

738
FIVE-YEAR BUDGET PROJECTIONS

HEARINGS
BEFORE THE
SUBCOMMITTEE ON
PRIORITIES AND ECONOMY IN GOVERNMENT
OF THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES
NINETY-FOURTH CONGRESS
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APRIL 3 AND 4, 1975

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FIVE-YEAR BUDGET PROJECTIONS

THURSDAY, APRIL 3, 1975

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES
AND ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 1201, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire.

Also present: Richard F. Kaufman, general counsel; Lucy A. Falcone, Robert D. Hamrin, L. Douglas Lee, Courtenay M. Slater, and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

The Subcommittee on Priorities and Economy in Government hopes today to carry forward what I consider to be an important ground-breaking exercise in economic policy: we are trying to think about the future in a rational, systematic way.

This morning marks the beginning of the seventh annual hearing on national priorities to be held by this subcommittee.

Three years ago, during the 1972 hearings entitled "National Priorities—The Next Five Years," we were encouraged by a number of economic experts, including Alice Rivlin, to pay attention to the future implications of current budget decisions, to try to anticipate future economic conditions and to hold annual hearings on the 5-year outlook.

The members of this committee have consistently urged the administration to include in the budget document 5-year projections of budget outlays together with a discussion of the underlying economic assumptions.

This year, in the current budget document, we have such projections and the discussion of assumptions.

I want to strongly commend the administration for providing Congress with this kind of analysis. I assume that we will be provided with similar information in all future budget submissions.

One of the purposes of this hearing is to examine the administration's analysis, to see whether its economic assumptions are reasonable, and to understand the priority choices implicit in its projections.

Most importantly, we want to refine the concept of 5-year projections and try to help improve the analysis so that it will be more useful in the making of economic policy.

We are very pleased to have with us this morning two public servants who occupy important positions in the making of economic policy in different branches of the Federal Government.

The Honorable William E. Simon, Secretary of the Treasury, is our first witness, followed by Alice M. Rivlin, Director of the newly established Congressional Budget Office.

Secretary Simon, we are always happy to see you and to hear your views. You have been most forthright and candid in your appearances on Capitol Hill, and after reading your prepared statement I can say that today is no exception.

In fact, for an administration spokesman you have presented us with a rather unusual, almost unique judgment; namely, that you disagree rather vigorously with the 5-year projections and the accompanying analysis contained in the budget document.

I understand, Mr. Secretary, that you unfortunately will have to leave early, at 11. And for that reason we will get into it. And I understand that you can brief your very substantial and impressive statement, and then we will have Mrs. Rivlin brief hers and get into the questions as quickly as we can.

Go right ahead, sir.

**STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE
TREASURY, ACCOMPANIED BY EDGAR R. FIEDLER, ASSISTANT
SECRETARY FOR ECONOMIC POLICY; AND SIDNEY L. JONES,
COUNSELOR TO THE SECRETARY**

Secretary SIMON. Thank you, Mr. Chairman.

These hearings provide a timely and important recognition of the need to carefully consider national economic priorities, and I welcome this opportunity to appear before you.

Chairman PROXMIRE. I might say that both of your statements will be printed in full in the record.

Secretary SIMON. Thank you, Mr. Chairman. As I just said to my good friend, George Herman, unfortunately instant news and the comments we make today are not terribly newsworthy, but again they are critically important. It is an important subject that we have to focus on in planning the future direction of this country. And I welcome this opportunity to appear before you with Ed Fiedler and Sid Jones from the senior economic staff of the Treasury Department.

A more thoughtful consideration is certainly required to avoid repetition of the severe economic distortions of the past decade. Your leadership in the Joint Economic Committee has provided a unique forum for such discussions for many years. But the sharp cyclical swings, unprecedented double-digit inflation, unacceptable levels of unemployment and increasing uncertainties about the future adequacy of raw materials and productive capacity have created a real sense of urgency. Any immediate relief resulting from the economic recovery, that now appears to be getting underway, will be only temporary if

fiscal and monetary abuses are built into the system causing even more violent booms and busts.

The American people must understand the competing demands in making priority decisions as well as the remarkable creativity and productivity of the U.S. economic system when it is allowed to function properly. Your series of 13 major papers presented to Congress on such diverse subjects as education, women's rights and opportunities, civil rights, health, social security, the media, defense, the environment, consumer protection, government productivity, agriculture foreign affairs, and Federal disaster relief programs, as well as your many thoughtful floor statements on allocation of credit, wage and price controls which have provided a real service to this Nation and I commend you for it, Mr. Chairman.

I especially admire your call for elimination of many obsolete regulatory functions of Government which are unnecessarily restricting the efficiency of the U.S. economy. But the entire Congress, every executive agency and the general public must recognize that the ranking of claims against the potential output is now one of our most important four economic challenges. We cannot do everything immediately and we must consider the proper allocation of resources and functions between the public and private sectors. I am confident that we can cooperate to make these decisions, but we need more effective analysis and planning.

Today I am going to limit my brief remarks to three specific points which affect future national economic priorities: (1) my skepticism about the economic assumptions used in the 5-year estimates presented in the President's fiscal year 1976 budget, either as a description of the probable economic results or as a proper guideline for national policy; (2) the productive capacity of the U.S. economy which will ultimately determine which priority goals can be met; and (3) the Federal Government's role in identifying national priorities and necessary policies.

The Congressional Budget and Impoundment Control Act of 1974 requires a 5-year projection of Federal budget outlays and receipts that would result from the continuation of existing and currently proposed programs with adjustments for anticipated population trends and economic conditions. Additional spending programs beyond the existing commitments are not included.

The key economic assumptions underlying the fiscal years 1976 to 1980 estimates have received widespread attention, particularly the pessimistic inflation and unemployment figures. For calendar year 1976 the Consumer Price Index increase was estimated to be 7.8 percent and the unemployment rate forecast remains close to 8 percent.

Sluggish improvement in both measures was assumed but at a very unsatisfactory rate. It is important to note that the figures for calendar years 1975 and 1976 are forecasts of probable economic developments but the longer-term figures for 1977 through 1980 are projections of trends that would be consistent with the general goals of gradually returning to lower levels of inflation and improved employment conditions.

I do not believe that the economic assumptions used in preparing the 5-year budget estimates are a sound indicator of the likely pattern of inflation and unemployment in the near term or that precise

projections can be made for later years. In such a volatile period it is important to maintain perspective rather than frequently shifting policies in response to each new econometric forecast, particularly when the underlying assumptions for such predictions are so uncertain. The record in recent years clearly demonstrates the uncertainties of economic forecasting using the somewhat mechanical models available. Even short-term forecasts covering only a few months are often wrong and economists have difficulty even describing current economic conditions as multiple statistics are reported and subsequently revised.

Another serious limitation of the economic assumptions presented in the fiscal years 1976 and 1980 budget figures involves the unfortunate tendency of forecasters to give only one estimate. For example, an unemployment rate of 8.1 percent is the forecast for 1975 but no indication of the possible range of results is indicated. It is obvious that the actual figure could fall somewhere within a broad or narrow range on either side of the published estimate. For many policy decisions it is more important to know the range of possible results and their probabilities than it is to have a single estimate.

In even the most simple economic forecast a series of estimates about investment and savings decisions in each sector of our \$1½ trillion economy must be made. In estimating unemployment figures additional decisions about the growth of the labor force, job mobility and other demographic variables are required. We too often receive false signals because only the single estimates are presented and a misleading consensus is implied because the range of possible results and their probabilities are not discussed. There is also the familiar problem that where there are two economists there will be three opinions expressed and the rate increases geometrically for other groupings. My economist wrote that line.

Mr. FIEDLER. The other groupings are politicians.

Secretary SIMON. Yes.

But even if the budget's economic estimates are a reasonable approximation of the future economy we should not passively accept those results. As Secretary of the Treasury and Chairman of the Economic Policy Board, I am not satisfied with the projected levels of inflation or unemployment.

The challenge of economic leadership is to provide a more stable economic environment in which the private sector recovery can accelerate. Such improvement requires a restoration of consumer and business confidence. Expedient actions designed for short-term political benefit will not restore that confidence. Therefore, there is an important role for the Government in identifying national goals and establishing more stable fiscal and monetary policies.

We still have the premier economy of the world and rapid, though somewhat erratic, economic growth continues to occur. But Americans recognize that output gains and high per capita incomes do not instantaneously solve all of our national problems. When we apply too much pressure on our system to produce goods and services, the inevitable result is inflation and shortages. If increased government spending exceeds the resources available and the monetary system finances the resulting deficits, the economy eventually becomes overheated. The underlying growth trends of the U.S. economy will provide sustained progress but we cannot realistically expect to satisfy every new claim.

Unfortunately, we have clearly forced the level of Government spending beyond the willingness of society to pay for the programs provided. At the conclusion of fiscal year 1975 we will record our 14th Federal budget deficit in the past 15 years and the 40th deficit in the past 48 years. And the budget outlook over the next few years is clearly a matter of great concern.

In trying to respond to so many diverse interest groups the Federal Government has frequently distorted the efficiency and stability of the entire economic system and has created an accelerating momentum of outlays which has eroded our fiscal flexibility in responding to changing priorities and current problems.

The Federal Government obviously has a fundamental role in decisions about the uses of the national output. Unfortunately, it is widely believed that the Government's role is limited to simply balancing the Federal budget over time. In reality, Federal decisions influence the entire economy through direct purchases, taxes, transfer payments and a variety of research and grant programs which serve as seed capital for determining private sector activities. Total Government spending now comprises over one-third of the total economy and the upward trend may accelerate if the growth of transfer payments continues to increase rapidly.¹

In describing the pervasive influence of Federal decisions in allocating available resources among competing claims I am not suggesting that we should have a controlled economic system. To the contrary, I am strongly committed to the private sector as the superior source of economic progress and my experiences in Government have reinforced those beliefs. But we must recognize the major impact of Government decisions on every sector of our economy.

Unfortunately, debates about setting national economic policies are too often limited to arguments about the allocation of functions between the public and private sectors. In considering national economic priorities a much broader perspective is required. The total productive capability of the entire economy must be first identified before attempting to rank and select specific claims against that potential output. Estimating the total economic capacity of the system avoids the simplistic arguments that additional Government programs can be continuously created to meet every claim by simply shifting resources from the private to the public sector. Adding new Government commitments is not feasible if the total production capacity of the economy is exceeded.

This guideline has been frequently violated as total demand has increased too rapidly for the economic system to absorb. When this happens the economy begins a boom and bust sequence with severe inflation, and unemployment distortions, such as occurred in the late 1960's and again during the last 3 years. The inflation and unemployment caused by these wide swings disrupts the entire U.S. economy as well as our international stability. Unfortunately, the overheating process has often been caused by excessive rates of increase in Government spending. The results of such excesses persist long after economic conditions change because spending programs are rarely eliminated.

¹ See chart 1, p. 13.

A study of total capacity was prepared in 1969 by the Council of Economic Advisers. As summarized in table 1 of my prepared statement the fulfillment of the total claims already identified in 1969 required a relatively rapid expansion of output to keep pace:

The existing, visible, and strongly supported claims already exhaust the national output for some years ahead. This is not to say that no other claims included in these calculations should have preference over claims not recognized here. The basic point is that if other claims are to be satisfied some of those recognized here will have to be sacrificed. Economic Report of the President, 1970, page 80.

In short, the creation of new priorities, or expansion of existing commitments at an accelerated rate, will require giving up or curtailing some existing claim. Once it is recognized that the potential GNP has already been committed to existing claims the consideration of new outlay requests should become more realistic. Spending decisions should then concentrate on realining claims rather than merely adding additional commitments to satisfy diverse interest groups. This point is particularly important in considering the massive amounts of private capital investments required to meet future capacity and employment needs. Instead of reducing capital investment to release resources for Government social programs, the amount of private outlays must be accelerated. This basic requirement means that Government spending and tax policies should be directed toward creating a more balanced budget so that the future flow of savings is not diverted away from private investment into the financing of large Government deficits.

Although the projections of potential output and claims summarized in table 1 are necessarily based on many arbitrary assumptions, the framework of analysis suggested is useful in considering national economic priorities for at least three important reasons:

1. Existing claims on the potential national output, even assuming rapid growth, tend to exhaust the probable national output into the future. If new commitments are to be made, then existing claims must be eliminated or curtailed.

2. The Federal Government's fiscal policies will directly affect which claims are satisfied through the influence of its spending and tax policies.

3. The prospective level of private capital investment will be directly affected by the pattern of government spending and deficits.

Unfortunately, the actual pattern has been completely asymmetrical with deficits occurring almost every year. See table 2, prepared statement. While some economists have tried to justify this pattern, I believe that by concentrating on short-term economic stabilization goals rather than long-term allocation of resources our fiscal policies have become a disruptive force. Too often fiscal policies have lagged economic developments so that the desired stimulus or restraint typically arrives long after the business cycle changes. The "emergency" spending programs created to pull the economy out of a recession often add to the subsequent overheating of the economy and create additional commitments that last far into the future.

A corresponding reduction of these programs during periods of economic expansion is unusual. The result is an escalating pattern of Government programs, which are oriented toward the problems of

the past and restrict the Government's ability to respond to new national priorities or current problems.

The most recent effort to regain control of the fiscal process is the creation of the congressional Budget Committees. This action properly recognizes that the only meaningful budget control consists of self-discipline. Quantitative guidelines have never survived the pressures of political elections or powerful pressure groups.

It is ironic that we have waited 200 years to adopt a congressional procedure for considering individual spending programs as parts of a total budget only to begin the process during an unusually chaotic period of economic change. But this approach offers the only real promise of developing congressional discipline in considering the total economic importance of the Federal budget.

The next step is to expand the process to consider longer-term goals and finally to relate the Government spending actions to the total capacity of the economic system as suggested earlier. When this entire cycle is completed we will recognize that individual pieces of legislation cannot be simply added without considering what existing claims need to be eliminated or curtailed. The economic discipline of allocating scarce resources to different claims according to national priorities can be ignored for brief periods, but the economic distortions of the past decade indicate that this is a costly decision.

My experiences in Government service convince me that we must become much more rigorous in evaluating new claims against our future national output. The economy will continue to grow and meet many of our needs, but we cannot realistically expect to satisfy every competing claim. Accordingly, in assessing the growth of Federal spending, we must recognize the realistic growth capabilities of the total economy. In recent years, we have lacked the discipline to maintain the necessary balance.

It is vital that the process of sorting out of national economic priorities begin now—not when the recession is over, not when inflation is under control, and not when the next election is over, but now.

Twenty years ago it was apparent in this country that we were heading for an energy crisis. One report after another confirmed it, but instead of providing wisely for the future, we insisted upon living foolishly for the moment. Now we are beginning to pay the price, and we will go on paying for some time to come.

In the same way, we have seriously abused the private enterprise system and have so encouraged the enormous growth of Government that we are heading toward another serious crisis. The United States is rapidly coming to a crossroads where we must decide what type of economic system we want. I hope that we will continue to emphasize the free enterprise system in America and roll back the forces of restrictive Government. The choice is one that our generation is called upon to make. Unless we act soon, the decision will be made for us by default.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Simon follows:]

PREPARED STATEMENT OF HON. WILLIAM E. SIMON

Mr. Chairman and Members of this Subcommittee: These hearings provide a timely and important recognition of the need to carefully consider national eco-

conomic priorities, and I welcome this opportunity to appear before you. A more thoughtful consideration is certainly required to avoid repetition of the severe economic distortions of the past decade. Your leadership in the Joint Economic Committee has provided a unique forum for such discussions for many years. But the sharp cyclical swings, unprecedented double-digit inflation, unacceptable levels of unemployment and increasing uncertainties about the future adequacy of raw materials and productive capacity have created a real sense of urgency. Any immediate relief resulting from the economic recovery, that now appears to be getting underway, will be only temporary if fiscal and monetary abuses are built into the system causing even more violent booms and busts.

The American people must understand the competing demands in making priority decisions as well as the remarkable creativity and productivity of the U.S. economic system when it is allowed to function properly. Your series of thirteen major papers presented to Congress on such diverse subjects as Education, Women's Rights and Opportunities, Civil Rights, Health, Social Security, the Media, Defense, the Environment, Consumer Protection, Government Productivity, Agriculture, Foreign Affairs and Federal Disaster Relief Programs is an impressive effort and I commend you for it. I particularly admire your call for elimination of many obsolete regulatory functions of government which are unnecessarily restricting the efficiency of the U.S. economy. But the entire Congress, every Executive agency and the general public must recognize that the ranking of claims against the potential output is now one of our most important economic challenges. We cannot do everything immediately and we must consider the proper allocation of resources and functions between the public and private sectors. I am confident that we can cooperate to make these decisions but we need more effective analysis and planning.

My testimony will not focus on the improving prospects for near-term recovery beyond repeating my fundamental concern about avoiding fiscal and monetary excesses during the current transition which would inevitably lead to even more serious economic distortions within a relatively brief period of time. Nor will I discuss current budget and tax issues. Instead, I will limit my brief remarks to three specific points which will affect future national economic priorities: (1) my skepticism about the economic assumptions used in the five-year estimates presented in the President's Fiscal Year 1976 budget, either as a description of the probable economic results or as a proper guideline for national policy; (2) the productive capacity of the U.S. economy which will ultimately determine which priority goals can be met; and (3) the Federal Government's role in identifying national priorities and necessary policies.

I. THE FIVE-YEAR BUDGET ESTIMATES

The Congressional Budget and Impoundment Control Act of 1974 requires a five-year projection of Federal budget outlays and receipts that would result from the continuation of existing and currently proposed programs with adjustments for anticipated population trends and economic conditions. Additional spending programs beyond the existing commitments are not included. Reasonable assumptions about demographic patterns are usually possible but anticipating changing economic conditions has proven to be extremely difficult, if not impossible. Unfortunately, the five-year budget projections are dependent upon several key assumptions about the economy because the budget results are increasingly affected by economic developments. Retirement and other social insurance benefit payments are linked to consumer price changes. Medicare, Medicaid and other transfer payments are also affected by price developments. Numerous entitlement programs, such as unemployment compensation claims, are directly tied to the status of the economy.

Federal construction and federally assisted programs respond to economic conditions. Interest on the national debt depends upon the general financial markets. Tax receipts obviously are determined by individual and business incomes.

The key economic assumptions underlying the FY 1976 to 1980 estimates have received widespread attention, particularly the pessimistic inflation and unemployment figures. For calendar year 1976 the Consumer Price Index increase was estimated to be 7.8 percent and the unemployment rate forecast remains close to 8 percent.

