643

THE 1974 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-THIRD CONGRESS

SECOND SESSION

PART 3

FEBRUARY 25, 26, 28, AND MARCH 4, 1974

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THE 1974 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 25, 1974

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

The committee met, pursuant to recess, at 10:05 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (vice chairman of the committee) presiding.

Present: Senator Proxmire and Representative Reuss.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Richard F. Kaufman, general counsel; William A. Cox, Lucy A. Falcone, John R. Karlik, L. Douglas Lee, and Courtenay M. Slater, professional staff members; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. The committee will come to order. Previous sessions of the Joint Economic Committee's 1974 annual hearings have been devoted to a number of different aspects of the economic outlook. We have received excellent testimony. Yet, somehow, there has been little discussion of the basic human dimensions of the combination of recession and inflation which presently confronts the country.

If inflation continues at the rate of last year—that is, in excess of 8 percent—it will mean that even an inflationary wage increase of 10 percent would be more than wiped out. This is because, with a $1,000 increase on a $10,000 wage, for example, inflation will take $800 and additional Federal and State income taxes and social security taxes will take some $300, leaving even the wage earner who enjoyed a very large wage increase worse off. The vast majority of wage earners who pay increase, if at all, is likely to be less than 10 percent. Real income, of course, will drop.

For those in fixed income the inflation will be disastrous. Tens of millions of Americans holding savings accounts or Federal or municipal corporate bonds will—no real income will improve in those savings at all. In fact, of course, real wealth of this kind will sharply drop in value.

Furthermore, if unemployment rises to 6 percent by midyear, as now seems likely, that will mean 5½ million persons out of work. It will mean several million more working short hours or part time.

It will mean that the economy will produce $70 billion less in goods and service than if it were operating at its full potential.

This means $70 billion less of food, clothing, housing, and other things available to meet the needs of the country. It also means less revenue for the Government, less profit for business, and a lot less income for workers. With real income already falling because of inflation, the average family can ill afford the additional loss of income due to the failure to maintain full employment.

Real spendable earnings declined by 2 percent in January alone, the largest single month decline since this series was begun in 1964. The decline was due to the combination of fewer hours worked and higher prices. If January is any indication of what lies ahead for the rest of the year, the average American family is in for a very tough year. And, of course, the difficulty is that it is so hard to design policies that go both ways at once, to enable us to fight inflation, restrain the economy through either monetary or fiscal policy or any other means that is available that will hold prices down, and at the same time expand job opportunities. This is the really serious dilemma.

We have titled our panel this morning "Income and Employment." Obviously, it is a timely subject. The committee is very fortunate to have as witnesses three of the country's most distinguished economists.

Our first witness is Mr. Robert A. Gordon, professor of economics at the University of California at Berkeley. Mr. Gordon is perhaps the country's leading expert in the economics of employment and unemployment. In the 1960's he served as chairman of the Gordon commission which reviewed the official employment statistics. Mr. Gordon has recently been chosen president-elect of the American Economic Association, and I congratulate the AEA on their wise choice.

Our second witness is Mr. Guy E. Noyes, senior vice president of the Morgan Guaranty Trust Co. As one who worked very briefly for J. P. Morgan and Co., which I did back in 1940–41, I of course, have great admiration and respect for anyone who can succeed in that large and powerful corporation. Before going to Morgan in 1965, Mr. Noyes was Director of Research and Statistics for the Federal Reserve Board.

Our final witness will be Mr. James Tobin of Yale University. Mr. Tobin served as president of the American Economic Association in 1971. His presidential address that year was a fascinating exposition of his theory of inflation, a theory which seemed very satisfactory at that time. But of course, 1971 is ancient history now on the inflation front. We are eager to hear how 1973 and 1974 can be put into his or any other rational framework.

Mr. Gordon, please proceed.

STATEMENT OF ROBERT A. GORDON, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, BERKELEY, CALIF.

Mr. Gordon. Thank you, Senator Proxmire.

I shall summarize my comments and submit my prepared statement for the record.

It has been announced that today's hearings on the "Economic Report of the President" will deal with the subject of "Income and Employment." In my comments I shall concentrate upon the report's treatment of employment and unemployment.

The first page of the President's part of the Economic Report refers to the decline in unemployment that occurred during 1971–73. So far as 1974 is concerned, he is apparently prepared to see the unemployment rate rise significantly. He has nothing to offer to cope with this problem except the promise of a more expansionary fiscal policy "if necessary", urging Congress to improve the system of unemployment compensation, and a plea to the public for "patience."

Not a word is said about the tragically high unemployment rates among the underprivileged segments of the labor force, or about what is likely to happen to these already high unemployment rates in the year ahead. Nor can we find a word about the possible need for improved manpower programs and an expanded system of public service employment to cope with our serious problems of structural, as well as worsening cyclical, unemployment. The Council of Economic Advisers is equally silent on this subject.

Nor does the President have anything to say about the decline in average spendable weekly earnings in the private nonfarm economy between 1972 and 1973, or about the failure of real hourly earnings in the same sector to increase at all between these 2 years.

I turn now to the Council's treatment of our domestic macroeconomic goals. One brief section of their report carries the title "Goals for 1974." The text makes clear that this section is mistitled. The administration apparently has no domestic macro goals for 1974 except in the negative sense that, if things get bad enough, it promises to act, presumably through a more expansionary fiscal policy than is reflected in the President' budget message.

What the Council does in this section on goals is to make a forecast—unemployment averaging "a little above 5½ percent" and presumably rising to 6 percent or more before beginning to decline, an inflation rate of 7 percent, and a rise in real output of 1 percent. These are our short-term goals and the administration will apparently be content if events in 1974 permit these so-called goals to be met. It is not prepared to do anything to reduce unemployment or the rate of inflation below these goals.

At least so far as 1974 is concerned, this is the way the Council interprets the goals of full employment, price stability, and rapid economic growth. Presumably, we cannot do anything about the situation, so we might as well lie back and enjoy it, or at least tolerate it.

The Council then moves on to discuss a variety of policies to achieve their so-called goals for 1974. Here again the only mention of any steps to cope with higher unemployment in 1974 is a proposal to extend the duration and expand the coverage of unemployment compensation.

The Council then goes on to talk about our "Goals Beyond 1974". The emphasis in this section is almost exclusively on the goal of rapid economic growth. There is not a single mention of the other macroeconomic goals, and growth is to be stimulated through providing a more favorable environment for business and by increasing the flow of savings to the private sector. The emphasis is entirely in terms of aggregate supply. The possible need to maintain or restrict aggregate demand is ignored. And there is presumably no need for long-term planning to cope with structural unemployment or with the increasingly strong cost-push forces operating to drive wages and price upward.

The Council's emphasis in this part of its report on growth, on the need to provide a more favorable environment for business and to stimulate the flow of savings into private investments—in part through a budgetary surplus—reminds me of the "Economic Reports" in the closing years of the Eisenhower Administration. In 1959–60, the Economic Reports worried about inflation and how to stimulate growth through tax changes that favored investment and through maintenance of a surplus in the Federal budget. It seemed content then that an unemployment rate of 5½ percent was a reasonable approximation to the full employment goal.

The present Council does do a little bit better than this. It wants a budgetary surplus to provide funds for private investment only at high or full employment, and later in the report—as it has done before—it seeks to provide a statistical basis for lowering its sights with respect to the full employment goal.

But I still find it striking—and reminiscent of official policy attitudes in 1959–60—that a discussion of "Goals Beyond 1974" ignores the problem of unemployment and places almost exclusive emphasis on aggregate supply and on financing private investment in an environment favorable to business expectations. I also find it striking that in a section concerned with long-term goals there is no mention of the long-term inflation problem—except for the inference that stimulating the growth of output will hold inflation within acceptable limits over the long pull. This, to put it bluntly, is nonesense, at least in today's setting.

I turn now to a more detailed discussion of the Council's interpretation of the objectives of the Employment Act of 1946 and its present approach to defining and quantifying the goal of full employment.

On page 49 of the report, the Council proudly declares that "in terms of the objectives of the Employment Act 1973 was a successful year." It then goes on to cite as evidence the record highs in employment, production and consumers' real income. But there is not a single mention of unemployment.

In 1973, during which the objectives of the Employment Act were presumably achieved, the national unemployment rate averaged 4.9 percent, and the Council and everyone else have predicted that it will be considerably higher in 1974. The rate for nonwhites in 1973 was 8.9 percent; for teenagers it was 14.5 percent; for nonwhite teenagers, it was about 30 percent. And in the urban ghettoes, the corresponding rates were higher still. Nor does this end the list of high unemployment rates in 1973, a year in which the objectives of the Employment Act were presumably substantially achieved.

The point I want to make here is that the Council—and also too many economists on the other side of the political fence—think of the concept of maximum or full employment entirely in terms of a single number. I think the time has come to give up this concentration on a single figure in seeking to implement the goal of full employment.

If I were to stop here, I should probably be applauded by the Council. In both last year's and this year's report, in its effort to secure public acceptance of a full employment target that results in a national unemployment rate considerably above four percent, the CEA described maximum employment as "a condition in which persons who want work and seek it on reasonable terms can find employment". And it adds, and again I quote, "There is no single statistic which can signal the achievement of the condition we seek."

They are certainly correct that no single figure corresponds to their definition. The implication of their definition is that the groups with relatively high unemployment rates are demanding—or are being forced to demand by minimum wage laws and union and other pressures—unrealistically high wages. Push wages down among these less favored groups, and we can then define full employment in terms of a satisfactorily low national unemployment rate.

Given the existing wage structure and the imbalance between demand and supply at these wage rates in the various segments of the national labor market, then we have to settle both for a national rate considerably above 4 percent and for even higher unemployment rates for the less favored groups in the labor force.

And, short of bringing down relative wages for these high unemployment groups, there is nothing we can do about it. So far as I can recall, there is not a word in the report about possible ways of increasing the demand at present wage rates for these groups with relatively high unemployment rates or about improving mobility from the high unemployment to the low unemployment sectors of the labor market.

I stated a bit earlier that the time has come to stop defining the full employment target in terms of a single figure. We need a battery of employment targets—at least by age, sex, and race. Instead of accepting the relatively high rates for youth, women, blacks, and other minority groups, and then looking to see how their changing shares of the labor force affect the national rate, we need to develop a comprehensive set of programs to bring down the relatively high rates for these groups to more acceptable figures.

This does not necessarily mean the same low rate for all age-sex-ethnic groups. But it does mean that we should seek to achieve the goal of full employment not only through the conventional macro instruments of monetary and fiscal policy, but also through a much larger investment in a comprehensive manpower policy, which, in my opinion, should include a permanent program of public service employment—and on a much larger scale than what we have had since 1971.

I believe strongly that we should not take today's differentially high unemployment rates as given, do little or nothing about them, and then argue that our full employment goal must correspond to an unemployment rate close to 5 percent because the less favored groups in the labor force have increased in relative size.

This leads me to the arithmetic exercise that the Council undertakes in this year's report to demonstrate how much the changed age-sex composition of the labor force has worsened the overall unemployment rate. A similar but yet different calculation was carried out in the January 1972 report.

I refer the committee to my prepared statement for an evaluation of these two calculations. The one this year implies that the changed age-sex composition of the labor force has raised the national unemployment rate by eight-tenths of a percent since 1956. The one 2 years ago suggests that it has been raised by five-tenths of 1 percent.

Whichever version of these calculations that we use, there is no doubt that the changed age-sex composition of the labor force has made it more difficult to achieve a 4 percent unemployment rate today than was the case 10 or 15 years ago. But this does not suggest to me, as it apparently does to the Council, that we merely accept this fact and settle for a target unemployment rate in the neighborhood of 5 percent. To me it suggests the urgent need for a greatly expanded and improved set of manpower programs—including, again, public service employment—to reduce unemployment wherever it is relatively high. But this is a topic that the report steadfastly ignores.

I turn now to a few brief comments on the report's discussion of the distributrion of income. The Council finds that there has been no significant change in the distribution of income among families since World War II. Incomes are about as unequally distributed today as they were 25 years ago.

I think most economists who have looked into the matter would agree with this conclusion. But one qualification should perhaps be added. The Council's table on page 140 suggests that the distribution of income in 1972 was somewhat more unequal than in 1966. This may reflect primarily the fact that unemployment was considerably higher in 1972.

Several points bother me about the Council's discussion of earnings differentials among groups, particularly with respect to the apparent narrowing of the differential between black and white earnings. My qualims have to do with the neglect of racial differences in unemployment and labor-force participation. I do not deny that there has been some improvement in the earnings of blacks relative to whites. But as the Council's own figures on page 153 demonstrate, hourly earnings of blacks compare much more favorably to those of whites than do annual earnings. Blacks not only receive lower hourly wages, but on the average they work fewer hours per year.

In this connection, the Council says nothing about one respect in which the position of black males has been worsening. I refer to the dramatic decline that has been occurring in labor-force participation rates of black males, a trend that shows up even for men under the age of 45 and which, if anything, accelerated in the latter part of the 1960's.

I might add here that I think that the Council minimizes the extent to which blacks get locked into relatively dead-end jobs—certainly much more so than whites. In this connection, I refer the committee and the Council to the considerable body of literature on the dual labor market. I shall take the liberty of adding also that I think the Council has, in its discussion of the distribution of income, been too much influenced by the human capital literature.

Limitations of time preclude any extended comments on the Council's discussion of the low income population and of government transfer payments. Again, a good deal of useful information has been assmbled, and, on the whole, one can agree with what is said about trends and causal factors at work.

It was in this section of the report that my mind went back to the discussion of poverty in the Economic Report 10 years ago. Then the Council communicated a sense of urgency and of the need for significant government action. It is true that the incidence of poverty has declined significantly over the last decade, and that there has been a tremendous increase in Federal transfer payments to those in need. But there is obviously much that still remains to be done. I was impressed by not only the objective character of the Council's treatment of the poverty problem, but also by its careful abstention from policy recommendations.

Thank you, Mr. Vice Chairman.

Senator PROXMIRE. Thank you very much, Mr. Gordon.

[The prepared statement of Mr. Gordon follows:]

PREPARED STATEMENT OF ROBERT A. GORDON

TREATMENT OF THE DOMESTIC GOALS OF MACROECONOMIC POLICY IN THE NEW ECONOMIC REPORT OF THE PRESIDENT

It has been announced that today's hearings on the new *Economic Report of the President* will deal with the subject of "Income and Employment." The three major goals of domestic macroeconomic policy are usually considered to be full employment, rapid economic growth, and a moderate degree of price stability. In my comments, I shall concentrate upon the *Report's* treatment of the first of these goals, although I shall also touch briefly on its handling of the other two. I shall also have something to say about the Council's chapter on the distribution of income.

I

I shall begin by mentioning a few things in the President's part of the *Report*. The first page refers to the decline in unemployment that occurred during 1971–1973. So far as 1974 is concerned, he is apparently prepared to see the unemployment rate rise significantly, at least in the first half of the year. He has nothing to offer to cope with this problem except the promise of a more expansionary fiscal policy "if necessary," urging Congress to improve the system of unemployment compensation, and a plea to the public for "patience." Not a word is said about the tragically high unemployment rates among the underprivileged segments of the labor force or about what is likely to happen to these already high unemployment rates in the year ahead. Nor can we find a word about the possible need for improved manpower programs and an expanded system of public service employment to cope with our serious problems of structural (as well as worsening cyclical) unemployment. The Council of Economic Advisers is equally silent on this subject.

I might add that, while the President points proudly to the rise in "the real income of American consumers per capita, after taxes," since 1971, he is understandably silent about the decline in average spendable weekly earnings in the private nonfarm economy betwen 1972 and 1973 or about the failure of real hourly earnings in the same sector to increase at all between these two years.

Let me turn now to the Council's treatment of our domestic macroeconomic goals, particularly the goal of full employment. The brief section of their report beginning on page 27 carries the title "Goals for 1974." The text makes clear that this section is mistitled. The Administration apparently has no domestic macro goals for 1974 except in the negative sense that, if things get bad enough, it promises to act, presumably through a more expansionary fiscal policy than is reflected in the President's budget message. What the Council does in this section on *goals* is to make a *forecast*—unemployment averaging "a little above 5½ percent" and presumably rising to 6 percent or more before beginning to decline, an inflation rate of 7 percent, and a rise in real output of one percent. These are our short-term "goals," and the Administration will apparently be content if events in 1974 permit these "goals" At least so far as 1974 is concerned, this is the way the Council interprets the goals of full employment, price stability, and rapid economic growth. Presumably, we can't do anything about the situation, so we might as well lie back and enjoy it—or at least tolerate it.

The Council then moves on to discuss policies to achieve their "goals" for 1974—being prepared for a more expansionary (or restrictive) fiscal policy than now planned if the economy "is clearly running outside the general track described here," suggestions for a desirable rate of increase in the money supply, a brief reference to housing policy in terms of steps already taken, a longr discussion of "managing the energy shortage," a statement on the desirability of removing wage and price controls, and the need for the United States to participate in steps toward further international cooperation in view of the oil crisis. The only mention of any steps to cope with higher unemployment in 1974 is a proposal to extend the duration and expand the coverage of unemployment compensation.

The Council then goes on to talk about our "Goals Beyond 1974." The emphasis in this section is almost exclusively on the goal of rapid economic growth. There is not a single mention of the other macroeconomic goals. And growth is to be stimulated through providing a more favorable environment for business and by increasing the flow of savings to the private sector—in part by ensuring a surplus in the federal budget at full employment (however that is defined), as well as by improvements in financial markets, overhauling our transportation system, and moving toward a more efficient system of international exchange. The emphasis in this treatment of long-term goals is entirely in terms of aggregate supply. The possible need to maintain (or resterict) aggregate demand is ignored. And there is presumably no need for long-term planning to cope with structural unemployment or with the increasingly strong cost-push forces operating to drive wages and prices upward.

The Council's emphasis in this part of its *Report* on growth, on the need to provide a more favorable environment for business and to stimulate the flow of savings into private investment (in part through a budgetary surplus), reminds me of the *Economic Reports* in the closing years of the Eisenhower Administration. In 1959–1960, the *Economic Reports* worried about inflation and how to stimulate growth through tax changes that favored investment and through maintenance of a surplus in the federal budget. It seemed content that an unemployment rate of 5½ percent was a reasonable approximation to the full-employment goal. The present Council does a bit better than this. It wants a budgetary surplus to provide funds for private investment only at 'high" or "full" employment, and later in the *Report* (as it has done before) it seeks to provide a statistical basis for lowering its sights with respect to the full employment goal. But I still find it striking—and reminiscent of official policy attitudes in 1959–1960—that a discussion of "Goals Beyond 1974" ignores the problem of unemployment and places almost exclusive emphasis on aggregate supply and on financing private investment in an environment favorable to business expectations. I also find it striking that in a section concerned with long-term goals there is no mention of the long-term inflation problem—except for the inference that stimulating the growth of output will hold inflation within acceptable limits over the long pull. This, to put it bluntly, is nonsense in today's setting.

II

I turn now to a more detailed discussion of the Council's interpretation of the objectives of the Employment Act of 1946 and its present approach to defining and quantifying the goal of full employment.

On page 49 of the Report, the Council proudly declares that "in terms of the objectives of the Employment Act," namely, "maximizing employment, production, and purchasing power," "1973 was a successful year." It then goes on to cite as evidence the record highs in employment, production, and consumers' real incomes. But there is not a single mention of *un*employment.

In 1973, during which the objectives of the Employment Act were presumably achieved, the national unemployment rate averaged 4.9 percent, and the Council and everyone else have predicted that it will be considerably higher in 1974. The rate for nonwhites in 1973 was 8.9 percent; for teenagers it was 14.5 percent; for nonwhite teenagers, it was about 30 percent. And in the urban ghettoes, the corresponding rates were higher still. Nor does this end the list of high unemployment rates in 1973, a year in which the "objectives of the Employment Act" were presumably substantially achieved. Last year nonfarm laborers experienced an unemployment rate of 8.4 percent; in construction, the industry rate was 8.8 percent; and there were other occupations and industries with unemployment rates significantly above 5 percent.

The Council does recognize the higher unemployment rates of youth and women later in the Report, but it does so merely to explain why the increased shares of these two groups in th labor force mean that we must now settle for a higher overall unemployment rate than 10 or 15 years ago.

The point I want to make here is that the Council—and also too many economists on the other side of the political fence—think of the concept of "maximum" or "full" employment entirely in terms of a single number. I think the time has come to give up this concentration on a single figure in seeking to implement the goal of full employment.

If I were to stop here, I should probably be applauded by the Council. In both last year's and this year's report, in its effort to secure public acceptance of a full-employment target that results in a national unemployment rate considerably above 4 percent, the CEA described "maximum employment" as "a condition in which persons who want work and seek it on reasonable terms can find employment." (Page 58 of the 1974 *Report.*) And it adds (page 59): "There is no single statistic which can signal the achievement of the condition which we seek." They are certainly correct that no single figure corresponds to their definition. The implication of their definition is that the groups with relatively high unemployment rates are demanding—or are being forced to demand by minimum wage laws and union and other pressures—unrealistically high wages. Push wages down among these less favored groups, and we can define "full employment" in terms of a satisfactorily low national unemployment rate. Given the existing wage structure and the imbalance between demand and supply at these wage rates in the various segments of the national labor market, then we have to settle both for a national rate considerably above 4 percent and for even higher unemployment rates for the less favored groups in the labor force.

And, short of bringing down relative wages for these high-unemployment groups, there is nothing we can do about it. So far as I can recall, there is not a word in the *Report* about possible ways of increasing the demand at present wage rates for these groups with relatively high unemployment rates or about improving mobility from the high-unemployment to the low-unemployment sectors of the labor market.

I stated a bit earlier that the time has come to stop defining the full-employment target in terms of a single figure. We need a battery of employment targets—at least by age, sex, and race. Instead of accepting the relatively high rates for youth, women, blacks, and other minority groups, and then looking to see how their changing shares of the labor force affect the national rate, we need to develop a comprehensive set of programs to bring down the relatively high rates for these groups to more acceptable figures. This does not necessarily mean the same low rate for all age-sex-ethnic groups. But it does mean that we should seek to achieve the goal of full employment not only through the conventional macro instruments of monetary and fiscal policy but also through a much larger investment in a comprehensive manpower policy, which, in my opinion, should include a permanent program of public-service employment (and on a much larger scale than what we have had since 1971).

Some years ago I proposed a set of unemployment rates by age, sex, and color (and also by occupation) as targets for a full-employment policy. I may have been too optimistic, because my targets for the different segments of the labor force yielded a national unemployment rate of about 3 percent. But I still think this is the sort of figure that we should shoot for. I believe strongly that we should *not* take today's differentially high unemployment rates as given, do little or nothing about them, and then argue that our full employment goal must correspond to an unemployment rate close to 5 percent because the less favored groups in the labor force have increased in relative size.

This leads me to the arithmetic exercise that the Council undertakes in this year's *Report* to demonstrate how much the changed age-sex composition of the labor force has worsened the overall unemployment rate. A similar but yet different calculation was carried out in the January, 1972, *Report*. It is worthwhile to consider these two sets of calculations, which have also been performed by nongovernment economists.

In this year's *Report*, the Council takes the 1973 unemployment rates for the different age-sex groups and weights each group's unemployment rate by its share of the labor force *in 1956*, when the national rate was only 4.1 percent. The result of the changed weights is to reduce the 1973 national rate from 4.9 to 4.1 percent, a difference of as much as 0.8 percent. The implication of this calculation is clear. If we only had the same composition of the labor force in 1973 as in 1956, the national unemployment rate would have been close to 4 percent. This is further evidence that we really did have full employment last year.

Two years ago, the Council performed a somewhat different calculation. Instead of multiplying current unemployment rates for the different age-sex groups by their 1956 shares of the labor force, it took their unemployment rates in 1956 and weighted them by their shares of the labor force in 1971. This change in weights raised the 1956 national unemployment rate from 4.1 to 4.4 percent. (A similar calculation carried out for 1973, using the 1956 unemployment rates for each age-sex group and its share of the labor force in 1973, yields a national rate of 4.6 percent, or 0.5 percent higher than in 1956.)

Which of these two methods is more useful in helping us to estimate how much more difficult it is to achieve a 4 percent national unemployment rate today than in 1956? The calculation in this year's *Report* suggests that the changed age-sex composition of the labor force has increased the national rate by 0.8 percent; the Council's previous calculation, applied to the 1973 figures, sugests that the effect on the national rate has been only about 0.5 percent. Even this, of course, is serious enough.

Of the two calculations, the one in the 1972 *Report*, which weights 1956 unemployment rates by each group's share in the labor force today, is the easier to interpret. It tells that even if we had today the same age-sex specific unemployment rates that we had in 1956, the changed age-sex composition of th labor force would give us a significantly higher overall unemployment rate than before. But it may minimize the magnitude of the change that has occrured, because it ignores the effect of the changed composition of the labor force on the dispersion of unemployment rates, raising rates for those groups whose share of the labor force has increased and lowering them for groups, like males age 25–64, whose relative unemployment rates have declined. On the other thand, this year's calculation, in which current age-sex unemployment rates are weighted by 1956 labor-force shares, does reflect, perhaps too sensitively, the effect on unemployment rates of particular age-sex groups of their changing shares in the labor force. Indeed, it also reflects the effect of other forces—like the differential effect on age-sex unemployment rates of cyclical fluctuations in the demand for labor.

Whichever version of these calculations that we use, there is no doubt that the changed age-sex composition of the labor force has made it more difficult to achieve a 4 percent unemployment rate than was the case 10 or 15 years ago. But this does not suggest to me, as it apparently does to the Council, that we merely accept this fact and settle for a target unemployment rate in the neighborhood of 5 percent. To me it suggests the urgent need for a greatly expanded and improved set of manpower programs—including, again, public employment—to reduce unemployment wherever it is relatively high. But this is a topic that the *Report* steadfastly ignores.

III

I turn now to a few brief comments on the *Report's* discussion of the distribution of income. The chapter in the *Report* provides a useful integration and summary of information that is not available in any single source.

As I read this chapter, I was reminded of the chapter on poverty in the *Economic Report of the President* of January, 1964, just 10 years ago. The present *Report* deals with the entire income distribution rather than with just those below the poverty level, but, quite naturally, it also has a good deal to say about low incomes and about the role of transfer payments in reducing the incidence of poverty. The most interesting contrast between the discussion of low incomes in the 1964 and 1974 Reports is in tone and emphasis. The 1964 *Report* was strongly normative and reflected a sense of urgency. In effect, it was providing the factual background for the Johnson Administration's "Great Society" programs. The discussion in this year's *Report* is positive in tone, coolly dispassionate, and leads to no policy recommendations.

The Council finds that there has been no significant change in the distribution of income among families since World War II. Incomes are about as unequally distributed today as they were 25 years ago, despite the rise in transfer payments, the increased labor force participation of women, and the strong efforts that have been made to reduce discrimination by race and sex and the incidence of poverty has declined as real income per capita has risen, in the labor market. While the relative position of some groups has improved the distribution of income has not changed in the direction of significantly greater equality. I think most economists who have looked into the matter would agree with this conclusion. But one qualification should perhaps be added. The Council's table on page 140 suggests that the distribution of income in 1972 was somewhat more unequal than in 1966. This may reflect primarily the fact that unemployment was considerably higher in 1972.

Several points bother me about the Council's discussion of earnings differentials among groups, particularly with respect to the apparent narrowing of the differential between black and white earnings. My qualms have to do with the neglect of racial differences in unemployment and labor-force participation. I do not deny that there has been some improvement in the earnings of blacks relative to whites. But as the Council's own figures on page 153 demonstrate, *hourly* earnings of blacks compare much more favorably to those of whites than do *annual* earnings. Blacks not only receive lower hourly wages but, on the average, they work fewer hours per year. In this connection, the Council says nothing about one respect in which the position of black males has been worsening. I am referring to the dramatic decline that has been occurring in labor-force participation rates of black males, a trend that shows up even for men under the age of 45 and which, if anything, accelerated in the latter part of the 1960's.

I might add here that I think that the Council minimizes the extent to which blacks get locked into relatively dead-end jobs—certainly much more so than whites. In this connection I refer the Committee and the Council to the considerable body of literature on the dual labor market. I shall take the liberty of adding that I think the Council has, in its discussion of the distribution of income, been too much influenced by the "human capital" literature.

Limitations of time preclude any extended comments on the Council's discussion of the low-income population and of government transfer payments. Again, a good deal of useful information has been assembled, and, on the whole, one can agree with what is said about trends and causal factors at work. It was in this section of the *Report* that my mind went back to the discussion of poverty in the *Economic Report* 10 years ago. Then the Council communicated a sense of urgency and of the need for significant government action. It is true that the incidence of poverty has declined significantly over the last decade and that there has been a tremendous increase in federal transfer payments to those in need. But there is obviously much that still rmains to be done. I was impressed by not only the objective character of the Council's treatment of the poverty problem but also by its careful abstention from policy recommendations.

Senator PROXMIRE. Mr. Noyes, go right ahead, sir.

STATEMENT OF GUY E. NOYES, SENIOR VICE PRESIDENT AND ECONOMIST, MORGAN GUARANTY TRUST CO., NEW YORK, N.Y.

Mr. NOYES. Mr. Vice Chairman, I am honored to have been asked to testify before your committee, especially in the distinguished company of Professor Gordon and Professor Tobin.

The focus of this discussion, income and employment, is not an area in which I have specialized, and certainly I have no unique prescription to urge upon you for the achievement of the elusive goal of stable economic growth at full employment.

I do, however, have the opportunity to talk with many people engaged in a wide variety of businesses about the situations in their industries. In the process I collect quite a lot of information that goes beyond the regularly published economic statistics, and that information is helpful to me in understanding the extremely complex and basically unprecedented economic situation in which we now find ourselves. Perhaps the most useful contribution that I might make today is to share with you some of the facts and insights I have gleaned from my daily work.

By way of stagesetting, let me refer first, however, to some aggregate statistics which are, I am afraid, all too familiar to you. In the second and third quarters of last year real growth in the United States averaged less than a 3 percent annual rate. In the fourth quarter it was 1.6 percent, and in the current quarter it will almost certainly be negative. Thus, we find that for nearly a full year the United States has been expanding at a rate below its long-term trend and below most estimates of the rate of growth in its potential output. While I do not particularly like the phrase, I suppose one might say that we have been in a growth recession since last spring. The point I want to make is that the economic is not just now beginning to slow down; it has, in fact, been slowing down for a long time. Despite this really quite dramatic deceleration in the rate of growth, shortages continue to persist and multiply and upward pressure on prices has, if anything, intensified.

It is in this paradox—the persistence not only of price pressures from rising costs, but of actual shortages, in the face of a significant and extended slowing in economic activity—that I would like to examine with you. You may have noticed that I have referred to "actual" shortages. One of the things that I have tried to do in talking with businessmen is to inquire into the extent to which the shortages that are so apparent in so many areas today are artificial, in the sense that normal flows have been distorted by price controls or have been created by significant amounts of materials being withheld from the market for speculative or other reasons. There is no question but that controls have diverted some scarce items out of domestic consumption into exports and have probably discouraged maximum output in some cases.

There is also no doubt that there have been some purchases of commodities by other than ultimate end users for speculative purposes. Both the available aggregate data and conversations with people in shortage-plagued businesses suggest that these influences have not been the dominant ones, however. Instead, the scarcities we face trace to the fact that we simply have not been producing enough nor do we seem to be able to produce enough of a wide range of critical raw materials and some finished products to satisfy current demands I think some of the specifics I shall mention in a moment illustrate this.

It would probably be redundant for me to comment on the petroleum situation in the light of the testimony you have already heard from Mr. Simon and others. I try to keep abreast of this problem in terms of its impact on the economy, but I have no information with respect to it which is not otherwise readily available to your committee. I might just not that the end-product price and supply problems flowing from the limited availability, and the tremendously increased cost, of crude petroleum are both complex and pervasive. The impact on the agricultural fertilizer industry, which was already struggling to meet the demands on it, is only one example. Somewhat the same situation prevails with respect to plastics.

But the real paradoxes appear when we get away from petroleum and petroleum-related scarcities. It is not surprising that even a slowed down economy should have difficulty in adjusting to price and availability changes of the magnitude that have occurred in the case of oil. The almost incredible thing is that automobile production and residential construction could be cut back as massively as they have been with so little visible relief to the supply situation in such basic materials as copper, steel and aluminum.

Since this time a year ago, housing starts have declined by 40 percent. Automobile production is off by one-third. Yet not only do we find the basic raw materials used in building autos and houses still tight, many products are backordered. For example, auto-related products such as wheeled tractors, heavy trucks, buses, office machinery, and, of course, sub-compact and compact autos themselves, remain in very tight supply, with sales at present constrained by availability, a condition which, rightly or wrongly, people in these industries expect to continue to prevail throughout 1974.

Despite the cut-back in steel usage in the auto industry, steel mills are running at capacity and steel is reported being imported at prices everywhere from 25 percent to 100 percent over the U.S. price. Both housing and autos are large users of aluminum, yet aluminum producers are still limiting orders.

Paints and solvents are, of course, affected by petroleum availability but even so it is amazing that such a drastic cutback in two of the principal uses of these products has had so little impact on the supply-demand relationship. Autos and housing are also large users of paper and paperboard, both in construction and for the shipment of components, and still there is no sign yet of any relief from shortages in this industry.

Copper is another vivid case in point. Last week March contracts were at about double the price of a year ago, when auto and housing production were running all out.

The observations I've made about supply problems in the industrial segment of our economy are based largely on the comments of people in the affected businesses. But a quick glance at the current release on industrial production confirms and emphasizes the paradox. The index for auto production is 90 percent of the 1967 base year level for January, as compared to 130.2 last January—off 31 percent. It is down 33 percent from last year's peak in July. Yet we find iron and steel production at 130.1 percent of the base year, up from 118.6 percent a year ago. Even output of lumber and lumber products is running well above year-ago levels. I could cite dozens of other examples, but perhaps the situation is best summarized by stating the simple fact that in the fourth quarter of last year, after three quarters of slow growth, marked by dramatic declines in two major industries, major materials production in the United States was still at a record 96 percent of capacity, up from 93.8 percent in the first quarter of the year.

Let me turn very briefly at this point to the spectacular surge in prices—and the related shortages—of agricultural commodities. Despite all that has been said and written about food prices, I am surprised to find how few people know exactly what has happened to the cost of key agricultural commodities at wholesale in the last 18 months. Let me mention just a few.

In early September, 1972—just about 18 months ago—the price of corn was $1.35 a bushel, a year later it was about $2.50; last week it was about $3.20. In the same period, wheat has moved from $1.95 to over $6. While the spotlight has been on these grains, other commodities have also escalated.

Within the relatively recent past, the price of raw sugar has about doubled and so has that for cocoa. Peanut oil was 15 cents a pound in September, 1972, and was 45 cents last week.

In the case of these and other critical commodities, we are not talking about annual rates of price increase of 7 percent or 8 percent, or even 10 percent or 20 percent, but 100 percent. Confronted with dwindling and disappearing growth and not just creeping but exploding inflation, it is hard not to feel some dismay and even despair.

Not surprisingly, this scramble to acquire materials and commodities, even in the face of declining sales of final products, has produced some developments in regard to inventories which I think will attract increasing attention in the months ahead. In real terms, that is to say in constant 1958 dollars, nonfarm business inventory investment averaged a little less than $3 billion at an annual rate in the first three quarters of 1973. In the fourth quarter, the rate jumped four-fold to over $12 billion. Some of this was obviously due to a backing up of larger-sized automobiles in the hands of manufacturers and dealers, but even after making a generous allowance for this development it appears that the rate of inventory accumulation almost trebled in the closing months of 1973. How long this high rate of inventory buildup will continue and just how rapidly it will reverse itself I do not know. There is every indication that it is continuing in the current quarter.

This phenomenon, while it might have been anticipated, has become evident largely since the Economic Report was prepared. It raises policy problems that have not been faced in recent years. The phrase cost-push inflation has generally been a euphemism for wage-push inflation. The argument has often been made, with telling effect, that general monetary and fiscal policies should be pursued which would "float out" increased money wage costs so as to maintain "full employment". This involves inflating prices, and thereby deflating real wages, in order to restore a relationship between the real wages, in order to restore a relationship between the real cost of labor and its real productivity which would assure a continuing high level of employment. Whether equating real wages and the real cost of employing labor in this way is a cruel hoax, as some have called it, or a benevolent public policy is arguable.

Unlike labor, commodities and materials do not live, breathe, and eat—they do not suffer. To "float out" the recent huge increases in the costs of materials by policies which would balloon demand sufficiently to maintain "4 percent unemployment" of materials capacity would, in my judgment, be a cruel hoax by any standard.

Thank you, Mr. Vice Chairman.

Senator PROXMIRE. Thank you very much, Mr. Noyes.

Mr. Tobin, go right ahead, sir.

STATEMENT OF JAMES TOBIN, STERLING PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. TOBIN. Mr. Vice Chairman, I would like to begin by congratulating the Council of Economic Advisers for the 1974 Economic Report. One of the major functions of the Council, I have always felt, is to educate the public, and this Report is an admirable, clear, professional analysis of many current economic problems.

Chapter 5, to which Mr. Gordon already referred, is probably the most careful and thoughtful interpretative summary available of the basic facts on distribution of income in the United States.

The review of the energy situation in Chapter 4 puts the problem in much needed historical and economic perspective. I hope that this committee, the Congress, and the public will not overlook these and other contributions of this document while concentrating, as is natural and customary at this time of year, on macro-economic outlook and policy. I turn now to that topic, which is central to the obligations of the President, the Council, and this committee under the Employment Act of 1946.

To me, as to Robert Gordon, the most striking thing about administration policy, as set forth in the Report, is that it remains the same in this year of slowdown and near-recession as it was last year during a boom. For fiscal policy, the "steady as you go" policy is indicated by the absence of change in the full employment budget surplus. For monetary policy, the report envisages a continuation of growth rates of the money stocks, 5 percent per year in M_1 and 8 percent in M_2, which barely keep pace with the projected increase in GNP. In short, policy is not designed to improve the 1974 outlook but merely to let it happen.

Now, this would be understandable if the prospect for 1974 were satisfactory. But the forecast is for a 1 percent growth of output in an economy normally capable of 4 percent, and for unemployment averaging 5½ percent, or more.

Even by the Council's own calculation, full employment corresponds to 4.9 percent unemployment. Under the Employment Act, the administration is supposed to recommend corrective policy when the objectives of the act are not being fulfilled.

A standpat policy would also be justified if it were true that overall production is now limited by the supply of petroleum or other bottlenecks. The report does not take this view. Instead, it emphasizes the flexibility and adaptability of the economy. I agree. The technical possibilities of substitution and conservation, by consumers and producers alike, are large even in the short run. The main impact of the energy shortage is on the pattern and aggregate size of demand. It is true that neither the Federal Reserve nor the Treasury can create oil. But they can create demand.

I have no reason to doubt the Council's forecast as a best estimate, but the uncertainties are even greater than normal. In particular, the downside risks appear substantial for several reasons:

One, uncertainties about energy availabilities and cost in the short and long run may delay investment plans. Certainty that oil prices are permanently on a higher plateau would induce substantial investment in energy substitution, conservation, and development.

On the other hand, certainty that the current crisis will pass would encourage the execution of previous investment plans which assumed cheap and abundant energy. In the meanwhile investors do not know what kind of houses and skyscrapers to build or where to build them, what kind of vehicles the public will demand next year, what kind of fuel to plan to use for power and heat, and so on.

Second, the consumer saving rate may shoot up. The energy crisis prevents or discourages normal expenditures on travel, automobiles, and appliances. In addition, moreover, consumers have no confidence in the economic outlook or in the Government's management of the economy.

Third, the Council's forecast does take account of the demand leakage due to the higher cost of imported oil. In addition, there will be a substantial internal transfer of income to domestic oil producers and to farmers. The marginal propensity to spend of the beneficiaries is almost surely lower than that of the consumers who pay the higher prices. This will also be true if part of the gains of oil producers are taxed, unless the budget is increased to pay out the taxes.

The reason for the "steady as you go" policy is given at the beginning of the report. We must, it says, "bring inflation under control, and accept the cost of doing so, for the sake of avoiding the greater costs of an accelerating inflation". To do so, we "must be prepared to stay the long course." The costs of inflation, whether steady or accelerating, are not described anywhere in the report. Neither are we told how long the economy must be kept below its full employment potential, now revised downward. But the implication is, I think, that the Council believes we should stay at about 5½ percent unemployment for several years. The strategy is very reminiscent of the gradual disinflation policy of 1969–71.

The large increases in price indexes last year and this year are not indicative of the basic rate of inflation in the economy. During 1973, price indexes rose between 7.1 percent, the GNP deflator, and 17.3 percent, the wholesale price index. A better estimate of the continuing inflation rate is the 4.4 percent increase last year in unit labor costs. Food and fuel, as well as the other things Guy Noyes has been mentioning, are, of course, the principal reason why price indexes have been rising so much faster. But the commodity price increases reflect drastic one-time shifts in world demand and supply. They are nonrecurrent, unlike wage inflation which has a momentum of its own. Macroeconomic policy should not be made on the assumption that oil cartels triple prices every year, or that the world shortage of grains and proteins steadily worsens at the same pace as in 1973.

It is important to distinguish the inflation of 1973–74 from the inflation of the preceding years. Our chronic problem since 1966 has been a roughly parallel upward drift in prices and in money incomes. This self-sustaining inflation has been terribly difficult to arrest, but it has not occasioned any national loss of real income or any substantial redistribution.

The sudden increases of commodity prices in 1973 and 1974 are a different matter. The depreciation of the dollar, relative to other currencies, has increased prices of imports and exportable goods. This does represent a real national loss.

We must now export more of our own production to obtain the same volume of imports. The terms of international trade are less favorable to the United States, and under present international monetary arrangements we are no longer able to buy imports with paper dollars. Likewise, the increased costs of imported petroleum are a real national loss, at about $10 billion this year.

At the same time the sudden emergence of world scarcities of food and fuel is bringing about a large internal redistribution of income and wealth from wage earners and other ordinary consumers to owners of agricultural land and mineral resources. Farmers have gained about $20 billion, annual rate, of national income, and petroleum producers will probably gain a like amount. The price increases are signals of real scarcities. The losses suffered by consumers are not the result of inflation. They are unavoidable. The price bulge which registers the losses is the symptom of a real problem, rather than the problem itself.

The administration is understandably anxious to keep this bulge from escalating the on-going rate of wage inflation. If wage settlements this year were to reflect fully the current rates of increase in prices, our underlying rate of inflation would move up a notch. Experience of the last 8 years tells us that moving it back down is very difficult.

The record, so far, is moderately hopeful, and there are some reasons why one would not expect the current inflation of commodity prices to pull wages all the way up after them. These price increases do not improve the bargaining power of most employees. They do not inflate the profits of employers—in many instances the opposite is true. Many observers believe that a wage-wage spiral, in which workers try, in turn, to keep up with their peers in other industries and unions, is at least as important as wage-price-wage spiral in which workers try to keep up with the cost of living. In our chronic underlying inflation, this distinction is of secondary importance, but the commodity inflation of 1973–74 is entirely outside the wage-wage dynamic.

The Council's complacency toward the slowdown foreseen for 1974, stems from their belief that higher unemployment for a longer period of time will keep the price bulge out of wage inflation. While I agree in principle that inflation rates and unemployment rates are inversely related, I doubt that the outcome this year will depend very strongly on whether the unemployment rate is or is not brought below 5 percent by the beginning of 1975. We may well have a sustained period of underproduction and underemployment without avoiding the risks of accelerating inflation.

The special circumstances have suggested, it seems to me, a different strategy. I believe that American consumers, wage earners, and union leaders, are quite capable of understanding that scarcities of food and fuel make it impossible for their real incomes to grow at the accustomed pace. I think they would accept wage guideposts for 1974 and 1975 which recognize this fact of life. They would accept such guideposts, that is, if they were consulted in their formulation and if they had confidence that the real sacrifices were going to be equitably shared.

To that end, gasoline rationing and removal of oil company tax privileges would improve the general social climate. Workers would be more likely to accept guideposts, perhaps, if they were assured that real burdens of layoffs and short time were not about to be piled on top of the burdens of commodity scarcities. It is true that the administration does not enjoy, either generally or in the specific realm of economic and energy policy, the credibility and confidence which would make this strategy an easy one to execute. But I think it should be tried nonetheless.

I think that monetary policy should be more expansionary than it has been recently, and more expansionary than the Council projects for 1974. To be specific, the Federal funds rate, I think, should be 7 percent—and lower still if the decline in economic activity continues—rather than 9 percent, where it is now.

Thanks to the uncertainties about the economic outlook and Government policy, savers and investors have been displaying increased preference for holding money and other liquid assets. Increased liquidity preference is painfully obvious in the stock market, and it is also evident in the slowness of the decline in short-term interest rates which has accompanied the economic slowdown and the recent pace of monetary expansion.

In these circumstances, the Fed should be satisfying the public's increased liquidity preference even though the growth of money supply bulges temporarily as a result. Failure to do so is deflationary, just at a time when the economy at large and the housing sector in particular need an actively expansionary policy.

It is a fallacy, I believe, to compare current nominal interest rates with the current inflation rate and to conclude that the real interest rate is close to zero. The relevant comparison is between nominal interest rates and actual operational profit opportunities. Past increases in price indexes do not indicate future profit opportunities. Retrospectively, investments in agricultural land and mineral reserves have paid off handsomely. Such speculative holdings are not in any case employment-creating substitutes for investments in reproducible capital. But that is not the main point. The main point is that rational investors would not extrapolate the recent nonrecurrent increases in commodity prices.

Now, there is a market, the stock market, which values the earnings prospects of capital investments, and the market signal is unmistakable. The precipitous fall in price/earnings multiples, about 33 percent in a year, tells us that the earnings prospects have fallen, in the market's opinion, relative to interest rates. The market's view is partially confirmed by statistical evidence of the relative squeeze of corporate profits in recent years, both in dollars and in the percentage of the reproduction costs of corporate capital. Some of this evidence is presented in the Economic Report itself.

Given these signals, given the depressed state of the economy and residential construction, it is difficult to understand the argument that the real rate of interest is low enough already. I do not agree with either half of the Council's argument against expansionary monetary policy. Their argument is that it is already too late for monetary policy to help during the first half of 1974 and that no help is needed for the second half.

Finally, although Mr. Gordon covered this much more freely, I would like to make a couple of comments on the Council's observation that an overall unemployment rate of 4.9 percent is equivalent to a rate of 4.1 percent in 1956. This calculation supports an apparent shift from 4 to 5 percent unemployment, about, as the employment target of macroeconomic policy. The effective target is an even higher rate of unemployment, since the Council is clearly willing to fall short of its employment target in the interests of moderating inflation.

My first comment, like Mr. Gordon's, is that if this macroeconomic policy is followed, it should be combined with a vigorous effort to provide public service employment. The costs of antiinflation policy should not be borne by the disadvantaged workers whose job prospects in the normal labor are curtailed.

My second comment is that we must use extreme care in assuming that any demographic group is permanently associated with a particular rate of voluntary unemployment, its 1956 rate or any other. Even though the overall unemployment rate was 4.1 percent in 1956, we are not warranted in assuming that the 1956 unemployment rate of every demographic group reflected voluntary search behavior. Moreover, the labor market attachment of a group may charge over time. In particular, as women are becoming more and more career-oriented, it would not be right to assume that in-and-out labor force behavior affects their unemployment today as much as it did in 1956. I am not challenging the general conclusion that the unemployment rate at which labor markets are as tight as they used to be at 4 percent is now higher than 4 percent. This is supported in the report by evidence other than the demographic calculations. I am simply expressing the hope that the demographic calculation of a variable unemployment rate equivalent to 4 percent in the past will not become a full employment standard before a good deal more consideration has been given to its implications.

Thank you, Mr. Vice Chairman.

Senator PROXMIRE. Thank you, Mr. Tobin.

Well, we have a clear, sharp, clash of opinion in the panel it seems, over the question that I posed in my opening statement. Mr. Gordon and Mr. Tobin seem to espouse the notion that we must stimulate the economy by fiscal and monetary policy much more vigorously than the administration intends to, and you both conclude that their policies are neutral, more or less.

And, Mr. Noyes, you take the position that to do so would be inflationary and might not be successful in providing the jobs that are needed.

Would you like to resond to Mr. Tobin's conclusions, particularly that the inflation last year was not caused by excessive stimulation of fiscal and monetary policy, but on the contrary, was the result of international factors, particularly, food and energy?

What is your comment on that?

Mr. NOYES. Well, Mr. Vice Chairman, perhaps I don't express myself as clearly as Professor Gordon and Professor Tobin, for which I apologize.

I agree with a great deal of what they said, and I certainly agree with Professor Tobin, that the commodity inflation that we had in 1973, would not and should not be characterized as a demand—pull inflation in any aggregative sense.

I pointed out myself, as you know, that we have in fact been in th midst of a slowdown in the rate of growth for almost a full 12 months now. The thing that I was expressing concern about, you might say we are both concerned about, is complacency. I am more concerned about the complacency toward the rate of inflation, while they, I think, are more concerned about the complacency toward the unemployment rate.

Now, we could—this is the point I was trying to make—convert what was a commodity cost push inflation, very easily, into a full-scale inflation in 1974, if we are not extremely careful. That is my major concern.

Senator PROXMIRE. Now, I want you to spell it out as specifically as you can, how we exercise that care, because you end up with an emphatic statement that, "To 'floatout' the recent huge increases in the cost of materials by policies which would balloon demand sufficiently to maintain 4 percent unemployment of material capacity would, in my judgment, be a cruel hoax by any standards."

So you wouldn't go to 4 percent. I do not think anybody here would. Mr. Tobin just finished by saying that he thinks that 4 percent is unrealistic, but, of course, the administration—now, we have 5.2 percent unemployment, the administration expects 5½ percent, and I think there is every indication that within the next few months it will go close to 5½ percent and it may go 6 percent this year.

What would you advocate? Would you advocate a more expansive fiscal policy?

Would you advocate a greater increase in credit?

Mr. NOYES. I understand. What I said—the 4 percent that I referred to at the end of my statement—was the utilization of capacity in the materials industries.

The Federal Reserve Board maintains an index of capacity utilization in major materials. This ran at 96 percent of capacity.

Senator PROXMIRE. I am well aware that Mr. Burns——

Mr. NOYES. That was what I was referring to in my closing remark.

Senator PROXMIRE. When you say 4 percent unemployment and then you say of materials capacity, it is true.

Mr. NOYES. That is what I meant to say. If I misled you, I am sorry.

Senator PROXMIRE. But my question is, How do you design a policy which is going to stimulate the economy sufficiently to reverse our increasing unemployment without having inflationary consequences?

Mr. NOYES. I certainly would not pretend to be able to design something that I would have confidence could do that. The thing that I was concerned about, in the President's Economic Report, was that there seemed to be an acceptance of what was then estimated as a 7 percent increase in the deflator for 1974, over 1973, as inevitable, because certain basic raw material costs had, at that time, risen to a certain level when the report was being prepared.

We have had very substantial increases in the costs of these materials since that time. If you carried forward the rationale of the Report—that there is nothing we can do about these commodity cost increases—and that we just have to let them flow through to an increase in general prices; you would be looking not at a 7 percent figure but a 9 or 10 percent figure, and a 12 or 15 percent figure for consumer prices. And I sincerely believe that inflation in that magnitude would be disastrous for the United States.

Senator PROXMIRE. All right let me try to break this down into two parts. One part is what we do about this commodity problem that you refer to. One obvious step we can take is to try to exert some control over our exports—very sensitive—a very difficult thing to do, because we are aware of our responsibility to other nations, and the fact that we are the rich nation and we consume more than others do, and so forth.

Now, if you are not going to do that, I do not see what you can do, very effectively, about it.

The other point however, and I wish you would address yourself to this too, is what we do about the rising level of unemployment, whether you would disagree with Mr. Gordon and Mr. Tobin, who seem to feel that w should provide more public service jobs, expand Federal spending perhaps in other areas, or reduce taxes and ease credit.

Mr. NOYES. I understand the question, sir.

Again, this is not false modesty, but I really do not pretend to be an expert in the area which you are now addressing yourself—Mr. Gordon and Mr. Tobin are.

I agree with Mr. Gordon that an aggregative number like the overall level of unemployment is probably the wrong target and that we should have a variety of targets with respect to various age, sex and racial sectors of the labor force, and—I think, myself—that the unemployment problem is one that has to be tackled on a disaggregate basis. I think that was also the implication of what Mr. Gordon had to say. I suppose this would imply a series of policies designed to improve unemployment, particularly in those sectors where it is extraordinarily high. But to pretend that I have, or could fabricate, a specific program for that, would really be pretentious of me because I have not applied myself to that problem over the years I am not sure I could if I had, but I have not.

Senator PROXMIRE. Let me ask you, Mr. Gordon. First, let me say how much I appreciate your reasserting your notion of having goals for unemployment for whites, for blacks, for women, and for teenagers. This is something you have suggested before.

I intend to write Mr. Stein and to ask him if he will give us something like that. I think that is most helpful and we should have done that long ago. It is a very sensible policy.

But let me ask you to expand what seems to me to be not quite clear. You say it is nonsense that increasing supply would be the answer for inflation in the long run. That is undoubtedly a great oversimplification of what you did say, but the position the administration takes is that this is their principal thrust; they have been able to get away with it fairly well with many people and I would like to ask you, as an eminent economist, to say why you say it is nonsense.

Mr. GORDON. I think I can put it fairly briefly and bluntly. What are loosely called the cost push factors that are operating not only in the American economy but in all of the advanced economies in Western Europe have been getting stronger over the last decade.

I spent several months in Europe this past fall and talked with officials and economists in England, France, Sweden, officials of OECD, and also in Germany, and I was impressed by the way that the unemployment-inflation tradeoff had been worsening in all of these countries.

Interestingly, unemployment has been rising also. A structural componnt, as they refer to it loosely, has been increasing in England, in Germany, in Sweden, and perhaps in some other countries, and the rate of inflation, the rate of wage increases, has been accelerating also.

I think to some extent the same thing has been happening in this country. I agree with the things that hae been said in the last 5 or 10 minutes that we do have to distinguish between what can be called a demand pull inflation involving food and various raw materials, but we do not have to assume that that rate of increase will continue indefinitely.

But apart from that, the pressures from the wage side have been growing stronger, and I would like to call the committee's attention to the fact that the increasing unemployment rates among the groups whose share of the labor force has been growing, has a counterpart. And that counterpart is the decline in the relative unemployment rates of prime age males, 25 to 64—particularly 25 to 54.

Unemployment rates for this group are now down to or below where they were in 1956. Indeed, they are close to the levels of 1953. We had the same experience earlier. We have upward pressures on wages when unemployment is rising. In the strongly unionized sectors, whose prime age males play the dominant influence, we can still have cost push which to some extent originates on the wage side.

I would like to take this opportunity, if I may, Mr. Vice Chairman, to speak about what might be done during 1974. I have indicated that I believe that we should have a—on the macro side, an expansionary policy, or at least a moderately expansionary policy, to cope with rising unemployment.

But I would certainly suggest that we again take a micro look at the way we use macro policy, and if I am going to try to cope with rising unemployment in 1974, I would not simply blindly recommend that all components of the budget be increased at the same time. I would concentrate on a substantially increased budget for public service employment where you can get the most bodies employed per dollar spent.

And, at the same time, we should look for ways to trim back on other components of the budget which will at the same time relieve some of the demand pressures on scarce materials.

And if I may reflect, in this case, my prejudices as a citizen rather than as an economist, I would suggest a big increase in the public service budget and a cut in the defense budget.

Senator PROXMIRE. Thank you very much, that certainly reflects my view, too. My time is up. I yield to Congressman Reuss.

Representative REUSS. Thank you, Mr. Vice Chairman, and I thank each one of you for your very valuable contribution this morning.

Let me start with Mr. Tobin. I certainly think you are on the right track when you say, as you do, that you are going to get labor to accept wage guideposts. You have not only to consult them but to give them confidence that real sacrifices are going to be equitably shared.

Then you go on to say that you would do something about gasoline rationing and the removal of oil company tax privileges and do something about unemployment.

And I surely agree with you that each one of those three things needs to be done. I wonder, however, whether it really is enough to ask labor to sit still on wage stability?

Let me show you what I have in mind. Despite the pat on the back you give to chapter 5 of the economic report, with its summary of distribution of income in the United States, I find that that chapter obscures the recent development that I find alarming.

Mr. Gordon hints at it in his presentation. The staff of the Joint Economic Committee has broken down those Census Bureau income distribution figures and they indicate that since 1968, right up until and through 1972—the last year for which we have figures—the shares of national before-tax income enjoyed by the three quintiles at the bottom of the heap, for example, those making at today's figures, $13,000 a year or less, have deteriorated and the share of the top 20 percent and the top 5 percent has increased—true, only by a percentage point or two, but that is on the order of $10 billion a year.

So, point one that I put to you, is that the lower three-fifths, in terms of income receipts of American families, has even on a before-tax basis, been hurt in the last 4 years.

Secondly, I ask you to take into account the differential effect of the kind of inflation we have had, an inflation which has borne down most heavily on food, fuel, interest rates and other things which are in the working man's market basket in much greater bulk than in the overall market basket.

And thus, as a staff study of the Joint Economic Committee within the last few weeks has shown, lower income people get rocked proportionately much more than higher income people because of the nature of the current inflation.

Finally, on taxes, the one group in this country who have had their taxes increased by the Federal Government in recent years are the below $13,000 income people whose burden of the payroll tax has gone up very appreciably $200 or $300 a year in that period.

That being so—and I thank you for your patience in listening to this—is it not necessary that you have a few more cards in your hand when you go to working people and ask them to sit still for wage modesty?

Do you not, in short, need to throw in a tax cut for low- and moderate-income people as a guid pro quo for wage moderation?

For all I know, you would distribute some of your budgetary additions that way, but here we are in 1974. We have to know what to do and who better to ask than people like yourself.

Mr. Tobin. Well, I think my first priority for the budget would be a public service employment program, a very vigorous and extensive one.

Representative Reuss. Good, Mine too. Let us spend $3 billion on that.

Mr. Tobin. And I would do that before going to tax cuts.

Representative Reuss. Stipulated, now we have done that, what do we do?

Mr. Tobin. I agree with most of what you said, Congressman Reuss.

I never have approved of the way we finance social security with a regressive payroll tax, and I am in favor of reform of the personal income tax. Those reforms certainly could be an additional part of a social contract for incomes guideposts.

Representative Reuss. You have admitted that even your modest little suggestions in your statement, as part of the administration's part of the social contract are somewhat preposterous.

So that you might as well construct what you really think would be a fair offer if you were President.

Mr. Tobin. I think that is right. I did spell out details. We have to recognize that we have suffered some real losses in national product, relative to our normal path of growth. One event was that we finally abandoned the previous fixed exchange rate dollar. We were living under an illusion in the past that we could import a lot of goods without paying for them with exports, or that we could make a lot of other expenditures overseas without paying for them across the exchange markets. We wanted to get out of our chronic balance of payment deficit situation, and we took very drastic measures to get out of it. But no one told the American people that there would be a very real cost to pay when we finally succeeded in changing our exchange rate.

And that event happened to coincide with a demand boom all over the world. The joint result is that our exportable goods are attracted to pay for our imports. We cannot avoid the fact that somebody in this country is going to take those losses. There is no use fooling ourselves about that.

These same events redistribution at home which is very hard to unwind. Some redistributions are more popular than others. We redistributed $20 billion to the agricultural sector, maybe more, away from wage earners and consumers.

Representative REUSS. But the facts that growth in real incomes will be slowed by one, the higher prices we have to pay as a result of changes in the international value of the dollar and two, worldwide commodity scarcities in many commodities which raise prices over and above the devaluation factor.

Does that not suggest that we need to pay more attention to income distribution in this country than we did in the days of old when we could promise an ever larger pie every year and, hence, even though the distribution stayed the same, since everybody's share got bigger in absolute terms, there was not as much discontent as there is now?

Mr. TOBIN. Well, I think it was already important enough to worry about income distribution. But, I accept not the present situation makes it ever more important.

There are two kinds of income redistribution. One has to do with size distribution, the shares of different quintiles do which you referred earlier. This is mainly a matter of tax policy and transfer income policy on the part of the Government.

The other shifts are horizontal, from urban wage earners and consumers to farmers, and to owners of mineral deposits, and to people who work in those areas. Although these may have some effect on size distribution as well, their main impact is that people who are not in the groups which are benefiting from the structural changes are not going to see their incomes grow as fast as they would like or are accustomed to have them grow.

We have been socked 2 years in a row with very dramatic and spectacular changes in relative prices. These raise price indexes, because price changes are inevitably more up than down in modern economies. Relative prices changes do not occur symetrically some prices rising, others falling. The only things that go down in price are pocket calculators.

In these circumstances the problem of an antiinflationary policy seems to be a rather special one. It would be unrealistic and inefficient to suppress adjustments of relative prices that have good reason to occur. The problem is to keep these adjustments out of the ongoing continuing basic underlying rate of wage inflation. So far they have not been built in. The main task of 1974 is to continue that good record.

My main point of my argument was that that this task is not going to be accomplished by deflationary or stagnant aggregate demand. The situation is very special. The little to do with the differences in aggregate demand between one administration's forecast and a more expansionary policy. The situation requires a different approach.

Senator PROXMIRE. I would like to ask each of you gentlemen, starting with Mr. Gordon, this question. Mr. Modigliani, who is, as you know, an eminent economist, testified before us on Friday last. He said that one of the most useful things Congress could do as far as the economy is concerned is to impeach President Nixon.

He said if we impeach President Nixon it would end uncertainty, economic uncertainty. He said that it would mean that we could replace him with a man with whose policy we might disagree, but that could act with decisiveness and consistency, hinting that President Nixon has been inconsistent and seemingly indecisive.

We have, this morning, one former and one about-to-be President of the American Economic Association, and a senior economist for the bank which has become in the eyes of many the essence of the establishment.

I think it would be very helpful for us if we could have a comment from each of you on that proposal by Mr. Modigliani. Not that we are governed by that kind of thing, of course, in making our decision, but I think it would be very helpful for us to understand what would be the economic consequences of impeachment.

