the most productivity generating kind of investment and, therefore, the indirect effect on the prosperity of the whole society.

Representative BROWN. So, in effect, if you reversed the level of taxes and made it 74 percent being paid by corporations and 24 percent by individuals the response would be that the individuals would be paying considerably more for the price of the products that he buys and ultimately would be paying those taxes anyway, wouldn't he?

Mr. STEIN. Well, of course, you couldn't reverse it. There isn't that much corporate profit in the first place. We already take about half of the corporate profits in taxes so the only thing—

Representative BROWN. And the average take on personal income taxes.

Mr. STEIN. Well, we take something like 20 percent.

Representative BROWN. The Federal Government.

Mr. STEIN. In personal income taxes and social security contributions together.

Representative BROWN. Let me change the subject just for a minute. In addition to being Lincoln's birthday, I am advised that the Sierra calendar tells us that this is also Charles Darwin's birthday, and I am curious to know what your assessment is of the economic impact of something that I am not sure how Darwin would have felt about one way or the other. I guess he would have approved, the lowering birth rate, 2.1 percent reproduction level which we are now having in the United States, that—2.1 children, rather, I am sorry, per family, the impact of that being that we would just barely maintain our population or may not quite maintain the population of the United States.

Is that going to have a rather severe economic impact in the future or what kind of impact? Have you been able to give any thought to that? I don't know whether this is covered in the women's section or not.

Mr. STEIN. Well, it is not exclusively a woman's problem. [Laughter.] We are impressed with these facts and have been asked, as a matter of fact, by the President to study their implications, which we expect to get to as soon as we can conclude these hearings.

For one thing, of course, one must not exaggerate the shortrun implications of this. The size of the labor force, and a lot of other things, for the next 30 or 40 years, will not be very much influenced by this. The effect of the rates of growth will be some time off.

But you can see, of course, that there will be certain implications in reducing, for example, the proportion of the national output that needs to be devoted to schools and other things primarily connected with children; that it would provide an opportunity possibly for increasing the ratio of capital to labor force and increase the rate of growth of real output per capita. It has a number of possible consequences, but I would not want to speculate about them because it is a fairly tricky field.

Representative BROWN. My time is up, but to mention one other thing and that is the reducing number of people, young people, in the labor force and increasing the number of people in the social

security beneficiary section which is part of our body politic which means that the rates on those who work may have to be even higher to take care of those who are recipients of those benefits.

Chairman PATMAN. I would like to present our new member, the honorable Member from New York, Mr. Carey. You are recognized for 10 minutes.

Representative CAREY. Thank you, Mr. Chairman. It is not my first appearance in the committee but the first appearance in which I have been called upon to be heard. I am most reluctant to follow the questioning of my distinguished colleague from Ohio since my wife and I continue to hold the record, in this and many other Congresses. I have been doing my part and I am sure Mr. Stein knows of this.

But, like all families today facing the market basket, our primary concern is the impact that monetary policies around the world and the adoption of the Smithsonian agreement and similar economic policies are likely to have on the family pocketbook. But I am not going to try to pursue that in these 10 minutes.

Mr. Chairman, in my absence, I regret I could not have been here earlier, Mr. Stein, have we been discussing this morning, the belated and interim follow-ons to the Smithsonian agreement and what effect they are going to have on policies, such as import surcharges and so forth?

Mr. STEIN. I said I did not want to discuss that question.

Representative CAREY. You did not want to discuss that. So we will drop that one.

Perhaps as a new Member I should ask you, what line would you like to pursue? [Laughter.]

Mr. STEIN. We might talk about whether we are in favor of high expenditures and high taxes.

Representative CAREY. Seriously, are there areas in which our governmental expenditures are under scrutiny to examine what we can do to pare our dollar gap and the balance-of-payments gap? I have particular reference to troop strengths and force reductions, and so forth.

Mrs. WHITMAN. This comes under the same rubric that Mr. Stein mentioned. I think that this whole question of the international situation is one package.

Obviously, all of those things, monetary, trade, defense, and so forth, are all part of this same question. They are, being, and will continue to be discussed with other countries around the world and, again, I don't think this is a terribly good time to go into the details because they are not easily separable.

Representative CAREY. Well, I think you know at the initial discussion of this, Mrs. Whitman, you referred to the lag theory in devaluation, that we have not realized the pickup in our exports or reduction in imports because of the lag on the impact of devaluation.

At least two writers that I have perused over the weekend tend to dispute the lag theory, that pricing policies of competitive governments are more a factor than the so-called lag.

Do you hold to this lag notion? How long do you expect the lag to continue after the previous devaluation before we see some impact?

Mrs. WHITMAN. I am sorry, I am not sure what theory you were talking about when you talked about the competitive pricing policies of governments.

Representative CAREY. Well, in other words, Japan and Germany cut profit margins so that the devaluation didn't have the impact that we expected it might have. That is one reason.

Mrs. WHITMAN. Well, it is my impression that even in Japan and Germany it is firms that are doing the buying and selling and not the government, though clearly there are some interrelationships, but my point was simply that historically we have observed that the impact of devaluations tends to be spread out over a period of time. The impact tends to be delayed for a period at least of months and perhaps longer. After that it tends to be felt over a period which, I think, is generally better measured in years than in months; this is simply an empirical observation based on past experience with devaluations.

There are some conceptual or theoretical reasons for expecting this to be the case, the main one of which has to do with the fact that the first impact of a devaluation is always in the wrong direction. What it does initially is simply raise the price of a country's imports and, therefore, the value of the imports. The response of real trade flows, the volume of exports and imports, takes more time simply because people who export and import have established patterns of buying and selling and they don't change those immediately in response to a shift in prices. So it is for that reason you would expect to see what we have seen in the past: a delay in the impact of the devaluation and also some spreading out of the impact.

Having said all this, obviously I wouldn't for a minute deny that the impact so far was not what we had hoped. We said this in our report and we continue to say it.

I am quite sure that this is related to the policies pursued in other countries—I know there were indeed cases in which exporters in other countries chose to take a reduction in profit margins rather than allow the full impact of the devaluation to affect their prices.

There were also some cases of importers from this country who allowed their profit margins to rise rather than allowing that full impact to take effect in that direction.

To what extent this was due to the decisions of private firms and decisionmakers and to what extent government policies abroad were involved I simply am not prepared to say.

Representative CAREY. Well, it is enough on that point. I am instructed in my service on the Ways and Means Committee, by Mr. Rinfret, that the Smithsonian Agreement, to paraphrase him, "is now in Smithereens." Perhaps the devaluation which was a produce of that, a corollary of that, should be left where the Smithsonian Agreement now seems to find itself.

I am concerned in my service on the Ways and Means Committee that two issues of paramount importance to the public of our country, are not discussed in very great detail in the economic report. Namely tax reform, tax tailoring, tax revision of some kind. Even though that was promised early in the year and, secondly, no mention of welfare reform which is a major drain to great cities and metropolitan centers of our country. Neither one of those has been given any attention in the economic report, yet they are two pressing economic concerns among local governments and metropolitan governments particularly.

Would you comment on that, Mr. Stein? First, on tax reform, and second, on welfare reform. Are we through with it with the administration?

Mr. STEIN. No; not at all, in neither case. The report of the Council of Economic Advisers is not the usual vehicle by which the administration presents a proposal for tax reform to the Congress. The administration is at work on this subject, and the President will consider suggestions which are now being developed, and when he has made a decision about this he will make a recommendation to the Congress.

We are very concerned with this problem. It is not an easy problem. As a member of the Committee on Ways and Means I am sure you are aware of that, but you should not interpret its omission from our report as being indicative of any lack of interest.

Similarly with respect to the welfare problem. Let's say the administration-congressional relations of the previous 3 years have left that matter in a state of considerable disarray which we have not been able to correct for the purposes of writing our report, and we thought it better to confine ourselves to other matters of importance—God knows the report is long enough—on which we had something to say.

Representative CAREY. It is long enough but I wish it were just a little longer because considerable disarray, as you characterized the welfare system, adds up to disaster. The present welfare system is a major disaster area in our economy. A nonproductive segment of our population is draining heavily on the middle and lower income taxpayers who have been forced to carry the local welfare burden. Welfare is a drain on the economy; it saps the economic energies of low-land middle-income taxpayers through high local taxes.

Mr. STEIN. Well, the administration, as you know, has been very concerned with this. We have made some proposals in the past which did not find favor here, and we are reexamining it. There have been a number of changes made. People don't seem quite aware of the fact that although the big package was not adopted there were a number of changes made such as the fact that the Federal Government is taking over the full financing of welfare for the adult categories, and other things have been changed so this is not a static situation but the administration is at work on it.

Representative CAREY. Well, thank you, Mr. Stein. More change will be most welcome. Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

I suggest that we continue on the 10-minute rule and probably get through soon after 12 or 12:30, if it is all right with the members of the committee. All right. I will take my 10 minutes now.

Mr. Stein, it was mentioned in the budget that the taxpayers were paying 74 percent of tax revenues and the corporations were paying about 24 percent.

I notice in your statement, U.S. budget in brief, fiscal year 1974, it says, individual income taxes 49 percent and the corporations 14 percent. I assume that is approximately correct. Of course, we know that a large part of that 14 percent attributed to corporations is ultimately paid by the individual income taxpayers through prices. There is no way to stop that, I am sure, so I just wanted to indicate what the budget report says in regard to the questions brought up a few minutes ago.

Mr. STEIN. Somebody was quoting to me Congressman Albert and that is how we got the 74 and 24, I think.

Chairman PATMAN. Yes, sir.

May I make a statement about the reason for the hearing today. Mr. Stein, you will recall when we decided to have a hearing I first said that I wanted the committee to have a vote on it. We had a vote on whether or not we would have hearings during the recess. Nothing was said about holidays, and the vote was about 8 to 4, to the best of my recollection, 8 to 3, somewhere along about that ratio. Anyway, after we decided to have hearings, I suggested we have a hearing, the next hearing, on the 15th, that is this coming Thursday, and someone suggested that maybe we could get a better date, and finally you yourself came up with the date of the 12th that you wanted it the 12th instead of the 15th, and I said without opposition we will just set the date to the 12th. That is the way the date was set. There was not any intention to desecrate any holiday but you never know now when holidays are. You take, for instance [laughter], the 19th, next Monday, we were talking about a hearing then; well that is, isn't that, Washington's birthday, George Washington's birthday, February 22? It is changed to the 19th, so you never know about these holidays. So I don't think we have committed a real major error in having the hearing today in compliance with your request.

Mr. STEIN. We are not complaining about it. We work every day.

Chairman PATMAN. No, sir, you have not complained at all.

Now, Mr. Stein, I am surprised so much attention is given to the prime rate, a rate that nobody fixes except the bank itself. Do you know of anybody else who fixes that prime rate except the bank itself?

Mr. STEIN. Well, they have been having a little help lately, haven't they?

Chairman PATMAN. Well, of course, the Government has been trying to help them but that is in violation of the antitrust laws. If they would do what the Government has been insisting on they would be violating the antitrust laws.

Mr. STEIN. The Government is not asking them to collude for this purpose. They are asking them individually.

Chairman PATMAN. Well, one time in my district when I was district attorney in Texas, the price of gasoline was raised 4 cents a gallon overnight, and I was persuaded to start an immediate investigation. We did it before a grand jury. We had several of the oil dealers in, and every one of them denied there was any conspiracy, they just happened to have it 4 cents a gallon up that morning, and everybody was charging that price, and finally late one evening at the grand jury session one young man, who hadn't been in the business very long, said "Well, I will just tell you the truth about this. We didn't have any written statement and we didn't have any conversational understanding with the various people, we just observed an unconversational understanding."

So it looks to me like this 6 percent prime rate in the discussion, it looks to me the banks are trying to arrive at an unconversational understanding, and if they do arrive at 6 percent by agreement that is in violation of the antitrust laws. But I assume that they would get out of it by presenting proof that they were persuaded to do that by Government representatives. I don't think we should have any rate agreed upon in that way.

When the RFC was in being the country was benefited greatly. That \$500 million corporation, the Reconstruction Finance Corporation generated \$41 billion in money in 21 years, supplied all the money and capital necessary to prevent hard times, but when the RFC was repealed in 1952 or 1953, and it was repealed very quickly.

Then when people wanted large amounts of money and they went to the New York banks. They found a different ball game in operation. There was no competition between these big banks. The interest went up a little but they began charging higher compensating balances, and then they began to demand a part of the action.

That is going on now. It was commenced right after the RFC was repealed. So considering the fact that the prime rate is not a real genuine rate, nobody fixes it, nobody determines whether or not it is observed or complied with, it is just fixed by the bank itself. If you are entitled to a prime rate and you are seen coming in the bank door, they can in a split second raise that rate higher or make it lower. They can change it automatically themselves without conferring with anybody on earth and without violating any regulation, rule or order. So I don't see much to the prime rate.