ECONOMIC ASSUMPTIONS

(Calendar years, dollar amounts in billions)

Item	1973 actual	1974 actual	Assumed for purposes of budget estimates			
			1975	1976	1977	1980
Gross national product: Current dollars..	\$1, 295	\$1, 397	\$1, 498	\$1, 686	\$1, 896	\$2, 606
Constant (1958) dollars:						
Amount.....	839	821	794	832	879	1, 061
Percent change.....	5. 9	-2. 2	-3. 3	4. 8	5. 6	6. 5
Prices (percent change):						
GNP deflator.....	5. 6	10. 2	10. 8	7. 5	6. 5	4. 0
Consumer Price Index.....	6. 2	11. 0	11. 3	7. 8	6. 6	4. 0
Unemployment rate (percent).....	4. 9	5. 6	8. 1	7. 9	7. 5	5. 5

Sluggish improvement in both measures was assumed but at a very unsatisfactory rate. It is important to note that the figures for calendar years 1975 and 1976 are forecasts of probable economic developments but the longer-term figures for 1977 through 1980 are projections of trends that would be consistent with the general goals of gradually returning to lower levels of inflation and improved employment conditions.

I do not believe that the economic assumptions used in preparing the five-year budget estimates are a sound indicator of the likely pattern of inflation and unemployment in the near term or that precise projections can be made for later years. In such a volatile period it is important to maintain perspective rather than frequently shifting policies in response to each new econometric forecast, particularly when the underlying assumptions for such predictions are so uncertain. The record in recent years clearly demonstrates the uncertainties of economic forecasting using the somewhat mechanical models available. Even short-term forecasts covering only a few months are often wrong and economists have difficulty even describing current economic conditions as multiple statistics are reported and subsequently revised. Unfortunately, the methodology of computer forecasts often creates a false impression of accuracy and certainty. I sometimes think that economists use decimal points in their forecasts to prove they have a sense of humor. But the forecasting errors of the past few years have been anything but humorous. The sharp increase in the unemployment rate and the rapid erosion of inflation pressures in recent months indicate that these two key assumptions may already be far off the mark and the figures for subsequent years are even more questionable. Like any other management tool, the questioning process required for preparing an economic forecast is probably more valuable than the resulting estimates. Public officials should never accept such tenuous forecasts as a firm basis for policy decisions, particularly during periods of sharp cyclical swings.

Another serious limitation of the economic assumptions presented in the FY 1976 and 1980 budget figures involves the unfortunate tendency of forecasters to give only one estimate. For example, an unemployment rate of 8.1 percent is the forecast for 1975 but no indication of the possible range of results is indicated. It is obvious that the actual figure could fall somewhere within a broad or narrow range on either side of the published estimate. For many policy decisions it is more important to know the range of possible results and their probabilities than it is to have a single estimate. In even the most simple economic forecast a series of estimates about investment and savings decisions in each sector of our \$1½ trillion economy must be made. In estimating unemployment figures additional decisions about the growth of the labor force, job mobility and other demographic variables are required. We too often receive false signals because only the single estimates are presented and a misleading consensus is implied because the range of possible results and their probabilities are not discussed. There is also the familiar problem that where there are two economists there will be three opinions expressed and the rate increases geometrically for other groupings.

But even if the budget's economic estimates are a reasonable approximation of the future economy we should not passively accept those results. As Secretary of the Treasury and Chairman of the Economic Policy Board, I am not satisfied with the projected levels of inflation or unemployment.

The challenge of economic leadership is to provide a more stable economic environment in which the private sector recovery can accelerate. Such improvement requires a restoration of consumer and business confidence. Expedient actions designed for short-term political benefit will not restore that confidence. Therefore, there is an important role for the government in identifying national goals and establishing more stable fiscal and monetary policies.

I believe we can do better than the economic assumptions suggest. But we must first demonstrate that government decisions will emphasize economic goals that stretch beyond the next scheduled election; that our future productivity and employment opportunities require increased rates of capital investment; and, that vigorous competition within the framework of a free enterprise economy is still the best approach to maintaining the strength and creativity of the United States.

II. NATIONAL ECONOMIC PRIORITIES

We still have the premier economy of the world and rapid, though somewhat erratic, economic growth continues to occur. But Americans recognize that output gains and high per capita incomes do not instantaneously solve all of our national problems. When we apply too much pressure on our system to produce goods and services, the inevitable result is inflation and shortages. If increased government spending exceeds the resources available and the monetary system finances the resulting deficits, the economy eventually becomes overheated. The underlying growth trends of the U.S. economy will provide sustained progress but we cannot realistically expect to satisfy every new claim.

While the need for responsible demand management is generally accepted, each special interest group assumes that its claim is unique and deserves satisfaction. Unfortunately, we have clearly forced the level of government spending beyond the willingness of society to pay for the programs provided. At the conclusion of FY 1975 we will record our fourteenth Federal budget deficit in the past fifteen years and the fortieth deficit in the past forty-eight years. And the budget outlook over the next few years is clearly a matter of great concern. In trying to respond to so many diverse interest groups the Federal Government has frequently distorted the efficiency and stability of the entire economic system and has created an accelerating momentum of outlays which has eroded our fiscal flexibility in responding to changing priorities and current problems.

The Federal Government obviously has a fundamental role in decisions about the uses of the national output. Unfortunately, it is widely believed that the government's role is limited to simply balancing the Federal budget over time. In reality, Federal decisions influence the entire economy through direct purchases, taxes, transfer payments and a variety of research and grant programs which serve as seed capital for determining private sector activities. Total government spending now comprises over one-third of the total economy and the upward trend may accelerate if the growth of transfer payments continues to increase rapidly (see Chart 1). In describing the pervasive influence of Federal decisions in allocating available resources among competing claims I am not so strongly committed to the private sector as the superior source of economic progress and my experience in government have reinforced those beliefs. But we must recognize the major impact of government decisions on every sector of our economy.

Unfortunately, debates about setting national economic policies are too often limited to arguments about the allocation of functions between the public and private sectors. In considering national economic priorities a much broader perspective is required. The total productive capability of the *entire* economy must be first identified before attempting to rank and select specific claims against that potential output. Estimating the *total* economic capacity of the system avoids the simplistic arguments that additional government programs can be continuously created to meet every claim by simply shifting resources from the private to the public sector. Adding new government commitments is not feasible if the total production capacity of the economy is exceeded. This guideline has been frequently violated as total demand has increased too rapidly for the economic system to absorb. When this happens the economy begins a boom and bust sequence with severe inflation, and unemployment distortions, such as occurred in the late 1960's and again during the last three years. The inflation and unemployment caused by these wide swings disrupts the entire U.S. economy and international stability. Unfortunately, the overheating process has often been caused by excessive rates of increase in government spending. The results of such excesses persist long after economic conditions change because spending programs are rarely eliminated.

A study of total capacity was prepared in 1969 by the Council of Economic Advisers and published in the *Economic Report of the President* for 1970. The pattern of real increases in Gross National Product was projected for 1976 using trend estimates of the growth of the labor force, national productivity gains, expected unemployment and the annual average number of hours worked per person. The existing claims against the projected GNP were then identified, including personal consumption, business investment, housing and government spending. All of these claims were adjusted to reflect demographic and economic assumptions. Federal spending was projected to include only existing programs plus new proposals for revenue sharing, welfare reform and pollution abatement outlays. As summarized in Table 1, the fulfillment of the total claims already identified in 1969 required a relatively rapid expansion of output to keep pace: "... the existing, visible, and strongly supported claims already exhaust the national output for some years ahead. This is not to say that no other claims included in these calculations should have preference over claims not recognized here. The basic point is that if other claims are to be satisfied some of those recognized here will have to be sacrificed." *Economic Report of the President*, 1970, p. 80.

These projections in the Council of Economic Advisers analysis are hypothetical estimates based on somewhat arbitrary assumption, and actual results have varied during the intervening years since the study was completed. Nevertheless, a crucial point is evident: decisions on national economic priorities must reflect total output potential and all existing claims rather than focusing only on Federal budget outlays. Whenever resources are limited recommendations to add new government programs must consider the prospective impact on the private sector. In short, the creation of new priorities, or expansion of existing commitments at an accelerated rate, will require giving up or curtailing some existing claim. Once it is recognized that the potential GNP has already been committed to existing claims the consideration of new outlay requests should become more realistic. Spending decisions should then concentrate on realigning claims rather than merely adding additional commitments to satisfy diverse interest groups. This point is particularly important in considering the massive amount of private capital investments required to meet future capacity and employment needs. Instead of reducing capital investment to release resources for government social programs, the amount of private outlays must be accelerated. This basic requirement means that government spending and tax policies should be directed toward creating a more balanced budget so that the future flow of savings is not diverted away from private investment into the financing of large government deficits.

III. GOVERNMENT POLICIES AND PRIORITIES

Although the projections of potential output and claims summarized in Table 1 are necessarily based on many arbitrary assumptions, the framework of analysis suggested is useful in considering national economic priorities for at least three important reasons:

1. Existing claims on the potential national output, even assuming rapid growth, tend to exhaust the probable national output into the future. If new commitments are to be made, then existing claims must be eliminated or curtailed.
2. The Federal Government's fiscal policies will directly affect which claims are satisfied through the influence of its spending and tax policies.
3. The prospective level of private capital investment will be directly affected by the pattern of government spending and deficits.

The traditional view of the government's role has been that a balanced budget is a symbol of fiscal responsibility. Accordingly, when deficits occurred, the government was expected to restrict outlays and/or increase taxes. However, it is obvious that as a result of economic fluctuations the surplus or deficit for any specific year will inevitably be different from the arbitrary target. The "annual balance" rule eventually was replaced by the concept that balance should occur over the course of the business cycle so that fiscal policies could be used to stimulate the economy despite any resulting deficits. The relatively unknown corollary of this "pump-priming" policy, of course, is that budget surpluses should occur during periods of above-average economic activity to create the desired balance over time. Unfortunately, the actual pattern has been completely asymmetrical with deficits occurring almost every year (see Table 2).

While some economists have tried to justify this pattern, I believe that by concentrating on short-term economic stabilization goals rather than long-term

allocation of resources our fiscal policies have become a disruptive force. Too often fiscal policies have lagged economic developments so that the desired stimulus or restraint typically arrives long after the business cycle changes. The "emergency" spending programs created to pull the economy out of a recession often add to the subsequent overheating of the economy and create additional commitments that last far into the future. A corresponding reduction of these programs during periods of economic expansion is unusual. The result is an escalating pattern of government programs, which are oriented toward the problems of the past and restrict the government's ability to respond to new national priorities or current problems. Finally, the "full employment" budget was introduced to correct the asymmetrical pattern of deficits, but this tool has not provided the necessary discipline. All of these approaches have failed because the Executive Office and Congress have been unwilling to shift their attention to longer-term goals or to face up to the agonizing experience of saying no.

The most recent effort to regain control of the fiscal process is the creation of the Congressional Budget Committees. This action properly recognizes that the only meaningful budget control consists of self-discipline. Quantitative guidelines have never survived the pressures of political elections or powerful pressure groups. It is ironic that we have waited two hundred years to adopt a Congressional procedure for considering individual spending programs as parts of a total budget only to begin the process during an unusually chaotic period of economic change. But this approach offers the only real promise of developing Congressional discipline in considering the total economic importance of the Federal budget. The next step is to expand the process to consider longer-term goals and finally to relate the government spending actions to the total capacity of the economic system as suggested earlier in my testimony. When this entire cycle is completed we will recognize that individual pieces of legislation cannot be simply added without considering what existing claims need to be eliminated or curtailed. The economic discipline of allocating scarce resources to different claims according to national priorities can be ignored for brief periods, but the economic distortions of the past decade indicate that this is a costly decision.

IV. SUMMARY

My experiences in government service convince me that we must become much more rigorous in evaluating new claims against our future national output. The economy will continue to grow and meet many of our needs, but we cannot realistically expect to satisfy every competing claim. Some will have to be eliminated or restrained. Accordingly, in assessing the growth of Federal spending, we must recognize the realistic growth capabilities of the total economy. In recent years, we have lacked the discipline to maintain the necessary balance. From calendar year 1966 through calendar year 1975 the GNP will have increased from \$749.9 billion to approximately \$1.5 trillion, a gain of 100 percent. From fiscal year 1966 through fiscal year 1976 Federal budget outlays will jump from \$134.7 billion to at least \$349 billion, an increase of 160 percent. Some would welcome this acceleration of Federal spending because they favor a different approach to allocating functions between the private and public sectors. I strongly disagree because I believe the private enterprise system is the world's most efficient approach to increasing output and preserving personal freedoms. But whichever course our mixed economy takes in the coming years, the need for a more rigorous consideration of national economic priorities is necessary.

It is vital that the process of sorting out of national economic priorities begin now—not when the recession is over, not when inflation is under control, and not when the next election is over, but now.

Twenty years ago it was apparent in this country that we were heading for an energy crisis. One report after another confirmed it, but instead of providing wisely for the future, we insisted upon living foolishly for the moment. Now we are beginning to pay the price, and we will go on paying for some time to come.

In the same way, we have seriously abused the private enterprise system and have so encouraged the enormous growth of government that we are heading toward another serious crisis. The United States is rapidly coming to a crossroads where we must decide what type of economic system we want. I hope that we will continue to emphasize the free enterprise system in America and roll back the forces of restrictive government. The choice is one that our generation is called upon to make. Unless we act soon, the decision will be made for us by default.

Thank you.

CHART 1.—GOVERNMENT AS A PERCENT OF GNP, 1929-2000

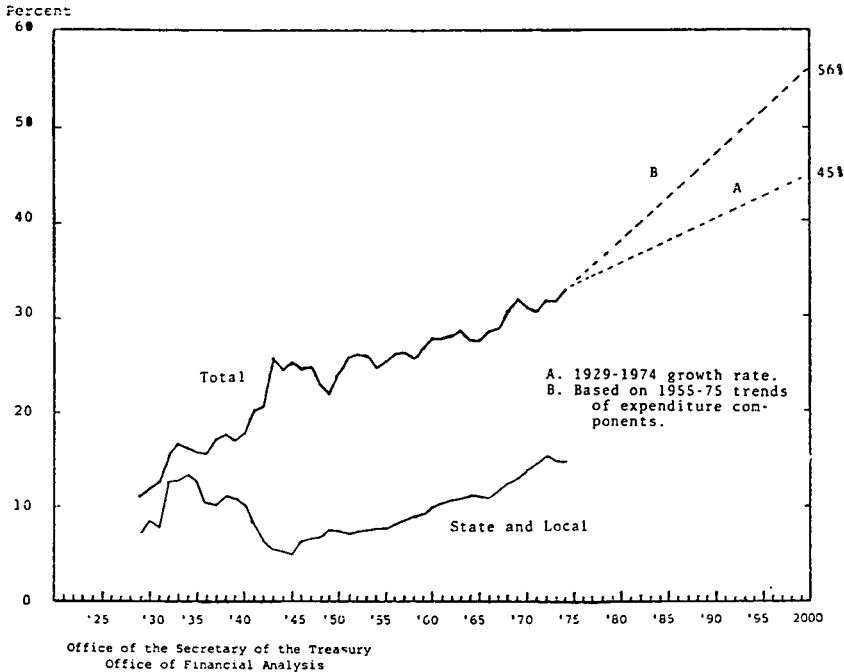


TABLE 1.—REAL GROSS NATIONAL PRODUCT, 1955, 1966, AND 1969, PROJECTIONS FOR 1975-76

	Actuals			Projections	
	1955	1966	1969	1975	1976
	Billions of dollars, 1969 prices				
Gross national product available.....	569.0	845.5	931.4	1,199	1,251
Claims on available GNP.....	569.0	845.5	931.4	1,188	1,232
Federal Government purchases.....	69.8	88.3	101.3	83	83
State and local government purchases.....	53.8	94.4	110.8	140	144
Personal consumption expenditures.....	344.3	519.2	577.5	788	802
Gross private domestic investment.....	96.9	137.5	139.8	192	198
Business fixed investment.....	55.1	92.0	99.3	128	134
Residential structures.....	34.5	29.4	32.0	52	52
Change in business inventories.....	7.3	16.1	8.5	12	13
Net exports of goods and services.....	4.2	6.1	1.9	5	5
Unallocated resources.....	0	0	0	11	19
Addendum: Federal surplus or deficit (-), national income accounts basis.....	5.6	-.2	9.3	25	32
Per capita personal consumption expenditures.....	2,083	2,637	2,842	3,529	3,641
	Percent of total GNP available				
Gross national product available.....	100.0	100.0	100.0	100	100
Claims on available GNP.....	100.0	100.0	100.0	99	99
Federal Government purchases.....	12.3	10.4	10.9	7	7
State and local government purchases.....	9.5	11.2	11.9	12	12
Personal consumption expenditures.....	60.5	61.4	62.0	34	64
Gross private domestic investment.....	17.0	16.3	15.0	16	6
Business fixed investment.....	9.7	10.9	10.7	11	11
Residential structures.....	6.1	3.5	3.4	4	4
Change in business inventories.....	1.3	1.9	.9	1	1
Net exports of goods and services.....	.8	.7	.2	(1)	(1)
Unallocated resources.....	0	0	0	1	1
Addendum: Federal surplus or deficit (-), national income accounts basis.....	1.0	0	1.0	2	3

¹ Less than 0.5 percent.

Note.—Projections are based on projected Federal expenditures (see table 27) and their influence on various components of GNP.

TABLE 2.—FEDERAL BUDGETS CHANGES IN THE UNIFIED BUDGET OUTLAYS BY FISCAL YEAR, 1961-76

[Dollars in billions]

Fiscal year over preceding year	Federal outlays	Dollar increase	Percentage increase	Surplus or deficit
1961.....	\$97.8	\$5.6	6.1	-3.4
1962.....	106.8	9.0	9.2	-7.1
1963.....	111.3	4.5	4.2	-4.8
1964.....	118.6	7.3	6.1	-5.9
1965.....	118.4	-0.2	-----	-1.6
1966.....	134.7	16.3	13.8	-3.8
1967.....	158.3	23.6	17.5	-8.7
1968.....	178.8	20.5	13.0	-25.2
1969.....	184.5	5.7	3.2	+2.8
1970.....	196.6	12.1	6.6	-2.0
1971.....	211.4	14.8	7.5	-23.0
1972.....	231.9	20.5	9.7	-23.2
1973.....	246.5	14.6	6.3	-14.3
1974.....	268.4	21.9	8.8	-34.9
1975 (estimate) ¹	313.4	45.0	16.8	-51.7
1976 (estimate) ¹	349.4	36.0	11.5	

¹ Last official budget estimates published Feb. 3, 1975. Subsequent decisions have increased the probable level of outlays and the size of the deficit.

Chairman PROXMIRE. Thank you, Mr. Secretary.
Director Rivlin.

STATEMENT OF HON. ALICE M. RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mrs. RIVLIN. I will try to summarize this quickly, Mr. Chairman, so that we will have some time for discussion.