Mr. GORDON. I can answer that question, Mr. Vice Chairman, only in two parts, or by dividing it into two parts—dividing my answer into two parts.

Incidentally, I have been warned by the staff that this question would probably be coming. I will speak first only as a citizen, not as an economist, and certainly not as president-elect of the American Economic Association.

To put it bluntly, I have mistrusted Richard Nixon since he first ran for Congress. I hope that will be a sufficient answer to your question in my capacity as a citizen.

Now, as an economist, I do not particularly have anymore confidence in Mr. Ford's economic leadership or potential economic leadership, than I do of that of Mr. Nixon. I do not know whether we would be any better off with Mr. Ford as President or not.

Senator PROXMIRE. Mr. Noyes.

Mr. NOYES. Well, I have known Franco Modigliani for a long time. He is a good friend of mine. We talk about things. He always is surer of what would happen than I am and that is true again in this case. I really just do not know whether it would be good for the economy or bad for the economy.

I have given some thought to this question. Certainly the pursuit of an impeachment proceeding in the House and a trial by the Senate would have some unfortunate economic repercussions on the country. Whether the ultimate removal of Mr. Nixon as President and his replacement by someone else would help to solve any of our economic problems I really could not say.

I do not see any reason why most of the things, at least those I am most concerned about, would be altered significantly by it.

Senator PROXMIRE. Mr. Tobin.

Mr. TOBIN. You mentioned the American Economic Association in asking that question, but I know you realize that any opinion I express here is purely a personal one.

As a citizen, I think the question of impeachment should be completely divorced from economic considerations. If the economy were booming along with full employment and price stability, and if the charges in regard to the perversion of the office of the Presidency were confirmed, then I think impeachment and conviction should occur, regardless of economic circumstances and risks.

And, on the other hand, impeachment should not happen just because it might help the economy.

Senator PROXMIRE. I agree with you on all that, but that was not my question.

My question is, What effect would it have? I am asking your opinion on what effect it might have—if you could give me that kind of an opinion—and I would recognize, as I implied, or tried to imply, this certainly would not be any consideration as far as this Senator is concerned, and undoubtedly not a consideration of other Senators or Congressmen, but it would be useful to know what an eminent economist felt might be the effect of this kind of change.

Mr. Tobin. Well I think that whatever happens there is going to be a great deal of uncertainty about the leadership of the Government for some time to come. The proceedings will take some time. The uncertainties are going to be with us for the good part of a year, unless final action occurs a lot more quickly than, as a reader of newspapers, I am led to expect.

I do believe that the decisiveness of the administration with respect to domestic policies has been undermined by the general peril in which the President finds himself. Once the impeachment issue is resolved, the Executive might be curageous and firmer in dealing with domestic economic problems. That is very speculative altogether.

Senator Proxmire. Do you think, however, that once it is resolved we would have a policy that would not be much different whether we have President Nixon or President Ford, is that right?

Mr. Tobin. Pardon me.

Senator Proxmire. I say, I take it that the important impact, such as it is economically, would be the resolution of the difficulty, once it is resolved, or the resolution of the impeachment. Once that determination is made, whether it is made favorably to Mr. Nixon or unfavorably, would be less important than that a resolution that is reached.

Is that right?

Mr. Tobin. Well, from an economic point of view, I think the important thing is that whoever is in charge would feel confident enough to make some perhaps unpopular decisions, Take gasoline rationing for example. I think there has been too great a fear, a misplaced fear, about the public response. The administration is hesitant because it is already so anxious about its public standing. Under different circumstances they might have bitten the bullet before now.

Senator Proxmire. How about the control program?

Do you think that is a victim of this possibly?

Mr. Tobin. Very possibly. But I do not think one should be too quick to assume that the administration could act decisively even under the current circumstances if they wanted to. Secretary Kissinger is doing so in foreign policy.

Senator Proxmire. Let me get back, then, to economic policy. The suggestion that you made as your first choice for coping with the present economic dilemma we face is public service employment. Both you and Mr. Gordon emphasized that. We recently had Mr. Okun before us, and Mr. Okun argued that public service employment is just too slow. He said that his experience with the Council of Economic Advisers and as an observer was that in 1962 we tried to institute a public service employment program. It did not really hit until 1966; 1966, of course, was inflationary at exactly the wrong time.

That, of course, was emergency public works. But it was emergency public works, and his feeling was that if we put in public service employment that it would take a little too long. He preferred a tax reduction idea.

Mr. TOBIN. Well, I do not like to come into every situation like this and then have it said it is too late. Some time should be the time to start, so it is not always too late.

Senator PROXMIRE. Most economists argue—you might differ with this—that the main problem is now, between now and July, the feeling is that automobiles, housing and so forth will pick up in the latter part of the year.

If that would be the case, then a program of this kind started now might be too late, let alone the few weeks it would take us to enact it.

Mr. TOBIN. I do not think it is going to be too late at any time, because the groups of workers for whom this program is particularly designed have very high unemployment rates, even when the general unemployment rate is below 5 percent.

The major point of public service employment programs and related public policies is to reduce structural and frictional unemployment, so that we can use our macrotools on monetary and fiscal policy to aim higher for employment, lower for unemployment, then we are able to do now. The purpose is to improve the general functioning of the labor market, and in particularly to help workers at the end of the queue. They are still in trouble, even if we get below 5 percent overall.

Senator PROXMIRE. Then you certainly would not have the key to an unemployment percentage, you would not have it eliminated once you get below 5, 5.2 percent, or whatever.

Mr. TOBIN. No.

Senator PROXMIRE. Or put into effect when it gets into a——

Mr. TOBIN. My general feeling is that this is somthing that we need as a structural measure at all times. As for the particular problem of expanding aggregate demand this year, instituting public service employment spends money, and any way of spending money is good in a time of slowdown. But even if you had to do it by collecting taxes at another time, I would still be for it.

Meanwhile, for additional expansion of aggregate demand this ear, perhaps as Mr. Okun and Congressman Reuss suggested, one would have to go for a tax cut, I also emphasize easier monetary policy to the housing industry going.

Senator PROXMIRE. Easier monetary policy to get the housing industry going does take time. Does it not take time to work down that mortgage rate if you do it with monetary policy? Do you not have to use a specific program, perhaps of subsidizing interest rates for low-cost housing—down to, say, 7 percent, or something of that kind?

Mr. TOBIN. Well, you can do both. I am not persuaded that these lags about monetary policy are inexorable, that it is sure to be 6 months before anything happens. If you do something vigorously enough on general monetary policy in the first half of the year, it would begin to have some effects.

Senator PROXMIRE. Mr. Gordon.

Mr. GORDON. Well, I would disagree with my good friend Mr. Okun on a couple of points.

First, I would point out that the, what might be called the employment multiplier per dollar of expenditure is a whale of a lot larger for a public service employment program than it is for a tax cut.

First, any kind of an expenditure increase has a larger dollar effect on GNP than as a comparable tax cut. This is the difference between the expenditure multiplier and the tax multiplier. But beyond that, of the various kinds of public expenditures, public service employment has the largest effect in terms of people put to work, because there is a minimum of use of the increased expenditurs for purchases of supplies, complementary equipment and so on. And there is, further, no drain off on the reduction of inventories that could take place as expenditures are increased.

Second, let me also take strong issue with Mr. Okun on the matter of the promptness of effects. The 1971 public service employment experiment was extremely successful in terms of the promptness with which people were put to work. The program went into effect in the summer of 1971; by about January of 1972 or there abouts, all of the funds had been committed, and there had been a significant increase in employment in State and local revenue jurisdictions.

And then finally, I would like to make a plea again for something that I have been urging on the Congress for several years now. When we think of public service employment, we should think in terms of what I call the two-tier system; one part that would be triggered by national unemployment rate, but a second part that would be permanently in effect.

Now, Mr. Okun is talking about our permanent need to reduce the high unemployment rates, and I emphasize that in my own prepared statement; that is, for the permanent program. But over and above that, we need a triggered program that would go into effect when the national unemployment rate rises above some figure that we had agreed on, and when Public Service Employment jobs would be available where people were thrown out of work for cyclical reasons, as in the present case, maladjustments that affect particular industries.

Senator PROXMIRE. My time is up, but I do want to say, in fairness to Mr. Okun, that he did not necessarily oppose public service employment; in fact, I think he favors it. But he just argued that it is something that moves slowly and it is hard to put into effect compared with some other methods.

Congressman REUSS.

Representative REUSS. I will not ask any more questions about the absent Arthur Okun—he might want to revise and extend. I would want to take up one point you just made, Mr. Gordon.

I agree with you—and always have—that the best way to get jobs, if jobs are what you want, and I think they should be, is to make them directly by a public service jobs program.

When you were talking, however, about the secondary effects, namely, the people who did not have jobs, but who now under public service employment have jobs at a prevailing wage paying $7,000 a year, or whatever it comes to, those people will spend almost all of that money and that will have the kind of stimulative effect which you and Mr. Tobin are after. I would put it to you that a substantially identical stimulative effect can be obtained from a properly constructed tax cut.

If you are going to give all of the benefits of your tax cut, as I believe you should, to those who need them most, I would think that the people to whom that tax cut is given will spend all of the money that you place in their pockets by a tax cut; so that from the standpoint of secondary stimulus, there is no real choice between public service employment and that kind of a tax cut. In fact, I think you ought to have both.

Mr. GORDON. I will not argue with you, Congressman Reuss, on the desirability of a tax cut, particularly for lower income groups; but I will argue with you that the effects of a tax cut are similar or the same as increasing public service employment.

Representative REUSS. I did not say that.

Mr. GORDON. I thought you did.

Representative REUSS. No, what I said was an increase in public service employment right away creates a job, and that is great, so I vote for that. But the secondary effects, it seems to me, are, dollar for dollar, pretty similar, dollar for Federal dollar.

Mr. GORDON. I agree with that. People put to work in public service employment are consumers and will spend their incomes on presumably the same sorts of things that consumers would if they had a tax cut. It might not be quite the same because the difference in income to the recipient would be different; in one case, a man goes off welfare or unemployment compensation into a full-time job.

But let me make the point that public service employment aims directly at the high unemployment groups. A tax cut leaves those high unemployment groups still suffering high unemployment.

Representative REUSS. And therefore they are aimed at different things, I agree.

Let me ask you and Mr. Tobin to address yourselves to some antiexpansionists who would say of your expansionist stance that you are just going to create more inflation by putting that much more spending power in people's pockets.

Would your answer be that (1) the newly created spending power, in large measure, is likely to impinge not on scarce goods but on goods that are not so scarce, that can be brought into being by added production, which is not at full capacity; and (2) to the extent that it does represent a little more marginal demand for scarce goods, some of that can be handled by rationing, as in gasoline, and for the rest it is a price worth paying?

Would you differ from that or improve on it?

Mr. GORDON. First of all, before I turn the microphone over to Mr. Tobin, just as I do not expect a rise in unemployment during the next 6 months significantly to retard the rate of inflation, so I do not think that the modest decline in unemployment that might come from a stepped-up public service employment program would significantly accelerate inflation.

Beyond that, I perhaps am the only person in the room that would not give up wage-price controls. Then perhaps——

Representative REUSS. Do not be sure.

Mr. GORDON. Perhaps I exaggerate my minority position.

And above all, on the wage side, whatever form of income policy we move toward, guidelines, guideposts, some form of controls in particular sectors, I would urgently suggest to the administration that they have a labor advisory committee or group—not the sort of joint employer-labor advisory committee that caused so much difficulty in the early days of the wage-price control experiment—and that an attempt be made to install in the leaders of organized labor confidence in the administration. And asking for labor support in holding down wages is making serious efforts to do something about the price situation also.

I do not know whether that cooperation would be forthcoming or not, but I would certainly try. And I am reminded, with Jim Tobin sitting over here, that back in the days of the wage-price guidelines, when I would drop in on Walter Heller occasionally, I would plead with them to get more formal cooperation from labor, and to form a recognized labor adisory group.

Representatie REUSS. Mr. Tobin, would you address yourself to the point I restated? Why will not your expansionist program simply bid up the price of existing goods? How are you going to avoid more inflation?

Mr. TOBIN. Well, if I thought that the economy was actually operating under an absolute supply limitation, that we could not get additional output produced by providing additional demand, then of course I would agree that it would be foolish to recommend expansionary monetary or fiscal policy. But I do not think that is the case.

There is slack in the economy even though there are some bottlenecks. Let us not fool ourselves. I do not deny that if you pour in more demand, you cannot be sure that some of it will not go into sectors where there are bottlenecks. Buyers will be bidding more for scarce commodities at the same time they are spending most of the funds in areas where it is possible to increase production and employment. So I am willing to accept some accentuation of the demands for things that are in shortage at this time in the interest of the greater amount of production and employment elsewhere.

You see, I do not really think that you should deflate the whole economy sufficiently to avoid bidding up the prices of the scarcest commodities in the most bottlenecked sectors. That is paying a very great price, adding scarcities of one's own design to those that are inevitable.

Now, could I just make a suggestion in regard to the tax cut that you mentioned earlier?

In the first place, I do not think that the full employment budget surplus that we now have is excessive as a long-run matter. I do not think it is too big. I have some sympathy with the administration's view that in the happier days to come it is a good idea to have a modest full employment surplus. I say this on the general grounds of having enough savings for expansion of capacity, I would not want any big permanent tax cut for this reason.

Representative REUSS. Well, I would for the people who have been disadvantaged in the last 4 or 5 years.

Mr. TOBIN. Reshufflings or rearrangements of tax burdens is one thing, and a general reduction in capacity of the revenue system is another——

Representative REUSS. I meant by reshuffling, close loopholes and give it to the poor.

Mr. TOBIN. Well, I am in favor of that, but I am also in favor of giving assistance to people who are not taxpayers, who are so poor that they are not even paying taxes. I understand there is some sentiment in the Congress for converting into tax credits some exemptions, perhaps some deductions. Credits are generally more equitable than the present tax code. That that is a very good way to go, I think. It might be the vehicle by which demand were pushed into the economy this year.

But I would make these tax credits, cashable, so that they do not just go to people who are well enough off to be taxpayers, but to everybody. Those who do not have a sufficient gross tax liability to use the tax credits could get them in cash.

Representative REUSS. Well, all of this, let us stipulate it, has to be positioned on H.R. 1, Welfare Reform, because obviously what you do with the tax system has no impact on those who do not pay taxes.

Thank you, Mr. Vice Chairman.

Mr. GORDON. Mr. Vice Chairman, may I call the committee's attention to a point which I wish would be more often discussed: that, the Council's interpretation of a figure for full employment and unemployment rate, corresponding to full employment. There is not a full employment surplus and there has not been for a long time. We are talking about something in the neighborhood of 5 percent equals full employment. The full employment budget is still being calculated on the assumption of an unemployment level of 4 percent.

Senator PROXMIRE. Now I would like to ask each of you gentlemen to comment on the observation that was made by Mr. Gordon. I would like to ask Mr. Noyes and Mr. Tobin to comment on the controls: whether or not we should continue controls. As you know, we are going to have to make that decision in the next few weeks, and the committee on which I serve, the Banking Committee, will have to decide shortly.

At any rate, the administration has recommended that we eliminate most controls—maintain a Cost of Living Council to monitor inflation. Mr. Burns has propesed that we do the same, except that, in pace-setting industries, we provide for a mechanism by which wage and price increases could be held up for 30 to 45 days while hearings are held and then no capacity to stop them, but at least Congress could act if they wished to do so. Or the President could recommend action to the Congress so you could focus some attention on some of the big industries.

Mr. Gordon has indicated his view that we should maintain wage-price controls.

Mr. Tobin and Mr. Noyes, how about it?

Mr. TOBIN. I indicated in my statement that I think the important thing is to have an agreed consensus on wage policy, and——

Senator PROXMIRE. Does that mean wage controls or not?

Mr. TOBIN. I had in mind not formal controls, but a guidepost reflecting a consensus negotiated and agreed.

Senator PROXMIRE. Would it be numerical? 9 percent, 8 percent?

Mr. TOBIN. It would be numerical.

Senator PROXMIRE. It would be?

Mr. TOBIN. It would have to be numerical, and it would be reached by consultation with the union leaders.

Senator PROXMIRE. Mr. Meany has suggested 12 percent. Do you think we could arrive at a guidepost that would be capable of being negotiated with Mr. Meany or with organized labor and not inflationary?

Mr. TOBIN. I just do not know. The point I am trying to make is you have to put all of the cards on the table. Some one-shot events have occurred, and in real terms these just cannot be complete compensation. Consequently the future of inflation in the country depends on how much of the price bulge is absorbed into the ongoing dynamics of wage inflation.

Senator PROXMIRE. I agree with you. I think that is very, very critical. I just wondered how this mechanism was actually going to work.

Here you would have a situation, as I understand it, in which you would not have any legal, mandated limitation. If for example, the union group should agree on a 15-percent increase and that should exceed the guideline, then it would not go into effect, but we would deplore it and try to prevent that kind of thing happening in the future. Would that be the case?

Mr. TOBIN. Arthur Burns' suggestion may have some merit in that connection. That review would not in the end prevent something beyond the guidepost from taking effect.

Senator PROXMIRE. Now this would affect both prices and wages. You seem to emphasize wages rather than prices.

Mr. TOBIN. Yes, we would have to do it for prices, too, if we took Mr. Burns' suggestion. That would be necessary to obtain the general consensus. I am not particularly keen about the extension of formal wage and price controls.

Senator PROXMIRE. As I understand it, then, what you would recommend is that we have authority to hold public hearings on wage and price decisions in the pacemaking industries, but not the authority to roll them back unless Congress decided in a particular case that it was excessive.

Mr. TOBIN. Well, I do not want to get committed on particular details of a proposal I have not studied.

Senator PROXMIRE. We have got to commit ourselves on these details in a hurry, as you know.

Mr. TOBIN. I have not prepared myself on that, on Mr. Burns' proposal or others in that area. I do think that some part—perhaps a small part but some part—of the shortage problem, that Jack Noyes described earlier, relate to rigidities of price controls. I am not sure that scarcities can be administratively managed. However effective the market system may be, maybe it can do a better job than improvised bureaucracy. That is the reason I am worried about continuation of formal price controls.

Senator PROXMIRE. Mr. Noyes.

Mr. NOYES. Well, I can be very brief, because I find myself almost in exactly the same shoes as Professor Tobin.

First, I am convinced that the present controls system has outlived its usefulness and is probably counterproductive at this time and should be dismantled as soon as possible.

I am not aware of any magic formula that might be substituted for it, which would necessarily produce highly constructive results. But I would not rule out the possibility that there is such a formula. I have not been persuaded as yet that anyone has hit upon one that would be particularly helpful.

Senator PROXMIRE. We are on the verge of what might be the most disastrous and calamitous inflation in the history of this country. As you know, we had very serious inflation last year. We see what is happening in Europe with the enormous wage settlements that are being demanded, in Britain and elsewhere, Germany and elsewhere. And we have the head of our biggest labor organization asking for a 12 percent guideline this year.

Now it seems to me that we should not, as a Government we cannot simply sit back and say we are going to let controls go and look at it and monitor it and watch it and comment from time to time. I think if we are going to have any economic leadership, it seems to me we have to step into this situation, tough and difficult as it may be.

Now you gentlemen say you have no magic response. We have to come up with some kind of a response whether it is magic or even if it is a mistake; we have to make some kind of decision. That decision may be to do nothing, which is what the administration's position, I think, largely is; or it may be to come in with a guideline and fight hard for it.

You, I gather from what you are saying, Mr. Noyes and Mr. Tobin, is that you feel we ought to develop some kind of a guideline, but that it should not be across the board and it should not be mandated in all cases.

Mr. NOYES. To be perfectly clear, I have no philosophical objection to controls, but I do think the idea of coming up with something, even if it is a mistake, is a thing that you should be very careful not to do. That would be my point.

Senator PROXMIRE. Well, you do come up with something, even if you do not do anything, but whatever you do is going to have a profound effect, including the option of no action.

Mr. NOYES. I agree; but on the other hand, counterproductive action would be the worst thing that you could do at the present time. And I think we should be very careful not to do something that would make the situation, which I agree with you is very dangerous, even more dangerous.

Senator PROXMIRE. All right, just one more thing, then, Mr. Noyes, what would you say would be especially counterproductive? You warn us against that; you indicate that the worst thing we could do is to take action that would be a serious mistake. What would you regard as a serious mistake?

Mr. NOYES. All right, to give an example of the kind of thing I have in mind, which I am sure neither you nor anyone else would seriously consider, would be to increase Government expenditures in areas where we know there are tremendous shortages of basic materials. This would be clearly a disastrous policy.

Senator PROXMIRE. Some of our defense spending, for example.

Mr. NOYES. If we do not—if we want to stimulate the economy by increasing Government expenditures—but if we rush out and do it without looking at the impact of the expenditures, we might in fact funnel all the impact right back smack into existing bottlenecks. This would be a disastrous policy.

Senator PROXMIRE. All right. Mr. Gordon, you say that you favor controls. I wish you would tell us, though, how this would work, because you are a very brave man to make that suggestion; at least you are a very lonely minority. We have had 25 witnesses before the Senate Banking Committee and none has recommended it. We did not have labor appearance, but the labor people oppose wage-price control continuation, too, as you know.

Now, you favor it, but I would like to hear how you could possibly solve this very tough problem. We had 5½ percent guidelines last year, wage guidelines, and we had low price guidelines, and nobody paid much attention to it.

Now, what would you provide for guidelines this year, which would be helpful?

Mr. GORDON. First of all, Mr. Vice Chairman, I do not have any answers any more than the next man or your earlier witnesses. I think that taking a medium long-term look at the situation, not just that year, but looking ahead several years, that the important problem is to hold down the rate of increase in wages, in money wages. hTis is certainly the crucial factor in Europe, Western Europe, and the countries that I referred to earlier, and I think it will be increasingly the case in the United States. There needs to be some sort of Government policy that will contribute to wage restraint.

Now, I am not suggesting that the present wage-price controls be continued in precisely their present form. I would urge on the Congress and on the administration that, program that would put particular weight on restraints on money wages, they be realistic. I would have to urge that you cannot get the cooperation of organized labor in a policy of wage restraint unless there is also a means of implementing some program of price restraint. That does not necessarily lead, to repeat, to precisely the form of wage-price controls we have had in the various stages I, II, III, IV, and we are now going, apparently, into stage V.

But a program of wage restraints calls for cooperation from labor and often a quid pro quo. And the quid pro quo has to be some plan that would hold down those kinds of price increases that labor sees as particularly important.

Back in the beginning of the first Nixon administration, I also urged privately, as the rate of inflation accelerated, that with a presumably conservative, business-oriented administration, this was the time to get employers to stiffen their backs and to resist excessive wage increases. This apparently has not been done.

What can be done alone those lines, I do not know. I enjoy in a way, the position I have put myself in this morning, because on some important position I am taking a very antiadministration stand, but here I am, in fact, saying that something has to be done for controlling perfectly understandable large wage demands with some form of machinery for influencing wages during 1974 and 1975.

I would certainly try to talk Mr. Meany out of his 12 percent. This would be highly inflationary. It is based on the assumption, I gather, that we are going to have or have had something like a 9 percent rate of increase in the CPI, and then on top of that labor is entitled to the usual 3 percent.

And the alternative, the increase in real income, is not going to be 3 percent this year. And if there is to be any progress in controlling inflation, a considerable number of money incomes have to go up less than the rate of increase in prices during the past year. It is simply arithmetic. Let us sit down with the leaders of organized labor and discuss what all the implications of that arithmetic are.

Senator PROXMIRE. I would like to try once more, Mr. Noyes, finally, with another question.

You said toward the conclusion, not the very conclusion, of your statement:

> The argument has often been made with telling effect that general monetary and fiscal policy should be pursued which would float out increased money wage loss so as to maintain full empoyment. This involves inflating prices and thereby deflating real wages in order to restore a relationship between the real cost of labor and its real productivity, which would assure a continuing high level of employment. Whether equating real wages and the real cost of employing labor in this way is a cruel hoax or a benevolent public policy is arguable.

Now, you simply state it, and you do not take a position on it. I do not want to misstate your conclusion, but I infer from what you observed here that there is a danger that monetary and fiscal policy might be so expansive in the coming year that it would be a cruel hoax, that it might be a cruel hoax, and that it would be counterproductive.

Is that correct?

Mr. NOYES. I want to make it clear, Senator, that what I am referring to here is the fact that we have not had shortages in just a few things, like petroleum, but over a very wide range of basic materials that are used in all phases of production—tremendous shortages and tremendous price escalations. All of the major materials, not just one or two or three, are still in short supply and production is substantially at capacity levels.

What I was trying to say is that if we try to raise the general level of prices enough to justify those price increases, we will find ourselves with a very, very high rate of inflation, which will, in fact, result in a substantial reduction in the level of real wages.

Senator PROXMIRE. But is that the way it works?

That is, it seems to me, a kind of reverse way of putting it. Usually it works the way that Mr. Gordon and I were just discussing a minute ago. And there is a tendency, an understandable simple tendency on the part of labor to say, look there has been this inflation, including, as you say, the principal inflation in commodity prices and energy and food and so forth; we want our wages to reflect that increase plus productivity.

Now, Mr. Gordon points out that if you do that, it is a serious mistake and it is inflationary. But you say something a little different. You are not talking about wages; you are talking about trying to inflate other prices to put them on a par with the increase here.

Is that right?

I have not heard that argument made.

Mr. NOYES. I quite agree, sir, I was trying to emphasize, and perhaps I addressed myself to it too exclusively, that we are in a most unusual situation at the present time. We have been in a slowed-down economy for almost a year, an economy that has been expanding at less than its potential and will probably be expanding at a negative rate in the current quarter.

Yet, in spite of that year of less than potential operation, we still find a wide range of commodities and materials—not just one or two, but a wide range, both agricultural and industrial—which are still in short supply and for which the costs are literally continuing to explode.

Senator PROXMIRE. Well, this is a new contribution, Mr. Noyes. We know that prices are going up rapidly; the Wholesale Price Index right across the board, but where is the evidence of these shortages except in the energy area and perhaps in the food area?

We have some shortages, certainly. You have that index you refer to, which has been challenged by some. But specifically, what are the shortages?

Would you list them for us?

Mr. NOYES. I have given you a sort of informal listing in my statement, but I will run over them again in response to your question. Steel, literally unbelievable almost, despite the cutback in automobiles, and housing is in short supply. We were importing steel at premium prices, well in excess of the U.S. posted price of steel.

Copper is in short supply. Copper futures have been exploding, literally, day by day in the past few weeks. Aluminum is in short supply. Paper and paperboard are in short supply. Many of our other nonferrous metals are in short supply.

I would not pretend to be an expert on each one. I will not try to give you a list, because I probably would get one or two in it that perhaps are not. But if you speak to people who are in the business——

Senator PROXMIRE. Do you have independent evidence of these shortages, other than the sharp rise in prices in these areas?

Mr. NOYES. Well, independent evidence, is, in legal terms——

Senator PROXMIRE. What I am saying is, the price rise suggests there is a shortage. But we know these are industries that are characterized by oligopoly or price leadership and so forth. Certainly there have been many times when the price of steel has gone up, and they were operating at 70 percent of capacity. They are operating at close to capacity now, I would agree, but the prices of these other things are subject to manipulation.

Can you establish these shortages?

Mr. NOYES. Well, "establish" again is a strong word. Let me put it this way. I have been impressed that when I talked to people who are involved in these industries and who have no reason to try to mislead me, they continually, and up until as recently as early in the month of February, report that their problem—and I find this a paradox, as I indicated—after a year of slow growth is still that they cannot get an adequate supply of basic materials to operate their industries at their full capacity.

Senator PROXMIRE. Are you satisfied that the policies that have been adopted, including the policy that Mr. Dunlop has been able to negotiate with respect to fertilizer and some other areas, are sufficient, or is there something else we can do about this, those serious shortages you talk about?

Mr. NOYES. Well, I think myself that the inventory figures that I referred to——

Senator PROXMIRE. Because you said controls were not the principal problem.

Mr. NOYES. Well, the thing that happens, the things that I discover, even somewhat to my surprise, is that after people have told me that the whole problem is controls, they take the controls off in that area, and then the problem is still there. So obviously, the whole problem was not controls.

I am being quite candid with you. It was very fashionable to say that this was "just a controls problem," and if we took the controls off it would go away. I have found that people in industry——

Senator PROXMIRE. This is—you see, what is really demoralizing, if this is the case, then it seems to me the inflation is going to be far greater in this coming year without controls. If you take controls off and still have these shortages, then, brother, watch out. The prices can really go up out of sight.

Mr. NOYES. If I have concerned you about this: that is, perhaps, what I meant to do. I am very concerned about, as I say, the paradox and the unique nature of the present situation in which we have a slow-down economy which is so widespread——

Senator PROXMIRE. So we could have an explosion of price increases in some of these areas?

Mr. NOYES. I am afraid it is not that we could have; we are having, really, an explosion right now.

Senator PROXMIRE. Well, it could get worse. We could just about be getting rid of controls in some of the areas where it was most——

Mr. NOYES. I would hope from the fact that we are now beginning to see some inventory accumulation which we do not have the figures on in such a way that we can identify——

Senator PROXMIRE. But a lot of that inventory accumulation is in big automobiles.

Mr. NOYES. There is undoubtedly——

Senator PROXMIRE. Statistically?

Mr. Noyes. Considerable in large automobiles, but it seems to go beyond that. The data suggest that somewhere along the line users of steel are beginning to accumulate inventory, users of copper are beginning to accumulate inventory, and that before long, we may see some reduction in these tremendous price pressures.

Senator Proxmire. I just have one other area that I wanted to discuss briefly, and then I am through.

You alone, Mr. Gordon, among the panel, pointed out something that I feel strongly about, the inflationary effect of the big increases in the defense budget. We have been unable to persuade the administration to focus attention on the economic consequences of the defense spending. We are trying to get Secretary Schlesinger before the committee, and I think he will come some time soon, but we have not been able to get him so far.

Mr. Stein told me that the Council looked into the black box of the defense budget once and found there was nothing there. What he was implying, I think, is that economic analysis of the defense budget will not contribute much to our understanding of the economy. The further implication of Mr. Stein's view is that there is not much difference to the economy in defense spending and nondefense spending.

You have already indicated that you think there is, with respect to shortages, with respect to the fact that the Bureau of Labor Statistics had pointed out that $1 billion of defense spending gives you 57,000 jobs; $1 billion of spending in educational services provides 104,000 jobs.

Have you done, or are you aware of, any studies that inquired into the consequences on the domestic economy of spending for defense?

For example, has anybody studied whether defense spending is inflationary or whether it is responsible or contributing to some of the material shortages?

Mr. Gordon. I do not know of any specific studies on that subject. There may be. Nor have I done any specific research on the subject. But simply having rough notions of the extent to which military expenditures go into the purchase of equipment which involves metals, steel, copper, many other things. it simply stands to reason that the sort of proposal for a substantial increases in the defense budget this year certainly does not mitigate any inflationary pressures and may well add to them.

And certainly, if you were looking for a way of reducing unemployment, I would not pick military expenditures—increase in military expenditures—as a way to get the largest possible increase in employment for $1 billion increase in Government expenditures.

Senator Proxmire. Is it not also true that the nature of military procurement, with so much of it negotiated, so much of it on a pretty much cost-plus basis, that it does tend to push up both wages and prices more sharply than in the rest of the economy, in the private sector?

Mr. Gordon. This is my impression, but I cannot provide you with detailed documentation.

Senator PROXMIRE. Mr. Noyes or Mr. Tobin, would you like to comment on it?

Mr. NOYES. Well, I would say, Senator, that you know so much more about this than I do, I would be very reluctant to comment. But I think this is an area which I think you might very well look into. It is almost impossible for anyone on the outside to estimate accurately what the economic impact of a particular military budget might be.

But, certainly, to the extent that it is possible, increased military expenditures, or even existing military expenditures, should be resisted in areas where we are dealing with shortages.

Senator PROXMIRE. You see, one of the problems with this budget is that their increases, 83 percent of the increases, are in two areas: A big increase, a very big increase, in transfer payments, including social security benefits, medicare, medicaid, and so forth; and the military is the other big area.

Now, both of these are economically sterile. They do not provide job training; they do not build houses; they do not provide for any economic goods. This is something that concerns me. It does not seem to concern most economists very much, but it seems to me that that particular concentration is peculiarly inflationary. It indicates that this budget, while it might be construed as a neutral budget, might have a perverse effect in the area of at least some prices and wages.

Mr. NOYES. I think, sir, you are one of the best informed people in the country on this subject, so I am reluctant to make any comment, but I am delighted that you are asking these questions.

Senator PROXMIRE. Thank you very much, Mr. Noyes, Mr. Tobin, and Mr. Gordon. This has been most helpful.

Now, tomorrow morning at 10 o'clock we are going to meet in room 2128 of the Rayburn House Office Building to hear the head of the Federal Reserve Board, Mr. Arthur Burns.

The committee stands recessed.

[Whereupon, at 12:25 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, February 26, 1974.]

THE 1974 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 26, 1974

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

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

Present: Representatives Patman, Widnall, and Conable; and Senators Proxmire and Javits.

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

OPENING STATEMENT OF CHAIRMAN PATMAN

Chairman PATMAN. The committee will please come to order. The Joint Economic Committee, composed of 10 Members of the House of Representatives and 10 Members of the Senate, has met here this morning to continue hearings on the President's Economic Report. Traditionally we always hear from the Chairman of the Federal Reserve Board.

I was unable to be here the last 2 weeks, so the vice chairman, Hon. William Proxmire, U.S. Senator from Wisconsin, graciously presided over the committee. And I am deeply grateful to him for his services in doing that. Bill Proxmire is one of the most knowledgeable, one of the most intelligent, one of the most able Members of the U.S. Congress. He and I have been chairman and vice chairman of this committee for a long time, and I know something about his ability. And I thank him most sincerely for his services the last 2 weeks during this investigation and hearing.

Mr. Burns, we look forward to hearing you on this important question of the President's report to the Congress for 1974. You have a prepared statement. You may proceed, sir, as you desire. We are grateful to you for coming before us to give us your views about the economy and what can help the economy in particular, and what will not hurt it. So you are recognized, sir. And you may proceed in your own way.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. BURNS. I am pleased to meet once again with the Joint Economic Committee to present the views of the Federal Reserve Board on the condition of the national economy.

Economic life never stands still. During 1973, taken as a whole, the real output of our economy moved to a higher level, unemployment fell, domestic sales rose, exports soared, and business profits improved. But the year was also characterized by sharp contrasts in the movements of production, income flows, prices, and practically every economic factor. Financial markets experienced great turbulence, and both the Nation's mood and its economic activities suffered as the forces of inflation gathered momentum.

Early in 1973, our economy was in the midst of a boom of exceptional intensity. Business expenditures for new plant and equipment were accelerating, home-building activity was at a record level, consumer spending was moving up briskly, and exports were climbing in response to exhuberant activity abroad and an improved competitive position of American goods in foreign markets. With the demand for goods and services increasing so strongly, growth in total real output during the first quarter rose to an anuual rate of almost 9 percent. Production of our nation's factories and minues increased even faster.

But as inevitably happens in the course of a vigorous cyclical upswing, constraints on supply soon began to be felt. Shortages of raw materials and component parts became widespread in the second half of the year, when the rate of utilization of the productive capacity in the major materials-producing industries reached 96 percent. And as unemployment rate for adult males kept falling, it became harder and harder to find skilled workers.

Special problems in some markets contributed to the slowing pace of economic expansion. The volume of residential construction was adversely affected by stringency in the mortgage market—a subject to which I will return. Also, retail sales became rather sluggish after the first quarter, in part because consumers had recently stocked up on automobiles and other consumer durable and were somewhat reluctant to increase their installment debts further. But the basic reason for the weakening of retail trade was erosion of the buying power of American families.

During 1973, average weekly earning of workers in the private nonfarm economy rose about 7 percent, which is a large increase by historical standards. The level of consumer prices, however, rose even faster. With social security and other taxes also increasing, the real weekly take-home pay of the average worker was about 3 percent lower at the end of 1973 than a year earlier. Inflation reduced also the real value of savings. Even if we take no account of the decline in the prices of common stocks, the dollar value of the other financial assets held by individuals rose less than consumer prices during 1973; in other words, the real value of these accumulated savings actually declined during the year.

Many consumers responded to the decline of their real income and savings by postponing or canceling plans for buying big-ticket items. Sales of new autos began to slip in the spring, and so too did purchases of furniture and appliances. Factory shipments of mobile homes reached a peak in the first quarter, then declined by almost one-third by yearend. And the drop in sales of new conventional houses was not only a response to stringency in the mortgage market; it reflected also the declining real income of the average American worker and the sharply higher price of new homes.

Inflation thus seriously retarded economic progress last year, as it has often done on prior occasions. Let me turn, therefore, to the reasons why our inflationary problem worsened in 1973.

In view of the strong cyclical expansion in economic activity that developed in late 1972 and early in 1973, it would have been difficult to avoid some additional upward pressure on prices under the best of circumstances. In retrospect, it might be argued that monetary and fiscal policies should have been somewhat less expansive during 1972. It is the Board's judgment, however, that any upward pressures on prices arising from this sources were overtaken and swamped by powerful special factors that added a new dimension to our inflationary problem.

A major source of the rapid inflation during 1973 was the coincidence of booming economic activity in the United States and in other countries. Production rose rapidly throughout the industrial world; price of labor, materials, and end products were bid up; and inflation accelerated everywhere.

Another complicating factor was the depreciation of the dollar in foreign exchange markets during the first half of last year. The dollar's decline magnified the impact of world-wide inflation on our price level. Higher prices of foreign currencies raised the dollar prices of imported products, and these effects spread through the economy. And as the dollar became cheaper for foreign buyers, our expert trade expanded, thereby reinforcing pressures of domestic demand on our resources.

Exports were also stimulated by the worldwide expansion of industrial output. Our country has long been a major supplier of industrial materials, component parts, and capital equipment. Sharply higher foreign orders for these items added powerfully to growing domestic requirements.

The resulting demand pressures became particularly intense in the major materials-producing industries—that is, industries producing aluminum, steel, cement, synthetic fibers, paper, paperboard, and the like. In some of these industries, productive capacity had grown little in recent years—a result of the low rates of profitability from 1966 to 1971 and, to some degree also, of the restrictions imposed by environmental controls. Since our industrial plant was incapable of accommodating the upsurge in demand last years, acute shortages developed for a wide range of basic materials.

To make matters worse, disappointing harvests in 1972—both here and abroad—forced a sharp run-up in food prices during the first 8 or 9 months of 1973. Later, the disruptive manipulation of petroleum shipments and prices by major oil-exporting countries caused a spectacular advance in the prices of gasoline and heating oil. Rapidly rising prices of food and fuel, in fact, have accounted for a large part of our recent inflationary problem.

These sources of inflation are still with us. In January, there was a large further rise in wholesale prices of fuels and of farm and food products. Widespread increases occurred also among industrial commodities. And consumer prices moved up at an annual rate of nearly 13 percent, with about three-fourths of the increase accounted for by food and energy items.

In short, the character of the recent inflation has been very different from the advances in the general price level that troubled us in earlier business-cycle expansions. Last year, a worldwide boom was in process; the dollar was again devalued; agricultural products, basic industrial materials and oil were in short supply, and price increases of these products were enormous.

When an economy is beset by inflationary forces of such exceptional character, direct controls over wages and prices are apt to be rather ineffective. The classical tools of economic stabilization—that is, general monetary and fiscal policies—can be more helpful at such a time, but limitations on their practical use in the environment of 1973 must also be recognized. When prices of numerous commodities are being moved up by powerful special factors, a strongly restrictive monetary and fiscal policy, aiming to achieve average price stability in a short time frame, would drive other prices sharply down and soon lead to intolerably high unemployment.

The Federal Reserve has sought to shape monetary policy in these troubled times with a sensitive eye to changing economic and financial forces. In view of the inflationary tendencies already evident in the spring of 1972, the mounting pressures in financial markets were allowed to express themselves in higher short-term interest rates. Later that year, as evidence emerged of worldwide inflationary problems, the Federal Reserve moved further toward monetary restraint. Open market operations were conducted so as to exert pressure on the reserves of commercial banks, and margin requirements on common stocks were raised.

By early 1973, expansion of the money stock and related bank credit began to slow. Private credit demands, however, remained exceptionally strong, with most of the increased demand concentrated in short-term markets. Commercial banks, in particular, were deluged with business loan demands. The consequence was a sharp rise in short-term market interest rates; long-term rates followed suit, although with a lag and to a much smaller degree.

The rise in money market rates, together with heavy customer loan demands, induced commercial banks to step up their borrowing at the discount window. The Board sought to discourage expansion of bank reserves through this source, and also to emphasize the restrictive thrust of monetary policy, by raising the discount rate in successive steps from 4½ percent at the beginning of 1973 to 7½ percent in August.

In addition, shortly before midyear, the Board increased the reserve requirements on demand deposits of member banks. Earlier, the reserve requirement applicable to increases in large-denomination time certificates of deposit had been raised from 5 to 8 percent. Later on, this marginal reserve requirement was raised further—to 11 percent. These changes in reserve requirements reinforced the restrictive effects of open market operations and of discount policy, and thereby helped to moderate the expansion in money and bank credit.

Toward the end of last summer, it became apparent that Federal Reserve policies had brought the major monetary and banking aggregates under good control. For example, the narrowly defined money supply grew at an annual rate of 5½ percent in the third quarter, compared to 7¼ percent in the first half of the year and 7¾ percent in 1972. Again, total loans and investments at all commercial banks grew at an annual rate of about 12 percent in the third quarter, compared with 18 percent in the first 6 months.

Evidence also began to accumulate after mid-1973 that the rate of expansion in overall economic activity was tapering off. In late September, therefore, the Federal Reserve moved away very cautiously from its earlier policy of active restraint. Open market operations began to be conducted with a view to easing somewhat the availability of bank reserves, and this policy was cautiously extended when the oil shortage further clouded the economic outlook. In addition, the marginal reserve requirement on large-denomination certificates of deposit was reduced last December from 11 to 8 percent, and this January the margin required on purchases of common stock was set at 50 instead of 65 percent.

Looking back over the past year, we believe that the course of monetary policy was generally appropriate. Growth rates of monetary and credit aggregates were slowed, as they should have been in a period of intense inflationary pressures. And the response of monetary policy to the slowing pace of economic expansion last fall was timely but prudent, as we again think the circumstances required.

The financial developments that I have sketched had a serious impact on the residential mortgage market and the home-building industry. In view of the social importance of this industry, let us turn back and review the special problems that developed in the market for residential mortgages.

During the second quarter of 1973, as yields on short-term market securities became increasingly attractive, individuals began to channel more of their savings into market securities—in some cases, withdrawing funds from time and savings accounts at depositary institutions for this purpose. In consequence, new commitments for mortgages, particularly by savings banks and saving and loan associations, began to taper off. Reduced availability of mortgage credit thus reinforced the adverse effects on homebuilding that stemmed from rising interest rates, inflated construction costs, and declining real incomes of many workers.

In view of the extensive division of personal savings into market securities, it was clearly essential to enhance the ability of depositary institutions to compete for savings funds. The Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board therefore moved jointly at mid-year to raise interest-rate ceilings on consumer-type time and savings deposits, and to remove all interest-rate constraints on certificates of deposit with maturities of 4 years or longer.

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At about the same time as this action was taken, the Board imposed a marginal reserve requirement on large-denomination certificates of deposit, as I noted earlier. This addition to the cost of funds raised by commercial banks was expected to discourage business loans, and thereby help to make more bank funds available for residential mortgages or other uses.

Most depositary institutions moved quickly, but prudently, to take advantage of the greater opportunity that the new interest-rate regulations gave them to compete for the savings of individuals. Yields on short-term market securities, however, continued to climb during the summer, and savings flows to the depositaries weakened further.

The weakness of time and savings deposits at nonbank thrift institutions during the summer months led the Congress to pass legislation in October requiring interest-rate ceilings on all categories of consumer-type time and savings deposits. The effects of this legislation are uncertain, since the worst of the savings flow problem had passed by September. Many of the interest-sensitive depositors had by that time already shifted their funds into market securities, and market interest rates too had begun to decline.

The flow of savings to the thrift institutions strengthened over the remainder of 1973, and mortgage credit became more readily available. At present, mortgage interest rates are appreciably lower than they were last summer and fall. The homebuilding industry, however, continues to be depressed.

Last year's experience has demonstrated once again how vulnerable the mortgage market still is to changes in general credit conditions. The Board addressed this problem in a report to the Congress 2 years ago. We continue to believe that adoption of a flexible tax credit on business investment is the most important single step that could be taken to reduce the instability in mortgage finance and homebuilding.

Let me turn, finally, to the matters that are of chief concern to this committee—namely, the outlook for economic activity and prices, and the responsibilities for public policy that this committee has under the Employment Act.

The Nation faces at the present time a severe shortage of petroleum products that is slowing business activity and aggravating our inflationary problem. Shortages of other materials and supplies also remain acute. While these difficulties are limiting production in some firms, other enterprises—as previously noted—are experiencing weaker demand for their products. The oil shortage has had particularly adverse effects on the purchase of new autos, of homes in outlying suburban areas, of recreational vehicles and other travel-related goods and services. For some of these items, demand had begun to weaken even before the oil crisis.

A downward adjustment of production and employment is therefore underway. Industrial output declined in December and again in January, and unemployment last month rose rather sharply, to 5.2 percent of the labor force. I would expect some further weakening of economic activity, with industrial production probably declining and unemployment rising in the months immediately ahead.

The current economic slowdown, however, does not appear to have the characteristics of a typical business recession. To date, declines in employment and production have been concentrated in specific industries and regions of the country, rather than spread broadly over the economy. In some major sectors, the demand for goods and services is still rising. Capital spending plans of business firms remain strong, and so do inventory demands for the many materials and components in short supply. Meanwhile, prices are continuing to rise very rapidly.

Expenditures by businesses for fixed capital will probably continue to rise in view of the urgent need for added capacity in a number of our basic industries. Residential construction may pick up later in the year, in response to the improvement that has been occurring in mortgage credit supplies. With Government expenditures at all levels also moving higher, it seems unlikely at present that the current economic slowdown will become pervasive or be of extended duration.

Our Nation's business firms and consumers already have found ways to economize on their uses of oil and other forms of energy. For example, there have been significant declines during recent months in the use of fuel oil and electricity across the National. As 1974 moves on, these adjustments may be expected to continue. Domestic output of crude oil will increase gradually; electric utilities will shift to greater reliance on coal; auto manufacturers will expand their capacity to produce the smaller cars that are increasingly demanded by consumers: and myriad other adjustments will be made to the energy problem. In numerous ways we are, even now, laying the basis for recovery in business activity.

Improvement in the price performance of our economy during 1974 is well within our means. The rise in consumer prices should moderate later this year as petroleum prices decline or level off in response to the drastic adjustments now underway in oil markets around the world and as our own food supplies expand in response to incentives for farmers to increase production. There are other favorable price developments on the horizon. A slower pace of economic activity, both here and abroad, may cause a decline in the prices of industrial raw materials and internationally traded commodities. Also, the net appreciation of the dollar over recent months in foreign exchange markets should restrain the prices of imported goods and moderate the demand for our exports, thereby increasing the supply of goods available in domestic markets.

Realistically, however, we can hardly expect a return to general price stability in the near future. Substantial increases in the prices of numerous commodities and services are practically unavoidable this year. Relative prices of many items are now badly out of balance. Prices of materials, for example, have recently risen very swiftly, and many of these cost increases are still to be passed through to the prices of end products.

A more fundamental factor affecting the course of inflation in 1974, however, may well be the course of wages and unit labor costs. Increases in wage rates have been edging up since last spring. If economic activity proceeds sluggishly this year, as now seems likely, productivity gains will probably be even smaller than they were last year. A rise of wages that is faster than we have recently experienced would therefore put great upward pressure on costs of production and ultimately on prices.

Whatever the cause, if rapid inflation continues this year, it may undermine confidence, send interest rates soaring, and wreck our chances of regaining a stable and broadly based prosperity in any near future. It may also destroy the gains we have recently made in strengthening our competitive position in world markets, and in improving our balance of payments. Let us not overlook the fact that the sharp rise in prices that occurred this January has already served to reduce the dollar's strength in foreign exchange markets.

A great deal of uncertainty now surrounds the outlook for the balance of payments. One thing, however, is entirely clear—our trade balance, and that of other oil-importing countries, will be affected very adversely by the price of imported oil. Fortunately, our competitive position in world markets is stronger than it was several years ago, and our exports may therefore increase at a good rate despite the slowdown that now appears to be underway in the economies of Europe and Japan. Even so, our merchandise trade balance will probaby register a substantial deficit in 1974 because of the rising oil-import bill. Other nations that are more heavily dependent on imported oil than we are could well experience trade deficits of unprecedented magnitude.

Increases in the revenues of oil-exporting countries will therefore be huge. The bulk of these revenues will be invested, since only a small part can be spent productively for imports in the short run. Consequently, many industrial countries will experience large capital inflows in 1974.

Because of the size and efficiency of our capital markets, the United States is likely to receive, directly or indirectly, a substantial share of the capital flow from oil-exporting countries. But there may also be additional outflows of capital from the United States. Some nations will wish to finance their oil payments by borrowing in our financial markets. Also, private capital outflows may increase because of the recent relaxation, here and abroad, of controls on capital flows. In the end, the net flow of capital to this country might equal, or even exceed, the decline in our trade balance attributable to the larger dollar value of oil imports; but the way in which the balance of payments will unfold is highly uncertain, and this will require great vigilance on our part.

The problems for international financial markets created by the present price of oil are very serious. Short of some reversal of policy by the oil-exporting nations, there is no way to avoid them. Nor is there any way to avoid adjustments in our own economy to the more limited supplies and higher costs of petroleum products.

In short, public policy at the present time is confronted with an exceptionally difficult economic situation: Inflation is proceeding at a dangerous pace; unemployment is rising; strong inflationary forces are likely to continue in 1974; and international financial relations have become strained.

Our best chance of surmounting these difficulties is to face up squarely to the gravity of the inflation problem. Inflation cannot be halted this year. But we can and should move resolutely this year to establish a dependable framework for a gradual return to reasonable price stability. Direct controls over prices and wages will not be of much further benefit in this effort. Machinery for reviewing wages and prices in pace-setting industries can, however, prove helpful; and so, too, may a concerted effort to enlarge our capacity to produce industrial materials, enhance productivity, and further reduce prevailing restrictions on international trade. But, in the end, inflation will not be brought under control unless we have effective management of aggregate demand through general monetary and fiscal policies.

In the current economic slowdown, the task of monetary policy will not be the same as in a classical business recession, when a considerable easing in the supply of money and credit can be expected to provide the financial basis for the subsequent recovery. As a consequence of the oil shortage, our capacity to produce may actually decline in 1974, or at best rise at an abnormally low rate. A highly expansive monetary policy would do little to stimulate production and employment, but it would run a serious risk of rocking financial markets, causing the dollar to depreciate in foreign exchange markets, and intensifying our already dangerous inflationary problem.

Fiscal policy can be used to better advantage than monetary policy in promoting prompt recovery in the present economic environment. Selective measures such as an expanded public employment program, increased unemployment benefits, or some liberalization of welfare payments in hard-hit areas, may be useful in cushioning the economic adjustments now underway. Also, a selective tax policy of accelerated amortization could stimulate investment in the energy and other basic materials industries, thereby relieving the more critical shortages of capacity that have recently proved so troublesome.

Current economic conditions may justify special fiscal measures of this kind. But the Board would strongly advise against adoption at this time of broadly stimulative fiscal measures, such as a general tax cut or substantially enlarged expenditures. It is not clear that a strong dose of fiscal stimulus is needed now, and we surely need to proceed cautiously at a time when the price level is still soaring.

This influential committee can be tremendously helpful in getting our economy back to a sound track. Last month's advance of the consumer price index—an increase at an annual rate of more than 10 percent—is a grim warning that we are on the brink of a two-digit inflation. It is of vital importance to the current state of confidence and the long future of our Nation that we make significant progress in slowing the rate of inflation this year.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you very much, Mr. Burns. We appreciate your testimony. Your views and comments on the economy will be helpful to us in evaluating the President's report.

I would like to ask you a few questions. And without objection we will proceed as we usually do on this committee; each member will be recognized to ask questions, and we will have the 10-minute rule.

So I would like to ask you, Mr. Burns, why the Fed has been so reluctant to help out in the housing crisis. We have been in a crisis for some time. And now, instead of being in a recession in housing, I believe you will have to admit we are in a depression. You will admit, will you not, Mr. Burns, that our situation is more than just a recession in housing?

Mr. BURNS. I have said so in my statements, Mr. Chairman.

Chairman PATMAN. Good. I am glad that you did. You know, we have more than 1 million fewer housing starts right now than we had a year ago; isn't that correct?

Mr. BURNS. Yes, housing starts are down about a million, or perhaps a shade more.

Chairman PATMAN. You know that is not good for America. None of us would say that it is. And yet the Fed has been very reluctant, the way I view it, to be of help in the housing market.

Now, the Fed has plenty of money for everything else, seemingly, but not for housing. And we are on a great campaign now for environmental quality. We are all joining in on that campaign, but one of the first things I think that we must have is adequate housing, decent housing, stable housing, and sanitary housing, of course. And yet we are making very little progress. And today the family which buys a home, say, for $20,000, which is a low-priced home, must obligate itself to pay $20,000 for the home over the traditional term of 30 years and the rate of interest that is being charged. The result is—no one objects to paying reasonable rates of interest, but they do object to excessive and extortionist interest rates. And the interest rates on this $20,000 home would cost them $40,000 during this period.

In other words, the person buying a home under the traditional terms and interest rates and charges will have to pay for three $20,000 homes in order to get title to one $20,000 home. Now, that has been going on for some time. It occurs to me that the great Federal Reserve System could arrange some way to come to the relief of the people on situations like that. A home is something that is vitally necessary, especially for families with children, and most families have children. But we don't seem to be getting much out of the Federal Reserve on it. I just wonder why you have not allowed the housing people to go to the discount window and get money at reasonable rates of interest.

What is your discount rate now, Mr. Burns?

Mr. BURNS. Seven and one-half percent.

Chairman PATMAN. Isn't that pretty high in comparison to the past decade?

Mr. BURNS. Oh, yes. It is the highest discount rate in Federal Reserve history.

Chairman PATMAN. Well, you are not proud of that, I know. What is being done to relieve it, to make the discount rate less?

Mr. BURNS. Well, if the discount rate were lowered from its present level, then the commercial banks which borrow from the Federal Reserve would be subsidized by the Federal Reserve. We don't think that is a good idea. The rate on Federal funds, which are the main alternative to the discount window, is now about 9 percent. And you surely would not want the Federal Reserve to be subsidizing on a liberal scale the commercial banks of this country.

Chairman PATMAN. I don't think anyone has advocated that: I don't know of anyone stating that they approve or advocate a method of that kind. But you referred to the 7½-percent rate being the highest in history. We have had several records the last few years on interest rates. And I remember when Mr. Nixon came in—and I am not saying this to reflect on the President—interest rates were about 6 percent. That was in 1968, at the time of the November election. And in 6 months, on June 9, 1969, interest rates were the highest in history, 8½ percent. And they have been going at that rates pretty well ever since, the highest rates we have ever had in this country.

It occurs to me that there are means and methods, with a great Federal Reserve System such as we have, of which you are the Chairman, whereby we could do better than that. It is terrible for people to live in homes that are not habitable; it is terrible that they have to pay such excessive and exorbitant interest rates. I just wonder if the Fed has ever given consideration to trying to adopt a plan that would be fairer to the poor people especially, that would be acceptable to them, so that they could pay for their homes in a reasonable length of time at reasonable rates of interest.

Has the Fed ever tried to devise a plan of that type, Mr. Burns?

Mr. BURNS. Let me try to answer that, Mr. Chairman. But before I do, I think I should comment on the fact that while interest rates have been very high in recent years, interest rates at least have moved down as well as up.

Short-term interest rates at the present time are 2 to 2½ or 3 percent lower than they were in September of last year.

Chairman PATMAN. Will you pardon me, Mr. Burns?

But the housing market doesn't depend on short-term rates so much; it is long term.

Mr. BURNS. I know that. And long-term interest rates have also come down some. Mortgage interest rates now are about 50 basis points lower than they were in the late summer and early fall of last year.

You overlook the fact, Mr. Chairman, that we have been in the grip of an inflation of extraordinary intensity, by far the most rapid inflation that we have had since the Korean war, and possibly we are beginning to exceed even that pace. At a time when prices are rising very sharply, the lenders, expecting to be paid in cheaper dollars, will insist on a somewhat higher interest rate, and borrowers are willing to pay that rate because they expect to pay back in cheaper dollars. When you make allowance for what has happened to the price level, you will find that interest rates in recent years, if anything, have been on the low side in real terms. It is the one price that has been flexible. It is a price that is very sensitive to the rate of inflation.

And when you speak of the Federal Reserve not concerning itself with the housing industry, well, I must advise you, Mr. Chairman, that by attending to the problem of inflation as we have been trying to do, we are doing a great deal more than anybody else is doing to help the housing industry. Inflation is the real difficulty that that industry is suffering from.

Chairman PATMAN. My time is up, but I would like to let you know what I have in mind for future questions.

I want to get right down to the question of you having in your portfolio at the Federal Reserve Banking System $79½ billion, in U.S. bonds that you paid for with U.S. currency. Now, if you had canceled the bonds when you paid for them——and I remind you that Mr. William McChesney Martin said they were paid for once—there is no reason why interest should be paid on them. But you are requiring interest to be paid on them at the rate of about $4 billion a year. I don't see any reason why the people should be compelled to suffer extortionate interest rates when you have a backlog of bonds that can be converted into capital overnight if you desire to do it, and take the burden off the people to some limited extent at least. Now, these bonds have been paid for in U.S. money, and reflect the credit of the U.S. Government.

You are talking about fighting inflation. You are not fighting inflation that way, you are creating inflation, because whenever you pay the money out for the bonds and don't cancel the bonds, you have double inflation. You have inflation caused by the payment of the money out for the bonds, and you have further inflation by the bonds not being canceled like debts should be canceled.

Now, I think that is a terrible reflection on our country, that we do not have some way to get our debts paid when they have been paid.

And all we want to do when we see what is happening is to stop this secrecy in the Federal Reserve System, stop it entirely, and have an audit like all other agencies have in the U.S. Government except the Federal Reserve System. The GAO audits the Atomic Energy, they audit the military expenditures, they audit everything that is important in the Government. And there is no objection except by the Federal Reserve.

So the Federal Reserve is holding $79½ billion worth of bonds that have been paid for with good U.S. currency one time. And now they will have to be paid for again unless something is done.

So, I think that you should agree, Mr. Burns, that we should have this audit and find out exactly where we are. We don't know where we stand exactly. We know that is a bad policy for the Fed to do that. If we allow and tolerate the Federal Reserve to continue such an operation of that kind—they already own 18 percent of the Federal debt today that didn't cost the Fed one penny—they will soon own 100 percent of the debt, about $490 billion, nearly $500 billion. And then when they get through with that, they can begin on the $2 trillion of debts that we have outstanding that are not in the form of Government obligations.

So, unless this thing is stopped I don't see how it can have a very good end for this Government. It is terribly bad, and it is getting worse.

You said a while ago that it looks like we are going to have worse conditions if things remain like they are. And I can't understand that. I am going to wait my turn and yield to other members now, but when I get back to me I want to ask you some more questions along that line.

Congressman Widnall, you are recognized.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Burns, welcome before the committee again. We certainly value your tesimony very highly, because we know that your integrity is unquestioned.

Mr. Burns, in your statement, in discussing some of the causes of the rapid rate of inflation during 1973, you refer to "coincidence of booming economic activity in the United States and in other countries" and the contribution which this boom made to our domestic inflation. In retrospect, could anything significant have been done to lessen the impact of this coincident boom on our domestic price levels? If so, what?

Mr. BURNS. Well, I don't really see what we could have done. We have trouble enough running our own country. We have had inadequate success in managing our own economy. We don't have the authority to manage the economies of other countries. They are autonomous. If they adopt expansionary policies, it is not anything we should interfere with, and it is not anything that we very well could interfere with. Other countries have been seeking prosperity in their own way just as we have.

Now, developments of this kind occur from time to time in history. Before 1907 you had such a coincidence of booms. You had one before 1920. And there are others in history, before 1873.

Representative WIDNALL. I think we fully understand that, Mr. Burns. But what certainly isn't clear to our own people is the parallel situation that is taking place throughout the world today. We used to have opportunities afforded us for new fields to enter into as outlets for our products, new places and new programs that we could develop that could take care of certain situations domestically in our own country. But we don't have those complete opportunities that we had in the past. And we have had a shrinking of natural resources throughout the world, and a dependence by the United States on foreign sources for many of these natural resources, which we didn't have before. And as a result, we have inflation on the products that are available here in the United States.

What alarms me a bit—and I don't think I have publicly discussed this before—is the dependence of the United States today on social security taxes. Actually, the fact is that the social security taxes go into our general revenues and are spent almost as fast as they come in. They are not dedicated revenues. And many people think that they are, they think they are to take care of the old people and the disabled people that are here in the United States.

Do you believe that another form of taxation might be more helpful toward stabilizing our economy than the great dependency on social security taxes?

Mr. BURNS. I think that our social security taxes have been going up very rapidly, and that they have become a very considerable burden on our working people. Before turning to other forms of taxation, I think we ought to reexamine our whole social security system. I do not like to criticize the Congress, and what I am about to say I do not wish to say in a critical manner. But it is a fact that social security benefits have been going up much more rapidly than the rise in the cost of living. In October of 1972 social security benefits were raised 20 percent. And we have had significant increases since then. Well, naturally, when benefits are increased at that rate of speed, taxes have to go up.

This is a very heavily taxed country at the present time. Our taxes in the aggregate at all governmental levels come to something like 35 percent of the dollar value of our national output. And the average American taxpayer feels that something over one-third for the tax collector is quite enough, perhaps too much.

I do think it would be wise to reexamine our tax system. At the moment I am not ready to suggest to you or to the Congress what these changes ought to be. But I do feel that social security taxes have become an exceptionally heavy burden on working people, particularly in the lower income brackets, and some relief there, I think, would be salutary. And I would urge that.