In your view does it make sense to hold the prime rate at 6 percent and forget about all other rates? The prime rate only helps the big corporations generally, and does not help anyone else. Why should that rate be so sacred and draw so much attention when it is absolutely meaningless?

I wouldn't say it is a fraud because they have not agreed to it altogether. If they were to do it, would be a fraud. So why spend so much time on the rate that is fixed by the individual bank itself and by no one else?

Would you explain that, please, Mr. Stein?

Mr. STEIN. Yes, Mr. Chairman.

In the first place it isn't correct to say that the attention is focused on the prime rate to the exclusion of other rates. The Committee on Interest and Dividends has focused its attention on those rates which are, as Chairman Burns says, institutional rates or administered rates or rates which are not set instantaneously in a nearly perfect market say like the Treasury bill rate, and there have been three main rates on which they have focused attention, the mortgage rate, consumer credit rate, and the prime rate as being kind of a guide to other lending rates that the banks charge for customers who don't get the prime rate. But the two rates that most concern the consumers have been the mortgage rate and the consumer credit rate.

Chairman PATMAN. Let me say Mr. Burns was interrogating by correspondence four banks that raised their prime rate one-quarter of one percent. That seems to me like it is a very ineffective goal against high interest rates when all over the Nation today a poor man who wants to buy a \$20,000 home, according to present rates and present financial charges, must obligate himself to pay \$60,000, the price of three homes, before he can get title to that one home. In other words, he pays twice as much for financial charges, including, of course, the interest rates, as he pays for the home itself.

Now when that is going on right here in broad daylight, and when the principal economic evils in this Nation today are inflation and poverty, it seems to me we are dawdling with very small potatoes, particularly in view of the fact that the consumers are paying 18 percent, 24 percent, 42 percent even up to 240 percent and no mention is made of that. High interest rates are causing poverty all over this Nation.

I am disappointed that the Commission on Interest and Dividends does not do something about this situation because it is terrible.

You know, every time you raise interest rates you raise prices. Prices of all goods offered for sale are immediately raised. Every time you raise prices you cause more inflation. A quick step toward rolling back these interest rates would be the most meaningful step that could be taken in the direction of stopping inflation. Unquestionably that is true.

Mr. STEIN. May I comment?

Chairman PATMAN. Yes, briefly because my time has expired. [Laughter.]

Mr. STEIN. I think the facts are basically incorrect.

Chairman PATMAN. Beg pardon?

Mr. STEIN. I think the facts cited are basically incorrect, particularly with respect to consumer installment credit. One thing we do have as a result of the operation of the Committee on Interest and Dividends is a set of figures about rates being charged. We have rates on consumer installment credit for new automobiles, for example, 10.26 percent in January 1972, 10.01 percent in January 1973.

For mobile homes 10.94 in January 1972; 10.54 in January 1973.

My point is not so much that they have declined—they have declined a little—but that we are not in the 36- or 100-percent range of interest rates for consumer credit.

Chairman PATMAN. You have a Federal Government which has no national usury rate. The Federal Government could have interest rate ceilings. Can you name one State that has an effective usury law?

Mr. STEIN. Well, you see the rates are being—there is competition in this market, and the rates are being—

Chairman PATMAN. Competition? 240 percent, 42 percent.

Mr. STEIN. But as I have just—

Chairman PATMAN. They break your arm if you don't meet the monthly installments.

Mr. STEIN. But they are not charging 240 percent. As I have just indicated consumer goods other than mobile homes and automobiles are paying 12 percent, other personal expenses—

Chairman PATMAN. I can cite State laws that permit it.

Mr. STEIN. State laws permit but it is the market that determines it.

Chairman PATMAN. All right, I will not take any more of my time.

Mr. Proxmire.

Senator PROXMIRE. Could I ask Mr. Stein to supply for the record the material which you have been reading? The staff says we don't have that. Don't give us any personal reference but when you correct your remarks include it.

Mr. STEIN. Yes.

[The information referred to follows:]

Since January 1972, the Federal Reserve has been gathering data on bank rates charged on small loans to businesses and loans to farmers and consumers at the request of the Committee on Interest and Dividends. The statistics are issued monthly as a Federal Reserve Statistical Release No. G. 10.

INTEREST RATES CHARGED ON SELECTED TYPES OF BANK LOANS

Type of loan	Interest rate (percent per annum)		
	January 1972	December 1972	January 1973
Small short-term noninstallment loans to businesses ¹	7.31	7.54	7.70
Farm production loans (1 year or less maturity):			
Feeder cattle operations.....	7.55	7.66	7.74
Other farm production operating expenses.....	7.63	7.95	7.89
Consumer installment credit for:			
New automobiles (36 months).....	10.26	10.01	10.01
Mobile homes (84 months).....	10.94	10.69	10.54
Other consumer goods (24 months).....	12.57	12.55	12.46
Other personal expenditures (12 months).....	12.74	12.77	12.65
Credit card plans.....	17.11	17.24	17.13

¹ Loans of \$10,000 to \$25,000 maturing in 1 year or less.

Note: The interest rates shown on this release are based on a survey conducted jointly by the Federal Reserve System and the Federal Deposit Insurance Corporation of loans made during the first full calendar week of each month by a sample of 370 insured commercial banks. They represent simple unweighted averages of the "most common" effective annual rate reported by respondents in each loan category. The "most common" rate is defined as the rate charged on the largest dollar volume of loans in the particular category during the week covered in the survey. Consumer installment loan rates are reported on a truth-in-lending basis as specified in the Federal Reserve Board's Regulation Z.

Senator PROXMIRE. Mr. Reuss, Senator Humphrey, and Mr. Carey have asked you about the monetary crisis and you have said you cannot discuss it because of present negotiation. We understand you can't go into any detail in the private negotiations going on along this matter but this is a very, very critical aspect of our economy. As you know, this committee is going to have to file a report within a few weeks and this committee is just not going to be silent on that. Maybe you wish we would be, but we are not going to be and we shouldn't be. It is our duty to have some kind of a comment or recommendations on what we think Congress should do, or should not do, and what the administration should do, so if you can give us any enlightenment on this at all, would you feel you could answer any questions in general terms on what our fundamental policies should be that would help correct the situation or do you think for the time being we can't discuss it?

Mr. STEIN. Well, this just happens to be the world's worst day for doing it, but I think you will have to know more before you have to write your report which I believe is due on April 10. But if you would like to ask more general questions we would try to help you.

Senator PROXMIRE. Fine. I want to get into that a little later and am sure the members of the committee will also. Before I do that I would like to ask another question that Congressman Carey brought up, that Senator Humphrey has brought up in previous inquiries that we have not got into, you say the omission of tax reform from your report is appropriate at this time because usually it has not been in the report, it may come along later but it seems to me if the tax reform proposal is going to have any significance, any kind of an economic impact, it ought to be in your report.

After all, this report sets forth the kind of economic policies we ought to have. There are very few government actions I can think of that can have a more profound economic effect than tax policy.

Now, if there is not going to be a significant recommendation in 1973 or in time to have an effect in 1974 so we can take cognizance of it in our report, you would be right and perhaps that is the kind of reform recommendation the administration has in mind. But almost any kind of significant and substantial improvement in our tax structure, any equity improvement would have a serious economic effect; isn't that true?

Mr. STEIN. Yes. I think there are two things to be said about that. In the first place, we have indicated that our expectation is that the proposals put forward would probably constitute a balanced package so that it would not be—

Senator PROXMIRE. Not raise revenue?

Mr. STEIN. Not raise or reduce revenues.

Senator PROXMIRE. So if you proposed policies that might slow down the expansion of the corporate sector to some extent then you would provide a corresponding reduction in personal income taxes. I am not saying you would do that but that is an example of the kind of thing you have in mind?

Mr. STEIN. We said we do not propose an increase in the general level of taxes so if we propose a package there would be some increases, there would be some decreases, but don't hold me to the last dollar.

Furthermore, with respect to the economy in 1973, our experience with previous reform proposals—well, I remember the one that President Kennedy sent up—it was a year and a half before we got that through the Congress.

Senator PROXMIRE. I realize it may take time for what I am saying, you won't have a revenue effect, it can have a serious effect as you know on the economy by perhaps discouraging some investment activity, or encouraging some consumption activity, it could have a significant overall economic effect.

Mr. STEIN. I am just suggesting that the effect of these things probably would not come in 1973—they might. But in any case, we are not prepared to submit a tax reform package.

Senator PROXMIRE. What you are saying then is any tax reform legislation would be long term, would more likely be enacted next year than this year, certainly likely to have an economic effect next year than this year; is that correct?

Mr. STEIN. Yes, sir; I would hope if we presented it this year, it would be enacted this year.

Senator PROXMIRE. One of the things in the unemployment picture which is encouraging, we tend to overlook the encouraging aspects, if you compare 1959 and 1972 when we had about the same level of unemployment it averaged about 5½ percent in both those years, the fact is that the high areas of unemployment in 1959 were blue collar areas, they averaged 7.6 percent that year; 1972 it is down to 6.5 percent. Whereas in the area where there was a strain in the labor force, the white collar area, it was only 2.6 percent unemployment in 1959; now it is up to 3.4 percent.

What I am saying is this leveling out should give us a situation in which there is less strain, manpower strain on resources, less of a tendency to have to increase pay and, therefore, increase prices because there is a shortage of people.

It seems there is a leveling off situation going on in the economy that will be helpful. Incidentally, the level of inflation in 1959 was less than

1 percent. Don't you think this is a factor, along with the increased number of women and teenagers in the work force, that also ought to be taken into consideration.

Mr. STEIN. Certainly.

Senator PROXMIRE. It ought to be taken into consideration in terms of indicating that our inflation picture is maybe a little better in that degree.

Mr. STEIN. Yes. Well, as I said it is a factor in which there are a number of variables. The one you mentioned is one, along with the change in the number of women and young people and the change in educational attainments, and so on.

Senator PROXMIRE. One reason there is such uneasiness about inflation, the stock market, the dollar crisis, the attitude of economic forecasters, and so forth, in predicting inflation is because you and your administration and the economic experts all seem to feel that 4 percent unemployment would now be inflationary or reaching it in the foreseeable future would be inflationary.

Yet you have a full employment budget posited not on 5-percent unemployment or $4\frac{1}{2}$ percent unemployment—your forecast for this year—but 4-percent unemployment. So that 5-percent unemployment we have a fat deficit, at $4\frac{1}{2}$ percent unemployment we have a big deficit, only at 4 percent you come into balance. So many people looking at this say that this budget—regardless of what the administration talks about it being a restrained, being in balance of full employment, that full employment figure of theirs, that 4-percent unemployment figure of theirs—is inflationary and hence, in trying to achieve it in this way and having a big deficit at $4\frac{1}{2}$, is going to be inflationary.

Do you have an answer to that?

Mr. STEIN. Yes. I don't think that the inflationary consequences of the budget depend on the size of the full employment deficit but do depend on the change in the size of the full—

Senator PROXMIRE. Depends on both.

Mr. STEIN. Depends on the change. I don't think we will have this, and there might be other reasons for not doing it, but I think that we could go along with a stable full employment deficit of moderate size, once we had adjusted to it, for a long time without generating inflation.

Senator PROXMIRE. Now lets take that exact point and see what happens when you break down your fiscal policy into 2 half-years. Now on a full employment basis, the budget moves from a slight deficit in 1973 to a balance in 1974—a shift of \$3 billion. On the surface, this seems to be a modest shift towards restraint which the administration says is necessary to avoid an inflationary pace of expansion. As you say, timing is important. If we look at the impact of the budget during the year, however—during the year—we get a far different picture.

Correct me if I am wrong. In the first half of calendar 1973, the budget will be sharply in deficit due in large part to refunds paid on overwithholding. In the second half of the year, the budget becomes sharply restrictive, much more so than is indicated by year-to-year comparisons.

It seems to me that moving the budget sharply from a deficit to surplus from the first to second half of 1973 will come at precisely the wrong time. By the end of 1973, the impact of cuts in our housing program will begin to be felt; the economy will be slowing down throughout 1973 as is suggested in your report. Won't a shift of close to \$10 billion in the budget at a time when the economy is already slowing down run the risk of choking the expansion? Don't we risk overkill at the end of 1973 similar to budget overkill that produced the 1969-70 recession?

Mr. STEIN. Well, we don't think so. I think that these figures that you have given are terribly heavily influenced by these refunds as you indicated, and we found that in the early part of 1972, when the budget numbers were also very heavily influenced by the overwithholding which was the earlier counterpart of the later refunds, that overwithholding did not restrain consumer expenditures.

Senator PROXMIRE. Well, they are a counterpart but not necessarily the same thing. It makes people a little more flush when they have in their hands a little bit more and are liable to spend it.