I welcome the opportunity of discussing with you today some of the issues raised by long-range budget projections. As you are well aware, the Congressional Budget and Impoundment Act of 1974 gives the Congressional Budget Office considerable responsibility for projections.

Moreover, projections are not just an ancillary duty of the CBO. They are central to its function and to the reason it was created. Over the years Congress has become increasingly aware of several weaknesses in its capacity to make informed budget decisions. One weakness was the lack of a legislative procedure for considering the budget as a whole.

A second weakness has been that the Congress made budget decisions very late and without adequate attention to the future implications of current choices.

The new budget procedures give some hope of improving the ability of Congress to make budget decisions in the light of fuller information about future consequences. The emphasis on projections in the new legislation holds much greater hope for real improvement in the process if Congress takes the projections seriously, as I believe it must. Indeed, projecting the consequences of alternative budget decisions has to become the first, not the last step, in Congress decision process.

Indeed, little will have been accomplished if the Congress retains its traditional focus on current year decisions, even with the new budget procedures, making current year decisions first and then asking, "Let's see what these decisions mean for the future." If, however, Congress starts with forward projections, asking itself, "What do we

want to see happen 5 years from now or 10 years from now," debates these questions, and then translates its desires back into current budget decisions, the process will have been significantly altered for the better.

During the past 5 years the budget messages have focused increasingly on the longer range. The budget just submitted by the President—that for fiscal year 1976—represents the most complete effort to date in the area of long-range projection. Not only does it contain a detailed breakdown of outlays and budget authority by agency and function for the next 5 years, but it also provides an explicit presentation of many of the underlying assumptions concerning such economic factors as gross national product, income, inflation, unemployment, interest rates and Federal pay. The administration should be applauded for its openness and its willingness to provide this detail.

The controversy that has swirled around the long-term budget projections presented in the President's budget and the long-term outlooks referred to in the statements of a number of administration officials, including the Secretary of the Treasury, however, indicates that more detailed long-range projections can at times act to generate more heat than light.

Some of the problems stem from what I regard as a basic confusion between four quite distinct types of projections. Because this confusion is shared as often by those producing long-range budget outlooks as by those consuming these prognostications, I think it would be useful to spell out the four types of projections and the uses to which they might be put.

The most straightforward of these is the "current services" type of projection that attempts to show the budget outlook that would result if the Nation's basic revenue structure remains unchanged and if existing expenditure programs are maintained at their current real service levels. This type of projection answers the question: What will happen if we don't do anything new? It may sound straightforward, but it is rather a complicated question which I go into a little bit in my prepared statement as to what really is meant by a "current services budget." It is one which my new office is actively working with the administration on to develop a consensus on concepts for current services projections.

A second type of long-range budget projection represents a desired course of policy, rather than a picture of the government sector that would result if no new initiatives were forthcoming. This type of projection is the answer to the question: What will the budget be like if we enact certain specified policies, if we increase defense capability, enact national health insurance, reform the tax system in specified ways, et cetera?

The "most desired" type of projection—or rather a whole array of alternative projections of this type—is actually the most useful for decisionmakers. To make sensible informed current decisions the Congress needs to begin thinking in terms of alternative budget futures and making decisions about which of the most desired projections it actually wants to see become a reality. This type of projection, however, is even harder to make honestly and accurately than the current services type. But it needs to be attempted.

Still a third type of projection is that which is in essence a forecast of that which is most likely to occur. These most likely forecasts involve judgments about what the goals of various segments of society are, how the political process will interpret and modify these goals, and how actual economic developments will affect the results.

Most likely forecasts are best left to the private sector, since they have almost no usefulness for decisionmakers. Decisionmakers need to think about "What will happen if," and then do the best they can to choose a course that will lead to the desired outcome. They have no particular use for most likely forecasts and are unlikely to be very objective about them in any case.

The final type of projection that can be placed alongside of the current services, the most desired, and the most likely might be labeled the most feared. Generally this type of projection involves some dire outcome such as the public sector absorbing all personal income at some future date or the public debt growing to unmanageable proportions.

While such projections invariably are prefaced by a conditional statement relating to past experience, such as "if between now and 1990 the public debt grows at the rate experienced during the past decade," the sensationalism of the conclusion detracts attention from the qualifying phrase and the audience is generally not given any basis for evaluating the probability of the events contained in the conditional phrase. Despite these weaknesses, these cataclysmic projections do serve a useful purpose in that they highlight the long-run implications of certain short-term trends and this can bring home how unsustainable some of these trends are.

Having spelled out these four types of long-range budget projections let me now say a few words about those contained in the budget documents. Basically these fall somewhere between the current services and the most desired type of projection. The administration has explicitly warned that these are not to be taken as forecasts of likely outcomes nor are they to be regarded as long-range policy recommendations. However, they are not current services projections either because the base from which the projections are made includes many of the policy initiatives of the President for the coming fiscal year.

Long-range budget projections like other numbers often take on an air of finality and of correctness once they are published. Users of such projections, therefore, should be armed with a healthy dose of skepticism as the Secretary has emphasized. The process of making any type of long-range projections is judgmental not scientific. There are no "correct" or "right" sets of projections, for projections are the product of a multitude of assumptions. They can be tested only when all of the assumptions are realized.

Considering that those offering projections operate in a world where they are rarely evaluated and where their audience often does not have the expertise needed to question their premises, it is incumbent on those of us who make the projections to abide by several basic rules. In some respects these rules may be compared to the Surgeon General's warnings on cigarette packages.

First, those generating projections should specify clearly the basic type of projections that are being made—is a current services, most likely, most feared, or most desired scenario being produced? An ex-

explicit statement explaining the type of projection that is being made will reduce misunderstanding as well as set the ground rules for criticism.

Second, the assumptions concerning basic economic factors that underlie the projections should be spelled out in detail. Only with such explicit detail can the user of the projections have some feel for the credence that he should give the projections. Moreover, it should be possible for the user of the projection to plug in his own assumptions without too much difficulty and to find out easily how sensitive the projections are to changes in basic assumptions, such as a shift in the assumed inflation rate from 6 percent to 8 percent. It is not so important that the users of projections reach agreement on which assumptions are "best," but it is important that they know exactly what assumptions were used and how the results would be affected if the assumptions were changed.

Third, those who produce projections should be required to insure a degree of consistency in their assumptions. At the simplest level this involves making sure that the unemployment, inflation, income, and tax figures fit together in a realistic fashion.

Finally, the consequences of certain assumptions should be spelled out when these assumptions are of a crucial nature and an effort should be made to evaluate their likelihood. Many of the assumptions that must be used in the process of constructing a long-range budget projection involve areas which we know little about. In other cases the assumptions, while sounding reasonable to the generalist, may be highly unlikely from the expert's viewpoint. For example, it may sound plausible that welfare rolls or social security beneficiaries should grow over the next decade at roughly the same rate as they have in the past 10 years.

To a layman, an assumption to this effect, therefore, would raise few eyebrows. However, as someone who has studied the history of the past decade knows, much of the recent growth in welfare and social security rolls can be attributed to an increased fraction of those eligible to receive benefits actually receiving them.

For example, Barbara Boland in her study of the AFDC program for this committee estimated that participation among female-headed families who were eligible for AFDC benefits rose from 63 percent to 91 percent between 1967 and 1970. The future growth of recipients can clearly not be propelled much by increasing this fraction. If the welfare rolls were to grow as rapidly as they did in the past 10 years it would indicate either a significantly increased rate of family disintegration in America or a major change in the eligibility requirements for the AFDC program.

Similarly, the fraction of the population over 64 years of age who are receiving social security payments rose from 69 percent in 1963 to 86 percent in 1973. A sustained expansion in recipients could only be accomplished if the age of retirement were lowered significantly.

In closing let me say a few words about the role that the Congressional Budget Office will play in the area of long-range budget projections. Naturally, I would hope that we would closely observe the rules which I have just outlined. I would also hope that, in time, we could develop the capacity to provide semiannual or even quarterly

revisions of long-run projections of revenues and major expenditures, in addition to the more detailed annual analysis provided for in the Budget Act.

Finally, I would hope to develop in the Congressional Budget Office the capacity to provide long-range projections under a variety of assumptions concerning basic economic conditions. Congressmen as well as experts differ with respect to desirable, tolerable, and likely levels of inflation and unemployment, factors which have a profound impact on the shape of long-range budget projections. The Congressional Budget Office, hopefully, will be in a position to provide some insight into how such projections vary when one changes the set of assumptions upon which they are based. Of course, in this area as well as in others we stand ready to accept the advice and the insights of members of this committee as well as other members of Congress on how long-range budget projections can be made more useful and more understandable.

[The prepared statement of Mrs. Rivlin follows:]

PREPARED STATEMENT OF HON. ALICE M. RIVLIN

Mr. Chairman of Members of the Committee: I welcome the opportunity of discussing with you today some of the issues raised by long-range budget projections. As you are well aware, the Congressional Budget and Impoundment Act of 1974 gives the Congressional Budget Office considerable responsibility for projections. The Office is required by Section 308(c) to issue a report detailing the long run implications of congressional budget actions as soon as is practicable after the start of the fiscal year. This report will contain five year projections of budget authority, outlays, revenues, and tax expenditures. The responsibility for assisting committees in the preparation of five-year budget outlay estimates for bills and resolutions that are reported (Section 308(a)) will also place the Congressional Budget Office squarely in the long-range projection business.

Moreover, projections are not just an ancillary duty of the CBO: They are central to its function and to the reason it was created. Over the years Congress has become increasingly aware of several weaknesses in its capacity to make informed budget decisions. One weakness was the lack of a legislative procedure for considering the budget as a whole deciding whether revenues were adequate to finance expenditures, whether larger or smaller deficits or surpluses were appropriate, and whether the priorities on both the expenditure and revenue sides reflected the desires of the Congress as a whole. The creation of two budget committees with responsibility for collecting the views of other committees, considering budget policy as a whole, and reporting two concurrent resolutions on the budget, gives the Congress for the first time a process for debating and voting on budget policy.

A second weakness has been that the Congress made budget decisions very late and without adequate attention to the future implications of current choices. Appropriations have generally not been passed until the year to which they applied was well underway, and decisions have often been made with little understanding of the commitments for future years that were involved. This lateness in decision-making robbed Congress of flexibility; it was already locked into decisions for the current year because major alterations in programs cannot be made quickly. It also meant that decisions often had unintended future consequences, locking future Congresses into difficult positions because apparently small programs turned out to have large future costs or apparently small tax changes entailed major future revenue losses. Some of these decisions might not have been made if the future consequences had been understood at the time of the decision.

The new budget procedures give some hope of improving the ability of Congress to make budget decisions in the light of fuller information about future consequences. Changing the fiscal year helps a little; it will increase the probability that appropriation actions will be completed by the time the fiscal year starts. The emphasis on projections in the new legislation holds much greater hope for real improvement in the process if Congress takes the projections seriously, as I

believe it must. Indeed, projecting the consequences of alternative budget decisions has to become the first, not the last step, in Congress' decision process. Indeed, little will have been accomplished if the Congress retains its traditional focus on current year decisions (even with the new budget procedures), making current year decisions first and then asking "Let's see what these decisions mean for the future?" If, however, Congress starts with forward projections, asking itself "What do we want to see happen five years from now," debates these questions, and then translates its desires back into current budget decisions, the process will have been significantly altered for the better.

During the past five years the budget messages have focused increasingly on the longer range. The FY 1971 and FY 1972 budget documents contained brief but informative five year projections of total federal outlays and receipts. The 1973 budget expanded on these five year outlooks by differentiating the changes that could be attributed to the initiatives contained in the budget from those that were related to existing programs. Both the 1974 and 1975 budgets went one step further, supplementing this information with a detailed breakdown of outlays and budget authority by functions and by agencies for the year following that of the budget. The budget just submitted by the President—that for Fiscal Year 1976—represents the most complete effort to date in the area of long-range projection. Not only does it contain a detailed breakdown of outlays and budget authority by agency and function for the next five years, but it also provides an explicit presentation of many of the underlying assumptions concerning such economic factors as gross national product, income, inflation, unemployment, interest rates and federal pay. The Administration should be applauded for its openness and its willingness to provide this detail, for without such information it is difficult to gauge the value of any long-term projection.

The controversy that has swirled around the long-term budget projections presented in the President's budget and the long-term outlooks referred to in the statements of a number of Administration officials, however, indicates that more detailed long-range projections can at times act to generate more heat than light. Some of the problems stem from what I regard as a basic confusion between four quite distinct types of projections. Because this confusion is shared as often by those producing long-range budget outlooks as by those consuming these prognostications, I think it would be useful to spell out the four types of projections and the uses to which they might be put.

The most straightforward of these is the "Current Services" type of projection that attempts to show the budget outlook that would result if the nation's basic revenue structure remains unchanged and if existing expenditure programs are maintained at their current real service levels. This type of projection answers the question: What will happen if we don't do anything new? No matter how straightforward this may sound, the concept of "Current Services" is fraught with ambiguities and difficulties. While we may all agree that social security outlays must be increased to reflect the growing population of eligible recipients and the erosion of benefit payments by inflation if real service levels are to be maintained, it is by no means clear how one estimates constant real service levels in defense procurement or water pollution abatement programs. Furthermore, there is the basic problem of determining how one should handle programs whose activity levels are specified by existing laws to rise or fall in future years. Moreover, current services have to be projected on the basis of assumptions about what will happen to the price level and to the state of the economy over the projection period, and it is by no means obvious what assumptions are the most useful. These and related issues are currently being addressed by the Office of Management and Budget, this Committee, the Budget Committees, the GAO, and the Congressional Budget Office, so that a Current Services Budget can be developed by November 10, 1975, and projected into the future on a useful basis.

A second type of long-range budget projection represents a desired course of policy, rather than a picture of the government sector that would result if no new initiatives were forthcoming. This type of projection is the answer to the question: What will the budget be like if we enact certain specified policies, if we increase defense capability, enact national health insurance, reform the tax system in specified ways, etc.?

The "Most Desired" type of projection—or rather a whole array of alternative projections of this type—is actually the most useful for decisionmakers. To make sensible informed current decisions the Congress needs to begin thinking in terms of alternative budget futures and making decisions about which of the most desired projections it actually wants to see become a reality. This type of projec-

tion, however, is even harder to make honestly and accurately than the "Current Services" type. Proponents of particular policies tend to minimize their cost, while exaggerating the cost of policies they do not especially favor. Moreover, for this type of projection to be useful to the decisionmaker the different alternatives must reflect the same assumptions about price and unemployment and other economic variables in the future and it must be known what those assumptions are.

Still a third type of projection is that which is in essence a forecast of that which is most likely to occur. These "Most Likely" forecasts involve judgments about what the goals of various segments of society are, how the political process will interpret and modify these goals, and how actual economic developments will affect the results. The preceding two types of projections that I have referred to are not of this sort at all and it would be wrong to criticize them if history showed them to be far from that which actually occurred. "Most Likely" forecasts are best left to the private sector, since they have almost no usefulness for decisionmakers. Decisionmakers need to think about "What will happen if . . .?" and then do the best they can to choose a course that will lead to the desired outcome. They have no particular use for "Most Likely" forecasts and are unlikely to be very objective about them in any case.

The final type of projection that can be placed alongside of the "Current Services," the "Most Desired," and the "Most Likely" might be labeled the "Most Feared." Generally this type of projection involves some dire outcome such as the public sector absorbing all personal income at some future date or the public debt growing to unmanageable proportions. While such projections invariably are prefaced by a conditional statement relating to past experience, such as "if between now and 1990 the public debt grows at the rate experienced during the past decade," the sensationalism of the conclusion detracts attention from the qualifying phrase and the audience is generally not given any basis for evaluating the probability of the events contained in the conditional phrase. Despite these weaknesses cataclysmic projections do serve a useful purpose in that they highlight the long-run implications of certain short-term trends and this can bring home how unsustainable some of these trends are. However, considering the danger of misuse and misunderstanding, persons in positions of responsibility should engage in cataclysmic projecting only after careful warnings to their audience.

Having spelled out these four types of long-range budget projections let me now say a few words about those contained in the budget documents. Basically these fall somewhere between the "Current Services" and the "Most Desired" type of projection. The Administration has explicitly warned that these are not to be taken as forecasts of likely outcomes nor are they to be regarded as long-range policy recommendations. However, they are not "Current Services" projections either because the base from which the projections are made includes the policy initiatives of the President for the coming fiscal year. For example, the 1980 revenue and outlay figures supplied in this year's budget incorporate the effects of the President's tax changes, energy proposals, and social legislation (the cap on federal pay and retirement benefits and the changes in the food stamp program).

These projections do represent the long-run implications of the Administration's short-term goals even if they do not reflect the longer run policy objective of the President. Furthermore, even over the longer haul there appears to be a degree of inconsistency in the way different program areas are handled. While entitlement programs are allowed to grow only at the pace implied by price rises and increases in recipient populations, defense procurement is projected to increase by 4 percent per year in *real terms*. Moreover, for no obvious reason, the defense projections have inflation assumptions built into them while many domestic programs other than entitlements do not. Functional categories such as "education, manpower, and social services" and "revenue sharing and general purposes fiscal assistance" are projected on the assumption that there will be no growth to cover price rises and hence a real decline in the value of the benefits provided. A separate general "allowance" is made to cover some types of cost increases in domestic programs as a whole.

Long-range budget projections like other numbers often take on air of finality and of correctness once they are published. Users of such projections, therefore, should be armed with a healthy dose of skepticism. The process of making any type of long-range projection is judgmental not scientific. There are no "correct" or "right" sets of projections, for projections are the product of a multitude of

assumptions. They can be tested only when all of the assumptions are realized.

Since—with the exception of forecasts—long-range budget projections do not have as their objective the spelling out of a “Most Likely” scenario, the test of history can rarely be applied. Even “Most Likely” forecasts seldom can be evaluated for actual events and may turn out to be the “Most Unlikely”—the oil boycotts, the droughts, and the political upheavals—rather than the expected. Considering that those offering projections operate in a world where they are rarely evaluated and where their audience often does not have the expertise needed to question their premises, it is incumbent on them to abide by several basic rules. In some respects these rules may be compared to the Surgeon General’s warning on cigarette packages.

First, those generating projections should specify clearly the basic type of projections that are being made—is a “Current Services,” “Most Likely,” “Most Feared,” or “Most Desired” scenario being produced? An explicit statement explaining the type of projection that is being made will reduce misunderstanding as well as set the ground rules for criticism.

Second, the assumptions concerning basic economic factors that underlie the projections should be spelled out in detail. Only with such explicit detail can the user of the projections have some feel for the credence that he should give the projections. Moreover, it should be possible for the user of the projection to plug in his own assumptions without too much difficulty or at least to find out easily how sensitive the projections are to changes in basic assumptions, such as a shift in the assumed inflation rate from 6 percent to 8 percent.