Representative WIDNALL. We have witnessed a drop in the prime interest rates recently from the high to, now I believe in some places it is down below 9 percent, 8¾ percent, is that correct?

Mr. BURNS. That is——

Representative WIDNALL. Do you think that drop will continue? Does it look as though it will continue?

Mr. BURNS. Much depends on what happens to the rate of economic activity and the general price level. If we can win some control over inflation we are going to have significantly lower interest rates in this country. If we don't, and we go the Latin American way—and that is the way we seem to be going—we will have interest rates that are a great deal higher than any that we have yet seen.

So, the fundamental factor, I think, is——

Chairman PATMAN. Would you repeat that, Mr. Burns, please?

Mr. BURNS. Yes.

If we don't bring inflation under control, and if we go the Latin American way, as we seem to be going, we will have interest rates on Latin American standards. In other words, they will be a good deal higher than they are at present.

Representative WIDNALL. And the interest rates themselves are largely dependent on the fiscal policy of the United States and not on the monetary policy, isn't that so? Or is it a combination of the two?

Mr. BURNS. I think it is a combination of the two. But if you take the fiscal policy of this country, in the years 1970 through 1974, if I remember correctly, the cumulative deficit for that 5-year interval was about $68 billion. And if you include, as I think you should, off-budget expenditures and also the outlays by Government sponsored corporations, that figure will rise to over $100 billion.

Now, we have had deficits year after year. And they have been huge. And they certainly have left their mark on the price level in this country. To run deficits on the scale that we have had in an era of extraordinary prosperity such as we have enjoyed is an invitation to inflation. And we have had it.

Representative WIDNALL. You have stated in your statement that the real value of accumulated savings declined during 1973.

Do you think that there will be a great propensity toward consumer spending in the first half of 1974, as people prefer to spend their dollars rather than have their purchasing power erode in savings deposits? Or is the principal effect of a high rate of inflation to stimulate greater savings even though the savings are rapidly eroded by inflation.

Mr. BURNS. I wish I could answer that question. Consumer behavior has not been systematic enough to enable me to answer that question with great confidence.

Let me make, however, one generalization drawn from studies of inflationary episodes throughout the world. And the generalization is as follows.

In the earlier stages of inflation, there is a tendency for people to accumulate more currency. But after a certain stage, when people become aware that they are holding on to a depreciating asset, they begin to move it out of their hoards with increasing speed. In other words, the turnover of money speeds up very rapidly. People try to get hold of goods which they expect to appreciate in price. And they buy things today because things are still to be had at bargain prices relative to the prices they expect tomorrow. I am not ready to say that the American public is as yet at that stage.

Representative WIDNALL. Thank you, Mr. Burns. My time is up.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. Mr. Burns, you have emphasized very heavily this morning the importance of stopping this rapid increase in prices and inflation as perhaps our principal economic problem, certainly one of the top two or three we have. You said in your statement:

> If rapid inflation continues this year, it may undermine confidence, send interest rates soaring, and wreck our chances of regarding a stable and broadly based prosperity in any near future.

Now, last September I asked you to comment on the criticism of the Federal Reserve Board monetary policy and allegations that it had been highly inflationary. You wrote me an excellent letter, a very detailed reply on November 6. I asked a number of prominent economists to comment on your reply. One of the most useful and ablest comments was by Mr. Friedman, of the University of Chicago.

I would like to ask the staff to distribute a copy of Mr. Friedman's letter to the press, and it will be available to other members if they want to look at it.

Mr. Friedman's response is very critical of the policies that you have followed, and he charges that they are highly inflationary. I would like to read one paragraph from Mr. Friedman's letter and then ask you to comment on his documentation criticizing your position.

Representative WIDNALL. Mr. Chairman, would the gentleman yield at this point?

Senator PROXMIRE. Yes.

Representative WIDNALL. Wouldn't it be helpful for the record to have the reply of Mr. Burns, together with the reply of Mr. Friedman, in the record?

Senator PROXMIRE. Yes; I will be happy to do that. They are lengthy replies, but I am happy to do it.

Chairman PATMAN. Without objection, it is so ordered.

[The replies referred to follow:]

[Article from the Federal Reserve Bulletin, No. 11, vol. 59, November 1973]

MONEY SUPPLY IN THE CONDUCT OF MONETARY POLICY

The role of the money supply in the conduct of monetary policy was discussed in detail in a letter sent on November 6, 1973, by Chairman Arthur F. Burns, Chairman of the Board of Governors, to Senator William Proxmire of Wisconsin.

The letter, a copy of which follows, describes the extent and the significance of variations in the growth of the money supply, and relates the actual behavior of money supply data during 1972 and 1973.

I am writing in further response to your letter of September 17, 1973, which requested comments on certain criticisms of monetary policy over the past year.

As stated in your letter, the criticisms are: (1) "that there was too much variation from time to time in the rate of increase in the money supply, that monetary policy was too erratic, too much characterized by stops and starts"; and (2) "that the money supply had increased much too much last year, in facte that the increase would have been too much even if we had been in the depths of a recession instead of enjoying a fairly vigorous economic expansion."

These criticisms involve basic issues with regard to the role of money in the economy, and the role that the money supply should play in the formulation and execution of monetary policy. These issues, along with the specific points you raise, require careful examination.

CRITICISM OF OUR PUBLIC POLICIES

During the past 2 years the American economy has experienced a substantial measure of prosperity. Real output has increased sharply, jobs have been created for millions of additional workers, and total personal income—both in dollars and in terms of real purchasing power—has risen to the highest levels ever reached.

Yet the prosperity has been a troubled one. Price increases have been large and widespread. For a time, the unemployment rate remained unduly high. Interest rates have risen sharply since the spring of 1972. Mortgage money has recently become difficult to obtain in many communities. And confidence in the dollar at home and abroad has at times wavered.

Many observers have blamed these difficulties on the management of public economic polices. Certainly, the Federal budget—despite vigorous efforts to hold expenditures down—continued in substantial deficit. There has also been an enormous growth in the activities of Federally sponsored agencies, which, although technically outside the budget, must still be financed. The results of efforts to control wages and prices during the past year have been disappointing. Partial decontrol in early 1973 and the subsequent freeze failed to bring the results that had been hoped for.

Monetary policy has been criticized on somewhat contradictory counts—for being inflationary, or for permitting too high a level of interest rates, or for failing to bring the economy back to full employment, or for permitting excessive short-term variations in the growth of the money supply, and so on.

One indication of dissatisfaction with our public policies was provided by a report, to which you refer in your letter, on a questionnaire survey conducted by the National Association of Business Economists. Of the respondents, 38 per cent rated fiscal policy "over the past year" as "poor"; 41 per cent rated monetary policy "over the past year" as "poor"; only 14 per cent felt that the wage–price controls under Phase IV were "about right." If this sampling is at all indicative, the public policies on which we have relied are being widely questioned. Many members of the above group, in fact, went on record for a significant change in fiscal policy. In response to the question of whether they favored a variable investment tax credit, 46.5 per cent said "yes," 40 per cent said "no," and 13.5 per cent expressed "no opinion."

Let me turn now to the questions raised in your letter and in some other recent discussions about monetary policy. I shall discuss, in particular, the role of money supply in the conduct of monetary policy; the extent and significance of variability in the growth of the money supply during 1972–73.

ROLE OF MONEY SUPPLY

For many years economists have debated the role of the money supply in the performance of economic systems. One school of thought, often termed "monetarist," claims that changes in the money supply influence very importantly, perhaps even decisively, the pace of economic activity and the level of prices. Monetarists contend that the monetary authorities should pay principal attention to the money supply, rather than to other financial variables such as interest rates, in the conduct of monetary policy. They also contend that fiscal policy has only a small independent impact on the economy.

Another school of thought places less emphasis on the money supply and assigns more importance to the expenditure and tax policies of the Federal Government as factors influencing real economic activity and the level of prices. This school emphasizes the need for monetary policy to be concerned with interest rates and with conditions in the money and capital markets. Some economic activities, particularly residential building and State and local government construction, depend heavily on borrowed funds, and are therefore influenced greatly by changes in the cost and availability of credit. In other categories of spending—such as business investment in fixed capital and inventories, and consumer purchases of durable goods—credit conditions play a less decisive role, but they are nonetheless important.

Monetarists recognize that monetary policy affects private spending in part through its impact on interest rates and other credit terms. But they believe that primary attention to the growth of the money supply will result in a more appropriate monetary policy than would attention to conditions in the credit markets.

Needless to say, monetary policy is—and has long been—a controversial subject. Even the monetarists do not speak with one voice on monetary policy. Some influential monetarists believe that monetary policy should aim strictly at maintaining a constant rate of growth of the money supply. However, what that constant should be, or how broadly the money supply should be defined, are matters on which monetarists still differ. And there are also monetarists who would allow some—but infrequent—changes in the rate of growth of the money supply, in accordance with changing economic conditions.

It seems self-evident that adherence to a rigid growth-rate rule, or even one that is changed infrequently, would practically prevent monetary policy from playing an active role in economic stabilization. Monetarists recognize this. They believe that most economic disturbances tend to be self-correcting, and they therefore argue that a constant or nearly constant rate of growth of the money supply would result in reasonably satisfactory economic performance.

But neither historical evidence nor the thrust of explorations in business-cycle theory over a long century gives support to the notion that our economy is inherently stable. On the contrary, experience has demonstrated repeatedly that blind reliance on the self-correcting properties of our economic system can lead to serious trouble. Discretionary economic policy, while it has at times led to mistakes, has more often proved reasonably successful. The disappearance of busines depressions, which in earlier times spelled mass unemployment for workers and mass bankruptcies for businessmen, is largely attributable to the stabilization policies of the last 30 years.

The fact is that the internal workings of a market economy tend of themselves to generate business fluctuations, and most modern economists recognize this. For example, improved prospects for profits often spur unsustainable bursts of investment spending. The flow of personal income in an age of affluence allows ample latitude for changes in discretionary expenditures and in savings rates. During a business-cycle expansion various imbalances tend to develop within the economy—between aggregate inventories and sales, or between aggregate business investments in fixed capital and consumer outlays, or between average unit costs of production and prices. Such imbalances give rise to cyclical movements in the economy. Flexible fiscal and monetary policies, therefore, are often needed to cope with undesirable economic developments, and this need is not diminished by the fact that our available tools of economic stabilization leave something to be desired.

There is general agreement among economists that, as a rule, the effects of stabilization policies occur gradually over time, and that economic forecasts are an essential tool of policymaking. However, no economist—or school of economics—has a monopoly on accurate forecasting. At times, forecasts based largely on the money supply have turned out to be satisfactory. At other times, such forecasts have been quite poor, mainly because of unanticipated changes in the intensity with which the existing money stock is used by business firms and consumers.

Changes in the rate of turnover of money have historically played a large role in economic fluctuations, and they continue to do so. For example, the narrowly defined money stock—that is, demand deposits plus currency in public circulation—grew by 5.7 per cent between the fourth quarter of 1969 and the fourth quarter of 1970. But the turnover of money declined during that year, and the dollar value of gross national product rose only 4.5 per cent. In the following year, the growth rate of the money supply increased to 6.9 per cent, but the turnover of money picked up briskly and the dollar value of GNP accelerated to 9.3 per cent. The movement out of recession in 1970 into recovery in 1971 was thus closely related to the greater intensity in the use of money. Occurrences such as this are very common because the willingness to use the existing stock of money, expressed in its rate of turnover, is a highly dynamic force in economic life.

For this as well as other reasons, the Federal Reserve uses a blend of forecasting techniques. The behavior of the money supply and other financial variables is accorded careful attention. So also are the results of the most recent surveys on plant and equipment spending, consumer attitudes, and inventory plans. Recent trends in key producing and spending sectors are analyzed. The opinion of businessmen and outside economic analysts are canvassed, in part through the nationwide contacts of Federal Reserve Banks. And an assessment is made of the probable course of fiscal policy and also of labor-market and agricultural policies, and their effects on the economy.

Evidence from all these sources is weighed. Efforts are also made to assess economic developments through the use of large-scale econometric models. An eclectic approach is thus taken by the Federal Reserve, in recognition of the fact that the state of economic knowledge does not justify reliance on any single forecasting technique. As economic research has cumulated, it has become increasingly clear that money does indeed matter. But other financial variables also matter.

In recent years, the Federal Reserve has placed somewhat more emphasis on achieving desired growth rates of the monetary aggregates, including the narrowly-defined money supply, in its conduct of monetary policy. But we have continued to give careful attention to other financial indicators, among them the level of interest rates on mortgages and other loans and the liquidity position of financial institutions and the general public. This is necessary because the economic implications of any given monetary growth depend on the state of liquidity, the attitudes of businessmen, investors, and consumers toward liquidity, the cost and availability of borrowed funds, and other factors. Also, as the Nation's central bank, the Federal Reserve can never lose sight of its role as a lender of last resort, so that financial crises and panics will be averted.

I recognize that one advantage of maintaining a relatively stable growth rate of the money supply is that a partial offset is thereby provided to unexpected and undesired shifts in the aggregate demand for goods and services. There is always some uncertainty as to the emerging strength of aggregate demand. If money growth is maintained at a rather stable rate, and aggregate demand turns out to be weaker than is consistent with the Nation's economic objectives, interest rates will tend to decline and the easing of credit markets should help to moderate the undesired weakness in demand. Similarly, if the demand for goods and services threatens to outrun productive capacity, a rather stable rate of monetary growth will provide a restraining influence on the supply of credit and thus tend to restrain excessive spending.

However, it would be unwise for monetary policy to aim at all times at a constant or nearly constant rate of growth of money balances. The money growth rate that can contribute most to national objectives will vary with economic conditions. For example, if the aggregate demand for goods and services is unusually weak, or if the demand for liquidity is unusually strong, a rate of increase in the money supply well above the desirable long-term trend may be needed for a time. Again, when the economy is experiencing severe cost-push inflation, a monetary growth rate that is relatively high by a historical yardstick may have to be tolerated for a time. If money growth were severely constrained in order to combat the element of inflation resulting from such a cause, it might well have seriously adverse effects on production and employment. In short, the growth rate of the money supply that is appropriate at any given time cannot be determined simply by extrapolating past trend or by some preconceived arithmetical standard.

Moreover, for purposes of conducting monetary policy, it is never safe to rely on just one concept of money—even if that concept happens to be fashionable. A variety of plausible concepts merit careful attention because a number of financial assets serve as a convenient, safe, and liquid store of purchasing power.

The Federal Reserve publishes data corresponding to three definitions of money and takes all of them into account in determining policy. The three measures are: (a) the narrowly defined money stock (M_1), which encompasses currency and demand deposits held by the nonbank public (b) a more broadly defined money stock (M_2), which also includes time and savings deposits at commercial banks (other than large negotiable time certificates of deposits); (c) a still broader definition (M_3), which includes savings deposits at mutual savings banks and savings and loan associations. A definition embracing other liquid assets could also be justified—for example, one that would include large-denomination negotiable time CD's, U.S. savings bonds and Treasury bills, commercial paper, and other short-term money market instruments.

There are many assets closely related to cash, and the public can switch readily among these assets. However money may be defined, the task of determining the amount of money needed to maintain high employment and reasonable stability of the general price level is complicated by shifting preferences of the public for cash and other financial assets.

VARIABILITY OF MONEY SUPPLY GROWTH

In the short run, the rate of change in the observed money supply is quite erratic and cannot be trusted as an indicator of the course of monetary policy. This would be so even if there were no errors of measurement.

The record of hearings held by the Joint Economic Committee on June 27, 1973, includes a memorandum that I submitted on problems encountered in controlling the money supply. As indicated there, week-to-week, month-to-month, and even quarter-to-quarter fluctuations in the rate of change of money balances are frequently influenced by international flow of funds, changes in the level of U.S. Government deposits, and sudden changes in the public's attitude toward liquidity. Some of these variations appear to be essentially random—a product of the enormous ebb and flow of funds in our modern economy.

Because the demands of the public for money are subject to rather wide short-term variations, efforts by the Federal Reserve to maintain a constant growth rate of the money supply could lead to sharp short-run swings in interest rates and could risk damage to financial markets and the economy. Uncertainties about financing cost could reduce the fluidity of markets and could increase the costs of financing to borrowers. In addition, wide and erratic movements of interest rates and financial conditions could have undesirable effects on business and consumer spending. These adverse effects may not be of major dimensions, but it is better to avoid them.

In any event, for a variety of reasons explained in the memorandum for the Joint Economic Committee, to which I have previously referred, the Federal Reserve does not have precise control over the money supply. To give one example, a significant part of the money supply consists of deposits lodged in nonmember banks that are not subject to the reserve requirements set by the Federal Reserve. As a result, there is some slippage in monetary control. Furthermore, since deposits at nonmember banks have been reported for only 2 to 4 days in a year, in contrast to daily statistics for member banks, the data on the money supply—which we regularly present on a weekly, monthly, and quarterly basis—are estimates rather than precise measurements. When the infrequent reports from nonmember banks become available, they often necessitate considerable revisions of the money supply figures. In the past 2 years, the revisions were upward, and this may happen again this year.

Some indication of the extent of short-term variations in the recorded money supply is provided below. Table 1 shows the average and maximum deviations (without regard to sign) of M_1 from its average annual growth rate over a 3½ year period. As would be expected, the degree of variation diminishes as the time unit lengthens; it is much larger for monthly than for quarterly data and is also larger for quarterly than for semiannual data.

In our judgment, there is little reason for concern about the short-run variations that occur in the rate of change in the money stock. Such variations have minimal effects on the real economy. For one thing, the outstanding supply of money is very large. It is also quite stable, even when the short-run rate of change is unstable. This October the average outstanding supply of M_1, seasonally adjusted, was about $264 billion. On this base, a monthly rise or fall in the money stock of even $2½ billion would amount to only a 1 per cent change. But when such a temporary change is expressed as an annual rate, as is now commonly done, it comes out as about 12 per cent and attracts attention far beyond its real significance.

TABLE 1.—DEVIATIONS IN M_1 FROM ITS AVERAGE RATE OF GROWTH, 1970 THROUGH MID-1973

[Percentage change at annual rates]

Form of data	Average deviation	Maximum deviation
Monthly	3.8	8.8
Quarterly	2.4	5.5
Semiannual	1.8	4.1

The Federal Reserve research staff has investigated carefully the economic implications of variability in the growth of M_1. The experience of the past two decades suggests that even an abnormally large or abnormally small rate of growth of the money stock over a period of up to 6 months or so has a negligible influence on the course of the economy—provided it is subsequently offset. Such short-run variations in the rate of change in the money supply may not at all reflect Federal Reserve policy, and they do not justify the attention they often receive from financial analysts.

The thrust of monetary policy and its probable effects on economic activity can only be determined by observing the course of the money supply and of other monetary aggregates over periods lasting 6 months or so. Even then, care must be taken to measure the growth of money balances in ways that temper the influence of short-term variations. For example, the growth of money balances over a quarter can be measured from the amount outstanding in the last month of the preceding quarter to the last month of the current quarter, or from the average amount outstanding during the preceding quarter to the average in the current quarter. The first measure captures the latest tendencies in the money supply, but may be distorted by random changes that have no lasting significance. The second measure tends to average out temporary fluctuations and is comparable to the data provided on a wide range of nonmonetary economic variables, such as GNP and related measures.

A comparison of these two ways of measuring the rate of growth in M_1 is shown in Table 2 for successive quarters in 1972 and 1973. The column labeled M shows annual rates calculated from end-months of quarters; the column labeled Q shows annual rates calculated from quarterly averages.

TABLE 2.—GROWTH RATES OF MONEY SUPPLY ON TWO BASES

[Percentage change at annual rates]

Quarter	M	Q	Quarter	M	Q
1972:			1973:		
I	9.2	5.3	I	1.7	4.7
II	6.1	8.4	II	10.3	6.9
III	8.2	8.0	III	.3	5.1
IV	8.6	7.1			

As may be seen, the quarterly averages disclose much more clearly the developing trend of monetary restraint—which, in fact, began in the second quarter of 1972. Also, the growth of M_1, which on a month-end basis appears very erratic in the first three quarters of 1973, is much more stable on a quarterly-average basis. For example, while the level of M_1 did not expand significantly between June and September, the quarterly-average figures indicate further sizable growth in the third quarter. For purposes of economic analysis, it is an advantage to recognize that the money available for use was appreciably larger in the third quarter than in the second quarter.

EXPERIENCE OF 1972-73

During 1972, it was the responsibility of the Federal Reserve to encourage a rate of economic expansion adequate to reduce unemployment to acceptable levels. At the same time, despite the dampening effects of the wage-price control program, inflationary pressures were gathering. Monetary policy, therefore, had to balance the twin objectives of containing inflationary pressures and encouraging economic growth. These objectives were to some extent conflicting, and monetary policy alone could not be expected to cope with both problems. Continuation of an effective wage-price program and a firmer policy of fiscal restraint were urgently needed.

The narrowly defined money stock increased 7.4 per cent during 1972—measured from the fourth quarter of 1971 to the fourth quarter of 1972. Between the third quarter of 1972 and the third quarter of 1973, the growth rate was 6.1 per cent. By the first half of 1973, the annual growth rate had declined to 5.8 per cent, and a further slowing occurred in the third quarter.

Evaluation of the appropriateness of these growth rates would require full analysis of the economic and financial objectives, conditions, and policies during the past 2 years, if not longer. Such an analysis cannot be undertaken here. Some perspective on monetary developments during 1972–73 may be gained, however, from comparisons with the experience of other industrial countries, and by recalling briefly how domestic economic conditions evolved during this period.

Table 3 compares the growth of M_1 in the United States with that of other industrial countries in 1972 and the first half of 1973. The definitions of M_1 differ somewhat from country to country, but are as nearly comparable as statistical sources permit. It goes without saying that each country faced its own set of economic conditions and problems. Yet it is useful to note that monetary growth in the United States was much lower than in other major industrial countries and that it also was steadier than in other countries.

TABLE 3.—GROWTH IN MONEY SUPPLY

[Percentage change at annual rates]

Country	1971 Q4 to 1972 Q4	1972 Q4 to 1973 Q2
United States	7.4	5.8
United Kingdom	14.1	10.0
Germany	14.3	4.2
France	15.4	8.7
Japan	23.1	28.2

Table 4 shows, in summary fashion, the rates of change in the money supply of the United States, in its total production, and in the consumer price level during 1972 and 1973. The table is based on the latest data. It may be noted in passing that, according to data available as late as January 1973, the rate of growth of M_1 during 1972 was 7.2 per cent, not 7.4 per cent; and that the rate of increase in real GNP was 7.7 per cent, not 7.0 per cent. In other words, on the basis of the data available during 1972, the rate of growth of M_1 was below the rate of growth of the physical volume of over-all production.

Table 4 indicates that growth in M_1 during 1972 and 1973 approximately matched the growth of real output, but was far below the expansion in the dollar value of the Nation's output. Although monetary policy limited the availability of money relative to the growth of transactions demands, it still encouraged a substantial expansion in economic activity; real output rose by about 7 per cent in 1972. Even so, unemployment remained unsatisfactorily high throughout the greater part of the year. It was not until November that the unemployment rate dropped below 5½ per cent. For the year as a whole, the unemployment rate averaged 5.6 per cent. It may be of interest to recall that unemployment averaged 5.5 per cent in 1954 and 1960, which are commonly regarded as recession years.

TABLE 4.—MONEY SUPPLY, GNP, AND PRICES IN THE UNITED STATES

[Percentage change at annual rates]

Item	1971 Q4 to 1972 Q4	1972 Q4 to— 1973 Q2	1972 Q4 to— 1973 Q3
Money supply (M_1)	7.4	5.8	5.6
Gross national product:			
Current dollars	10.6	12.1	11.7
Constant dollars	7.0	5.4	4.8
Prices:			
Consumer price index (CPI)	3.4	7.1	7.8
CPI excluding food	3.0	4.0	4.1

Since the expansion of M_1 in 1972 was low relative to the demands for money and credit, it was accompanied by rising short-term interest rates. Long-term interest rates showed little net change last year, as credit demands were satisfied mainly in the short-term markets.

In 1973, the growth of M_1 moderated while the transactions demands for cash and the turnover of money accelerated. GNP in current dollars rose at a 12 per cent annual rate as prices rose more rapidly. In credit markets, short-term interest rates rose sharply further, while long-term interest rates also moved up, though by substantially less than short-term rates.

The extraordinary upsurge of the price level this year reflects a variety of special influences. First, there has been a worldwide economic boom superimposed on the boom in the United States. Second, we have encountered critical shortages of basic materials. The expansion in industrial capacity needed to produce these materials had not been put in place earlier because of the abnormally low level of profits between 1966 and 1971 and also because of numerous impediments to new investment on ecological grounds. Third, farm product prices escalated sharply as a result of crop failures in many countries last year. Fourth, fuel prices spurted upward, reflecting the developing shortages in the energy field. And fifth, the depreciation of the dollar in foreign exchange markets has served to boost prices of imported goods and to add to the demands pressing on our productive resources.

In view of these powerful special factors and the cyclical expansion of our economy, a sharp advance in our price level would have been practically inevitable in 1973. The upsurge of the price level this year hardly represents either the basic trend of prices or the response of prices to previous monetary or fiscal policies—whatever their shortcomings may have been. In particular, as Table 4 shows, the explosion of food prices that occurred this year is in large part responsible for the accelerated rise in the overall consumer price level.

The severe rate of inflation that we have experienced in 1973 cannot responsibly be attributed to monetary management or to public policies more generally. In retrospect, it may well be that monetary policy should have been a little less expansive in 1972. But a markedly more restrictive policy would have led to a still sharper rise in interest rates and risked a premature ending of the business expansion, without limiting to any significant degree this year's upsurge of the price level.

CONCLUDING OBSERVATIONS

The present inflation is the most serious economic problem facing our country, and it poses great difficulties for economic stabilization policies. We must recognize, I believe, that it will take some time for the forces of inflation, which now engulf our economy and others around the world, to burn themselves out. In today's environment, controls on wages and prices cannot be expected to yield the benefits they did in 1971 and 1972, when economic conditions were much different. Primary reliance in dealing with inflation—both in the near future and over the longer term—will have to be placed on fiscal and monetary policies.

The prospects for regaining price stability would be enhanced by improvements in our monetary and fiscal instruments. The conduct of monetary policy could be improved if steps were taken to increase the precision with which the money supply can be controlled by the Federal Reserve. Part of the present control problem stems from statistical inadequacies—chiefly the paucity of data on deposits at nonmember banks. Also, however, control over the money supply and other monetary aggregates is less precise than it can or should be because nonmember banks are not subject to the same reserve requirements as are member banks.

I hope that the Congress will support efforts to rectify these deficiencies. For its part, the Federal Reserve is even now carrying on discussions with the Federal Deposit Insurance Corporation about the need for better statistics on the Nation's money supply. The Board of Governors also expects shortly to recommend to the Congress legislation that will put demand deposits at commercial banks on a uniform basis from the standpoint of reserve requirements.

Improvements in our fiscal policies are also needed. It is important for the Congress to put an end to fragmented consideration of expenditures, to place a firm ceiling on total Federal expenditures, and to relate these expenditures to prospective revenues and the Nation's economic needs. Fortunaely, there is now widespread recognition by Members of the Congress of the need to reform budgetary procedures along these broad lines.

It also is high time for fiscal policy to become a more versatile tool of economic stabilization. Particularly appropriate would be fiscal instruments that could be adapted quickly, under special legislative rules, to changing economic conditions—such as a variable tax credit for business investment in fixed capital. Once again I would urge the Congress to give serious consideration to this urgently needed reform.

We must strive also for better understanding of the effects of economic stabilization policies on economic activity and prices. Our knowledge in this area is greater now than it was 5 or 10 years ago, thanks to extensive research undertaken by economists in academic institutions, at the Federal Reserve, and elsewhere. The keen interest of the Joint Economic Committee in improving economic stabilization policies has, I believe, been an influence of great importance in stimulating this widespread research effort.

I look forward to the continued cooperation with the Committee in an effort to achieve the kind of economic performance our citizens expect and deserve.

THE UNIVERSITY OF CHICAGO,
DEPARTMENT OF ECONOMICS,
Chicago, Ill., February 20, 1974.

Hon. WILLIAM PROXMIRE,
Joint Economic Committee,
U.S. Senate,
Washington, D.C.

DEAR BILL: Here is the comment on Arthur Burns' reply to your letter of September 17, 1973, that I mentioned to you in Washington.

I shall appreciate your entering it in the records of the Joint Economic Committee.

Sincerely yours,

MILTON FRIEDMAN

Enclosure.

THE UNIVERSITY OF CHICAGO,
DEPARTMENT OF ECONOMICS,
Chicago, Ill., February 20, 1974.

Hon. WILLIAM PROXMIRE,
Joint Economic Committee,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: On September 17, 1973, you asked the Chairman of the Board of Governors of the Federal Reserve System to comment on certain published criticisms of monetary policy. On November 6, 1973, the Chairman replied on behalf of the System. This Reply has been widely publicized by the Federal Reserve System. It was reprinted in the *Federal Reserve Bulletin* (November, 1973) and in at least five of the separate Federal Reserve Bank *Reviews.*

The Reply makes many valid points. Yet, taken as a whole, it evades rather than answers the criticisms. It appears to exonerate the Federal Reserve System from any appreciable responsibility for the current inflation, yet a close reading reveals that it does not do so, and other evidence, to which the Reply does not refer, establishes a strong case that the Fed has contributed to inflation. The Reply appears to attribute admitted errors in monetary policy to forces outside the Fed, yet the difficulties in controlling and measuring the money supply are largely of the Fed's own making.

The essence of the System's answer to the criticisms is contained in three sentences, one dealing with the Fed's responsibility for the 1937 inflation; the other two, with the problem of controlling and measuring the money supply. I shall discuss each in turn.

RESPONSIBILITY FOR INFLATION

"*The severe rate of inflation that we have experienced in 1973 cannot responsibly be attributed to monetary management*" (italics added).

As written, this sentence is unexceptionable. Delete the word "severe," and the sentence is indefensible.

Th Reply correctly cites a number of special factors that made the inflation in 1973 more severe than could have been expected from prior monetary growth alone—the world-wide economic boom, ecological impediments to investment, escalating farm prices, energy shortages. These factors may well explain why consumer prices rose by 8 per cent in 1973 (fourth quarter 1972 to fourth quarter 1973) instead of, say, by 6 per cent. But they do not explain why inflation in 1973 would have been as high as 6 per cent in their absence. They do not explain why consumer prices rose more than 25 per cent in the five years from 1968 to 1973.

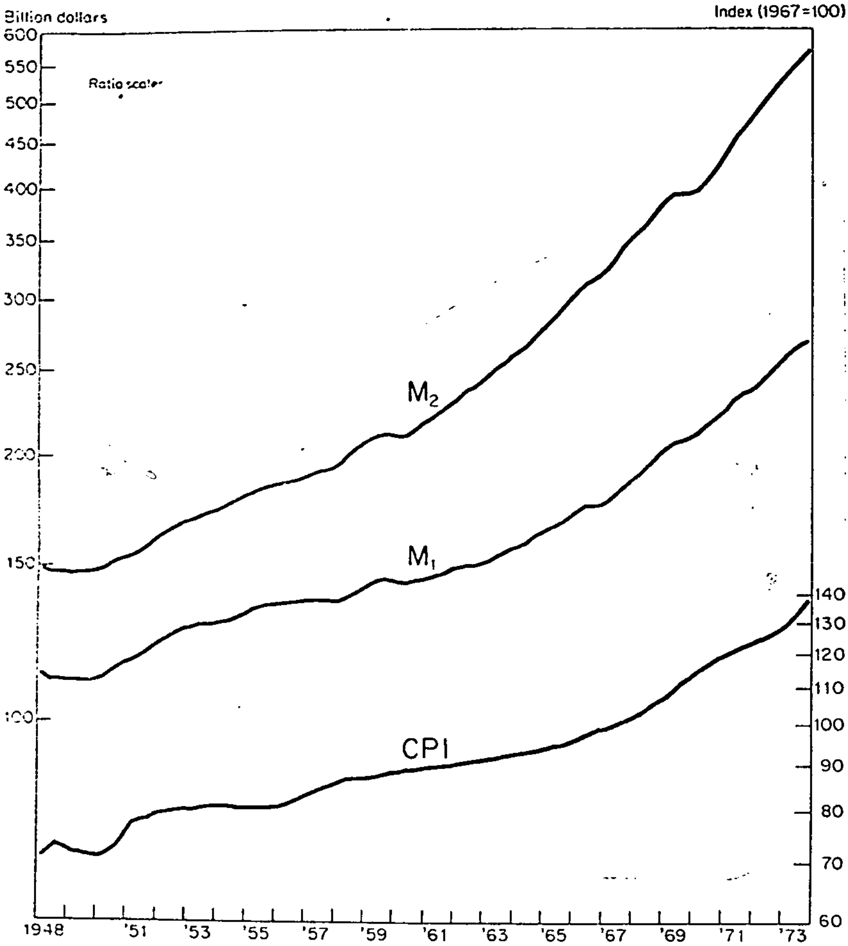
The Reply recognizes that "the effects of stabilization policies occur gradually over time" and that "it is never safe to rely on just one concept of money." Yet, the Reply presents statistical data on the growth of money or income or prices for only 1972 and 1973, and for only one of the three monetary concepts it refers to, namely, M_1 (currency plus demand deposits), the one that had the lowest rate of growth. On the basis of the evidence in the Reply, there is no way to evaluate the longer-term policies of the Fed, or to compare current monetary policy with earlier policy, or one concept of money with another.

From calendar year 1970 to calendar year 1973, M_1 grew at the annual rate of 6.9 per cent; in the preceding decade, from 1960 to 1970, at 4.2 per cent. More striking yet, the rate of growth from 1970 to 1973 was higher than for any other three-year period since the end of World War II.

The other monetary concepts tell the same story. From 1970 to 1973, M_2 (M_1 plus commercial bank time deposits other than large C.D.'s) grew at the annual rate of 10.5 per cent; from 1960 to 1970, at 6.7 per cent. From 1970 to 1973, M_3 (M_2 plus deposits at non-bank thrift institutions) grew at the annual rate of 12.0 per cent; from 1960 to 1970, at 7.2 per cent. For both M_2 and M_3, the rates of growth from 1970 to 1973 are higher than for any other three-year period since World War II.

As the accompanying chart demonstrates, prices show the same pattern as monetary growth except for the Korean War inflation. In the early 1960's, consumer prices rose at a rate of 1 to 2 per cent per year; from 1970 to 1973, at an average rate of not far from 10 per cent. The accelerated rise in the quantity of money has clearly been reflected, after some delay, in a similar accelerated rise in prices.

Movements in Money and Prices
1948 - 1973



However limited may be the Fed's ability to control monetary aggregates from quarter to quarter or even year to year, the monetary acceleration depicted in the chart, which extended over more than a decade, could not have occurred without the Fed's acquiescence—to put it mildly. And however loose may be the year-to-year relation between monetary growth and inflation, the acceleration in the rate of inflation over the past decade could not have occurred without the prior monetary acceleration.

Whatever therefore may be the verdict on the short-run relations to which the Reply restricts itself, the Fed's long-run policies have played a major role in producing our present inflation.

There is much evidence on the shorter-term as well as the longer-term relations. Studies for the United States and many other countries reveal highly consistent patterns. A substantial change in the rate of monetary growth which is sustained for more than a few months tends to be followed some six or nine months later by a change in the same direction in the rate of growth of total dollar spending. To begin with, most of the change in spending is reflected in output and employment. Typically, though not always, it takes another year Reply properly stresses, many factors affect the course of prices other than to 18 months before the change in monetary growth is reflected in prices. On the average, therefore, it takes something like two years for a higher or lower rate of monetary growth to be reflected in a higher or lower rate of inflation.

Table I illustrates this relation between monetary growth and prices. It shows rates of change for three monetary aggregates and for consumer prices over two-year spans measured from the first quarter of the corresponding years. The average delay in the effect of monetary change on prices is allowed for by matching each biennium for prices with the prior biennium for money. Clearly, on the average, prices reflect the behavior of money two years earlier.

TABLE I.—MONEY AND PRICES

Dates for M_1, M_2, M_3	Annual percent rates of growth from 1st quarter to 1st quarter of indicated years for— M_1	M_2	M_3	Consumer prices	Dates for consumer prices
1959-61	0.8	2.5	4.6	1.1	1961-63
1961-63	2.4	5.9	7.6	1.3	1963-65
1963-65	4.1	6.9	8.3	2.7	1965-67
1965-67	3.7	7.2	6.7	4.2	1967-69
1967-69	7.3	9.4	8.8	5.5	1969-71
1969-71	4.8	6.3	6.4	3.9	1971-73
1971-73	7.2	10.4	12.6	[1] [9.1]	1973-

[1] 1st quarter 1973 to 4th quarter 1973.

To avoid misunderstanding, let me stress that, as the table illustrates, this is an average relationship, not a precise relationship that can be expected to hold in exactly the same way in every month or year or even decade. As the changes in the quantity of money. Over short periods, they may sometimes be more important. But the Federal Reserve and the Federal Reserve alone has the responsibility for the quantity of money; it does not have the responsibility, and certainly not sole responsibility, for the other factors that affect inflation. And the record is unmistakably clear that, over the past three years taken as a whole, the Federal Reserve System has exercised that responsibility in a way that has exacerbated inflation.

This conclusion holds not only for the three years as a whole but also for each year separately, as Table II shows. The one encouraging feature is the slightly lower rate of growth of M_2 and M_3 from 1972 to 1973 than in the earlier two years. But the tapering off is mild and it is not clear that it is continuing. More important, even these lower rates are far too high. Steady growth of M_2 at 9 or 10 per cent would lead to an inflation of about 6 or 7 per cent per year. To bring inflation down to 3 per cent, let alone to zero, the rate of growth of M_2 must be reduced to something like 5 to 7 per cent.

TABLE II.—RECENT MONETARY GROWTH RATES

Calendar year	Annual percent rate of growth of— M_1	M_2	M_3
1970-71	7.0	11.8	12.8
1971-72	6.4	10.2	12.5
1972-73	7.4	9.5	10.6

CONTROLLING AND MEASURING THE MONEY SUPPLY

"*The conduct of monetary policy could be improved if steps were taken to increase the precision with which the money supply can be controlled by the Federal Reserve. Part of the present control problem stems from statistical inadequacies*" (italics added).

Again these sentences from the Reply are literally correct, but they give not the slightest indication that the difficulties of controlling and measuring the money supply are predominantly of the Fed's own making. The only specific problems that the Reply mentions are the "paucity of data on deposits at nonmember banks" and the fact that "nonmember banks are not subject to the same reserve requirements as are Federal Reserve Mmbers."

Non-member deposits do raise problems in measuring and controlling the money supply, but they are minor compared to other factors. The Reply's emphasis on them is understandable on other grounds. Almost since it was established in 1914, the Fed has been anxious to bring all commercial banks into the System, and has been worried about the defection of banks from member to non-member status. It has therefore seized every occasion, such as the Reply provides, to stress the desirability of requiring all banks to be members of the System or at least subject to the same reserve requirements as member banks.

Control.—Non-member banks raise a minor problem with respect to control. Their reserve ratios do differ from those of member banks. But non-member banks hold only one-quarter of all deposits, this fraction tends to change rather predictably, and changes in it can be monitored and offset by open market operations.

A far more improtant problem with respect to control is the lagged reserve requirement that was introduced by the Fed in 1968. This change has not worked as it was expected to. Instead, by introducing additional delay between Federal Reserve open market operations and the money supply, it has appreciably reduced "the precision with which the money supply can be controlled by the Federal Reserve." Other measures taken by the Fed have had the same effect. In an article on this subject published recently, George Kaufman, long an economist with the Federal Reserve System, concluded, "by increasing the complexity of the money multiplier, proliferating rate ceilings on different types of deposits, and encouraging banks, albeit unintentionally, to search out non-deposit sources of funds, the Federal Reserve has increased its own difficulty in controlling the stock of money. . . . To the extent the increased difficulty supports the long voiced contention of some Federal Reserve officials that they are unable to control the stock of money even if they so wished, the actions truly represent a self-fulfilling prophecy."

Even more basic is the procedure used by the Open Market Desk of the New York Federal Reserve Bank in carrying out the directives of the Open Market Committee. These directives have increasingly been stated in terms of desired changes in monetary aggregates rather than in money-market conditions. However, the Desk has not adapted its procedure to the new objective. Instead, it tries to use money-market conditions (that is, interest rates) as an indirect device to control monetary aggregates. Many students of the subject believe that this technique is inefficient. Money-market conditions are affected by many forces other than the Fed's operations. As a result, the Desk cannot control money-market conditions very accurately and cannot predict accurately what changes in money-market conditions are required to produce the desired change in monetary aggregates.

An alternative procedure would be to operate directly on high-powered money, which the Fed can control to a high degree of precision. Many of us believe that the changes in high-powered money required to produce the desired change in monetary aggregates can be estimated tolerably closely even now. They could be estimated with still greater precision if the Fed were to rationalize the structure of reserve requirements.

Measurement.—Repeatedly, in the past few years, the Fed's statisticians have retrospectively revised estimates of monetary aggregates, sometimes, as in December 1972, by very substantial amounts.

The one source of measurement error mentioned in the Reply is the unavailability of data on non-member banks. This is a source of error because non-member banks report deposit data on only two, or sometimes four, dates a year. The resulting error in estimates for intervening or subsequent dates has sometimes been sizable, but mostly it has accounted for a minor part of the statistical revisions. In any event, this source of error can be reduced drastically by sampling and other devices which the Fed could undertake on its own without additional legislation.

More important sources of error are seasonal adjustment procedures and the estimation and treatment of cash items, non-deposit liabilities, and foreign held deposits.

It has long seemed to me little short of scandalous that the money supply figures should require such substantial and frequent revision. The Fed is itself the primary source of data required to measure the money supply; it can get additional data it may need; it has a large and highly qualified research staff. Yet for years it has failed to undertake the research effort necessary to correct known defects in its money supply series.[1]

CONCLUSION

For more than a decade, monetary growth has been accelerating. It has been higher in the past three years than in any other three-year period since the end of World War II. Inflation has also accelerated over the past decade. It too has been higher in the past three years than in any other three-year period since 1947. Economic theory and empirical evidence combine to establish a strong presumption that the acceleration in monetary growth is largely responsible for the acceleration in inflation. Nothing in the Reply of the Chairman of the Federal Reserve System to your letter contradicts or even questions that conclusion. And nothing in that Reply denies that the Federal Reserve System had the power to prevent that sharp acceleration in monetary growth.

I recognize, of course, that there are now, and have been in the past, strong political pressures on the Fed to continue rapid monetary growth. Once inflation has proceeded as far as it already has, it will, as the Reply says, take some time to eliminate it. Moreover, there is literally no way to end inflation that will not involve a temporary, though perhaps fairly protracted, period of low economic growth and relatively high unemployment. Avoidance of the earlier excessive monetary growth would have had far less costly consequences for the community than cutting monetary growth down to an appropriate level will now have. But the damage has been done. The longer we wait, the harder it will be. And there is no other way to stop inflation.

The only justification for the Fed's vaunted independence is to enable it to take measures that are wise for the long-run even if not popular in the short-run. That is why it is so discouraging to have the Reply consist almost entirely of a denial of responsibility for inflation and an attempt to place the blame elsewhere.

If the Fed does not explain to the public the nature of our problem and the costs involved in ending inflation; if it does not take the lead in imposing the temporarily unpopular measures required, who will?

Sincerely yours,

MILTON FRIEDMAN,
Professor of Economics.

Senator PROXMIRE. The reply of Mr. Burns, incidentally, has been widely publicized in the Federal Reserve bulletin and elsewhere. But I think that is a useful point.

Mr. Friedman says:

For more than a decade, monetary growth has been accelerating. It has been higher in the past three years than in any other three-year period since the end of World War II. Inflation has also accelerated over the past decade. It too has been higher in the past three years than in any other three-year period since 1947. Economic theory and empirical evidence combine to establish a strong presumption that the acceleration in monetary growth is largely responsible for the acceleration in inflation. Nothing in the Reply of the Chairman of the Federal Reserve System to your letter contradicts or even questions that conclusion. And nothing in that Reply denies that the Federal Reserve System had the power to prevent the sharp acceleration in monetary growth.

Now, I would like to come to the specific documentation and ask you to reply to it.

Mr. Friedman agrees that there are undoubtedly many causes of inflation in addition to monetary policy. But he argues that monetary

[1] On January 31, 1974, after this comment had been drafted, the Board of Governors of the Federal Reserve System announced "the formation of a special committee of prominent academic experts to review concepts, procedures and methodology involved in estimating the money supply and other monetary aggregates." I have agreed to serve as a member of this committee.

policy is the principal factor involved. His reply recognizes that the effects of stabilization policy occurs gradually over time—that has been your persistent position, Mr. Burns—it is never wise to rely on just one concept of money. And yet the reply presents statistical data on the growth of monetary policies for only 1972 and 1973, and for only one of the three monetary components it refers to; namely, M–1.

Now, on the basis of the evidence in the reply there is no way to evaluate the longer term policies of the Fed or to compare current monetary policies with earlier policy or one concept of money with another.

Now, what Mr. Friedman does is to take the last 3 years, 1971 through 1973, and compare that with the preceding decade. He finds that using M–1, the limited concept of money, that money is increased 6.9 percent in the last 3 years compared to 4.2 percent in the decade of the sixties. M–2 has increased 10.5 percent compared to 6.7 percent. And M–3 has increased 12 percent compared to 7.2 percent. And then he points out that prices during this period have also accelerated, in this case about twice as rapidly in the period 1971 to 1973 as they did in the previous decade.

What is your response to this broader criticism of Fed policies which include this longer period and include the last 3 years rather than simply the last year or so?

Mr. BURNS. Senator Proxmire, you wrote me a letter, and you raised some very specific questions. I wrote you a very long and I think scholarly reply. My reply was addressed to our questions. It was not addressed to Mr. Friedman's questions.

Mr. Friedman is a very dear friend of mine. I don't wish to engage in any debate with him or with any other economist. Let me merely say that what Mr. Friedman has written on this subject in his letter of reply to you, putting aside the specific figures, but taking the intellectual structure of his argument, could have been written 50 years ago, or a hundred years ago, when our Federal Government played a very small role in our national economy.

Mr. Friedman focussed on the year 1971, 72, and 1973, and he gave in his letter of reply to you detailed figures for those years. Let me give you some figures on the Federal budget for those years. In fiscal 1971, we had a deficit under the unified budget of $23 billion. In fiscal 1972, a deficit of $23.2 billion. In fiscal 1973, a deficit of $14.3 billion. If you now take the off-budget outlays of Federal agencies, and also the outlays of government-sponsored corporations, if you cover this entire Federal sector, including categories that are excluded from the budget, then the deficit for these 3 years is as follows: 1971, $23.3 billion. 1972, $27.4 billion. 1973, $25.7 billion.

Now these are extraordinary figures, as I think you know. There is nothing like that in our financial history except for the period of World War II.

Yet if you read Mr. Friedman's very interesting letter to you, you will not find even one word about fiscal policy, Federal expenditures, or their relation to Federal revenues. I submit that whatever the shortcomings of monetary policy may have been—and we are dealing with a question where there are no angels, Senator, everyone here is a sinner and everyone has made mistakes—it is important to recognize that the huge deficits of recent years have had an enormous influence on the rate of inflation in this country. And you must remember that the Federal Reserve, among other things, is the Government's banker.

Senator PROXMIRE. Mr. Burns, let me just interrupt to say that I would feel much more comfortable if you give me those deficits in terms of the full-employment balance. And I think in those years there might not have been deficits at all. Sure, the deficits were large. But they were also large, as you know in the thirties, very large, in percentage terms, much larger in relationship to the economy. But at that time we continued to have prices falling. The point that I am trying to make, Mr. Burns, is that it seems to me that you have to relate this to a full-employment concept. And if you do so, you don't have deficits of anything like this size, isn't that right?

Mr. BURNS. I don't agree with you at all.

Senator PROXMIRE. Let's assume that the fiscal policy has played a significant part, and I agree it may well have done so.

Let me ask you again about this point that Mr. Friedman raises. The fact is that we did have a sharp increase in every measure of money, M–1, M–2, and M–3, in that period as compared to the previous decade. We also had a sharp increase in prices during that period.

Mr. BURNS. That is correct.

Senator PROXMIRE. Don't you think there is a connection, or do you think that is simply an accident?

Mr. BURNS. Of course there is a connection. What would you have wanted the Federal Reserve to do in a year like 1972, when the year started out with an unemployment rate of 6 percent and did not go below 5½ percent until November, a fact that became public only in the month of December? What would you have had the Federal Reserve do?

Senator PROXMIRE. Mr. Burns, it is true that you are in a position that I think you can defend always on the ground of saying, we had to increase this because otherwise unemployment would have risen sharply and the economy would have gone into a nosedive. I think that is an excellent answer. But what I am trying to do now is to find out whether or not there has been this connection. I think that we may very well agree, after this discussion, and other discussions, that there isn't any way to cope with inflation in this country, we are going to have to accept it.

Mr. BURNS. No, I am not going to agree to that.

Senator PROXMIRE. Or we are going to have to take the position that we certainly haven't come up with the answer, because what you are telling us is that the policy, as I understand it, that the Federal Reserve Board had no alternative except to follow a policy——

Mr. BURNS. We had an alternative.

Senator PROXMIRE. You have had an alternative, but that would have been to increase unemployment.

Mr. BURNS. Exactly.

Senator PROXMIRE. And you are going to have exactly the same problem this coming year, if unemployment increases as it has increased in the last 3 months very sharply—and more forecasts indicate that it will—I think you are going to be in a very serious dilemma, you may very well have to ease monetary policies. We may have to do the same kind of thing with respect to the budget, we may have to develop a budget in substantial deficit again. We do that, however, and we have to recognize that we are going to have an inflationary situation. I don't think it helps to say there is nothing else we can do. that it is going to work out somehow. Let's face squarely our dilemma. And I think then we can begin to ask questions that can determine whether or not we want to pay the price of doing something about it.

Mr. BURNS. You know, Senator, there are some people in this world—and I am not going to refer to anyone by name, it doesn't matter—who think that it is the business of the Federal Reserve to correct for every mistake that is made by the private sector of our economy or by Congress or by the executive establishment. But Congress has not given the Federal Reserve that power, and I don't think the Congress should give the Federal Reserve any such power.

As for the power that we have, we could stop this inflation in a very few months, and stop it dead in its tracks. We have not done it. And we have no intention of doing it, because the only way we could do that is to bring the distress of mass unemployment on this Nation.

Senator PROXMIRE. That may very well be true.

Let me ask you if you would agree with this concluding argument of Mr. Friedman:

> There is literally no way to end inflation that will not involve a temporary, though perhaps fairly protracted, period of low economic growth and relatively high unemployment. Avoidance of the earlier excessive monetary growth would have had far less costly consequences for the community than cutting monetary growth down to an appropriate level will have now. But the damage has been done. The longer we wait the harder it will be. And there is no other way to stop inflation.

Do you agree with that rather rigorous insistence on this kind of choice, a choice which I think most of us, many of us at least would make on the side of saving, if this is the case, then we will have to find some way of ameliorating the consequences of inflation?

Mr. BURNS. You are drawing me into something, Senator, that I said I didn't want to do. And I hope we can end this. I don't want to quarrel with my very good friend. You have questions to put to me about economic policy, but let's——

Senator PROXMIRE. That isn't the question. It doesn't matter. You and Mr. Friedman highly respect each other, you are both excellent economists. And as I have said, I think you and Mr. Kissinger represent two of the best appointments I have seen in 17 years.

Mr. BURNS. Thank you very much.

Senator PROXMIRE. But that has nothing to do with the issue. The issue is, what is the answer here? Is Mr. Friedman right or wrong?

Mr. BURNS. Let me examine his statement. It says:

> There is literally no way to end inflation that will not involve a temporary, though perhaps fairly protracted, period of low economic growth and relatively high unemployment.

Now, what I find difficult in that sentence is, how soon—it states there is no way to end inflation, but the time frame of that objective of ending inflation is not specified. I think that we can end inflation over the next 2 or 3 years without going through a period of heavy unemployment.

Senator PROXMIRE. You accept that argument?

Mr. BURNS. No, I do not accept his conclusion. I am more optimistic about our ability, provided—

Senator PROXMIRE. My time is up. But tell us, what do we do without going through an unemployment period caused by tighter money and more restrictive fiscal policy, either/or?

Mr. BURNS. Well, the question is not whether we go through an unemployment period. The question is whether we can manage this problem without going through a fairly protracted period of low economic growth and relatively high unemployment. For a brief period I am afraid we will just have to take that.

You know, one can talk about money supply from now until doomsday. But what we have now in our country is not a deficiency of demand, but a reduction in our capacity to produce, because of the sudden and very serious oil shortage. And the effects have ramified—take our automobile factories—over the country. A large part of automobile capacity you can just write off, it is dead. It is dead because people don't want to buy big cars. Now, at a time like this we will have to suffer, I am afraid, some unemployment. But I think the period could be brief. And if we conduct our monetary and fiscal policies prudently, I think we can get onto a track that will gradually diminish the rate of inflation. At the end of perhaps 2 or 3 years we can return to price stability without going through a protracted period of heavy unemployment.

Chairman PATMAN. Mr. Burns, I want to ask you some questions about the thrift institutions.

I thought that order of the Federal Reserve Board of July 5 was a very unfortunate order. And it appeared to me to be a downright attack on the thrift institutions. It apeared to me that the Federal Reserve Board was making a decision that we have often found in the newspapers and from prominent writers on financial matters, that the Federal Reserve is determined to get rid of any financial lending institutions——

Mr. BURNS. Will you be good enough to identify the action that you are describing that we took at that time?

What did we do on that date?

Chairman PATMAN. July 5?

Mr. BURNS. Yes. I don't recall.

Chairman PATMAN. Regulation Q.

Mr. BURNS. All right.

Chairman PATMAN. And you were one of the promoters of Regulation Q. And we put it in for 1 year. And finally we were persuaded to extend it another year, and then another, and then another, And all during that time the Federal Reserve was obligated to bring us a good reason for regulation Q having low interest rates. And the Federal Reserve never did bring that document to us, to my knowledge. And so by allowing Regulation Q rates to go up it was ruinous to the savings and loans, mutual savings banks, and the credit unions.

For instance, the owner and publisher of the biggest paper in Cleveland called me at my home in Texarkana and said, "Mr. Patman, I wish you were here in my seat seeing what I see. I can see the savings and loan office. They have long lines. They are going in there to get their money. And then they are going right over to the Federal Reserve Bank to get 8¼-percent interest on securities approved by the Federal Reserve."

I though that was a terrible thing. In other words, it was causing the people, for no good reason, to take their money out of thrift institutions that were making loans for housing, and doing the best they could under difficult circumstances, inducing them to take that money out, and because of the government's own competition—which was not well founded, and not necessary to my mind—to take these bonds offered by the Government at a much higher price.

So, I think all that is due to the fact, Mr. Burns, that you are operating in secrecy. And I think that is a terrible thing for any part of the government to operate in secrecy.

Mr. Burns. I think that is a statement that you cannot substantiate.

Chairman Patman. Let me get through with it. And maybe you will agree with me.

Mr. Burns. I will never agree to an untrue statement, Mr. Chairman.

Chairman Patman. Let me give you some facts that I think that you will be compelled to accept.

In our form of government we are supposed to be a representative government. The people who elect their representatives should have something to do with the running of their government, the executive, the legislative, and the judiciary.

Now, the legislative is supposed to be very close to the people. The House is, the Senate with its 6-year term is not as close, but it is satisfactorily so.

But then we have the executive branch that really has power. The Constitution of the United States says the President shall execute the laws. He has complete control of the execution of the law. Nearly all the money that we appropriate goes for that purpose, for the execution of laws that Congress has passed, these hundreds of billions of dollars, we will say. Well, now, of course, the executive branch only has one elected person in it, elected by the people, that has any power to do things. And he can fire everybody in it, the whole 2,400,000 if he wants to at any time. He has complete control. The legislative branch, which makes the laws, has only 535 elected people out of 18,600 people in that department.

And then the judicial branch has only 7,500 people, and not one of them is elected.

So the number of people that is supposed to represent all the people and carry out the will of the people in effect have very little power in this Government.

Now, the executive, one man, the President, has more power than all the rest of them. He not only executes the laws as the Constitution provides, but he spends the money in doing so that is appropriated by Congress. Next year it will be about $304 billion. That is an enormous amount of money. So you cannot deny, Mr. Burns, that the elected representatives are subordinated in the way the Government is being operated and has been operated for the last 2 or 3 or 4 years, with the impoundment of funds, and not carrying out the wishes of Congress, and things like that.

So. we have reached a sad state in this country, according to the way I see it. And I think that you will have to agree that a situation where the President is supposed to be over the Federal Reserve System, but no President except Harry Truman has ever had a confrontation with the Federal Reserve. And he won, he won a complete victory.

You know about that. It was in 1951, after we had gone along for 14 years with a low rate of interest to keep the people from being under hardships of different kinds for many decades to come. We had a very low interest rate, 2½ percent. It was not violated. It was kept at 2½ percent. People could put their money in the Treasury and get 2½ percent interest, and they could get their money any time they wanted to if they could find another investment. And the people were well satisfied. But for some reason the Federal Reserve Board met, after 14 years of success in that, and proclaimed a regulation that said that we will take the ceiling off of these bonds that we gave during World War II and the Korean war, and they can sell for any price that a holder can get for them.

And Mr. Truman hit the ceiling. He said, "We will never do that." And he called the Board into his office in the White House. The papers were filled with it at the time. And Mr. Truman gave them to understand that they couldn't get by with that. And they were determined to do it. And so he told them that he was going to make known to the American people that what they had done was against the national interest. And he said, if you gentlemen don't change that, I am going before the American people by television and radio and denounce you as traitors; if you don't change that order I am going to call you names and let the country know who has done this terrible thing that will cost you hundreds of billions of dollars in the future and bring about hardships.

And they met, and in 30 minutes changed that. And that was a confrontation with the Federal Reserve by one President of the United States that was successful; it was the only one that has ever had a confrontation with the Federal Reserve.

Now, if the Executive would do his duty the way I read the Constitution, the Executive would be opposing a lot of these things that the Federal Reserve is doing. The Federal Reserve is not independent. There is nothing in the Constitution saying they are independent. There is nothing in the law saying that they are independent. They have assumed that independence without the authority of law. The President is obligated under the Constitution to execute all laws, not just a few. But Presidents try to avoid the Federal Reserve—it is too big, there are big people behind it, too much power. A lot of them were afraid, I guess, to do it because they thought maybe that the public interest might suffer or they themselves might suffer. And members of Congress are inclined not to vote their convictions, I believe, for that same reason.

So I want to tell you, Mr. Burns, we are going through a different era now. And I think that people are doing more thinking than they have ever done before. And I don't believe the Federal Reserve can get by with this secrecy and hoarding all this money, $79.5 bilion, after buying it with the Government's money, and then requiring the people to pay interest on that in the amount of $4 billion a year that has already been paid for once. And if that is not corrected, I think the Congress is going to go down more and more in the esteem of the people. And I think that a correction will have to be made, or our Government will not be around here in the form that it should be for very long. Because the people are getting disturbed. And I think they have a right to be disturbed. I don't see how certain things can happen and go on and there not be any criticism of it, or any protest of it, they just tolerate it.

So I just want to suggest to you that I believe that we should give more consideraion to what we have just brought up here this morning and see if we can't get a more satisfactory solution. We should make it possible for the savings and loans, the people who build the houses in this country—we wouldn't have half as many houses were it not for savings and loans. And we must give them an opportunity, must give the mutual savings banks an opportunity, the credit unions, and others.

And I think it is terrible—I think it is a disgrace, Mr. Burns, for the Federal Reserve to just—I wouldn't say in a greedy manner, but I can't understand why it has done it, hoarded $79.5 billion of money that doesn't belong to the Federal Reserve—the Federal Reserve didn't pay a penny of it, the U.S. Government paid it—hoarded that money and not permitted its use for things like housing and education and health, things that should be on a must list, to be taken care of first. And every bit of that money if necessary should be used on the basic needs of the people and the country. It is needed now.

And it would hold down those interest rates, hold them down. Interest rates cause inflation. Every time interest rates go up, prices go up, and as prices go up, more inflation.

My time is up.

Congressman Widnall.

Representative WIDNALL. I would like you to abide by the same rules that all the rest of us are governed by. You are 3 minutes over time right now.

Chairman PATMAN. All right, I will yield you 3 minutes.

Representative WIDNALL. I am not asking that.

Chairman PATMAN. Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman.

Mr. Chairman, I shall subtract 3 minutes from my time gladly, as they are waiting for me on the Senate floor.

Mr. Burns, I rushed over this morning out of respect for you, whom I consider to be one of our most eminent public servants, and of tremendous use to our country.

I have just two questions. I notice in your statement you say:

"Machinery for reviewing wages and prices in pace-setting industry can, however, prove helpful."

Now, the administration says it is not going to ask for an extension of the Economic Stabilization Act, and that it is going to control petroleum through the provisions of a separate law, and seek only control over health costs. Everything else comes off. Question A is: What machinery have you been talking about?

Question B is: Is it a substitute for the ESA, or in your judgment should the ESA be continued for another year?

Mr. BURNS. Let me come specifically to the machinery for reviewing prices and wages that I have in mind. This could be done through the Cost of Living Council as presently constituted, or through some other agency. From my viewpoint that doesn't much matter. Let us say that the Cost of Living Council finds that a particular price or wage increase is likely, in its judgment, to have widespread and injurious effects on the economy. Then the Cost of Living Council would have the power to suspend this price or wage increase for a period of some 30 to 45 days. An ad hoc board would be appointed to review the facts surrounding the particular price or wage development, to hold hearings, and to publish a report with recommendations to the parties. Then, later on, compliance reports would be issued. Say for example, that the question at issue is the price of steel, and that the ad hoc board has handed down a certain recommendation. If that recommendation is accepted by some steel companies, but is not accepted by others, the degree of compliance and the direction of compliance would be indicated in a publicized report.