Mr. STEIN. We think that could be but we don't expect it to happen. We think consumers acted as if they were aware of their true liability and did not cut back their spending because of the overwithholding, and we expect them correspondingly not to give a big boost to their spending, although we made some little allowance for it because of the refunds that they will receive.

Also, there are some other temporary factors in here. We are getting a lump over the end of last year and the early part of this year—a big lump of revenue sharing—but the effects of that on the economy will be spread out. We think it is not reasonable to look at this thing in such small time periods with the expectation that everything happens immediately.

Senator PROXMIRE. But the arithmetic is pretty clear, and I would be glad to get that reassurance. I don't think we necessarily have a substantial record to show the refunds won't have that stimulative effect now, and especially that the change will be clear in the latter half when you are likely to have a slowdown that could be serious.

I would like to get into an area that may be a little embarrassing to ask about, and embarrassing to respond to, but I think it ought to be asked directly and I think this committee has as much interest in this as any, and so I am going to do so.

Hobart Rowen, as you know, may not be your favorite columnist but he is a man we can all agree has great ability, and he said this recently:

The Council of Economic Advisers is on its way downhill in the Nixon administration, and while conceding that any President has the right to structure his advisory team the way he wants to, some critics of the President feel strongly it is a mistake to let the CEA, as an institution, suffer a loss of prestige.

He goes on to indicate that the criticisms are these, and I would like to give you a quotation. This is an ex-chairman of the opposite party, who says bluntly:

"Stein has been making too many speeches. How can the President rely on him for the best professional advice when he's out there selling the (political) program?"

The danger, as some see it, is that the removal of a professional, politically independent CEA from direct, regular and frequent access to the President deprives him of straight-from-the-shoulder economic advice.

Says Walter W. Heller, under whom the CEA had its hey-day in 1961-64, "the President of the United States badly needs an economic group to tell it as it is, and lay it on the line so that he doesn't get politically strained advice. The way he (Nixon) has set it up, makes it less likely that he will get the facts that way."

What's your response to that? No. 1, do you have the direct access to the President on any kind of regular basis, and No. 2, do you feel you can give him nonpolitical professional advice unaffected by your role in the last campaign?

MR. STEIN. Well, I do have direct access to the President. I see the President frequently. Moreover, I think people do not understand that the process of making economic decisions in a government is always one in which a great many people are involved under any circumstances. The President is not sitting there, you know, deciding day to day what to do about the price of aspirin, and so on. He makes certain big decisions. A lot of other decisions are made at other levels, even the decisions which are made at the level of what might be called the Presidency, the level of the group in the White House, and the Executive office.

We have, as I say, direct access to the President. We have a much heavier involvement in the overall process of decisionmaking now than at any time since I have been here, earlier—and I can't speak about previous administrations.

As far as the degree of confidence the President has in me, I can assure you that his confidence in me was not diminished by the fact that I made some remarks about the Senator from South Dakota, and—

SENATOR PROXMIRE. My time is up, Mr. Chairman, but I am positive that is the case. Of course, that is not what I am asking about. The President's confidence in you is undoubtedly great but the question is whether a partisan can give the same kind of professional advice that somebody less partisan can give.

CHAIRMAN PATMAN. Your time has expired.

MR. BROWN.

REPRESENTATIVE BROWN. I would just like to observe I think that perhaps partisanship has crept into economics or vice versa over the past several years. I think it has occurred on this committee as it has perhaps with reference to the participation of present and former members of the Council of Economic Advisers in the whole arena of economics and political circumstances in our society today.

MR. STEIN, in your testimony you state that the rate of expansion of money and credit in 1973 should be somewhat reduced if we are to attain our goals of maximum employment and price stability.

This perhaps relates to the questions that the chairman was asking about the interest rate. Do you have any projections of what would happen to interest rates if money supply growth were held to your recommendations in 1973?

MR. STEIN. In our last appearance we did make some predictions about interest rates on the assumption of the economy behaving as we have forecast in general, and Mr. Solomon did it then and perhaps he can do it again.

REPRESENTATIVE BROWN. Mr. Solomon?

Mr. SOLOMON. We think that rates will tend to move up on balance in 1973 but at a modest rate. We think there will still continue to be some abatement of inflationary expectations of a more durable variety that will affect the long-term rates. But we do foresee some strong demand for credit and obviously those strong demands cannot be met by creating new money without creating new inflation.

Representative BROWN. The last time we had a 4-percent interest rate as a prime rate was back in 1959. That is 15 years ago. Are we ever likely to get back to that level again?

Mr. SOLOMON. I think it is possible if we get the inflation rate down to the kind of inflation rates we had then.

Representative BROWN. What do we have to have either in terms of the rate or period of time for certain inflationary rates?

Mr. SOLOMON. You need durably to convince the lender that long-term holdings will not suffer erosion from inflation in excess of the kind of 1, 1.2 percent per annum which we have had historically. Lately we have been having very high inflation rates and he is convinced they are going to continue and he is therefore being cautious.

Representative BROWN. So if we get the inflation rate down to a 3-percent rate we can expect the rates of interest to hover at what level on a consistent basis?

Mr. SOLOMON. Well, there is no way of forecasting what the real rate of interest ought to be in any society. It depends upon the relative strengths of demand for savings and the supply of savings. Numbers like 3 percent have been used for the real rate of interest. I suppose the money rate of interest will be 3 plus this inflation rate.

Representative BROWN. Say that again now, the inflation, the interest rate, the prime interest rate, usually runs at the inflation rate plus what?

Mr. SOLOMON. Plus a 3-percent real rate.

Representative BROWN. So that at a 3-percent inflation rate it would be at 6.

Mr. SOLOMON. That is about right, yes. Mind you I am guessing, nobody has ever seen this animal called the real rate. You can measure it only ex post.

Representative BROWN. That is what it has run traditionally.

Mr. SOLOMON. That is what it seems to have run.

Representative BROWN. The theory of consumer spending on which you are forecasting in 1973, is it, what are you saying about the consumer, is he going to be less confident of the future with the phase 3, is he going to be more confident of the future than he has been, more cautious? What is his attitude likely to be?

Mr. SOLOMON. The forecast for the consumer has been made quite explicitly. We don't believe that in the early part of the year he is going to respond to these refunds he is going to get instantaneously. In the first place they will move into savings.

Representative BROWN. Savings in what way?

Mr. SOLOMON. The personal saving rate will raise.

Representative BROWN. He will put it on not paying off debt then.

Mr. SOLOMON. Not necessarily, no. He could pay off debt which does, of course, comprise personal saving. That is one way you save by paying off debt. But we do not expect his expenditure patterns

to change significantly. The big factor for 1973 is a very large rise over the year in his disposable income and we expect him to respond to this with a steady strong increase in his expenditures.

Representative BROWN. Has the rate of the creation of consumer debt changed radically?

Mr. SOLOMON. It was going very strong last year, in 1972, and we expect it to go strong. High consumer credit tends to be associated with high purchases of automobiles and other durables.

Representative BROWN. And what has happened to the rate of investments in stocks and bonds, that is, long-term debt of corporations. Has that increased significantly as you would expect it to do in a recovery period?

Mr. SOLOMON. Well, from the point of view of the individual of the household, he has been disinvesting, he has been taking his money out of stocks on net balance for a long time.

Representative BROWN. How long?

Mr. SOLOMON. From direct ownership of stocks. Oh, I don't remember the figures but at least for the last 10 years. It has been a steady, long-term trend. But he has been getting a ownership right in stocks indirectly through mutual funds or pension funds.

What has happened last year and still continues is that he also now is disinvesting in mutual funds, redemptions have exceeded sales now steadily for about 15 months.

Representative BROWN. Is that likely to continue?

Mr. SOLOMON. We don't know.

Representative BROWN. Do you have an analysis of the reasons for it?

Mr. SOLOMON. Well, the performance of mutual funds after late 1968 haven't been all that good on the average and there has been a great deal of confusion about the institutions in the securities markets and both of these factors have probably led individuals to be less enthusiastic about mutual funds than they were in the past.

What exactly they are doing with the money we cannot trace. He still has got a big stake in common stocks but through more and more indirect means.

Representative BROWN. Obviously, it must relate to the feeling he is not going to get the same kind of return from investments in stocks that he would get otherwise, isn't that right?

Mr. SOLOMON. Correct. That is his evaluation of it. Whether he is right or wrong I cannot say.

Representative BROWN. But that relates certainly to the profit picture and the public attitudes about inflation and so forth, doesn't it?

Mr. SOLOMON. In part.

Representative BROWN. Let me get into one other area, if I may. I think one of the concerns of economic policymakers has to be the distribution of benefits and economic growth throughout the system, whether or not they are well distributed, and in the 5-minute period that we had the other day I asked this same question, but got only a very brief answer. Can you cite any statistics to show that the current economic expansion either is or is not reaching all sectors of the population? I am interested in particular in rural areas, the agricultural sector, blacks, the people who generally have been considered to be not doing as well perhaps as some other sectors of the economy.

Mr. STEIN. Well, Mr. Congressman, as I indicated the last time when you asked that question, the statistics that would really be most useful in answering it with respect to 1972 are not yet available. We do have some information which I cited about the start rates of new businesses, the rates of failures of businesses by size, which indicate that small businesses, new small businesses, are being started in larger numbers than earlier, and that their rates of failure have declined very substantially.

We do know, to refer to one point you specifically asked, that the black male unemployment rate fell very significantly during 1972.

We have some other evidence about agriculture to indicate that the off-the-farm employment opportunities have increased very substantially, which makes a great contribution to the incomes earned on the smaller farms.

If you would like we would try to assemble some of this in better shape and put it in the record.

Representative BROWN. I wish you would.

[The information referred to follows:]

SUPPLEMENT OF HON. HERBERT STEIN IN RESPONSE TO QUESTIONS
OF REPRESENTATIVE BROWN

The Current Population Reports of the Bureau of Census provide the most comprehensive information about income distribution. Since this information is not available for 1972, it is not possible to make a thorough evaluation of the distribution of gains from the current economic expansion.

Several other sources of information indicate that the benefits of this expansion are being broadly distributed. As discussed in the Economic Report (page 36 and Table III), profits of nonfinancial corporations are increasing as they typically do during a recovery. However, relative to the increase in corporate production the increases thus far in this economic upturn have fallen short of the improvement during the upturns after 1949, 1958, and 1961. Only in the post-1954 upturn did corporate profits rise more slowly. Profits of nonfinancial corporations rose 16 percent in 1972. Payrolls were 9.5 percent higher in 1972 because of both higher wages and salaries and expanded employment. Although profits increased faster than payrolls in 1972, it is also true that profits (measured by the ratio of before-tax profits to the value of output) were lower than all but 2 years since World War II—1970 and 1971. In contrast, the corresponding 1972 ratio of payrolls, including fringe benefits, was the highest since 1947 except for 1970 and 1971. This indicates that returns to owners of capital did not rise exorbitantly relative to returns to labor in the corporate sector.

The number of employed persons has increased very sharply over the past year or so and these gains appear to have been widely distributed. Although the monthly numbers exhibit some volatility, especially when disaggregated into relatively fine age-sex and racial categories, the latest available information tends to confirm this and to indicate further improvements compared to the information available when our Annual Report was written. Averaging the months of January and February 1973, the percentage increase in total civilian employment was 2.8 percent from the comparable 2-month period a year ago. Employment has grown more rapidly for Negro workers in general and for the major age-sex groups. The latest data also seem to suggest a welcome strengthening in the labor market situation of Negro teenagers whose employment has risen 18.3 percent over the past year or so.

It is worth noting that employment growth for each of the groups in Table 1 has been larger than the rate of increase of the population of each group.

The growth of real hourly compensation of private nonfarm employees, which excludes earnings of proprietors, compares quite favorably with developments in previous recoveries. Over the full eight quarters of this upturn, real hourly increased at 3.1 percent annual rate which is just below the average of the four other recoveries since World War II. The increase during 1972 was substantially faster than at comparable stages of 3 of the 4 previous recoveries since World War II.

The number of new business incorporations reached an all-time high in 1972 as did the index of net business formation which advanced 6.2 percent according to preliminary estimates. The number of business failures fell from 41.7 per thousand in 1971 to 38.3 last year. This was the lowest failure rate since 1953, except for 1969. The number of failures was down 7.5 percent among commercial and industrial businesses with liabilities under \$100,000 and 7.0 percent among larger businesses.

Another indication of improved prosperity among smaller businesses is provided by information on after-tax earnings of different sized manufacturing corporations. Data for the first 3 quarters of 1972 show that smaller corporations showed a significantly greater improvement in profits, compared with a year earlier, than larger corporations. Corporations with assets under \$1 million had an 96.5 percent gain in after-tax profits. All corporations showed improvements but these were progressively smaller for larger sized corporation. (Table 2).