It is not so important that the users of projections reach agreement on which assumptions are “best,” it is important that they know exactly what assumptions were used and how the results would be affected if the assumptions were changed.

Third, those who produce projections should be required to ensure a degree of consistency in their assumptions. At the simplest level this involves making sure that the unemployment, inflation, income, and tax figures fit together in a realistic fashion. Often “cataclysmic” projections do not meet such a test. As a more complex level consistency requires that similar methodologies are used to generate the forecasts. A “Current Services” budget outlook cannot be one that has social programs rising by price and population increases while the defense or highway sector increases in real per capita terms.

Finally, the consequences of certain assumptions should be spelled out when these assumptions are of a crucial nature and an effort should be made to evaluate their likelihood. Many of the assumptions that must be used in the process of constructing a long-range budget projection involve areas which we know little about. In other cases the assumptions, while sounding reasonable to the generalist, may be highly unlikely from the expert’s viewpoint. For example, it may sound plausible that welfare rolls or social security beneficiaries should grow over the next decade at roughly the same rate as they have in the past ten years.

An assumption to this effect, therefore, would raise few eyebrows. However, as someone who has studied the history of the past decade knows, much of the recent growth in welfare and social security rolls can be attributed to an increased fraction of those eligible to receive benefits actually receiving them. For example, Barbara Boland in her study of the AFDC program for this Committee estimated that participation among female-headed families who were eligible for AFDC benefits rose from 63 percent to 91 percent between 1967 and 1970. The future growth of recipients can clearly not be propelled much by increasing this fraction. If the welfare rolls were to grow as rapidly as they did in the past ten years it would indicate either a significantly increased rate of family disintegration in America or a major change in the eligibility requirements for the AFDC program. The latter would be inconsistent with a “Current Services” projection while the former might be considered unrealistic. Similarly, the fraction of the population over 64 years of age who are receiving social security payments rose from 69 percent in 1963 to 86 percent in 1973. A sustained expansion in recipients could only be accomplished if the age of retirement were lowered significantly. To take yet another example, grants in aid to state and local governments if they were to maintain the rate of growth experienced in the 1965–75 period during the next five years would amount to some \$115 billion dollars and would absorb roughly one quarter of the federal budget. While a simple statement that grants in aid were assumed to grow at their past pace would not be treated as startling by any but the experts in the field, it would represent a very significant change in intergovernmental fiscal relations and in the level of state and local taxes.

In closing let me say a few words about the role that the Congressional Budget Office will play in the area of long-range budget projections. Naturally, I would hope that we would closely observe the rules which I have just outlined. I would also hope that, in time, we could develop the capacity to provide semi-annual or even quarterly revisions of long-run projections of revenues and major expenditures, in addition to the more detailed annual analysis provided for in the Budget Act. The experience of the past few months shows that long-range budget projections have a way of becoming dated very quickly as changing economic conditions shift views of what assumption are relevant. Expectations of future inflation rates have dropped significantly in recent months, tax laws have been modified, new expenditure programs have been enacted. Such events make the estimates of three months ago totally outdated. For this reason the capacity to update these estimates at least in some crude fashion at something more than annual intervals is needed. Finally, I would hope to develop in the Congressional Budget Office the capacity to provide long-range projections under a variety of assumptions concerning basic economic conditions. Congressmen as well as experts differ with respect to desirable, tolerable, and likely levels of inflation and unemployment, factors which have a profound impact on the shape of long-range budget projections. The Congressional Budget Office, hopefully, will be in a position to provide some insight into how such projections vary when one changes the set of assumptions upon which they are based. Of course, in this area as well as in others we stand ready to accept the advice and the insights of members of this Committee as well as other members of Congress on how long-range budget projections can be made more useful and more understandable.

Chairman PROXMIRE. Thank you very much, Director Rivlin.

I would like to start off by discussing one aspect of the significance of projections, Mr. Secretary and Director Rivlin, particularly this notion of cataclysmic projections. Now, not today so much, Mr. Secretary, but at times in the past you have talked about the danger that domestic spending particularly, which could grow at such a very rapid rate that it would overwhelm us, and account for one-half of the total GNP by the year 2000. In fact, in the President's budget message, this was not you speaking, but the President said were the growth of domestic assistance programs to continue for the next two decades at the same rates as in the past 20 years, total Government spending would grow to more than half our national output.

Let me ask you first, Mr. Secretary, do you expect domestic assistance programs to grow at the same rate over the next 20 years as they did over the past 20?

Secretary SIMON. I would certainly hope not, Mr. Chairman. If you just are using the simple arithmetic of suggesting what has happened in the past will, indeed, happen in the future, I think Alice's statement and mine are pretty consistent and in fundamental agreement on the—

Chairman PROXMIRE. I do not think so. I think there are some fundamental differences.

Secretary SIMON. Well, I wanted to make a point on the social security aspect that I think was neglected when we talked about increased beneficiaries. Let us talk for a minute about two other things. One, the increased benefits over the last 15 years in social security have increased approximately 141.5 percent. Also, let us look at what we have been doing as far as finding new beneficiaries to assist. I think the new earned income credit, negative income tax, is a step in this direction. We are always finding ways of helping more and more people, and I use that term advisedly.

On your second point, Mr. Chairman, when we talk about what I have said in the past, which I steered away from this morning, I am getting tired of repeating myself when I talk about the financial im-

plications of deficits. As Paul McCracken correctly stated, these risks have been ignored, by and large, by the academic economists. If you want me to describe my warnings of the danger that is occurring as cataclysmic, well, that is all right. As to sensationalism, which is the conclusion referred to by Alice, I do not know which conclusion she referred to, but I think the conclusion that I warned about last October, November, and December, primarily as we were entering into this what I call danger zone, is evidenced, Mr. Chairman, by what happens in the real world rather than what occurs in the economists' models. Such models very often bear no relationship to the real world. One need only look at what is occurring in the capital markets today.

People have very little understanding of the capital markets and, indeed, what effect these extraordinary interest rates have on our economy at this time and on economic recovery. It is absolutely incredible to me that at the height of the steepest recession in 40 years, as it will undoubtedly turn out to be, that we could have interest rates even approaching the levels that they are right now. And our deficit bears directly on the expectations of people in the future and their willingness to lend money to the prospective borrowers.

Chairman PROXMIRE. I want to get into that perhaps if we can in a minute, but I want Director Rivlin to comment on what is likely to happen in the domestic assistance programs and her expectations.

Mrs. RIVLIN. I do not really think that that is my role, Mr. Chairman, to comment on what I think is most likely. My job at the moment is to create an assistance to the Congress so that you can really see what the implications of different assumptions would be.

Chairman PROXMIRE. Well, you made some observations that were most useful in discussing aid to dependent children and social security, and you point out that in both cases we are approaching a limit of eligible assistance. And as Secretary Simon pointed out, we might get in some new programs.

We were not in new programs before, we have gotten into them, and we might get into them again, so on the basis of what you have already told us, would you give us some further enlightenment as to what may happen? I am not asking what is most likely to happen, but what are the possibilities as you see them?

Mrs. RIVLIN. Clearly the possibilities for taking in new beneficiaries for most of the so-called eligibility programs are not very great. We have done that. And that is one of the things, and it is only one, which has propelled the very substantial rise in those spending figures over the last few years.

Another is an increase in benefit levels.

Now, what may happen in the future is really anybody's guess, and it seems to me there are certainly choices before the Congress. Does it want to include new beneficiaries in some of these programs? It is a little bit hard for me to figure out what groups these would be in say, social security, although clearly an extension or a change of the welfare program into a negative income tax, or a guaranteed annual income for a male head as well as a female head of families would involve substantial costs.

I am not willing to predict whether the Congress will do that or not. That is a matter of personal philosophy and mine and the Secretary's may well differ as to whether that would be good or not.

Chairman PROXMIRE. But, is it a matter—

Mrs. RIVLIN. What I would like to see is that we would have the Congress have well in front of it the costs, you know, what costs would be entailed if it did that.

Chairman PROXMIRE. And certainly one of the most important and useful aspects of these projections is that they give us exactly this kind of warning so that we know where we are going.

Mrs. RIVLIN. Right.

Chairman PROXMIRE. Furthermore, these projections we have before us now, far from indicating that we are going to be overwhelmed by domestic assistance programs, show the reverse, they show on the basis of projections, which may or may not be right, on the basis of projections, domestic assistance programs will be a declining percent of gross national product, not increasing, a declining percent of gross national product in 1980 compared to what it is now. Is that not correct?

Mrs. RIVLIN. I think that is right, and I might mention another aspect of this. The Secretary's chart 1, which shows growth in total Government expenditures, and it shows it growing rapidly over the last several decades, but it also shows clearly that what has been propelling the growth and the percentage of the GNP going to Government as a whole has been the increase in State and local government. Now, it is important to understand why that has been happening in the past, and much of it has been for things like increases in school populations which are not likely to recur on any assumptions we now know about the birth rate.

I would just like to see sorted out of the Secretary's chart some of the reasons for the past growth so that one can make a more reasonable estimate of what is likely to happen in the future.

Chairman PROXMIRE. All right. Now, let us get to another matter quickly if we can. A second cataclysmic projection heard with great frequency in the past few days as a possibility is that the budget deficit may be up to \$80 billion or even \$100 billion. This projection is arrived at, it seems to me, by taking every spending proposal that some Senator or Congressman may suggest and is glanced at by a congressional committee, and assuming that we might enact it. The fact is that the Congress has increased cuts as well as increased the proposals, and we have consistently and sharply cut defense spending in the past, and the chairman of the Appropriations Committee, John McClellan, has been a defender of the Defense budget in the past, estimates that we will cut the President's budget by \$5 billion this year in defense alone, and we are going to cut the foreign aid budget by \$1 or \$2 billion. It is true that the Congress is likely to go over in some respects, but Mr. Secretary, I do not see any way that we could have a \$100 billion deficit unless we have the deficit by reason of a further slowdown in the economy, increased unemployment, a sharp dropoff in profits and a reduction in revenues, because the economy is not moving ahead.

Secretary SIMON. Mr. Chairman, I testified about a month ago, and I did not testify about \$100 billion. I documented, not bills and legislation that, as you said, were merely being glanced at, but legislation that was being seriously considered by the Congress. And in this testimony I warned, not predicted or projected, that if these actions and inactions by the Congress took place they could result in a deficit

slightly in excess of \$81 billion. I did not bring that testimony with me. But for the record I will supply the specifics of that. But I do remember that the President had \$52 billion of original budget deficit, \$17 billion of deferrals and rescissions, additional expanded unemployment programs and a couple of other smaller programs that brought it to that number, and so it really was not what was being glanced at, but there was a real danger that these programs would be enacted. One could carry this process farther, as other people have testified before the Congress, and look at other spending programs that could be enacted, or additional unemployment programs, expanded benefits, and get the number up to \$100 billion. I was not predicting, nor am I now predicting \$100 billion, but I think \$80 billion is a danger.

[The following was subsequently supplied for the record:]

[The relevant part of Secretary Simon's testimony of March 17 before the Senate Budget Committee follows:]

Since the Budget was completed, it has become clear that the deficits are going to be much larger than originally contemplated. As OMB Director Lynn reported to you last Wednesday, budget developments that have already taken place—the President's release of highway funds, the Congressional action on food stamp costs, a lower estimate of offshore oil receipts, and other items—have caused the deficits to increase from \$34.7 billion to \$37.8 billion for fiscal 1975 and from \$51.9 billion to \$55.5 billion for fiscal 1976.

Beyond that, there are a number of budget developments in process right now, the results of which are predictable with a reasonable degree of certainty:

The tax cut that will soon be enacted by Congress will be considerably larger than the President proposed.

Congressional inaction on rescissions, deferrals and legislation proposed by the President to hold down the rapid growth of outlays will add heavily to the expenditure totals, especially in 1976.

Further extensions and improvement in unemployment benefits will be enacted.

Reasonable estimates of the amounts involved in these items, with due allowance for the partly offsetting higher budget receipts that will result from the accompanying higher level of incomes, shows that we should now be thinking in terms of budget deficits of at least \$45 billion for FY 1975 and \$80 billion for FY 1976.

As enormous as these deficit figures are, let me note that they do not represent an outer limit of what might actually develop. They include nothing for any of the legislative proposals now under consideration in almost every Congressional committee—such programs as larger public service employment, accelerated increases in social security and SSI payments, health insurance for the unemployed, and many many more. Thus there is a real danger of deficits that go well beyond these numbers.

Chairman PROXMIRE. Is it not true that a major determinant of the size of the deficit is the unemployment rate? And if the unemployment rate goes to 9 percent and stays there for a while, as many experts seem to think it will, under those circumstances we could have a much steeper deficit, and is this not really the problem? Is it not important that we adopt policies, monetary policies and fiscal policies that will stimulate the economy and prevent that kind of catastrophic effect?

Secretary SIMON. I would say the general economic picture is the determinant on the size of the budget deficit looking into the second half of fiscal year 1976 in two aspects. First, you are correct, Mr. Chairman, on the unemployment rate. Second, of course the revenue loss to the Treasury during declines in economic activity that we have experienced will be important.

Chairman PROXMIRE. Has the administration revised its unemployment estimate?

Secretary SIMON. Our unemployment estimate was revised from the original and now is in the area of 9 percent.

Chairman PROXMIRE. In the area of 9 percent?

Secretary SIMON. Yes, sir. That is the peak estimate.

Chairman PROXMIRE. Did the President take that factor into account when he said he would not permit actions that would permit the deficit to go above \$60 billion on Saturday night when he spoke?

Secretary SIMON. Yes, he did.

Chairman PROXMIRE. He took the 9 percent unemployment figure into account?

Secretary SIMON. And, of course, he made the assumption that the deferrals and the rescissions would be acted upon by the Congress.

Chairman PROXMIRE. Did he mean an average of 9 percent in the coming year or the peak?

Secretary SIMON. No, that was the peak, sometime during the second half of this calendar year.

Chairman PROXMIRE. Let me go back to the longer term outlook. What is the administration doing to avoid the excessive growth of Government spending which they properly fear and which you fear? I do not mean on a temporary basis such as the lid on social security, but what are the long-run cost-saving measures, such as comprehensive social security reform? The only new program in the President's budget is energy development, and that will cost more money. Do we have any programs from the President that will reduce this danger?

Secretary SIMON. The President's present goal, Mr. Chairman, is to avoid new programs and avoid incurring the explosive growth of Federal spending in the years ahead. Also, to take a look after coordinating with the budget process that is new in the Congress, which is so critically important, at the reordering of priorities in this country. As the President has said, these actions will be accompanied by a tax reform package later this year. There should be regulatory reform as well. All of these things are being done right now.

Chairman PROXMIRE. Well, I hope that they will be forthcoming, because I think you will agree, since you have been such a vigorous spokesman against excessive and wasteful spending, unless we have some kind of recommendations from the Executive, it is going to be very difficult for Congress to come up with a logical, and fair and effective way of reducing this long-term spending.

Secretary SIMON. Of course, Mr. Chairman, we have no monopoly on good ideas. That is why I stressed working with the Congress and the Budget Committees on establishing priorities. That is why the President sent \$17 billion in deferrals and rescissions up, which is a step in that direction. But I do not think many people liked the particular suggestions that he sent up.

Chairman PROXMIRE. And I supported the President in many of those respects. However, I think that what we need is a recognition of the fundamental problem which you have underlined and others have the problem of social security and other transfer payments.

Secretary SIMON. And I would like to work with you on the regulatory—

Chairman PROXMIRE. Of finding a way of getting into this that would rely on the expertise that only the executive can really give in a substantial way.

Secretary SIMON. And I would like to work with you on the regulatory process, Mr. Chairman. As you have said on so many occasions, this does require action. There are so many constituencies to protect the special interests that they are doing the American people great damage and costing them tens of billions of dollars.

Chairman PROXMIRE. Now Mr. Secretary, I am somewhat surprised at the 9 percent. I have said that it was an estimate that many had made, but this is the first time that I have heard it from an administration executive. Mr. Greenspan's top estimate, as I recall before this committee was 8½ percent.

Secretary SIMON. Alan said 9 percent recently. I have used this figure for the last couple of weeks. The troika has prepared new estimates of the economic outlook within the last 2 or 3 weeks.

Chairman PROXMIRE. What will the average for the year be, do you have that?

Secretary SIMON. I will supply that for the record. I do not remember the average for the year.

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

Our current estimate of the average unemployment rate for 1975 is in the area of 8.8 percent.

Chairman PROXMIRE. Do you have an estimate as to what it will be at the end of the year, end of the calendar year?

Mr. FIEDLER. We expect it to begin declining before the end of the year. I do not remember the figure.

Chairman PROXMIRE. At what time will it peak at 9 percent?

Mr. FIEDLER. I cannot give you that number. I do not have it in my head.

Chairman PROXMIRE. Now, one of the most startling elements in these projections is the different treatment of defense and civilian programs. Director Rivlin referred to that. It seems to be quite startling in these 5-year projections. You may very well believe that defense spending should grow 4 percent per year in real terms, 4 percent plus inflation, and you are entitled to your opinion, but the civilian programs are not projected in terms of what we want to see happen, but in terms of what would happen automatically if there were no new policy initiatives beyond those recommended in this year's budget. So my question is what possible use to Congress is a 5-year projection which is such a hybrid of different projection techniques which you have for some reason, and I cannot understand unless it be because you put the top priority on defense spending. Defense has a 4-percent increase in real terms, and there is no increase for the other programs. Why is that?

Secretary SIMON. The President believes very strongly in a strong defense position.

This administration has been committed to the goal of the United States not becoming the second-class power in this world. This requires a constant vigilance in this dangerous world as far as our national security is concerned. This has very grave economic implica-

tions as well. And this reflects the President's deep feeling on this subject, Mr. Chairman.

Chairman PROXMIRE. Well, what he is saying then is that the top priority should go to the military and the defense expenditures. I am not saying that that is right or wrong, but is that the fact?

Secretary SIMON. I really would not say that that is top priority. I would say that is a leading priority.

Chairman PROXMIRE. Well, why is it not the top priority when it is the only area that the President singles out for an increase from the 5-year projections, the only one? Nothing else is singled out, education, health, cancer research, nothing else. Only the defense.

Secretary SIMON. There again, these priorities, when you are forced, as we are, to make a 5-year projection by law, certain assumptions are made based on thousands of events that have yet to occur. The President has said on many occasions that health reform, for instance, is going to be a necessary item. And I am sure that as we get into health reform, or welfare reform, or tax reform, that these priorities are going to shift. This comes under the heading of the reordering of priorities.