I would not expect hearings of this kind to be held with regard to very many items. I don't think that is necessary. But I do think that there are pace-setting industries in this country on the price side and on the labor side, and some watching would be salutary.

Senator JAVITS. So that the two mandatory features would be the ability of the agency, whichever it may be—and you suggest the Cost of Living Council—to suspend the price increase, with the requirement that it would not be mandatory; that is, the Government could be defined by a particular line of business which didn't want to follow the recommendations, is that correct?

Mr. BURNS. That is correct.

Senator JAVITS. Now, the last point of that, just to complete that, how would that apply to wages?

Mr. BURNS. In the same way.

Senator JAVITS. In other words, a material wage increase would also have to run the same gauntlet.

Mr. BURNS. That is right.

Senator JAVITS. That is a very interesting procedure. And then you wouldn't care whether the ESA was extended or not, just so long as there was a suitable law on June 1 to install the system?

Mr. BURNS. That is correct.

Senator JAVITS. Do you think that would exercise adequate restraint in keeping the inflationary situation from really running away? And I share fully your deep concern with the possibility of a two-digit inflation or a galloping inflation in this country.

Mr. BURNS. I think this is likely to prove effective. I have talked to businessmen more extensively about this than I have talked to people in the labor field. And I am told by a number of heads of our large corporations that a recommendation handed down by such a board would be something that they would feel bound to respect. They are not sure about other businessmen. I do believe the record will be uneven. But we don't need perfection to make improvement.

Senator JAVITS. But if we kept the ESA on the books and we chose then to apply controls to the findings of the board, we could do so, although you could not start that way in the first instance, isn't that true?

Mr. BURNS. I think controls at the present time are probably doing more harm than good. And I would have some doubts about standby authority to the President.

Senator JAVITS. You would?

Mr. BURNS. I would, for the reason that business has experienced more than one freeze in the past 3 years. And I think there would be some tendency on the part of business firms to raise prices that otherwise might be kept at their present level or even lowered, out of fear that a few months from now we might have another freeze.

Senator JAVITS. Mr. Chairman, I would hope very much that when the Banking and Currency Committees of both Houses—and Senator Proxmire is a ranking member on our side—consider the extension of ESA, that they give every consideration to Mr. Burns' plan. And I hope, Mr. Chairman, notwithstanding your differences with him on the Federal Reserve, and a few words exchanged on that score, I think you both enjoy a very healthy mutual respect, if I may say that as a friend of both.

The only other question I have, Mr. Burns, is to ask you—as my staff tells me you intimated—what is included in the selected measures of fiscal policy that you think might be helpful at this time? I thoroughly agree with those you have named. What about the matter of putting social security taxes on a sliding scale, like the income tax, so as to take the heavier burden off the lowest paid worker?

Mr. BURNS. Well, I am not sure about the remedy, and the best form that it might take. But I do think that the social security tax has become a very heavy and indeed an excessive burden on workers in our lowest income groups. And some relief there I think is desirable.

Senator JAVITS. Thank you, Mr. Burns.

And thank you, Congressman Widnall, for getting me this time when I needed it badly.

Chairman PATMAN. You had suggested, Mr. Burns, that you had a luncheon engagement. And we will respect that. And we agreed to recess at 12 o'clock. It is going to be difficult to have an afternoon session, because the House Banking and Currency Committee has a meeting here at 4 o'clock. And at 2:30 Congressman Widnall and I have to be at the House Administration Committee to take up the budget for the whole Banking and Currency Committee, we must be there. So I wonder if we could agree that we will ask you to come back if there is a demand, at some satisfactory time mutually agreeable, and with the understanding that we can submit to you written questions which you will answer as promptly as you can, and return the answers with your corrected transcript to the committee, and then allow each member the right to extend his remarks.

Senator PROXMIRE. I wonder if we can use the remaining 7 or 8 minutes before 12 noon for questions?

Chairman PATMAN. Yes. I will yield.

Senator PROXMIRE. Mr. Burns, you have commented on what we can do within our limitations on monetary policy. We know our limitations as to fiscal policy. And Senator Javits briefly discussed the possibility of using controls. And, of course, that is limited, too. This inflation last year was very largely caused by international developments. Now, we are helpless to control our relationships with other countries and the impact of imports and exports on our own prices. In fact, I think you can make a strong case that the double devaluation had a considerable effect on the inflation in this country. The estimates by Fortune magazine are that the effects on imports alone was $11 billion in 1973, and the impact on imports might have been even greater because of the effect of food exports, and the great world demand there.

My question is this. Do you think that we can develop some kind of an early warning system, some kind of a system for controlling exports perhaps with conditional contracts so that deliveries would be made conditional on the availability of adequate reserves in this country, so that we can cushion ourselves against skyrocketing food prices caused once again by world demand?

Mr. BURNS. I think that a system like that could probably be devised. I would have grave doubts about the wisdom of doing so.

Senator PROXMIRE. What do we do? Are we helpless with respect to the impacts of international development on our price level?

Do we revalue the dollar?

Mr. BURNS. We are not helpless. But this particular device can, of course, be used by other countries. And in fact we are suffering now from a restriction of exports of oil to this country. If we, the strongest economic power in the world, begin resorting to this tool of economic policy, it will spread very quicky, and in the end I am afraid it will hurt us as well as others.

Senator PROXMIRE. What can we do?

Mr. BURNS. On the international side?

Senator PROXMIRE. What can we do to protect ourselves against continued inflation caused by the high rising price of imports and the drain on our limited resources by exports?

Mr. BURNS. This is going to make the Chairman, for whom I have the very highest personal regard, very unhappy. And I regret that. But I have got to face up to the facts as I see them.

At the present time, in the month of February, Treasury bills in this country have been yielding approximately 7 percent. With the exception of Switzerland, in every other industrial country comparable short-term interest rates are considerably higher. In the United Kingdom, 15½ percent. Germany, 10⅝ percent. France, 12.5 percent. Belgium, 8.5 percent. Netherlands, 9⅝ percent. Japan, 12 percent. Canada, 8.5 percent. Now, this discrepancy in short-term interest rates has been causing an outflow of capital, short-term capital from this country.

Interest rate differentiations have a very different effect when you operate under a floating exchange system than when you operate under a fixed exchange rate system. Under a fixed exchange rate system, when there are interest rate differentials and capital moves out of the country, the exchange rates in the short run—which may turn out to be a very protracted period as we have learned—do not change. But under a floating system, when capital moves out from this country, the prices of foreign currencies will rise, or if you like, the dollar will depreciate. And when prices of foreign currencies rise, the price that we have to pay for the goods that we import from abroad goes up. Therefore, unhappily, we have to watch interest-rate differentials more now than we have in the past. It is another burden that the Federal Reserve System just has to carry.

Senator PROXMIRE. Mr. Burns, aren't you just giving us another impossible dilemma? The answer here seems to be a policy which would permit at least short-term rates to rise; that is the implication that I get.

Mr. BURNS. No. There have been——

Senator PROXMIRE. You don't want to do that.

Mr. BURNS. No, there are other factors that are working the other way. I think the implication is that there are numerous factors that have to be balanced.

Senator PROXMIRE. What can we do? That was my question. If we can't follow a policy of permitting our rates to rise so that we don't lose capital, what can we do?

Mr. BURNS. Senator, the major source of our economic difficulties—on the price front and on the unemployment side and on the international side—is the way in which we have been conducting ourselves in this country and letting inflation get a grip on what is happening here. We have got to get inflation under control.

Senator PROXMIRE. Every time we come to a specific area, whether it is fiscal policy, monetary policy, controls, or doing something about the dollar's effect in the world market, we find that the action we have to take has fallout effects which are to perverse to follow.

Mr. BURNS. I wouldn't be that pessimistic. The Federal Reserve, I think, is continuing to restrain the rate of growth is the money supply and bank credit. We don't think that is causing inflation. On the contrary that is helping to lay the foundation for better performance of prices. Nor do I think that we are intensifying the unemployment problems.

Senator PROXMIRE. I am going to do this again.

I apologize for referring so frequently to Mr. Friedman, but he is a very able man, and he puts the case very strongly. And it is a question that I think has to be asked of you, Mr. Burns. I will conclude it this way.

The only justification for the Fed wanting independence is because it enables it to take measures that are wise for the long running even if not popular in the short run. That is why it is so discouraging to have the reply consist almost entirely of a denial of the responsibility for inflation and to attempt to place the blame elsewhere. If the Fed does not explain to the public the nature of our problems and the costs involved in ending inflation, if it does not take the lead in imposing the temporary unpopular measure required, who does? Would you like to answer that as briefly as you can?

Chairman PATMAN. He is obligated to answer it for the record.

Senator PROXMIRE. Maybe he would like to answer it now. Maybe not.

Mr. BURNS. I think that is excellent counsel. And I think my testimony today should indicate that that is exactly what we are trying to do.

Senator PROXMIRE. Thank you.

Chairman PATMAN. The committee will stand in recess until 10 o'clock Thursday morning.

[Whereupon, at 12:03 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, February 28, 1974.]

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

RESPONSE OF HON. ARTHUR F. BURNS TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN PATMAN

In his book, *Six Crises*, Richard Nixon noted (pp. 309-311) that you called on him urging action to stimulate the economy in 1960. He said:

"Burns' conclusion was that unless some decisive governmental action were taken, and taken soon, we were heading for another economic dip which would hit its low point in October, just before the elections. He urged strongly that everything possible be done to avert this development. He urgently recommended that two steps be taken immediately: by loosening up on credit and, where justifiable, by increasing spending for national security. The next time I saw the President, I discussed Burns' proposals with him, and he in turn put the subject on the agenda for the next Cabinet meeting.

"The matter was thoroughly discussed by the Cabinet but, for two reasons, Burns' recommendation that immediate action be taken along the lines he had suggested did not prevail. First, several of the Administration's economic experts who attended the meeting did not share his bearish prognosis of the economic prospects. Second, even assuming his predictions might be right, there was strong sentiment against using the spending and credit powers of the Federal Government to affect the economy, unless and until conditions clearly indicated a major recession in prospect.

"Unfortunately, Arthur Burns turned out to be a good prophet. The bottom of the 1960 dip had come in October and the economy started to move up again in November—after it was too late to affect the election returns. In October, usually a month of rising employment, the jobless rolls increased by 452,000. All the speeches, television broadcasts, and precinct work in the world could not counteract that one hard fact."

Question 1. Is this statement about you by President Nixon true?

Answer. Yes.

Question 2. If the Federal Reserve Board is independent and non-political, how do you justify giving this sort of advice?

Answer. May I remind you that I was a private citizen in 1960. I then served as Professor of Economics at Columbia University and President of the National Bureau of Economic Research. I did not return to Washington until 1969, and first assumed my responbibilities at the Federal Reserve in February 1970.

As for the events of 1960 discussed by Mr. Nixon, the advice I gave was the advice of a professional economist responding to an inquiry on how the government could stimulate the economy.

Question 3. In 1970 you became Chairman of the Federal Reserve Board which at that time owned approximately $61 billion of Government securities. Between 1970 and the 1972 election, the Federal Reserve Banks bought approximately $10 billion of Government securities—increasing the portfolio to some $71 billion.

Did you buy this $10 billion of Government securities to aid the re-election of President Nixon in November 1972?

Answer. No. The System bought those securities pursuant to directives issued by the Federal Open Market Committee. One of the safeguards provided in the Federal Reserve Act against playing politics with monetary policy is that open market operations—one of the principal means of executing policy—are controlled by this twelve-man committee. So it would have been impossible for me to bend the decisionmaking process to political winds even if that had been my motive. Needless to say, that was not my motive, and I hope that on reflection you may conclude that it was really not necessary to ask this question.

Question 4. In other words, from 1970-1972 did you not as Chairman have your Board do precisely what both Chairman Martin and the Eisenhower Cabinet in the 1960 election refused to do?

Answer. No.

After your appointment to the Chairmanship in 1970 you said the following:

"The responsibility of the Federal Reserve is to supervise monetary policy —that is, the supply of credit and currency. . . . The Federal Reserve Board's autonomy was conceived for the purpose of maintaining the integrity of the currency. I think it's quite proper, then, that the monetary authority be independent of the political authority."[1]

But in 1957 you said this:

"The Employment Act of 1946 pledges the Federal Government to 'utilize all its plans, functions, and resources' to foster economic expansion and to help prevent depressions. The Federal Reserve authorities, being members of the Government, are bound by this statutory declaration of policy."[2]

Question 5. Do you think these statements are compatible?

Answer. Yes. The Federal Reserve is bound by the policy declared in the Employment Act of 1946. There is no conflict between the objective of maintaining the integrity of the currency and the policy declared in the Act of promoting "maximum employment, production, and purchasing power."

Question 6. Your proposal to extend reserve requirements to nonmember banks and on NOW accounts would, at the same time, let nonmember institutions that would be required to maintain Federal Reserve reserve requirements use the discount window. That is correct, isn't it?

What purposes would be served by widening access to the discount window? Would it help businesses and consumers in places where nonmember banks are a major competitive factor? Would it help housing to let thrift institutions that provide NOW accounts have acess to the discount window? How would it serve the public interest to widen access to the discount window?

Answer: The Federal Reserve discount window is available for use by member banks in meeting temporary requirements for funds or to cushion more persistent outflows of funds pending an orderly adjustment of the banks' assets and liabilities. Certain seasonal credit needs may also be met through the discount window, and the Board's regulation governing member bank borrowing provides for emergency credit in unusual circumstances.

The Board's proposal to extend reserve requirements to the demand deposits and NOW accounts of all financial institutions contemplates that nonmember institutions would have wider access to the discount window, subject to the limitations that the Board may prescribe. Under present law, credit is extended to nonmembers only in highly unusual circumstances.

Federal Reserve lending through the discount window helps individual banks adjust to liquidity pressures stemming from day-to-day changes in national financial markets or from local developments. While banks have a number of alternatives available to offset a sudden drain of deposits or to meet unexpected and urgent demand for credit in its community, it is sometimes difficult for banks—especially smaller banks outside the money centers—to be prepared for all eventualities. Without access to the discount window, it might be necessary for a bank to remain more liquid than otherwise, and under such circumstances a bank would tend to be less accommodative of the credit

[1] New York Times magazine, Nov. 9, 1969.

[2] As published in *The Business Cycle in a Changing World*, N.Y. National Bureau of Economic Research; distributed by Columbia University Press, 1969. (Studies in Business Cycles, No. 17.)

needs of its community. Extending the use of the discount window to nonmember commercial banks, to the extent the Board found appropriate, would make it possible for such banks to conduct their business with more confidence in their ability to make needed adjustments and would therefore redound to the benefit of its customers.

The adjustment process for thrift institutions is different than that for commercial banks. Credit needs of thrift institutions generally are of longer duration than those of banks, and the Federal Home Loan Banks have created appropriate credit facilities. As NOW accounts are introduced and expanded in volume, however, thrift institutions may experience greater volatility in their deposits. A facility such as the Federal Reserve discount window may serve to reduce the amount of liquid assets held in place of mortgages and other long-term investments, and thus be helpful for short-term adjustment purposes. The administration of short-term credit to thrift institutions which are members of the Home Loan Bank system would need to be undertaken with the close cooperation of the Federal Home Loan Banks.

Question 7. Housing starts in January were at an annual rate of only 1.3 million units. This is less than 50 per cent of what we need if we are to meet the targets of the 1968 Housing Act. We've got to do better, don't you agree?

I notice that the Federal Reserve now holds in its portfolio more than $2 billion of Federal Agency obligations, and I am told that nearly three quarters, about $1.5 billion, consists of housing oriented obligations, Fannie Maes, Home Loan Bank Board and FHA obligation. Is that right? I want to compliment you for finally, if grudgingly, using your open market powers to assist housing and I want to ask why you can't do more? Over the past year, the Fed's portfolio of earning assets rose nearly $9 billion. Assuming about the same rise in the coming yeaar, why can't the Fed buy another $3 or $4 billion of housing securities? That would surely give housing a boost, wouldn't it?

Answer. Private housing starts in December 1973 were at a seasonally adjusted annual rate of 1.4 million units. In January 1974, the rate of production rose to 1.5 million units, and in February to 1.8 million.

Additional housing facilities have been provided by mobile homes and by starts of publicly owned units—all of which contribute toward the targets of the 1968 Housing Act. In February 1974, assuming that the rate of mobile home shipments remained near its January level, the annual rate of additions to the total stock of housing totaled around 2.3 million units.

Rehabilitation of older dwellings has also picked up recently; in the fourth quarter of last year, the rate of increase in home improvement credit outstanding was more than two-fifths larger than in the same period of 1972.

Some recovery in housing starts is now widely anticipated over the course of this year. Also, a high rate of expenditure for rehabilitation of existing homes will probably continue, especially at a time of emphasis on energy conservation. These developments would mark further progress toward meeting our nation's housing goals.

As of the end of 1973, the Federal Reserve System held in its portfolio almost $2 billion of Federal agency obligations. Nearly 70 per cent of this amount consisted of the housing credit agencies. Our purchases of these securities are designed to add breadth to the market for Federal agency issues without running the risk of dominating that market. To this end, our guidelines currently provide that System holdings of any one Federal agency issue shall not exceed 20 per cent of the amount of the issue outstanding, and that aggregate holdings of the issues of any one agency shall not exceed 10 per cent of the amount outstanding.

These guidelines are not presently limiting in a significant way our capacity to add to the System's portfolio of agency securities. It is my judgment, moreover, that no good purpose would be served by acquiring a substantial volume of additional agency securities for the System's open market account at this time. In recent months, financial markets have been quite receptive to new issues of agency securities. Also, the volume of such issues will be relatively moderate in the months immediately ahead, because savings and loan associations have been reducing their borrowing at the Federal Home Loan Banks. The Home Loan Bank System has actually retired over $1–1½ billion of its outstanding debts since last October. In these circumstances, large Federal Reserve purchases of securities issued by the housing credit agencies would not materially affect conditions in the residential mortgage market. We will, however, be alert to any changes that may take place in the mortgage market.

Question 8. I am sure that you, as well as I, want to assure as a long-term continuing matter, that sufficient funds are allocated for housing to meet our housing goals. So, I would like you to comment on two proposals for achieving this objective. One is to establish a National Development Bank to provide credit on reasonable terms for housing and other social priority investments such as energy development projects. The Bank could be capitalized by issuing stock to which the Treasury would subscribe and could also obtain funds by selling debt obligations in the open market in amount not to exceed 20 times the paid up capital stock. Operating funds, including to cover any difference in tight money periods between lending and borrowing rates, would be provided by Congressional appropriations. Wouldn't you agree that such a bank would go a long way towards assuring that sufficient funds are allocated to housing and other priority investments?

The second proposal is to require that all financial institutions make prescribed minimum investments in mortgages and other securities which Congress deems to be priority investments. Wouldn't this be a fair and equitable way of achieving our purpose?

Answer. The objectives that might be served by the creation of a national development bank for housing and other high priority sectors have some merit. Insofar as the residential mortgage market is concerned, however, I know of no reason why a new institution of this type would be expected to improve materially on the tested performance of the existing Federally sponsored housing intermediaries, such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal Home Loan Banks. The operations of these agencies, in fact, might tend to be displaced by the creation of a new institution.

The proposal to prescribe minimum investments in mortgages for all financial institutions is objectionable on several grounds.

First, public policy should not employ coercive measures of this kind as long as better alternatives are available. Actually, public policy already requires nonbank thrift institutions to hold a large share of total assets in mortgages as a condition of preferential tax treatment. Extension of the restriction without tax benefit to other major financial institutions would be inequitable.

Second, if investment restrictions of this kind were imposed broadly on financial institutions, the long-run gain for residential mortgage investment might turn out to be limited. Funds attracted to mortgages through coercion would tend to drive down yields on mortgages, and thereby discourage lending on a voluntary basis.

Third, over the long run, the public interest would not be served by additional structural impediments to the flow of credit within money and capital markets. In the home mortgage market itself, we have seen all too often the counterproductive effects of unrealistic barriers on mortgage interest rates, whether in the form of usury ceilings on conventional loans or statutory or administered ceilings on Federally-underwritten loans. Instead of assuring borrowers access to low-cost mortgage funds, such rate ceilings have at times virtually dried up the supply of credit available for loans subject to this type of non-market constraint. Rather than erecting still another structural barrier in the financial markets, a better alternative would be to work toward further improving the attractiveness of mortgages relative to other competing kinds of investments. In that way, credit will flow more readily to the sectors where effective credit demands are most urgent.

The Board's March 1972 report to the Congress, "Ways to Moderate Fluctuations in the Construction of Housing," describes several possible approaches that would enhance the investment appeal of the mortgage instrument.

Question 9. Last summer, as I see it, the Federal Reserve unnecessarily put money markets into near panic and disrupted financial flows especially into thrift institutions and housing. You did this by sharply cutting the growth of important monetary aggregates, including Federal Reserve credit, the monetary base and the M-1 money supply. For example, in the year ending June 1973, money supply grew nearly 9 per cent but for the next three months. it didn't grow at all. As a result, interest rates already climbing with inflation suddenly shot up, skyrocketed. For example, the commercial paper rate jumped more than 200 basic points from June to September and October. Money markets went into near panic, thrift flows were disrupted and housing starts were cut back drastically. How can we be assured that this won't happen over and over again? Why can't the Fed supply money at a moderate rate on a continuing basis and keep interest rates off the roller coaster you have put them on so often in the past?

Answer. During the course of 1973, the growth rate of M_1 varied rather markedly on a month-to-month basis. These erratic monthly movements show up in the quarterly growth of M_1, if the quarterly growth rate is measured from the final month of one quarter to the final month of the next. However, when growth rates are measured from the average amount of money outstanding during a preceding quarter to the average amount outstanding during a current quarter, erratic temporary fluctuations in the money supply are averaged out.

Growth rates for M_1 in 1973 on this latter basis are shown in the first column (labelled Q) of the table below; they are compared with growth rates for quarters calculated from average levels in the final months of the quarters (the second column, labelled M).

ANNUAL GROWTH RATES OF M_1 IN 1973 BY QUARTERS

	Q	*M*
I	7.0	3.8
II	7.5	11.5
III	5.5	−0.2
IV	3.9	7.5

The behavior of the quarterly average figures is more reflective of the underlying trend of monetary expansion in the course of 1973.

Last year, there was a sustained rise of interest rates into the late summer; this was followed by a decline in interest rates over the remainder of the year.

The movements of interest rates reflect much more than the course of monetary policy. They also reflect basic economic forces—fiscal policy, the public's saving and investment propensities, etc. When the economy is operating close to capacity limits—as our economy was throughout most of 1973—interest rates are apt to rise, often sharply, since the demand for goods and services, and related demands for credit, remain strong. Last year, inflationary expectations stemmed in large measure from price increases associated with commodity shortages and the sizable devaluation of the dollar in the first half of the year. Efforts to forestall interest rate increases in 1973 by adding more liberally to bank reserves, and encouraging faster growth in money, would only have added to our inflationary problem and—sooner or later—to greater upward pressures on interest rates.

It is by no means clear that efforts to maintain a constant growth rate of the money supply would reduce interest rate fluctuations. Demands for money are quite volatile in the short-run. Random shifts in demands for cash balances stem from the extremely large flow of funds in our economy, from short-run changes in the level of U. S. Government deposits, from international capital flows, and from sudden changes in attitudes toward liquidity. Efforts to maintain a relatively constant growth in money supply at a time when demands for cash balances are changing could intensify—rather than moderate—short-run swings of interest rates.

Moreover, the Federal Reserve's ability to control money supply over short time periods is limited, partly because a growing part of the money supply consists of deposits in nonmember banks that are not subject to reserve requirements set by the Federal Reserve. A staff memorandum on problems encountered in controlling the money supply was included in the record of hearings held by the Subcommittee on International Economics of the Joint Economic Committee on June 27, 1973.[3]

[3] "How Well Are Fluctuating Exchange Rates Working?", hearings before the Subcommittee on International Economics of the Joint Economic Committee, 93d Congress, 1st Session. June 20. 21. 26. and 27, 1973, pp. 189-193.

THE 1974 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 28, 1974

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

The committee met, pursuant to recess, at 10:10 a.m., in room 318, Russell Senate Office Building, Hon. William Proxmire (vice chairman of the committee) presiding.

Present: Senators Proxmire, Humphrey, Bentsen, and Javits.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Richard F. Kaufman, general counsel; William A. Cox, Jerry J. Jasinowski, John R. Karlik, Courtenay M. Slater, Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. The committee will come to order. This morning it is a pleasure to welcome, as our witness, Secretary of Agriculture Earl Butz. The agricultural outlook is obviously an important part of the total economic outlook for 1974, and we have asked Mr. Butz to discuss the prospects for agricultural prices and supplies. I hope that by paying more attention to agriculture this year, the committee can do its part to avoid any repetition of the unfortunate situation of last year, in which the entire economic community—inside and outside of Government—was taken by surprise by events in the agricultural sector.

Mr. Butz, I note that you begin your statement by saying that this in an "exciting and challenging time" for U.S. agriculture. I would like to point out that it is also a "challenging" time, as you know, for the consumer. The challenge lies in paying the grocery bill. For millions of people in poor countries, such as India, the challenge lies quite literally in getting enough food to stay alive. With the decline in the U.S. food for peace program and with the growing difficulties these countries face in obtaining fertilizer for their own crops, this "challenge" is increasing.

So while this may be an "exciting and challenging" time, it is also a very difficult time for many, many people, in the United States and elsewhere. It is a time at which we cannot afford any more mistakes. Our grain reserves are already drawn down. Our prices are already at peak levels. There is no cushion. We cannot afford the loss in production which would result if we fail to make fuel and fertilizer available to farmers. We cannot afford any more disruptions of the marketing chain such as those which were caused by the meat price freeze last summer and by the truckers strike a few weeks ago. We cannot afford the damage which is done to traditional patterns of world trade when we suddenly impose poorly thought out export limitations, as we did last summer with soybeans. We simply have no more margin for error.

I regard it as of the utmost importance, therefore, that we listen carefully to your statement this morning, Mr. Butz, that we question you thoroughly, and that all of us work to see that our agricultural policies succeed in meeting a very difficult combination of objectives—a fair return for the farmer, a reasonable price, and an assured supply for the American consumer, and a responsible export policy.

Mr. Butz, I think that you are an extraordinarily intelligent and articulate man, and certainly one of the most articulate we have in our Government. And I think it is a good thing that the farmers have a spokesman who is vigorous and aggressive. All of us from the farm States have been conscious of the inequities that the farmers have suffered for so long with low incomes, and although income increased very sharply last year, it is my conviction, on the basis of what I have seen, that farmrs are still not getting an income equal to that of those off the farm. But they have done much, much better than they have for a long, long time.

And I notice in your statement that you indicate that this is likely to be another relatively good year for farmers, but not as good as last year. At any rate, we have many problems here, and many issues we would like to discuss with you and ask you about. And you proceed in our own way. Other members of the committee will be here shortly. Go right ahead.

STATEMENT OF HON. EARL L. BUTZ, SECRETARY OF AGRICULTURE, ACCOMPANIED BY DON PAARLBERG, DIRECTOR OF AGRICULTURAL ECONOMICS, DEPARTMENT OF AGRICULTURE

Secretary BUTZ. Well, Mr. Vice Chairman, thank you very much for those kind remarks, and especially the complimentary remarks personally. I might say I wish you would have felt that way 2 years ago and would have voted for my confirmation, as was true of some others. Agriculture has improved.

Senator PROXMIRE. Well, I voted against your confirmation, Mr. Butz, and my vote against your confirmation was again because although I thought you were extraordinarily intelligent and articulate, I disagreed with your position that had been indicated before you took office, and I am still not convinced.

Secretary BUTZ. I might say, Mr. Vice Chairman, it is a position that has been largely responsible for a tremendous increase in the price to the farmers.

Senator PROXMIRE. Oh, come, Mr. Butz. You certainly would not take credit for what has happened in the world which has made for this enormous increase in demand. You are a very powerful and influential person, I am sure, but you did not eat all of that bread, and consume all of that enormous farm production that resulted in this increase in demand and soaring farm prices.

Secretary BUTZ. I think, Mr. Chairman, this administration had something to do with turning around agricultural policy in this country, and in lessening the controls on agriculture and expanding the opportunities for output. But that is beside the point.

Senator PROXMIRE. Well, we will get into that during the questioning, I am sure. I am glad you reminded me of that. I will be consistent, and I will demonstrate that when I question you a little later.

Secretary BUTZ. I am delighted, sir, with the change in your attitude and I appreciate it very much.

Mr. Vice Chairman and members of the committee, this is an exciting and challenging time for U.S. agriculture. After four decades of agricultural policy which attempted to restrain productive capacity, we are entering an era when agriculture can take full advantage of growing domestic and world demand. Farmers are responding to the signals from the market by planting increased crop acreages and record production is in prospect this year.

The impact of the rise in farm output will be noticeable at the grocery store before many months have passed. The larger supplies coming on the market. especially in the second half, will ease pressure on food prices. Though some further increases are likely into spring, there is a strong likelihood that retail food prices will begin to stabilize by summer.

Farmers will have another good income year. We expect the net to be second only to the record realized by farm operators in 1973. Even after adjustment for the price inflation, the 1973 income was well above any previous year. The implications of growing world demand for American agricultural products can scarcely be overemphasized. Let us look at how it came to be.

The pressures of expanding demand on world supplies began to mount in 1973 when world cereal production fell 3 percent, interrupting a recent trend increase of 3 percent annually. A poor Peruvian anchovy catch helped reduce protein feed supplies. These reductions coincided with rising world demand, fueled by rising incomes, devaluation of the dollar, and growing preferences in many nations for more livestock products in the diet.

The impact of export demand is measured by the export statistics. Our 1973 calendar year agricultural exports reached $17.7 billion, almost 90 percent more than in 1972. Agriculture's trade balance rose to $9.3 billion. enough to more than offset a deficit of $7.6 billion in our non-agricultural trade. Our total balance was favorable for the first time since 1970. And I may insert parenthetically, Mr. Vice Chairman. that this net surplus in our agricultural trade last year of $9.3 billion, by a strange coincidence coincided almost exactly with our bill for the import of petroleum last year of $9.3 billion.

This extraordinary foreign demand, along with strong domestic demand, reduced our grain, and soybean stocks and prices climbed. Farmers responded by producing record crops of corn, wheat, and soybeans in 1973, following the big harvests of 1972. Strong foreign demand also pushed up cotton prices, and supplies are tight despite a slight drop in domestic mill use. Livestock producers, on the other hand, cut back production under the pressure of rising feed prices and market uncertainties resulting largely from price ceilings on meat. Cattle slaughter in 1973 was off 6 percent from 1972, despite record inventories as the year began. Hog slaughter was down 9 percent. Broiler production slipped 2 percent and eggs 5 percent. Total milk output was down 3 percent.

Events of the last 2 years precipitated economic developments that will continue to challenge agriculture in the years ahead. Not so long ago, levels of farm prices and income were mainly determined by developments within this country. This is not to say that economic events abroad were unimportant to our economy. We have been exporting the production from 20 to 25 percent of our cropland. Our trade in agricultural products has yielded dollars that helped offset our unfavorable trade balance in the nonfarm sector. Farm products were vital in food for peace and other programs to assist and help in the development of other nations. Nevertheless, during most past years, we carried substantial stocks which cushioned our markets against abrupt changes in supply and demand abroad.

This is no longer so. American agriculture has come of age in the world community. We do not have large stocks and we are now in the "free" market for many of our major agricultural commodities. Our prices now are much more sensitive to developments abroad. Consequently, we must give far more weight to world conditions in assessing the agricultural outlook than we have in the past.

Another factor that enters more emphatically into our outlook appraisals is the world monetary situation. We have been accustomed to think of the dollar as a solid rock about which other currencies ebb and flow. Events of the last couple of years have demolished this notion. By mid-1973, the dollar had depreciated by an average of 17 to 18 percent compared with the currencies of our major agricultural trading partners.

Moreover, it has undergone numerous, short-time fluctuations in relation to currencies of individual countries in response to changing world conditions. As a result of the realignment of the U.S. dollar, prices for U.S. commercial exports, expressed in foreign currencies, are now averaging about 9 percent lower than would otherwise have been the case. Although the value of the dollar has recently increased on the world market, it remains to be seen whether or not this is a transitory development.

As we look toward the 1974 crop season, we find that strong world demand continues to press on tight supplies. World grain production in 1973–74 is expected to be at record levels. This will permit some increase in use but stocks are low and supplies are likely to be relatively tight well into the 1974–75 crop year. Oilseed production is outrunning use but demand for rebuilding stocks is likely to keep prices relatively high.

The outlook for the U.S. economy suggests a very small growth in real output this year, but inflation will continue strong, particularly through the first half. Unemployment seems likely to rise some and corporate profits will decline substantially. Capital investment in plant and equipment will provide strength, but housing will continue to lag, and business investments in inventories are likely to decline late in the year. Consumer expenditures will be only modestly higher, and will mainly reflect higher prices of nondurable goods. Purchases of major durable goods will be down. Consumers will tend to use their income to maintain the volume of purchases of nondurable goods, pay debts, and increase their savings. Two likely bright spots in the economic picture are rising investment and strength of the dollar in world trade. This is the general domestic economic framework in which farmers will be selling their output this year.

Aside from weather, the greatest question mark in the outlook is the availability and price of farm inputs. Farmers are in a strong financial position. The ratio of debts-to-assets and net cash income-to-debt are the most favorable in recent years. Also, short-term interest rates on farm loans have moderated somewhat, so farmers can obtain funds for production and needed capital items.

We see no overall problem in getting farm fuel. Needs will be about 3 percent greater than in 1973, and farmers can expect to pay 30 to 50 percent more for both gasoline and diesel fuel. Diesel stocks are much improved, reflecting increased output this winter and mild weather which reduced fuel requirements. Gasoline supplies should be generally adequate, excepting perhaps for farmers who purchase fuel at retail service stations. By the time spring work gets underway, the distribution system established under the new petroleum allocation program will be well under operation. Farmers are to receive 100 percent of their fuel needs, but they would do well to order in advance from a distributor with adequate stocks. USDA has set up a system to help.

The fertilizer picture is mixed. Supplies of potash are more than adequate to meet requirements, but nitrogen could be short of requirements by 5 percent and phosphate by about 12 percent. Although these shortages obviously will have some effect on yields, and impact should be small. We are trying to persuade fertilizer producers to first satisfy domestic users and thus minimize the shortages.

Since fertilizer was exempted from price controls on October 25, price increases for nitrogen products have ranged from 55 to over 70 percent, prices of phosphate products are up about 40 percent; potash prices have increased 26 percent. However, the spread between export and domestic prices has not narrowed because export prices also have soared.

Demand for farm labor will approximate that of 1973. Although cropland will be expanded by some 17 million or more acres—largely in feed grains and wheat—the effect on demand for labor will be largely mitigated by widespread adoption of enermy conservation measures such as reduced tillage.

The farm wage bill will likely be about 8 percent higher as hired farmworker wage rates increase from the 1973 average of $2 per hour without room and board to around $2.20 per hour by the end of the year. We expect farmers will find it difficult to hire workers at current wage rates, even though unemployment rates have risen in the past couple of months. Labor shortages will be most acute for harvesting highly seasonal labor-intensive crops. Although supplies of inputs will be limited and prices high, we do not expect this situation to severely curtail production capabilities.

Farm output should increase about 5 percent over 1973 if weather is normal. Production per man-hour should increase about 4 percent. Prospective plantings indicate about 127 million acres to be planted to feed grains, up 5 percent from 1973. Production may total 235 million tons, 15 percent more than in 1973. This would be ample for projected needs and permit some recovery in stocks. Feed grain prices are nearly double those of a year earlier and will stay strong because of tight supplies and strong demand, particularly foreign demand. Changes in prices this summer will hinge primarily on the outcome of the U.S. crop and foreign demand prospects.

Farmers intend to plant about 55.5 million acres of soybeans, down slightly from 1973. But with a bigger carryover, total supplies would rise to a record 1.8 billion bushels. This will be above prospective needs and stocks will rise further by the fall of 1975.

Early forecasts indicate a 1974 U.S. wheat crop of about 2.1 billion bushels, a fifth more than last year's record. Farmers are responding to favorable prices and the 1974 wheat program by increasing acreage.

Disappearance will tail off during January–June. Many foreign buyers who bought early will likely limit further purchases, but exports will set a new record—1.2 billion bushels. Domestic use may lag behind last year as less wheat is fed. Heavy exports and prospects of small stocks pushed wheat prices to record levels. Farm prices are holding at well over $5 per bushel. The futures market indicates prices may weaken somewhat by next July.

Old crop wheat stocks next summer are projected to be the smallest since the summer of 1947. To alleviate the concern of domestic users about the adequatey of supplies, we have launched a three-point program: (1) Encouraging foreign buyers to postpone purchases until new crop wheat is available; (2) attempting to persuade the Canadians and Europeans to increase their supplies for export; and (3) temporarily removing barriers to the importation of wheat into the United States.

If markets are allowed to function, there will be no shortage of flour in the United States. World wheat stocks are large enough to allow a transition from old crop to new crop wheat without a disastrous runup in domestic prices.

Retail bread prices rose 28 percent in the last year and averaged 31.9 cents a one-pound loaf in December. Some further increase is likely as processors pass on recent cost increases. The farm value of wheat in that loaf rose about 50 percent last year to 4.5 cents in December. Still it accounted for only 17 percent of the total retail price of bread. The flour-miller spread increased 50 percent. The baker-wholesaler spread lagged, so it probably will continue to adjust.

With bigger 1974 crops, demand for transportation services will continue strong, especially for grain and soybeans from major producing areas. The supply of railroad cars and trucks will not fully meet needs. We anticipate problems in Northern tier States and from more distant points elsewhere. Still, commodities will reach ports and terminal markets.

Agricultural shippers face higher transportation costs as carriers pass on higher fuel costs, and other costs associated with lower speed limits and general price increases.

Problems in shipping grain and perishables by rail are likely unless substantial improvements in equipment utilization are made. This would add to demand for truck movement. Although agricultural truckers should generally receive basic fuel needs, severe local shortages could develop. Fuel problems are expected to be greatest for shippers of perishables.

The bigger feed supplies later this year will encourage expansion in meat ouptut, but most of the impact will come in 1975. Meanwhile, the price ceilings imposed on meat in 1973 and high feed costs continue to affect output. Farmers hesitated to put more cattle on feed last summer and fall, so most of the moderate increases expected in beef output will come in the second half. Pork producers have been reluctant to expand production in the face of high feed prices and market uncertainties, but some recovery is expected in the second half. Poultry producers are taking steps to moderately expand 1974 output.

The 1973 market disruptions are also still affecting other foods. Prices for practically all major categories have been increasing this winter, reflecting tightening supplies, higher farm prices, and rising costs of processing, transporting, and distributing. Grocery store food prices this winter may average around 5 percent above the fourth quarter of 1973, including the sharp January advance we have already experienced.

A marked change in the food price situation is in prospect later this year. The rate of increase is expected to slow during the spring with prices perhaps 2 to 3 percent above first quarter levels. Retail food prices would level off after mid-year and perhaps decline slightly toward the end of the year. The average for all of 1974 may be about 12 percent above 1973, less than the 14.5 percent increase between 1972 and 1973.

In contrast to 1973, most of this year's increase in retail prices will result from increased marketing costs. Rising wage rates, energy and material costs and transportation charges will continue the upward push on marketing costs and margins through the year.

The problems of low-income citizens in adjusting to rising food prices were considerably eased by last year's legislation. Under that legislation, the department has raised eligibility levels for Food Stamps and the value of Bonus Food Stamps to reflect the rises in food prices. Similar adjustments will be made every 6 months. We anticipate a substantial increase in the number of families participating in the food stamp plan.

The legislation also provides for closing out the food distribution program for families. In addition we are taking a look at the remaining program which provides commodities to schools and institutions. There is a serious question whether this system, which was designed to make use of foods acquired under our price support programs. should be maintained or converted to a cash plan or a voucher plan analogous to the Food Stamp Plan.

If the energy crisis results in increased employment the food stamp program will be available to those temporarily out of work.

In summary, 1974 will be another strong year for agriculture.

World and domestic demand is strong and supplies are likely to remain fairly tight. Farm prices for both crops and livestock will average higher than in 1973, but with stocks generally low, markets will continue sensitive to changes in prospects for the growing crops.

Farmers will pay much higher costs of production and will find supplies of many inputs short of requirements and priced very high. Though shortages may be critical in local areas, generally farmers will be able to get the crops in, tend them, and harvest them. Given good weather, they will produce a record output this year, demonstrating once again that given the stimulus of a free market environment, farmers can and will produce for abundance. The increased supplies coming in the markets beginning in summer will ease much of the pressure on retail food prices. This should begin to stabilize by summer.

Although farmers' prices and production will increase, their costs are rising even faster. Consequently, the net income realized will be down $1 to $2 billion from the high level of 1973. The 1974 income still will be second highest on record by a good margin.

Mr. Vice Chairman, that concludes the formal statement.

Senator PROXMIRE. Thank you, Mr. Secretary.

Mr. Secretary, it is very hard to give your statement about what will happen to food prices this year as much credibility as we would like to give it. It seems to represent the same song the administration has presented for over a year. In your statement you say, and I quote: "The larger supplies coming on the market, especially in the second half, will ease pressure on food prices. Though some further increases are likely into spring, there is a strong likelihood that retail food prices will begin to stabilize by summer."

Now, what did you say last year, almost precisely a year ago—well, it was eleven months ago? You appeared or I should say this was a study by a group of which you were a member, and you said, this group said this:

> During the remainder of 1973 food supplies should expand significantly, although most of the expansion will occur in the second half of the year. Once additional supplies supplies reach the market, farm prices should move down quickly and we should have a flattening out on retail price.

Now, as you know, we have had a great disappointment. Prices, far from flattening out, went right through the roof. What is there in the present picture to assure us that that will not happen again?

Secretary BUTZ. May I ask what is the report you are quoting from?

Senator PROXMIRE. I am quoting from a report of the Cost of Living Committee on Food made last March 20.

Secretary BUTZ. Then it was dated when?

Senator PROXMIRE. March 20.

Secretary BUTZ. March 20. That is a very good question. Let me illustrate specifically. On March 20, 1973, the farmers of America had indicated their intentions to increase farrowings of pigs the last 6 months of 1973 by 6 percent. This was their honest intention. In previous years those intentions have pretty well materialized, with some little deviation from time to time.

Between March 20 last year and the middle of June tremendous pressures were developed for price ceilings on food products, for rollbacks, and there was pressure developed in the Congress and the administration and price ceilings were placed on food products, including meat. This came after consumer boycotts had developed, and consumer boycotts were effective in reducing consumption of meat. They were effective in driving down the price of meat. And they sent a signal right back to the producers that you had better cutback production, and whereas a year ago March 20 farmers had indicated their intention to farrow 6 percent more pigs, in the last 6 months of 1973 they actually farrowed 1 percent less. Now, I guess one of the principal reasons that we missed our forecast was that we could not forecast the actions that would develop as a result of consumer and political pressures to send the wrong signal back to the producers. And producers are not stupid. They read that signal fast, they figured that out with a dull lead pencil. They did not put their steers in the feedlots, they did not put their steers in the feedlots 6 or 8 months ago, and they simply cannot come out now. They sent their pregnant sows to slaughter. That represents pork loins that we are not buying today. And they reduced flocks of chickens, and I think that was one of the principal factors that made our forecasts of a year ago not come true.

Senator PROXMIRE. That certainly is one of them. However, is it not true that fundamental overall was the fact that far from having an abundance of farm products, such as wheat and feed grain, that we had a sharp diminution in our supplies as the year went on? Is that not true? Go ahead.

Secretary BUTZ. Well, that contributes to part of it, to be sure.

Senator PROXMIRE. Was not that a major contribution?

Secretary BUTZ. No, I do not think so. We came out of the year last year with a carryout of over 700 million bushels of corn. We could have fed more corn than we did feed. We simply slowed down our feeding.

Senator PROXMIRE. Let us take a look at the wheat situation and how it ties in to the bread problem. In the 1960's we had about a 1-billion bushel carryover, as I understand it.

Secretary BUTZ. That is right.

Senator PROXMIRE. And about a year ago it was 438 million bushels. Today, as I understand it, it is 178 million down very, very sharply. That constitutes, furthermore, about 10 percent of the annual disappearance, a little more than a month. That seems to me to be a very narrow inventory, a situation in which an increase in exports, or a difficulty in our crop, in our weather could upset the situation very badly and result in the kind of situation that the bakers and others have been warning about.

Secretary BUTZ. Well, that is always a possibility, Mr. Vice Chairman. Of course, the bakers have been saying we are going to come out of this market here with no carryout which simply is not true. Our best estimates right now are that we are going to come out with about 178 million bushels of old crop wheat on June 30, but by June 30 we are going to have new crop wheat come on the market from the Southwest, from Texas and Oklahoma, and we estimate by June 30 we will have 250 to 350 million bushels of new crop wheat on the market.

Senator PROXMIRE. That will be only a part of the market and the West will not get their share until August or so, is that not correct?

Secretary BUTZ. It is part of the national supply of wheat, nonetheless, and its sales makes wheat available to go into the export market at that time too. Mr. Vice Chairman, I think you are absolutely correct when you say the carryout of 178 million bushels of wheat is minimal. However, our domestic consumption of wheat in this country right now runs somewhere in the neighborhood of 550 million bushels a year for human consumption.

Senator PROXMIRE. Is this not precisely the kind of a supply situation that could very well result in another sharp increase for wheat and food grains communicated to wheat, and other food in the coming year?

Secretary BUTZ. No, sir. In view of the prospects we have for production in 1974, we are going to have a wheat crop in 1974 of something right now in excess of 2 billion bushels, and our current projection is around 2.1 billion bushels.

Senator PROXMIRE. Have we not had an erratic record, if we look at the whole, say, last 30 years, and does it not depend very greatly on what kind of weather we have?

Secretary BUTZ. In the main, winter wheat has come through very well. We have a drought situation in the weather in southern Oklahoma and the Texas Panhandle, but in the main our winter wheat has come through in good shape, and three-fourths of our wheat is winter wheat. Farmers' intentions to plant spring wheat I think is up some 20 percent; we are going to have a very substantial increase in acreage of spring wheat this year. I think at the moment there is almost no way that we can have a short wheat crop in 1974.

Senator PROXMIRE. Well, we hope you are right but, of course, as I say, weather is something none of us can predict with real assurance. How about the possibility of sharp increases in exports beyond what we plan?

Secretary BUTZ. Well, I think the best evidence we have at the moment of what is going to happen in the wheat situation next year is the way the total market judges it, and we looked at yesterday's market, for example, in Chicago and I see a very substantial difference between old wheat crop an dnew wheat crop. Yesterday in Chicago apparently the market thought we must be going to have a lot of wheat, or decrease in demand, and it dropped the limit yesterday, as it did the day before. But when I look at the difference, let us say March wheat, and September wheat, there is right now a difference of 62 cents. The market, the total judgment is expressed in the market indicates that this situation is going to be easier when the new crop wheat comes on.

Senator PROXMIRE. But that market attitude is very volatile, and it may go up or down.

Secretary BUTZ. As conditions change, indeed it does.

Senator PROXMIRE. The fundamental problem seems to me to be to determine who is responsible for assuring that we have adequate food supplies, both in this country and for the world, for that matter, as we are such a very important factor in world food supplies and the major exporting country along with Canada. And if we fail to have a conscious Government program providing adequate supplies, it seems to me we are just constantly playing Russian roulette with the consumer, and the available food supplies for people throughout the world.

Secretary BUTZ. Mr. Vice Chairman, I quite agree with you, and I think that the Government has moved very wisely in the direction of providing adequate supplies. The Agricultural Act of 1973, passed by this Congress last year, and signed by the President I think represents a 180-degree turn in the philosophy of farm program in this country. For 40 years, with the exception of short wartime periods, we have operated on the philosophy of cutback and curtailment and allotments.

Senator PROXMIRE. Here is the problem that bothers me. We have such a small carryover, and you admitted that 178 million bushels is not anything like we have had in the past, it is not any cushion at all, and could result in a large increase in prices. What it seems to me is called for is some kind of a stockpile policy so that we have sufficient reserves available so that we can, in an emergency, in the event of a crop failure, or in the event of a crop failure abroad, or in the event of some increase in exports for whatever reason, we are in a position to meet it without a crisis which many people feel may be impending.

Secretary BUTZ. Mr. Vice Chairman, you raise a point that a lot of people raise, and that is we ought to have a strategic reserve, we ought to have some kind of governmentally held reserves. But let me point out what did happen 1½ years ago. We did have governmentally held reserves, we had a lot of wheat owned by the Government, as you pointed out yourself a moment ago.

Senator PROXMIRE. That is right.

Secretary BUTZ. We had nearly 1 billion bushels in Government control of one kind or another which caused market depressing and it was costly.

Senator PROXMIRE. A year ago we had about 438 million bushels, which was a lot less than we had——

Secretary BUTZ. Which was about normal.

Senator PROXMIRE. About half what we had in the 1960's.

Secretary BUTZ. But this was a comfortable figure, but 2 years ago or 18 months ago we had twice that much. We did have a reserve, but when prices started up, and the cost of food started up, we got tremendous pressure from various groups to put that reserve on the market. In response to pressure we did put it on the market. I think we put it on too soon and clogged up the channels of distribution. It made us run out of freight cars, it disrupted our market. But there was tremendous consumer pressure, translated to political pressures from various sources to dissipate that stock, and to get it on the market. And I think that is what always happens when you have got a so-called strategic governmentally held reserve, the pressure to dissipate it comes prematurely, and you do not have it when you really need it, like right now.

Senator PROXMIRE. You are not contending, however, that we would be better off with a small reserve, or with very little carryover than we would be with four or five times as much carryover? You are not saying that with 178 million bushels we somehow are better to meet an emergency situation than we would be if we had 1 billion? You are not saying that, are you?

Secretary BUTZ. Oh, no, sir. No, sir. I did not say that at all. All I said was in a time like this of rising food prices like we have experienced the last year, the consumer pressure, which becomes political expression to put those reserves in the market is so intense that you put them in the market prematurely. It would be nice now if we had them, but let us just remember how a year and a half ago when we had them the pressure was then to get rid of them.

Senator PROXMIRE. Well, what I am saying is that there does not seem to be any program or policy on the part of the administration to build, No. 1, a strategic, substantial strategic reserve for this country; and, No. 2, to cooperate with the United Nations Food and Agricultural Organization for building an international reserve that would be helpful in international emergencies.

Secretary BUTZ. I would not say there is no evidence of cooperation. There is some disagreement on the type of reserve we might have in this deal, Mr. Vice Chairman. For a long while the food purchasing agents of the world have grown accustomed to the United States carrying their inventory for them. It was always here. We did not carry it consciously and purposely, but it was the end result of our price support program, and we had heavy inventories of feed grains and food grains and of cotton. By the same token, the domestic spinners and millers of America got used to always having their inventories carried by the U.S. Government. Japan typically had about 3 weeks' supply of grain in Japan, 3 weeks on the ocean. They have discovered in the last year that that is a vulnerable position and they are now buying ahead. They have expanded their own reserves by a substantial period of time but they now own, and have in place either in Japan or in the countries where they are produced. By the same token, we are trying to tell our bakers, for example, and they have been in the news recently about wheat, we have been trying to tell them that they cannot be depending on the U.S. Government to carry their reserves with the ceiling price guaranteed, where the price gets to the point where the CCC could release it. They knew they would not have to pay above that price. We are trying to tell them they have to go into the market now and buy wheat to assure their supply in the free market. And I think what we are doing now is we are shifting the reserve function from the U.S. Government to the private trade. That is not to say that we do not have a reserve policy and do not have reserves. We do, and along with that we are encouraging maximum production this year. We are not paying for a single acre to be idle in 1974, and we can do that. I think the reserve situation will then take care of itself.

Senator PROXMIRE. Well, I have great confidence in the private market, and I think the private market, of course, always has served their country marvelously over the years, but I just do not see how society can make a conscious, planned decision by relying on the competing, the disparate, fractured groups to make the decision. We just do not know what they are going to do. The one agency that can act for the whole society and act effectively is the Government. If we simply say well, we are going to have the private enterprise provide for the reserves, it seems to me you do not have a program at all.

Secretary BUTZ. Well, private enterprise has always provided reserves until we got to the point where reserves got too big and they could not carry it, and at that point we stepped in.

Senator PROXMIRE. What I am talking about is the Government should have a program, it seems to me, of building within this country a substantial reserve. I know it takes a long time to do it, and I know this is a very difficult year to begin it, but it seems to me if we indicated we have that kind of intention and determination that that could have a salutary effect, plus it would seem to take care of our obligation to countries throughout the world, particularly the poor countries that depend so heavily on our exports.

Secretary BUTZ. Mr. Vice Chairman, I think if at the present moment the Government announced a program to set up a strategic reserve, and that we were going to enter the market and acquire it, and you would have to do that to make it effective. Instead of making the daily limit go down in the last few days it would have gone up the daily limit for the next week, and would have aggrevated the current price situation in that there would be another substantial buyer source entering the market.

Senator PROXMIRE. Are you saying then that it is wise to move in this direction buy not now?

Secretary BUTZ. I certainly would not do it now, because this is not the time to have another buyer enter the market for purposes of immobilizing the supplies.

Senator PROXMIRE. I was not suggesting that we should necessarily go out to the market and try and acquire hundreds of millions of bushels of wheat, and a great deal of corn and so forth. What I am trying to indicate——

Secretary BUTZ. How else could you get it?

Senator PROXMIRE [continuing]. Is that we should indicate that we intend to build up a reserve over the years, that this is a settled policy, and we are going to do our best to try to protect the American consumer by making sure that an adequate reserve is available and not relying on whatever happens in the private market.

Now, let me ask you about prices. In your statement you say that food prices will go up 5 percent in the first quarter, 3 percent in the second for a total of 8 percent in the first half. And then it will level off in the second half of the year and perhaps decline slightly. Now, what you are saying is that by July, unless I misinterpret you, and perhaps I do, what you seem to be saying is that by July prices will already be at 12 percent above the 1973 average, and you pin a great deal of hope on what is going to happen in the last half of next year, a hope that was disappointed, for one reason or another last year, a similar hope was disappointed last year. Is this an accurate description of what you anticipate?

Secretary BUTZ. Well, I think I am reasonably certain this will take place, one, given an average weather this summer. At the present time that is all we can hope for. Second, that we are not going to get to messing around with price ceilings again. If we send the wrong signal back to our cattle producers, we can expect the same experience we had last year, and pressure developing to do that. I think one of the reasons we are going to get a wheat crop this year of 2.1 billion bushels, an absolutely phenomenal figure for our farmers, is that it pays to do it. And the signal was sent back that we want wheat. I think if we were to accede to the pressures being put on by the American Bakers Association, and move vigorously to slap export controls on wheat, and depress the price of wheat, we could get less top dressing of wheat in the spring, and yield would go down some. Farmers simply respond that way. If we can avoid further messing around with these price signals in agriculture and have average weather, I am reasonably comfortable with these forecasts.

Let me point out——

Senator PROXMIRE. Secretary Butz, I would agree that farmers certainly would respond if they thought that the prices were going to drop sharply. The problem, however, is not that, as I see it. The problem is to protect the consumer against the possibility of skyrocketing prices in wheat, which would communicate themselves immediately in higher bread prices. And as you know, the consumption of bread and similar products is much greater for low-income people than it is for high-income people, so this would hit the people who are most sensitive to the fluctuation in food prices most directly and most sharply.

Secretary BUTZ. Mr. Vice Chairman, I thought bread might come up this morning, and I sent somebody out to get a loaf this morning. May I speak about it for a moment?

Senator PROXMIRE. Yes, indeed.

Secretary BUTZ. It has been in the news the last few days, and the pressure has been put on in the last few days by the bakers and some other people who jump on this bandwagon. This is mostly wheat in this loaf of bread. A one-pound loaf of bread, and it varies from store to store, costs about 40 cents, with taxes. This is a sliced loaf of bread. It is a one-pound loaf of bread and it has got 20 slices in it. At the present price of wheat, there is less than 8 cents worth of wheat in this loaf of bread. One bushel of wheat will make approximately 69 loaves, one-pound loaves of bread. So we have got a little less than 8 cents of wheat in this loaf of bread at the farm price of wheat. The bread costs 40 cents. That means that the wheat costs one-fifth of the loaf of bread. If there are 20 slices in here, I am going to take out the number that represents the wheat in this loaf of bread. That will be four slices, one, two, three, four. I got a piece of crust on there, and I will take it off.

Senator PROXMIRE. Will you show us how many slices that represented of a 40-cent loaf of bread a year ago or 2 years ago?

Secretary BUTZ. I will get to that in just a minute. But bread was not 40 cents a couple of years ago either. I will come to that.

Senator PROXMIRE. Wheat was a whale of a lot less.

Secretary BUTZ. Let me finish my illustration. There are 16 slices left to represent what the bakers put in. They are the ones raising all of this noise in the last few days. I want to get this turned around.

Senator PROXMIRE. I am glad you took the commercial wrapper off.

Secretary BUTZ. Ok. There are, Mr. Vice Chairman, four slices here, one, two, three, four. That represents the farmers' input in that 40-cent loaf of bread at the present price of wheat. There are 16 slices here that represent what went into that loaf of bread after it left the farm. Now, you can understand why I get a little teed off when all of the people talk about the four slices as representing the cost of bread. I am getting tired of chasing that four-slice rabbit. I would like to chase the 16-slice rabbit for a while. I think this is the place where we attack food prices in this country, it is the place we look for increased efficiencies, it is the place we look for cost reductions, it is the place we look to get the featherbedding out of it that runs costs up.

Senator PROXMIRE. Let me just say, Mr. Secretary, that I think you make an excellent point. I could not agree with you more that farmers do get a relatively small proportion of the consumer's dollar, especially in bread. There is no question about that. But the problem that bothers this Senator, and I think bothers many others, and bothers the bakers perhaps, is what is going to happen if we export so much of that, of our wheat that we have a scarcity, and we have a scarcity and then the whole situation changes dramatically and there is simply not enough wheat to provide the bread necessary to feed our people.

Secretary BUTZ. The baker, we are talking about him.

Senator PROXMIRE. Then you have the bread lines.

Secretary BUTZ. The bakers are talking about May of this year, a scarcity in May?

Senator PROXMIRE. We do not know. It depends on what happens to the weather, because we have no reserve to assure us it will be May.

Secretary BUTZ. The new crop wheat comes in and we are going to have a lot of wheat, but let us look at May, for example. Again I look at yesterday's paper, and the bakers say that we are going to have dollar bread by May. That is as phony as at $3 bill. Yesterday the price of May wheat in Chicago closed 9 cents below the price of March wheat. Now, if these bakers really believe what they have been saying, that we are going to have a wheat shortage in May, and the price of the wheat is going to escalate in May, they should go out right now and buy their wheat. It is in the country, it is out there now, it is for sale, it is being bought. They can buy wheat for May delivery right now at 9 cents below the wheat for March delivery. The plain truth is they do not believe what they are saying.

Senator PROXMIRE. Well, as you know, it was announced in the paper today the big combines, the biggest bakers, have done this. But this is not an industry that is characterized entirely by big business. We have small bakers, we have many in our State, and I am sure there are some in Senator Humphrey's State. They cannot afford that. They do not have the working capital, so they are not able to go out and buy that much wheat. And as a result, they have to depend on what is going to happen later on. There is a prospect, and I think you conceded that prospect, and the prospect is far more serious now than it was last year because of our low carryover, but you could have a scarcity of wheat to a point where you might have either rationing of bread or people simply not getting the bread they need, and this would be particularly harmful to low-income people who eat far more bread in relationship to their diet.

Secretary BUTZ. I quite agree with you, but the possibility of that is nil. I get——

Senator PROXMIRE. Well, why is it nil?

Secretary BUTZ. I guess you are saying the small bakers are hard pressed by costs, and they cannot meet this competition, and they would like to bring this wheat price down by exporting so that they can take a slice off of here and put it here. Is that what you are saying?

Senator PROXMIRE. No, I am not saying they want to beat the system. What they are trying to do is get a situation where there is less likelihood of a serious scarcity of wheat developing.

Secretary BUTZ. This means they want the price of wheat to go down.

Senator PROXMIRE. Well, in part. But the whole thing is not translatable entirely in terms of price. It is also just availability of the product.

Secretary BUTZ. That means then if they want the price of wheat to go down they would like to take a slice off here and put it up here, is that right?

Senator PROXMIRE. They do not want the price of wheat to go right through the roof. I am not talking about going down. They may be able to tolerate an increase of 10, 15, or 20 percent, but if the price goes up double, if the price goes up 100 percent because the scarcity is that bad, then you have the catastrophic problem that I am concerned about.

Secretary BUTZ. Right. If they feel that way, all they have to do is buy the wheat.

Senator PROXMIRE. And my point is that the bigs boys can do it, and the smaller bakers are not in the position to do that, and many of our communities are served by small bakers.

Secretary BUTZ. That poses a problem.

Senator PROXMIRE. Senator Humphrey.

Senator HUMPHREY. Mr. Secretary.

Secretary BUTZ. Senator, how are you this morning?

Senator HUMPHREY. Fine, very good, sir. I would like to just follow up a little bit on the wheat question. I am sorry that I could not be here a little bit earlier, and maybe my questions will be not following in the logical sequence, but I think we can——

Secretary BUTZ. This was baked from Minnesota wheat, incidentally.

Senator HUMPHREY. I thought it looked very good. High nutrition, vitamins from Humphrey's Drug Store in there, too, I trust, as supplements.

Mr. Secretary, maybe the record is already filled with this information. What is your estimate now of the crop, wheat crop for next year?

Secretary BUTZ. Our present estimate is approximately 2.1 billion bushels, up about 400 million bushels-plus from last year.

Senator HUMPHREY. Now, that estimate was based upon what I call optimum conditions, if I may respectfully suggest. I mean——

Secretary BUTZ. Well, conditions at the moment for these estimates, whatever they happen to be.

Senator HUMPHREY. Weather?

Secretary BUTZ. Based on conditions that actually exist, including the dry weather we are having right now in southwest Oklahoma and the Panhandle of Texas.