While small manufacturing firms have shown gains in recent years, the same improvement has also extended to small firms in agriculture. Much of the improvement for these farm families has resulted from increasing amounts of off-farm employment and earnings. While 1972 data are not yet available, the trend between 1969 and 1971 clearly shows that farm families with small sales of farm products have gained increasing amounts of income from off-farm employment (see Table 3). Farm families selling less than \$2,500 of farm products averaged about \$8,500 of income from nonfarm jobs in 1971. With nonfarm economic activity rising in 1972, these incomes are expected to have shown further increases. Over one-third of all farm families were included in this group in 1971; they earned nearly 90 percent of their total income from nonfarm jobs.

TABLE 1.—CHANGES IN CIVILIAN POPULATION AND EMPLOYMENT FROM JANUARY–FEBRUARY 1972 TO JANUARY–FEBRUARY 1973

Characteristics	Percent change from January–February 1972 to January–February 1973	
	Civilian population	Civilian employment
White.....	1.7	2.7
Adult males.....	2.0	2.3
Adult females.....	1.6	2.5
Teenagers.....	1.4	6.3
Negro and other races.....	2.6	4.8
Adult males.....	2.6	4.3
Adult females.....	2.5	3.5
Teenagers.....	3.0	18.3

Source: Department of Labor.

TABLE 2.—PROFITS AFTER TAXES OF MANUFACTURING CORPORATIONS

Asset size	Millions of dollars		
	1st 3 quarters, 1971	1st 3 quarters, 1972	Percent change
All sizes.....	23,058	26,349	14.3
Under \$1,000,000.....	792	1,556	96.5
\$1,000,000 to \$10,000,000.....	1,461	2,006	37.3
\$10,000,000 to \$50,000,000.....	1,306	1,616	23.7
Over \$50,000,000.....	19,500	21,170	8.6

Source: Federal Trade Commission.

TABLE 3.—INCOME EARNED BY FARM FAMILIES FROM OFF-FARM SOURCES: 1969, 1970, AND 1971

Farm size as measured by farm sales	1969	1970	1971
Less than \$2,500.....	\$7,065	\$7,977	\$8,479
\$2,500 to \$9,999.....	4,667	5,218	5,490
\$10,000 or more.....	3,701	4,184	4,424

Source: Department of Agriculture.

Representative BROWN. I would like to have a comment on that, and since this may be my last go-around, I gather I don't get an opportunity every other time, I would like to get your comments on how we might determine effectively what a new full employment rate is. I am not wedded to the 4 percent unemployment either or the 4.5, maybe it is 4.3 and a half or 4.7 and a half. Can you give me some indication about how we can get that determined without having it, I am sure it will be politicized at the time that it is suggested, but without having it determined strictly on a political basis.

Mr. STEIN. Well, if you would like us to write something more about this we can. My own view is that this is a search for a will-o-the-wisp; that the condition, the full employment condition, is the one that we defined in our report as a condition in which those people who are making reasonable search for employment on realistic terms can find it, and what that will mean as a statistic is something that will vary from time to time, and which we won't know in advance. But I would try, if you would like, to elaborate this idea further for the record.

Representative BROWN. Really, what I want to know is how can we get it. I think CED promulgated the idea originally, didn't they, the 4 percent; am I wrong in that?

Mr. STEIN. Well, we used it back in 1946, 1947. We didn't attach the same policy significance to it which has since been attached. We used 4 percent for the purpose of defining the full employment budget which, I think, is a very limited use, and an appropriate use, but we were not implying by that that it should be public policy, as I have said many times, to get down to 4 percent no matter what and to get no lower no matter what. But you see we have come a long ways since we wrote, when the Employment Act was passed, and the CED was, of course, writing those things, and we were basically then looking at a situation in which we had had behind us a decade of gross mismanagement of the economy and gross deficiency of total demand, and that was what, on the whole, employment policy was about.

Well, this is not our situation any longer. So I think that the search for the permanent optimum figure is not likely to be well rewarded. But if you would like us to write further about it I will.

Representative BROWN. I wish you would.

[The information referred to follows:]

This response is adapted largely, but not entirely, from a section in the 1973 report of the Council of Economic Advisers, "Guide to Overall Economic Policy," pp. 71-73.

The basic mandate for policy set forth in the Employment Act is to achieve "maximum employment, production, and purchasing power." The question of the precise meaning of those goals was left unresolved when the Act was passed in 1946 and has remained open ever since.

In the early 1960's a judgment was put forward that maximum employment for that time would be achieved when 96 percent of the labor force was employed, which meant 4 percent unemployed. Paralleling this estimate was a calculation of "maximum output," usually called potential GNP, which was conceptually the output that would be realized if the economy were operating at full employment. Estimates of potential GNP, at constant prices, were actually derived by assuming that the potential level of output was equal to the level of actual output in mid-1955, and that it would increase at a trend rate based on underlying changes in population, the proportion of the population that would be in the labor force, hours of work, and productivity. The trend rate was adjusted from time to time to reflect changes in the underlying variables. The benchmark period, mid-1955, was selected because it appeared to reflect most of the characteristics associated with noninflationary full employment, including an unemployment rate close to 4 percent (the actual rate of unemployment for the second and third quarters of 1955 was 4¼ percent).

These estimates of maximum employment and potential output were not considered to be either immediate or permanent guides to policy. In fact, policy in the early 1960's recognized that too fast a push to maximum employment or potential output could be dangerous. At the same time the 96 percent employment rate, or 4 percent unemployment rate, was considered to be an "interim" goal, which might be changed later as a result of improvements in labor markets or other developments.

These judgments applied to conditions expected in the early 1960's. In retrospect, the standard they suggested seems to have been in the correct zone: Steady noninflationary expansion did raise the rate of employment to 95½ percent and the ratio of actual to potential output to 99 percent by mid-1965, and both rates might have risen somewhat further or could have at least been sustained without generating inflation, had the normal course of events not been disrupted by the subsequent rapid rise in defense spending and the associated budget deficits. However, as the Council's report of 1967 notes, "In 1966 as unemployment hovered just below 4 percent of the labor force, prices rose at a clearly unacceptable rate. . . the experience of 1966 clearly suggests that expanding demand cannot lower the unemployment rate much below the present level without bringing an unacceptable rate of price increase. Under present conditions, an overall unemployment rate close to 4 percent appears to be associated with an approximate balance between supply and demand in most labor markets. A higher level of demand for goods and services would create inflationary pressures in both product and labor markets."

The standards are a less reliable guide to policy for the 1970's than they were for the 1960's. Large and unpredicted changes have taken place in the nature, composition and behavior of the labor force, employment and unemployment, as well as in the length of the workweek. The number of adult males, 25 years and over, who constitute the key segment of the U.S. labor market has been growing extremely slowly. In contrast other components of the labor force, such as young people and adult women, have been growing extremely rapidly. As a result the composition of the labor force has changed significantly. The share of secondary groups in the total has risen from around 40 percent in 1948 to nearly 52 percent today.

For various reasons (e.g., the tendency for individuals in the secondary market to move in and out of the labor force with much greater frequency, and the rapid expansion in their supply) unemployment rates for the secondary group as a whole have been significantly higher at all stages of the cycle than corresponding rates for adult males. The evidence shows that the gap in rates has been widening.

The joint consequence of the rising share and widening gap is that the overall unemployment rate associated with any given rate of unemployment for adult males is significantly higher today than it was 20 or 10 years ago. The size of the shift since the early 60's is estimated at around half a percentage point. Also the economy itself has been through the worst and most prolonged period of price and wage inflation since World War II. These changes have important implications for the guidance of policy.

Given that our knowledge of the interrelation between the levels of output, employment, and prices at "maximum employment" is incomplete, it would be preferable to think of each objective, not in terms of a single value but as a range of values. Furthermore, the behavior of the economy in the near future will be determined not only by whether it is operating below or above some numerical potential output or below or above some target rate of employment, but also by the speed and manner with which it approaches the range of its potential levels. Against the background of recent inflationary history it is necessary to give the economy reasonable assurance that policy will not repeat the fiscal errors which ignited the inflation in the first place. Too fast a dash for a numerical target of potential would rekindle inflationary expectations and behavior that might make the potential itself unattainable, and would make it unsustainable if attained, whereas a more gradual approach which allows for the sensitivity of wages and prices to expectations would make the potential not only attainable but sustainable.

The Government can neither precisely predict what maximum employment or maximum production will be nor can it precisely control the level of actual employment or production. What the outcomes should be and will be depends upon private behavior—upon the amount of work and production that people want to do on realistically achievable terms—as well as upon public policy. The contribution of public policy is to create conditions in which people can reach their

desired employment and production goals through feasible behavior in the market. One aspect of this contribution is that the total demand for output in money terms should be sufficient so that people who want to work can find work without an unrealistically large departure from accustomed and expected patterns of wage behavior.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Mr. Stein, the Joint Economic Committee for some years has been asking the Federal Reserve to stay within the 2 percent to 6 percent band on the projected growth of the money supply, narrowly defined.

What is the administration's advice to the Fed this year?

Mr. STEIN. Well, we have not suggested to the Federal Reserve any target for the annual growth of the money supply during 1973. This is a matter on which they will have to make decisions as time passes. We have suggested, certainly everybody has agreed, they didn't need the suggestion from us, that the rate of expansion should be lower than it was in 1972.

Representative REUSS. Would you be satisfied with, say, a 7 percent expansion of the money supply in 1973?

Mr. STEIN. Well, as I said we are not in the business of setting a number now. We are satisfied that they have come down from the very high rates of expansion that were occurring in the latter part of 1972.

Representative REUSS. Then that I may be sure I understand what you are saying, you are saying that the Council of Economic Advisers and the administration would not be disturbed to have the Federal Reserve exceed the 6 percent upper limit which the Joint Economic Committee has traditionally suggested?

Mr. STEIN. We would want to see what was going on in the economy at that time. You are asking me to make a distinction between 7 and 6, and I don't think we really know that much about it. For one thing the revision of the statistics by that degree is not uncommon. So I would not want to state a target for them.

Representative REUSS. Let's see whether you maybe can be induced to show a similar deference to the Fed on another matter.

They have come out quite strongly for the variable tax investment credit and would cut it back in a time like the present to zero or close to zero, and then raise it in a time of recession and wholly insufficient capital investment to a greater rate, 10 percent or more. Are you opposed to that?

Mr. STEIN. First, you said they would cut it back at a time like the present to zero. I am not aware that they have said that.

Representative REUSS. Well, they would cut it back.

Mr. STEIN. They would cut it back under some circumstances. We suggested in the report that this is a matter that should be studied and I certainly did not propose it with the idea that we were against it. We are not satisfied that we know the final answer to that. But we are pointing to the desirability of trying to increase and improve our instruments for fiscal management and that seems to be a possibility. We have done some work on it. There is a lot there, it is not easy and we are not sure of the answer, but it is a matter in which we are very interested.

Representative REUSS. At any rate you are not going to do it this year.

Mr. STEIN. Do what? Of course, we don't have the authority—
Representative REUSS. Lower the percentage on the investment credit.

Mr. STEIN. We don't have the discretion to lower the percentage. We would have to ask Congress.

Representative REUSS. Right. You are not going to ask Congress.

Mr. STEIN. Well, I would say I guess it is unlikely that we will.

Representative REUSS. One more question—on how you picked on the \$13 billion actual deficit instead of \$10 billion, \$16 billion, what you will? I believe your answer to Senator Proxmire, to a somewhat similar question, was that the \$13 billion gave you a full employment balance, but you haven't answered to my satisfaction what the magic in that is. Obviously, with the structure of the labor market, you don't think it is possible to get down to a 4-percent unemployment rate this year. So why is it helpful to say we picked \$13 billion because that would just yield, that deficit would just yield, at full employment a balance, since you are not going to get to full employment—I am not saying your \$13 billion is wrong, and I am pulled and tugged as to whether it should be 13 or 10 or 16 or 20 or whatever, but how valuable is the full employment concept when by your own admission you can't get that.

Mr. STEIN. As you suggest, we didn't start with 13, we got to 13 because that is the number that came out when you went to a full employment balance.

Given the state of the economy that we foresaw, full employment balance implied a \$13 billion deficit. So the real question is what is so great about an operational full employment balance, it seems to me. And, of course, that is a debatable question.

As I said in answer to Senator Proxmire, I think the operational thing is not whether you are in balance or not, but whether the full employment deficit is rising or falling. I think a rise in the full employment deficit is stimulative, a decline in the full employment deficit is restrictive. But I also think we need some kind of rule to which we can adhere most of the time. I believe that if you told us or we told you to make up your mind every year what it should be, whether it should be a \$10 billion full employment deficit or \$10 billion full employment surplus, that the results of that would not be very good because I think the pressures—

Representative REUSS. I hasten to add I am not telling you this.

Mr. STEIN. Yes, I am trying to give you a little lecture about this subject [laughter] on which I have written a great deal, as you know. But anyway, if our policy was just to decide from time to time what should be the size of a full employment deficit or surplus, I think that the net effect, given the weakness of our forecasting ability, and the strength of the political forces, would be always deficits and always increasing deficits. We need some kind of rule which we will agree upon conventionally as a limitation to our agreed upon errors.