Chairman PROXMIRE. But it seems there are definite plans in the defense area, some kind of a program, a feeling as to where we are going, and an absence of it in these other areas.

Secretary SIMON. Well, they have their projections because there is a long leadtime in the expenditure of funds for the building of all of the military capability, in the size of the troop strength and all of the other parts of the defense program. I must admit I am certainly not an expert. Jim Lynn, who I understand will be testifying tomorrow, can go into that in greater depth, although I rather think Jim Schlesinger would be a better one to outline the specifics of what we have to do in each particular program.

Chairman PROXMIRE. Apparently what the administration has decided to do is to accept the desired level or the recommendations of the Secretary of Defense, and not do the same with respect to health, education and welfare, or housing, or any of these other programs.

Secretary SIMON. I do not think that is accurate at all. I do not think there is another sector in our economy that has received more assistance than housing and, indeed, continues to receive assistance with all of the programs for subsidizing interest rates, the tandem programs, the Ginnie Mae—GNMA—and Fannie Mae—FNMA—and Federal Home Loan Bank advances.

Chairman PROXMIRE. Of course there are lots of programs in all of these areas, but what I am talking about is that there is no increase permitted anywhere as far as projections except in defense. Everything else is flat, everything else is on a present services basis.

Secretary SIMON. There again, it is not a matter of the President accepting what the Defense Department recommended. I have no idea if that is what the Defense Department explicitly recommended or not. But this budget, looking out 5 years in the future, is the President's decision, not a particular cabinet officer's view. And what we have to remember is that these are assumptions. These assumptions are not even projections. These assumptions are going to change realistically as events occur that are necessarily unforeseen right now, Mr. Chairman.

Chairman PROXMIRE. Mr. Secretary, I want to be sure I understand your position concerning the 5-year projections in the budget. Are you saying it is not possible or practical to make reasonable assumptions or estimates about future economic conditions?

Secretary SIMON. I will not talk about the practicality because I happen to think long-range planning is important. It is important for the Government. We have always done it, and so has business. We did it in the private sector. But I will say that these forecasts, and Alice says maybe they should be updated every 6 months—well, I think they are updated. They are constantly updated. These uncertain events that I referred to occur because things are going to change. Therefore, no one can predict 2, 3, 4, 5 years into the future with any precision whatsoever by using these sets of numbers. They are based on assumptions. The long-range assumptions were made in a different fashion than the short-range forecast. We are relatively more certain, and I underline again relatively, about the forecasts for 2 years. But the long-term projections are calculated by simple arithmetic techniques, by extrapolations starting with a forecast level at the end of 1976. They are necessarily imprecise.

Chairman PROXMIRE. Are you telling us the forecasts in the budget do not represent the administration's views, that recovery from the recession will be sluggish, there will be more rapid recovery?

Secretary SIMON. I made the statement several times that I share Arthur Burn's point of view. He has testified several times, and I have confidence in the dynamic U.S. economy, that these forecasts, as they are updated, are going to show a brighter picture.

Chairman PROXMIRE. Would you tell us what you expect then for the next 2 years in terms of recovery, how much economic growth?

Secretary SIMON. I think an awful lot depends on the financial implications that I spoke of before. These events, indeed, are occurring right now. And what happens to the housing recovery and interest rates which are at a high level right now if we do not remove some of this burden from the capital markets? But I see the inflation rate declining. It has already declined faster and further than many, or most I should say, have predicted. That is a very positive factor, Mr. Chairman, in one very important area that cannot be quantified; that is, consumer confidence in the economy and the confidence of the American people in their Government. That is very difficult to quantify.

Chairman PROXMIRE. Of course it is, and it is very, very hard to make these estimates. And it may be that you do not want to do that for us, but I would appreciate it very much since you do indicate that you do not think that the projections represent a forecast, or a tenable forecast. They are simply a mechanical report. What do you think is likely for development over the next couple of years in terms of recovery? We would like to know that from the chief economic spokesman in the administration.

Secretary SIMON. It is extremely difficult to predict because we keep turning these projections that the law required us to put into the budget deficit into forecasts and they are not forecasts. They are made, some of them, on simple arithmetic assumptions. But I have a fundamental faith as far as the strength of the American economy goes, assuming that we take certain actions in the financial area that will not abort the housing recovery, or potentially impede an economic recovery. I think that that is important.

Chairman PROXMIRE. All right now, Mr. Secretary, I do want to respect your desire to leave early. And I hope you can stay a little longer. But, I would like to ask you one question at least before you go. In light of your disagreement with the budget forecasts, I am very curious as to how the table of forecast projections got into the budget document, what it means in terms of administration policy from the principal Cabinet officer whose responsibility is economic policy and objects to such an important statement. Will you respond to my observation and tell us whose views the forecasts and objections represent? Do they represent the President's, the Chairman of the Council of Economic Advisers, the Director of OMB or whose?

Secretary SIMON. These are not views of really anybody. They are a mechanical set of assumptions based on judgment, human judgments, Mr. Chairman, about what is going to occur 3, 4 and 5 years from now. As you well know, Mr. Chairman, economic policymaking is an ever evolving thing.

Chairman PROXMIRE. Let me break this down, because what the budget of the United States says, and let me read it to you on page 41, it says, "The short-term economic assumptions presented in this section have been developed in a quite different way from the longer run assumptions. The assumptions for calendar year 1975 and 1976 are forecasts of probable economic conditions during these years." And my question is, as far as these 2 years are concerned, who is making these forecasts, and who is responsible for them?

Secretary SIMON. Well, fortunately I have the gentleman sitting at the table here that worked on all of these forecasts, and he can comment on detail on all of the aspects of how the projections were made.

Chairman PROXMIRE. Well, I am trying to find somebody who will take responsibility for them. Is it your responsibility, the President of the United States, or whose?

Secretary SIMON. It is the President's ultimate responsibility, but as the chief economic spokesman and the Secretary of Treasury, I am obviously responsible for projections or assumptions.

Chairman PROXMIRE. Well, what puzzles me, and perplexes me is that I understood you to say that you thought these projections for 1975 and 1976 were pessimistic, that we will do better, that you do not think these forecasts are accurate.

Secretary SIMON. I was really talking more about 1977 through 1980 and the inability to forecast 3, 4, and 5 years into the future, as I have said several times. And I stand by my basic belief in the strength of our domestic economy.

Chairman PROXMIRE. Well, that is what your statement said, and I quote, "I do not believe that the economic assumptions used in preparing these 5-year budget estimates are a sound indicator of the likely pattern of inflation and unemployment in the near term." In the near term. And the budget document itself says that these are the forecasts of the administration. Perhaps you would change your mind?

Secretary SIMON. In the near term, we talk about the decline that I spoke of a minute ago in the inflation rate which has come down

faster than expected. And now the projections are beginning to look like it could decline farther than anyone expected before the end of this year. That is a very positive element.

Chairman PROXMIRE. Yes, that is very helpful, but now you have told us that you think that the inflation rate is likely to be improved. And I understand that. How about the growth in the unemployment rate? Are you modifying that at all either way?

Secretary SIMON. We are more certain right now of the recovery than at any time in the past as far as the early signs that we are seeing. Increasingly, the private forecasters that I have been reading recently are projecting that the upturn could, indeed, occur in the third quarter. The positive growth in the third quarter would, of course, extend into the fourth quarter and carry on through 1976. These are the positive developments that are happening. You see, as conditions change in our economy the assumptions that are made at the time that this budget document was prepared become outdated.

Chairman PROXMIRE. Well, that is right. That is right.

Secretary SIMON. And that is what occurs.

Chairman PROXMIRE. You see, that is one of the difficulties we have. On page 80 of your budget assumptions, you say that public officials should never accept such tenuous bases as firm policy decisions, and I agree with that, but we have to make assumptions, we do not like it, but we have to do it.

Secretary SIMON. Yes, we do.

Chairman PROXMIRE. The policies you adopt or recommend now, by the time they go into effect and have their real impact, it is going to be 1 year, or 1½ or 2 years down the pike, and so we have to make some kind of forecasts.

Secretary SIMON. And we have to understand the range of uncertainties that exist around the forecasts and the assumptions that we are making, and make sure that we are constantly flexible to the changing conditions in the economy. As I said before, in the real world we must adapt our economic policies to this change. And that is what we attempt to do. Sometimes, as our projections change according to changing economic conditions, our credibility becomes a problem because people say: "Well, last month you said this." Events have occurred that require us to change our forecasts right now, and that, indeed, is what is always going to happen.

Chairman PROXMIRE. You are widely reported, Mr. Secretary, to have opposed the bill, the tax bill that passed the Congress. Do you feel that now that that is law that it is going to help at least in the near term in stimulating the economy and reducing the level of unemployment?

Secretary SIMON. Yes, I do. And I think a tax cut is a valuable tool, as the President suggested, as far as the support for the economic recovery that we believe is going to occur in the middle months of this year. But my concern about the tax cut was that parts of it are in danger of becoming permanent, thereby adding to the danger of deficits as far as the eye can see. Also, that it was not the simple and immediate tax cut that was recommended, but a combination of many welfare and tax-reform gimmicks of questionable form.

Chairman PROXMIRE. Secretary Dunlop indicated this morning that he expects this to result in a 0.7-percent reduction in unemployment, about a million new jobs. How do you feel about that?

Secretary SIMON. Well, John is an expert in labor and unemployment figures, and I would accept his analysis, Mr. Chairman.

Chairman PROXMIRE. All right. Let me ask you finally, because as I say I am imposing on your time, and I apologize to Director Rivlin, but she understands that you have to leave shortly, but let me ask you about your concern that this tax cut and other policies of the Federal Government are likely to set off an inflationary situation within a couple of years.

It is very difficult for those of us on the committee to understand how that can develop when we have an economy that is operating at about 70 percent of capacity in the industrial sector, and an economy in which we have more than 8 percent unemployment. And you have indicated this morning you expect it to go to 9 percent. And an economy in which we have a gap of some \$200 billion that we are not producing, that we would produce if we had unemployment at a 4½-percent level. Under these circumstances, where really are the inflationary forces which you have been so concerned about? Is it not likely that over the next couple of years that there is plenty of room for stimulation and for expansion of the economy without general inflation taking hold?

Secretary SIMON. I take exception to your saying the economy is operating at 70 percent capacity, because it is not in many areas. Many of our basic industries are operating at over 90 percent of capacity.

Chairman PROXMIRE. Such as?

Secretary SIMON. Such as steel. I talked yesterday about this. Recent numbers for steel production are 2,600,000 tons. At the height of the peak of steel production output was 2,900,000 tons.

Chairman PROXMIRE. They have increased their capacity over the last couple of years and are increasing it steadily.

Secretary SIMON. They are not increasing their capacity anywhere nearly enough to support an economy, a stable economy here in the United States. And I had a long discussion on this subject yesterday with a gentleman who is an expert in this area.

Chairman PROXMIRE. I want to take a look at the statistics. It seems to me that they are operating below the 90 percent, and they are operating far below their preferred rate. They can produce more.

Secretary SIMON. They are operating below their peak rate, but if our information and forecasts are right, as far as both coming out and moving into positive growth. Most estimates indicate a shift in the economy to positive growth in the fourth quarter and into next year. The gap in the steel industry is going to close very quickly and we will see the impact of excess demand, as far as steel is concerned on prices of automobiles, et cetera.

Chairman PROXMIRE. Now, steel is producing, they are producing less steel now than they were a year and a half ago.

Secretary SIMON. As I say, they are down, and the recent figures show 2,600,000 from the 2,900,000 level at the peak.

Chairman PROXMIRE. The overall figure that impresses us is that we are 14 percent below our potential, farther below our potential than we have been at any time during the last 25 years, and to talk about inflationary pressures under these circumstances seems to me to be talking about a never, never land.

It is just hard to see where the inflationary pressures, at least pressures in terms of excessive demand—I agree we could have increased prices because of the energy situation, possibly because of a wage-cost push, but in terms of being concerned about stimulating the economy, or providing too much demand, I think it is very difficult for me to perceive where that is.

Secretary SIMON. There again, as you said, Federal spending programs always—I think you said, but I do not want to put words in your mouth, but Federal spending—and I know I have said this also—arrive in the economy at the wrong time. The lag, as we saw in Nancy Teeters' recent study of the emergency spending program of 1962, caused the moneys to be still spent in 1971.

Chairman PROXMIRE. You are absolutely right.

Secretary SIMON. I think we found, Mr. Chairman, in 1971 that our economic black was overestimated. This has been a subject of much criticism. I do not have the figures with me, but I am going to provide them for the record. We discovered that we were much closer to capacity than we realized. The capacity numbers that have been compiled have been under severe attack. And I know there is one noted economist whose work I read recently, Pierre Rinfret, who documents this. Again I do not have the numbers. The only one I have is for steel because of a recent conversation I had with an expert in that area. He maintains the capacity of many industries is over 90 percent. There is a gap in others, I agree with that, but I just do not have the ones to document which are the ones in this category. But I am going to get it and supply it to you.

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

The private study of the available plant capacity was conducted by Pierre A. Rinfret of Rinfret Boston Associates, Inc. The figures referred to by the Secretary are summarized in the attached table which is dated March 1975. The current capacity figures have the following limitations according to Mr. Rinfret:

1. The U.S. Department of Commerce and the Federal Reserve Board statistics grossly underestimate the rate of capacity utilization in American industry.
2. There is virtually no reserve capacity in American industry as a whole or in manufacturing, particularly if you exclude the air transportation, aerospace and electric utility industries.
3. Out of 16 industry categories in manufacturing, eleven are operating at or above the 90 percent capacity utilization rate.
4. The manufacturing, mining, railroads, gas utilities and "commercial and other" sectors are operating at above 90 percent of capacity.
5. The evidence is clear. We are desperately short of capacity. The Government has erred and erred horribly in this statistical area. That has led and will continue to lead to erroneous policy decisions unless they restudy, reevaluate and redo their statistics in this vital area.

CAPACITY UTILIZATION, MARCH 1975

Industry	Utilization rate	Is this level of operation higher, lower, or about the same as in 1974? (Percent distribution)		
		Higher	Lower	Same
All industries ¹	84.5	13.2	45.0	41.7
Manufacturing.....	86.6	14.2	51.3	34.4
Nonmanufacturing ¹	78.6	10.5	28.1	61.4
Manufacturing.....	86.6	14.2	51.3	34.4
Durable goods.....	86.6	12.8	50.0	37.2
Primary metals.....	89.7	8.7	39.1	52.2
Iron and steel.....	90.5	11.8	23.5	64.7
Nonferrous metals.....	88.0	-----	83.3	16.7
Electrical machinery.....	87.2	50.0	-----	50.0
Nonelectrical machinery.....	94.5	15.0	40.0	45.0
Transportation equipment.....	75.3	23.5	58.8	17.6
Motor vehicles and parts.....	79.2	11.1	77.8	11.1
Aerospace.....	67.2	42.9	42.9	14.3
Stone, clay and glass.....	77.7	-----	72.7	27.3
Other durable goods.....	85.7	-----	72.7	27.3
Nondurable goods.....	86.7	16.2	52.9	30.9
Food and beverage.....	89.2	23.5	17.6	58.8
Textiles.....	72.5	-----	100.0	-----
Paper.....	87.9	-----	80.0	20.0
Chemicals.....	82.3	33.3	50.0	16.7
Petroleum.....	89.7	22.2	22.2	55.6
Rubber.....	80.4	-----	100.0	-----
Other nondurable goods.....	82.1	14.3	57.1	28.6
Nonmanufacturing ¹	78.6	10.5	28.1	61.4
Mining.....	94.8	-----	-----	100.0
Railroad.....	87.1	-----	75.0	25.0
Air transportation.....	81.0	-----	66.7	33.3
Other transportation.....	89.4	-----	50.0	50.0
Public utilities.....	76.6	12.5	22.5	65.0
Electric.....	74.3	12.5	18.8	68.8
Gas and other.....	86.0	12.5	37.5	50.0
Commercial and other.....	78.0	16.7	16.7	66.7

¹ Excludes communication.

Chairman PROXMIER. This is why it would seem that it would be very desirable to develop programs that meet certain tests: (1), that they can have an effect right now; (2), they can be cut off and cut off sharply later. This is why I hope that we would take a good, sympathetic look at the housing bill that we are going to mark up in the Banking Committee beginning on Monday. This is a bill that will have triggers in and out we hope, have triggers involving unemployment, as unemployment goes below a certain level the program ends. As housing starts get above a certain level the program ends. Either one would end it. It would also be related to a flexible interest rate so that those that get a 6- or 7-percent mortgage would, after a couple of years, have to pay higher mortgage rates if the market is higher, so you would limit the Government's obligations. We calculate that we can provide jobs at \$450 a job compared to \$17,000 a job in highway building, and \$25,000 in jobs in the space programs. So I do hope that you will take a look at housing as a program that would be ideal under these circumstances. About 95 percent of the money would be from the private sector, with the discipline of the private sector, and very, very little governmental expenditures, but a massive effect on providing employment.

I realize that you are a busy man, Mr. Secretary, and I very much appreciate your being here. We would appreciate it if you could permit your economists to remain as we engage in colloquy with Mrs. Rivlin, and perhaps they could join in. But thank you very much, Mr. Secretary. You were most gracious to come, and I know you have other appointments.

Secretary SIMON. Thank you, Mr. Chairman.

Chairman PROXMIRE. Now, Director Rivlin, we have covered a lot of ground, and I unfortunately had to kind of concentrate on the Secretary. And now I will give you an opportunity to respond if you have any general response to any of the questions, or I will go ahead with some of the questions that I have.

Mrs. RIVLIN. No. Go ahead.

Chairman PROXMIRE. One of the areas that I did not have a chance to really explore in very much detail with the Secretary is who is responsible for these projections, and who should be responsible. Have you given any thought to how this can be done in the most efficient, and fair and effective manner?

Mrs. RIVLIN. I have given some thought to what should happen on Capitol Hill. And it is my hope that by next year we will have something equivalent to the troika on Capitol Hill; that is, a joint capacity to make forecasts on a variety of assumptions, and by joint I mean the two Budget Committees, the Joint Economic Committee and my office working together and producing forecasts which we might not at all agree on as to which was the best one, but at least we have a capacity for agreeing on what are the implications of various assumptions.

Chairman PROXMIRE. Director Rivlin, Mr. Simon makes a rather strong statement when he says that public officials should never accept tenuous forecasts as a firm basis for policy decisions, particularly during a period of sharp cyclical swing. You are an economist of distinction, and you both make and utilize projections and forecasts. Would you like to take an opportunity to comment on that observation?

Mrs. RIVLIN. Well, I am not sure exactly what the Secretary meant. On the one hand, it is true that all forecasts should be taken with some skepticism. On the other hand, as you yourself pointed out, decisionmakers have no choice. They have to do something, and doing anything means you make the best guess you can about the future implications of what you are doing and you do it. There is no way you can not make decisions.