Senator HUMPHREY. But the assumptions when these crop estimates were made included adequacy of fuel?

Secretary BUTZ. That is correct.

Senator HUMPHREY. Of fertilizer?

Secretary BUTZ. That is correct.

Senator HUMPHREY. Of transport, of normal weather?

Secretary BUTZ. That is correct.

Senator HUMPHREY. So that there is not any—what I would call—any alternative estimate that might take into consideration the fact that the weather might no be so good? For example, there are some weather patterns this winter that indicate that we might have some trouble. There is no alternative estimate that would tell us what the crop would be if we were short of fertilizers, or if we were short of the diesel fuels? In other words, you have one estimate, is that not right?

Secretary BUTZ. Yes.

Senator HUMPHREY. I am just trying to pin down what the department has.

Secretary BUTZ. We revise that estimate month by month, and as the season wears on, each month we get out our crop estimates, and as the conditions change the estimates change.

Senator HUMPHREY. But the estimate now, and my point is that I was tabbed for years as Washington's No. 1 optimist, and I have yielded to the Department of Agriculture on its estimates on this. And I want you to be right. Do not misunderstand me. But being born and raised originally in South Dakota, that is my early background, I saw the variabilities of weather, and that maybe was one of the reasons I could understand what happened in the Soviet Union in 1972, having been used to looking at beautiful weather in Dakota in June, and we would have no crop, and this is in the thirties, and by August we were through, burnt out. Now, my point is on these estimates, as of now, you are basing them upon availability of credit and of all of the import, is that not correct?

Secretary BUTZ. Yes.

Senator HUMPHREY. How much wheat is distributed presently for export?

Secretary BUTZ. Well, for the total year we figure 1.2 billion for the total. Total year?

Senator HUMPHREY. That is what I mean.
Secretary BUTZ. Yes. The main bulk has been shipped, and we have deferred some of that in the new crop wheat, too.
Senator HUMPHREY. But you figure about 1.2 billion?
Secretary BUTZ. For the year.
Senator HUMPHREY. Is that what is contracted for, or is that what is just estimated?
Secretary BUTZ. It is our estimates for the total shipments abroad, and it has nearly all been contracted for or shipped.
Senator HUMPHREY. Do you have reports——
Secretary BUTZ. Yes, sir.
Senator HUMPHREY [continuing]. That really substantiate a figure, or get away from the estimate and really just get down to bedrock?
Secretary BUTZ. Weekly reports. I guess what you want is the unshipped contracts. Is that what you want?
Senator HUMPHREY. That is right.
Secretary BUTZ. I will have Mr. Paarlberg read those figures.
Mr. PAARLBERG. The outstanding sales, Senator Humphrey, all wheat, mixed, not yet shipped, as of the reporting date February 22, was 465 million bushels.
Senator HUMPHREY. Now, that plus what has been shipped, what will that leave us for carryover?
Secretary BUTZ. Well, we estimate our carryover at the present time at 178 million bushels, some carryout old crop wheat on June 30.
Senator HUMPHREY. No, I asked now—you said much of this is that of the 1.2 billion that you figure?
Secretary BUTZ. Yes.
Senator HUMPHREY. About 800 million has been shipped, and there is about 400-some——
Secretary BUTZ. Approximately, yes.
Senator HUMPHREY [continuing]. Million yet to be shipped. When you add those two figures together, what do you have as a carryover, based upon your estimates on crops? What will you have left over?
Secretary BUTZ. Well, the carryover, the estimate of the carryover bears no relationship to the estimated 1974 production, because the estimated carryover is 1973 and previous crop years. And at the present time we estimate 178 million. Now, a part of that, now, I see the discrepancy in the figures, part of that is that we have better than 150 million bushels of export contracts with unspecified destination, unspecified price. These were mostly export contracts put on as insurance against the possibility of export controls like we had last year on soybeans.
Senator HUMPHREY. If I could just say on that point, Mr. Secretary, one of the large firms in my State, the Cargill Company, which is a big exporter, says they are going to export every one of those.
Secretary BUTZ. Yes, sir, Cargill.
Senator HUMPHREY. So, I do not——
Secretary BUTZ. But Cargill has no export contracts with unspecified price, unspecified destinations. Their contracts are all firm contracts. The same is true——

Senator HUMPHREY. Can you be sure that the others would not be firm?

Secretary BUTZ. The same is true of Continental. They have no unspecified market, no unspecified price contracts. Four of the other big exporters do, and they add to approximately 150 million bushels.

Only last week, Senator, I was on the telephone to the heads of these four talking about this, and it was pointed out that week by week, as we get these weekly figures, the figures on the insured contracts decrease about as much as actual shipments increase. That is as it should be. But the decrease in unshipped contracts is almost entirely in those contracts with a firm destination and a firm price. The unfirm destination and the unfirm price or no price has been holding about constant, which means that they are not filling, that means they do not intend to fill it. I have been in communication with the heads of those firms, and I said that I can give you every reasonable assurance that we are not going to impose export controls, and that if we do we learned our lesson in the soybeans last year, not to cut across contracts. This was a very disastrous experience we had last year. In view of that, I am confident that when next week's figures come in, and subsequent weeks we are going to see a progressive and substantial reduction in the reported amount of export contracts without firm destination and without firm price.

Senator HUMPHREY. Now, the people that I have talked to in the private trade, Mr. Secretary, do not agree with that. I have to be honest with you about it. I mean, this is a point of difference.

SecretaryBUTZ. I agree with you. On Cargill——

Senator HUMPHREY. And Continental, the two giants.

Secretary BUTZ. Those two. They have no unfaced contracts, theirs are firm, that is correct.

Senator HUMPHREY. Do you not think in your estimates we ought to presume, since we have gone through quite a turbulent period here in the market situation, presume for our own safety, or our own well-being that these contracts might very well be filled?

Secretary BUTZ. No, sir.

Senator HUMPHREY. Is not that a reasonable presumption in light of the world demand for product?

Secretary BUTZ. No, sir. That in my mind is not a reasonable presumption, because I think they were put on in the first place abnormally large. They are primarily contracts between a parent and a foreign subsidiary. They are the kind that can be washed out with no damage to the market, the kind that can be bought back or can be sold to somebody else. And I think when we make our estimates in the department we have to rely on our very best judgment on this matter, and our best judgment is that in the main they will not be fulfilled.

Senator HUMPHREY. It is my feeling, and I just want to put it in the record, that there is yet unknown, unanticipated business in the international market, that we are not at all sure what is going to happen ahead. We have uncertain crop conditions in certain parts of the world that may require a substantial high buy that is at the present time not contracted for. And my own argument with the department is not over your sincerity, or your purpose, or your integrity on it. It is that you do not have what I call optional plans, or alternative estimates based upon not the normal patterns, but on some of the abnormalities.

Now, the GAO, the General Accounting Office, took a look at some of the figures that you have, and they came up with a carryover of around 32 million bushels. The General Accounting Office informs the committee that the wheat carryover stock could be as low as 32 million by June 30, 1974. Now, I do not say the GAO has the equipment to make the estimates that the department has, but this is an arm of Congress, and we have to look to them. Some of the estimates that we have made staff-wise, and on the Committee on Agriculture and Forestry run around 38 to 40 million carryover. Now, whether it is 178 million or 32 million or 50 million, the fact of the matter is when the bakers are in here, and I am not picking up the case for a dollar a loaf of bread, but the question is how much is left over for the bakers, and with this kind of market pressure how high is the price going to really go?

Secretary BUTZ. Well, I think, Mr. Vice Chairman, that what you say is right about estimates, that they are estimates and the actions, of course, can vary in either direction. We can move in the direction of a tighter wheat situation, or we can move in the direction of an easier wheat situation. We might err on the other side, too, you understand.

Before you came in we mentioned we are taking two or three actions in the department to ease this wheat situation. We have lifted the import quotas on wheat, and some Canadian wheat is, in fact, moving into the United States from lower Ontario. Some soft wheat is, in fact, moving in. This constitutes, I think, a very real ceiling over how high wheat prices could go. This will be especially true when the Great Lakes thaw out, and you can move wheat out of Port Arthur up there.

We have deferred a million tons of the Russian purchases of wheat of old crop wheat which has been deferred into new crop shipments. And I think I want right here to pay my express gratitude to Ambassador Dobrynin for being so very cooperative in this respect. And I will simply say that on two occasions I visited with him about this and the people at the staff level. He said, "We have enough wheat in place to get us by the time when your new wheat comes in, if you can ship us wheat in July and August to get us by the time when our new wheat comes in." We have, in fact, deferred 1 million tons of shipment that had been contracted for, old crop wheat, into July and August shipments of new crop wheat. That is being done.

I think, Senator, that we have moved on the front of contingencies here.

Senator HUMPHREY. Well, I only think it is fair to say that our reserves are very low and I do not think anybody is going to argue about that. They are the lowest they have been for years. Some lady says 27 years, and I think they are about the lowest they have been since the days of about 1948.

Senator Huddleston sent you a letter on February 25 and I want to associate myself with it, and I am going to incorporate a copy of the letter in the record.

Senator PROXMIRE. Without objection, so ordered.

[The letter referred to follows:]

February 25, 1974.

Hon. EARL L. BUTZ,
Secretary, Department of Agriculture,
Washington, D.C.

DEAR MR. SECRETARY: As you know, the Senate Agriculture Committee's Subcommittee on Production, Marketing and Stabilization of Prices, of which I am Chairman, conducted a February 4 hearing on the wheat and feed grain supply for the remainder of the current marketing year.

At the time of the hearings, most witnesses agreed that the situation was going to be tight, especially for wheat, over the next few months. In the days since those hearings, we have continued to monitor the situation closely. If anything, events that have transpired suggest that we should be more pessimistic than we were on February 4. It is, of course, true that U.S. wheat exports are down somewhat and that there are indications that Canada will play a greater role in the world market. At the same time, however, demand on the world market remains high; weather conditions are a serious question in the Midwest where winter wheat is first harvested; there are reports of higher and higher bread costs throughout this nation; future prices remain high.

For the sake of all consumers, I hope the Department's contention that the U.S. will get through the upcoming months without major dislocations are correct. I continue, however, to feel that they are too optimistic.

By your own figures, the U.S. wheat crop is already oversold. The wheat which does remain is stored in scattered locations which makes transportation difficult. The idea that new-crop wheat can be harvested and fed into the processing-distribution system depends upon a number of factors, all of which are not guaranteed—weather, fuel and transportation.

In view of this, it seems essential to me that the Department take further action. Otherwise, we could see shortages of grain, higher bread prices, and a repeat of the soybean embargo situation—which, whether intentionally or unintentionally, was one of the worst-administered actions ever.

New discussion should be undertaken with exporting firms immediately to obtain additional information on exports scheduled for delivery to unidentified destinations in order to determine whether or not these exports really will be shipped.

The Department of Agriculture, with respect to any new export sales beyond those presently contracted for, should request exporters to review such potential sales with the Department—especially when large amounts are involved. Such voluntary action by exporters might help avoid a later need for export controls.

If these actions are not taken, I believe there is a strong possibility that we will, indeed, have unreasonably high grain prices and scarcities in the upcoming months. That would inevitably lead to pressure for an embargo which, if imposed too late, would likely involve cutting across contracts and no preconsultation with our regular trading partners. In other words, a repetition of the soybean episode!

Food supplies are basis—and not only must be assist those who produce, but we must also assist those who consume. We are currently playing a type of Russian Roulette with wheat supplies. If we are lucky and there are no surprises, the potential dangers will prove to be only empty chambers, but if one goes off—in the form of bad weather or a disaster in some part of the world—the grain game will be over and the reality apparent.

Therefore, I think that it is imperative that the Department reexamine the situation and I urge that you do so immediately.

Sincerely,

WALTER D. HUDDLESTON,
U.S. Senator.

Senator HUMPHREY. And Senator Huddleston and I work very closely together in the Committee on Agriculture and Forestry on the subject of supply and demand. And I am Chairman of the Foreign Agricultural Policy Subcommittee. He said here, for example:

New discussion should be undertaken with exporting firms immediately to obtain additional information on exports scheduled for delivery to unidentified destinations in order to determine whether or not these exports are really being shipped.

And we have commented on that. He continues:

The Department of Agriculture, with respect to any new export sales beyond those presently contracted for, should request exporters to review such potential sales with the Department—especially when large amounts are involved. Such voluntary action by exporters might help avoid a later need for export controls.

Then he goes on to say:

If these actions are not taken, I believe there is a strong possibility that we will, indeed, have unreasonably high grain prices and scarcities in the upcoming months. That would inevitably lead to pressure for an embargo which, if imposed too late, would likely involve cutting across contracts and no preconsultation with our regular trading partners. In other words, a repetition of the soybean episode!

Mr. Secretary, I must say that I do not believe that you will let that happen.

Secretary BUTZ. I shall resist it to the limit of my strength.

Senator HUMPHREY. And I want to make sure that we set up the machinery or means to prevent that from happening. And then as Senator Huddleston has also pointed out, he, like myself, is deeply concerned over your estimates because the demand in the world market remains, weather conditions are a serious question in the Midwest where winter wheat is first harvested. There are reports of higher and higher bread costs throughout the Nation and futures prices remain high.

Just one final thing and my time is up. You said here, for example, you have taken action to remove, what do you call them, quotas?

Secretary BUTZ. Import quotas.

Senator HUMPHREY. Have you taken action to remove the tariff on flour?

Secretary BUTZ. To answer that, I am informed that that would require congressional action, sir.

Senator HUMPHREY. I do not think it does. I want to help you on that. I am of the opinion that the Department thought so. We have had a little study made of it, and I believe there are three laws, the Trade Expansion Act of 1962, title 19, United States Code, section 1313, the Tariff Act, and section 5 of the Trading with the Enemy Act that would permit the President, under three separate laws, to unilaterally reduce or totally eliminate these tariffs. And I believe that that might be something that the Department ought to look into at once.

I also want to call your attention that your reliance upon Canadian cooperation should be reevaluated, not because they do not want to cooperate, but yesterday the Prime Minister in Ottawa made it very clear that the Canadian Government is going to take firm action to lower prices on food and energy for Canadians. And this may mean that some of the exports that the Canadians have intended to make, or wheat supplies that they had intended to reserve for export may very well be held back. The Canadian Government is acting firmly, guarantees lower prices for the consumers, he said, in these two areas.

At this point I would like to place in the record the text of the news release announcing the intentions of the Canadian Government.

Senator PROXMIRE. Without objection, so ordered.

[The news release follows:]

CANADIAN GOVERNMENT INDICATES USE OF TWO-PRICE SYSTEM FOR SOME FOOD PRODUCTS

Ottawa, February 27, UPI.—The Government said today its main priorities in the new session of Parliament would be lower prices and secure supplies of food and energy for Canadians.

Stabilizing food prices and supplies was given the most attention in the speech from the throne opening the second session of the 29th Parliament. The speech, outlining Government legislative plans, was prepared by the Government and read by Governor General Jules Leger.

The speech again rejected the price and wage controls proposed by Conservative Leader Robert Stanfield.

Measures to increase food supplies and lower food prices took up nearly one third of the 11-page speech. The speech said a food stabilization program would establish both minimum and maximum price levels for basic farm products. It said this would provide a minimum guarantee of farm income and a maximum ceiling for consumer prices.

To buffer Canadian prices against skyrocketing international food prices, the speech indicated the Government would use a two-price system for some food products—a controlled price for the domestic market and the international price for export sales.

The references to energy policy generally repeated the Government's previous policy announcements—including establishment of a national petroleum corporation and a single price for oil products across Canada.

The speech also promised measures to end discrimination in railway freight rates.

Other proposals included increased aid to small businessmen and exporters. But the greatest emphasis was given to providing "an adequate and dependable supply of quality food" and "reasonable food prices." It said prices must be "reasonable" for both the farmer and the consumer.

Guarantees against unduly low prices to producers must be coupled with guarantees against unduly high prices to consumers," it said.

A specific measure to permit a two-price system for domestic and export markets of food products would involve "amendments to the export and import permits act to provide the Government with better means to stabilize the Canadian market."

To increase the productivity of farmers and fishermen, the Government promised guaranteed loans for new equipment purchases, better manpower policies, improved storage facilities, an income stabilization plan, a new feed grains policy, and better transportation.

Senator HUMPHREY. Now, my time is up on this, and I will yield to the Vice Chairman.

Senator PROXMIRE. Senator Javits had to answer the phone. He is next in line, and as soon as he comes back I will yield to him.

Mr. Butz, there is little dispute that the Department of Agriculture did a poor job of forecasting food price increases last year. The record was so bad that the administration asked Professor Karl Fox of Iowa State to do an independent review of the deficiencies in food price forecasting. Mr. Fox has completed that review and I have examined a copy of his findings. He found that not enough attention was given to economic intelligence by the Department of Agriculture and Secretary of Agriculture. He says:

It seems to me that the overriding need is this: The economic intelligence function must be given increased salience in the organizational structure of the U.S. Department of Agriculture and in the attention and concern of the Secretary of Agriculture.

Now, what have you done, Mr. Secretary, to improve the economic intelligence reporting system in the Department, and are you giving close attention to it?

Secretary BUTZ. I suppose I should say that the first thing I have done is have a session with Karl Fox. It is a good report. On the whole I think Mr. Fox was rather complimentary of our total program. He found that we fell down in some places. We are beefing up our total economic intelligence work in the Department. We have an increase in the budget next year for this. We have provided for closer coordination between our Economic——

Senator PROXMIRE. Well, would you agree that it was a disastrously wrong forecasting last year?

Secretary BUTZ. Yes, last year was bad, a very bad year for forecasting.

Senator PROXMIRE. Particularly for forecasting in the food area.

Secretary BUTZ. Oh, yes. Many other areas, too. It was just a bad year for forecasting.

Senator PROXMIRE. Most of the year it was food inflation, and it was inflation that was not anticipated, and it embarrassed all of us who had anything to do with economic policy in Government. Go ahead, sir.

Secretary BUTZ. That is correct. And along that line, a little while back our Department forecasted, as I indicated in the past, that the average cost of food at retail in this country for 1974 might average 12 percent above the average of 1973. We anticipate that the bulk of that increase will be increased marketing costs and services, and perhaps to a lesser degree will reflect increased farm prices, whereas a year ago it did, in fact, reflect the increased farm prices and margins were squeezed.

I might point out, however, when those figures came out of the 12 percent increase from 1973 to 1974, the popular interpretation in the headlines was 12 percent increase from here, holy smokes, where are we going to. Much of that increase is behind us right now, in the level of the retail food prices right now.

Senator PROXMIRE. How much of that increase is behind us right now?

Secretary BUTZ. About 8 percent is behind us.

Senator PROXMIRE. So we have that 8 percent increase in January and February.

Secretary BUTZ. Well, in December, too. But in January and February we have had these rapid increases.

Senator PROXMIRE. We are talking about this year, the 12 percent increase this year, not December. This year, January and February.

Secretary BUTZ. When we said 12 percent, it was the average of 1973 to the average of 1974, and about 8 percent of that is behind us already.

Senator PROXMIRE. Well, it would have been simpler—December would have pulled up the average of 1973?

Secretary BUTZ. Yes, somewhat.

Senator PROXMIRE. Well, I want to come to my point on this in a couple of minutes. But first I want to ask you this: The President's economic report suggests that the world demand for food stuffs has shifted to a permanently higher level. This is something that many people did overlook, and it is something that is going on and has been not just the past few years but for the past 10 or 15 years as affluence in Europe and Japan have increased and their diets have changed. This could mean the United States will face continued pressure on food prices. What long-range studies have been made of world supply and demand for food, and what do they show?

Secretary BUTZ. Well, our Economic Research Service is monitoring that all of the time, and do you want to summarize that, Mr. Paarlberg?

Mr. PAARLBERG. Yes. We have projected the probable production of food in the various countries of the world, including in our own country, to the year 1985, taking into account what scientific knowledge is available, and what inputs and resources are available. Assuming the kind of price inducements that seem likely, our projection indicates that in the less developed countries of the world the per capita supplies are likely to increase at a modest rate of about one-half of 1 percent annually.

Senator PROXMIRE. Have you tried to relate that to the population of the countries? That has been our serious problem.

Mr. PAARLBERG. Yes. This is per capita. What this says is——

Senator PROXMIRE. So on a per capita basis one-half of 1 percent?

Mr. PAARLBERG. One-half of 1 percent annually. What that says is that the food production, as near as we can judge, will keep a half a step ahead of the continued increase in population. Now, that is not enough to provide adequate nutrition for the many millions of people whose diets are very poor, and there is inequitable distribution of the food supplies that do exist. But nevertheless we anticipate some slight incremental improvement in food supplies around the world on a per capita basis.

Senator PROXMIRE. That assumes, I take it, that we will have ample fertilizer?

Mr. PAARLBERG. It does. Adequate supplies. Of course, this is to 1985, and by that time the additional plants will have been built and put in place.

Senator PROXMIRE. And a continued and vigorous technical assistance program?

Mr. PAARLBERG. It does. It assumes those things which may or may not come about.

Senator PROXMIRE. Well, now, that is only a part of the question, and not perhaps even most of the answer. How about the demand in the affluent countries and throughout the world?

Mr. PAARLBERG. That will increase at a more rapid rate. We project increases in food supplies per capita in developed countries at a rate of about 1.5 percent a year, which is three times as great a rate of increase as in the less developed countries, which would mean a widening of the gap between the wealthy and the poor countries.

Senator PROXMIRE. Furthermore, the trouble later has been the dramatic change in the nature of food consumption being shifted from carbohydrates to protein consumption and an enormous acceleration of the consumption of wheat because, of course, you use much more wheat when you consume it through protein, through animals, through steaks and hamburgers instead of eating bread. Now, is that related, Mr. Paarlberg, to the overall situation? What does that show?

Mr. PAARLBERG. That is the big element in the increased per capita consumption in the developed countries, the improvement of diets in those countries.

Senator PROXMIRE. All right. Now, as I understand it, you have said, and maybe I misunderstood you, a 1.5 percent increase in the affluent countries in production?

Mr. PAARLBERG. In per capita availability of food supplies.

Senator PROXMIRE. And how about as big an increase in consumption?

Mr. PAARLBERG. That would be the same thing. Over a period of time production equals consumption. What you produce you eat, and you do not eat anything that is not produced.

Senator PROXMIRE. Well, I am not sure I am getting anywhere then. What I am really trying to determine is the impact this all is likely to have on demand for food from this country and perhaps any projections you may have on prices.

Mr. PAARLBERG. Well, we have made projections on demand for U.S. food, and we project a gradual increase over time in exports from this country, particularly feed grains and soybeans, and to some extent wheat, and perhaps some diminution from the very high exports of the last year, but a resumption and a continued flow in the overall export pattern over time.

Senator PROXMIRE. I am talking about price. Can you make any finding at all on what is going to happen to price in that period?

Mr. PAARLBERG. We have not made estimates of absolute price. We have assumed that the relative price for farm products would be such as to give incentives and encouragement to production.

Secretary BUTZ. May I comment on that briefly, Mr. Vice Chairman?

Senator PROXMIRE. Before you do, let me just say that the problem is you get a small increase, a relatively modest increase in production and supply, and an explosion in demand, and it seems to me as we accommodate to the situation you could have a very serious food inflation continuing for 10, 12 or 15 years at least. That is what haunts many of us.

Secretary BUTZ. May I comment briefly on that?

Senator PROXMIRE. Yes.

Secretary BUTZ. I think you put your finger on something that is of major concern to a lot of people. It is the modern revival of the old Malthusian theory that population out-races food supply, and many people have justly and honestly been concerned about that now. But let us look at our track record in American agriculture here over the last 20 or 25 years. We have increased our total production in this country of feed grains by something like, and I will check this for the record, but something like 40 percent. We have increased our soybean production sevenfold. We have increased our wheat production by 25 percent on fewer acres than we had 25 years ago. To accomplish this, we have accomplished this by the input of science primarily, and technology and capital. Now then, there is no reason to believe that we have suddenly run out of science.

Senator PROXMIRE. I am concerned that there may be a situation that I am going to ask you about a little later on, but before I yield to Senator Javits, let me say the problem is that the increase that you cite, for instance, in soybeans, most of it lately has been because of increased acreage planted in soybeans. There has not been that much increased production per acre of soybeans, for example. Furthermore, the productivity, which has been great, I think the greatest in agriculture by far than any other sector of our economy, it has been the real distinction, the real source of power that we have compared to the Soviet Union, in my view. But that has slowed down sharply in the last few years, and in the last couple of years it has not grown at all. In fact, in the last year I think it has actually declined.

Secretary BUTZ. This brings me to the very point I want to make. You mentioned soybeans, and relative to soybean yield we need a breakthrough now. I am not scientific enough to be able to draw a blueprint for that breakthrough, but there are enough competent young brains in this country doing research in genetics, and plant composition, in the transformation of radiant energy in the solar system into a form we can use in grains that they can do it. We have recommended a substantial increase in our research budget in production for this very thing in the next year, and it is now before this Congress. We have had two or three spectacular increases in corn yield. We had one with hybrid corn, and it went up, and then plateaued for a while. Then we learned how to mechanize the nitrogen cycle, and then we got fairly cheap nitrogen, and you could put it on, and it went up again at that time, and then we sort of had the plateau again here. Soybeans we have plateaued here, and there is need for a major breakthrough. And I have enough confidence myself in the scientific genius of the young Americans, that given the resources they will accomplish this. And I refuse to believe that we have suddenly plateaued permanently in our scientific efficiencies in agriculture.

Senator PROXMIRE. I see. The problem that concerns me is that there is some significant increase because of technology as such but a great deal of the increase has been because we motorized and electrified our farms, and that took place, a great deal of it, in the thirties and forties and the early fifties. And we now no longer have that kind of era productivity increase to look forward to, and that has been the dramatic change.

Secretary BUTZ. Quite right. In the long run, there is no doubt that we have to bring population under control, but in the short run, for the rest of this century I am confident that given the resources in research and development and technology we can meet this. Agriculture is essentially an energy converter. We are all energy conscious these days. Let me give a little illustration of what we do. We all use the radiant energy from the solar system as a source of energy. We cannot use it directly. In agriculture we use the plants as a vehicle to convert that into a form we can use. How efficient are we doing this?

Three or four years ago out at Purdue University, on one July afternoon, I looked out the window at the nice, bright sunshine, and I got to wondering how much energy hits an acre of land on a day like this. So I called the dean of engineering, who was a professor in thermodynamics, and I said, "Give me an idea in terms that I can understand of how much energy is on an acre in a day like this." And he asked a few simple questions like how big was an acre and things like that. And he said, "Energy equal to 5 tons of coal." I said, "Okay, this is a July day, and let's average it into February." And he said, "Well, okay, on an annual average about 4 tons of coal per day, energy from the radiant heat from the solar system." And I said, "Okay, let us assume we have 125 bushels of corn, year in and year out, how much energy is that equivalent to." And we figured everything, the grain, the stalk, the whole business, and he said, "Well, about 4 tons of coal," and I had a concept that I could grasp, that we have learned now through pretty good agricultural techniques how to capture in 1 whole year as much energy as God pours on an acre every day, and we think we are pretty good. I told my friend, the dean of engineering, I said, "That is not so hot, is it?" He said, "I would not be very proud of that in engineering with a low efficiency rate like that." Here we are, one 160th part of that energy, three-tenths of 1 percent. If we learn how to double corn production and we will be getting 180th of a part, and if we learn to quadruple we will be getting one 90th part, 1 percent, and that is the kind of stuff I like to put in front of young scientists to get to work. It is out there. Frankly, I am not uncomfortable about the prospects of the world being able to feed the world the rest of this century.

Now, beyond that we simply have to bring greater population growth under control. At some point you must do that. But I think our capacity to meet this problem the rest of this century is solid if we support the efforts to increase this energy conversion I am talking about.

Senator PROXMIRE. My time is up.

Senator Javits.

Senator JAVITS. Thank you. Mr. Secretary, I am very interested in that part of your presentation as it relates to our work on the economic report, which deals with the relatively new position of agricultural products in foreign trade. I repeat what you said in your statement: "Since fertilizer was exempted from price controls on October 25, price increases for nitrogen products have ranged from 55 to 70 percent, prices for phosphate products are up about 40 percent; potash prices have increased 26 percent. However, the spread between export and domestic prices has not narrowed because export prices also have soared."

Now, you first start by saying, or least intimating, that the exemption from price controls was good. Then you follow up by saying that it means nothing because it immediately cancelled itself out in the fact that export prices soared, too. So the total result was everything soared.

Now the question is, Do we need an export control act which will at least provide us for the opportunity to regulate on a sensible and methodical basis what we do and do not wish to export? I have introduced such a bill. It is S. 2411, and it may not be the answer, but at least it tries to determine in advance, by estimate, what ought to be exported. Then if no more can be exported, you have some ability to affect the relationship between foreign and domestic prices. But at this rate you have none. What is your comment?

Secretary BUTZ. Well, first, Senator, when price controls were removed on domestic fertilizer prices, we obtained a quid pro quo promise from the manufacturers of fertilizers that they would, in fact, divert shipments from the foreign markets to the domestic markets which they have, in fact, done in the first quarter of 1974. Now, at the time we lifted those ceilings last October sometime, their contracts were in place for exports the last quarter of 1973 and you could not do much about that. But I want to say to the credit of the domestic fertilizer manufacturers, they did, in fact, follow through with that, in the face of rising prices for fertilizer abroad. As nearly as we can tell, and the Cost of Living Council monitors this rather closely, as nearly as we can tell, much of this increase in fertilizer prices is at the local distributor level. He has already contracted for his fertilizer from the manufacturers, and the major suppliers, but at the local level he has increased his margins a great deal, and it varies a great deal around the country. We hear a lot about the fertilizer shortage, and we do not have enough fertilizer to meet our demands this spring partly because demands are up because of the increased acreage, and secondly because of $3 for corn and $5 for wheat, and they simply just put on more fertilizer, and there we have inflated demand and we will, in fact, ship more tons of fertilizer this year than last year. And I say ship for delivery to our farmers. Last fall we had an exceptionally good fall for fall farrowing, and our fall farrowing is well ahead of normal for last year through the whole corn belt and the Great Plains area. Use of fertilizer is well ahead of normal except nitrogen, because it is volatile, and you do not put it down in the fall. We are going to have more fertilizer than the year before, but not all everybody wants.

Senator HUMPHREY. More anhydride?

Secretary BUTZ. More than the year before, total year shipments, but not all everybody wants. That $3 for corn, you pour it on.

Senator JAVITS. Mr. Secretary, you did not answer, however, all of my question. You dealt with some control over the amount of exports so that we do not get into that situation again.

Secretary BUTZ. Yes. I think there are two sides to that question, Senator. As you know, we had experience with export controls on soybeans last year, which proved to be a disastrous experience. Now, it is true we did something we should never do again, we cut across export contracts. This was unfortunate, and yet I think the experience we had with soybeans last year ruptured our credibility as dependable suppliers in the world market and I do not want to have that kind of an attitude grow regarding American agriculture. I presume if we came to the point where we limited exports of, let us say, fertilizer purchases abroad, we would say, OK, it is a short step to limit exports of wheat, or soybeans, or corn, or cotton, and again we face the problem of credibility as a dependable supplier.

Senator JAVITS. Mr. Secretary, I advocate no such plan, and I think you made a terrible mistake, or at least our government did, in post-facto action on exports. What I say is that you have to lay out in advance what you are going to export, and what you are going to reserve for the domestic emergency, and what you are going to reserve for foreign famine. Then the whole world knows that you have contracts within those limitations, and if you have more than you had thought you would have, then you auction off, and the Government gets revenue from the licenses which result in more exports. But at least everybody knows exactly what you are going to do, and you do not allow the foreign prices bid up domestic prices on the theory of draining away supplies which we have a right to count on at home. Now, is that not essential as we become so much more significant both in terms of our exports and imports of agricultural products to ourselves and to the world?

Secretary BUTZ. Well, there is much support for your point of view.

Senator JAVITS. Well, I ask unanimous consent to include in the record S. 2411, which I have introduced with Senator Stevenson, and to get your comments, on it, Mr. Secretary. Is that OK?

Secretary BUTZ. Yes; sir.

Senator PROXMIRE. Without objection, so ordered.

[The bill (S. 2411) referred to and comments thereon follow:]

[S. 2411, 93d Cong., first sess.]

A BILL To amend the Export Administration Act of 1969 to provide for the regulation of the export of agricultural commodities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress, assembled, That this Act may be cited as the "Export Priorities Act".

SEC. 2. The Export Administration Act of 1969 is amended—

(1) by inserting immediately before the caption of section 1 the following:

"TITLE I—GENERAL PROVISIONS";

(2) by redesignating sections 1 through 14, and all cross references thereto, as sections 101 through 114, respectively;

(3) by striking out "this Act" wherever it appears in sections 101 through 114, as redesignated, and inserting in lieu thereof "this title":

(4) by striking out "This Act" in section 113(a), as redesignated, and inserting in lieu thereof "This title"; and

(5) by adding at the end thereof the following new title:

"TITLE II—AGRICULTURAL EXPORTS CONTROLS DEFINITIONS

SEC. 201. As used in this title—

"(1) the term 'Secretary' means the Secretary of Commerce unless otherwise indicated; and

"(2) the terms 'agricultural commodity' and 'commodity" mean any raw agricultural commodity produced in the United States, including flour, meal, and oil derived from any such commodity.

"DETERMINATION OF QUANTITY AVAILABLE FOR EXPORT

"SEC. 202. (a) Within ninety days after the beginning of the crop year for any agricultural commodity, the Secretary of Agriculture shall determine the quantity of the crop of such commodity, if any, that will be available for export and inform the Secretary of Commerce thereof, who shall thereupon publicly announce such determination.

"(b) Such determination shall be made by estimating the total quantity of the commodity that will be produced in the crop year and subtracting from such quantity (1) the quantity of the commodity the Secretary of Agriculture estimates will be needed for domestic consumption, and (2) the quantity of the commodity the Secretary of Agriculture estimates will be needed for a reasonable carryover, including a reasonable quantity for disaster relief assistance and other emergency conditions. The quantity of the commodity remaining, if any, shall be the quantity available for export.

"EXPORT LICENSING AND ALLOCATION OF EXPORT AUTHORITY

"SEC. 203. (a) No agricultural commodity may be exported to any foreign country in any year unless the person exporting such commodity has been issued an export license by the Secretary for the quantity of such commodity to be exported to such country or unless such commodity has been exempted under section 207(a)(3) of this Act.

"(b) The quantity of any commodity available for export in any crop year shall be allocated among foreign countries by the Secretary on the basis of the quantity of such commodity exported to such countries during a representative base period and on the basis of such other factors as the Secretary determines to be fair and equitable and sufficient to protect the interests of traditional customers of the United States. In carrying out his functions under this subsection, the Secretary shall consult with the Secretary of Agriculture, the Secretary of State, with other departments and agencies of the United States Government, and with other interested persons. The Secretary may from time to time make such adjustments in allocations under this subsection, including the reallocation of any unused foreign country allocation, as may be necessary to meet changes in international supply or demand or to avoid hardship.

"(c) The Secretary may, in his discretion, reserve not more than 10 per centum of the quantity of a commodity available for export in order to meet unexpected increases in foreign demand resulting from natural disaster, crop failure, changes in existing trading patterns in that commodity, or other similar causes.

"ISSUANCE OF EXPORT LICENSES

"SEC. 204. (a) Each year, at such time as he determines appropriate, the Secretary shall announce, in the case of each foreign country, the quota determined for such country for each commodity. At the same time the Secretary shall announce the time, manner, and place for the submission of bids for the purchase of licenses to export specified quantities of such commodity to specified countries.

"(b) Licenses for the export of any commodity in any year shall be sold to the highest responsible bidders unless the Secretary determines that the bids are too low or that there has been collusion among the bidders.

"ADMINISTRATIVE REVISION OF QUANTITY AVAILABLE FOR EXPORT

"SEC. 205. The Secretary may revise upward or downward the quantity of any commodity previously announced as available for export in any year if he determines on the basis of new information that the quantity originally announced was erroneous or that the quantity originally announced should be revised for other reasons.

"EXPORTS TO DEVELOPING COUNTRIES

"SEC. 206. The Secretary may issue a license to any exporter without the payment of a license fee if, after consultation with the Secretary of Agriculture, Secretary of State, and the Secretary of the Treasury, he determines that (1) the license is for the export of a commodity to a developing foreign country with a serious balance-of-payments deficit, and (2) such action would be in the best interests of the foreign relations of the United States and would not adversely affect the regulatory program provided for in this title.

"ADMINISTRATION

"SEC. 207. (a) The Secretary is authorized to issue such rules or regulations as may be necessary to carry out the provisions of this title, including rules and regulations—

"(1) providing for the reduction, suspension, or termination of the allocation of any agricultural commodity made under this title to any foreign country if the Secretary finds that such country is reexporting all or any portion of such allocation under circumstances that tend to disrupt the regulatory program established under this title;

"(2) limiting or prohibiting the sale or transfer after issuance of export licenses issued under this title if the Secretary finds such limitation or prohibition necessary to the orderly administration of the regulatory program established under this title; and

"(3) exempting from application of this Act any agricultural commodity the domestic production of which the Secretary determines will equal or exceed domestic and foreign demand.

"(b) The authority conferred on the Secretary by this title shall not be executed without the approval of the Secretary of Agriculture.

"USE OF FUNDS RECEIVED

"SEC. 208. Fees collected by the Secretary on export licenses issued under this title shall be deposited in a special account in the Treasury and shall be available without fiscal year limitation to help carry out the National School Lunch Act, the Child Nutrition Act of 1966, the Food Stamp Act of 1964, and the commodity distribution program provided for under section 416 of the Agricultural Act of 1949, except that not less than 10 per centum of such fees shall be available only for carrying out agricultural research and conservation program to increase agricultural productivity.

"APPLICABILITY

SEC. 209. This title shall be applicable to agricultural commodities harvested in calendar year 1974 and subsequent years."

DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY,
Washington, D.C., June 3, 1974.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
House of Representatives.

DEAR MR. CHAIRMAN: This is in response to a request by Senator Jacob K. Javits, at a meeting of the Joint Committee on February 28 to hear Department testimony on the 1974 Economic Report of the President, asking for our views and recommendations on S. 2411, a bill "To amend the Export Administration Act of 1969 to provide for the regulation of the export of agricultural commodities".

The Department does not favor enactment of this legislation.

The bill has several sections to which we object, and our positions are set forth in the attachment entitled "Detailed Statements In Support of USDA Position Against Enactment of S. 2411". In general, we feel that the rigid export licensing and country quota mechanisms proposed by the bill, as well as proposed authority for the Secretary of Commerce to place in reserve 10 percent of annual commodity production available for export, would seriously interfere with the operations of the market and would be damaging to long-term U.S. export potential. Many of the points covered in this bill are dealt with in a more flexible manner in the Administration's recommended extension/amendment of the Export Administration Act of 1969, as amended. These recommendations are embodied in H.R. 13840 and S. 3282, which we recommend for your favorable consideration.

The Office of Management and Budget advises that there is no objection to the presentation of this report from the standpoint of the Administration's program.

Sincerely,

J. PHIL CAMPBELL.
Acting Secretary.

Attachment.

Detailed Statements In Support of USDA Position Against Enactment of S. 2411

USDA has two major, general objections to this bill, in addition to several specific problems with the proposed regulatory systems. First, while we recognize that a primary goal of American agriculture is to provide adequate food supplies for all Americans at prices consistent with the economic needs of all sectors of our society, we also must appreciate the growing importance of U.S. agricultural exports to the U.S. balance of trade situation. Recent trade balance surpluses have been achieved largely as a resut of unparalleled increases in agricultural exports, and the 1974 outlook, with unrestricted production for several commodities, is even brighter. This increase has been possible because of unrestricted market orientation of U.S. agricultural exporters. Although many have found minor flaws in this system in the past year, we fear that the stringent export licensing and country quota systems advocated by this bill would have a depressing effect upon U.S. agricultural production, would hinder U.S. exporters in their foreign marketing efforts and in the final analysis would reduce U.S. agricultural exports at a time when they are of utmost importance to our economy. Second, the powers of the Secretary of Agriculture under Section 4(e) of the current Export Administration Act of 1969, as amended, would be circumscribed by the proposed new Title II, "Agricultural Export Controls". The new title would regulate farm exports through the Department of Commerce, with the advice and approval of this Department. We believe that the function of determining commodity availabilities and the need for agricultural export controls should rest primarily with the Department which has the expertise in agriculture and which is charged with the responsibility for maintaining U.S. agricultural programs.

Our specific objections are presented in order of the proposed sections. First, Section 202 calls for the creation of a system which is already in existence. This Department has long published timely estimates of U.S. production, domestic consumption needs, carryover stocks, and quantities available for export. In addition, under the Agriculture and Consumer Protection Act of 1973, we have established an export monitoring system for several major agricultural commodities, under which we maintain running totals for U.S. export commitments and publish them weekly. These programs enable the Secretary to discharge his duties under the current Export Administration Act.

Section 203 (a) and (b) and Sections 204–207 would seriously discourage U.S. export efforts by establishing export licensing and country quota systems. It should be recognized that, in international agricultural trade, exports to any country may vary sharply from year to year—due to local production levels, changing government trade policies, and normal trade competition. To preclude U.S. exporters from concluding large export sales, at favorable prices, to new customers would seriously curtail U.S. export possibilities and lead U.S. farmers to question the need for expanded production. The Secretary of Commerce's authority to expand quotas under Section 203(b) could be effected only as a result of "unused" foreign country allocations, and, unfortunately, after prospective new buyers had already turned to less-encumbered sellers. If foreign buyers are seriously concerned about their ability to procure U.S. commodities in the future, they are free to assure such supplies by concluding long-term supply contracts with private U.S. exporters. In fact, expanded use of long-term contracts is encouraged by this Department (for obvious reasons of market stability and improved production planning), and the absence of export quotas is influencing foreign buyers to make increasing use of forward contracting.

In addition, we are concerned with Section 203(c), under which the Secretary of Commerce is empowered to place 10 percent of commodities available for export in reserve for a variety of reasons. The issue of international stockpiling is an important problem which will be under discussion between exporting and importing countries in the framework of the World Food Conference scheduled for this November. It will also become an issue during the multilateral trade negotiations. It is our position that importing countries should begin to accept their fair share of the responsibility and cost for the maintenance of necessary food stocks. It would seriously hinder our efforts in this regard if foreign buyers felt that the Secretary of Commerce was going to reserve 10 percent of U.S. commodities available for export in order to establish reserves which might or might not be necessary. Such a system probably would also lead to decreasing U.S. export prices.

Finally, we are concerned that the system of export licensing and arbitrary country quotas would signify that the United States was abandoning its efforts to support a multilateral trading system and was withdrawing to a system of bilateral agreements—complete with trade deals in which countries with a comparative advantage in farm exports often are excluded. Foreign buyers would also question why the United States was not fulfilling its obligations under the General Agreement on Tariffs and Trade, where, in Article XI, we have agreed not to institute "prohibitions or restrictions other than duties, taxes or other charges . . . on the exportation or sale for export of any product destined for the territory of any other contracting party".

The current Export Administration Act is due to expire on June 30, 1974. Accordingly, the Administration has proposed legislation (introduced as S. 3282 and H.R. 13840) to extend the Act with amendments that would provide protection for the American consumer while assuring that the United States can be an unencumbered participant in the world trading community. We recommend the enactment of the Administration's proposal in lieu of any further consideration of S. 2411.

Senator JAVITS. Also, Mr. Secretary, I noticed in the Monthly Economic Letter, February 1974, one of the banks in my own home community, the First National City Bank, though they challenge some of your figures on wheat and on the supply of wheat, and they say:

Although the price of bread, as Secretary Butz claims, is not likely to go as high as $1 per loaf, wheat probably is in shorter supply than admitted by the USDA—even when its own statistics are used.

I ask unanimous consent that the article out of the Monthly Economic Letter be made a part of my remarks, Mr. Vice Chairman.

Senator PROXMIRE. Without objection, so ordered.

[The article referred to follows:]

[Article from the Monthly Economic Letter, First National City Bank, New York, N.Y., February 1974]

WHY CONSUMERS MAY GET HIT IN THE BREADBASKET

"Greater demand from abroad could pull the U.S. wheat surplus down almost to the zero level. The result, more likely than not, will be another shortage—and higher bread prices.

The irony of a Russian official offering to sell wheat to the United States has brought fears of an impending wheat shortage forward to share the front pages with the energy shortfall. In the process, America's image as the world's breadbasket has vanished along with its erstwhile surpluses of food grains. And the American consumer—with milling and baking interests talking $1-a-loaf in one ear and the government making soothing sounds in the other—is beginning to realize that the truth probably lies somewhere in between.

The evidence is starting to mount. At Kansas City, No. 1 hard winter ordinary protein wheat jumped to a record $5.93 per bushel on January 14 before receding to $5.55½ late last month. Even so, the latter price is still more than twice the year-ago level.

Similarly, the New York wholesale price of hard winter wheat flour recently spurted to a record $15 per hundredweight before softening to $14.35, a level 60% higher than the $8.95 of a year ago. Going further down the distribution line, in New York City retail prices of broad rose 4–5¢ for a one-pound loaf in recent weeks to 42–45¢. And bread prices there might rise by an additional 2–4¢ a pound if, as is anticipated, flour prices rise further.

The prospect of wheat and flour shortages is the direct result of U.S. wheat exports which have been running at unprecedented levels. And domestic millers and bakers are greatly concerned about the availability of sufficient wheat and flour supplies before the new-crop harvest of the No. 1 bread grain begins.

The U.S. Department of Agriculture has several times in recent months urged mill interests to fend for themselves in maintaining adequate wheat inventories. Under old farm programs, the government always had a supply of unredeemed, surplus wheat, which it could inject into the market to stabilize prices. But since recent shortages abroad caused world prices to soar, that carryover has gone, and U.S. farmers are virtually growing for the market.

An exporter of wheat can complete a sale and then buy in the futures market for later delivery. A miller must have bookings of flour from bakers in order to know what price he can afford. But with wheat prices record high, bakers have been extremely cautious in covering future flour requirements, in the hope that prices would become more favorable for them.

As one flour mill broker recently stated: "Without flour sales protection, no flour mill can afford the cost and risk of maintaining a large inventory." Meanwhile, the USDA contends that the bakers are holding up the inventory process and that it is the bakers who must commit themselves for flour for the balance of the crop year so millers will know how much wheat to book.

THE BATTLE JOINED

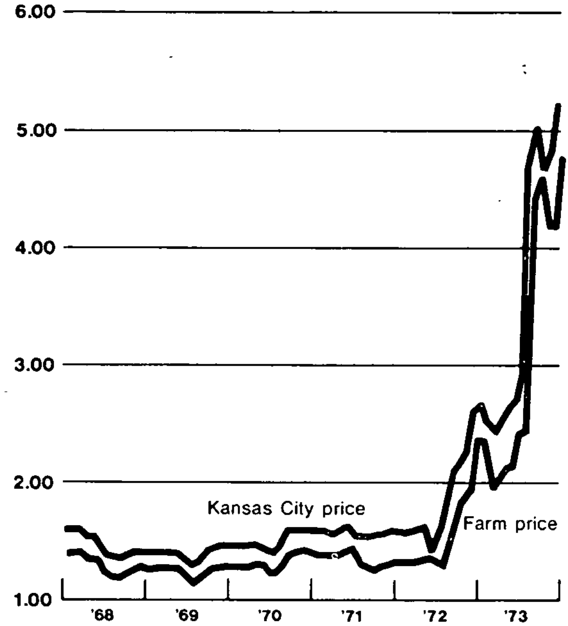
Although smoldering for several months, the difference of opinion between the millers and bakers and the USDA on the possibility of a wheat shortage hit the headlines on January 9. That day, Bill O. Mead, chairman of the American Bakers Association, declared that wheat supplies this spring could become scarce enough to boost the price of a family-size loaf of bread of 1½ pounds as high as $1. Alluding to the sharp rise in prices of wheat and flour, Mr. Mead declared:

"At any price, the quantities of wheat available for future delivery are very limited and a wheat shortage appears inevitable this spring unless export controls are instituted on wheat. The demand from abroad has increased to unanticipated levels. The absence of export controls, and the fear that such controls may soon be imposed have caused foreign customers to buy in unprecedented quantities and at whatever price is necessary to obtain such quantities.

Impending wheat shortage?

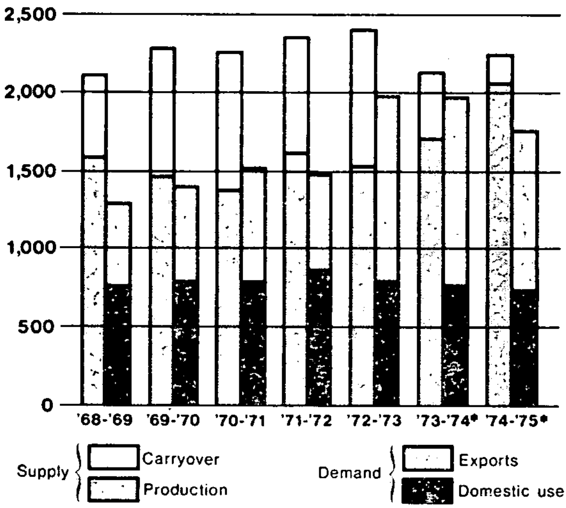
Prices hit a new high. . .

(dollars per bushel)



. . .as supplies dwindle

(millions of bushels)



*projected

Note: Crop year begins July 1. Kansas City price applies to No. 1 hard winter ordinary protein wheat.

"To state it simply, foreign buyers are hoarding U.S. wheat . . . There is no way of escaping some kind of export control on wheat and other cereal grains, if the American consumer is to receive reasonable equity. The longer the delay, the greater the disruption, and the more painful the solution."

Shortly after Mr. Mead's statement, USDA officials issued denials that export controls were needed. Perhaps the most scathing retort came from Secretary of Agriculture Earl L. Butz. Taking direct aim at Mr. Mead's $1-a-loaf prediction, Secretary Butz accused the bakers of "intentionally or unintentionally" launching "an irresponsible scare tactic . . . to catch the headlines and perpetrate a hoax on consumers . . . Why don't you tell consumers the truth about bread? Tell them that the average price of a 1½ lb. loaf of bread is about 47¢ and that the farm value of the wheat in that size loaf of bread is just over 7¢. Other costs and profits account for 40¢ of the 47¢ cost of a 1½ lb. loaf of bread."

In order for the wheat in a 1½ lb. loaf of bread to be responsible for $1 bread, Secretary Butz said, the farm value of that wheat would have to jump from the present 7¢ to 60¢—the 60¢ being the difference between $1 per loaf and the other 40¢ of nonwheat costs and profits in a loaf. For the farm value of the wheat in a 1½ lb. loaf to rise to that 60¢, wheat at the farm would have to rise to about $33 per bushel, six times the present price.

Mr. Butz went on to say that the USDA was working closely with the grain industry in monitoring the export situation to make sure that no serious problems develop. In this connection, he indicated that wheat exporting firms have been asked to defer overseas delivery of wheat until the new crop year. Also, he pointed out that by late May and June we will have wheat coming off Southern and Southeastern farms, and that this wheat will be cheaper than present wheat.

After assuring consumers that there will be adequate wheat, Secretary Butz recalled that costly farm programs of the past virtually guaranteed grain surpluses to the milling and baking industries at rock-bottom prices for nearly 40 years. "Now," the Secretary declared, "the milling and baking industries must assume the responsibility for assuring their own supplies of raw materials, as other industries do. Uncle Sam isn't paying for it any more."

VANISHING SURPLUSES

The U.S. carryover of old wheat last July 1 amounted to 438 million bushels, about half of stocks on hand a year earlier and the smallest in six years. Added to the record 1973 crop of slightly over 1.71 billion bushels, U.S. total wheat supplies in the current 1973-74 marketing year are indicated at around 2.15 billion bushels, down from about 2.41 billion last season.

Against these supplies, the USDA is currently estimating 1973-74 distribution of wheat at 1.97 billion bushels, including 772 million for domestic use and exports of 1.2 billion. On this basis, the July 1, 1974 carryover of old wheat is projected at 178 million bushels, the smallest since the 1947 carryover of 83.8 million bushels. However, many in the wheat trade—pointing to actual exports since July 1 and sales commitments for the balance of the season —believe that 1973-74 full-season exports could exceed 1.3 billion bushels. In that event, the July 1 carryover would be close to zero.

Actually, a zero wheat carryover—a complete exhaustion of old supplies—is virtually impossible, since a minimum of about 150 million bushels is needed in the pipelines. At that level, however, since mills are spread out over the country, spot shortages of supplies undoubtedly would occur in some areas.

Although the price of bread, as Secretary Butz claims, is not likely to go as high as $1 per loaf, wheat probably is in shorter supply than admitted by the USDA—even when its own statistics are used.

In fact, the USDA has been doing its utmost to get exporters to postpone shipments and to encourage importing nations to defer arrivals until new-crop supplies are available. Moreover, the Administration has been urging Canada and other foreign wheat producers to speed up their exports to big importers abroad. Obviously, these actions have been taken to ease the pressure on U.S. supplies from wheat-hungry countries—particularly since the current Argentine crop is on the short side and the harvest in Australia, while well above a year ago, is not up to previous expectations.

Another attempt to maximize available wheat supplies was the Administration's recent suspension—following a recommendation of the Tariff Commission

—of import quotas on wheat and milled wheat products through June 30. These import quotas—which amounted to 800,000 bushels of wheat and 4 million pounds of milled wheat products per year—were largely assigned to Canada, which has used only a very small fraction of its quota for wheat.

Despite this suspension, with Canadian wheat generally selling for higher prices than comparable U.S. grades, little wheat from that source is expected in the months ahead. Shipping facilities are scarce and transportation costs from Canada to most U.S. destinations are high. If the suspension of quotas is continued past June 30 and world wheat supplies become more plentiful, wheat imports from Canada would increase markedly. But even while the quotas are suspended, the USDA believes that large-scale imports might be discouraged by import duties of 21¢ per bushel of wheat and 51¢ per hundredweight of milled wheat products.

Assuming that domestic millers and bakers can somehow manage to get enough wheat to meet their needs in the months ahead, a wheat supply crisis would be averted. And once new crops are available, the supply situation should improve materially. The prospective record winter wheat crop of over 1.5 billion bushels plus a sizable spring wheat harvest indicated by planting intentions suggest that—if weather and other growing conditions are favorable—the 1974 U.S. total wheat crop will reach a new all-time high of 2 billion or more bushels.

A harvest of that size—unless crops in other countries dip below expectations and keep pressure on U.S. exports—probably would rebuild the U.S. carryover of old wheat by July 1, 1975 to around 450 million bushels. However, a 2 billion bushel crop, or a crop of any size, cannot be counted on until it is actually harvested. It may be recalled that the USDA had hoped for a 1973 corn crop of 6 billion bushels but the final count, while a record harvest, was 5.64 billion bushels. The same thing could occur in wheat. For today, as always, nothing is certain except death and taxes—and perhaps shortages of such key commodities as wheat and petroleum.

Senator JAVITS. Would you comment on that, Mr. Secretary?

Secretary BUTZ. Yes. We discussed this, Senator, some before you came in. That is why I have these stacks of bread right here. I pointed out, I just bought that bread this morning for 40 cents. These 4 slices here represent the farm value of the wheat, and these 16 slices right here represent something besides wheat. And when these people get talking about wheat being the fact of driving up the price of bread, they are simply—they are talking about the wrong pile of bread slices. We are going to come out of this wheat marketing year with a small carryout. Nobody argues that point. But it will be adequate to keep our people supplied with bread at prices that should not exceed present prices, unless the manufacturers decide to widen their margin.

Senator JAVITS. Well, the only thing that I was zeroing in on was the adequacy of the supply, where they have challenged your figures. The article shows why they challenge our figures, and I would like a reply to that, because that affects a price question on the ground of scarcity.

Secretary BUTZ. We will be glad to.

Senator JAVITS. Not on the ground of overhead, or what is getting what in the distribution process. Okay?

Secretary BUTZ. Yes, sir.

Senator JAVITS. Now, my last question, Mr. Secretary, is this: I notice in your statement you speak of the following fact: "World wheat stocks are large enough to allow a transition from old crop to new crop wheat without a disastrous runup in in domestic prices." I am worried about the words "disastrous runup." In short, what kind of runup in domestic prices do you expect? You may not think it is disastrous, but a lot of other people may think it is.

Secretary BUTZ. The word "disastrous" was put in there in light of the campaign in recent days of the American Bakers Association in which they have done a great disservice to the American farmer and the American food industry in reporting a scare about running out of bread. When the chairman of the American Bakers Association, 3 or 4 weeks ago, first came out with this statement of dollar bread, he caused flour shelves in the supermarkets to dry up. Some women who do not even know how to bake a biscuit bought 8- or 10-pound sacks of flour, and stashed it way back in the kitchen shelf saying that "I am too smart to get caught, and it will stay there until the weevils eat it up." I am trying to assure the American people that we do have enough wheat to get through, and we are not going to run out of bread. As I said before you came in, by the time June 30 comes we will have in addition to the old crop wheat that carries out, we will have 250 million or 300 million bushels of new crop wheat, part of it from Senator Bentsen's State, and from the Southwest, and that will be on the market, and the pressure to put it on the market early this year is tremendous, because it is a 60-cent premium right now in marketing before the bulk of new crop wheat hits the market.

Senator JAVITS. Mr. Secretary, you still did not quite define the use of the word "disastrous," which is what I asked. You said there would not be a disastrous runup. Do you expect there will be any runup, and, if so, what will it be?

Secretary BUTZ. If you were to double the price of wheat right now, which is, of course, a preposterous assumption, if you were to double the price of wheat right now you would add—I am talking about wheat at $10 a bushel which, obviously, is impossible in the current situation—it would add another 7 or 8 cents to the price of this loaf of bread, if they kept everything else constant. But the trouble is the percentage increases are through, across the board on the price of wheat.

Senator JAVITS. So really it could be a disastrous runup if we have no control over the added costs and markups through the channels of distribution, is that not true?

Secretary BUTZ. That is quite right. That is precisely what has happened. That is why we have 16 slices here after it leaves the farm and 4 slices to the farmer.

Senator JAVITS. That could pyramid if the wheat going into a loaf of bread went up 7 or 8 cents?

Secretary BUTZ. Well, I think it could.

Senator JAVITS. It could pyramid, so perhaps you would get close to this scare word of a dollar wheat. Is it not then necessary that we have some machinery, that we have some control over the size and the addition in the passthrough?

Secretary BUTZ. I think we have that now. The passthrough controls are still on the food distribution.

Senator JAVITS. Will they be after we let the ESA lapse after April 30, which is what the administration is proposing?

Secretary BUTZ. But at that point competition works. Let us take the baking industry right now. As the vice chairman pointed out a while ago, there are many small bakers you say having trouble right now, and part of the problem is technological problem within the baking industry. There are four or five large baking institutions in the country that are pretty efficient, and you cannot have two prices for the same kind of bread on the same shelf. You take it at the lower price. If we were to raise the price of bread to permit these inefficient bakers to recover all of their costs, then the big ones get in an excess profits position. I think competition is working right now to control bread prices.

Senator JAVITS. Well, Mr. Secretary, my time is up and I cannot ask any more questions. It only seems to me that there is a strong contradiction within the fact that right now you complain that there are 16 slices against 4, and the competition is going on, and somehow or other competition is going to avoid that pyramiding when the whole equation doubles. And I must say that I cannot see it, unless at least power to impose controls remains in the hands of the Federal Government, and that is exactly what the administration is against.

Thank you, Mr. Vice Chairman.

Senator PROXMIRE. Before I yield to Senator Bentsen, let me just emphasize what Senator Javits has said and point out the problem is not entirely reducible to a price equation. The difficulty is you might have such a scarcity that you would not get $10 wheat, but you just would not have wheat available for bread. You would not have it available so that you could make it available to the American people, and I just do not think there is any price under some circumstances, that you will be able to provide bread to the American people, under some circumstances, if there is this very, very low inventory, this low carryover that we have which is aggravated by bad weather, or by export developments, and that is the problem and that is what haunts us.

Senator Bentsen.

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

Mr. Secretary, I am told about 30 percent of the farm production is directly related to fertilizer, and we are having a tough time obtaining enough fertilizer in Texas and across the Nation. Yesterday we passed in the Senate a resolution asking the Federal Power Commission to give a priority to the fertilizer industry for natural gas, and we have been told by the industry that if they had a steady and an assured supply that they could conceivably increase their production from 300,000 to 400.000 tons a year. That would be of some help. Still. I think we would have a shortfall from what we really need in fertilizer.

Secretary BUTZ. It would be a major help.

Senator BENTSEN. Yes. But would you be in a position to support a resolution and ask the Federal Power Commission to give such a priority?

Secretary BUTZ. Before I can answer that I have to know what the demands are for other priorities, and obviously that has to be decided on a national basis. We do make anhydrous ammonia out of natural gas, and this currently is a limiting factor. I think we have had a rather short sided policy in recent years in having a price ceiling on natural gas. It has discouraged added production and encouraged uneconomic consumption. And now we have paid for it in not having enough anhydrous ammonia. Off the top of my head, I think I would support that.

Senator BENTSEN. Yes. Certainly one of the highest goals we can have in this country is one for an adequate food supply and to hold down the price to the consumer, and to help the farmer by letting him have a bountiful production.

Secretary BUTZ. Right.

Senator BENTSEN. Another point, I notice in your statement you refer to nitrogen products being up 55 to over 70 percent since October of last year, and the price of phosphate products are up by about 40 percent and potash prices have increased 26 percent. Now, I talked to a major supplier of fertilizers in Texas yesterday, and I read his invoices showing that nitrogen on October 25 for him was $55 a ton, compared with $115 a ton today, a 109-percent increase. Phosphate was $105 a ton compared with $176 a ton today, 67-percent increase. And potash was $48 a ton compared with $70 a ton today, a 45-percent increase. Now, how can you relate these kinds of field costs with what you have testified to?