So then the question is what is a good rule. It seems to me that full employment balance is a good rule because balance is a thing which strikes people kind of intuitively as being sensible. It mobilizes on behalf of a sensible fiscal policy a lot of traditional ideas. If you compare it to any other number zero is one which people seem to like better.

Representative REUSS. Could I stop you at that point to ask this question: Although I hate to say it, it would seem to me that in a situation where your full employment balance can actually in real life be obtained only with a different labor composition than what you have got, maybe \$13 billion is too much.

Mr. STEIN. Well, you see we haven't ruled out—

Representative REUSS. You can overheat the economy if you boil at 4.8.

Mr. STEIN. We haven't ruled out the 4 percent at all, so that we don't regard it as at all unreasonable that we will, as this economy progresses through 1973, 1974, reach a state in which we not only have a full employment balance but have actual balance.

Now, so the question of whether—and you can ask, are we overheating the economy, is our deficit too big. The usual complaint I thought from your side of the aisle was the other but anyway—

Representative REUSS. I am being sneaky. [Laughter.]

Mr. STEIN. As we look at the facts in 1973 we think that we are—we have a policy which will give a steady noninflationary expansion.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Reuss.

Senator Humphrey.

Senator HUMPHREY. Mr. Stein and your associates, I want you to know I too have a high regard for your professional competence.

Mr. STEIN. Thank you.

Senator HUMPHREY. But I am disturbed and worried about what I consider to be a kind of a party line, for lack of a better phrase, in both the Budget Message and the Economic Report.

You have even indicated it here in your testimony when you said that "In order to avoid higher taxes we have got to avoid higher expenditures." I noticed in the Economic Report or the Budget Message the President says "The 1974 budget fulfills my pledge to hold down Federal spending so that there will be no need for a tax increase."

Then there is a good little political phrase that "The budget will continue to move the Nation's economy toward a goal it has not achieved in nearly two decades, high employment prosperity for America's citizens without inflation and without war."

Now the Economic Report says "Only by holding," I repeat the words "only by holding the line on Federal spending will we be able to reduce the inflation rate further in 1973."

Now, I would expect to make something like that in a political speech but I know you are an economist and I don't think you believe that only by holding the line on Federal spending will we be able to reduce the inflation rate further in 1973.

Wouldn't you think that tax policy might also have something to do with the inflation rate, that monetary policy might have something to do with the inflation rate, that international economic policy might have something to do with the inflation rate. Wouldn't you think that economic controls might have something to do with the inflation rate?

Why this pap that is fed out to the American people as if it is Holy Writ, that the way that you control inflation entirely is by the control of Federal spending, when you know, and I know that sometimes when you cut Federal spending you put the load right back on State and local government.

Now, a tax is a tax, whether it is put on at the local level or the Federal level. Frankly, Federal taxation is generally more equitable.

Is it better, for example, to cut down on Federal aid to education than put the property tax up back home? Is this the way that you control inflation? Does Federal taxation control it, or Federal spending, have an effect on inflation but local spending does not?

You know I am a pharmacist and there used to be a medication called Ward's Liniment. I can't remember exactly what it said on the label but here is a pretty good description of it. "Ward's Liniment cure for fever, ingrown toenails, backache, toothache, diarrhea, constipation, pneumonia, chickenpox, and headaches," and it covered a few other things, and that is about what this thing says. It says only by holding the line on Federal spending will we be able to reduce the inflation rate further in 1973, a kind of a Ward's Liniment prescription of economic policy.

Mr. STEIN. Well, Mr. Senator—

Senator HUMPHREY. Your observation, please.

Mr. STEIN. In the first place, I should point out to you that you are reading from the President's message, not from ours and he is not a professional economist.

Senator HUMPHREY. Well, by the way, maybe I am wrong but was—

Mr. STEIN. Neither is he a pharmacist.

Senator HUMPHREY. I thought he had more to say about the Government than you did, and not only that, but he is supposed to be reporting on your message.

Mr. STEIN. No, this is his message, he submits a message.

Senator HUMPHREY. You disagree with that then, you think the President is wrong? I would like to have you go on record here. [Laughter.]

Mr. STEIN. No, although he does not have a Ph. D. in economics he understands it very well.

Senator HUMPHREY. For this we forgive him.

Mr. STEIN. I will explain it.

Obviously, in a textbook there are various ways to control inflation, but as we look at the real world of 1973 we think that holding down increases in Federal spending is the critical point. We have adopted a set of controls but as everybody knows the worldwide experience is that the great dangers of controls is that they lull government and countries into a sense of false security which leads them to think that they can overlook such fundamental things as government spending and fiscal policy and rely on controls, and that is the way that controls generally pop out. Now with respect to the question of whether this could be done by monetary policy—

Senator HUMPHREY. By the way, I am not, you see I am not, an absolutist, I believe in compounds, mixtures, and I—all I was asking—the word here "only" bothered me and I think it should bother anybody because I think it is sheer political poppycock, and what I am getting at—aren't there other means that can be used and ought to be used along with control on spending?

Mr. STEIN. Certainly. All we are saying is this is an indispensable ingredient. You have to do certain other things but you cannot fail to do this one.

Senator HUMPHREY. This is one of the indispensable ingredients.

Mr. STEIN. This is the one.

Senator HUMPHREY. You think you can control Federal spending if the money supply goes berserk?

Mr. STEIN. This is the one that seemed to us most in doubt and, therefore, most in need of emphasis, because it is the one that we share with the Congress.

Senator HUMPHREY. Well, hasn't the Congress had a pretty good record, and we will give you a better one this year—I want you to know, you are going to get a lot of cooperation this year on Federal spending. The cuts may not come where you want them but they will be there, believe me. We may even get into a little of, beyond just the peripheral flesh here, we will touch up some things around here in this budget.

But I resent, deeply resent, the effort that is being made to paint this Congress as if it is a profligate spender with no sense of fiscal responsibility, and I resent the President of the United States and his officers coming before this committee or any other committee trying to paint a simple picture.

You know, and I know, and you have got a situation—listen to this—and how can you people come up here time after time, and you do, and ignore these facts as if somehow or other they were going to fade away tomorrow afternoon—a dollar crisis the likes of which this country has never faced since the Civil War and speculation going on by fellow Americans at the expense of the American honor, the American fiscal integrity, a balance-of-payments deficit crisis.

I remember when President Johnson had a \$4 billion balance-of-payments deficit, there wasn't enough room on the front page to print the headlines. They were massive, the country was in mortal danger, and I can remember the President calling in bankers and businessmen, and we did get voluntary cooperation.

Your balance-of-payments deficit is running at over \$10 billion, trade deficit of \$7 billion, unbalanced budget, unemployment at 5 percent, and you got a report here signed by the President that says that only by holding the line on Federal spending will we be able to reduce inflation rates further in 1973, and I read your report on the international scene, and the President's comment on it. It is very limited, and I might add that again I am coming back to tax reform and I am not going to buy the argument from you, Mr. Stein, or anybody else that tax reform means tax increases to the average guy. It doesn't. Tax reform will come on preferential income and it ought to. There is a need of tax reform, and I think that a President or an administration that can come down here with budget cuts that cut right into the heart of people's needs, that can raise a billion dollars cost on the old people in this country, and can't find time to come up with a tax reform package for this year, is an administration that is out of touch with the people and reality and, frankly, I think your economic message does not have balance, and you talked about balance when it ignores fiscal policy, tax policy and it does ignore tax policy. It doesn't say a thing about tax policy, except that hopefully everything is going along just jolly.

We need some recommendations. Here you have got the relationship between GNP and money supply. Some of us you know, have had at least our beginning courses in economics but the economics that touches me is what is touching the people.

What do you think should be the relationship between the growth of money supply and the growth of the GNP? GNP is forecast at 9 percent during 1973. What should be the money supply rate, if there is any relationship?

Mr. STEIN. Well, there is a loose relationship, and this is a matter that the Federal Reserve decides, as you know, during the course of the year. They have an Open Market Committee that meets approximately every 3 weeks. We talk with the Board and with the Chairman regularly. We are not in the business of setting forth a target for 1973.

Senator HUMPHREY. Why aren't you? You give us advice on everything else, Mr. Stein. We have had other people up here from the Council of Economic Advisers, we had Mr. McCracken 2 or 3 years ago, he gave us advice on the money supply.

What do you think is a fair rate of money supply?

Mr. STEIN. I will not speak for Mr. McCracken but I think that I personally was much more simple-minded about this subject when I came here than I am now. That is a backward way of putting it, but anyway the relation is not an easy one. I don't think there is any purpose in setting out now what should be the year's rate of growth for the money supply. We do have to set out some things for the year about the budget because decisions are made on an annual basis about the budget. Decisions about the money supply are not made on an annual basis.

Senator HUMPHREY. I point out, Mr. Stein, and I don't disagree with you on what you said, but you stick it to us on the budget. You get the mail rolling in to every Congressman that somehow we have no concern for this country. That has been the greatest political propaganda that has taken place in this country since I don't know when. Here it comes in, it is all Congress' fault, and I charge this administration with no courage to face the tax question.

You know and I know taxation has a fundamental effect on this economy and I charge this administration with waffling on international economics. You haven't made up your mind what you are going to do and you can't say that this does not affect the whole economy of this country. What you have been doing is waging a political battle against the Congress of the United States, not necessarily, not you alone, Mr. Stein, but from the President on down, and I think it is wicked, wrong, simplistic, and the worst kind of politics because the record of the Congress is not that bad.

I submit that to control inflation is not just to be done by watching the Federal budget, and I submit that the Federal budget isn't the only thing that results in taxation. The mayors of this United States have been up here and are telling they have got to raise their local taxes.

By the way, I don't buy all this stuff you are saying about inflation. Go on out and see what is happening to a man who gets his car repaired. I don't know what all these statistics are, but go on out here and talk to the people, the girls who work in these offices, about the rents that have gone up here the last 2 weeks. We have got a little wage increase for our workers, for the people around here, and rents have gone up 25 percent right in this district. Where is the Government's interest in the people? That is inflation. That is a damn sight more important than what happened to some corporate director who is getting \$200,000 a year.

What is happening to people out around this country who have to buy a new automobile? They have more gimmicks on them than you can count. I represent ordinary people. Most of the people the other ones can take care of themselves. But I don't think these reports get right down to what people are thinking about, and I haven't seen yet a policy of this administration that is as concerned about speculators of the dollar as they are about a bingo game. Who are these rascals that are running around with the dollars speculating about our money? I read in this morning's paper multinational corporations and oil companies.

Have you got any comment on that? I am fed up with them.

Mr. STEIN. I want to make one comment about this being the worst fiscal and monetary crisis since the Civil War.

Senator HUMPHREY. Since the 1930's.

Mr. STEIN. That reduced it by 75 percent. But anyway, I think we have learned to deal with our international monetary and economic problems in a much more constructive way, and I think you will see that. To interpret this in the light of what has happened at some earlier stage when we or other countries put their economies through the wringer, very stringently, because of an international monetary crisis is entirely a mistake.

Now with respect to the other question, we stated in our report that the fiscal problems of the government could be met by restraining expenditures without increasing taxes and it is the preference of this administration to do it by restraining expenditures.

Senator HUMPHREY. Now, wait a minute, that is the simplistic point, Mr. Stein, and I will not accept that kind of testimony in my time in life, and I am somewhat of an educated man; there is a difference between tax reform and increase in taxes in the public's mind and that is what we are talking about. This is a democracy, we are not meeting with the faculty of Yale or Dartmouth. We are talking about people out here, ordinary citizens.

Are you going to tell me that the only answer here is either restraint of Federal expenditures or increased taxes at the Federal level? Are you going to ignore State and local government expenditures, State and local government taxes? Are you going to ignore State and local tax reform as an economic adviser to the President?

Mr. STEIN. Well, as I said when we were here before the alternative to holding expenditures down is to raise taxes. Now if you want to call a tax increase on somebody else a tax reform, that is the common definition, I don't think that is a very good contribution to the discussion.

Senator HUMPHREY. I do. I think if you have got 200 people in this country who are not paying a dime of income tax and getting \$250,000 a year, it is a damn outrage, it is unfair, and it destroys faith in the system. I think preferential income in this country can stand a tax increase.

Mr. STEIN. We have been over these numbers. I am sure you have heard them explained by the Assistant Secretary of the Treasury, but in any case, and they are very misleading but in any case, we are concerned with situations in which individuals may not be paying their fair share of taxes. But we are also concerned with not having an increase in the total tax burden in this country, and not having an increase in the total share of the national output that runs through the Federal Government.