Chairman PROXMIRE. So that what you are saying is it is a counsel of despair not to make projections, or discredit them and say we cannot use them because they are too inaccurate?

Mrs. RIVLIN. I am certainly not saying that at all. I am saying one should always bear in mind that the future is uncertain, but that the only sensible way to make decisions is to do the best you can, to forecast what is likely to happen given alternative policies, and you choose the policy that again, in your judgment most likely gets you to the desired outcome. You have to make conditional forecasts in the process of making those decisions. There is no way out of that.

Chairman PROXMIRE. The Secretary suggested one way that it could be moderated, at least, and that is that we have a range of expectations rather than to have a specific with a decimal point. With, for example, that unemployment at 6.8 percent at a certain time, instead of that range, indicating the consequences within the range, and then the unemployment would be within a certain range. Would that be better, do you think, more realistic?

Mrs. RIVLIN. Oh, I think probably that is useful if there is real disagreement about what the implications of the policy are. It may be useful to recognize that there is that disagreement by providing a range, but it really does not help the decisionmaker very much.

Chairman PROXMIRE. Well, does it not help the public and the Congress? I think that many perhaps misinterpreted these projections and felt, wow, we are going to have a 6.8 percent unemployment in 3 years, and I think you would recognize that that is really not a reliable forecast, and the range might have given the public and the Congress a better notion of the expectation, that it is likely to fall between 6½ and 7 or something of that kind.

Mrs. RIVLIN. Yes, I think that is probably useful. But presumably the public will still pick the mid, and should pick the mid-point in the range as being the forecaster's most likely estimate, and there is no way out of that one.

Chairman PROXMIRE. All right. In your statement you note that the Congressional Budget Office and others are currently discussing the current services budget projections for the Office of Management and Budget. The Joint Economic Committee staff has also had some informal discussions with the Office of Management and Budget on this subject, and in discussions with our staff, OMB has indicated it is not clear from section 605 of the Congressional Budget and Impoundment Control Act that future statutory cost of living adjustment benefits and Federal pay increase should be included in the current services projection. It is our feeling that the law intended these adjustments to be included and that they should be. What is your position on this issue? When I say you, in your discussions with OMB did you discuss the importance with OMB of including these projections in future current services budgets?

Mrs. RIVLIN. Let me say I hope that there will be a joint position, our office will not have a separate discussion with OMB on the current services budget. It seems to me, personally, most sensible to include the cost of living adjustments that are in the law in a current services budget. On the other hand, the really important thing it seems to me to know is what is included. One should be able to do it or not do it at the option of the user of the statistics, so to speak.

Chairman PROXMIRE. Well, in view of the fact that this committee has responsibility to review the current services budget, and submit an evaluation, I think our staff should be included in any discussions relating to the current services budget. Would that be agreeable to you?

Mrs. RIVLIN. Yes. Absolutely.

Chairman PROXMIRE. In your prepared statement you distinguished several types of projections and you set out several guidelines to projectionists to follow to avoid pitfalls in constructing these kinds of calculations. Would you briefly outline what is wrong with the administration projections and how they can be improved? I have asked what possible use to Congress is a 5-year projection which is a hybrid of different projection techniques, that it makes no sense, and if you would like to comment, sir, from the Treasury, that is fine too. In other words, I talked about what you talked about too, that you have 4 percent as an increase in real terms for the Defense Department and nothing for anything else.

Mrs. RIVLIN. Well, I think that is right. My criticism of the administration I guess is not that any particular set of projections are wrong, but that it would have been more useful to spell out more clearly what the assumptions were. As you correctly point out, the 5-year forecasts in the budget are a hybrid. They are not a current services projection. They are hybrid in several senses. They do single out Defense for a real increase of approximately 4 percent, which was not included in the domestic side. Now, I think that can only represent an administration priority, as you suggested earlier. There must have been some reason for singling out Defense to grow faster than the rest.

There is also a sort of a strange, and to me not entirely explicable difference just in the statistical treatment of the projections, that the inflation forecasts were built into the defense programs, and into the entitlement programs, but not into other domestic programs. Those were presumed to stay at the same dollar levels, which mean a real decrease if inflation is assumed, and it is. And a separate casual allowance was made for a possible cost increase in other domestic programs. That is not in any sense wrong, it is just a little bit peculiar, and it would seem to me that the projections would be more useful if the inflation assumptions were treated the same way and were spelled out more clearly in all of the programs.

Chairman PROXMIRE. I just cannot for the life of me understand why this was done this way, because if everything which is simply projected for 5 years without allowance for inflation, as was done with the domestic side of the budget, and without any real increase, then these would obviously just be projections, but they are not. I think that is a message here, and maybe you could tell us what it is.

Mr. JONES. I cannot comment on the forecast in detail because I did not participate in the troika exercise. Mr. Greenspan, Mr. Lynn—

Chairman PROXMIRE. Pardon me, sir. Would you identify yourself for the record?

Mr. JONES. I am Sidney L. Jones, counselor to the Secretary of the Treasury. As to the techniques of the forecasting, they really were, as I understand them, somewhat mechanical repetition of the traditional troika II model forecasting techniques in which the programs beyond the immediate years are simply extrapolated arithmetically.

As to the decision on the inflation rate, I do not know the background on that.

As to one or two other points that are made in the prepared statement, was made in the context which I think you are stating it in, and that is we are condemning blind confidence in arithmetic projections. We are not saying that one should not plan. It reminds me of the phrase: "To fail to plan is to plan to fail."

Chairman PROXMIRE. The startling thing here is the defense part of it was not mechanical. They put into it two things. No. 1, as Director Rivlin just pointed out an inflation adjustment, and No. 2, an increase of 4 percent. That was not in anything else.

Mr. JONES. I do not know the reason why the inflation estimate was made in that way.

Chairman PROXMIRE. All right. Secretary Simon has been extremely hard, and Director Rivlin on forecasters pointing out that they

have been often wrong. Now, it seems to me the administration's economists are the ones that have been most consistently wrong, while a number of economists outside of Government have been critical of what the administration has been doing. What is your view of the state of the art of forecasting?

Mrs. RIVLIN. Well, it is hard to have a general view of the state of the art of forecasting I think. It is certainly true that in the last year forecasters on the state of the economy both in and out of the Government have been wrong for a couple of different reasons. One, and I think this cannot be laid at their door; namely, that much of what happened in the economy over the last year or two has been propelled by events that could not reasonably have been forecast by economists or, indeed, by anybody else.

Chairman PROXMIRE. Let me just interrupt to give you just what I am talking about. On page 37 of this year's President's economic report, and I do not know why they included this in here, there is a reference to what was predicted by the Government economists last year. Now, listen to this:

Forecasting looking at prospects for 1974 a year ago the Administration saw a weak first half and a recovery setting in by mid-year, 1974, led by an upturn in housing and a recovery of the automobile industry from its depressed condition at the start of 1974. The Administration also expected a slower rate of inflation, that was last year, after early 1974, associated deceleration of price rise in petroleum and farm and food products.

One hundred percent wrong, wrong on every point. And to hear the administration criticizing the forecasters, when these forecasts were objected to by outside economists, it seems to me particularly hard to accept. Do you want to comment on that?

Mr. JONES. Yes. You remember perhaps in 1971, Chairman McCracken of the Council of Economic Advisers sent you a letter explaining the components of the infamous \$1.65 billion forecast. As backup to that, since I was Paul's special assistant I remember doing a study of forecasting at the Council of Economic Advisers. During the decade of the 1960's, the average error was 1.2 percent, and in a study done by Mr. Kuznets of longer term forecasting for the private sector economists, turned out to be an average error of 1.7 percent. So, we have certainly not done well as Mrs. Rivlin indicated in the past year. But I would not agree that private forecasters had a better grasp or better projections of the decline in the second half of 1974 than those within the Government who made projections.

Chairman PROXMIRE. What has happened to the margin of error in the 1970's? The margin of error in the 1960's apparently was not bad. Why are they getting worse, because of outside developments?

Mrs. RIVLIN. Let me come back to the problem with forecasts. I think we are mixing up several things. One is that there really have been substantial outside shocks to the American economy in the last several years from events that could not have been predicted, like the oil embargo. To have predicted that you would have to be a political seer and not an economist. And the economists who did not predict the rapid increases in the price of oil cannot be faulted as economists, only as poor readers of the international scene perhaps. And the same would go for some of the increases in agricultural prices due to crop failures. You cannot reasonably expect economists to predict those.

There have been though I think two other problems. One is that it is extremely difficult to predict turnarounds in the economy when it is moving in a particular direction. The administration in power is often apt to be much more optimistic than can be realistically sustained, although I think perhaps one has to let them be that way. That is their job. My memory of the predictions of the second half of this year was that the administration was consistently much more optimistic than most private forecasters. On the other hand, the situation toward the end of last year did deteriorate much more rapidly than anybody really expected. The inflation, the recession got worse and a lot of people had been saying outside of the Government that it was a much more serious danger than the Government realized, but I think even they were taken by surprise at how rapidly things deteriorated. And the fact that the administration's projections of the unemployment rate were out of date almost as soon as they were published was evidence of that.

Mr. JONES. I suppose, Mr. Chairman, I base my comments on sitting in meetings where we do invite in outside economists approximately monthly. We bring them in from the whole spectrum of economists. I think we have been good at that and in August and September—

Chairman PROXMIRE. Is the Treasury bringing people like Walter Heller and John Kenneth Galbraith—

Mr. JONES [continuing]. Yes. And Samuelson.

Chairman PROXMIRE [continuing]. And Samuelson.

Mr. JONES. Heller has been in meetings twice within the last 3 months that I have sat in on. Chairman Greenspan is holding such meetings approximately every 2 months with groups of outside economists. At the last meeting we had Paul McCracken, Herb Stein, Whitman, we had Heller, we had Meltzer from Carnegie. Samuelson was in the earlier meeting. He was not in the last one. We also had Otto Eckstein.

Chairman PROXMIRE. That sounds very impressive, and that is good to hear.

Mr. JONES. Now, the Treasury also has the traditional consultants meeting, but we have been concentrating on special subjects. For example, we had a group of retail economists from the private sector, Ford, Armstrong, Texas Instruments, and RCA. We have had meetings of financial economists twice within the last 2 or 3 months.

But I think what Mrs. Rivlin has been saying, and what the Secretary's statement attempts to say, is that obviously as economists we would never deny forecasting or attempting to look ahead. That is really part two of the Secretary's statement. The value of that earlier CEA 5-year study is in indicating the complexity of priorities. What we were trying to say is that in setting policy you cannot zigzag with every econometric projection that comes out. Because one does come out biweekly, or each month, you have to have an underlying path that you are trying to follow. Now, there is where the divergence has occurred. We might prefer a certain kind of social path or a certain kind of defense path. Those are legitimate arguments.

Chairman PROXMIRE. Mrs. Rivlin, last year the House Committee on Budget tentatively adopted a budget which they would recommend to Congress and in releasing the recommendations they pro-

vided detailed information showing how the recommendation in fiscal year 1976 differs from the President's recommendations. However, I have seen no indications from the House committee on what the longer term implications of these recommendations are, and I personally feel it would be useful if the House committee would get together with your office to develop some 5-year projections that would be made each year prior to the adoption of the concurrent budget resolution so that we will have a far better and clearer picture of what that budget would mean, and what we could do with the budget if we knew where it was leading. Do you have any plans for developing that capability?

Mrs. RIVLIN. We do not only have plans, we are required by law to do so, Mr. Chairman, to have that kind of capability. Once we are fully rolling, which we will not be for several months, we will be responsible for making projections not only—

Chairman PROXMIRE. When will you make these projections? These projections on the House budget, the House 1976 fiscal year budget?

Mrs. RIVLIN [continuing]. For this year I do not know. We are not in a position to make them yet. They may make them themselves. Once we are in business, and we are not now as you know, we will make them very quickly. And as soon as—

Chairman PROXMIRE. When do you expect to be in business?

Mrs. RIVLIN. By the middle of the summer I expect to have some kind of a staff that will be able to help on that.

Chairman PROXMIRE. Let me just finally go over parts of your prepared statement that I think are particularly helpful and useful. You say, and I quote, "Little will have been accomplished if the Congress retains its traditional focus on current year decisions, making current year decisions first and then asking, 'Let's see what the decisions mean for the future?' If, however, Congress starts with forward projections, asking itself 'What do we want to see happen 5 years from now?' debates these questions, and then translates its desires back into current budget decisions, the process will have been significantly altered for the better."

Well, that is exactly what we are driving at, and we want to achieve, and that is a most helpful observation.

And then I thought that your analysis of the difference between the treatment by the administration of defense and nondefense was very helpful and a most useful insight.

And then you say this:

First, those generating projections should specify clearly the basic type of projections that are being made—is a "current services," "most likely," "most feared," or "most desired" scenario being produced?

The administration did not tell us that. Apparently current services was what most of the budget is, and most desired perhaps is what the defense budget was, but they did not tell us that. They did not tell us what the assumptions were, why it was 4 percent and not 3 or 5 or more or less.

And you say:

An explicit statement explaining the type of projection that is being made will reduce misunderstanding as well as set the ground rules for criticism.

Second, the assumptions concerning basic economic factors that underlie the projection should be spelled out in detail. Only with such explicit detail can a user of the projections have some feel for the credence that he should give the projections.

And Mr. Jones, I think this would be particularly helpful in these projections in the future if we know what the economic thinking was, what the background was. At this time it was mechanical and simple, and I think maybe it had to be that for the very first one, but I hope we can refine it and base it on the kind of professional economic advice which you have indicated just now, you have indicated that you are getting from people all over the country and you will tell us what it is.

Mr. JONES. I would assume for a relatively short period of time it will always have to be arbitrary and somewhat mechanical. But again, as we indicate in the Secretary's statement, when the Council did that 5-year projection, that did spell out, as you remember, the individual claims, the claims of the personal sector and the claims in housing, and the business sectors.

Chairman PROXMIRE. Well now, that is useful. Now I am getting far beyond that. I am talking about what are the economic assumptions as to growth, as to growth of the economy or rate of inflation, the other elements that would color it and affect it?

Mr. JONES. That is implicit.

Chairman PROXMIRE. Family formations and a whole series of things that we want explicitly.

Mr. JONES. I agree that family formations were not in that. I agree.

Chairman PROXMIRE. And then I thought Mrs. Rivlin, that your analysis of the AFDC and the social security program, pointing out how they seem to be reaching a limit was most useful. That is the first time that I have seen that kind of thing. Maybe it has occurred elsewhere, but this is the first time that I have seen that kind of a refutation of the notion that this is going to go on forever, and we are going to be swamped in welfare unless we drastically change the program. I think that this is very helpful indeed to us.

Now, on the next to the last page you say:

Such events make the estimates of 3 months ago totally outdated. For this reason the capacity to update these estimates at least in some crude fashion at something more than annual intervals is needed.

What do you suggest, quarterly, semiannually, how do we go about this?

Mrs. RIVLIN. I think quarterly is probably about the best one to do since a lot of the information that goes into the forecasts do not come out much more rapidly than that. And I guess I disagree with what I think Mr. Jones said earlier, that one should not make use of the most recent information that one has. Now, that does not mean one always changed policy, but I think it is extremely useful to keep changing your forecasts and your projections in the light of whatever is the most recent information you have.

Mr. JONES. I did not mean that you do not change your expectations. Certainly, as a former official with the Bureau of Economic Analysis and the Census, no one is more sensitive to statistics than I am, but one need not change their basic underlying policies with every new headline statement. I have the Wholesale Price Index with me today, it just came out this morning, and that is useful information. It helps us in planning, but certainly it should not result in a basic change in policy.

Chairman PROXMIRE. Let me try to sum up, and I hope that both of you will feel free to correct me if I am unfair or inaccurate on what

I have heard this morning. Surely the Secretary of the Treasury made a most remarkable statement in disagreement with the administration's forecast and projections for the budget and the economy. Indeed, if Mr. Simon were a member of another Government agency, for example the Defense Department, in such disagreement with official policy, he might be dismissed, and he might suffer the fate of Ernie Fitzgerald.

Secretary Simon said unemployment would go to 9 percent this year, and this is the first time that the unemployment rate has been pegged that high by an administration spokesman before this committee. Certainly it is a major revision of what was estimated earlier this year.

Director Rivlin, in her first I think official appearance before a congressional committee since she has been appointed the Director, No. 1 gave an incisive analysis of four types of budget projections including the most feared, or cataclysmic projections so constantly used and misused these days.

Second, an ambitious work program for her own office, promising to attempt alternative budget projections as showing results of different policy actions, semiannual or even quarterly I think you just said projections.

And third, an objective, professional commentary on the projections contained in this year's budget.

She has also stated her intent to develop a greater economic forecasting capability in Congress, comparable to the administration troika, combining the resources of the two Budget Committees, the Joint Economic Committee and the Congressional Budget Office.

What impressed me the most about today's testimony is first, the serious charge of sensationalism made against some of Mr. Simon's projections. It seems that the Pentagon's technique of "worst case" analysis has been imparted into the Treasury Department.

The second outstanding feature of this hearing was the agreement by both witnesses that the administration's economic forecasts and projections are based either on error or confusion.

Tomorrow we will hear from the best man in the Federal Government to respond to this criticism, James T. Lynn, Director of the Office of Management and Budget. Mr. Lynn will testify at 9:30 in this room, and we would be delighted to have you, Mrs. Rivlin, if you are free to attend. He was supposed to be here this morning to be with you, and it would have been an interesting way to discuss these things since he is kind of the administration opposite number. But if you will be here tomorrow we will be very grateful.

And at 11 tomorrow we will be hearing from Julius Shishkin who is the Commissioner of Labor Statistics about the new unemployment figures.

Now, Mr. Jones, perhaps I have been a little harsh on the Secretary, a man that I admire and respect and like very much. If you would like to respond, go ahead.

MR. JONES. We attempted to make a very constructive statement on priorities, and I hope it was. I believe the Secretary was expressing skepticism with the 5-year projections and not ridiculing them in any way, and emphasizing the point, that the assumptions contained in those projections are not his policy goals. He thinks we can and should do better. And I think the Congress would agree.

The detail on the unemployment rate and the troika projections which are made approximately once each month, those unemployment rate projections have been increased, as the Secretary indicated to the figures of 9 percent, and he indicated he would bring forth the average for the year which you had asked for.

So far as the statement goes as to the—what's the word used—the sensationalism of the Secretary's statement, I assume this refers largely to his comments on the risks involved in the size of the deficits with relationship to the financial markets. These statements were brought forth about 3 months ago. I do not believe people correctly recognize that we were talking in the main about when the economic recovery returns, and the private sector borrowing is then added to the very large—

Chairman PROXMIRE. Of course, you were also talking about Government spending as a proportion of GNP and the \$100 billion deficit.