Secretary BUTZ. Well, obviously the figures we gave were average figures, and our best estimates of what the average is, and you get all kinds of variation in situations like this. As I pointed out earlier, I think the major suppliers have, indeed, contracted their fertilizer to distributors with reasonable price increases, whatever reasonable is. It is up, and there is a lot of variation in the price at the local distributor level. In some cases we have got even a good deal of information that some farmer comes in and says I will give you this, and I do not have enough, and it simply pays you at $5 for wheat, you know, and the demand for nitrogen for top dressing is tremendous, and he can pay a terrific price for it, and you get a lot of variation at the local level.

Senator BENTSEN. But is not this also happening, Mr. Secretary, do you not have new brokers entering in there and adding extra tiers in the way of the incremental costs who are picking up these short supplies and have really been able to increase this price?

Secretary BUTZ. In some cases it may be. On the other hand, I think a good many of our so-called independent distributors are probably dropping out, which means that you may have some decrease in the brokers in between where it goes right down through company outlets all the way down.

Senator BENTSEN. Well, let me talk to you about another one of your forecasts of food increased prices this year 12 percent, and I have some modest understanding of the difficulty of forecasts. But a year ago this month the Department projected a 6-percent food price increase, and as we all know, the prices went up about 14.5 percent. Now, what have you been able to do, have you been able to do anything where you think you have been able to close in on estimates any better than you have in the past?

Secretary BUTZ. Well, I think so. Shortly before you came in this question came up of the so-called Mr. Karl Fox report, which made some analysis of our total price forecasting mechanism. I think the answer is yes. We have beefed up our price analysis division, an economic forecasting division, and economic research service. We have combined our export marketing service for our foreign agricultural service administratively so that we get our foreign reporting more centralized under I think a very careful control of the Department. There are some things obviously that we cannot control.

Before you came in we pointed out a year ago how we made those forecasts. In the meantime we had a tremendous consumer pressure for food price ceilings, and they were imposed. We sent the wrong signals back to our producers. Instead of increasing livestock output, they decreased, which is one of the reasons we are short right now in beef supplies and pork supplies. We ordered it last year. I hope we do not do it again. If we do it again, we will be just as wrong as we were the year before.

Senator BENTSEN. I know some comments were made earlier concerning research and development on food production, and I have a deep interest and concern in that regard. I understand that back in 1955 that R. & D. represented about 10.7 percent of the Department of Agriculture budget, and now it is down to about 2.5 percent. I suppose in total dollars it is somewhat above what it was, but as a percentage of the budget, and in actual dollars, there has been a substantial decrease. Yet, I look at the situation where they tell me in Texas where our calves, our cows calve at about 80 percent, and that if we would have a 2-percent increase that that would mean approximately 53 million pounds of additional beef in Texas. Surely that would help the price. And we would have more plentiful supplies, and we have had some incredible payoffs in the past with our green revolution and our hybrid seeds and increasing production of grain. With such a payoff, it seems to me that where we have been able to get the consumer's part of the dollar down to about 16 percent for food, now we are seeing it starting back up again, and it seems to me counterproductive at this time to be cutting the percentage. I really would like to see support for an increase in R. & D. for agriculture.

Secretary BUTZ. Well, thank you very much, Senator, and I could not agree with you more. You have one of the Nation's greatest research establishments at College Station, Tex., at Texas A. & M., and they have turned out some tremendously important research in the field stations in Texas.

The percentage is down, Senator, not because of any decrease in dollars. We have, in fact, increased our support to agricultural research, perhaps not in some years as fast as the costs have increased. The percentage has come down, however, because of the tremendous increase in food distribution programs in the Department of Agriculture. In the budget that was submitted last month, for example, our food distribution programs in agriculture will absorb 64 percent of our total budget. This worries me. We have recommended, frankly, the transfer of this whole program to the Department of HEW where it can be completely integrated with the total welfare program. In the current year ending next June 30, our food distribution programs absorbed something like 52 percent of our total budget, and I think it is the growth of those things that has made other things decline relatively.

Senator BENTSEN. Have you not actually had a decrease in the number of people recently in R. & D.?

Scretary BUTZ. There has been some decrease because our increased appropriations in some years have not kept up with the increased costs. This is a matter of grave concern. I think you are absolutely right in calling attention to it, and we have recommended a substantial increase in our research budget for next year. In cattle, for example, a limiting factor in beef production right now is we only get one calf per cow per year, and it takes—and if we could somehow get multiple births, what a tremendous breakthrough it would be.

Senator BENTSEN. Sure. With the fertility drug today, and what we are seeing done with them, perhaps we could do something on multiple births in cattle.

Secretary BUTZ. We are working on that. But there is still a 9-month gestation period. I understand last year, somebody last year, in the other body I am sure, somebody introduced a resolution to cut the gestation period in cows to half, thinking we might get twice as many calves. He may have been right.

Senator BENTSEN. You mean they would have fall calves and spring calves?

Secretary BUTZ. Right.

Senator HUMPHREY. And not on weekends.

Senator PROXMIRE. Thank you.

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

Senator PROXMIRE. Senator Humphrey.

Senator HUMPHREY. Mr. Secretary, I think we are going to come here to the point of a parting of ways in some things. Last year about this time the Department projected a 6-percent increase in the cost of food, and it turned out to be about 20 percent. Last year about this time you projected $1.76 a bushel average price for wheat for the first 5 months of the marketing year. I do not need to tell you it was far higher than that. And based on that projection, by the way, the Department made advance payments to farmers between $400 million and $500 million, which I doubt that you are going to be able to recover.

Secretary BUTZ. Under the law we cannot. And we had to make a projection based on a period of time set by law.

Senator HUMPHREY. My point is that your guesses are so bad, and I had an argument with Mr. Stein here a while ago of what the rate of inflation would be. It was in May I think of this year, and he was still holding to the idea it was going to be something like 4 percent. So I just bet him the best dinner in town, and wine, and dancing girls, and the whole business, that he was wrong, that it would be higher. Now, I do not want to have to make a bet with you, because you and I both live in the same house over here at Harbor Square, and we may just have to, you know, go up from one apartment to the other to have dinner. But you are just going to be dead wrong.

Secretary BUTZ. I will bring my bread with me, Senator.

Senator HUMPHREY. I want to talk about that bread, too.

Secretary BUTZ. I will bring it along.

Senator HUMPHREY. No, you are not going to bring it along. I am going to come down and eat at your place because I am going to be right and you are going to be wrong. I just feel sincerely Mr. Secretary, that you are running these estimates too close to the line of trouble.

Now, back in 1947, 1946–47, the President of the United States had to declare an emergency, a food emergency because the wheat stocks had gotten down to 84 million bushels, which on the basis of population was the equivalent to about 124 million bushels now. Now, you are estimating a carryover of 178 million bushels, and that is if the Lord blesses you, and me, and the farmers, and everything goes just hunky-dory all the way across the line, if everything works out. I just submit that your estimates, even if you are right at 178 million, places us in a very precarious position. It opens the whole subject of wheat to market speculation, if there is any transportation delays, if there is any blockage in the pipeline, which by the way really we have not talked about here. I mean, this whole process of marketing could cause a tremendous rise in the cost of food, because when one product goes up there is a tendency for a substitute on the part of the other, and products seem to sort of follow each other. Now, you have said here you take four slices of bread out of that loaf and that is the price, that is the wheat that goes into that bread. But that wheat is handled. That is what the farmer gets, yes, but that wheat is handled by elevator operators, and by brokers, and by processors, and so on and so on, and by the time that wheat gets into that loaf of bread it has had a much greater impact upon price than what it was by going up another dollar a bushel, let us say, to the farmer. All of their increments, all the way along the line, even the salesman pick up 10 percent on it, so I think we ought not to kid ourselves that an increase in the price of wheat tends, let us say there is a dollar increase in the price of wheat, that it will have a substantial impact upon the price of a loaf of bread, because you build your percentages on the base price, and as the base price goes up, so do your percentages, all the way along the line, they go up. I just want to——

Secretary BUTZ. I think you are right, Senator. But let me say that what disturbs me is that when the price of wheat will come down after the new crop wheat, as the market now indicates it will come down by 60 or 75 cents; I do not think this is going to come down any.

Senator HUMPHREY. I could not agree with you more.

Secretary BUTZ. I think that you can argue that only on the uprise with a percentage increase, and if you take a dollar off the price of wheat you could not have that argument.

Senator HUMPHREY. I agree. Once these prices are fixed in, they are very hard to ever get down. You know, the farmer has waited a long time to get a decent price. I am not complaining about his price of wheat right now, and I think that he is entitled to this, to a good price. But I do think you have been a little harsh on the bakers.

Secretary BUTZ. That is only because they were harsh on me, Senator.

Senator HUMPHREY. Let me just say that they have got some—Mr. Victor Olson of the Minnesota Bakers Association was in to see me. He is out of my political persuasion, and he made it quite clear. I doubt that he has really been beating the tom-toms for Hubert Humphrey out in Minnesota. He is a middle-income businessman, and quite an activist in the opposition party. He was just terribly concerned about what is happening, and he is a good man. He is a good businessman. Now here, for example, is the analysis of the wheat supply situation by the American Bakers Association where they take the departmental figures and they come out with a minus carryover of nine. Now, they take your figures and they show, for example, what the price is as of February 3, 1974, the carryover for July 1, 1973, what the imports are, the total supplies, the total domestic disappearance, and then adding to it the balance left for export. And when they get through with it, instead of having a carryover, you are in a deficit. Now, that is the extreme case. I say the bank article that the Senator from New York, Mr. Javits, refers to again points out that your figures are overly optimistic. And I might say that the private trade itself feels that your figures are overly optimistic. My point to you is that because there is this feeling, and because we are dancing between the fires, so to speak, that you ought to be watching it with exceeding care to see that we do have sufficient carryover.

Now, for example, the carryover even at 178 million bushels, if that were to be, and let us say we take your figure; what is the projection for the next crop year? These carryovers are so small that any kind of bad weataher just leaves us in an incredibly difficult situation. And if there is one thing we have learned lately, is that other countries that are food importing countries are going to bank food. I mean, they are going to buy more than they really need. They cannot be caught short. They just simply cannot be in that position, and unless we watch for ourselves here somewhat, we are going to be caught short; producing fabulous crops, we are going to be caught short ourselves, and our American consumer is going to be up in arms.

Now, Mr. Paarlberg and I were at a little meeting last night, and I have a great, high regard for Mr. Paarlberg, and we were over at the Brookings Institution discussing some matters like this, and honest men disagree on these matters. My only point with the Department is that I think you are walking on the thin edge of a very, very new surface, and you can topple over. I just do not want that to happen.

I am going to ask unanimous consent that the analysis of the American Bakers Association that I referred to, with a couple of items, one by Robert Wager, president, American Bakers Association, and the statement of Mr. Quinlan, the general counsel, Associated Retail Bakers of America, be placed in the record just to give their side of it here.

Senator PROXMIRE. Yes. Without objection, so ordered.

[The material referred to follows:]

MEAT, HEAT AND NOW THE WHEAT CRUNCH

(An analysis of the wheat supply situation by the American Bakers Association, February 15, 1974)

WE'RE RUNNING OUT OF WHEAT!

The U. S. is running out of wheat! Impossible! We produce three times more than we consume. But here are the USDA's own figures through February 3, 1974. Read 'em and weep American consumers—

U. S. WHEAT SUPPLY AND DEMAND SITUATION

Wheat—1973–74 crop year

	Millions of bushels
Supply (as of Feb. 3, 1974):[1]	
Carryover July 1, 1973	438
Crop 1973	1, 711
Imports	1
Total Supply	2, 150
Domestic disappearance (as of Feb. 3, 1974):[1]	
Food	532
Seed	80
Feed	160
Total	772
Balance left for export	1, 378
Exports (as of February 3, 1974):	
Exports shipped [1]	814. 7
Exports unshipped [1]	514. 2
Estimated wheat exports as flour and other products	50. 0
Total destined for export	1, 378. 9
Carryover July 1, 1974 (*deficit*)	(. 9)

[1] Statistical Reporting Service, USDA.

Unless the government takes immediate action there could be no bread on our tables for up to four weeks this spring.

No hamburger buns.

No rolls for hot dogs at the ballgames.

No bakery snacks for children.

No birthday cakes.

And no pizza.

These are the USDA's own figures. We are not alone in reaching this conclusion with their figures. Frederick Uhlmann, head of the Chicago Board of Trade, also projects a zero total carryover. Yet USDA clings to the official fiction of a 178 million bushel carryover.

FROM SURPLUS TO DEFICIT—THE EXPORT BINGE

At the end of the 1971-72 crop year, the U.S. had a wheat carryover of 863 million bushels, and at the end of the 1972-73 crop year it was 438 million bushels. Yet today we are projecting the smallest wheat carryover in 25 years. How did we get here from there?

The answer begins with the Soviet wheat deal in the summer of 1972, when before officials in USDA realized what was happening, Soviet buyers snapped up over 400 million bushels of wheat at about $1.65 a bushel. The Russian sale, by itself, was not large enough to create a wheat shortage. But it set off a chain reaction around the world, generating orders from many nations seeking available American wheat. During the crop year ending June 30, 1973, every one of the top 12 foreign destinations for American wheat took more grain than the previous year. With wheat in the vanguard, our agricultural exports increased over 90 percent to $17.7 billion.

Exports continued at a record pace into the current crop year. As a result, our seemingly inexhaustible store of wheat vanished in just 18 months.

Let's analyze the USDA figures a little further. There are five different classes of wheat:

Hard Red Winter—The basic bread wheat;
Soft Red Winter—Used in cakes and snack foods;
White—Used in cakes and snack foods;
Durum—Used in pasta products such as spaghetti, macaroni, and noodles;
Hard Red Spring—Used in rolls and also as a bread wheat blend.

Here is the USDA's latest supply projection for each class:

Hard red winter	[1] −23.0
Soft red winter	6.3
White	9.2
Durum	2.8
Hard red spring	67.4
Total	[2] 62.7

[1] In millions of bushels as of Feb. 1, 1974.
[2] Exports of flour and other products will amount to an estimated 50 million bushels, leaving an insignificant carryover. We calcaulate the necessary coarryover for the 2d quarter of 1974 at 250 to 300 million bushels. This will provide an adequate amount for production processes and the transportation pipeline from farmer, to miller, to baker.

The huge prospective deficit for hard red winter is especially ominous. It means we face the real possibility of a bread blackout. That 23 million bushels would produce over 1.2 billion pounds of bread—enough to feed the entire country for more than a month.

$7 BILLION IN ADDED COSTS TO CUSTOMERS

In 1972, Americans paid $125 billion for food. In 1973, our total food bill jumped $14 billion to $139 billion. Gary L. Seevers, the agricultural expert on the Council of Economic Advisers, has estimated that "perhaps half of the acceleration in food prices could be attributed to factors associated with the worldwide boom in export demand." Thus the export binge has cost the American consumer $7 billion from his frayed pocket in 1973.

THE USDA'S "NO WIN" POLICY FOR AMERICAN CONSUMERS

Despite the stark, overwhelming evidence of an impending wheat shortage USDA has no idea how much wheat will be needed to assure an adequate domestic supply until the new crop is harvested late this spring and summer. Moreover, USDA maintains it has no responsibility to assure an adequate domestic supply of wheat. USDA believes its only responsibility is to provide a free and open market for buyers and sellers. This may be classic theory but in reality, it means individual American buyers must bid against the state monopolities of Russia, China and other countries, some of whom can buy on generous American credit terms as the Soviet Union did in 1972. It's an exciting game—but the American consumer looses most of the time. The USDA policy amounts to nothing more than Russian roulette with the American grain supply.

The USDA believes American consumers are the richest in the world and should compete with other countries for the commodities they want without favor from their own government. The disastrous results of this policy are plain for all to see.

THE USDA ANSWER—FIRST DENY IT—THEN BLAME SOMEONE ELSE—THEN HOPE ANOTHER COUNTRY WILL BAIL US OUT

Over the past months the USDA has employed three strategies to deal with the growing wheat shortage. First, it attempted to cover up the problem with a blizzard of press releases denying any shortage. When this became untenable because its own figures revealed the magnitude of the problem, the Department attempted to deny responsibility and shift the blame to millers and bakers.

Secretary Butz advises us we can avoid higher wheat prices later by contracting for our requirements now. The trouble with this idea is that it would force us to trade our bakers' hats for a gambling license. It would commit us to high bread prices for the next five months, or ruin in the marketplace if wheat prices drop.

Cost of Living Council regulations require bakers to reduce their prices when ingredient costs go down. So if one baker can buy flour cheaper than any other, the economics of the marketplace, reinforced by SOLC regulations, requires all of them to reduce their bread prices. Thus the risk of extended forward purchasing is too great for most bakers to assume. They simply can't afford to buy flour many months in advance.

Secretary Butz should also recognize that a baker's contract is no guarantee of flour delivery later this year. If all the wheat has been exported by April, there will be none to fulfill his contract in May.

Now the Department is falling back on voluntary schemes to increase domestic supply and reduce exports—such as removing wheat import quotas, encouraging early sale by Canadian and European wheat agencies and negotiating stretch-outs in American export sales. But no one knows whether these devices will leave an adequate domestic supply for the remainder of the crop year.

Our analysis of the USDA's latest strategy leads us to believe that it too will fail. *First*, removal of import quotas is unlikely to generate substantial additional imports. The USDA acknowledged this in recent testimony before the Tariff Commission. *Second*, so long as American prices are less than Canadian and European wheat prices, which they presently are, there is no reason for other nations to shift their purchases. There is a growing suspicion among knowledgeable observers that the Canadians and the Europeans will hold their unsold wheat until the American supply is exhausted, so they can sell it for whatever the traffic will bear, like the Middle East oil sheiks. If this occurs, dollar a loaf bread could look cheap.

Third, there is no evidence the export stretch-out strategy is paying off. Actual exports are continuing at a high level. The announced Soviet deferral was relatively small, and has been offset by other sales and shipments. If the Department knows how many bushels can be saved for domestic use by this method over the next five months, it has an obligation to come forward and tell the American people. For if it cannot, then the American economy will truly have been burned far worse than Secretary of the Treasury George Shultz knew last September, when he acknowledged that we had gotten "burned" in the Soviet wheat deal.

(Rubbing salt in our wounds, the Russians have now indicated they might sell us back some of our own wheat, to ease the shortage USDA created, but not at the price we sold it to them, at the going market price—a gigantic profit for the Soviet Union!)

Nothing could more perfectly illustrate the folly of USDA's unlimited export policy. Only through gross mismanagement could the United States, which produces nearly three times more wheat than we consume, reach a position where we are dependent on the good will of foreign governments for the maintenance of our wheat supply.

President Nixon has established a national goal of energy independence by 1980. We believe it is just as important that the United States be independent of foreign nations for our supply of basic foods which we produce in abundance. All our mechanical energy will be of little value if our people lack essential food energy in their diet.

Wheat is the largest single source of human energy, accounting for more than 15 percent of our requirements. In contrast, beef supplies only half of wheat's energy contribution—(7.4%). Paradoxically, while the Food and

Drug Administration has just acted to make bread more nutritious by increasing its B vitamin and calcium content, the USDA is following a policy which threatens to remove bread from our stores. Thus, the Federal Government gives with one hand, and takes away with the other.

WHAT'S THE ANSWER?

There is no easy answer to the wheat shortage. The ABA does not favor an embargo on foreign wheat shipments. We believe wheat farmers should receive a fair price for their crop. We support the commodity export program and recognize its importance to our balance of payments. All we ask is that USDA leave a little for the home folks.

We believe President Nixon stated the proper policy for our country last June 13, when he said, "In allocating the products of America's farms between markets abroad and those in the United States, we must put the American consumer first." But this is precisely opposite of what the USDA is doing.

To carry out the President's policy, we recommend as a first necessary step, USDA should determine the minimum wheat supply necessary for domestic consumption during the second quarter of 1974. It should also prepare a plan to assure that supply. This is basic to any intelligent solution.

Then every effort should be made to avoid interference with existing private contracts. Delivery of foreign purchases should be delayed whenever possible into the new crop year. But we do not know whether these efforts have achieved significant savings of U.S. wheat. It is now time to lift this effort out of the Agriculture bureaucracy and assign it high priority in the White Houe. The Director of the Council on International Economic Policy should be given responsibility for securing firm agreements from other governments to delay their shipments until after July 1.

Third, the government should review planned concessional sales and donations under the PL 480 program to determine which ones could be postponed without causing undue hardship in foreign lands.

Finally, if these methods do not yield the necessary assured domestic supply, the Secretarys of Commerce and Agriculture should move under the Export Administration Act of 1969, to establish an export licensing system. This should be combined with an immediate announcement that 1973-74 U. S. wheat is "sold out" and that no additional export licenses will be granted for sale of such wheat. This would allow most existing contracts to be filled, but permit the government to adjust actual shipments as necessary to provide an adequate wheat supply for American consumers.

We believe a combination of these actions will succeed in keeping bread on the American table this spring. But obviously, these are emergency measures. They should not be repeated year after year. In the future we must have better planning and a long range policy for allocation of our wheat between domestic needs and foreign markets.

Unless USDA acts, and acts quickly, there may be a bread shortage or no bread in America this spring and summer. People may have to stand in line for a loaf of bread, at much higher prices, the way they now wait in line to buy gasoline.

Bread shortages and empty bakery shelves can be avoided. If there is enough wheat there will be enough bread. But the Agriculture Department gives us nothing but words. We can't bake words and Americans can't eat words. Inaction now will mean breadlines later.

REMARKS OF ROBERT J. WAGER, PRESIDENT, AMERICAN BAKERS ASSOCIATION, FEBRUARY 26, 1974

Many months ago, when bakers first began warning of an impending wheat shortage, we were accused of being fear merchants, and our statements were dismissed by USDA spokesmen as ridiculous. But as exports steadily mounted, and USDA's own estimate of the carryover gradually dwindled, we have been proved right. The latest USDA figures now project a nearly zero wheat carryover. And still export sales continue. Just last week, Brazil, Taiwan and Pakistan purchased almost 19 million bushels for April-June delivery.

Unless swift action is taken, American consumers face the grim prospect of a bread shortage this spring and our industry may go over the brink to economic ruin.

But there appears little prospect USDA will act in time. Outwardly it seems unconcerned. Week after week it continues to issue the same reassuring carry-over forecast, while anxiously hoping that Canadian sales and Soviet deferrals will rescue us from our precarious situation.

USDA has a very simple position. It tells us first that it has no idea how much wheat will be required to assure an adequate supply of bread for American consumers this spring. Second, USDA says it has no responsibility to assure there will be bread for the American people. Third, USDA believes that since Americans are the richest people in the world, they should compete with the governments of other countries for the agricultural commodities they want.

This lack of concern for the American consumer produced 20 percent increase in food prices last year and the prospect of even greater inflation this year. In 1973, we paid $14 billion more for our food than we did in 1972. Gary L. Seever, a member of President's Council of Economic Advisers, has estimated that half of this increase—$7 billion—was caused by the export boom. The ABA calculates that wheat exports alone cost the American consumer $840 million in higher bread prices last year.

Earl Butz, and his USDA propaganda machine, will promptly deny this, but recent history shows their predictions are like a railroad ticket—good for one day only. In September 1972, Mr. Butz said that foreign wheat sales would cause "less than half a cent increase" in the price of a loaf of bread. In July 1973, he raised the estimate to a penny a loaf. Finally in November 1973, a government study showed that soaring wheat prices had added five cents a loaf to the cost of bread.

Secretary Butz has added a new dimension to the credibility gap. Early last year he predicted "food prices would probably increase no more than in 1972, because food prices started at a rather low level, and increased a great deal—about 4 to 4.5 percent." He added that by the end of 1973, he expected food prices to decline. Well, we all know what happened—food prices went through the roof. Earl Butz' credibility gap makes the Grand Canyon seem small by comparison.

Now Secretary Butz has replaced last year's policy of gross mismanagement of our wheat stocks with a new policy of reckless risk. Even Kyle Randall, Chairman of USDA's Outlook and Situation Board, has expressed some doubts about our situation. Just two days ago, he said that though there's a possibility we'll have enough wheat to get through, "A slight change in the figures could mean serious problems." In 1974 Secretary Butz is asking the American people to gamble their bread money on a six "if" parlay. He is betting we will squeeze through into the new crop year:

1. If there is enough fertilizer;
2. If there is good weather;
3. If there is enough gasoline to harvest the crop;
4. If there is no withholding of the new wheat by the farmers in Oklahoma and Texas, waiting for higher prices;
5. If there are voluntary shipping delays by the Soviet Union and other large foreign purchasers; and
6. If there are substantial sales by Canada and the EEC to take the pressure off the American market.

The trouble with this gamble is that Mr. Butz must win them all—or the American people will lose the bread on their table. And looking at his recent record, I'm inclined to bet he'll role snake eyes again.

The White House is already warning there may be "regional dislocations." For all of you who don't understand governmentese, this means some people around the country will have to go without bread for awhile.

So, what should be done? The ABA starts from the proposition that President Nixon was right last June, when he said "In allocating the products of America's farms between markets abroad and those in the United States, we must put the American consumer first." It's time for USDA to implement this policy and get on the side of the American consumer, instead of the Soviet Union and other foreign governments.

The ABA has a four point program. It is set forth in the paper many of you have already received. More copies are available outside the door.

It states:

1. USDA should determine the minimum wheat supply necessary to assure a full supply of baked foods during the second quarter of 1974, and develop a plan to assure that supply.
2. The Director of the Council on International Economic Policy in the White House, Mr. Peter Flanigan, should be assigned responsibility for securing firm agreements from foreign purchasers to delay their shipments until after July 1.
3. The government should review planned concessional sales and donations under the PL 480 program to determine which ones could be postponed without causing undue hardship in foreign lands.

And fourth, if these methods do not yield the necessary assured domestic supply, the Secretarys of Commerce and Agriculture should move under the Export Administration Act of 1969, to establish an export licensing system. This should be combined with an immediate announcement that 1973-74 U.S. wheat is "sold out" and that no additional export licenses will be granted for sale of such wheat. This would allow many existing contracts to be filled, but permit an adequate wheat supply for American consumers.

When you talk with your Senators and Congressmen today, ask them to send a letter to Secretary Butz and President Nixon telling them they support the ABA program and urging its implementation by the government. If they will also send a copy to the ABA office, that would be appreciated.

Also ask them to put a statement in the Congressional Record supporting our position. Tell them if they do, the ABA will cut it out and send it to every baker in their state or district.

Our position is reasonable and responsible. You can advocate it with confidence. Today, we are petitioning our government for redress of legitimate grievances. It is our right as citizens to do so. So as you walk around the Hill today, you can be proud for what you are doing is in a long, time honored tradition.

Statement by William A. Quinlan, General Counsel, Associated Retail Bakers of America

I am William A. Quinlan, of Annapolis, Maryland, appearing as General Counsel of the Associated Retail Bakers of America.

With me is Mr. Helmut Gerst, of Gerst's Cake and Cookie Shop, Seaford, Long Island, New York, a member, for the New York Region, of the Board of Directors of the Associated Retail Bakers of America, and President of the Master Bakers Association of Nassau and Suffolk Counties, New York.

"ARBA" is the national, non-profit membership association of retail bakers,—those who produce bread and other bakery foods for sale in their own stores directly to consumers.

Both Mr. Gerst and I have been associated with the baking industry in various capacities during all of our working lives.

We are here to make a brief statement of the need for emergency Government action to avert a serious shortage of wheat, flour, and bread and other bakery foods which will otherwise occur before July of this year.

Others from the industry also will testify to the emergency, but there are several points we want particularly to bring to your attention or emphasize for the retail baker.

We believe the United States Department of Agriculture should be called to a public accounting, to separate fact from fancy.

The Department still is publishing statistics of export commitments showing that this year's crop of wheat will be exhausted before the next crop year begins on July 1, 1974.

Dr. Don Paarlberg, its Director of Agricultural Economics, told a Senate Agriculture Subcommittee on February 4, 1974, "if the reported [export] sales are all consumated, then virtually the total available supply from the 1973 crop has ben committed and the carryover is practically zero." Even that was a misleading optimistic statement.

First, it presumes that the entire 1973 crop is "available" for export or domestic use, as though all of it could be drained from the channels of distribution, down to the very last bushel, whereas many millions of bushels will be in those channels. Just how many we do not know, but we do remember what it was like in 1946-47 when the carryover fell to 84 million bushels. There was such a shortage that the President had to declare an emergency, to which I should like to refer further in a moment. And 84 million bushels then were the equivalent of approximately 124 million now, because of increased population.

Second, having assumed that the entire remainder of the 1973 crop is available for export or domestic use, leaving nothing in the pipelines, it says the carryover would be "practically zero." In fact, according to the Department's own published figures on export commitments, it would be 2.6 million bushels less than zero,—a deficit of that much for total wheat of all types, but a deficit of 26.6 million for hard red winter wheat, the basic bread wheat.

Why, in the face of those export commitments, does the Department insist that we will squeak by with a total July 1 carryover of about 180 million bushels (down from its earlier estimate of 300 million, which was barely adequate)?

It is "convinced" or, in the next breath, it "suspects" the Senate subcommittee was told, that export shipments will be less than sales, and so they have unconvincingly "concluded that some 170 million bushels of reported sales will not in fact be consummated and that the carryover of old crop wheat on July 1, 1974, will be approximately 180 million bushels."

"If this proves correct," the Department said, "it will be the smallest carryover in 26 years. It would be tight but it would not be disastrous."

To do something about this "tightness" it says it is trying to persuade foreign buyers to postpone purchases and to persuade Canada and European countries to sell. But all of this is nebulous and sounds like wishful thinking. The only specific figure mentioned was 18 million bushels on which the USSR had agreed to a postponement. (There has since been a press report of another 30 million, although we have seen no official confirmation). And, at the same time, the Department is allowing still more sales for export to be made.

The Department of Agriculture is playing Russian Roulette, with the gun at the head of the American consumer.

We believe the American people are entitled to some hard, clear, complete facts.

The Department also speaks ambiguously of new crop wheat harvested before mid-June, saying the total supply of wheat, old and new, will "probably be considerably greater" than the old crop carryover.

We submit that in reality the normal availability of new-crop wheat is essentially as follows: Around May 15–20 a truckload or carload or so will appear in southern Texas. In the next week or ten days wheat will ripen south of San Antonio; the flow will gradually increase to around June 1. That generally is absorbed by exporters, with low freight expense to Gulf ports. By the first week in June, harvesting moves into southern Oklahoma. In that State a fine crop would be 10 million bushels; usually it is only 50 to 75 million, and usually it is low in protein. Around June 10–15 the combines are in northern Oklahoma and southern Kansas, and this usually is wholly or partly a valuable harvest. As to "availability," however, it must be remembered that the wheat must go through a complex from fields to elevators to flour mills, the vast majority of the mills being scattered over the United States, including the large eastern milling center of Buffalo, New York. Another three or four weeks will elapse before most bakery flour mills will have new crop wheat in their mill mix—usually up to July 4–10. Only about 15 bakery flour mills, ranging from Texas to Kansas, will have new crop wheat before July. Rains may lengthen the time another week or ten days. And mills will be contending for the new wheat, and facilities, including rail cars, will be inadequate.

The idea of justifying an inadequate carryover of old-crop wheat on a basis of alleged early availability of new-crop wheat is one that has emerged during the controversy over proposed export controls. It should be disregarded.

The Department says bakers should have bought flour or wheat to fill their needs until next July, instead of letting it go to Russia, China or other foreign buyers.

Even if flour would keep until July, retail bakers would have no place to put it. They have hardly enough room in their shops for a normal supply of a few days. Some of them have been able to buy flour for future delivery, although others were unable to get flour distributors or mills to accept such orders, or unable to make the advance payments required in other cases. Some felt it would be unpatriotic to disbelieve the assurances of our Government and indulge in scare-buying. We know of none who has bought or considered buying wheat futures. They would not know how to go about doing so.

Flour mills do hedge with wheat futures to fix their wheat cost when they contract to sell flour for future delivery. But of what use will wheat futures or contracts for future flour deliveries be if there is no wheat?

I mentioned the emergency declared in 1946–47. The Department told Senator Robert Taft, Jr., in a letter of November 6, 1973, that the carryover in 1947 was only 84 million bushels, as though to assure him that we could get by on such a carryover. It did not point out that 84 million then is equivalent to about 124 million now. Nor did it say that was the time of a wheat and feed shortage which caught the Department by surprise in February, 1946. The Administration then was forced to declare an emergency and it ordered milling of "long extraction" flour, limited inventories of wheat and flour, appointed a "President's Famine Emergency Committee" to reduce domestic consumption of wheat by 40% through a crash program including small loaves and thin slices, and restricted flour production to 75% of the previous year. Again, in the next crop year, the President found it necessary to appoint a "Citizens Food Committee" which called for emergency measures including "meat-less" and "wheat-less" days.

There has been much talk of bread going to $1.00 a loaf, which has served only to divert attention from the problem and from what should be done about it. To my mind the real question is whether there will be bread at any price.

We respectfully submit that the Congress should insist that the Department of Agriculture immediately make public all the hard facts it has relevant to present and prospective wheat supplies, including the facts, if any, as to the quantities of export sales on which foreign buyers have agreed to postponing shipment. If those facts do not give clear assurance of adequate supplies for American consumers, then the Congress should promptly enact legislation to compel the preservation of such supplies. The bill H.R. 10844 is an excellent basis for such action.

Mr. Chairman, we very much appreciate this opportunity to tell you and your colleagues of our grave concern and our views as to supplies of wheat, and we thank you for all you are trying to do on behalf of the American consumer and those who, like the retail baker, serve her daily with wheat foods.

Senator HUMPHREY. Now, Mr. Secretary, I want to go back to some projections. In your statement you said, "The average for all of 1974 may be about 12 percent above 1973," price for food, "less than the 14½ percent increase between 1972 and 1973." I want to openly challenge the forecasts for several reasons and ask you why my more pessimistic outlook is not more realistic. Now, in view of the very tight wheat and grain price situation, which is not likely to see any relief until early summer, and in view of the grocery store food price increases of about 20 percent in December and in January, it seems reasonable to assume that the first quarter supermarket or grocery store food prices will continue to run at about 20 percent annual rate. Nor do I see anything to indicate that this rate of increase will decline in the second quarter of this year, because the crop is not in. What are the specific factors that would cause the food price increase in the first half of this year to be less than 20 percent?

Secretary BUTZ. Well, much of that increase has already occurred.

Senator HUMPHREY. Yes. That is right.

Secretary BUTZ. Again, before you came in we pointed out we forecast approximately a 12 percent increase average 1973 to average 1974. Of that, approximately 8 percent or two-thirds of that increase is behind us in the past 2 months where we have had rather rapid increases. There will be another 3- or 4-percent increase in the second quarter of 1974 over the first quarter of 1974, mostly reflecting increased distribution costs that are being written into this thing very promptly.

Now, in the second half, I think the evidence is clear that we are going to have increased per capita supplies of beef and probably poultry, although such a short-range prediction item is difficult to forecast. The placements we will have of beef, the numbers are there. Placements in feed lots have slowed down some now, some have, and our feeders are in distress again. But placements will increase, and those will be coming the latter part of the year. Likewise, there may be some recovering in farrowing of pigs, and once they get here——

Senator HUMPHREY. Right. But do you see any possibility that in the first two quarters, the first 6 months of this year, that there is going to be a reduction below the 20 percent price increase?

Secretary BUTZ. Oh, yes. Yes. We are not forecasting that. Twenty percent from what? From now?

Senator HUMPHREY. Well, you had a 20-percent increase, food increase of prices of 20 percent in December and January.

Secretary BUTZ. Twenty percent compared with the year previous?

Senator HUMPHREY. Yes. That is right.

Secretary BUTZ. With the previous year.

Senator HUMPHREY. Yes.

Secretary BUTZ. And that is precisely what I am talking about.

Senator HUMPHREY. You average it out at 12 percent over the year.

Secretary BUTZ. There is a misunderstanding; 12 percent from the average of 1973 to the average of 1974. The average of 1974 would include some easier price situation in meats the last half of 1974, if markets increase as we think they will. So when I am predicting a 12 percent increase average to average, approximately 8 percent of that is already behind us, or two-thirds.

Senator HUMPHREY. What do you average then; what is your prediction for the first 6 months of this year in price increase?

Secretary BUTZ. First 6 months over what, the first 6 months of last year?

Senator HUMPHREY. What do you think will happen to food prices starting January 1 up to July 1? I mean, how much is it going to go up? Start from last year because that is where we left off.

Secretary BUTZ. Well, we had this big increase in January and February this year.

Senator HUMPHREY. Right. That is what I am talking about.

Secretary BUTZ. And you count that in. Now, we anticipate perhaps another 3 or 4 percent increase in the second quarter over the first quarter.

Senator HUMPHREY. That would be up to 23 to 25 percent.

Secretary BUTZ. Over the first 6 months of a year ago.

Senator HUMPHREY. That is right.

Secretary BUTZ. We predicted 12 percent and it is an average of 1973 to 1974.

Senator HUMPHREY. Let me just put it simpler. Are food prices going to be less this year than last year?

Secretary BUTZ. No. We did not say that. We said they would be 12 percent higher on the average.

Senator HUMPHREY. You said 12 percent. I would predict to you, sir, you estimate is overly optimistic, based on the increases that have been taking place in the market, and that the market situation on food grains is tight, wheat is tight, and the fact that on the feeder lots there has been real trouble insofar as bringing in enough cattle. I predict that your price increases, your price prediction, is very, very optimistic. I hope you are right. I hope you are right.

Secretary BUTZ. That is possible, Senator.

Senator HUMPHREY. But last year you were dead wrong. Herbert Stein was wrong in his estimates that were here, and with all of the evidence piling up, that we are going to have a short supply, which the whole world knows, I mean the world knows that there is a shortage of food——

Secretary BUTZ. But we are going to have the most massive increase in production this year we have ever had.

Senator HUMPHREY. I know. But we are going to have the most massive demand we have ever had. So what? It is like saying, gee, I am getting a bigger salary than I ever had, but what difference does that make when you have to pay more for your car, more for your electricity, more for your fuel?

Secretary BUTZ. Our best estimate is that given an average weather this year, there will be some buildup in stocks in this country and the world, not great, but at least you will end the downtrend.

Senator HUMPHREY. The projections do not indicate that thus far. I want to put in the record, and I hope I am wrong, you forecast for the second half of 1974 sharply lower food prices because of increased food supplies from new crops, but in view of the fact that much of this new crop will be replenishing exhausted crops, and with the factor of fuel and transportation rising, and it takes a long time for the farm price declines to filter their way to the grocery store, I do not see evidence to indicate a sharp declination of food price increases. You indicated on the bread that even if the price of wheat went down, the price of a loaf of bread is not going to go down.

Secretary BUTZ. What part of my statement are you reading from?

Senator HUMPHREY. Your indication is, your forecast for the second half is that there would be lower food prices. This is what you said here today.

Secretary BUTZ. I thought you said sharply increased food prices.

Senator HUMPHREY. No, sir. Sharply lower food price increases.

Secretary BUTZ. In my statement where I said, "Retail food prices would level off after midyear and perhaps decline slightly toward the end of the year." I believe you used the word "sharply."

Senator HUMPHREY. All right. We will alter it, slightly decline; decline slightly toward the end of the year.

Secretary BUTZ. Based primarily on bigger crops and increased supplies of cattle. We see them coming.

Senator HUMPHREY. Have you really noticed that even when there was an increase in the flow of cattle into the supermarkets that we really had any substantial decrease in prices?

Secretary BUTZ. That has been part of our problem, that margins have increased in recent times.

Senator HUMPHREY. That is right. And we have to look at this just not from your Department, Secretary Butz. I know you are a hard-working man, and you have done a lot of good things for our country. But in this business the Government has got to look at the total picture with the transportation problems, the mark-up, the profits, and as the lady said to me this morning, "I listened to the 'Today Show,' and on the 'Today Show' they had one person after another talking about inflation, all of the different problems, the energy, housing and taxes, the whole business, not just food but what happens in food, and while that is going on, and while these people are paying these high prices," there are people today in the corporate business of agriculture, food processing, and of retailing whose profits are unprecedented. This is mark-up. I know what happens in a mark-up when a product is scarce.

Secretary BUTZ. I may say that one of those comes to Campbell Taggart, headed by Bill Medd, chairman of the American Bakers Association, who initially made that scare tactic about dollar bread, and very shortly got a letter to his shareholders saying our company is not going to run out of flour, we are protected, and we have the best this year, and we are going to top it in 1974. I was not impressed.

Senator HUMPHREY. I know my time has run out, and I am going to request what I want to include in the record, Mr. Vice Chairman, my statement on my bill, S. 2005, the consumer and marketing reserves, and I happen to believe that this country has got to have certain types of reserves. The world situation has changed, the domestic situation has changed, and I would like to have published in the record my statement and a copy of that amendment.

Senator PROXMIRE. Without objection, so ordered.

[The material referred to follows:]

[From the Congressional Record, Feb. 19, 1974]

ADEQUATE RESERVES OF CERTAIN AGRICULTURAL COMMODITIES—AMENDMENT

AMENDMENT NO. 963

(Ordered to be printed, and referred to the Committee on Agriculture and Forestry.)

NATIONAL FOOD AND FIBER RESERVES

Mr. HUMPHREY. Mr. President, on behalf of myself, Senator MONDALE and Senators AIKEN, HARTKE, HUGHES, MCGEE, MCINTYRE, PASTORE, and STEVENSON, I introduce an amendment to S. 2005, a bill which Senator MONDALE and I introduced last summer, to provide for more adequate reserves of grains and soybeans.

The need for this legislation has become even more critical since last summer. Our Nation's reserves of both wheat and feed grains today are the lowest they have been in about 27 years. In fact, it is highly probable that U.S. carryover stocks of wheat by the end of this marketing year will reach almost zero. Carryover stocks of feed grains by the end of this marketing year also are expected to reach near record lows. These grains, of course, are the feedstock for livestock, dairy, poultry, and hog industries.

The effect of the changes to S. 2005, incorporated in my substitute amendment, is to simplify the reserve features, add reserve provisions for cotton, and give the Secretary of Agriculture authority to license exporters of agricultural commodities in short supply. It also gives the Secretary authority to require prior approval of certain export sales. It stops short, however, of authorizing any export embargoes or export limitations.

The amended bill continues the provision that if estimated carryover stocks go below the levels set in the bill—600 million bushels of wheat, 40 million tons of feedgrains, 5 million bales of cotton, and 150 million bushels of soybeans—the Secretary is authorized and directed to make loans and purchases, at not less than 100 percent of the established price for 1974 and 90 percent for 1975 through 1977, to bring the reserve stocks up to the levels in the legislation.

Also, whenever projected carryover stocks of a commodity fall below the level specified, the commodity is designated as a "critical commodity," and an exporter of a "critical commodity" must obtain an export license from the Secretary of Agriculture.

Government—Commodity Credit Corporation—stocks of "critical commodities" could not be sold on the domestic market for less than 135 percent of the established market price for wheat, feed grains, and cotton and 150 percent of the current loan rate for soybeans. Exports of CCC stocks of "critical commodities" could not be sold for less than 20 percent above the cash market price prevailing in the preceding week. This would price CCC stocks sold for export at about 20 percent higher than those sold for U.S. domestic use.

The Secretary of Agriculture is directed to maintain a weekly projection of foreign sales and domestic requirements in relation to available supplies of each designated "critical commodity." Each person licensed to export any "critical commodity" shall report exports of such commodity on a daily basis to USDA.

Prior approval by the Secretary of Agriculture must be obtained for exports of a "critical commodity" to any country when exports to that country in any given marketing year reach 120 percent of the previous year's exports. This provision is designed to prevent any country from raiding U.S. supplies unexpectedly, thereby assuring all buyers—both United States and foreign—equal access to U.S. supplies.

Mr. President, I was delighted to find that someone on the President's staff succeeded in alerting this administration to the need for food supply and price-stabilization measures for consumers.

The following illuminating paragraph appears on page 128 of the annual report of the Council of Economic Advisers, February 1974:

Wide swings in farm and food prices contribute to instability throughout the economy. This became especially clear in 1973 when rising food prices accelerated the overall inflation rate. Although instability will at times lead to reduced farm prices, there are existing standby measures that cushion the decline in farm incomes. *Comparable measures do not exist at present to moderate an acceleration in consumer food prices.*

This paragraph is followed by the statement that new conditions and new issues face agriculture. The new conditions and issues are discussed, but policy recommendations for dealing with them are lacking.

Mr. President, S. 2005, as amended by this bill, provides an effective, efficient, low-cost method of correcting this deficiency.

RESERVES FEATURES BENEFIT BOTH PRODUCERS AND CONSUMERS

S. 2005, as amended by this bill, provides for acquiring and managing reserves of grains, soybeans, and cotton within the general framework of the forward-looking Agriculture and Consumer Protection Act of 1973.

At this time, attractive economic incentives are needed to assure maximum crop production in 1974. The possibility exists, however, that the crops may be so large that market prices will fall below the target prices set in the 1973 act, $2.05 a bushel for wheat, $1.38 for corn, and 38 cents a pound for cotton.

This bill requires the Secretary of Agriculture to offer producers nonrecourse loans on the 1974 crops of these commodities at the target price levels, and to offer nonrecourse loans at not less than 90 percent of the target price levels in future years when the carry-in from the previous marketing year was less than the desirable minimum reserves listed above. Government loans on soybeans would be made on a comparable basis.

These particular provisions would not only provide farmers with higher floor-price protection in times of over-production, but also would reduce the Federal Government's liability exposure regarding direct payments during such

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periods, and provide consumers—both livestock producers and housewives—with reserve stock protection for any future periods of severe shortage.

In order to prevent stocks at the desired minimum levels from depressing market prices in future years, minimum Commodity Credit Corporation resale prices would be raised to 135 percent of the established or target prices for grains and cotton and 150 percent of the loan rate for soybeans when the projected carryover of any of these commodities falls below the minimum desirable levels specified earlier.

I believe that if this bill is approved promptly, the 1974 harvests will be larger than otherwise because of the much higher floor prices provided. Rather than allowing prices to fall below the target levels, if the harvest is bountiful, some stocks might be accumulated in the 1974–75 marketing year.

We might be so fortunate as to harvest such large crops in 1974 that $1 billion in stocks of these commodities would be placed under loan and turned over to the Commodity Credit Corporation at the close of the marketing year. If that should occur and 2 years later another short-fall occurred, these stocks would be available for sale at 135 percent of their original cost. This would more than cover storage costs.

A reserve program as authorized in S. 2005, if properly administered, would benefit producers, domestic consumers, and export buyers, and probably would result in some income to the Government, because of the substantially higher selling prices as compared with acquisition costs. Excessive and burdensome stocks would not be accumulated by the higher loan levels authorized in S. 2005, when supplies are short. As soon as supplies reach desirable levels, the Secretary of Agriculture may return to the lower nonrecourse loan levels authorized in the Agriculture and Consumer Protection Act of 1973.

EXPORT-MANAGEMENT FEATURES

S. 2005, as amended, also authorizes the Secretary of Agriculture to exercise a degree of control over exports of agricultural commodities in critically short supply. This is accomplished by four measures, all much less disruptive than resorting to export embargoes as in the case of soybeans in June 1973.

First, all exporters of an agricultural commodity designated as critical by the Secretary of Agriculture would be required to obtain an export license.

Second, all export sales of these commodities would have to be reported on a daily basis.

Third, prior approval by the Secretary would be required for export sales of any commodity in critically short supply when sales of that commodity to any individual country reach 120 percent of the previous year's exports to that country in any given marketing year.

Fourth, Government stocks of commodities in critically short supply may not be sold for export for less than 120 percent of the average cash market price prevailing in the principal markets in the preceding week.

Mr. President, U.S. farmers have a magnificent production record. Food supplies have been so abundant for the past two decades that consumers in the United States have been the best fed people in the world at relatively the lowest cost.

The situation changed abruptly in 1972, however, when the U.S.S.R. and the People's Republic of China entered the international grain markets to make up their short falls in domestic production at a time when weather was unfavorable for crop production in a large part of the world.

We must continue to be a reliable supplier in the international markets. Our farmers cannot prosper without access to world markets.

Yet, if we are to maintain reasonably stable economic conditions in this country, and assure stable supplies for our regular foreign buyers, we must exercise some control over exports of agricultural commodities in critically short supply. S. 2005, as amended, will permit this desired, yet minimum control.

Prompt approval of S. 2005, as amended, is urgently needed. It will give producers additional economic incentives and security, with a higher floor under 1974 crop prices, as they are forced to make record expenditures to produce these crops. It will give consumers and our regular export customers additional protection in case supplies of these commodities become critically short before the 1975 crops are harvested.

For the future, the bill would help keep farm prices from going as low as otherwise might be expected, and it would permit the accumulation of stocks and prevent their release until they are needed to stabilize consumer and export supplies in time of short supply.

Mr. President, I already have requested that hearings on this bill be held sometime in March.

Senator WALTER D. HUDDLESTON, chairman of the Subcommittee on Agricultural Production, Marketing, and Stabilization of Prices, of the Senate Committee on Agriculture and Forestry, has indicated to me that he expects to move forward on this legislation very soon.

Mr. President, I invite other Senators to join in sponsoring this legislation.

Mr. President, I ask unanimous consent to have my amendment to S. 2005 which is in the nature of a substitute, printed at this point in the RECORD.

There being no objection, the amendment was ordered to be printed in the RECORD, as follows:

AMENDMENT NO. 963

Strike out all after the enacting clause, and insert in lieu thereof the following:

That the Agricultural Act of 1970 is amended by adding at the end thereof a new title as follows:

"TITLE XI—CONSUMER AND MARKETING RESERVES

"SEC. 1101. (a) Effective only with respect to the 1974 through 1977 crops of wheat, corn, grain sorghum, barley, oats, rye, cotton, and soybeans, the third sentence of section 407 of the Agricultural Act of 1949, as amended, is amended by striking out the third proviso (relating to the minimum price at which certain grains in the stocks of the Commodity Credit Corporation may be sold) and inserting in lieu thereof the following: '*And provided further*, That the Commodity Credit Corporation shall not sell any of its stocks of wheat, corn, grain sorghum, barley, oats, rye, or cotton, respectively, at less than 135 per centum of the established price applicable by law to the current crop of any such commodity, or any of its stocks or soybeans at less than 150 per centum of the current national average loan rate for such commodity, adjusted (in the cast of all such commodities) for such current market differentials reflecting grade, location, and other value factors as the Secretary determines appropriate, if the Secretary determines that the sale of such commodity will (1) cause the total estimated carryover of such commodity at the end of the current marketing year for such commodity to fall below six hundred million bushels in the case of wheat, forty million tons (collectively) in the case of corn, grain sorghum, barley, oats, and rye, 5 million bales in the case of cotton, or one hundred and fifty million bushels in the case of soybeans, or (2) reduce the stocks of the Commodity Credit Corporation below two hundred million bushels in the case of wheat, fifteen million tons (collectively) in the case of corn, grain sorghum, barley, oats, and rye, 1.5 million bales in the case of cotton, or fifty million bushels in the case of soybeans; and in no event may the Corporation sell any of its stocks of any such commodity in any marketing year at less than 115 per centum of the current national average loan rate for the commodity, adjusted for such current market differentials reflecting grade, quality, location, and other value factors as the Secretary determines appropriate plus reasonable carrying charges, whenever the total estimated carryover of such commodity in such marketing year is in excess of the amount specified for such commodity in clause (1) above.'

"(b) Notwithstanding any other provision of law, whenever, for any marketing year, 'the Secretary estimates that the carry-over stocks of wheat will be less than six hundred million bushels, the carry-over stocks of feed grains will be less than forty million tons, the carry-over stocks of cotton will be less than 5 million bales, or the carry-over stocks of soybeans will be less than one hundred and fifty million bushels, the Secretary is authorized and directed to make available loans and purchases (1) to producers participating in the wheat, feed grain, or upland cotton programs, as the case may be, at not less than 100 percent of the established price for such commodity for the 1974 crop and at not less than 90 percent of the established price for such commodity for the 1975–1977 crops years and (2) to producers of soybeans on a comparable basis. As used in the preceding sentence, the term "feed grains" means corn, grain sorghum, barley, oats, and rye.'

"(c) (1) Effective only with respect to the 1974 through 1977 crops of wheat, corn, grain sorghum, barley, oats, rye, cotton, and soybeans, whenever the Secretary of Agriculture finds that the combined domestic requirements and export sales of any such commodity threaten to reduce the carryover of such commodity at the close of the marketing year for such commodity below the level specified for such commodity in clause (1) of the third proviso of the third sentence of section 407 of the Agricultural Act of 1949, as amended, he shall designate such commodity as a 'critical' commodity for the current marketing year, and thereafter, during such marketing year, no person may export any such commodity from the United States without an export license issued by the Secretary of Agriculture authorizing the export of such commodity by such person.

"(2) The Secretary of Agriculture shall require each person licensed to export any critical commodity to report daily all bona fide export sales of such commodity.

"(3) The Secretary of Agriculture is directed to maintain a weekly projection of foreign sales and domestic requirements in relation to available supplies for each designated critical commodity. Except for sales made to friendly countries under the Agricultural Trade Development and Assistance Act of 1954, at any time that the projected carryover stocks for any commodity in any marketing year fall below the level specified for such commodity in clause (1) of the third proviso of the third sentence of the Agricultural Act of 1949, as amended, the Commodity Credit Corporation may not, so long as the stocks of such 'critical' commodity remain below such level, sell any of its stocks of such commodity for export for less than 120 per centum of the weekly average cash price of the commodity in Chicago, Kansas City, and Minneapolis markets in the immediately preceding week, except that in the case of cotton, the minimum price at which such commodity may be sold shall be 120 per centum of the weekly average cash price in the designated spot markets reported by the U.S.D.A. in the immediately preceding week. None of the stocks of any commodity designated as a critical commodity under this section may be sold by the Commodity Credit Corporation to any buyer for domestic utilization unless such buyer agrees, in such manner as the Secretary of Agriculture may prescribe, that any stocks of such commodity sold to him will not be exported.

"(4) Whenever the projected carryover stocks of any commodity fall below the level specified for such commodity in clause (1) of the third proviso of the third sentence of the Agricultural Act of 1949, as amended, no quantity of such commodity may be exported to any foreign country in an amount that would result in total export sales to such country (from the United States) during such year in excess of 120 per centum of the amount of export sales of such commodity to such country (from the United States) in the preceding marketing year, unless the Secretary of Agriculture specifically approves the export of such quantity to such country.

"(d) The Secretary is authorized to issue such rules and regulations as he deems necessary to provide for the effective administration of this section.

"(e) In determining the quality of carryover of any commodity at the beginning of or during any crop marketing year and the quantity of any commodity owned by the Commodity Credit Corporation, there shall be included any quantity of such commodity contained in the disaster reserve inventory maintained under the provisions of section 813 of this Act.

"(f) There is hereby authorized to be appropriated such sum as may be necessary to carry out the provisions of this section."

Senator HUMPHREY. I also would like to ask for the comment of the Department a question an a proposal that I have offered in the Congress on an export management system. The bill would require prior approval of export of commodities in critically short supply with projected export when countries reach 120 percent of previous year's exports to that country. All exporters having an agricultural commodity designated as critical by the Secretary of Agriculture would be required to obtain an export license, and all export sales of these commodities would have to be reported on a daily basis. It is similar in part to the bill offered by Senator Javits.

Now, none of us are sufficiently expert in this to be sure that we know the right approach. I think all we are really looking at is how do we protect the American consumer on the one hand and a fair price for the farmer out there on the other hand. He is entitled to a fair price. He has subsidized consumers for 25 years around here and he is entitled to a fair price. And I think you have done a good job defending his interests, Mr. Secretary, speaking up for him, and I want to pay my respects to you for it. But I am worried that the Department, because it believes in the market theory, wedded to the fact that the only way to work things out is to let the market take its toll, so to speak, the market to work its will, that we can end up here producing a huge wheat crop, huge corn crop and having the American consumer not protected. And I notice that our neighbors to the north have seen fit this week to see that that is not going to happen, and Canada is one of the large exporters, grain exporting countries. We will have a political upheaval in this country if this happens, and the American consumer is not going to permit the situation to develop in which we export more than we should at the expense of the American consumer in the price that he has to pay. And we have got to find some way to balance it off without going to export, immediately imposed export controls. I think that other nations will understand this. They control exports for their benefit. It is the way we do it. If we come in and just slap on an export control without consultation, without prior notification, we are going to be in trouble. But if we have some kind of monitoring system, I think we can make it, and I offer the suggestions, not in controversy or as a confrontation, but I am deeply concerned and continue to be. And I have nothing to alleviate that concern. As a matter of fact, I am very much worried about your comment about world food production and population, and the balance of this century. I sharply disagree with you, Secretary Butz, with my high regard for your knowledge. I think that the population pressure on food supply the balance of this century, with growing affluence of any nation, is a matter of deep concern, and I notice in this morning's press in a study that is just another study that has just been made saying we face the prospect of critical world food shortages in this decade and I would say that between now and the year 2000 that I think that the Malthusian theory may be proven right, and we have to do better in international food planning.

Thank you, my time is up.

Senator PROXMIRE. I would like to follow up, Secretary Butz, on the questioning of Senator Humphrey in several respects. I want to make sure I understand what you said, when you indicated that prices might decline slightly at the end of the year. Are you talking about food prices to the consumer, or were you talking about farm prices?

Secretary BUTZ. Food prices to the consumer.

Senator PROXMIRE. Now, how much would farm prices have to drop for that to be possible in view of what we have been discussing, that a large proportion of the consumer dollar goes to the processor, and to the distributor, and to the truck driver and so forth?

Secretary BUTZ. Well, as the market drops in the futures market for grains——

Senator PROXMIRE. We are talking about all food prices. The problem is that there will be other inflating factors in the food business. Energy costs increases, of course, are going to be reflected in the higher food prices, not only from the farm but also from the transportation of food.

Secretary BUTZ. I think this forecast is based primarily on the indication of increased per capita supplies of red meat.

Senator PROXMIRE. But you could only get a dropoff to any extent, any slight dropoff of food prices if you had a sharp fall in farm prices, would you not?

Secretary BUTZ. I would not use the word "sharp" in this case. We are not going to have any sharp fall in farm prices, so I think it is unrealistic to expect wheat prices to continue at the present levels, or corn prices to continue at the present levels.

Senator PROXMIRE. You seem to say while wheat may not drive bread prices to a dollar a loaf, you seem to indicate that perhaps, just possibly other prices combined with increased wheat prices might give us a dollar a loaf. Is that correct or not?

Secretary BUTZ. No, I did not, no. I did not say that. There is no way we could get dollar bread between now and then.

Senator PROXMIRE. No way?

Secretary BUTZ. No.

Senator PROXMIRE. You will walk across the Potomac if we get dollar bread by December?

Secretary BUTZ. Yes, sir; on the 14th Street Bridge.

Senator PROXMIRE. Well, I was just hoping you would walk on water and make it possible not to use the bridge. The reason I am asking all of these questions is what do we do about this? What do we do about the situation which we have of the American consumer in such a difficult position?

Secretary BUTZ. I want to assure you, Mr. Vice Chairman, that the Department of Agriculture is not that careless in our attitude toward the American consumer. Obviously they are our customers, and our good customers, and are going to keep on being our good customers.

The year before last, as you indicated I think in your opening statement, or one of you did, the percentage of takehome pay that we spend for food in this country dropped as low as 15.6 percent or 15.7 percent. Last year for the first time in 15 years it increased a little bit to about 15.9 percent. This year it may be around 16. After that I would anticipate it would start along the downturn.

Senator PROXMIRE. That is right, and it is a story that you have told well, and it has not been told sufficiently, and it ought to be appreciated that people are spending a small, far smaller proportion of their income on food than at any time in history, and it is a great record. The trouble, however, is that it is an uneven record. People of low income spend more, and this last year there has been a reversal, and a painful reversal that is a higher proportion of income for food.

The problem, as I see it, is that you, and Secretary Shultz, and

Mr. Stein all indignantly oppose anything that might result in our controlling exports. Yes, almost everywhere in the world agriculture is controlled rigidly. Certainly in the Common Market there are tremendous restrictions and limitations on the free flow of agricultural commodities, and the British Commonwealth preference system has done this for years. In this country we are willing to see almost a free flow of farm products abroad. This is happening at a time when there are food shortages throughout the world, and the effect is to drive up the cost of food to the American housewife precipitously. Further, the food we send abroad does not go to the poor and the needy. It goes to those who can pay for it, the relatively well to do. In these circumstances do we not have an obligation to take care of American consumers first, and does not every country have a fundamental obligation to provide its own people with an abundance of relatively inexpensive food? Why should we be virtually the only country in the world to allow unfettered exports of our food while others refuse to do so?

Secretary BUTZ. Well, I think there are two sides to that, Mr. Vice Chairman. The American people have opted to import a substantial number of items that enter into our living standards. For example, the petroleum that we imported last year, while we decried the rising price of crude petroleum at the present time, with the import, I dare say that American wheat exports today buy more petroleum than 2 years ago. This is still a good way to pay for it, it is one of the best ways we have to pay for the many things we import like electronics and Italian made shoes.

Senator PROXMIRE. You know the restrictions that have been on petroleum.

Secretary BUTZ. Indeed, but we still import a substantial share. We do not get all of our petroleum imports from the Middle East. We get it from other places, too. But the point I am making is agricultural exports still represent the best single way we have to pay for the wide variety of things we have opted to import in this country that advances our level of living.

Senator PROXMIRE. I am not disputing that. I think that is right. And I think we should take full advantage of it, and I think it is something we have to count on. What I am concerned about, and what I think others are concerned about is the possibility that we might have an explosion of these exports in 1 year that could have a very serious effect on the American consumer, and we do not have any system of controlling. We just leave it to the market. That is the problem.

Secretary BUTZ. Well, that gets to be an effective system, I guess. It has caused some contracts for wheat that were to be shipped out of old crop to be deferred into new crop wheat.

Senator PROXMIRE. Last year we had a very, very unfortunate experience for the consumer.

Secretary BUTZ. The first time in 5 years.

Senator PROXMIRE. Well, we might have another one this coming year. I have been an advocate of an early warning system in terms of gathering facts about our exports and our export demands. If we had had such a factual system in place at the time of the Russian wheat deal, we would have known what was going on. And I have always believed that the minimum requirement for making public policy is the availability of the best possible intelligence; that is, having good data and statistics on which to base that policy so we know what is happening in the worldwide demand, for example.