We think that the Federal Government has not shown itself to be such a wise spender of our money, or of the people's money, that they should be entrusted with spending more of it. We think that is a fundamental issue in the country; it is an issue upon which apparently we disagree, and I suppose we have a process by which we resolve such issues. I could not resolve it by computer.

Chairman PATMAN. The time of the gentleman has expired.

I wonder if we can agree on a time we will take before we conclude today and for lunch.

Senator HUMPHREY. I am done.

Chairman PATMAN. Henry, how much do you want?

Representative REUSS. I don't want to ask Mr. Stein to come back again.

Mr. STEIN. Please don't.

Senator HUMPHREY. I have one question I want to give to Mrs. Whitman but I can do it in writing, on the so-called surcharge.

Chairman PATMAN. In 20 minutes we will conclude.

Mr. Proxmire.

Senator PROXMIRE. Mr. Stein, I want to follow up in some of the areas Senator Humphrey hit, and I want to go back to this area of the international crisis and the dollar crisis, because, as I indicated, I would come back to that and I think we should.

One of the most appalling economic failures in the past 4 years has been the alarming deterioration of our balance of payments and especially our balance of trade, and I think the dollar crisis is an indication of the effect of that.

In response to the question of what you would favor if the situation does not improve, Mrs. Whitman, you are quoted as saying, and I quote: "We don't rule out anything."

Now, there are very few recommendations in this report. When you say you don't rule out anything, what do you rule in? What could be included? What could be done?

Mrs. WHITMAN. I am sorry but I think I would have to stand on what Mr. Stein has already said. I am not going to speculate at this particular moment on what may or may not be done.

Senator PROXMIRE. I am not asking you to speculate, I am asking you to give us the options, what is available, what can be done, what can we do? For example, when the President responded in August of 1971, August 15, he froze prices. Is it possible we might have a price freeze again; is that a possibility?

Mrs. WHITMAN. I am sorry, if you are asking me the tautological question are these things possible, I suppose the answer is almost anything that you might come up with is possible. If we go beyond this, if you ask me what is being considered, I am sorry but we simply have to stand on what we said before.

Senator PROXMIRE. Can you give us any particular help at all? Can you tell us what kind of a program might be followed by the Congress? I am not asking for an immediate, whatever we are going to take, some immediate kind of action tomorrow or next week or next month. What are the kind of actions the Congress and the administration can take that would help in this area. Is it primarily an inflation area?

Mrs. WHITMAN. The international problem?

Senator PROXMIRE. Yes. Is it a matter of domestic inflation? If we get our inflation under control would that automatically solve the dollar problem?

Mrs. WHITMAN. I wouldn't say anything would automatically solve it. The fact clearly that we got our inflation under control last year did have and does have a salutary impact. I am sure to the extent we can keep it under control and thereby increase the amount of credibility that the people around the world have in our ability to do so, of course this will help.

Senator PROXMIRE. Well, you say of course we did, but we did not get our inflation under control. If we had we wouldn't have the dollar problem.

Mrs. WHITMAN. I can only say we had a better performance with respect to the rate of inflation last year than any other major industrial country.

Senator PROXMIRE. Better. Yes.

Mr. STEIN. Maybe a way to answer the Senator's question without commenting on the Senator's question is to say that the Secretary of Treasury presented a proposal for monetary reform last September, which contained indications of what we think should be the usually available means of adjustment when countries are out of equilibrium whether it is the United States or someone else. We described this at some length in the report, so there is a catalog of measures for bringing about economic adjustments which we think in a well-ordered world after everybody has reached agreement would be useful and available.

Now this does not reflect on the current situation where we have not yet reached that agreement.

Senator PROXMIRE. Let me indicate what are some of the—what I think should be in the report but are not. You do discuss vaguely and indefinitely the structural improvement that we need. You throw a bone to productivity, and indicate productivity is part of the answer here. But there are no plans, there is no staff, there is nothing in the budget for a productivity council. We now have a few, 12 full-time people, some of whom are professionals but there is nothing to set up productivity councils, the kind set up in World War II, the kind Chairman Burns was talking about; no kind of a productivity program that would inspire our industry and our private economy to be more productive.

Now is there anything except rhetoric here? How can you have a productivity program with no budget for it? There is nothing in the 1974 budget for productivity that I have seen. Maybe it has been put in later.

Mr. STEIN. For the National Commission on Productivity?

Senator PROXMIRE. That is right, there were 12 people in 1973 for which there was a budget allowed but there is nothing in 1974.

Mr. STEIN. Well, I must say I was not aware of that.

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

Funding for the continuation of the National Commission on Productivity past April 30, 1973 through June 30, 1974 is included in the fiscal year 1973 supplemental budget request and was submitted along with the President's fiscal year 1974 budget request. The appropriation request was submitted in the amount of \$5 million. Information regarding this submission can be found on pages 963-4, 1062, and 1072 of the 1974 Budget Appendix.

Senator PROXMIRE. All right.

Now take antitrust. This, many people say, is the heart of the more competitive—

Mr. STEIN. Let me say something about productivity.

Senator PROXMIRE. All right, fine.

Mr. STEIN. The National Commission on Productivity continues to exist. Of course, it existed before you passed the bill last year which authorized a large amount of money for it. It has done some very useful work, probably the most important being a set of recommendations that were developed under its auspices for improving productivity in the food processing and distribution industry. That work has now been turned over to the Cost of Living Council on setting up some machinery for implementing it. I think our interests in the promotion of productivity are not at all diminished. But anyway—

Senator PROXMIRE. Well, it certainly is a very, very limited recommendation in a limited area, and a very small staff to give us any assistance in an activity that you admit in your report is critical if we are going to get any control over inflation.

Talking about antitrust though, where are the results? You kick around Xerox, it is the one company I know that has a top, a chief executive officer who is active in the Democratic Party, maybe a few others, but there are not many, but how about steel, and autos, and metals, and the other areas where we have oligopolistic situations and where monopolistic pricing is a way of life. There is no kind of action on the antitrust front in those areas, is there?

Mr. STEIN. Well, of course, it is always possible to list a number of areas in which there is no action, but I think that our record for overall activity in this field is a good one. It will stand comparison with any previous administration, and we have kicked around IBM a little too. Are they Democrats up there? I don't know.

Senator PROXMIRE. At any rate you may be able to pick out a rare Republican somewhere who didn't come up with an adequate contribution who is kicked around, and in comparing it with past administrations, you are right, we have a dismal record of effective antitrust enforcements. Lots of talk about it, but no real results.

But one area that we all now recognize as being tremendously dangerous from an inflationary standpoint, and adverse balance of payments area, is oil.

Mr. Solomon did suggest we could do better here by developing our own resources, which is true, our refinery capacity can be increased. I am sure that is the case, but it seems to me there is no study here, no indication of what steps we can take to hold down what can be an explosively inflationary area, and one that can be exceedingly difficult for us and increasingly difficult in our balance of trade, balance of payments, dollar situation in years to come.

How about it? What kind of recommendations can you make here?

Mr. STEIN. Well, it is completely erroneous to say there has been no study here. This matter has been the subject of intensive study. There was a subcommittee of which Mr. Solomon was the chairman which did most of the economic analysis and there will be a message in which all will be revealed but we are not prepared to put it in the Economic Report.

Senator PROXMIRE. How long do we have to wait for that one?

Mr. STEIN. I think it will be within a couple of months.

Senator PROXMIRE. Now, well, I hope it is in a couple of months, let's say, this is February; we will expect it by the middle of April.

Won't the interruption of housing starts which is one of the most decisive actions in the budget, a moratorium, apparently of a year and a half on housing starts for moderate- and low-income people, won't this begin to have a profound economic effect at exactly the wrong time? The budget indicates that in fiscal 1973 the economic effect would be one-tenth what it will be in fiscal 1975. All the indications are we are going to have an inflationary situation for the next few months. But there are many people who feel we are going to have a slowdown in 1974 and 1975.

Under these circumstances I don't see how we can restore the housing starts very quickly either because it is not in the budget in 1974. It is going to take a long time to get going. To put money in for that, you are going to have to displace something else, knock some other high priority program out.

Mr. STEIN. Well, we don't foresee this slowdown. As we have indicated, of course, the real economy cannot go on rising at a rate of 7½ percent per annum for very long because our capacity and labor force just don't grow that rapidly, but we don't foresee a slowdown below the normal rate of growth of the economy.

But we recognize that this is something to which policy must be alert if we have reason to think that this was a serious danger, and we would come forth with action to forestall it.

Senator PROXMIRE. But here we have a situation where low and moderate income people are the ones who are going to be hit by high rents the hardest. You now have vacancy rates of less than 1 percent for single family dwellings in the country as a whole, very, very low and historical basis for rental units generally. This is going to aggravate it because we are going to have no new housing starts apparently for many months, perhaps for a year and a half, isn't that right, and isn't that inflationary?

Mr. STEIN. No, we are not going to have new commitments. We are going to continue subsidized starts during 1973 at a rate somewhat in excess of 1972.

Senator PROXMIRE. Commitments. That will have the lag effect that I talked about.

Mr. STEIN. And we envisage a very high rate of housing construction.

It must be understood there is not a one-to-one relationship between subsidized starts and the net additions to total starts.

If you have fewer subsidized starts there is a flow of mortgage money which becomes available for other uses, and which flows into the mortgage market. In fact—

Senator PROXMIRE. All our experience is, it just doesn't flow into the mortgage market for people of low incomes. If you have less than \$10,000 income you are just out of luck for getting low interest and subsidized housing.

Mr. STEIN. Our experience has been with subsidized starts, too.

Senator PROXMIRE. I would like to ask Mrs. Whitman, your chapter in the Economic Report on the status of women is welcome but what it shows is outrageous. Look at this body, there is not a

woman sitting up at this table, not a woman member of this committee, except Mrs. Griffiths—in the Senate we don't have any women—in the House it is only a little better, none on the Supreme Court, we have a bad record in government and almost as bad in private industry.

There are no recommendations here. I am delighted you made the study in the hope of making progress, but as I pointed out we have made very little progress in the form of job status for women in the last 20 years. What can you give us on this?

Mrs. WHITMAN. I think you have characterized this chapter. It was an initial effort of factfinding, and I think we did collect a substantial number of facts in an area in which there is massive ignorance. There is a widespread perception that there is a problem, but when you look at the dimensions of the problem and what form it takes, there is a great deal of misunderstanding. It is our expectation in the future our discussions on this subject will be able to be more policy oriented, but at the moment we are not coming forth with a policy program. We have indicated some areas that are of immediate concern or where there are some obvious questions but we have not had the opportunity in the 2 weeks since the report was issued to develop a fullfledged policy.

Senator PROXMIER. Let me just say is the bite of your recommendation going to be there is discrimination, that we have to have effective enforcement of antidiscrimination against women by both the Congress and the administration to make it really effective, more vigorous?

Mrs. WHITMAN. Of course there is, this is one area in which there has been substantial progress.

Chairman PATMAN. The time of the gentleman has expired.

Mr. Reuss, 2 minutes.

Representative REUSS. Mr. Stein, I suggest to you that the President's refusal to plug tax loopholes has contributed in part to the current international crisis. For example, one of the biggest loopholes is the provisions which allows American multinational corporations to escape scot-free on payment of any Federal income tax at all on their overseas income as long as they leave it over there building up and don't repatriate it in income. This has meant there has been more capital investments overseas than there otherwise would have been. It means less has been repatriated both of which has affected our balance of payments and finally it has put our multinationals in possession of billions of dollars, many of which have gone into Germany and played their part in the dismal act that has been unfolding. What about that? Shouldn't the President's no-plus policy take some part of the responsibility for the current crisis?

Mr. STEIN. Well, it is incorrect and unfair to describe our policy as one of no plug. I said we are working on a tax reform package which will be a balanced package but this does not imply that there will not be some increases in some areas.

As far as that particular matter is concerned, as I recall, President Kennedy recommended that something be done about it in 1961, when we had a Democratic Congress as we still do and nothing happened.

That is a matter, I agree, that needs to be considered.

Representative REUSS. That is my 2 minutes.

Chairman PATMAN. All right.

Now tomorrow we have three distinguished people as witnesses on a panel, and the next day we have another panel and then we will not have another meeting until February 20. Tomorrow is the 13th and the 14th and that is the balance of this week and the committee will stand in recess until 10 o'clock.

[Whereupon, at 12:55 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, February 13, 1973.]

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

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., February 21, 1973.

HON. HERBERT STEIN,
Chairman, Council of Economic Advisers,
Washington, D.C.

DEAR DR. STEIN: I am sure that you will agree with me that, in reaching their conclusions regarding an appropriate fiscal policy, the Members and staff of the Joint Economic Committee should have at their disposal the same basic information and estimates as are available to the Executive Branch. In order to fill a serious gap in the information currently available to us, I would like you to supply for the record of our hearing on February 12 the Council of Economic Adviser's estimates of receipts and expenditures on a National Income Account basis by half years, both actual and full employment, for fiscal years 1973 and 1974. You will recall that similar information was supplied to the Committee at its request last year.