Mr. JONES. Right, and that the return of the private sector borrowing, when added to the size of those deficits might well create serious risks. And I believe the events in terms of the size of the calendar in corporate borrowings, the alleged or the evident crowding out of some borrowers of lower quality, and the possibility that short rates seem to be firming, perhaps turning back, that the long rates have not come down commensurate with what one would expect in a recession as serious as we have I believe indicates that his warnings were proper warnings.

Chairman PROXMIRE. And indicates that the Federal Reserve ought to take another hard look at their lazy policy of failing to get growth in the money supply.

Mr. JONES. We never comment on monetary policies at the Treasury.

Now, as to the size of the deficit relative to the GNP, and those types of measures, I think the changes in recent months, or weeks or even days have been so volatile that a lot of the conversation of a few months ago when we were discussing \$35 billion and \$50 billion deficits have really become somewhat irrelevant.

And my final comment would be that those who made reference to single fiscal year deficits, fiscal year 1958, fiscal year 1968, as the basis for claiming that those deficits were easily absorbed, and the economy then moved on, really fail to note that these were sort of mountain peaks rather than a moving average of events over that period. In fiscal year 1959 and in fiscal year 1969 the economy returned to a small surplus. These were aberrations, in retrospect, involving very sharp deficits. I do not believe we are talking about the 1970's where we have had budget deficits of \$23 billion and \$23 billion back-to-back in 1971 and 1972. This year we face a budget deficit which will probably exceed \$40 billion. And in fiscal 1975, \$60 to \$70 billion to whatever the figure winds up being in fiscal 1976. These figures do not represent the same kinds of comparisons. We are now talking about an accumulation of pressures. The Federal Government borrowing will not be as quickly out of the financial markets as it was in the earlier time periods. Again, he is not trying to predict the worst case situation, only raising what he considers, with his background, in the financial market, to be a very serious question. What is the reaction of

the market trying to tell us? The calendar? What are the long-term interest rates trying to tell us? What are the debt-equity ratios in the private sector balance sheet trying to tell us? As you know, there has been a very heavy tilt toward debt, and largely short-term debt. We began in the 1960's with corporate balance sheets with about \$100 billion of short debt and \$100 billion of long debt.

We wound up that decade with \$100 billion long and \$200 billion short. So not only has the capital structures tilted toward debt, but it is a classic example of borrowing short and committing long.

Now, economists are correct that private sector financing needs are decimated during a recession. One need only go back to the 1930's where you can find current ratios, which is a poor measure of liquidity, but it is the one we use, where the current ratio went as high as 6 or 7 to 1 as opposed to the usual bankers' rule of 2 to 1. Why? Obviously, you collect your old debts, you do not make new inventory investments, you do not have accounts receivable, and your cash transactions are lower. That is not when the financial difficulty occurs in a recession. The financial difficulty occurs when the private sector comes back into the market to add to their working capital, to buy new inventories, and to have new accounts receivable. That was the period of time that the Secretary was looking down the road to and pointing out the concerns he had about the combination of financing and economic recovery, plus budget deficits of the magnitude that we are contemplating this year, next year and probably, although hopefully not, of that same magnitude. The revenues will come back onstream when recovery gets underway. Nevertheless, we may have large deficits. They have been interpreted as being sensational, but people who were laughing at us 2 or 3 months ago are at least considering the question today.

Chairman PROXMIRE. Would you like to comment, Mrs. Rivlin?

Mrs. RIVLIN. No, I do not want to comment on that. I just wanted to reiterate my desire to work closely with this committee as I build capability for forecasting, and it would be my hope that I could come back in a few months, flanked by my economists, and with a capacity for discussing with you our best estimates and the basis for them.

Chairman PROXMIRE. Very good. I might just say that I cannot resist saying to you, Mr. Jones, that it is fascinating when you get a man whose background has been in finance, and in the capital markets, and he is one of the most brilliant Wall Street operators who has ever come to Washington, and a very very successful one. But looking at it from that way, in that particular angle, overlooks it seems to me, the fundamental simple-minded point that you do not inflate the economy when you are operating so far below capacity, and have so many unused resources, when supply is so colossal in relation to demand. Also, it overlooks the point that all of the difficulties with firming interest rates, and if interest rates continue to fall is dependent on the money supply that has not grown over the past 4 or 5 months.

It is fascinating that the two men, the only two men, two prominent men at least who the newspapers identify as clearly opposed to the tax bill, and recommending to President Ford that he veto it were Secretary Simon and Federal Reserve Board Chairman, Arthur Burns, and

both because they were looking at it from the standpoint, it seems to me, of how this is going to affect the capital markets, how this is going to affect what the Federal Reserve Board has to do, and clearly if we run the country on the analysis that the main concern has to be the effect on the money market, it seems to me we might have a short sighted or too limited view, and we might prolong unemployment, and prolong the failure to recover more than we should.

Thank you very much.

Mr. JONES. Thank you.

Chairman PROXMIRE. Thank you, Mrs. Rivlin. As I say, the subcommittee will convene tomorrow at 9:30 and we will start off with Director Lynn. We hope that Mrs. Rivlin can be here if possible.

[Whereupon, at 11:55 a.m., the subcommittee recessed, to reconvene at 9:30 a.m., Friday, April 4, 1975.]

FIVE-YEAR BUDGET PROJECTIONS

FRIDAY, APRIL 4, 1975

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES
AND ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:35 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representative Long.

Also present: Richard F. Kaufman, general counsel; William A. Cox, Jerry J. Jasinowski, L. Douglas Lee, Loughlin F. McHugh, Carl V. Sears, and Courtenay M. Slater, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and Hon. Alice M. Rivlin, Director, Congressional Budget Office.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

Director Lynn and Director Rivlin, before we begin our hearing this morning on the budget projections, I have a statement respecting an event that occurred very tragically this morning. It relates to work that this subcommittee has done and I have done for some time. I am referring, of course, to the terrible tragedy that struck in Vietnam a few hours ago. I am calling the Defense Department and the Air Force to order a grounding of all C-5A's for an indefinite period of time.

While we do not know the cause of this accident, and it is possible there was sabotage, the evidence is piling up that these planes are structurally unsound and unsafe to fly.

I am also asking the chairman of the Senate Armed Services Committee to establish a special subcommittee to investigate the entire C-5A program and to reject the Pentagon's current request for \$900 million to correct the deficiencies in the C-5A pending the outcome of its inquiry.

This program has been a fiasco from its inception to this very instant. It is time that we stopped pouring more money into this flying rathole.

I awoke to the news this morning that a C-5A aircraft crashed with some 300 persons aboard near Saigon today. According to the Defense Department's first report of what happened there were 243 Vietnamese orphans and 43 escorts on the plane. In addition there was a crew of 15.

It is also reported that there are survivors although the number has not yet been determined.

I want to express my deepest sympathies to the families and loved ones of those who may have been killed in this terrible tragedy.

The C-5A has been surrounded by controversy ever since the \$2 billion overrun on its planned cost was disclosed before this subcommittee more than 6 years ago.

The disclosure of the cost overrun led me to inquire further into the C-5A program and my investigations revealed that there were severe problems with the construction of the plane as well as with its costs.

It was revealed that there were cracks in the wings of some of the planes and inherent weaknesses in the wing structures. The Air Force at first estimated that it would cost about \$15 million to repair the defects on all the planes.

This morning's crash marks the fourth C-5A that has been destroyed in accidents since the planes were delivered to the Air Force a few years ago. A total of 81 planes were built by Lockheed. There are now 77 planes left.

This year the Defense Department has revised its estimate of what it would cost to fix the C-5's. Instead of \$15 million, the Pentagon now wants \$900 million just to make the repairs. About \$5 billion has already been spent on this program.

The scandal, in addition to the cost overruns, is that the Air Force knew the planes were defective when they were first delivered. The Government did not have to accept them. It could have directed Lockheed to make the repairs, to deliver structurally sound airplanes.

Now the ultimate calamity has occurred and every individual who failed to exercise his responsibility to the public must share the blame.

If it turns out that this plane crashed because of any deficiency in the construction of the plane, that responsibility will be very heavy indeed.

Now, Mr. Lynn, I realize that the decisions about the C-5A were made before you became Director of OMB. But I hope you understand that the decision to continue funding the program, to spend nearly \$1 billion just to fix the wings, is a management decision. It is the kind of decision that the Office of Management and Budget should participate in.

I would hope that you would look into the question of how it was decided within your agency to go along with the Pentagon proposal to spend so much money to try to correct the deficiencies in the C-5A. I would also hope that you would take a hard look at the way OMB handles the defense portion of the budget.

I have been concerned for years about the double standard that exists within OMB with respect to defense and civilian spending programs, and that double standard is much in evidence in the 5-year projections contained in the budget document. Why do you not go ahead now with your statement and then I have some questions. Following Mr. Lynn's testimony we will hear about the new unemployment numbers.

We are very grateful to Director Rivlin for agreeing to cancel some of her commitments and appear this morning while Mr. Lynn was here, to make some very helpful, I think very helpful comment to your answers because we have the congressional expert to whom

we look on the budget along with the top executive from the administration.

Go right ahead, Mr. Lynn.

STATEMENT OF HON. JAMES T. LYNN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY PAUL H. O'NEILL, DEPUTY DIRECTOR; DALE R. McOMBER, ASSISTANT DIRECTOR FOR BUDGET REVIEW; AND RUDOLPH PENNER, ECONOMIC ADVISER

Mr. LYNN. Thank you, Mr. Chairman.

I welcome the opportunity to be here today. I have prepared a formal statement that runs some eight pages, but with your permission will insert the full statement into the record and I will just emphasize one or two points at the outset.

Chairman PROXMIRE. Very good, we would appreciate that. Your full statement will be printed in the record including the very helpful tables that you have attached.

Mr. LYNN. Thank you sir.

I think the main thing that I want to point out from this statement is that our forecasting in connection with the budget was limited to the two calendar years 1975 and 1976, and that when we run out our projections for the rest of the 5-year period that is just what it is, it is projecting, certainly not forecasting.

The other thing that I do want to point out is something that I think Director Rivlin referred to yesterday. I am a little new to this budget, too, as you pointed out, I was not in my present office when it was prepared, but I do know that there is a real effort to be as explicit as possible within the limitation of the system of the document that you want to have, the assumptions that went into the budget both for the current years and the out years.

My background is one of a corporate lawyer who dealt in corporate finance who tried to write his S-1's, prospectuses, merger proxy statements, and the like, and I do know that there is a procedure of learning, with each budget you learn more about the presentation, you learn more as to what ought to be disclosed, what is useful to be disclosed to the background assumptions and what is not useful to be disclosed, and I think in the 8 weeks or so that I have been on this job and have had an opportunity to look at budgets, present and past, I can see an evolution of this budget as Director Rivlin pointed out so well yesterday.

I do not think there is anything further for me to say at this point, Mr. Chairman. I think the best part of a hearing of this kind is giving the subcommittee an opportunity to ask questions and we will do our best to respond.

Chairman PROXMIRE. Very good.

[The prepared statement of Mr. Lynn follows:]

PREPARED STATEMENT OF HON. JAMES T. LYNN

Mr. Chairman and members of the subcommittee: I welcome this opportunity to discuss with your subcommittee the economic assumptions and 5-year projections published in the budget.

A number of people have taken the economic assumptions as representing an Administration "target," or as the Administration's judgment that "this is the best we can do." This is not what the assumptions are.

As the budget states, an economic forecast was presented for 1975 and 1976. This was our best estimate, at the time, of what the economy would be like given the President's program. Then, for the period 1977 to 1980, the budget presented assumptions—not forecasts—that were used in developing receipt and outlay projections. These assumptions were consistent with gradual movement toward relatively stable prices and lower unemployment.

With the gradual rates of improvement shown—for example, a steady 6½ percent annual rate of growth in real GNP—the projections do not reach either full employment or price stability by 1980. Nonetheless, the economic projections assume a more rapid movement toward full employment than the Nation has experienced in the past over nearly all peacetime periods of comparable length.

The longer-range projections are most assuredly not a long-term Administration "game plan" for the economy. The only policy decisions reflected in the economic assumptions are the recommendations set forth in the budget; and those recommendations directly affect only the forecast for 1975 and 1976.

There are good reasons for limiting the period covered by the policy decisions to 1975 and 1976. First, while the Administration's policies were decided in the context of longer-range objectives, we have learned to be modest about our forecasting ability and, therefore, about the suitability of today's policies for the unknown problems of tomorrow. Second, we know the direction in which to move and the range of speeds that are safe. We also know that conditions will change and require adjustment in both directions and speed. Third, on what may be a more philosophical plane, long-range forecasts and plans of the Government tend to underestimate the resiliency of the private sector. An explicit decision to limit our forecasts and policies to the immediate future and to plan to review them periodically in the light of developments in the private sector was reflected in the long-range figures published in the budget.

The major purpose of the economic assumptions presented in the budget was to provide a basis for making budget projections. Long-range budget projections have been presented in each of the last six budgets. The Congressional Budget Act makes this practice mandatory, and in the spirit of the Act's requirement we presented the projections in much greater detail than in the past. On an informal basis, we also provided the staff of this committee, as well as the House and Senate Budget Committee staffs, with supporting detail on those projections. Although the Act did not require presentation of long-range economic assumptions in the budget, we felt that their inclusion would aid the Congress and the public in understanding the basis on which the budget projections were made.

The purpose of the long-range budget projections is to indicate the degree to which resources would be committed by the continuation of existing and proposed programs at the levels recommended in the budget. As the budget explicitly notes (on page 42), These projections are not intended as forecasts of future receipts, outlays, or budget authority, because no attempt is made to predict future decisions or their effects. Nor are the projections intended as recommendations, since the continuation of Federal programs and taxes is a matter properly subject to continuous review in light of changing conditions.

Thus, the projections show the long-term implications of the budget recommendations, and of on-going program trends, in the absence of any future policy or legislative changes.

While the projections assume no initiatives or program reductions, or tax cuts, beyond those proposed in the budget, they do not assume a completely static world. The economic assumptions give them a dynamic element. Allowance is made for pay and price increases, for cost-of-living adjustments in beneficiary programs, for changes in beneficiary populations, and for increasing technological sophistication in space programs, military weapons systems, and energy research and development.

Like everything else in the budget, the long-range economic assumptions and budget projections are subject to continuous policy review. The economy is constantly buffeted by unexpected events, and these changes alter our views on the appropriate mix of policies. A projection that seemed realistic at one time, may seem overly modest or too ambitious given subsequent events. Similarly, a set of outlays or a tax structure that was appropriate to one of economic circumstances may be quite inappropriate in a changed environment.

The outlay projections, especially for the later years, are affected significantly by what is decided regarding whether or not to assume future renewal of programs, the authority for which expires after the budget year. Occasionally, the President has taken a public stand on such questions, in his budget message or elsewhere—for example, in urging renewal of the general revenue sharing pro-

gram. In such cases, the guidance provided by policy decisions were, of course, followed. Where policy issues were not significant—e.g., in estimating interest costs—the outlay projections were made on a technical basis consistent with overall policies.

In summary, the budget projections are a straightforward extrapolation of the budget recommendations, with no policy implications other than those explicit in the budget recommendations. Where we have had to make arbitrary determinations, we have tried to spell them out explicitly so that the bases of the projections will be understood on all sides.

POLICY EMPHASES IN THE 1976 BUDGET

Let me now turn briefly to the major policy recommendations conveyed in the budget. There were four main components to these recommendations: energy proposals, defense recommendations, proposals to provide fiscal stimulus, and proposals to maintain long-range control over the budget and prevent a rekindling of inflation as the economy recovers from the current recession.

The energy proposals were designed to be fiscally neutral in the short term and to operate through the market mechanism to discourage demand and stimulate domestic production of energy.

Fiscal stimulus was provided, first, through greatly increased aid to the unemployed, a type of spending that both helps those most in need and automatically phases out as the need for stimulus decreases. Second, additional stimulus was proposed to be provided through temporary tax reduction. The President has expressed his strong preference for stimulative measures that can be phased out as the need for them disappears.

The budget provided for increases in current-dollar outlays for defense and military assistance to enable our armed forces to maintain preparedness and preserve force levels in the face of rising costs. Finally, the budget recommended measures to control the long-term growth of budget commitments, particularly in the area of income support.

BUDGET TRENDS

In recent decades there has been a significant shift in the composition of the Federal budget. Spending for national defense has decreased from over 56 percent of the budget in 1956 to under 27 percent in 1976. At the same time, outlays for human resources—largely for Federal benefit payments for individuals—have increased substantially, from 22 percent of the budget in 1956 to over 51 percent in 1976. (See Table 1.) Moreover, in constant dollars—that is, after *adjusting for the effects of inflation—spending for national defense has decreased* nearly 20 percent over the decade ending in 1976, while outlays for human resources have increased over 135 percent. (See Table 2.)

The tremendous growth of our domestic assistance programs in recent years has, on the whole, been commendable. Much of the burden of aiding the elderly and the needy has been shifted from private individuals and institutions to society as a whole, as income transfer programs have expanded their coverage. These programs cannot, however, continue indefinitely to expand at the rates they have experienced over the past two decades.

Spending by all levels of government now makes up a third of our national output—compared to 18 percent in 1947 and less than 25 percent in 1955. Were the growth of domestic assistance programs to continue for the next two decades at the same rates as in the past 20 years, total government spending would grow to more than half our national output. This will not happen automatically, just as past increases have not. Rather, they reflect legislated program changes: broader social security coverage, medicare and medicaid, food stamps, and the like. These trends show the need to recognize long-run effects of continued automatic program increases, as well as the effects of proposals for new and expanded programs.

These calculations assume that defense spending is held level in constant dollars. But if domestic assistance programs were to continue to increase in the future at the rate of the past 20 years and we tried to keep total Federal spending at the current share of GNP—which is now about 22 percent—by decreases in defense, we would be down to the last soldier and the last gun early in 1985—just 10 years from now.

It is no longer realistically possible to offset increasing costs of domestic programs by further reducing military programs and strength. Therefore, the budget proposes some increase in defense outlays, in current dollar terms, to halt the relative decline of defense spending, and a moderating of the growth of domestic assistance.

Table 3 shows the composition of the 5-year projections of budget outlays. These projections show outlays for income security, health, and defense increasing as percentages of total projected outlays between 1976 and 1980. It should be noted, however, that the decline in both relative and absolute outlays for many other functions is due to the fact that allowances for pay and price increases are generally not distributed by function.

The major pay and price increases that are distributed by function in the 5-year projections are for income security benefit programs tied to the cost of living, medicare and medicaid and defense. Allowances for future civilian agency pay increases and for future increases in prices for civilian agency procurement are not distributed. The projections indicate the potential resources that remain uncommitted under currently-recommended policies; they are not forecasts of future decisions.