It is better to make judgments on the basis of information than on hunches, guesses and seat of the pants instincts. Now, unfortunately, Secretary of the Treasury, Mr. Shultz, opposes even gathering such data on ground that gathering it affects policy. Exporters are more likely to exaggerate their proposed exports if they think such facts might lead to export restrictions, and would want to get their nose under the tent before restrictions or export controls are put in place. What is your view? Does the gathering of such information offend against your strong views of unfettered freedom in the marketplace?

Secretary BUTZ. Why, no. No, we want as much information as we can get. And as a matter of fact, to have a free market to function properly depends on adequate information.

Senator PROXMIRE. Why not have an effective early warning system?

Secretary BUTZ. We are now, in fact, acquiring all of these warning systems, and you mentioned the Russians again. The Russians themselves did not know the extent of their grain requirements when they came here, and nobody could predict the hardest and the driest summer in 100 years in Russia. They came back 4 or 5, maybe 6 weeks later, and at that time they put their additional purchases in place.

Senator PROXMIRE. I am not asking for a precise prediction, but that one was so far off. You have long been on record opposing restrictions on agricultural products, quotas, price supports, import and export restrictions, the Brannon type of payments and so forth. Is that not true?

Secretary BUTZ. Yes, sir.

Senator PROXMIRE. Then tell me, Secretary Butz, why you do not oppose vehemently the present sugar program? It restricts imports. It gives the quota country by country. It provides production quotas within the United States. It limits the number of refineries. It makes production payments to farmers. It taxes the processors who pass the cost on to the consumers to provide payments to farmers. There is virtually every restriction known to man in that program, but year after year the Department of Agriculture promotes it.

And, as we all know who have been in Congress, there is often considerable hanky-panky connected with it. Why do you not oppose that program, recommend that we go to the free market in sugar, genuinely free market, not merely a free market for the very limited amount put up for bid on the world market, and lobby the President to veto any bill with the kinds of restrictions you have always opposed for other products? Now, what about it? Are not you and the Department, and the Farm Bureau and others being two-faced when you oppose restrictions but support the sugar quota system?

Secretary BUTZ. That is a very good question, and in public statements I have made in the last several months I did oppose this system, and philosophically I do oppose this system. And yet, you recognize political realities. I underestimated the power of the sugar lobby in this town. I underestimataed the influence the sugar lobby in this town has on members of this body right here, and soon I recognized that we were going to have to extend the Sugar Act——

Senator PROXMIRE. Well, why don't you urge the President to veto it?

Secretary BUTZ [continuing]. Therefore, we moved back to make such refinements as we could in this program. You know, somebody said that politics is the art of the impossible, and I realized a few weeks ago what was impossible in this respect. I am speaking very frankly.

Senator PROXMIRE. You are and I appreciate it. I wish you would go a little bit further, however, and urge the President to exercise his very powerful legislative function of veto. If you do that you can count on this Senator's vote, and I think you can very well have it sustained.

Secretary BUTZ. Well, I am delighted that I can count on that vote. There is a lot of sentiment the other way in this body though.

Senator PROXMIRE. I am sure there is, yes.

Secretary BUTZ. And it is very articulate.

Senator PROXMIRE. Well, it is mighty well financed, too.

Secretary BUTZ. That is what I am saying. I am saying I underestimated its power.

Senator PROXMIRE. How much food will the United States be sending abroad under Public Law 480 programs this year as compared to previous years?

Secretary BUTZ. We are not going to use Public Law 480 at all in the sense that we are disposing of surplus foods as it was initially set up to do. The primary criteria we have for Public Law 480 now is food and fiber for national security purposes and for welfare and relief purposes. And we are working in close concert with the National Security Council and with the State Department in determining those needs.

Senator PROXMIRE. You say you are going to use Public Law 480 for national security purposes?

Secretary BUTZ. Yes.

Senator PROXMIRE. In other words, food for peace for war?

Secretary BUTZ. Oh, no.

Senator PROXMIRE. That is one of the objections that I have had for a long time to the food-for-peace program. As you may know, this committee disclosed the fact 3 years ago that food-for-peace funds were being used in part for foreign military assistance, and now we passed a law last year ordering a halt for the use of food for peace for war. And in fiscal 1973 food for peace for war leaped to $154 million, it had been $67 million the year before, and the current year the cost is going ahead again this time to $348 million.

Secretary BUTZ. Well, there are some nations that we have a very substantial investment in. South Korea, for example, is rapidly moving toward an economically viable economy, but we do, in fact, put some foodstuffs into that nation. Or South Vietnam, where they simply cannot sustain themselves at the present time, and you get a situation like we have had in Ethiopia at the present time, with very severe droughts, or in central African nations with severe droughts, or Bangladesh where we do, in fact, have a program of food for humanitarian purposes. And so we have been working through the world food program through the offices of the FAO.

Senator PROXMIRE. What concerns me greatly is that this is a food-for-peace program, and the program is sold largely on a semantic basis, and this program was rightly sold to the Nation that we could provide more peaceful conditions or circumstances for the world by eliminating the great food needs that have aggravated and provoked this strife in the past, food for peace to countries like India and countries in Africa and so forth. You are providing it now primarily on a security basis for military purposes or for defense purposes, war, and if this is what we want to call them, it seems to me we at least ought to have the honesty of changing the name. I am not accusing you of any dishonesty, but our Government calling this a food-for-peace program is hypocrisy, it seems to me now.

Secretary BUTZ. I think it is being used now to preserve peace. We are not at war with anybody now. I think it is being used to preserve that situation.

Senator PROXMIRE. Well, we can argue that our Defense Department used to be called the War Department, in part War and Navy Department, and it can be argued that it is really a peace department, and that we build aircraft carriers and missiles and so forth, and it is really building them for peace, and I suppose that that is true, that people may look at them that way. But I think all of us feel that when we talk of the food-for-peace program we do not mean it to go to helping foreign armies. However, that military assistance may or may not be a good program, but I am inclined to think it is pernicious, but whether it is or not should not be called the food-for-peace program.

Secretary BUTZ. Let us separate military assistance from food assistance. They are two different things.

Senator PROXMIRE. Well, my staff has been unable to get an estimate from your office of the amount that will be spent on food for peace for war because of agreements entered into before the new law went into effect. Can you give us your best estimates of how much will be spent in fiscal 1975 and beyond?

Secretary BUTZ. No. I cannot tell you that right now.

Senator PROXMIRE. Can you do that for the record?

Secretary BUTZ. I will supply it for the record. We will get it for the record.

Senator PROXMIRE. And give us a country-by-country breakdown showing the amount spent for defense purposes for food-for-peace funds for each of the past 5 fiscal years.

Secretary BUTZ. I do not think we have the figures that we now spend for defense purposes. I will check.

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

The Department has been furnishing to the Joint Economic Committee, upon request, figures on common defense grants generally based on agreements signed with participating countries. In our budget presentation we project Public Law 480 programing on a commodity basis, but do not project such programing on a country basis.

Consequently we have not furnished country figures relating to fiscal year 1975. Until agreements are fully implemented we do not know the precise amount or timing of local currency grants.

Programing to an individual country depends, among other things, upon commodity requests, availability, and price. There follows a table reflecting the values of common defense grants derived from the values of agreements signed with participating countries during the past five years. No data are offered for fiscal year 1975 as no Title I Public Law 480 sales agreements providing for common defense grants are expected to be signed after June 30, 1974. While the appendix to the fiscal year 1975 budget indicates estimated financing of $113 million, these expenditures would arise from currency generations under agreements signed prior to fiscal year 1975 and would be reflected within prior year agreement totals.

PUBLIC LAW 480, TITLE I—VALUE OF SECTION 104(C) GRANTS PROVIDED IN SIGNED AGREEMENTS

[In thousands of dollars]

Country	Fiscal year— 1970	1971	1972	1973 [1]	1974 [2]
Cambodia		6,800	16,546.6	20,618.4	136,581.6
Korea	32,280	20,000			
Vietnam	75,130	164,640	50,640.0	143,200.0	227,240.0
Total	107,410	191,440	67,186.6	163,818.4	363,821.6

[1] Based on agreements signed and not on actual disbursements.
[2] Estimated on the basis of agreements signed through February 1974.

Senator PROXMIRE. Is this not your program, Mr. Secretary? Should you not have those figures, if anybody has them, is this not the Department of Agriculture's responsibility?

Secretary BUTZ. Well, yes, sir. But when you talk about the amount of food for peace for defense purposes, this is to make up food shortfalls in countries where we have a substantial investment. I have mentioned South Korea. They have not been at war for years. But we are still trying to maintain a viable economy there which is beyond their capacity to do, and we have done it in India for quite a long while, as you know.

Senator PROXMIRE. Well, it can only be used for defense purposes when specific agreements are entered into with those countries for that purpose, is that not correct?

Secretary BUTZ. You mean——

Senator PROXMIRE. This program.

Secretary BUTZ. You mean what they pay internally?

Senator PROXMIRE. What is generated by this program, yes.

Secretary BUTZ. I am not familiar with the details of that.

Senator PROXMIRE. How do you justify that enormous increase from $67 million a couple of years ago to $154 million, and then to $349 million for what is really in my view a military assistance program?

Secretary BUTZ. You are talking now about the Public Law 480 program?

Senator PROXMIRE. Yes, sir, that part of it.

Secretary BUTZ. Well, that includes a lot of countries. That includes rice to South Vietnam, for example, and if we are talking about the same thing, I am not right up on those figures.

Senator PROXMIRE. Well, elaborate on that, if you can, for the record and we would very much appreciate it.

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

The only countries whose Title I Public Law 480 agreements currently provide for common defense grants are Cambodia and Vietnam. The large increase in program levels for those countries is attributed mainly to substantially increased requirements for rice, particularly for Cambodia, coupled with sharply higher unit prices for rice. Current projections indicate that approximately 600,000 metric tons of rice will be shipped to Cambodia and Vietnam during fiscal year 1974 at a cost of well over $300 million. The unit prices for other commodities also have increased.

Senator PROXMIRE. I have one other area that I am very much concerned about, which both Senator Humphrey and Senator Bentsen mentioned, which is the importance of emphasizing research. Now, we have a food and forage lab that has been in the works now for 10 years, I think, at Madison, Wis., and your department has indicated that the capital cost is $8.5 million, and the annual cost of operating that is $3.5 million, and the benefits are $350 million a year, a 100-to-1 benefit-cost ratio. And somehow we cannot seem to move ahead with that. Now, of all of the areas where research would pay off and pay off clearly, it seems to me that any businessman who would not take advantage of this would be out of his mind.

Secretary BUTZ. Yes, sir.

Senator PROXMIRE. It would pay for itself in 8 days.

Secretary BUTZ. I think in the aggregate, Mr. Vice Chairman, our research facilities that have been built are out in the country, out in the various States, mandated by the appropriation committees of these two bodies in the Congress, now greatly exceed our capacity to utilize them. We have a great deal of unutilized and underutilized research facilities and research equipment, the limiting factor now being the support personnel, for scientists, and we have taken the position that before we make any more substantial investments in facilities, and the overhead that goes with it, we ought to bring our personnel and our scientific component up to match the existing facilities.

Senator PROXMIRE. Well, why can we not use these facilities? I wrote you last November 26, along with 11 of my Senate colleagues, and we said there are a number of reasons why we urge intensified consideration of this facility. An initiative of this sort is particularly important at this point when federally supported forage and dairy cattle research is declining precipitously. The number of science man-years devoted to forage, pasture, and range research dropped by 20 percent. In the same period man-years of dairy cattle research dropped from 603 to 524. This research cutback has taken place at a time when feed grain costs have moved sharply upward, and it is entirely possible that an acceleration rather than a cutback in production would permit farmers to rely to a great extent on cheaper forage crops in feeding of dairy and beef cattle, resulting in a lesser rise in the consumer price which we are now getting because of increased food costs. Despite this letter, the Department has seen fit to provide no funding for this forage research facility. Although there is an increase in research funding, there is very little if any of this that seems to be going to forage utilization.

Secretary BUTZ. We have received similar letters from other Senators and from other areas who want similar research facilities. We simply have to come back again to the point we think we make the best use of——

Senator PROXMIRE. How could you have a better payoff than 100-to-1? Do you have anything with a better cost-benefit ratio than that?

Secretary BUTZ. Well, do you have the basis for that estimate? That sounds to me like a Bureau of Reclamation estimate of a new irrigation project.

Senator PROXMIRE. No. I think it comes from your Department. We will provide the precise source and we will send it to you.

Well, Mr. Butz, thank you very much. You have been most patient and courteous, and I must say that while I did oppose your nomination, you have a winning personality. And even though I do think you are wrong on some policies, as I have indicated, I think you are certainly doing your best.

Secretary BUTZ. Well, thank you very much. In view of your voting record for my confirmation, I appreciate your comments, Mr. Vice Chairman.

Senator PROXMIRE. All right, sir. Thank you.

The committee will stand in recess until Monday morning when we meet to hear the head of the United Auto Workers, Mr. Leonard Woodcock.

[Whereupon, at 12:35 p.m., the committee recessed, to reconvene at 10 a.m., Monday, March 4, 1974.]

THE 1974 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, MARCH 4, 1974

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

The committee met, pursuant to recess. at 10:10 a.m., in room 318, Russell Senate Office Building, Hon. William Proxmire (vice chairman of the committee) presiding.

Present: Senator Proxmire.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Richard F. Kaufman, general counsel; Jerry J. Jasinowski, John R. Karlik, L. Douglas Lee, and Courtenay M. Slater, professional staff members; George D. Krumbhaar, Jr., minority counsel; and Michael J. Runde, administrative assistant.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. The committee will come to order. Mr. Woodcock, please come forward, sir.

Mr. Woodcock, the crux of the inflation problem is: Can organized labor discipline itself in 1974 to restrict its demands to a level that will not cause runaway inflation?

We have heard the principal economic policy spokesmen for the administration address themselves to the inflation problem. We have listened to the ablest independent economists in the Nation discuss it. We have given intensive study to this problem—and while Government spending and taxing policies. the credit policies pursued by the Federal Reserve Board, the international trade and financial policies of this and other countries all have a bearing on inflation, the crux of the problem lies in the lap of organized labor.

If organized labor pushes hard and successfully for wage increases in the area suggested by AFL-CIO President George Meany of 12 percent, there is no way in my view that this country can avoid a rolling, driving inflation that may end with the kind of economic disaster that now faces Britain and other countries. And big wage increases of this kind would also aggrevate unemployment because nothing would be more likely to discourage business expansion like a sharp increase in wage costs.

I know this is unfair. I know that of all segments of the economy, the wage earner was the prime sufferer last year. I know that profits—

real profits allowing for inflation increased immensely last year. I know that real farm income—allowing for inflation increased at a near record pace in 1973. Business and professional income, interest income, all had a great year. But the man who worked for wages for a living took it on the chin. He got little and as the year went on his real income allowing for inflation and taxes not only declined, but the decline became sharper as the year wore on, and in the first 2 months of this year as prices began to go out of sight, the wage earner's real income suffered a depression-like squeeze.

To call on organized labor for statesmanship modesty in holding down wage demands this year is like asking the working man to kiss the shoe that's kicking him.

This is the year price and wage controls are going to come off. We all know that prices are going to go up more sharply than ever, at least for a couple of months and perhaps for the entire year. But outside of the oil industry, profits are expected to fall in money terms and drop significantly in real terms. Farm income is likely to fall and perhaps fall sharply. Unemployment will probably increase throughout the year. Federal payroll or income taxes may go down.

So the situation for wage modernization may not be as bad as the year wears on, as it appears to be now. Those who seemed to benefit at the workingman's expense last year may suffer this year.

Now, if, in the absence of wage and price controls, we can maintain a moderate level of wage increases, then we have a fighting chance to luck out of the dismal outlook that faces us without falling into that fatal wage-price escalator and without the heavy unemployment that could very possibly accompany it.

Organized labor faces an immensely difficult choice here. This country's economic future to a very considerable degree lies within the discretion of you and other top labor leaders in this country, in my view.

You, Mr. Woodcock, and your union represent an unusually broad, public interest view. You and your union have a long record of fighting for civil rights, education, tax justice, eradication of poverty and in many other areas beyond the self-interest of your union members.

I can understand why labor leaders have been extremely reluctant to appear before congressional committees in the past year or so to tell us their views on inflation and what we can do in the public interest. It is not easy for you to do so. In fact it is very tough indeed.

But these hearings do constitute the principal opportunity this Congress has this year for developing the record on which this Nation's economic policy will be shaped. It would be an economic tragedy if the great unions of this country stood aside and remained silent. We need your advice, your criticisms, your recommendations.

You appear at a time when there is less leadership, less direction for economic policies than at any time I can remember and when our economic problems are as difficult as at any time I can remember.

So you are very welcome indeed and we are anxious to hear what you have to tell us.

STATEMENT OF LEONARD WOODCOCK, PRESIDENT, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW), ACCOMPANIED BY JACK BEIDLER, NATIONAL LEGISLATIVE DIRECTOR

Mr. WOODCOCK. Thank you very much, Mr. Vice Chairman.

With your permission, I would like to file the prepared statement.

Senator PROXMIRE. Yes, your prepared statement will be printed in full in the record. I have had a chance to study it over the weekend. And I must say it is an excellent prepared statement, hard-hitting, but very impressive.

Mr. WOODCOCK. And I would like to highlight it, and go to the specific questions which you raise in your opening statement.

I have with me Mr. Jack Beidler, UAW's national legislative director.

When the President sent his State of the Union message and the accompanying address, he spoke of a Nation making vigorous progress on all fronts against crime, unemployment, poverty, pollution, et cetera, which is certainly at odds with what the ordinary Americans I run into everyday believe. And he made statements such as, in 1973 unemployment reached low levels, and the purchasing power of the American people reached new highs last year. Even after allowing for price increases he said, people are now consuming more goods and services than they did a year ago. We don't think that is consistent with reality.

Then 2 days later when the Economic Report was sent up, which was only slightly less sanguine, it had this remarkable statement:

> A rapid rise toward full employment in 1973. And again the American people generally prospered despite the inflation in 1973, their incomes on the average rose more than prices.

I think, however, the economic statement, without using the words "forecast" or "recession," and certainly forecast the highest peacetime rate of inflation in our history, and the second highest rate of unemployment in 11 years. And that is foreboding because the record of the Council of Economic Advisers under this administration has not been too good in its predictability. Looking at their estimates for the jobless rate, in 1971 their estimate was 31 percent less than it was in fact; in 1972, 10½ percent; in 1973, 9 percent. On the inflation side, in 1970 they were 25 percent off the mark, and in 1971 9 percent, and in 1972 were on the mark.

But in 1973 to make up for being right once, they fell 77 percent off the mark. And if 1974 projections turn out to be as wrong by the average rate of inaccuracy over the last 4 years we will in fact see 6.5 to 6.7 percent unemployment, and 8.9 percent inflation, which would place it squarely among the worst years since World War II.

Now, even the estimate of 5½ to 6 percent means 600,000 to 1 million more workers will be without jobs in 1974 than 1973.

I would like to address myself, if I may, to what I call the new structuralism in economic theory advanced by the administration and many orthodox economists. The CEA says that maximum employment, the condition in which persons want work and seek it realistically on reasonable terms, was approximately met in 1973. Well, of course, we think that is an absurdity. When we take our unemployment rates as against other industrialized countries in the non-Communist world, we see them range from 0.8 of 1 percent in Germany to 3.8 percent in Italy, and even in Great Britain last year, facing horrendous economic problems, the rate of unemployment was only 4.4 percent. And what is happening now of course is that low unemployment is being redefined, and obviously it's complement, full employment. And it is quite obvious that this administration's attitude toward workers, women, black people, the young and the old people, who collectively of course constitute the vast majority of Americans, leaves much to be desired.

I would like to go back to the early 1960's briefly, Mr. Vice Chairman, when we were pulling out of the 1961 recession. And many conservatives argued then that the causes of unemployment were structural, that is, inherent to technological progress, automation, the rising predominance of services over factory work, and the increasing complexity of jobs. And they said, to drive unemployment below 5 percent, which was then the magic figure, would inevitably cause strong inflationary problems. But the facts disprove the theory. By the end of 1965 the unemployment rate had fallen to 4 percent, and it had touched 7.1 percent in 1961. And the price level was rising at a quite modest pace of about 2.9 percent. The rise in demand in 1961 did in fact dissolve a substantial amount of what had previously been considered hard-core structural unemployment among unskilled nonfarm laborers. Between mid-1961 and the end of 1965 employment increased almost 13 percent, it was about 1³⁄₁₀ as large as the increase in total employment. And as unemployment declined, the rate of unemployment among those nonfarm laborers declined much faster than the overall rate. Between the first quarter of 1964 and the first quarter of 1965, the unemployment increased almost 9 percent more than 3½ times as much as the increase in total employment.

Now, like the early sixties, we have them with us again. They have modified the old version to fit the times. This new analysis stresses the difference of unemployment rates among subgroups of the population. From 1971 to 1973 the decline in unemployment was proportionately less for nonwhites than for whites. It was also proportionately smaller for women than for men. Among teenagers the picture for blacks looks even worse: while the overall rate declined by 2.4 percentage points, the rate for nonwhite, 30 percent, declined very slightly and continued at depression levels. The breakdown of the rates for 20 years and older reveals not only further race differences but sex differences as well. And rates for women were higher than those for men within any race category of 1971. And the difference in percentages had increased by 1973. And again the situation was worse for nonwhites than for whites. And there is no doubt that the black, the young and the women suffered disproportionately from unemployment.

The conclusion which the President and his apologists imply either directly or indirectly should be drawn from those statistics on different rates of unemployment. That the social and personal burden of the new unemployment is not so great as the old variety, because the bulk of it concerns secondary workers, especially women and teenagers, rather than married men with families, and that real supply of labor from those subgroups is much tighter than the percentages suggest, because these secondary workers are either, very circumscribed as to location, type or condition of work they will actually accept, are apt to have low productivity, or they are only loosely committed to the labor force at all. Thus although normally looking for work, unemployed secondary workers are supposed to be unwilling or unable to accept most jobs which might be available, or are very likely to quit soon even if hired. And the unspoken judgment which is often implied, especially with respect to young people, and particularly black young people, is that they are lazy, unproductive, disinclined to work, and so forth.

Now, apart from the question of the accuracy of this reasoning, it is well to emphasize that there is a basic moral and constitutional question here regarding discrimination; is the right to work of women, or a black or a young person inferior to the right of a white adult male? That the latter unemployment should count more heavily in the jobless statistics and weigh more heavily in the minds of Government policymakers than the former. This is the unspoken assumption underlying the attempt to explain away the new unemployment, and I find it profoundly offensive.

Mr. Vice Chairman, I refer you to the quotes in my prepared statement, which I will not read, that we have given from James Tirone, Director of Communications of A.T.&T., in his paper, "Problem Oriented Manpower Research—A Management View," which attacked those myths.

Mr. Tirone's paper showed that the apparently insuperable problems associated with the secondary labor force are shown to be quickly dissolved by management when there is a strong incentive to do so from either market or legislative pressure.

The contention is that the social burden is lighter than suggested by overall unemployment rates. It is callous to assume that the unemployment problems faced by women or by young people are less important than those faced by adult men. Many women are heads of households and the sole support of their families. Even when a woman and her husband both work her earnings may be an essential part of the family's total income. Indeed, the average earnings of nonsupervisory workers in the first quarter of 1973, of $7,292 at an annual rate, were not sufficient to provide a family of four with standard of living equal to that set by the lowest of the "adequate budgets" computed by the Bureau of Labor Statistics. To attain even a barely adequate standard of living, therefore, the average worker has to have some other source of income. Most often this comes from the work of secondary workers in the family. And I suggest, sir, that strong action is required to get us moving back toward our goal of a truly full employment economy.

The rate of inflation, as we know, is breaking all records. The administration's various price controls programs have failed utterly.

The UAW has opposed these controls from the beginning because of their patent unfairness and built-in unworkability. They were heavy handed and relatively effective on the wage side but hopelessly inappropriate and ineffective on the price side. We predicted their failure. It gives me no pleasure to do so, but I must say we have proven correct. In 1971 to 1973, the whole period of the controls, consumers prices rose 9.7 percent. At the same time gross average weekly wages of nonsupervisory workers rose by 13.7 percent, but corporate profits increased by 36.3 percent.

In August 1971, when the new economic policy began, real spendable weekly earnings seasonally adjusted stood at $92.58 in constant 1967 dollars. In January 1974 they were $92.02, and are still sinking.

While we have opposed the control programs because of their unfairness and ineffectiveness, we are nevertheless deeply concerned about inflation.

And I would now like to address myself to the specific question you raise as to the wage push, the cost-push impact of labor demands.

The UAW has long advocated a wage policy of moderate annual increases tied to the long-term trend of the national or social productivity of the companies with which we deal, provided they are protected by cost of living. And I would suspect that Mr. Meany's 10 to 12 percent in effect flows from this concept. Although we say it is a little too low, but let's take the 3 percent as being generally accepted. And I think Mr. Meany is adding to that 3 percent the 7 to 9 percent frequently predicted for the inflation surge of this year. Well, one may say, if one feeds into the economy this 3 percent plus compensation for all of the inflationary factors reflected in the Consumer Price Index, that we are bound to keep inflation rolling. We don't believe so.

No. 1, let's take the UAW contracts now negotiated. We have the 3 percent. And we have the cost of living. First of all, it is not on a 100 percent basis. And on the old basis it was 1 cent to 0.4 cent. And we reduced that to 0.35, but then it comes out 3, because we moved from one table to another table——

Senator PROXMIRE. Explain that a little better. You say from 1 percent to 0.3 and 0.4, and so forth?

Mr. WOODCOCK. In the old contracts for every 0.4 change in the Consumer Price Index up or down there was a penny change in the wage.

Senator PROXMIRE. So it was less than a proportional increase in the wage?

Mr. WOODCOCK. At that time. In the beginning it was something like three-quarters, and of course as you go down the term of the contract, it became an increasingly smaller percent. We changed that 0.4 to 0.35. It should really have gone to 0.3, or possibly 0.28. We then translated that from the 1957–59 table to a 1967 table, where it came out as 0.3. But in fact it was not a change from 0.4 to 0.3, it was a change from 0.4 to 0.35. So the first thing is, it is not 100-percent protection. And secondly, in our agreements last fall we agreed that in any quarter in which new cost of living money is available we divert a penny to help pay for the very high cost of fringe benefits we negotiated last fall, to the extent of 10 quarters or a maximum set-aside of 10 cents.

The third thing is, there is a 90-day delay before the increased cost in food and everything else is paid to the worker, and before he recovers a portion of that cost.

And finally, if the Government through fiscal or monetary and other policies places restrictions on the budgets we continue to point to the defense budget—and when I hear Mr. Schlesinger say that the defense budget is now becoming a welfare budget, that is, the budget that we are using to respond to the lack of jobs in the economy, I find that appalling, because that is where the chief inflationary factor is in our opinion. If inflation can be moderated, then those cost of living wage increases are not paid.

Senator PROXMIRE. Let's see if I understand, then, the reflection of the cost of living in wage increases in your escalator provision. Can we get a rough estimate as to how much of the cost of living would be reflected in that escalator provision by itself? Would it be fair to say that it would be, say, three-quarters, or 80 percent, roughly, or something on that order, when you consider the lag and the other elements which you have explained?

Mr. WOODCOCK. It would be not much more than 80 percent, not making allowance for lag, and not making any allowance for the penny set-aside that we are making this week, for example. We should have had a 9-cent wage increase as the cost-of-living move over the last 3 months, but we will get 8 cents because the penny is set-aside for these other cost purposes.

May I say this. You make reference to Britain and the appalling problems that that nation faces. It so happened I was in London in March of 1971 when Ford of Britain was on strike. It was just a week or so after Mr. Ford had had lunch with Prime Minister Heath and emerged from the luncheon to say that there is nothing wrong with Ford of Britain, what is wrong is with Britain, and if they don't shape up we are going to ship out. And the heads of the two big unions involved in the Ford of Britain strike asked me if I would accompany them to a meeting with the Prime Minister, which I did. And we had an hour-long meeting. And to my great surprise, in the course of the meeting, Mr. Heath said to my two colleagues:

> Why don't you do what Mr. Woodcock does; have 3-year contracts with annual increases tied to national productivity protected by cost of living? If Britain could have that stability we could show our heels to the rest of Europe.

Obviously that didn't happen. But obviously Mr. Heath wouldn't have said that in my presence unless Mr. Ford had indicated to him that there was a willingness on the part of the company to do so.

So we say that our agreements, which are now being followed more and more, are in effect counter-inflationary, they are certainly infinitely preferable—say you are bargaining now, and you are going to bargain for an increase big enough to protect against inflation for the next 12 months, or the next 36 months—then you build that into the cost structure, and if in fact inflation stabilizes, those money wages are still paid. And that is why we say our approach is, in effect, counter-inflationary.

Now, the staff of your committee, Mr. Vice Chairman, recently updated the BLS intermediate budget for an urban family of four, and found that in 1973 they required $13,792 to maintain the moderate levels of living which that budget provides. There is no industry that pays a gross average weekly earning which would enable an urban family of four, with only the husband employed full time, to afford this budget.

Senator PROXMIRE. Let me just interrupt once more, because I think this is such an important point you make. And we have had a number of economists testify that a cost-of-living escalator is inflationary. The way you explain it, I think you have a very strong rebuttal to that position.

Furthermore, there is one other element here. It seems that your cost-of-living escalator is particularly helpful to low-income workers more than high-income workers, because, as I understand it, if you get a 1-cent increase that would mean that if a worker earns $3.33 an hour he would get full protection. If he made less than that he would get a little more than full protection, and if he made more than that he would get less than full protection. And the more he made the less complete protection he could get.

Mr. WOODCOCK. That is correct; the same number of cents per hour are paid to the highest paid worker and to the lowest paid worker within what we call the bargaining unit.

Senator PROXMIRE. The cost of living increase would compensate the worker a little more. That is the kind of inflation we have, food being a necessarily big element in the budget of the low-income worker.

Mr. WOODCOCK. That is correct, sir.

Now, getting back to the average rank-and-file non-agricultural worker. The fact is that working alone he cannot afford even the truly spartan lower BLS budget which would have required a gross annual income of $7,386 in the fall of 1972, while his annualized wages at that time amounted to $7,235. Fifteen months later wages have increased by 5.8 percent to $7,651, but the cost of the budget has gone up 10.3 percent to $8,147. And of course the erosion in lower income families purchasing power, as you have just indicated, has been worse than that because of the impact of food prices and now of course, of energy prices.

And may I say that our table headed "Retail Price of Selected Food Items," in the prepared statement, I think shows a startling picture. When you look at food prices on the average it is one thing, but when you look at the selected food items that we picked, the change from October 1972 to October 1973 on the items lamb chops, porterhouse steaks, veal cutlets, rib roasts, butter, and layer cake had a range of increase from 10.7 percent to a maximum increase of 21.4 percent.

When you look at the fare of the poor—frankfurters, bologna sausage, for example, dried beans, margerine, flour, and potatoes—the lowest increase was 31.1 percent, ranging up to a high of, for eggs, of 56.6 percent.

So that the average for food prices includes the fact that the poor are paying disproportionately higher than the average.

Now, half of the entire acceleration of the cost of living is attributable to the jump in food prices, and another 10 percent to price increases of energy items. Obviously much of the problem on the food front was the crop failures across the world in 1972.

Another important thing which is not going to go away is the rise in income in the industrialized world which has been going on for years. And it has driven up the demand for more expensive food stuffs such as meat.

But those didn't creep up on us overnight. This administration had to know it was happening in 1972. Still in the summer of that year the Government was still paying $3½ billion dollars to farmers to withhold 63 million acres from production. And I think it is pretty obvious why that was done.

The increase in concentration of the food industry I think is an economic problem. The number of farms has dropped by 60 percent in the past 35 years. And of those that remain less than 2 percent account for one-third of all farm sales. And through the whole food industry, from processing through wholesaling through retailing, there is increasing concentration.

And the inflation in energy prices is precisely similar and an even more virulent example. In essence, a fundamental problem arising out of the pressure of unplanned, accelerating demands against limited resources has been callously manipulated and exploited by the small group of immensely powerful corporations which control the flow of energy to the Western industrial world.

A very powerful influence in the whole inflationary problem is the growing monopolization of our economy by the big corporations. In 1950 the top 200 industrial firms controlled 47 percent of total manufacturing assets. By 1965 this had risen to 55 percent. In 1966, Willard Mueller, the former chief economist of the Federal Trade Commission, predicted by 1975 they would control two-thirds of all assets. In fact, his prediction was fulfilled 6 years earlier. In 1969 the top 200 corporations controlled the same share of assets held by the 1,000 largest in 1941.

And I suggest, Mr. Vice Chairman, that we seriously address ourselves to the task of creating new institutions capable of combining democratic control and public sovereignty, which after all is the basic rationale for competition as well, in the face of modern reality. We must do this not merely in order to contain inflation, but to restore and protect the very freedoms of the Nation.

In the Economic Report of the President there was for the first time in a long time a major chapter on the distribution of income which in itself was somewhat surprising. And that took note of the fact that the degree of income inequality was approximately the same in 1972 as it was in 1947, intending to draw from that conclusion that there is a basic social iron law which says these percentages are immutable. This, of course, is not true. From 1950 to 1968 there was a steady improvement in the degree of equality of family cash income. From 1960 to 1966 the share of total income going to the lowest 20 percent of the Nation's families increased by 0.8 percent, from 4.8 percent to 5.6 percent. And that was exactly matched by a decline in the share of the richest 20 percent, from 41.3 percent to

40.5 percent. And the share of the middle 60 percent was unchanged. These figures were still the same in 1968.

Then in 1969, under the Nixon administration, with a program for recession, unemployment and inflation, there is a dramatic shifting of the balance of economic power away from working people—the middle, the lower middle, and lower income—and in favor of professionals and the well-to-do. The result is that by 1972 the rich had succeeded in grabbing back even more than they had in 1960. The top 20 percent was $19,582. By 1972 the average income of the poorest percent in 1972. And the share of the next 20 percent increased from 23.8 to 23.9. The bottom 60 percent all lost out. In constant dollars, 1972 dollars—the average family income of the poorest 20 percent of American families was $2,708, in 1968, while that of the richest 20 percent was $19.582. By 1972 the average income of the poorest families had increased by $704 to $3,411, while the richest had increased their income by $6,566 to $26,148. This gap in real annual income increased from $16,874 to $22,773. And of course this doesn't tell half the story. What we really should be interested in is the distribution of effective claims on society's real goods and services.

Also, according to the report, quoting, "the combined effects of the tax and transfer mechanisms of Federal, State, and local governments appear to redistribute income toward low-income families." Now, this statement is totally unsubstantiated. First of all, total transfer payments only amounts to 7 or 8 percent of personal income. And of that, the largest share, over half, is paid in benefits not related to need, old-age survivors, and disability insurance.

Second, the Federal income tax is mildly progressive. Social security payroll taxes and State and local taxes are extremely regressive. And under the Nixon administration they have comprised a growing share of total revenues. This administration has taken great pride in the numerous tax concessions it has made available to the business sector. The most extreme ones have recently come to light. And the effect is to shift the total tax burden away from unearned to earned income, therefore strengthening the trend toward increasing concentration of capital and wealth.

With regard to energy, we are certainly willing to recognize that the days of cheap energy are over. Even if we succeed in moderating the rate of growth of per capita energy consumption in this country which we have got to do, new sources of energy will be much more costly to obtain. And we will be competing with the rapidly growing nations of Europe and Asia for the supplies that are available. We have got to ask ourselves, are our traditional economic institutions adequate to the task ahead. We are convinced that the evidence overwhelmingly points to the answer, no. And so we say, if any attempt to deal with the energy crisis is to be successful, it must concern itself with the reform of decisionmaking processes and the creation of new institutions apropriate to a world committed to equity, social responsibility, and efficiency, in the broadest sense of this term, that is, including resource conservation and environmental protection. And those principles must be honored as our economy adapts to increasing energy costs.

In the energy sector, primary responsibility for basic decisions over energy supply and distribution has been carried out by a tight clique of private oligopolies, particularly firms capable of manipulating the national and international market for their own gain. When energy was relatively abundant and cheap we could overlook some of the long-run social and efficiency costs of this arrangement. Now, however, we are forced to recognize that energy is a critical social resource requiring democratic planning in the public interest.

UAW has already published elsewhere our attempt to outline a comprehensive approach to the energy question which we believe pays due attention to the magnitude of the problem and to the basic principles we have already mentioned.

I would, however, like to say that with regard to this administration's excess profit tax, which was proposed in response to the enormous public outcry over oil company profiteering, I think it should now be clear to everyone that this is really an excise tax that will be passed onto the consumers by the companies.

Mr. Nixon has also spoken about the necessity of private industry investing $200 billion over the next 5 years to meet the energy problem. Now, there is no answer as to where this enormous sum of private capital is to come from. The companies of course are already demanding high prices, preferably supported or guaranteed in one way or another by the Government, incentive investment grants and incentives, and especially depreciation allowance, in order to generate profits large enough to finance this tremendous sum of investment. But high profits collected by monopolies under the aegis of Government policies are actually taxes. And if the public is to be taxed to finance energy development, the public should have a say on how those taxes are used. To permit the energy industry to in effect tax the public and keep the proceeds under their exclusive control, to be invested or squandered in any way they see fit, is in reality taxation without representation.

With regard to the administration's railway reorganization plan, we believe this is simply a scheme to help pay off the creditors and the managers who have been milking the system for years, while supervising the attrition of a vital transportation network which we really should be expanding.

And of the administration's much publicized transportation budget, over two-thirds is still for highways. And although we welcome the additional Federal money now being allocated to mass transit, we think that the administration's programs are far too little, and we hope they are not too late.

Finally, there is no evidence that this administration is seriously concerned about making a public effort to improve the efficiency of the private car. And may I say parenthetically, Mr. Vice Chairman, if the car fleet we have out on the roads now, today, had the fuel efficiency of the car fleet that was on the roads in the mid-1950's, there would be no gasoline problem in the U.S. Because the fuel efficiency at that time was twice what it is today. Now, this is not the problem of emission controls, because EPA has reliable figures that show that from the 3,500-pound weight and down, actual efficiency has in fact increased despite emission control. It is from the 3,500 weight and upward that fuel efficiency goes down, so that at the level of 5,500 pounds the drop is an 18.2 percent. And this is 1972, 1973 as against a baseline 67, not in the mid-1950's.

Now, what did the standard size Chevrolet weigh in 1958? It weighed 3,500 pounds, the exact breakpoint on efficiency today. What does the present day Chevrolet weigh? 4,700 pounds. So that there is a great deal that has been done to worsen this problem. And we think there should be a public effort to improve the efficiency of the private car, not by taxes, not by weight changes, that simply makes the inflation problem worse and drives up the price, but by setting standards for fuel efficiency precisely as we set standards on the emission side. We as a union have been campaigning for efficient economical cars long before the energy crisis made the headlines. There is obviously added power to our argument today. Had our advice been followed, we would not be facing catastrophic collapse or unemployment in a major sector of our industry. And it certainly is intriguing that the biggest corporation, the one having, you would think, the greatest intelligence gathering capacity, namely, the General Motors Corp., is today the one that has been caught the worst by the sudden turn of events. And we would have had over the years, had we paid more attention to more economical cars, jobs for thousands of American workers who have effectively been excluded because of the big three decision not to compete on the world market with exports from the United States, and to abandon a large segment of the domestic market to imports.

Now, the private automobile is by far the largest single user of scarce and increasingly expensive oil. And it is inevitable that no matter what is done to develop a public transportation system, the private car will continue to be the keystone of our transportation system. And that is why it is so tremendously necessary and important that we pay attention to these matters.

Now, the 1975 budget, when I quickly address myself to that, is not too remarkable a document. It has been billed as neither sternly restraining nor highly stimulative. In our belief it is moderately restrictive. And with the economy sliding into what could turn out to be the worst recession since World War II, this budget is clearly not good enough, and there is ample evidence, we think, that restrictive budgets do not reduce inflation at all, but they do aggravate unemployment. And the current situation clearly calls, we think, for an expansionary budget but not randomly expansionary. We can no longer rely on indiscriminate increases or decreases in simple aggregate fiscal variance to regulate our economy. There are a great many areas in which expenditures can be increased for programs which will address real social needs and will create employment and will not aggravate inflation. And we would hope that Congress is prepared to take the initiative.

In his budget message the President also talked about what he calls two major spending domestic thrusts, the national health insurance plan and welfare reform. I would like to describe Mr. Nixon's comprehensive health insurance plan as taxation with misrepresentation, the scheme to tax every American and send the proceeds to the health insurance industry. And Congress should get swiftly to the task of providing meaningful solutions to the aggravating, continued health crisis in which the country finds itself.

The administration is again this year seeking to expand the concept of sharing revenues with State and local governments. We have been opposed to revenue sharing from its inception, not because we have not believed in the responsibility of the Federal Government to assist State and local governments with their financial problems, but because we have doubted whether the national priorities reflected in the grants-in-aid programs replaced by revenue sharing would be well served by State and local governments.

In 1972, according to the Comptroller General, 18 States estimated that revenue sharing funds would permit some form of immediate tax relief. In 15 additional States it was felt that the funds would postpone future tax increases. In one State revenue sharing had reportedly reduced the pressure for introducing a broad-based State tax. Regressive State and local tax structures badly need reforming, but Federal revenue sharing moneys are intended for other purposes and are not the proper source of alternative financing.

In the general field of health the administration is requesting less funds than in 1974, although it does not look that way, because previously impounded funds have now been released. The request to reduce more health education expenditures—is especially baffling in the light of Mr. Nixon's devout interest in the passage of national health insurance which would obviously require substantially more doctors. dentists, nurses, and paramedical professional help.

In the area of housing, HUD officials are hailing as a major victory the President's approval of adding 100,000 units of leased low-income housing to the 200,000 units which were previously announced. But this would hardly put a dent in the amount of low-income housing which is needed. The Housing Act of 1969 calls for 600,000 low- and moderate-income housing units per year. And here is an example of how a good opportunity for public employment jobs for an essentially worthwhile purpose is not taken advantage of.

And I would say, Mr. Vice Chairman, in conclusion that if the President will not or cannot furnish the leadership we badly need in these difficult times, that Congress must. To begin with, there must be an all out effort to substantially reduce unemployment. Economic arguments apart, this should be a primary concern for humane reason. Unemployment is demeaning. But even on purely economic grounds, the unemployed should be viewed not as a burden, but as those that represent available manpower that can be used in the public's behalf and are now being wasted. Since the private economy is clearly unable to provide the millions of additional jobs we lack, and even substantially expansionary Government policies will take some time to get the private economy into motion, an ambitious Federal program of public service jobs is of the utmost necessity. There are innumerable tasks which could be undertaken by those publicly employed. And I might say that those tasks should be on a labor-intensive and not on an energy-intensive basis.

In addition, a greatly strengthened federally supported unemployment compensation system with higher benefits levels and longer duration periods is required.

And Congress should apply itself to a genuine, thorough-going reform of our tax system. We indicated that the distribution of income and wealth in this country is inequitable, and getting more so. The fact is that our tax structure is replete with loopholes which take away most of the progressivity which it may appear to have on paper. Particularly offensive is the regressive nature of the social security tax. In 1974 workers with wages or salary income up to $13,200, even if that income is only $1,000 for part-time work, pay 5.85 percent of their earnings for social security, while earned income above $13,200 is completely free of the tax. Thus a wager earner struggling to support his family on $7,500 a year, pays the full 5.85 percent of his wages, while a professional on a $40,000 salary has to pay only 1.93 percent of his earnings.

Moreover, a worker with dependents has to contribute just as much as one without them, and unearned income goes completely untaxed.

We are on record before Congress as being in favor of exempting income below the poverty level from social security contributions. Since the introduction of the low-income allowance for Federal income taxes in 1971, payroll taxes have constituted the major Federal tax burden of most families under the poverty level.

In testimony before the Senate Special Committee on Aging last year, John Brittain of the Brookings Institution made a proposal, which we support, calling for exemptions and deductions from pooled earnings identical to those under the income tax, which now amount to $4,300 for a family of four. We also support the concept behind his proposal to extend income relief farthur up the scale toward middle incomes, by means of a "disappearing" exemption.

Today I have touched upon some matters of grave concern to UAW members and their families. Among those matters unemployment and the energy crisis are the most pressing problems. It is fruitless to look for solutions from an administration characterized by confusion, lack of credibility, and callousness toward the plight of working people. In the current void of executive leadership, it behooves the Congress to step in with effective answers.

Thank you, Mr. Vice Chairman.

[The prepared statement of Mr. Woodcock follows:]

PREPARED STATEMENT OF LEONARD WOODCOCK

When I had the privilege of appearing before this Committee about three years ago to comment on the problems facing the economy, I remarked that "we have a government headed by an administration which follows a most erratic economic policy."

In retrospect, those were kind words. In fact this administration has thrust the nation into a state of near chaos by its complete lack of any principle or direction save that of pandering to the interests which paid for its election.

But the rest of the nation has been treated to vacillation and incompetence at best—and callous neglect, if not deliberate malfeasance, at worst.

In 1970, Mr. Nixon's first *Economic Report* focused on a pledge to control inflation with no increase in unemployment. In the President's own words:

* * * if we apply the hard lessons learned from the sixties to the decade ahead, and add a new realism to the management of our economic policies, I believe we can attain the goal of plentiful jobs earning dollars of stable purchasing power."

What were the "hard lessons of the sixties"? Over the entire 8 years from January 1961 when John F. Kennedy took office to January 1969 when Richard Nixon began his reign, unemployment averaged 4.7 percent and inflation 2.4 percent. And what was Nixon's "new realism"? By the end of 1970 unemployment was 6.1 percent, inflation was 5.5 percent and the economy was sinking into the first recession since the last Republican administration. In the five years from January 1969 to January 1974 Nixon's scorecard shows an average of 5 percent unemployment and 5 percent inflation.

A year later the President told Congress in his *Economic Report* that he was going to achieve price stability—

"* * * by relying upon free markets and strengthening them, not by suppressing them . . . [we] do not intend to impose wage and price controls which would substitute new, growing and more vexatious problems for the problems of inflation."

Six months later, a freeze was imposed on wages and prices. Since then we have had 2½ years of the most wildly careening, inept and inequitable economic policies in our history. As a result we are now sliding down the edge of the second recession Richard Nixon has bestowed upon us in four years. As the political and economic situation has deteriorated the quality of the President's leadership, far from growing in the face of adversity, (as he loudly proclaims that it has) has shrivelled to the vanishing point. Particularly worrying is the fact that the President's grasp of economic reality appears to have weakened alarmingly. The picture he painted in his State of the Union message and the accompanying Address, of a nation making vigorous progress on all fronts—against crime, unemployment, poverty, pollution, etc., is completely at odds with what ordinary Americans know to be the case. Statements such as "in 1973 . . . unemployment reached low levels," and "the purchasing power of the American people reached new highs last year . . . Even after allowing for price increases, people are now consuming more goods and services than they did a year ago . . ." were so patently ridiculous that the entire nation came away from the television set on January 30 shaking its head and wondering whether Mr. Nixon was living in a dream world of his own.

These doubts were not dispelled two days later by the President's *Economic Report* which was only slightly less sanguine, filled as it was with such misleading references and statements as "The rapid rise toward full employment [in 1973] . . ." and "The American people generally prospered despite the inflation in 1973 . . . their incomes, on the average rose more than prices."

Even the President's own Council of Economic Advisers could not swallow their leader's more blatant pronouncements. (The resulting display of mealy-mouthed hedging, dodging and equivocating by the administration's highest officials over such Nixon statements as "There will be no recession in the United States of America" was both undignified and demoralizing to the nation who watched.) The full text of the CEA's report presents a considerably gloomier picture of the economy than the President. They clearly predicted a recession (without using the word), the highest peacetime rate of inflation in history and the second highest rate of unemployment in 11 years. Yet under Nixon, the CEA has generally been more inclined to rosy propaganda than to objective evaluations. Its projections over the last five years have been consistently more optimistic than reality proved to be.

COUNCIL OF ECONOMIC ADVISERS FORECASTING RECORD 1970-74

[Percent]

	Jobless rate	Inflation rate [1]
1970		
Forecast	[2] n.a.	4.4
Actual	4.9	5.5
1971		
Forecast	4.5	4.3
Actual	5.9	4.7
1972		
Forecast	5.0	3.2
Actual	5.6	3.2
1973		
Forecast	4.5	3.0
Actual	4.9	3.5
1974		
Forecast	5.54+	7.0

[1] Rise in the GNP price deflator.
[2] Not applicable.

Note: All figures are at year end except 1971 jobless rate which are at midyear for both forecast and actual.
Source: Economic Reports of the President; Department of Commerce; Bureau of Labor Statistics; Fortune, January 1974.

Indeed, if 1974's projections turned out to be wrong by the average rate of inaccuracy over the last four years 1974 would see 6.5 to 6.7 percent unemployment and 8.9 percent inflation—which would place it squarely among the worst years since World War II.

A hard, cold look at the bare facts about our economy suggests that once again the administration's vision has been clouded by the dark rosy tint of its political sunglasses—and that Americans at large will suffer because of it.

What are the bare facts and what is the real state of the U.S. economy?

UNEMPLOYMENT

1974 will probably be one of the worst years for unemployment since World War II. The administration has predicted an unemployment rate of 5.5-6.0 percent which we think is much too optimistic. But even this "official estimate" means that 600,000 to 1 million more workers will be without jobs in 1974 than in 1973. In any case, the worker who loses a job is more than a statistic; the loss of the breadwinner's income is stark human tragedy. Nothing is of greater concern to workers and their families than jobs. No matter how wide the range of the interests of the UAW, our first priority is and always has been jobs and security for our members and the rest of the workers in our country.

Thus we are especially concerned when those entrusted with public policy refuse to recognize the unpleasant reality: In 1973, in spite of the fact that the economy was expanding strongly up to the fourth quarter, the unemployment rate still averaged 4.9 percent, or about 4.3 million workers. As usual, some groups suffered unemployment rates several times higher than the national average. Almost 9 percent of the nonwhite labor force was unemployed; among teen-agers, the unemployment rate was 14.5 percent.

Yet, the President's economic advisers believe that maximum employment—"a condition in which persons who want work and seek it realistically on reasonable terms can find employment"—was approximately met in 1973. While the overall unemployment rate stood only 1 percentage point below the 1971 peak—the highest in 10 years—and about 700,000 persons were too discouraged to look for work during the year, the administration concludes that "the combination of evidence for 1973 is strongly suggestive" that the goal of full employment specified in the Employment Act has been reached.

This is a truly disgraceful statement in a world where during the last 13 years all other major industrialized countries have averaged rates of unemployment dramatically lower than ours, ranging from .8 percent in Germany to 3.8 percent in Italy. Even Great Britain, facing a far worse economic situation than we did in 1973, had only 4.4 percent of her work force unemployed.

The basic economic theory the administration uses to excuse its failure to provide Americans who wish to work with jobs goes like this, "When the supply of labor is tight (unemployment is very low) an increase in overall expenditure (e.g., by government) will not induce greater output but will simply mean more money chasing the same amount of goods—which produces inflation." Confronted with the fact that unemployment is *not* very low while inflation is rampant, Nixon and his apologists resort to their typical tactic: prevarication in the face of uncomfortable facts. They simply redefine "low" unemployment (and its complement "full employment") to be, in effect, whatever unemployment happens to be at a time when prices are rising. No doubt if we had experienced 10 percent unemployment and 20 percent inflation the CEA and its allies in the orthodox economics profession would be contriving elaborate arguments to show that 10 percent unemployment is "full employment."

Complicated sophistry is used by the CEA to camouflage the basic fact that they are defining "full employment" to be whatever it is convenient for the administration to say it is. These arguments have been used before to explain away long lines of jobless workers but they are worth examining here because of what they reveal about this administration's attitude towards workers, women, black people, the young and the poor who collectively constitute the vast majority of Americans.

In the early sixties, when we were pulling out of the 1961 recession, many conservatives argued that the causes of unemployment were "structural," i.e., inherent to technological progress, automation, the rising predominance of services over factory work, and the increasing complexity of jobs. The structuralists did not believe the economy could provide jobs that a hard core of unemployed could handle: thus, the unemployment rate could not get below

5 percent without wages and prices being bid up. Accordingly, there was no use in increasing aggregate demand and the federal government was justified in not giving a greater stimulus to demand. However, the facts disproved the theory: by the end of 1965, the unemployment rate had fallen to 4 percent (it had touched 7.1 percent during 1961) and the price level was rising at a modest pace of about 2.9 percent. The rise in demand in 1961 did in fact dissolve a substantial amount of what had previously been considered hard-core structural unemployment—that among unskilled nonfarm laborers. Between mid-1961 and the end of 1965, their employment increased almost 13 percent and was about 1.3 times as large as the increase in total employment. As unemployment declined, the rate of unemployment among these nonfarm laborers declined much faster than the overall rate. Between the first quarter 1964 and the first quarter 1965 their employment increased almost 9 percent, more than 3½ times as much as the increase in total employment. By still another measure, the length of unemployment, the hard core of unemployed also could be seen to melt. In 1961 the percent unemployed who had been looking for a job over 27 weeks reached a peak of 1.4 percent of the labor force. At the end of 1965, their numbers accounted for less than .4 percent of the labor force.

The unemployment rate reached a low plateau of 3.4 percent from September 1968 through May 1969. By this time the expansion of the war in Indochina and the difficulties encountered by the government in financing it had resulted in rapidly rising prices. The ensuing economic contraction was the typical business-oriented response to conditions that enhance the economic power of labor. With high employment levels workers are not only able to demand wage increases but also hold a stronger bargaining position, as they often have other family members working or readier access to part-time and second jobs. The bargaining power of employers is weakened, since there are fewer unemployed to whom they can turn as an alternative source of labor. The engineered recession of 1969 succeeded in bringing the unemployment rate up to 6.1 percent while failing to abate inflation. In due time, a mild expansion got underway and the rate began to decline, but slowly. As in the early sixties we have again found ourselves confronted with the "five-percenters."

To be sure they have slightly modified the old version of the structural theory to fit the times. This new (but basically similar) analysis stresses the different unemployment rates among subgroups of the population.

From 1971 to 1973, the decline in unemployment was proportionately less for nonwhites than for whites (it was also proportionately smaller for women than for men). Among teen-agers the picture for blacks looks even worse; while the overall rate declined by 2.4 percentage points, the rate for nonwhites —30 percent—declined very slightly and is still at depression levels. The breakdown of the rates for workers 20 years and older reveals not only further race differences but sex differences as well; rates for women were higher than those for men (within each race category) in 1971 and the differences in percentages had increased by 1973. Again, the situation was worse for nonwhites than for whites. There is no doubt that the black, the young and women suffer disproportionately from unemployment.

The picture that emerges from the voluminous research along these lines suggests that the groups with high unemployment rates have them because they have relatively many short spells of unemployment, not so much because they become unemployed and stay unemployed for long periods of time. The reasons for this weak attachment to their jobs probably relate to the nature of the jobs themselves, the lack of job security, seniority provisions, and prospects of advancement. Part of this may be due to vocational dislocations, but much of it is almost surely employer determined.

The conclusions which the President and his apologists imply (directly or indirectly) should be drawn from the statistics on different rates of unemployment are: (a) the social and personal burden of the "new" unemployment is not so great as the "old" variety because the bulk of it concerns "secondary" workers—especially women and teen-agers—rather than married men with families; (b) the "real" supply of labor from these subgroups is much tighter than the percentages suggest because these secondary workers are either (i) very circumscribed as to the location, type or condition of work they will actually accept, (ii) apt to have low productivity or (iii) only loosely committed to the labor force at all. Thus, although nominally looking for work, unemployed "secondary" workers are supposed to be unwilling (or unable) to accept most jobs which might be available or are very likely to quit soon even if hired. The unspoken value judgment which is often implied—especially with respect to young people, and particularly young black people—is that they are lazy, unproductive, disinclined to work, etc.

Apart from the questionable accuracy of this reasoning it is well to emphasize that there is a basic moral and constitutional question here regarding discrimination. Is the right to work of a woman, a black or a young person inferior to the right of a white adult male, so that the latter unemployment should count more heavily in the jobless statistics and weigh more heavily in the minds of government policymakers than the former? This is the unspoken assumption underlying the attempt to explain away the "new" unemployment and I find it profoundly offensive.

But its scientific validity is also extremely dubious. James F. Tirone, director of communications of AT&T, in his paper "Problem-Oriented Manpower Research: A Management View" attacked many of the myths expoused by those who feel the supply of labor is much tighter than shown by unemployment rates:

"The age distribution and experimential background of the work force is not material to mass employment. Tight labor circumstances, from World War II and forward to the present, have demonstrated that employers make-do with or train those who are available to work. In the long run, neither of the foregoing processes has a major effect on the cost of production, assuming that there is a "long run" in the employee's association with the firm (which will be discussed subsequently.)[1]

"The long range effect of the Civil Rights Act and its amendments plus the regulations of the Office of Federal Contract Compliance will be to moot most of the artificial labor imbalances which have resulted from cultural limitations on the employment of women and minorities. The principle now is well established in the law that an employer's work force, if he is to defend his hiring policies against charges of discrimination and the penalties thereof, must in most cases reasonably mirror the relevant labor force seeking employment in a community.

In other words, the apparently insuperable problems associated with the "secondary" labor force are quickly dissolved by management when there is a strong incentive to do so from either market or legislative pressure.

As to the contention that the social burden of unemployment is lighter than suggested by overall unemployment rates, it is callous to assume that the unemployment problems faced by women or by young people are less important than those faced by adult men. Many women are heads of households and the sole support of their families. Even when a woman and her husband work, her earnings may be an essential part of the family's total income. Indeed, the average earnings of nonsupervisory workers in the first quarter of 1973 ($7,292 at an annual rate) were not sufficient to provide a family of four with the standard of living equal to that set by the lowest of the "adequate" budgets computed by the Bureau of Labor Statistics. To attain even a barely adequate standard of living therefore the average worker has to have some other source of income. Most often this comes fro mthe work of "secondary workers" in the family.

Young people need work experience as well as earnings; the former to develop needed skills and work habits, the latter to further their education or to contribute to family support. The continuing frustration suffered by subgroups of the labor force in the job market can only increase alienation and bitterness among these workers, contribute to crime and racism, and cement the boundaries of our urban ghettos. The social cost of unemployment is clearly unbearable and represents not only a dissipation of our present but the mortgage of our future as a better society.

In spite of all this, throughout the last four years we have seen the "new unemployment" theory of the labor markets used by the and its apologists as an argument towards the acceptability of higher unemployment rates. We

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[1] Tirone went on to say that in AT&T's experience, the length of service can be greatly improved and turnover among new hires greatly reduced by changes in management attitudes. The problem is that management rarely has any incentives in this direction since a manager's performance is very rarely judged by the rate of turnover in his work force. By implication if the cost of turnover rose substantially and labor became scarce this situation would change.

absolutely reject this "solution." In spite of all our wealth and power we have hardly advanced in 30 years toward the basic goal of providing every American with the opportunity to earn their living honestly and with dignity. For the President to claim that we nearly achieved full employment in 1973 is barefaced fraudulence—and the working people of the country know it. It is time to stop pussyfooting and playing with words. Strong action is required to get us moving back toward our goal of a truly full-employment economy. With the economy slipping steadily into a (possibly severe) recession there is no excuse for a restrictive budget. And that is what we have got. The President himself called it "moderately restrictive" and, in spite of its nominal 3 percent deficit, restrictive it is.

INFLATION

While unemployment rates threaten to go through the ceiling, the rate of inflation is breaking all records. The wholesale price index gives a grim indication of what is in store for the near future. While prices of energy and food items led the way with January-to-January rises of 76 percent and 30 percent respectively, the index for industrial commodities—a good indicator of inflationary pressures in the economy—was up 17 percent over the year. In the last month, wholesale prices rose by 3.1 percent, (equivalent to an annual rate of 44 percent) a huge increase exceeded only by the post-freeze jump of 5.8 percent in August last year. Since wholesale price increases usually show up somewhat later in retail prices, this figure coupled with the further sizable decline in industrial production in January, led the *New York Times* to assert that we were probably faced with "the worst set of monthly economic statistics in at least a quarter century."

The Administration's various price control programs have failed utterly. The UAW has opposed these controls from the beginning because of their patent unfairness and built-in unworkability. They were heavy handed and relatively effective on the wage side but hopelessly inappropriate and ineffective on the price side. We predicted their failure and, though it gives me no pleasure to do so, I must say we have been proven correct. From 1971 to 1973, consumer prices rose 9.7 percent. At the same time gross average weekly wages of nonsupervisory workers rose by 13.7 percent but corporate profits increased by 36.3 percent.

Perhaps as an epitaph to the new nearly defunct control programs it is appropriate to quote once more from President Nixon. In August 1971, when he introduced Phase I to the nation he said to workers: "In the four years between 1965 and 1969, your wages were completely eaten up by price increases. Your paychecks were higher but you were not better off." but what is the administration's own record? In August 1971 when the new economic policy began real spendable weekly earnings (seasonally adjusted) stood at $92.58 in constant 1967 dollars. In January 1974 they were $92.02 and still sinking.

While we have opposed the control programs because of their unfairness and ineffectiveness, we are nevertheless deeply concerned about inflation. In our own collective bargaining activities we have been careful not to throw fuel on the inflationary fires. Rather than to negotiate protective wage increases of a size which anticipates and thereby may contribute to inflation, our major collective bargaining agreements provide for "cost-of-living" increases which are merely reflections of and reactions to inflation generated by other causes. Pioneered by the UAW, cost-of-living clauses are sought by more and more unions to shield their members from rampaging prices.

As a trade union we are especially concerned about inflation on two counts. First, inflation tends to redistribute income in wrong and arbitrary directions. The elderly, who are unable to work and must live mostly on fixed pensions and/or still inadequate Social Security payments, are especially vulnerable. So are the poor who depend on welfare payments. Nor do employed persons escape: as we have seen, workers' wages hardly ever keep up with inflation—especially accelerating inflation. In the past year the real spendable earnings of the average rank-and-file worker with three dependents have dropped by an alarming 4 percent, the largest twelve month drop recorded since 1964.