In the future it would certainly be helpful if this information could be printed in the Budget or in the Economic Report so that it will be readily available to the public.

I am also enclosing some other questions which the Committee Members would like to have answered for the record of our hearings.

Thank you for your cooperation.

Sincerely,

WRIGHT PATMAN, *Chairman.*

THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
Washington, D.C. March 16, 1973.

HON. WRIGHT PATMAN,
Chairman, U.S. Congress,
Joint Economic Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed are the Council of Economic Advisers' estimates of actual and full-employment receipts and expenditures on a National Income Account basis by half years for fiscal 1973 and 1974, as requested in your letter of February 21. The estimates of receipts and surplus are given both including and excluding overwithholding, as estimated by the Treasury and converted to an NIA basis by Commerce. The existence of overwithholding not only necessitates two sets of figures for analysis, as indicated in the *1973 Economic Report of the President* (pp. 40-41), but also makes it more difficult to estimate the implied tax rate on personal income. We hope that the Members and staff of the Joint Economic Committee will find this information useful in reaching conclusions regarding an appropriate fiscal policy.

Sincerely,

EZRA SOLOMON
Acting Chairman.

Enclosure.

FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES, NIA BASIS

[SAAR, in billions of dollars]

Half year s	Expenditures	Receipts ¹	Surplus ¹	Receipts ²	Surplus ²
1972-II	252.3	224.4	-27.9	233.5	-18.8
1973-I	267.1	247.8	-19.3	241.5	-25.6
1973-II	269.0	260.8	-8.2	260.7	-8.3
1974-I	281.7	272.7	-9.0	271.7	-10.0

FULL-EMPLOYMENT BUDGET ESTIMATES, NIA BASIS

1972-II	250.4	237.5	-12.5	246.6	-3.8
1973-I	265.8	257.5	-8.3	251.2	-14.6
1973-II	268.2	267.0	-1.2	266.9	-1.3
1974-I	281.1	279.5	-1.6	278.5	-2.6

¹ Excluding overwithholding and associated refunds.

² Including overwithholding and associated refunds.

Sources: OMB and Commerce, CEA estimates.

RESPONSE OF HON. HERBERT STEIN TO ADDITIONAL WRITTEN QUESTIONS POSED
BY COMMITTEE MEMBERS

Question 1. The Council points out on pages 44-45 of your Annual Report that, with the advent of revenue sharing, it is of increased importance that we look at the fiscal impact of the combined government sector—State and local as well as Federal.

In 1972, State and local governments had an estimated surplus of over \$12 billion (NIA basis). This was an unprecedented situation. Prior to 1971, State and local governments always operated very close to a balance. In 1971 they had a \$5 billion surplus and, as I say, \$12 billion in 1972.

If we take the total government sector (Federal, State and local) the combined budget deficit was about \$6 billion. Had we been at full employment there would have been a surplus in the combined government budget. How large do you estimate this surplus would have been?

Have we had a combined full employment surplus that large before? When?

What accounts for this State and local surplus? To what extent is it the result of revenue sharing payments?

Do you estimate that there will be a similarly large combined government surplus in 1973? Could you supply for the record your estimates of receipts and expenditures of the combined government sector in 1973?

Has the Council of Economic Advisers undertaken, or do you plan to undertake, any studies of the distribution of Federal payments to State and local governments by level of government or by per capita income in the recipient communities?

Answer:

THE COMBINED FEDERAL, STATE AND LOCAL FULL-EMPLOYMENT SURPLUS

The attached table contains the most recent CEA estimates of the Federal Full-Employment Budget on an NIA basis for calendar years 1956 through 1972. To this has been added CEA estimates of the State and Local Full-Employment Budget, which turns out to be the same as the NIA figures for actual receipts and expenditures by State and local governments. Expenditures of State and local governments might tend to increase if the economy were at full-employment because more revenue would be available but might tend to decrease if the economy were at full-employment because fewer expenditures would be required for welfare and so forth. In the absence of any evidence to the contrary, it has been assumed that on balance State and local expenditures at full-employment would be the same as the actual figures.

Estimating State and local receipts at full-employment is somewhat more complicated. The elasticity of State and local receipts cannot be estimated directly from aggregate data because tax rate changes cannot be separated from changes in the tax base due to changes in GNP, nor is it feasible to investigate the tax rate and tax base of each individual State and local government. In addition, State and local governments can be expected to increase tax rates in response to any gap between potential and actual GNP in attempting to maintain their receipts. Various regressions have been run to estimate the impact of the gap between potential and actual GNP on State and local receipts net of Federal grants, and the estimated coefficients for the gap in these regressions have been used to reduce State and local receipts net of Federal grants by eliminating the increase in receipts due to the higher tax rates resulting from the gap. These reduced State and local receipts net of Federal grants have then been increased proportionately to the ratio of potential GNP to actual GNP, on the assumption that for given tax rates the response of receipts to GNP is unit elastic. Finally, Federal grants have been added to State and local full-employment receipts net of Federal grants, on the assumption that Federal grants are unaffected by the gap or the level of GNP at a point in time. The resulting estimates of full-employment State and

local receipts are very close to actual receipts, so that actual receipts of State and local governments have been used as the best estimate of full-employment receipts.

The combined Federal, State and local full-employment surplus for calendar 1972 is estimated to have been \$1.7 billion. As indicated in the attached table, the combined full-employment surplus has been larger than \$1.7 billion in 12 of the 16 years from 1956 through 1971. It is interesting to note that fiscal stimulus as measured by the swing from 1971 to 1972 in the combined full-employment surplus is only \$3.8 billion, as compared to \$11.6 billion according to the swing in the Federal full-employment surplus. If the additional Federal receipts from overwithholding are included, the Federal full-employment surplus shows a small swing to stimulus, but the combined full-employment surplus shows a swing to restraint.

STATE AND LOCAL SURPLUSES AND REVENUE SHARING

State and local surpluses are, as the attached table shows, primarily accounted for by the surpluses of the social insurance funds of State and local governments. In addition, there has been a trend toward lower deficits for all other funds of State and local governments since 1967, and this became a surplus in 1972. Total Federal grants to State and local governments increased by approximately \$8½ billion from 1971 to 1972, of which revenue sharing payments only accounted for about \$2½ billion, and these revenue sharing payments were substantially less than even the surplus of \$4.0 billion recorded by all other funds of State and local governments in 1972. It is thus clear that revenue sharing payments are not the primary cause of the State and local surplus in 1972; social insurance funds, other Federal grants, and the revenue efforts of State and local governments during recent years all appear to be more important factors in the State and local surplus.

ESTIMATES OF THE COMBINED FEDERAL, STATE AND LOCAL BUDGET FOR 1973

State and local expenditures are projected to be approximately \$183 billion in 1973. This represents a continuation of past trends with some additional spending due to the higher level of Federal grants and the surplus of 1972. State and local receipts are projected to be approximately \$195 billion in 1973. This is based on grants in the Federal budget and on the assumption that State and local tax receipts will not grow as rapidly with respect to GNP as in the past because the surplus of 1972 has reduced the likelihood of State and local tax increases in 1973. From the answers submitted to the questions about the Federal budget, it can be seen that the actual Federal budget on an NIA basis for calendar 1973 shows expenditures of \$268.1 billion, receipts of \$254.3 billion, and a deficit of \$13.8 billion; while estimates for the full-employment Federal budget on an NIA basis for calendar 1973 show expenditures of \$267.0 billion, receipts of \$262.2 billion, and a deficit of \$4.8 billion. The resulting estimates for the actual combined Federal, State and local budget on an NIA basis for calendar 1973 are expenditures of \$451.1 billion, receipts of \$449.3 billion, and a deficit of \$1.8 billion; while the estimates for the full-employment combined Federal, State and local budget on an NIA basis for calendar 1973 are expenditures of \$450.0 billion, receipts of \$457.2 billion, and a surplus of \$7.2 billion. Thus the actual combined deficit will decrease and the full-employment combined surplus will increase from 1972 to 1973, but this is due to the change in the Federal sector and not the State and local sector. It should be noted that estimates for Federal receipts and the resulting surplus or deficit exclude overwithholding, and including overwithholding would result in lower receipts in 1973.

STUDIES OF FEDERAL GRANTS TO INDIVIDUAL STATE AND LOCAL GOVERNMENTS

Because of the very large number of State and local governments and the limited staff and other responsibilities of the CEA, no extensive study is either planned or underway of Federal grants to individual State and local governments. However, the Fiscal Analysis Branch of the Budget Review Division in the Office of Management and Budget has been working on such studies, and information on this question is also available in Special Analysis N of the *1974 Budget* and in *Federal Aid to States*, published by the Treasury Department (Fiscal Service—Bureau of Accounts, Division of Government Financial Operations, 1972).

FULL-EMPLOYMENT BUDGET ESTIMATES: COMBINED FEDERAL, STATE AND LOCAL, NIA BASIS

[In billion of dollars]

	Receipts			Expenditures			Surplus			State and local surplus	
	Federal	State and local	Total	Federal	State and local	Total	Federal	State and local	Total	Social insurance funds	All other
1956	77.6	34.7	112.3	71.9	35.6	107.5	5.7	-0.9	4.8	1.4	-2.3
1957	85.3	38.2	123.5	79.3	39.5	118.8	6.0	-1.3	4.7	1.5	-2.8
1958	89.2	41.6	130.8	86.9	44.0	130.9	2.3	-2.4	-1	1.7	-4.1
1959	96.2	46.0	142.2	90.2	46.8	137.0	6.0	-8	5.2	1.9	-2.7
1960	106.2	49.9	156.1	92.0	49.6	141.6	14.2	.3	14.5	2.1	-1.8
1961	110.4	53.6	164.0	100.4	54.1	154.5	10.0	-5	9.5	2.3	-2.8
1962	115.1	58.6	173.7	109.4	57.6	167.0	5.7	1.0	6.7	2.5	-1.5
1963	123.0	63.4	186.4	112.9	62.2	175.1	10.1	1.2	11.3	2.8	-1.6
1964	120.3	69.5	189.8	117.5	67.8	185.3	2.8	1.7	4.5	3.1	-1.4
1965	125.5	75.5	201.0	123.2	74.5	197.7	2.3	1.0	3.3	3.4	-2.4
1966	140.3	85.2	225.5	142.9	83.9	226.8	-2.6	1.3	-1.3	3.7	-2.4
1967	153.6	93.5	247.1	163.6	95.1	258.7	-10.0	-1.6	-11.6	4.4	-6.0
1968	176.0	107.1	283.1	181.7	107.4	289.1	-5.7	-3	-6.0	5.0	-5.3
1969	198.4	119.7	318.1	189.6	119.0	308.6	8.8	.7	9.5	5.7	-5.0
1970	206.6	135.0	341.6	203.2	132.1	335.3	3.4	2.9	6.3	6.6	-3.7
1971	219.1	151.8	370.9	218.4	147.0	365.4	.7	4.8	5.5	7.5	-2.7
1972	233.9	175.3	409.2	244.8	152.7	407.5	-10.9	12.6	1.7	8.6	+4.0

1 Excluding overwithholding.

Source: Commerce and CEA estimates.

Question 2. On pages 75-76 of your Economic Report you discuss the possibility of using temporary changes in certain tax rates as a tool for economic stabilization.

Do you support the Federal Reserve Board's proposal for a variable investment tax credit? If the President did have authority to vary the investment tax credit would you anticipate the need to exercise that authority during the coming year?

In the event that Congress decides that Federal expenditures in fiscal 1974 should be somewhat higher than the total recommended by the President and that these expenditures should be financed by additional tax revenue, would you support repeal of the accelerated depreciation regulations and reduction or elimination of the investment tax credit as the means of raising these additional revenues? Are there alternative tax changes which would be preferable?

Answer. In its latest Annual Report the Council has indicated that it would be worth considering the possibility of temporary changes in taxes, like the investment tax credit, as a means of expanding the arsenal of weapons required for the conduct of fiscal policy. A variable investment tax credit has definite advantages but also poses difficulties. A careful consideration of the benefits and costs is clearly warranted.

An alteration in the investment tax credit during the coming year is not likely but one cannot completely rule out the possibility that it might be needed. The latest survey of business expenditures for new plant and equipment points to a 14 percent rise in spending from 1972 to 1973. Conceivably as the year progresses business could step up its spending plans and move into 1974 with as large or a larger planned increase in spending than scheduled for 1973. A slower rise in plant and equipment spending would be desirable partly because the margin of unused capacity will be smaller next year than in 1973 and partly because an excessive burst of plant and equipment spending might be followed by a drastic decline that could lead to a recession. It is also conceivable (but not likely) that the plant and equipment expansion could peter out quickly, in which case some further stimulus would be desirable.