The staff of this Committee recently updated the BLS "intermediate budget for an urban family of four and found that in 1973 it required $13,782 to maintain the moderate level of living which that budget provides. No industry pays gross average weekly earnings which would enable an urban family of four with the husband employed full time to afford this budget. In fact, the average rank-and-file nonagricultural worker cannot even afford the truly spartan "lower" BLS budget, which would have required a gross annual income of $7,386 in the fall of 1972 while his annualized wages at that time amounted to $7,235. Fifteen months later, wages have increased to $7,651 or 5.8 percent; but the cost of the budget has gone up 10.3 percent to $8,147.

The erosion in lower income families' purchasing power is in truth greater than these figures indicate. The lower that real household income is, the higher the proportion of it which must be used for food, and prices of food have increased twice as fast as consumer prices generally in the past year. Moreover, the foods whose prices rose most rapidly tend to be precisely those foods which weigh heavily in the diets of the poor, as the following list reveals:

Retail price of selected food items (percentage change from October 1972 to October 1973)

	Percent
Porterhouse steak	17.3
Veal cutlets	17.6
Rib roast	18.3
Lamb chops	10.7
Butter	21.4
Layer cake	14.3
Lettuce	0.0
Frankfurters	42.3
Bologna sausage	37.5
Eggs	56.6
Dried beans	37.6
Margarine	35.0
Flour	56.2
Potatoes	31.1

Source: U.S. Bureau of Labor Statistics.

Our second concern is that inflation or fear of inflation has been the main inhibiting cause of or, more accurately, *excuse for* the failure of government to carry out the national commitment to "maximum employment, production and purchasing power" expressed in the Employment Act. This involves the twisted logic of defining a target rate of unemployment in terms of the price level, an approach which relies on the analysis of the economy in terms of a trade-off between inflation and unemployment. I doubt whether this kind of analysis was ever appropriate for describing the behavior of our economy even in the distant past. It is obviously totally inadequate to account for current behavior.

The current inflationary experience is unlike anything we have experienced before. From 1951 to 1967, consumer prices went up an annual average of 1.5 percent—hardly "inflation" at all. Since then they have risen faster and faster. During the last 12 months inflation has accelerated to 9.4 percent, the highest peacetime rate recorded in our history, and shows no sign of abating.

There has been a truly catastrophic explosion in prices of food and energy items. About half of the entire acceleration in the cost of living is attributable to the jump in food prices and another 10 percent to price increases of energy items.

Nor is the end in sight. According to the Department of Agriculture, supermarket food prices are expected to climb 12 percent in 1974 but could soar as much as 16 percent and match last year's rise. Just two months ago, the Department of Agriculture predicted the first quarter 1974 climb in grocery store food prices would be 15 percent over a year ago. Now the Department is forecasting a rise of nearly 21 percent.

The food price explosion has been mainly attributed to worldwide shortages due to very poor crops. It is true that bad weather caused severe crop losses throughout the world; the Soviet Union, for example, saw its grain crop cut by one-fourth. The failure of the 1972-73 Peruvian anchovy crop—an important component of livestock feed—made owners of livestock turn to other sources of feed like corn and soybeans.

At the same time, rising incomes in the industrialized world, an event which did not happen overnight, drove up the demand for more expensive foodstuff such as meat.

The administration was aware of all these developments, as well as of the fact that the devaluation of the dollar was making American grain cheaper to the countries in Europe and Japan. Still, in the summer of 1972 the government was paying $3.5 billion to farmers to withhold 63 million acres from production. Some of these acres could have been put to production for the fall planting of the winter wheat crop, which normally accounts for about three-fourths of U.S. wheat production. This was not attempted—keeping farmers happy with hefty farm subsidies and high prices at election time probably had a lot to do with it. Instead, the now infamous Soviet Wheat Deal was allowed to take place—a colossal piece of incompetence and chicanery whose impact on domestic food prices and supply is still reverberating round the country. Thus, to place the entire blame for the increase in food prices—especially those of meat and cereal products—on poor weather and rising demand abroad is to tell an incomplete story. The impact of weather catastrophes was magnified by government inaction and a systematic policy of encouraging agricultural exports without regard for the consequences on domestic consumers.

Increasing concentration in the food industry is another powerful but less publicized part of the story. Although it has lagged behind industries such as transportation equipment, steel, chemicals and oil in this respect, oligopolistic control of farming, food processing and retailing has increased enormously.

The number of farms has dropped by 60 percent in the past 35 years. Of those that remain less than 2 percent account for one-third of all farm sales. *Fortune* estimates that if present trends continue 100,000 to 200,000 large farms will be all that are needed within a few decades to produce all of the nation's food. The cattle feedlot business has also become increasingly concentrated; currently only 1 percent of them produce over 60 percent of the nation's beef.

We can find instances of concentration in almost every sector of the food economy. In livestock, for example, not only is the final stage of raising beef and hogs greatly concentrated, of 3,000 meat processors, the *3 largest process 30 percent of the meat we eat.* Nine out of 12,000 vegetable canning and freezing companies made 55 percent of the 1967 profits in the industry; the 4 largest dairy companies produce about 43 percent of all dairy products. Buying and processing of grain is similarly controlled by a handful of corporate giants. Federal Trade Commission studies have found that cereal prices are 15 to 25 percent higher than would exist under competition because of the domination of the industry by just 4 firms. Finally, about four-fifths of all food is sold to consumers in supermarkets, half of which belong to extensive chains.

The growing concentration of the food industry and its impact upon consumers is yet another example of the pervasiveness of monopoly power in America. A shrinking number of growers, processors and distributors determine the kind of food we eat and the prices we have to pay. The current inflation in food prices reflects not only meteorological disasters and the pressures of a swelling population on limited world resources but also the growing power of monopolies to exploit these situations for their own ends.

Inflation in energy prices is a precisely similar and even more virulent example. In essence, a fundamental problem arising out of the pressure of unplanned, accelerating demand against limited resources has been callously manipulated and exploited by the small group of immensely powerful corporations which control the flow of energy to the western industrial world.

It is my feeling that this sort of situation is with us to stay: energy and food are merely the first (though perhaps the most fundamental). Our economies will be bumping up against fixed supplies in most other vital resources sooner or later. As these incidents occur painful adjustments will be necessary as something which was previously thought to be cheap to produce and plentiful in supply is found to be the opposite. Even under the best of circumstances these adjustments would impart recurring inflationary shocks. But current experience with food and energy suggests that these shocks will be far worse if corporate oligopolies are allowed free reign to manipulate and exploit the situation without regard for the public welfare.

The special problem in food and energy has combined with a broad, general pressure on all prices to give us the worst peacetime inflation in our history. Part of this general pressure on prices no doubt can be traced to devaluation of the dollar which put import prices up and encouraged exports, particularly of agricultural products (thereby making less available domestically). Developments in this area may be the only bright spot in the inflationary picture; the dollar has regained approximately one-half of the ground it lost. Even this, however, is very much a mixed blessing since an overvalued dollar while restraining inflation is a real threat to employment: it means stiff competition from imports in the domestic market and difficulty in selling our products abroad. In any event, most economists agree that devaluation and revaluation have relatively little effect on the rate of inflation compared to other influences.

Again, in our opinion a much more powerful influence is the growing monopolization of our economy by the biggest corporations. The United States has experienced several waves of rising business concentration in the past—notably the 1890s and the 1920s. None of these has even come close to what we have seen in the last 10–15 years, however. In 1950 the top 200 industrial firms controlled 47 percent of total manufacturing assets. By 1965 this had risen to 55 percent. In 1966 Willard Mueller, former chief economist of the Federal Trade Commission predicted that by 1975 they would control two-thirds of all assets. In fast his prediction was fulfilled six years early; in 1969 the top 200 corportions controlled the same share of assets held by the thousand largest in 1941. In 1974 their grip is undoubtedly even greater. In 1970 Mueller testified to the Antitrust Subcommittee of the House Judiciary Committee:

"All who recall the condition of the country in 1890 will remember that there was everywhere, among the people generally, a deep feeling of unrest. The nation had been rid of slavery . . . but the conviction was universal that the country was in real danger of another kind of slavery sought to be fastened on the American people, namely, the slavery that would result from the aggregation of capital in a few individuals and corporations for their own profit and advantage exclusively . . .".

A similar feeling is growing in the people today—accentuated, clarified and accelerated by the bitter experience of the energy crisis. The waves of industrial concentration in the 1890s and 1920s produced major political initiatives and gave birth to antitrust and other legal structures designed to safeguard freedom and social well-being from the rapacity of uncontrolled giant corporations. With modern technology, the international dimension of modern corporate giants, etc., the challenge today is immensely greater. To meet this challenge, bold imaginative programs will be required in coming years if we are to control effectively the inflation which is built in and inevitable in any situation where corporations exercise such profound and sweeping monopoly power as they do in the United States today. However, we do not feel that simple-minded trust-busting of the traditional variety provides an adequate solution. That approach was fashioned three quarters of a century ago and is no longer adequate by itself. In many areas of our economy modern technology and the scope for international integration have led to economies of scale beyond the wildest imagination of our grandfathers who conceived the original antitrust program. The potential fruits for mankind are comparably enormous, but they require the ability to plan the mobilization and allocation of capital and the organization of supplies and markets on a scale which is impossible for firms small enough to be "competitive" in the traditional sense. The giant corporations know this and this is the very reason why they grow and behave in the way they do.

Where traditional antitrust measures are feasible and practical they should be pursued. (Although our capacity even in this area is totally inadequate: just for the sake of illustration, the advertising budget of Proctor & Gamble alone is twenty times as large as the appropriation for the Antitrust Division of the Justice Department, which must monitor a trillion dollar economy.) However, where they are not adequate—and this now includes a very broad spectrum of the economy—we must seriously address ourselves to the task of creating new institutions capable of combining democratic control and public sovereignty (which, after all, is the basic rationale for competition as well) in the face of modern realities. We must do this—not merely in order to contain inflation but to restore and protect the very freedoms to which the nation was dedicated 300 years ago.

INEQUALITY

For the first time in decades the *Economic Report* of the President contains a major chapter on the distribution of income. This is somewhat surprising to us, not only because this is an area in which the experiences of the last 5 years has been particularly dismal, but also because Mr. Nixon himself has never given a high priority to greater equality in the distribution of income, wealth and power. Indeed, if anything, he has worked steadfastly for the opposite.

In the beginning of the chapter the report declares: "while the inequality of family income is quite stable over the long term, it varies over the business cycle." That the degree of income equality was approximately the same in 1972 as it was in 1947 is undeniable. But this does not mean as the report appeared to imply, that there is some underlying social law which prevents a greater degree of income equality. On the contrary, from 1950 to 1968 there was a steady improvement in the degree of equality of family cash income. Most of this occurred during the first 5 or 6 years of the 1960s (before the ruinous war in Vietnam had reached its height and began to undermine the real achievements of the Kennedy and Johnson administrations). From 1960 to 1966 the share of total income going to the lowest fifth of the nation's families increased by .8 percent from 4.8 percent to 5.6 percent—which was exactly matched by a decline in the share of the richest, fifth, from 41.3 percent to 40.5 percent. The share of the middle 60 percent was unchanged. These figures were still the same in 1968. Then, in 1969, enter this administration with a program for recession, unemployment and inflation which dramatically shifted the balance of economic power away from working people, the middle, lower-middle, and low income and in favor of employers, professionals and the well-to-do. Result: by 1972 the rich had succeeded in grabbing back even more than they had in 1960. The top 20 percent increased their share from 40.5 percent in 1968 to 41.4 percent in 1972 and the share of the next 20 percent increased from 23.8 percent to 23.9 percent. The bottom 60 percent all lost out. Stated in terms of dollars and cents, the widening gap is even more shocking and disgraceful. In constant 1972 dollars the average family income of the poorest fifth of American families was $2,708 in 1968 while that of the richest fifth was $19,582. By 1972 the average income of the poorest families had increased by $704 to $3,411 while the richest had increased their income by $6,566 to $26,148. This gap in real annual income increased from $16,874 to $22,737.

And yet even this does not tell half the story: what we are really interested in is the distribution of effective claims on society's real goods and services. The distribution of money income, as discussed by the President's report reflects only part of the real distribution of economic power and well-being. The report recognizes this and then goes on to list in detail those things which are excluded from money income which, if included would decrease the degree of inequality. But it passes quickly over those excluded items which would increase the degree of inequality on the glib excuse that there is not enough information about these items. This is ingenuous to say the least.

One excluded item is unreported income. It is well known that underreporting is far greater among the rich than among the poor and middle classes. Professor Joseph Pechman, working with 1966 data, estimated that, after correcting for underreporting, the income share of the poorest fifth was reduced by nearly one full percentage point, while the share of the richest fifth increased over three percentage points.

Far more important are capital gains, unrealized as well as realized. (Unrealized capital gains affect the allocation of credit and thus greatly influence the distribution of effective claims on goods and services.) Although figures as accurate as those for, say, medicare payments are obviously not available for capital gains, enough is known to make it quite clear that the effect of capital gains in increasing inequality immensely outweighs the entire combined effects of all the "equalizing" items listed with such care by the President's report. What is more, as inflation accelerates, the magnitude of total capital gains, the inequity of their distribution and their impact on the distribution of goods and services also grow exponentially. This is a lesson which has long been learned in Latin America—and it is now sinking home in the USA. In this context there is a certain irony in the President's boast that he owns no stock but has put his money (not to mention a good deal of the taxpayers' as well) into real estate: the stock market is not currently where the action is; bigger fortunes are being made faster in real estate speculation and development.

There are other problems with the report's treatment of equality. For instance, a man who earns $10,000 working hard for 40 hours a week, 52 weeks a year in a steel mill and a man who receives $10,000 in dividends while doing nothing at all are considered "equal" according to the report's statistics. This is patently absurd. To get a truly accurate picture of economic equality requires an investigation of the distribution of wealth—which reflects economic power and security. "Money income" on the other hand tends to reflect material consumption. Economic power and security are far less equally distributed than material consumption— but are no less important aspects of economic well-being.

This dismal tale of increasing inequality, completely ignored by the President's report, should rightly disgrace an advanced industrial nation, one that has constantly set itself up as the most successful model. But heaped on top of this disgrace is the sickening attempt of this administration and its economic advisers to pretend it isn't so.

The administration seeks to cover its tracks by substituting a comparative analysis of relative earnings by age, sex, race, etc., for a truly comprehensive analysis. By omitting the disproportionate impact of unemployment on different socioeconomic groups, and by ignoring the role of unearned and corporate incomes, Nixon's paid apologists try to convince Americans that we have never had it so good and that this administration has materially contributed to ensuring economic justice and equity. According to the report, "The combined effects of the tax and transfer mechanisms of Federal, State and local governments appear to redistribute income toward low income families." This statement is totally unsubstantiated and is particularly deceitful since this administration has deliberately striven to erode what redistributive elements there are in the tax/transfer system. In fact, considerable evidence exists to support the view that our overall tax/transfer system is not progressive at all. At best it is proportional (i.e. has no effect on the degree of equality). First, total transfer payments account for only 7-8 percent of personal income and of that the largest share—over half—is paid in benefits not related to need (these are Old Age, Survivors and Disability Insurance which are paid out in proportion to past earnings). Second, although the federal income tax is mildly progressive, Social Security payroll taxes and state and local taxes are extremely regressive, and under the Nixon administration have comprised a growing share of total revenue. This administration has taken great pride in the numerous tax concessions it has made available to the business sector, some of the most extreme having recently come to light. The effect has been to shift the total tax burden away from unearned to earned incomes, thereby strengthening the trend toward increasing concentration of capital and wealth. Not surprisingly, the Nixon administration prefers to keep this issue out of the public arena, but it is unlikely to be able to hold back the debate indefinitely.

ENERGY

The energy crisis of 1973-74 is forcing most Americans, if not the Council of Economic Advisers, into a dramatic reassessment of the manner in which economic policy for this key sector is made and implemented. That reassessment almost inevitably leads first to bewilderment and then to outrage at the clumsy inadequacy of the Nixon administration's approach. None of the administration's pronouncements on the subject go even half way towards dealing with the questions being raised by this reappraisal; the burden of dealing with the issues falls on Congress and the people they represent.

Most of us are willing to recognize that the days of cheap energy, the building block of our rapid economic growth in the past, are over. Even if we succeed in moderating the rate of growth of per capita energy consumption in this country, new sources of energy will be much more costly to obtain, and we will be competing with the rapidly growing nations of Europe and Asia for the supplies that are available. With this prospect before us, the dangers of trade wars and heightened economic instability are very real. We must ask ourselves a question completely ignored by the *Economic Report of the President*: "Are our traditional economic institutions adequate to the tasks ahead?" We are convinced that the evidence overwhelmingly points to the answer "no." Thus if any attempt to deal with the energy crisis is to be successful it must concern itself with the reform of decision-making processes and the creation of new institutions appropriate to a world committed to equity, social responsibility and efficiency (in the broadest sense of this term—i.e. including resource conservation, environmental protection, etc.). These principles must be honored as our economy adapts to increasing energy costs.

In the energy sector, primary responsibility for basic decisions over energy supply and distribution has been carried out by a tight clique of private oligopolistic firms capable of manipulating the national and international markets for their own gain. As long as energy was relatively abundant and cheap we could overlook some of the long-run social and efficiency costs of this arrangement. Now, however, we are forced to recognize that energy is a critical social resource requiring democratic planning in the public interest; the American people can no longer tolerate a situation in which a small group of powerful vested interests, concerned primarily with profit making and not with the public welfare, is able to exercise such complete control over the mix, the timing and the size of the flow of energy—the very lifeblood of the entire nation.

We have already published elsewhere our attempt to outline a comprehensive approach to the energy question which we believe pays due attention to the magnitude of the problem and to the basic principles we mentioned above. Therefore, I do not wish to go into great detail here. However, it is important for the nation to recognize that for all its talk and gesticulation, there is no evidence that the administration appreciates the seriousness of the issues which have been raised or that it is prepared to make the hard decisions necessary to deal with those issues. No doubt some of the foot dragging is due to the understandable reluctance of Mr. Nixon to offend the private energy interests. A typical example of his attitude is his so-called "excess profits tax," which was proposed in response to the enormous public outcry over oil company profiteering. In fact, it is clear to everyone that this is really an excise tax that will be passed on to the consumers by the companies. The President evidently has not yet learned that when painting white roses red it is advisable not to use water colors.

Some months ago the Federal Trade Commission filed a complaint against the nation's eight largest oil companies charging them with combining or agreeing to monopolize petroleum refining. A great deal of evidence was presented to support that claim. In view of the enormous consequences for the nation of such a conspiracy—if it occurred—it is obvious that action on these charges should be pursued vigorously. Yet William Simon, while still Deputy Secretary of the Treasury, took the unusual step of trying to intercede with the FTC to block the Commission's action on the complaint. No explanation was ever given to the public about this; and now William Simon is in charge of the nation's energy policy. The keystone of Simon's policy as energy chief has been his fuel allocation program. Apart from being inefficient (which is an understandable failing given the speed with which it was put together), the allocation program is also so complicated and obscured by legal jargon that the FEO itself has not been able to provide us with consistent explanations of important provisions. The result is that the program, despite appearances to the contrary, has in fact provided a cover under which the major oil companies have considerable freedom to maneuver as they wish—and in particular to squeeze independent dealers to the wall, something the majors have wanted to do for a long time.

The President's much touted energy Research and Development program is largely an amalgamation of already existing programs; only $2 billion of the announced $10 billion (to be spent over 5 years) is new money. Given the unprecedented magnitude of the tasks before us, this is little more than a public relations gesture. Against this paltry amount Nixon spoke of private industry investing $200 billion over the same 5 years. But the President carefully avoided the question of where this enormous sum of private capital is to come from. In fact the companies are already demanding high prices, (preferably supported or guaranteed in one way or another by the government) investment grants and incentives, special depreciation allowances, etc., in order to generate profits large enough to finance the needed investment. But high profits collected by monopolists under the aegis of government policy are actually taxes. And if the public is to be taxed to finance energy development the public should have a say on how those taxes are used. To permit the energy industry, to in effect, tax the public and keep the proceeds under their exclusive control—to be invested or squandered in any way they see fit—is in reality taxation without representation. As you know, that is something our forefathers fought a revolution over. It is contrary to the mst fundamental principles upon which this nation was founded—but it is what the oil giants want, and I suspect it is what Richard Nixon wants.

The administration's railway reorganization plan simply helps pay off the creditors and managers who have been milking the system for years while supervising the attrition of a vital transportation network which should instead be expanding.

Of the administration's much publicized transportation budget over two-thirds is still for highways. Although we welcome the additional federal money now being allocated to mass transit we think that the administration's programs are far too little—we hope they are not too late.

Finally, there is no evidence that this administration is seriously concerned about making a public effort to improve the efficiency of the private car. The UAW was campaigning for efficient, economical cars long before the energy crisis made the headlines. Now there is obviously added power to our argument. Had our advice been followed we would not be facing catastrophic collapse and unemployment in a major sector of our industry. In addition, over the years, there would have been jobs for thousands of American workers who have effectively been excluded because of the Big Three decision not to compete on the world market with exports from the U.S. and to abandon a large segment of the domestic market to imports.

The private automobile is, by far, the largest single user of scarce and increasingly expensive oil. Until the geography of economic activity is drastically changed, it is inevitable for better or for worse, that the private car will be the keystone of our transportation system. It is frankly staggering that the administration should show so little concern for this major aspect of the energy problem.

THE BUDGET

The 1975 budget is an unremarkable document. It advances few new initiatives and has been billed as "neither sternly restraining nor highly stimulative." In fact it is moderately restrictive (it would produce an $8 million surplus at the traditional "full employment" level of 4 percent unemployment) and totally unimaginative. With the economy sliding into what could possibly turn out to be the worst recession since World War II, this budget is clearly not good enough. True, upon publication of the budget administration spokesmen loudly declared that the President is prepared to "bust the budget rather than keep people out of jobs," (seemingly unaware that people are already losing their jobs by the hundreds of thousands, and that unemployment averaged 4.3 million people in 1973). But on December 11, 1973 Herbert Stein had testified before the Joint Economic Committee, Subcommittee on International Affairs, that the administration was reluctant to take direct job creating action for fear of inflation. In the light of the record we strongly suspect that Mr. Stein's testimony more accurately reflects the administration's real attitude.

Once again the old bugaboo inflation is being used as an excuse for doing nothing about unemployment, and ultimately nothing about inflation either. There is ample evidence that restrictive budgets do not reduce inflation at all—but they do aggravate unemployment. A serious attempt to control inflation would require a thorough-going attack on its root causes, which lie deep in the structure of our economy. We doubt the Nixon administration has any intention of embarking on such an endeavor—it would have to step on the toes of too many of its closest fat-cat friends. Under these circumstances to sell a budget which does nothing to stop our slide into recession on the grounds that anything else would be inflationary is little short of cynical fraudulence.[2]

The current situation clearly calls for an expansionary budget, but not randomly expansionary. The recent lessons of the energy crisis, the food situation and in countless other areas have taught us that we can no longer rely on indiscriminate increases or decreases in simple aggregate fiscal variables to regulate our economy. There are a great many areas in which expenditures can be increased for programs which will address real social needs, will create employment and will not aggravate inflation. I hope Congress is prepared to take the initiative, which the administration apparently will not, in utilizing these opportunities to at least cushion the decline of the economy and the unjust burden it places on working Americans.

In his budget message the President brings back proposals he calls his two major pending domestic thrusts—a national health insurance plan and welfare reform. I like to describe Nixon's "Comprehensive Health Insurance Plan" as

[2] How cynical is underscored by Mr. Stein's previously mentioned testimony to the JEC subcommittee. In the same testimony where he said that the administration was reluctant to take direct job-creating action for fear of inflation he also said that they were considering increased defense expenditures to boost employment. He did not explain why defense spending to create employment would be less inflationary than civilian spending. In fact the truth is that neither he nor his boss really care very much about unemployment. However, they did want to increase defense spending (for quite different reasons) and Stein was prepared to justify this by any argument which came to hand—without regard to the fact that in so doing he was contradicting himself. As we know the largest proportional expenditure increases in the new budget is in defense.

"taxation with misrepresentation"—a scheme to tax every American and send the proceeds to the health insurance industry. Congress should get swiftly to the task of providing meaningful solutions to the continuing health crisis in which the country finds itself. These solutions will come, not via the inadequate and misleading Nixon proposal, but by enacting the truly comprehensive program embodied in the Kennedy-Griffiths Health Security Bill.

With respect to welfare reform and the need for a guaranteed annual income scheme, it is indeed peculiar to hear the President call it one of his major spending programs when he allowed it to die a protracted death in the 92nd Congress. In any event no funds are requested until after 1975.

The administration is again this year seeking to expand the concept of sharing revenues with state and local governments by bestowing additional authority upon state and local agencies to determine how they will use federal funds for education, transportation and community development programs. We have been opposed to revenue sharing from its inception, not because we have not believed in the responsibility of the federal government to assist state and local governments with their financial problems, but because we have doubted whether the national priorities reflected in the grants-in-aid programs replaced by revenue sharing would be well-served by state and local governments. The scant information in the hands of Congress (reporting requirements are very weak) indicates that we were right. In 1972, according to the Comptroller General, 18 states estimated that revenue sharing funds would permit some form of immediate tax relief. In 15 additional states, it was felt that the funds would postpone future tax increases. In one state, revenue sharing had reportedly reduced the pressure for introducing a broad-based state tax. Thus, on a broad front, the top state priority of tax relief has been given precedence over federal priorities. Regressive state and local tax structures badly need reforming but federal revenue sharing monies intended for other purposes are not the proper source of alternative financing.

"Program consolidation," a nice gimmick that can make a proposal look much heftier than it really is, pervades Mr. Nixon's budget. The Energy Research and Development program that we have already mentioned is a good example. Even worse, "program consolidation" often obscures the fact that programs are either being neglected or discontinued. A good case in point is the HEW Department health budget where a popular program like Burton-Hill hospital construction (which the administration tried unsuccessfully to eliminate last year) has been meshed with three others and given a new name. The administration proposes to fund the new "consolidated" program at 24 percent of the level Congress voted for the four programs combined in FY 1974.

A further example of the consolidation game is to be found in the Manpower section. Here the shift in emphasis from federal to local and state responsibility is embodied in the new Comprehensive Manpower Assistance (CMA) program starting on July 1. Outlays requested in FY 1975 for programs to be merged into CMA are proposed to rise by 36 percent over the previous year's level, or from $1.4 billion to $2.0 billion.

However, nothing is being requested for the public service jobs program and, if it is to continue, state and local governments will have to fund it with CMA monies. This program received funds of $1.0 billion in FY 1973 and $600 million in FY 1974. When its proposed abandonment is taken into consideration it can be seen that states and localities would have not more but less money to fight joblessness in FY 1975.

EMERGENCY EMPLOYMENT ASSISTANCE OUTLAYS AND INDIVIDUALS SERVED, FISCAL YEAR 1972–75

Fiscal Years	Outlays	Individuals served	Average unemployment
	(Million)	(Thousand)	(Thousand)
1972	$559	87	5,002
1973	1,005	148	4,549
1974 (estimated)	631	119	[1] 4,312
1975	(2)		

[1] First 7 months of the year.
[2] The Department of Labor estimates that $350 million in next year's budget will be used for public service jobs. This would come out of the $1.6 billion CMA program.

While large sectors of our labor force remain unemployed and more workers are losing their jobs, spending for all manpower programs combined is to remain at the same level estimated for FY 1974, and over $100 million below the actual level of FY 1973. The decline in real terms is of course greater.

In the general field of health, the administration is requesting less funds than in 1974, although it does not look that way because previously impounded funds have been released. A request to pare the federal commitment to producing more health professionals is especially baffling in the light of Nixon's avowed interest in the passage of national health insurance which would obviously require substantially more doctors, dentists, and nurses.

In the area of housing, HUD officials are hailing as a major victory the President's approval of adding 100,000 units of leased low-income housing to the 200,000 units which were previously announced. But this would hardly put a dent in the amount of low-income housing which is needed. The Housing Act of 1968 calls for 600,000 low- and moderate-income housing units per year. Here is an example of how a good opportunity for public employment jobs for an eminently worthwhile purpose is not taken advantage of.

The 1975 budget is wanting on many other counts as well. To cite just a few: In education, the budget proposes a negligible increase from last year's level and a decrease from the amount appropriated by Congres for this year: federal public assistance grants to the states would be cut; the Office of Economic Opportunity would be phased out of existence, along with its community action programs.

RECOMMENDATIONS

The *Economic Report of the President* and the *1975 Budget* serve to document once again this administration's continuing wavering, ineptness and plain wrongdoing. If the President will not or cannot furnish the leadership we badly need in these difficult times, the Congress must—with a commitment to solve the great challenges ahead of us.

To begin with, there must be an all-out effort to substantially reduce unemployment. Economic arguments apart, this should be a primary concern for human reasons. Unemployment is demeaning to the unemployed and their families, and its sociological ramifications threaten the very fabric of our society. But even on purely economic grounds, the unemployed should be viewed not as a burden but as those who represent available manpower that can be used in the public's behalf and are now being wasted. Since the private economy is clearly unable to provide the millions of additional jobs we lack, and even substantially expansionary government policies will take some time to get the private economy into motion, an ambitious federal program of public service jobs is of the utmost necessity. There are innumerable tasks which could be undertaken by those publicly employed. In mass transportation, the development of public energy resources, environmental improvement, and the care of children, the aged and the ill, the needs are most numerous and pressing.

In addition, a greatly strengthened federally supported unemployment compensation system with higher benefits levels and longer duration periods is required. There should be 52 weeks of benefits in every state faced with major unemployment problems.

Congress should apply itself to a genuine, thorough-going reform of our tax system. We have indicated above that the distribution of income and wealth in this country is inequitable and getting more so. The fact is, our tax structure is replete with loopholes which take away most of the progressivity which it may appear to have on paper. Particularly offensive is the regressive nature of the Social Security tax. In 1974, workers with wages or salary income up to $13,200—even if that income is only a thousand dollars for part-time work —pay 5.85 percent of their earnings for Social Security, while earned income above $13,200 is completely free of the tax. Thus, a wage earner struggling to support his family on $7,500 a year pays the full 5.85 percent of his wages, while a professional on a $40,000 salary has to pay only 1.93 percent on his earnings. Moreover, a worker with dependents has to contribute just as much as one without them, and unearned income goes completely untaxed.

We are on record before Congress as being in favor of exempting income below the poverty level from Social Security contributions. Since the introduction of the low-income allowance for federal income taxes in 1971, payroll taxes have constituted the major federal tax burden of most families under the poverty level.

In testimony before the Senate Special Committee on Aging last year, John Brittain of the Brookings Institution made a proposal, which we support, calling for exemptions and deductions from *pooled* earnings identical to those under the income tax, which now amount to $4,300 for a family of four. We also support the concept behind his proposal to extend income relief farther up the scale toward middle incomes, by means of a "disappearing" exemption.

Today I have touched upon some matters of grave concern to UAW members and their families. Among those matters unemployment and the energy crisis are the most pressing problems. It is fruitless to look for solutions from an administration characterized by confusion, lack of credibility and callousness toward the plight of working people. In the current void of executive leadership, it behooves the Congress to step in with effective answers.

Senator PROXMIRE. Thank you, Mr. Woodcock, for a most impressive and without question the most comprehensive analysis we have had. We have had a very large number of witnesses, as you know, appearing before this committee representing the administration and representing the top economists in the academic community, too. Yours is the most comprehensive, and in many ways one of the most convincing expressions that we have had.

Mr. Woodcock, see if I can first make sure that I have an answer to the question that I raised in my opening statement about the prospects or possibility of wage increases provoking further inflation in 1974 and 1975. Your answer is to use a partial cost of living compensation, plus a 3-percent productivity increase which has been generally recognized by economists as only fair for labor because we do have that kind of productivity throughout the economy as a whole, you argue this would not be inflationary.

Now, the difficulty with that is that under the special circumstances we now have, with the transfer of income to the oil industry both in this country and abroad, with the transfer of income to the farm sector, if we get this kind of wage increase, don't you have an inflationary situation?

Now, the difficulty with that is that under the special circumstances we now have, with the transfer of income to the oil industry both in this country and abroad, with the transfer of income to the farm sector, if we get this kind of wage increase, don't you have an inflationary situation?

Mr. WOODCOCK. I said that is counterinflationary. It obviously can feed to the problem under certain circumstances. But we start with this premise. When the energy industry is gobbling up so much of the Nation's substance, and because to some degree the farmers have begun to come into their own for the first time in many years, that is not a comparable situation to energy, but it is obviously having its impact. To have the notion that workers, whether organized or unorganized, are going to be content with just 3 percent, and see that 3 percent disappear in the first 2 months of a wage contract, is just utopia.

Senator PROXMIRE. We all agree on that. Three percent would be ridiculous. We have a 5½-percent wage guideline now, it would have to be higher, and the question is whether or not the 12 percent that Mr. Meany is suggesting or something in that order would not be inflationary.

Mr. WOODCOCK. How did we come to 5.5 percent? I had something to do with that, because at the point it was created, when I was a member of the Wage Board. The Pay Board consisted of public people, labor people, and industry people. And so labor came in with a—our charge from the President was to bring inflation down to the range of 2½ to 3 percent by the end of 1972, I guess, was the charge. Okay. Labor came in and said, all right, we will accept that. So we will take the high end of that deal, 3 percent, and we will add to it 3.2 percent, which is what we think is the real long trend productivity factor. So our figure was 6.2. Industry came in and said, three plus 2—I guess it was 2 to 3 percent, and they took the low end. Anyway, they came in at 5 and the public members then came in with 3 plus the middle part of the range of 2 to 3 percent. And this is where the magic factor 5½ percent came from. It was hardly a scientific exercise, it was a political exercise. And of course in any event the inflation was considerably more than that.

Senator PROXMIRE. At any rate, what you are saying is that the arrival of the 5½ percent was based on the cost of living estimates at that time?

Mr. WOODCOCK. Not estimates, the goal, the President's hoped for goal.

Senator PROXMIRE. I see. And you say one realistic aproach is to take the cost of living we actually experience, use a 90 day lag for wage increases, and an additional 3 percent factor for productivity increases.

Mr. WOODCOCK. Plus the fact, Senator, that it goes into what we call the cost-of-living float. And for the full 3 years it stays in the float. So that if in fact the long promised leveling off or even dropping in food prices would reduce the Consumer Price Index, there would be a reduction in that flow, yes. And it has happened.

Senator PROXMIRE. I think that is a very important refinement. If a 12-percent guideline is adopted, just 12 percent, then it seems to me that you do have at least the potentiality of a more inflationary impact in wage increases than if you have the kind of float in wage increases you have been describing, which goes up and goes down. As the situation improves, which many people expect it to do with respect to food and with respect to energy as the year goes on, you would tend to get a drop in the rate of increases. It might be 4 or 5, 8 to 10, or 12 percent or even more but then it would go down.

Mr. WOODCOCK. That is correct. The bulk of the contracts coming up this year—aluminum is already essentially behind us—steel, communications, and aerospace—all of those are tied to the concept I have described.

Senator PROXMIRE. Do we need a goal for reducing inflation in 1974? Then we could have a guideline based on this goal. The administration has proposed no goal this year. In the past they have.

Mr. WOODCOCK. The goal has been illusory.

Senator PROXMIRE. That is right, the goal hasn't been achieved.

Mr. WOODCOCK. It certainly has not. And I think setting goals—part of the trouble we have in this country today is, we have a political crisis not just with regard to the Executive, because the people are fed up with being spoon fed illusions. And I think to kid them is just going to make the political problem worse.

Senator PROXMIRE. What specific recommendations do you have to cope with the inflation situation, in view of the fact that we have a guideline very likely to be abandoned? There is every indication that they will provide an exception for the health services, perhaps. The energy guideline is a mighty flexible one as far as the price is concerned. And you address almost all of your remarks, which are excellent, but you address them to the unemployment situation. What specific recommendations would you have to cope with what we seem to have, a terrific inflation surge which I am sure you are concerned about as well as the unemployment?

Mr. WOODCOCK. I am no monetary expert, but certainly the galloping rate of the increase in the money supply obviously has inflationary impact. And there are aspects of the budget that have a strong inflationary impact. When I hear Mr. Schlesinger say that there was $1½ billion put in there for its economical beneficial job effect, everybody knows that money spent through the Pentagon in terms of job creation is as nothing compared to money spent directly like for public service employment. And we still believe that there is gross waste in the defense budget of this country. I am not talking about the badly needed new weapons systems, or to close our eyes to the real world and what the Soviet Union may be doing. But it is still true that we have more naval captains and above and colonels and above on the Army and Air Force side than we had when we had all the men and women under arms in World War II. That wouldn't happen in any labor union or any corporation. But it happens in the Defense Establishment of the United States. And that is inflationary. And those are things that the Government can do things about.

Senator PROXMIRE. A number of members of the committee and also some witnesses have suggested that we provide for a temporary reduction in the payroll tax, social security tax, and do that with the understanding that this would increase take-home pay and perhaps lessen the pressure for wage increase. And therefore there would be less increase in the wage costs and less pressure from that direction toward inflation. Is this realistic? Could this be worked out, supposing Congress did provide for a reduction of 1 or 2 percent or something of that kind in payroll taxes; that is, from the 5½ down to 4½?

Mr. WOODCOCK. 5.85 percent currently.

Senator PROXMIRE. Supposing that were reduced, is it possible in your view to have that reflected in a lesser wage increase?

Mr. WOODCOCK. No, I don't think that would have any real effect. With regard to the social security tax, I have already stated that at the lower levels it should come off permanently, and there should be a pooling so that where a man and wife are both working at low levels of earnings and paying 5.85 percent on every dollar which they earn, that is really bad. That should be done permanently. But that would have little impact upon the wage demands.

Senator PROXMIRE. Why wouldn't it have a direct impact? After all, the effect on take-home pay would be as explicit and direct as a wage increase would be.

Mr. WOODCOCK. I am not saying it wouldn't have some impact. It would. But in practical terms it would have little impact upon the push for wage equity and wage protection, particularly in view of the profit situation. I am always somewhat saddened when I see the willingness of all the rest of the society to gang up on working people and have them solve all of the economic problems, and not go to where the real problems are.

Senator PROXMIRE. You feel that if there were that reduction—and you favor that reduction on a permanent basis—in payroll tax it should not be reflected in a lesser increase in pay?

Mr. WOODCOCK. The people I am talking about who are now most disadvantaged by collecting social security taxes from the first dollars earned are largely outside the organized labor sector, they are the working poor, and it would have no impact whatsoever on them because they have no control upon the incomes they receive, that is decided for them.

And I might say further in this regard, Senator, that when the Social Security System was first put into effect, and we had a $3,000 ceiling in 1936, that ceiling covered 95 percent of all the individual drawing wages and salaries in the U.S. With a ceiling of $13,200 we have progressively over the years kept that down. And that is a long way from 95 percent coverage. To have an equivalent coverage today we should be looking at raising that ceiling to get the necessary money and giving the relief at the bottom so that the tax system—why should I quit paying social security taxes at the level of $13,200? To me that tax runs to 2 percent or even less. And yet the working poor are paying a full 5.85 percent. It is terrible, it is really terrible. There isn't any other country in the whole non-Communist world that has as bad a system as we have both on the benefit side and the taxing side.

Senator PROXMIRE. You propose as a way to provide more jobs—and it appears more and more likely we are going to have to do that since we have had a big increase in unemployment in the last 3 months—the biggest increase since 1970—and you propose specific Government spending measures. This has been challenged by economists on two grounds. One is that it is extraordinarily difficult, with with an energy short economy, to increase employment in one area without decreasing it in another, because if you increase employment through Government spending, you have to have the energy necessary to get those people to work in the kind of work they do, and that simply takes the energy from another sector of the economy in which they are employed, and results in unemployment in that particular area. Furthermore, that kind of a shift tends to aggravate inflation, because as the Government spends more in that particular area, there is a scramble for the limited energy resources, and that tends to have an inflationary effect. What is your answer to that?

Mr. WOODCOCK. My answer to that is that emphasis should be on labor-intensive usages and not on energy-intensive usages.

Senator PROXMIRE. Give us a couple of examples.

Mr. WOODCOCK. I will give you a minor example in my own city of Detroit.

In the Detroit River we have a beautiful park. It is called Belle Isle. It is a big park. It is in a terrible state of deterioration. And simple labor-intensive, non-energy-intensive use could make that park what it used to be when I was a young man in Detroit, a place where people loved to go. And that in turn would have an effect upon energy consumption, because people wouldn't have to drive 40 miles away to get to a relatively decent State park if they had one right at their doorstep served by buses and whatever a beautiful park and recreation system needs.

In the State of Michigan we have railroad tracks that run north, but no train can go more than 40 miles an hour on those tracks because they are in such a terrible state of repair. They too could be put back into decent usage with low energy intensive application of labor.

And all of our cities and towns are dirty. And just cleaning those up could begin to instill in us a pride in our selves again as people in the Nation which we are sadly lacking. I think it could have tremendous morale effects.

Senator PROXMIRE. That is very interesting. Do you feel that that kind of imaginative concentration on jobs that would enable people to travel a little less, and to use less energy, could create a substantial number of jobs, that is, hundreds of thousands of jobs, the kind we need, and not just a few?

Mr. WOODCOCK. I believe that very sincerely.

Senator PROXMIRE. Now, the other part of the problem that was proposed to us—Mr. Arthur Okun, an economist whom I am sure you respect—he was Chairman of the Council of Economic Advisers under President Johnson, and he is a liberal economist—he said the difficulty is that it is so very hard to get those programs moving; it takes so long. He said the emergency public works program started in 1962 didn't bite in a really big way until 1966, and by that time it was inflationary. Now it is true that the public service employment is faster than that. But I wonder if it is possible for Government to move with enough speed to ward off a threatening recession. Much of our talk is about the 1975 budget. Not even the first part of that spending will be available legally until July 1 of this year. Our problem is now, next month, a month after. Some people argue that later this year the situation will improve, and that next year we may have very largely an inflation problem. Whether that is true or not we do need help now.

Mr. WOODCOCK. Government has to have that answer. The automobile industry, take the General Motors Corp., caught short as they are, when their profits are at stake, they know how to move mighty fast. I don't know why the Government hasn't moved fast, when the Government health, in an economic sense, is at stake. Why should it take 4 years to feed a decision of the Congress and the administration into reality, I don't understand.

Senator PROXMIRE. Well, one area where the Government can move rapidly is in unemployment compensation, if they will, and if they have the framework in which to operate. You said in your prepared statement: "There should be 52 weeks of [unemployment compensation] benefits in every State faced with major unemployment problems." Now, in the past, unemployment benefits have been triggered by either the local or national insured unemployment rates. Do you favor that approach? Are the triggers used in the past adequate—the 4.5 percent national insured rate, or the equivalent of a 6 percent total rate—the rate triggers, or should the benefits be triggered at some lower rates?

Mr. WOODCOCK. It is not stated specifically here, but we are coming to the viewpoint that there should be Federal standards both on the benefit rate and the duration, which should be on a permanent basis. Then in addition, we think that there should be Federal allowances to take care of localities and whole States that have serious unemployment problems beyond 1 percent. And I am not reacting to the past standards, whatever seems a reasonable standard for the present or future.

Senator PROXMIRE. I welcome with great enthusiasm your analysis of structural employment and the objections that the administration has made. We have got one of the top structuralists in Mr. Fellner, a member of the Council of Economic Advisers and he has used what I think is an alibi. So has Mr. Stein, and I think you have put it most persuasively this morning. Do you think it would be useful for us to set goals in addition to the unemployment goal we have, goals by classification—in other words, a specific goal for reducing unemployment for blacks, a specific goal for reducing unemployment for teenagers, for women, and so forth, so that we could begin not only to try to get down to 4 percent or less unemployment, but begin to reduce it sharply in those areas where it is so much higher?

Mr. WOODCOCK. Unless measures are taken to bring the average down and to set a goal for the new disadvantaged groups, the women, the minorities, including blacks, of course, Chicanos, and so forth, it tends to set up a competition. You know, in an automobile assembly plant, 4 years ago there were no women employed in the production process. The first women began to show up some 4 years ago. And they were well received by the men, and there were no apparent difficulties. But at the point the energy crisis hit and the big-car-plant layoffs started taking place, there was great antagonism on the part of the males against the fact that the women were here, which during the time of having no competition for jobs didn't appear. I think the experience of the early 1960's, the first half of the decade of the 1960's, showed, and then in the case of increasing aggregate demand, that the chief beneficiaries of reducing the unemployment rate are those who are, under normal circumstances, disadvantaged. And I think it would be well to keep an eye on it, but not necessarily set certain goals, because then that could indicate, OK, this goal is going to be met here by taking away from that group over there, which tends further to pull our society apart. And what we need desperately is to try to pull this society of ours together.

Senator PROXMIRE. At the same time the greatest problem really is with the groups I mentioned. The black unemployment, as you know, is twice as high as white unemployment. And unemployment among teenagers is four times as high as that among adults. This isn't true in England, where unemployment among teenagers is less than it is among adults. It is simply a matter of policies that aren't working at all. Goals help us focus on these policies—providing the kind of training for young people so that jobs will be available—might accomplish more. But certainly it would help us do a more effective job with respect to discrimination which still exists, as we know, in spite of the law, against women and against blacks and against children, too—young people, too to some extent.

Mr. WOODCOCK. I don't want to say that there should not be strong attention brought to this problem. I think our statement shows that we are anxious to have that done. But let's take the communities of Flint and Lansing and Pontiac, Mich., all General Motors towns, where now, male heads of families are on the streets, and unable to get other jobs. We have got to address his problem as well as the problem of the others.

Senator PROXMIRE. Now, you mentioned sliding down the edge of the second Nixon recession. Are we in a recession now in your view?

Mr. WOODCOCK. I think if we are not we are so close to it that I don't see anything that can turn us back. You know, when you take both automobiles and housing, such vital industries, and they are in such distressed conditions as they are currently, I can't see that being true without it having a wide rippling effect economically which will be quite difficult to reverse.

Senator PROXMIRE. Is the automobile industry in a recession right now?

Mr. WOODCOCK. Well, the American Motors Corp. isn't, thankfully, they are doing very well. And of the three, Chrysler is in the best position, Ford next, and General Motors by far the worst. And the big crunch of the impact has come upon General Motors because their greater commitment to big cars and to medium-sized cars, and further than that, their much greater commitment to low fuel efficient powerplants.

Senator PROXMIRE. Would you call the status of the automobile business now as one of recession?

Mr. WOODCOCK. The impact is so unequal. We have some 35,000 in General Motors on indefinite layoff, and we have anywhere, in any given week we have another 20,000 to 25,000 to as much as 50,000 or 60,000 on the street because of 1- or 2-week shutdowns. And those are mostly concentrated in certain areas; Flint, Mich., certainly is at depression levels at the moment, not simply recession, depression levels.

Senator PROXMIRE. What is the unemployment rate out there?

Mr. WOODCOCK. On an intermittent basis it must be crowding 20 or more percent.

Senator PROXMIRE. How much of the unemployment in the automobile industry is the result of the energy shortage and how much as a result of reduced economic activity overall?

Mr. WOODCOCK. Well, it is a mixture, because during the last 3 years, 1971, 1972, and 1973, we marketed in this country 32,700,000 automobiles, both domestic and imports, which means that one-third of all the cars on the road are 3 years old or less, so we have the most modern fleet on the road right now since the mid-1950's. Last year we sold 1½ million units, beyond the long-term trend line, obviously sales borrowed from the future. So that there would have been a slackening of the market this year in any event. But when you have on top of that the tremendous impact of the energy crisis, which hits at the big cars and the intermediates mostly, then we have a very severe condition.

Senator PROXMIRE. Now, there is an assumption on the part of the administration economists that the last half of the year is going to be better because they say the automobile industry will pull out of its slump as the big car production is replaced by small car production; they say there is a big demand for smaller cars, and General Motors and others will get into this in a much bigger way, and as they do there will be a turnaround. Do you think this is likely?

Mr. WOODCOCK. Well, General Motors is now saying that 50 to 60 percent of their production at the beginning of the next model year, which will be in September, will be in small cars. But you have to answer the additional question, what powerplants will be available, and how efficient will those power plants be? It is more than just having a smaller car. There are some smaller cars now being marketed that get 8 and 9 miles to the gallon. So the fact that they are smaller doesn't make them better from the standpoint of energy crisis. But to change an assembly plant can be done. Ford did it with their Wayne, Mich., plant. They changed that from intermediate and big cars to the Maverick in 52 days; they changed that around. But if their problem is a lack of available powerplants of smaller or more efficient variety, then that is a more difficult thing to handle. And it so happens right now that the Chrysler Corp. has a greater six-cylinder capacity than Ford and General Motors put together. And that indicates what commitment GM, for example, had made to the V-8 engine. And I don't know how fast they can move in that area.

Senator PROXMIRE. That sounds like there may not be as much of a recovery as we have hoped at the end of this year, from the shift to small cars, or the shift to more efficient engines.

Mr. WOODCOCK. Of course, it doesn't necessarily have to be a small car to be more fuel efficient.

Senator PROXMIRE. That is a much better way to put it. At any rate, it looks as if that may not be able to proceed as quickly as we had hoped.

As I stated in my opening statement, you and your union have a fine reputation for taking positions which are selfless, and sometimes they are extremely difficult for you. I was remembering the SST fights and other fights, the position you took, which took a lot of courage. The UAW has traditionally advocated free trade. For example, you did not support the Burke-Hartke bill as I understand it. Can you explain the reason behind the union's call for quotas for the import of automobiles? This appears to contradict your established free trade policy.

Mr. WOODCOCK. First of all, we don't think it is a contradiction in our basic policy, because the trade laws adopted by our April 1972 convention did advocate the use of the tariff as a protection against "overnight disruption of markets" and we instanced the bearing market which was having, practically overnight, a flood of import, primarily Japanese, which was just literally taking whole communities, mostly in Connecticut, and throwing those people on the street. We have set a temporary quota for 2 model years, and we are well into the first of those 2 model years.

Senator PROXMIRE. You said tariff, and this is a quota, which is considerably more severe.

Mr. WOODCOCK. It is the same principle. The overnight disruption of market is the same thing. And what we are asking for is that the imports, both captive—by captive I mean those owned by GM, et cetera—and other imports outside of North America—this does not apply to Canada—should be limited to the percentage of the market that they have achieved over the last 3 years. Over the last 3 years they had a penetration of 15 percent. And if that isn't done, then there could be a flooding of the market by imports, which could be putting the total burden——

Senator PROXMIRE. For how many would you say?

Mr. WOODCOCK. We are asking for the 2 model years; in other words, we are saying by the fall of 1975 if the industry hasn't taken the steps to meet this competition, then they are exploiting it. But they need the time. Now, people say, well, why didn't they do this before? We have been telling them that for years. But, the victim of their not doing it, is the worker.

Senator PROXMIRE. But isn't it awfully hard to get rid of those quotas? Once we have established them it seems you build in such a strong economic interest in continuing, so many jobs are at stake and profits are at stake that you have a very difficult time getting rid of them. We have a lot of trouble getting rid of the oil imports quota, even though the President's task force said we should get rid of it, and there was every indication that we should; it depleted our reserves and drained America first, and we followed that very bad policy. Once we establish these quotas even though they are only for 2 years, isn't it going to be very hard at the end of 2 years to ask industry to compete?

Mr. WOODCOCK. The legislation we are asking for would be specific in its terms. It would be for this period of protection.

Interestingly enough, the Detroit Free Press sent a survey team up to Flint to ask workers standing in lines at the unemployment compensation office, what do you think of Woodcock's proposal for a temporary limit on imports? And they all said yes. But interestingly enough, some of them said, it has got to be like he says, temporary, because if it isn't, we are going to put this country into a trade war. In fact, reading some of these answers, I was quite proud of the intelligence of those UAW members.

Senator PROXMIRE. Let me put it the other way. Canada has raised their oil prices to us, and raised them very sharply, as you know. Do you think we should open the Uunited States-Canadian Automobile Agreement as a means of bringing down their oil prices?

Mr. WOODCOCK. No.

Senator PROXMIRE. Why not? Why wouldn't that be a good basis?

Mr. WOODCOCK. First of all, the industry is so divided between our two countries, and rationalized. I think it is good for us, and to use that as a bargain wedge, offhand I would have to say no.

Senator PROXMIRE. Now, the Economic Stabilization Act expires on April 30, and as I have said, there is every indication that we will, if anything, get controls on the health industry, and maybe not even there, and continue with energy because that is a separate act. But am I correct that you are opposed to an extension of the present authority, and if so, what would you expect, if anything, in its place? Would you, for example, support controls where voluntary measures fail, or would you support prenotification in public hearings?

Mr. WOODCOCK. We have long supported the business of prenotification and public review boards, at least in those situations where there were price dominant companies as in autos, steel, and so on, although obviously there are problems that go beyond that. But we opposed the other types of legislation in 1970, 1971, 1973, and we are still opposed, and the record shows that it has been unworkable, and it has been unfair.

Senator PROXMIRE. What I am asking is—let me give you two options. One option suggested by the Chairman of the Federal Reserve Board is that we provide ad hoc committees, not under the control of the President, but ad hoc committees for what he called the pacesetting industries, and then there would have to be prenotification, 30 to 45 days before wage increases or price increases were put into effect. There would be hearings by the ad hoc committee. Now, regardless of the outcome of the hearings, and regardless of any recommendation they might make, the wages and prices would still go into effect. But that would give Congress an opportunity, if they wishes to react, to do so, or the administration might get Congress to react, and of course public opinion could focus on these increases and perhaps encourage either a compromise or rollback.

Mr. WOODCOCK. That essentially is the same as the bill we were advocating since 1958. I think you can make, however, a very good case that the chief inflationary problem is not in that sector of the economy, certainly not currently. But we would certainly be supportive of that.

Senator PROXMIRE. Well, I think that you can make the case certainly as far as prices are concerned, and I think there is no question that the wages have performed far better than prices in the last couple of years. But isn't it possible that in those industries where the catchups might occur that you might have the very big increases in wages, absent at least a public scrutiny of whether or not they are justified?

Mr. WOODCOCK. We certainly would never oppose a public scrutiny where there was not the question of compulsion in any area of the economy.

Senator PROXMIRE. Did I understand you, Mr. Woodcock, to indicate that you oppose any guideline at the present time for wages and prices?

Mr. WOODCOCK. Yes.

Senator PROXMIRE. Why? Because it would be a floor, and the bargaining would go off from there?

Mr. WOODCOCK. On the Pay Board I made that argument myself, to some degree. Our chief difficulty in the bargaining in the automobile and the agricultural implement industry last fall was, the Government says you can get 6.2 percent, and we are big and tough and powerful, why don't we beat that by 5 percent? And it becomes a handicap to sensible collective bargaining.

Senator PROXMIRE. Even within the domestic non-farm sector there is one conspicuous transfer of income, the transfer from oil consumers to oil producers. What should be done about it? The one option most actively considered has been the administration's so-called excise tax on crude oil. And you address yourself to that. And many of us feel that it would be a sales tax, and it would not stop the transfer of income. Should we enact the traditional type of excess profits tax, and repeal percentage depletion, and other special tax provisions, or control oil prices, and try to roll them back? All of these have their great difficulties.

Mr. WOODCOCK. They do.

Senator PROXMIRE. What would you propose?

Mr. WOODCOCK. We did not go extensively into the energy thing, because we had developed a very comprehensive overview of the whole energy matter with some specifications that are quite long as a statement and which we have sent to all Members of the Congress in both House and Senate, among others. And we are worried about the domination of the energy industry. Of the biggest 15 coal companies in the United States, only two of the 15 are in fact independent, and the others are owned by oil companies or by utilities or by steel companies. And there is a concern that we have on this horizontal monopoly where all the fields of energy are controlled by a relatively small group. We are also worried about vertical monopoly where there are controls from the crude oil all through the processing, the marketing, and the retailing. And we just don't think there are one or two or three easy answers. We think that the Congress, and hopefully the administration, could look at the total problem, because we accept the fact that the energy crisis is real, it is here short term, it is here long term. But it is being manipulated and it is being exploited. And the best interests of this Nation are not being taken care of.

Senator PROXMIRE. You think, then, that there should be for the long term vigorous antitrust action to bring the vertical monopolies that the oil companies have, the seven big oil companies, which have enabled them to reduce or negate the competition that they would have at the distributor levels, and at the refinery level, that that is part of it? How about the short term? How about this year? Would you favor a control of oil prices, the kind of action that Congress took in passing the energy bill?

Mr. WOODCOCK. We supported the energy bill both in the Senate and the House. Mr. Beidler and his associates were active in that.

Senator PROXMIRE. Do you support gasoline rationing now?

Mr. WOODCOCK. We are worried about gasoline rationing, in the absence of patriotic stimulus that we had in World War II, and the fact that unfortunately the American people in large part still think this is a hoax, and a put-on and a ripoff—and the conflicting statements that come from governmental sources, one person on who should know one day says, so and so, and the next day someone who is apparently equally privy to intelligence says almost the exact opposite, and that is not very good in terms of getting acceptance. I think that if the American people could be told what the facts are, and what really the facts are, that we have shown in the past, we have the capacity to have self-discipline. And I think it would have the necessary restrictions on gas usage.

Senator PROXMIRE. I agree with that. The hearings of this committee, however, reveal that nobody in Government knows the facts. The only information we get is from the oil industry itself. That is self-serving, it is contradictory, and it changes constantly. So that we just don't have any basis for knowing those facts. I can't see any reason why we shouldn't have them. They shouldn't be trade secrets.

It seems to me the Government can establish its own information gathering system. We have the best unemployment statistics, and price statistics, and so forth, in the world, although they can be improved, they are the best. And we certainly should be able to know what the reserves, production, imports, and so forth for oil are. But we do not have those facts.

Mr. WOODCOCK. I agree with that. It will take legislation to do it. Because that is where we start.

Senator PROXMIRE. So the Government gathers the facts itself. And even on Government-owned land, where the Government owns the oil, we permit private industry to come in, and if the Government is going to get knowledge about its own holdings, it has to pay for it. And of course it still comes from the oil industry itself, we don't have our own engineers and our own auditors and experts determine our own holdings.

Mr. WOODCOCK. Of course, in this regard, too, we advocate and support the setting up of a Government corporation, a TVA type, so that those criteria can begin to be established.

Senator PROXMIRE. A yardstick?

Mr. WOODCOCK. That is correct. That of course doesn't go to the short-term problem.

Senator PROXMIRE. Your prepared statement stresses the danger of increasing monopoly and industrial concentration in many areas. But one of the most conspicuous is the automobile industry. The Senate Antitrust Subcommittee has been conducting hearings on this question. And they have uncovered a puzzling failure of the Justice Department to act on information developed concerning the monopoly. What recommendations do you have for reducing concentration in the auto industry? You gave us the interesting observation this morning that the smaller firm in the industry has done the best job with respect to efficiency engines and efficient performance, and the biggest company has done the worst job by far. It would seem to me that we might be served by some kind of action. Is that practical? Do you think it would work? Do you recommend it?

Mr. WOODCOCK. I am not sure that given the advanced states of concentration that we have in an interdependent multinational economy, that the whole trust-busting antitrust procedures will work anymore. Take price, for example. Setting aside the present abnormal situation caused by the energy problem, and given a normal situation, there is evidence to say that General Motors, despite its size and concentration, is the most efficient producer. And if in fact they set this price at a level which will still return them a fair profit, at least two of the other three would have great difficulty competing and surviving. And we need, it seems to me, in view of the way technology has gone, and concentration, to take a look at not just going back to the standard of the Sherman Act, we need to take a few looks at the whole thing.

Senator PROXMIRE. Let's take another tack on this. You are critical of the administration for failing to promote the production of small and more energy efficient automobiles. What can and what should the Government do in this respect?

Mr. WOODCOCK. I think if standards were set that unless x percent of a given production met such and such fuel efficiency, 1975, 1976, increasing overtime, otherwise they would not be certificated for sale, which is precisely what we do in the emissions controls, that that is a much better way to approach that problem than by a weight tax or anything else.

Senator PROXMIRE. Let me ask you a question that has intrigued us ever since the point was raised by Professor Modigliani. He, as you know, is an eminent economist. He said, "The most constructive action that Congress could take this year with respect to the economy would be to impeach President Nixon." He says that would be the most constructive action, because it would help restore consumer confidence. And he argued that it would provide a more stable leadership. At the same time it seems that Vice President Ford would follow the Nixon economic policy very likely, and impeachment would put us through a traumatic experience that might shake the economy seriously. What is your reaction to this, Mr. Woodcock?

Mr. WOODCOCK. Well, back in August, following the "Saturday night massacre," I did issue on behalf of the UAW a statement that the impeachment process should go on, preferably that the President should resign.

Senator PROXMIRE. With respect to the economic effects, would this be good for the country or not?

Mr. WOODCOCK. The impeachment process itself, as you have indicated, is a long drawn-out process, and obviously there would be no overnight restoration of confidence. But it is a necessary condition for the continued political health of the Republican Party. If Mr. Nixon were no longer in office and Mr. Ford became the President, I don't know whether there would be any significant change in policy. I would think that there would be a much stronger Cabinet, we would return to a strong cabinet type of government, and the fact that Mr. Ford has personal integrity would be some reassurance to the Nation, considerable assurance.

Senator PROXMIRE. Mr. Woodcock, I want to thank you very much for a fine statement, and most responsive, and also, terse and direct answers. I think you have been certainly one of the most useful witnesses we have had. And I am very grateful to you. As I indicated when I talked to you about this, it is unfortunate that organized labor has not appeared before us before. We had hearings on the wage-price stabilization bill before the Senate Banking Committee, and labor decided not to come to that. And I am so grateful to you for coming this morning. It is not easy. It is a very difficult time to appear. But your testimony is just excellent, and very helpful.

These hearings will next convene in room 1114 in the Dirksen Office Building at 10 a.m. on Thursday, March 7. Our witness will be James Schlesinger, the Secretary of Defense. The committee stands in recess.

[Whereupon, at 11:40 a.m., the committee recessed, to reconvene at 10 a.m., Thursday, March 7, 1974.]

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