The President has already stated his opposition to a tax increase to finance additional Federal expenditures in fiscal 1974. Since the President's position is that a tax rise can be averted if the rise in expenditures is held in check, as outlined in the Budget, there is no point in speculating about alternative means of financing additional expenditures.

Question 3. In the Council of Economic Advisers' 1972 Annual Report the question was raised whether there are:

. . . structural characteristics in the modern American economy that make inflation inevitable, or inevitable in the absence of high unemployment? . . . Upon the answers to these questions will depend the possibility of holding down the rate of inflation after Phase II ends, not only below the heights reached after the Vietnam war expansion, but to an even lower level. These questions will be the subject of study by the Council of Economic Advisers.

In testifying before the Joint Economic Committee on October 26, 1972, Dr. Stein stated that this study was "going forward" and that "We will have more to say about it in our report."

The 1973 Annual Report contains no discussion of any such study. Has the Council of Economic Advisers completed a study of structural characteristics in the American economy which may contribute to inflation? If so, could that study be made available to the Joint Economic Committee?

If this study is not yet complete, when do you expect that it will be completed? Will the results be made available to this Committee?

Answer. The study referred to in the question is simply an intensification of a continuing effort on the part of the Council to analyze (a) the nature and structure of unemployment, (b) the nature and structure of inflation, and (c) the relationship between the two. Publication of a specific report is not envisaged. The results are not different from what is generally understood in academic circles, including the submissions made to the Joint Committee during the past year, and these results have influenced policy recommendations made by the Council.

Inflation.—Excess aggregate demand, stimulated primarily by overexpansive fiscal and monetary policy remains the primary cause of inflationary movements in the United States. The primary lesson for policy is that such excesses should be avoided in the future.

Structural factors, many of them traceable to specific governmental policies do contribute to the level of prices, and may contribute to the rate at which they rise. Among the recent actions which have been taken to offset some of these influences are (a) moves to remove restraints on the supply of agricultural products and (b) moves to reduce restraints on the importation of commodities in short supply.

Unemployment.—The nature and structure of unemployment in the United States has changed markedly in a number of ways. The number of adult males, 25 years and over, who constitute the key segment of the U.S. labor market has been growing extremely slowly. In contrast other components of the labor force, such as young people and adult women, have been growing extremely rapidly. As a result the composition of the labor force has changed significantly. The share of secondary groups in the total has risen from around 40 percent in 1948 to nearly 52 percent today.

For various reasons (e.g. the pendency for individuals in the secondary market to move in and out of the labor force with much greater frequency, and the rapid expansion in their supply) unemployment rates for the secondary group as a whole have been significantly higher at all stages of the cycle than corresponding rates for adult males. The evidence shows that the gap in rates has been widening.

The joint consequence of the rising share and widening gap is that the overall unemployment rate associated with any given rate of unemployment for adult males is significantly higher today than it was 20 or 10 years ago. The size of the shift since the early 60's is estimated at around half a percentage point.

These developments are relevant to economic policy in two ways (a) macro-economic policy must be cognizant that the economy's zone of full potential output may be reached before the overall unemployment rate declines to the 4 percent level conventionally associated with full capacity operations and (b) that further reduction in the overall unemployment rate beyond this point requires labor market policies, including manpower programs which are explicitly directed toward reducing the unemployment rates in the secondary labor market, especially for young people of both sexes.

An interagency task force has been set up to make specific recommendations on measures available for reducing the rate of unemployment among young people.

Question 4. The Joint Economic Committee has been trying for several years to persuade the Council to pay more attention to the economic implications of defense spending. Defense spending has been dropping steadily since 1969—from \$81.2 billion that year to an estimated \$76.4 billion in FY 1973.

(a) Can you tell us what effects this decline has had on unemployment, production and prices?

(b) Defense contract awards have also declined substantially since 1969, although they increased last year. Can you tell us what impact these changes have had on the defense industry?

(c) Can you tell us whether the drop in overall spending and in defense procurement have had any special regional impacts? Have any of the nation's areas or cities been especially hard pressed by the declines?

(d) What steps has the Administration taken to help regions or communities adjust to the economic problems that follow the closing of bases, shutdown of defense plants or other reduced activities as a result of defense cutbacks?

(e) We have been hearing about a decision to close down a number of military bases within the United States. High Pentagon officials have estimated savings of up to \$1 billion annually if unnecessary bases were eliminated. Has the Council undertaken any studies of the economic impact in the communities and regions where military bases might be closed or curtailed or made any recommendations on how problems from base closings or other reduced defense activities might be handled?

(f) The budget estimates a large increase in defense spending from \$76.4 billion in FY 1973 to \$81.1 billion in FY 1974, an increase of nearly \$5 billion in one year. The historical record shows a strong correlation between sharp upturns in defense spending and upturns in inflation. In your judgment, does the \$5 billion increase represent a potential inflationary problem?

(g) Charges are often made that our economy is dependent on defense spending—that the military budget acts like a crutch to the rest of the economy. Would a defense spending cut of from \$5 billion to \$10 billion in fiscal 1974 create any special economic problems? What would be the impact on employment of a defense cut of \$5 billion in FY 1974? Would any special programs be needed to absorb a cutback of \$5 billion or \$10 billion in a single year?

(h) In your testimony on February 6 you said that the Council has not found that there is a difference in the inflationary effect of one kind of spending over another and that, in fact, housing expenditures "could probably be more inflationary" than defense expenditures. What studies were conducted by the Council on the inflationary impact of defense and other kinds of expenditures prior to your appearance before the Joint Economic Committee? Please supply the Committee with copies of any such studies. Are you aware of studies of this question performed by any other government agencies? If you are, please supply us with copies of those studies.

(i) In a speech delivered on February 14, 1973 you asserted that real expenditures for defense has declined by over 30 percent, which is equivalent to about \$35 billion in today's prices. As you know the Commerce Department does not publish a deflator for defense purchases. Please explain the basis on which you developed the deflator for defense purchases implicit in the figures you cite. If a deflator for defense purchases has been developed why isn't it published by the Commerce Department? Is it correct that the figures you cite for real defense expenditures were developed by the Department of Defense? In deflating the prices of goods and services procured from industry can you tell us whether an analysis was made of defense price experience, or whether inflation rates were calculated on some other basis?

Answer:

SECTIONS (A) AND (B)

As the question notes, defense spending has fallen from \$81.2 billion in 1969 to \$76.4 billion in FY 1973. Abstracting from the rapid rise in the price level of defense purchases, the real decline has been much sharper. On an NIA basis, adjusted to constant dollar terms by the deflator for federal purchases, real defense purchases have declined over 30 percent between the peak level reached in the second quarter of 1968 and the fourth quarter of 1972. In terms of manpower employed in defense related industry, the decline between fiscal 1968 and the estimate for fiscal 1973 is almost 35 percent. The number of persons on active military duty declined from 3,547,000 in fiscal 1968 to an estimated level of 3,258,000 in fiscal 1973, and at the same time the number of civilians engaged in defense related employment (both in the civil service and industry) declined from 4,460,000 in fiscal 1968 to 2,893,000 in fiscal 1973. The latter figures are estimates developed by the Department of Defense and the Bureau of Labor Statistics.

Clearly, declines of this magnitude had an effect on unemployment and production. Because persons released from the armed forces have a very high participation rate in the civilian labor force, and because the same is equally true of persons who lose civilian defense related jobs the decline of 2.8 million people in defense employment (2.6 million of which occurred prior to mid-1972) had a large transitional effect on unemployment. Likewise the decline in defense production associated with the reduction in defense purchases also had an effect on the course of the index of industrial production. However the large increases the economy has enjoyed since mid-1971 in nondefense associated employment and production have more than offset the defense associated declines experienced earlier.

SECTIONS (C), (D) AND (E)

The regional concentration of defense related economic activity has, of course created adjustment problems for particular geographic areas. In 1970, the President established the Inter-Agency Economic Adjustment Committee (E.A.C) which focuses on affected communities the many Federal programs which can be of assistance in helping communities help themselves. The EAC provides expert advice to communities as well as the resources available from various Federal agency programs. According to the latest available information, (Economic Adjustment Committee, Status of Community Programs, Jan 31, 1973) the EAC was actively involved in adjustment efforts in some 39 different communities located in 22 states and the Commonwealth of Puerto Rico. The list of these communities (attached) provides perspective on the geographic impact of defense changes. Details are available in the report cited.

LIST OF STATES AND COMMUNITIES

State and county	Department of Defense installation or involvement	Page
Alaska: Kenai	Wildwood Air Force Station	1
California:		
Barstow	Fort Irwin	4
Norco	Naval Weapons Center	7
San Bernardino County	Aerospace Corp., San Bernardino operations	9
Ventura County	Aerospace Industries	11
San Joaquin County	Sharpe, Tracy Depots and Naval Communications Station	14
Connecticut:		
Bridgeport	Defense contractors	17
Middletown	Defense contractors	19
Florida:		
Brevard County	Defense and NASA direct and contract employment	22
Key West	Key West Naval Station	23
Illinois: Joliet	Ammunition Procurement and Supply Agency	26
Indiana: Crane	Crane Naval Ammunition Depot	27
Kansas: Wichita	Aerospace Industries	30
Maryland: Bainbridge	Brainbridge Naval Training Center	33
Massachusetts:		
Barnstable County	Otis Air Force Base	35
Haverhill	Defense contractors	36
Lowell	Defense contractors	41
Taunton	Defense contractors (Raytheon Co.)	43
Minnesota:		
Chandler	Chandler Air Force Station	44
Duluth-Superior, Wis.	Duluth Air Force Base	46
Wadena	Wadena Air Force Station	48
Montana:		
Conrad and Shelby	ABM Site	50
Lewistown	Lewistown Air Force Station	52
New Hampshire: Manchester ..	Greiner Air Force Station	54
New Jersey: Burlington	Burlington Army Ammunition Depot	55
New York: Nassau County	Defense-aerospace industries	57
North Carolina: Winston-Salem ..	Defense contractors	58
Ohio:		
Columbus	Navy aircraft and missiles plant	60
Wilmington	Clinton County Air Force Base	61
Oklahoma:		
Burns Flat	Clinton-Sherman Air Force Base	64
McAlester	McAlester Naval Ammunition Depot	67
Tulsa	Air Force plant No. 3	71
Oregon: Burns	Burns Air Force Station	72
Pennsylvania: Wilkes-Barre	Bendix Corp. Plant	74
South Carolina: Charleston	Defense contractors, Navy installations	75
Texas: Mexia	Defense contractors	77
Utah: Weber and Davis Counties ..	Hill Air Force Base, Ogden Defense Depot	78
Puerto Rico:		
Aguadilla	Ramey Air Force Base	80
Vieques	Defense contractors	83

Although the Council itself does not undertake detailed *regional* studies of the impact of defense changes, the Chairman of the Council is a member of the EAC.

SECTION (F)

The budget estimates that defense spending will rise from \$76.4 billion in fiscal 1973 to \$81.1 billion in fiscal 1974, most of it due to an increase in wages, pensions and prices. The effect of the budget in the economy depends of course on what happens to the total federal spending. The budget increase for the total is from \$250 billion to \$269 billion, and this in our opinion is not a potentially inflationary increase.

SECTION (G)

Large increases in defense spending and defense employment connected with the Korean War and with the Vietnam War were associated with very high levels of output (relative to potential output) and low levels of unemployment. This does not mean that the U.S. economy needs the artificial stimulus of such spending. Thus in the 1955-57 period, the economy operated at close to its potential level even with comparatively low levels of defense spending and employment. Likewise the current recovery toward the zone of potential is occurring inspite of the substantial cutback in defense associated employment that has occurred since 1968. Further sharp cuts in defense spending would, of course create further transitional problems that would require time for their effects to be absorbed by growth in the nondefense sectors.

SECTION (H)

An increase in purchases of goods and services either by the government sector or by the private sector, which is not offset by decreases in other demands on economic production have an expansionary effect. To the extent that net new demands are centered in sectors where the supply of skills and facilities is inelastic it also tends to exert an inflationary impact on prices. There is no evidence that defense spending, as such, has either a larger expansionary or a larger inflationary effect than other types of spending such as housing, net exports or plant and equipment. In technical terms the "multipliers" associated with defense spending are similar in size to those associated with other major forms of autonomous expenditures.

SECTION (I)

The Commerce Department does not publish a separate deflator of Federal defense purchases. The estimates for real defense expenditures used in the February 14, 1973 speech were derived by using the overall deflator for Federal purchases in the NIA accounts. Because defense purchases accounted for between 70 and 80 percent of all Federal purchases during the period covered, it can be assumed that a separate deflator for national defense purchases would not differ significantly from the overall deflator. The Defense Department does make its own estimate of a Defense "deflator", and according to the *Economics of Defense Spending* published in July 1972 this specific Defense deflator is somewhat flatter i.e., it reflects less inflation, than the overall federal purchases deflator.