Under these assumptions, defense outlays in current dollars are projected to rise from \$94 billion in 1976 to \$141 billion in 1980. Over 60 percent of this increase reflects pay and price increases.

Taking into account the effect of legislated cost-of-living increases, which the President has proposed to limit to 5 percent for fiscal year 1976, outlays for income security are currently projected to rise from \$119 billion in 1976 to \$167 billion in 1980. Excluding unemployment benefits, which are expected to decline over the projection period due to decreasing unemployment rates, outlays for income security and health programs are projected to rise at an annual rate of about 11 percent from 1976 to 1980, compared to 16 percent from 1966 to 1976. By 1980, these two functions make up over 44 percent of total projected outlays. As recently as 1968, they were less than 25 percent of the budget total.

In closing, let me commend the subcommittee for its recognition of the importance of reviewing the budget and budgetary priorities in long-range perspective. It is particularly important that we begin the difficult but necessary task of facing up to the rapid growth of social programs, and the problems that would be posed by continuation of past growth rates in this area.

Mr. Chairman, my colleagues and I will be glad to answer any questions that members of the subcommittee may have.

TABLE 1.—PERCENT DISTRIBUTION OF OUTLAYS BY FUNCTION

Function	1956	1960	1964	1968	1972	1976 estimate
National defense.....	56.4	49.0	44.5	44.4	33.4	26.4
Human resources:						
Education, manpower, and social services.....	.8	1.1	1.3	3.9	5.0	4.7
Health.....	.5	.9	1.5	5.4	7.5	8.0
Income security.....	14.0	19.8	21.2	18.8	27.6	34.0
Veterans benefits and services.....	7.1	5.9	4.8	3.8	4.6	4.6
Subtotal, human resources.....	22.4	27.6	28.8	32.0	44.8	51.2
Net interest:						
Interest.....	8.9	9.0	8.3	7.7	8.9	9.7
Interest received by trust funds.....	-1.7	-1.5	-1.4	-1.5	-2.2	-2.3
Subtotal, net interest.....	7.2	7.5	6.9	6.2	6.7	7.3
Physical resources: ¹						
General science, space, and technology.....	.2	.7	4.2	3.1	1.9	1.3
Natural resources, environment, and energy....	1.5	1.8	2.3	2.0	2.2	2.9
Agriculture.....	4.9	2.8	3.9	2.5	2.3	.5
Commerce and transportation.....	2.8	6.2	4.8	5.9	4.6	4.1
Community and regional development.....	.3	.5	.9	1.2	2.0	1.7
Subtotal, physical resources.....	9.7	12.1	16.0	14.9	12.9	10.5
All other:						
International affairs.....	3.4	3.2	3.1	2.6	1.6	1.8
Law enforcement and justice.....	.4	.4	.4	.4	.7	.9
General government.....	.7	1.2	1.2	.9	1.1	.9
Revenue sharing and general purpose fiscal assistance.....	.1	.2	.2	.2	.2	2.0
Allowances.....						2.3
Undistributed offsetting receipts ²	-4	-1.3	-1.1	-1.6	-1.3	-3.3
Subtotal, all other.....	4.2	3.7	3.8	2.5	2.3	4.6
Total.....	100.0	100.0	100.0	100.0	100.0	100.0

¹ General science, space, and technology was included in physical resources for this tabulation to conform to the classification used in testimony presented to the Senate Committee on the Budget. This classification was requested by the staff of that committee.

² Excludes interest received by trust funds.

Note.—Detail may not add to totals due to rounding.

TABLE 2.—FEDERAL OUTLAYS IN CONSTANT (FISCAL YEAR 1976) DOLLARS

[Fiscal years; in billions of dollars]

	National defense	Human resources ¹	Physical resources ²	Net interest	All other	Total
1966.....	114.7	76.2	46.5	26.8	10.4	274.6
1967.....	138.7	90.0	46.6	26.3	9.8	311.3
1968.....	154.5	98.5	50.7	27.6	8.7	339.9
1969.....	149.1	103.7	43.3	25.4	7.6	329.1
1970.....	134.3	111.6	43.1	24.6	7.2	320.7
1971.....	118.4	129.0	41.7	25.0	5.2	319.2
1972.....	113.3	144.9	43.2	25.6	7.8	334.8
1973.....	101.5	154.4	40.6	26.1	10.7	333.2
1974.....	97.4	161.3	38.0	24.1	7.4	328.2
1975 estimate.....	94.9	184.2	35.6	24.5	13.0	352.2
1976 estimate.....	93.9	182.2	37.3	26.1	16.2	355.6

¹ Includes education, manpower, and social services; health; income security; and veterans benefits and services.² Includes general science, space, and technology; natural resources, environment, and energy; agriculture; commerce and transportation; and community and regional development. General science, space, and technology was included in physical resources for this tabulation to conform to the classification used in testimony presented to the Senate Committee on the Budget. This classification was requested by the staff of that committee.

TABLE 3.—BUDGET OUTLAYS BY FUNCTION, 1974-80

[In billions of dollars]

Function	Actual 1974	Estimate			Projection			1980
		1975	1976	Trans. qtr.	1977	1978	1979	
National defense.....	78.6	86.1	93.9	25.8	105.5	120.4	131.5	141.4
Human resources:								
Education, manpower, and social services.....	11.6	14.9	16.7	3.1	14.0	13.8	13.7	13.6
Health.....	22.1	27.4	28.4	7.2	32.0	35.7	39.8	44.3
Income security.....	84.4	109.8	120.9	31.4	133.0	145.2	156.5	167.2
Veterans' benefits and services.....	13.4	16.0	16.2	3.9	15.4	15.0	14.6	14.3
Subtotal, human resources.....	131.5	168.0	182.2	45.6	194.4	209.7	224.6	239.5
Net interest:								
Interest.....	28.1	31.3	34.4	9.3	38.5	38.5	38.7	38.6
Interest received by trust funds.....	-6.6	-7.8	-8.3	-7	-9.2	-9.7	-10.2	-10.7
Subtotal, net interest.....	21.5	23.6	26.1	8.6	29.3	28.8	28.5	27.9
Physical resources: ¹								
General science, space, and technology.....	4.2	4.2	4.6	1.2	4.7	4.6	4.2	3.8
Natural resources, environment, and energy.....	6.4	9.6	10.2	3.2	12.3	12.8	11.7	9.7
Agriculture.....	2.2	1.8	1.8	.4	1.9	1.9	2.2	2.2
Commerce and transportation.....	13.1	11.9	14.7	3.8	15.4	14.8	14.9	15.0
Community and regional development.....	4.9	4.9	6.0	1.6	6.5	6.6	5.5	5.3
Subtotal, physical resources.....	30.8	32.3	37.3	10.2	40.7	40.6	38.5	36.2
All other:								
International affairs.....	3.6	5.0	6.3	1.6	8.2	7.3	6.8	6.6
Law enforcement and justice.....	2.5	3.0	3.3	.9	3.4	3.3	3.4	3.4
General government.....	3.3	2.6	3.2	.8	3.6	3.5	3.8	4.1
Revenue sharing and general purpose fiscal assistance.....	6.7	7.0	7.2	2.0	7.3	7.6	7.6	7.7
Allowances:								
Energy tax equalization payments.....		.5	7.0	1.8	7.0	7.0	7.0	7.0
Other pay, price, and contingencies.....		.2	1.0	.4	5.6	8.7	11.9	15.0
Undistributed offsetting receipts ²	-10.1	-6.6	-11.9	-2.7	-10.1	-10.4	-10.7	-10.9
Subtotal, all other.....	6.1	11.9	16.2	4.7	25.0	27.1	29.8	32.9
Total.....	268.4	321.8	355.6	94.9	395.0	426.7	453.0	477.9

¹ General science, space, and technology was included in physical resources for this tabulation to conform to the classification used in testimony presented to the Senate Committee on the Budget. This classification was requested by the staff of that committee.² Excludes interest received by trust funds.

TABLE 4.—CURRENT OUTLAY ESTIMATES

[Fiscal years; in billions of dollars]

	1975	1976
February budget estimate.....	313.4	349.4
Changes to date:		
Offshore oil and receipts (reestimate).....	2.5
Social security and other benefit payments (tax bill).....	1.9
Department of Defense (reestimate).....	1.0
Department of Health, Education, and Welfare (reestimate).....	1.0
Food stamps (congressional action and reestimate).....	.8	2.2
Public service jobs and summer employment (Presidential request).....	.1	1.8
Release of highway funds.....	(¹)	1.0
Rescissions and deferrals (congressional action).....	.5	.7
Veterans benefits (reestimate).....	.5	.6
All other (net).....	.1	-.1
Current outlay estimate.....	321.8	355.6

¹ \$50,000,000 or less.

Chairman PROXMIRE. The first thing I want to do, Mr. Lynn, is commend you and the Office of Management and Budget and staff for putting together the 5-year projections and accompanying discussion that appears in the budget document. I want to reinforce that effort and I hope it is clearly understood everything I say here this morning is intended to encourage you to making and continuing to make the 5-year projections even though we will be critical of part of it, as you might expect, but I think doing this job is most helpful. I think from my viewpoint, certainly from the view point of those who feel that the Federal Government is spending too much money, recognizing what this means in terms of what we will be spending 3 and 4 and 5 years ahead, is most useful, I think, in understanding the full consequences of it. I think some improvements can be made and this is one of the purposes of the hearing. At that time we must recognize that others have been critical of our projections and the concept.

Would you respond to the criticism that you have had, that you know of, perhaps on the basis of the criticisms of yesterday.

Mr. LYNN. The criticisms of yesterday? Which particular criticism?

Chairman PROXMIRE. There were a number of criticisms of the budget. Let me just start off with this Table 4 attached to your prepared statement presents revised outlay estimates for fiscal 1975 and 1976. This is the first I have seen these latest revisions. Fiscal 1975 outlays have been revised up \$8.4 billion from the February budget. Fiscal 1976 is up \$6.2 billion. (I note in passing that less than half of these increases can be attributed to any action by Congress.)

If I adjust receipts for the excess of the cost of the tax bill passed by Congress over the tax cuts originally proposed by the President, I get receipt estimates of \$273.1 billion in 1975 and \$293.4 billion in 1976, indicating a deficit of \$48.7 billion in fiscal 1975 and \$62.2 billion in 1976. If I make the further assumption that unemployment will average one-half percentage point higher in calendar 1975 than the administration estimated in February—and that seems reasonable in light of Mr. Simon's statement yesterday that unemployment will peak at 9 percent rather than 8½—then I should subtract at least another \$6 billion from fiscal 1976 receipts because of a weaker than expected economy. That gets the 1976 deficit up to \$68 billion.

The President said Saturday that he would hold the line on the deficit at \$60 billion. Mr. Lynn your estimates this morning indicate that that line has already been breached. Can you give me the receipt and expenditure figures which hold the deficit to \$60 billion? Do you agree or disagree with my calculations?

Mr. LYNN. Do I agree or disagree with your calculations or the President's?

Chairman PROXMIRE. Do you agree or disagree that the present evidence indicates that we have already breached or are very likely to breach the \$60 billion?

Mr. LYNN. I disagree that we are at or about to breach the \$60 billion. Based on the figures—

Chairman PROXMIRE. Indicate why you disagree with the statement I made?

Mr. LYNN. I would have to see the break out, sir, for example, on the tax bill. We would show and that would be the effect in fiscal year 1976, for example, of about \$300 million changed from the President's budget. We had \$10.2 billion and now it becomes \$10.5 billion.

Chairman PROXMIRE. This is the fact sheet, the backup that backed up the President's presentation last Saturday. It shows the conference bill for fiscal year 1975 is minus \$10.7 billion, fiscal 1976 minus \$10.5 billion.

Mr. LYNN. That is right, \$10.5 and the budget shows \$10.2 that is a net addition of \$300 million.

Chairman PROXMIRE. I see. You are assuming that all the President's energy tax proposals will be enacted.

Mr. LYNN. Of course. They should be and I think recent events in the Middle East would indicate that they should be and I urge the Congress to get on with that task.

Chairman PROXMIRE. In view of the developments that have already occurred, do you think that is realistic?

Mr. LYNN. I certainly hope so, sir.

Chairman PROXMIRE. You hope so. But does it seem to be realistic?

Mr. LYNN. I would hope that as Congress continues to explore what the options are that there will be no doubt in the mind of the Congress that this is a problem, the energy problem that must be addressed immediately, that we must make a start now, and that when you look at all of the options that the President's proposals are the soundest proposals to make that start and to carry into effective policies over the years ahead.

Chairman PROXMIRE. That makes the difference clear. The difference between your position and the position that we assume is that it seems to us very unlikely Congress will enact the President's energy tax increase. Then if it does not we are over the \$60 billion deficit.

Mr. LYNN. I think what you are pointing out is some confirmation of the testimony of Director Rivlin yesterday. One of the problems with projecting, one of the problems that all of us have is, every person will have his own idea as to what you ought to include in or include out in making or exclude out in making statements.

Chairman PROXMIRE. When will you adjust your revenue statements to the higher unemployment? I mentioned also in my statement, Secretary Simon yesterday stated that unemployment would peak at

9 percent rather than an $8\frac{1}{2}$ which the administration previously indicated.

Mr. LYNN. I think what you have to look at is the entire fiscal year, for example, fiscal year 1976. I have heard Mr. Greenspan testify on this at length. I believe he has testified on a couple of occasions where I have had the delightful opportunity of testifying with him, that he would not be surprised at a figure as high as 9 percent. That is the way he has put it, he also emphasized it is extremely difficult to predict accurately. As we saw last month where there was a continuation of the 8.2 rate—we all know one of the basic reasons, only it stayed at 8.2—was the large rate at which people had dropped out of the labor force in the sense of looking for employment. So that you have both what the particular unemployment figure means, and secondly, the difficulty in forecasting month to month what it is.

I think what you have to look at is what is expected for a longer period of time, what is expected for a 6-month period or annual period, and from what I have been told the economists within the administration really do not have any reason at this point to change their forecasts looking at the year as a total. I am talking about the calendar year now. In the latter part of the year we will see those trend lines running in the right direction. I should point out there are other changes. One of the changes with the inflationary rate dropping quicker than the forecast showed on the expenditure side there is some reduction.

Chairman PROXMIRE. The inflation rate dropping quicker than expected there will be a sharper drop on the revenue side than the expenditure side. That has been our experience so far. In other words as the inflation deepens, as it goes on and becomes greater, revenues have increased more rapidly than expected and in relationship to expenditures they have increased. With inflation declining why wouldn't the reverse be maintained?

Mr. LYNN. Well, I will go back to what I said earlier. I think we have to look at a longer period. We have to look at a 12-month period whether we are talking about calendar years—

Chairman PROXMIRE. We do. But in every single statement made virtually over the last 6 months, made by Mr. Stein and then made by Mr. Greenspan, have been proven to be understatements of the unemployment level. The first peak statement, as I recall of only a short time ago, only 18 months ago, was a 6 percent peak, that became $6\frac{1}{2}$ then 7, the absolute peak was to be $7\frac{1}{2}$ percent; and then it rose to 8, and finally to $8\frac{1}{2}$ percent. Every one of those have been exceeded without exception.

Mr. LYNN [continuing]. I would say that if I looked at the economic community, the economic forecasting community generally, that they have had great difficulty.

Senator PROXMIRE. I think that is right.

Mr. LYNN. Let me also say—

Chairman PROXMIRE. What I want to ask you, Mr. Lynn, is when are you going to make your reassessments as to the revenue expectations based on the change in unemployment?

Mr. LYNN. As required by the law we will make that change on June 1st. That does not mean, Mr. Chairman, that we do not look constantly at the state of the economy because, as the President has said

very, very often, this is a situation where you have to look at it week by week, month by month, and if you see definite signs that you have to change the amount of stimulus that you are recommending either upward or downward. You should not hesitate to make those changes. But I do want to emphasize what I said earlier, we still have the feeling when we look at the year as a whole that in the latter part of this year we are going to see the economy coming upward in the rate direction.

Chairman PROXMIRE. Mr. Lynn, yesterday Secretary Simon disagreed and challenged the economic assumptions in the 5-year projections prepared by your office and provided to Congress. Earlier this year Arthur Burns ridiculed the 5-year projections. My question is this: if two of the administration's top economic policymakers disagree with the projections—including the two year forecast for 1976 and 1977—whose projections are they?

Mr. LYNN. Well, first of all, you have characterized the testimony of those prior witnesses. I think we should let the testimony stand on its own terms. I have not read word for word Chairman Burns' testimony but I have seen enough excerpts of it to have had the impression what he was doing was reconfirming the fact that forecasting, particularly in the kinds of days that we live in, is extremely difficult even in 6 and 12 month periods, so to put forward any kind of a document, any set of explicit figures, is fraught with peril.

Chairman PROXMIRE. We realize that. What I am trying to find out is whose views are these. We have the impression, many of us, that Secretary Simon was the chief economic spokesman for the administration and—

Mr. LYNN. He is.

Chairman PROXMIRE. Mr. Burns was a very important part of the quadriad; so under these circumstances do the views they so strongly disagree with represent the views of the President or of the Council of Economic Advisers or just the Office of Management and Budget?

Mr. LYNN. The way these figures are put together is basically a troika effort, with Secretary Simon, Chairman of the Economic Advisers Mr. Greenspan, and the head of the Office of Management and Budget, and this was a joint effort of that group called the troiked in putting together the forecasts and the projections that are set forth on page 41.

Chairman PROXMIRE. This is the kind of statement that troubled me in that connection. Yesterday Secretary Simon said that, and I quote:

I do not believe that the economic assumption used in preparing the 5-year budget statements are a sound indicator or likely pattern of inflation and unemployment in the near term.

Mr. LYNN. What period was he referring to?

Chairman PROXMIRE. He is referring to the 1975-76 period in the near term.

Mr. LYNN. I am not sure what he is referring to in that regard. We would be the first to say, particularly as to the projections out for the other 3 years, that no one knows at this point for sure what is going to happen and all those are trend lines as best we can judge them. Even as far as 1975 and 1976 is concerned, these have to be statements, forecasts, as you said, that evidence by performance. This is an area where

one must be modest but what we tried to do here was give our best judgment, our best judgment as to what would happen during 1975 and 1976, then work some projections from that.

Chairman PROXMIRE. Now we have agreed.

Mr. LYNN. I also have a hunch that no matter how put forward, any forecast or any projections, we could find 10 other people who would disagree with them.

Chairman PROXMIRE. I am sure that is true. We also find, events may have made many of the forecasts look bad. We find, for example, inflation, as you pointed out, is moderating. We find unemployment has increased more rapidly than expected. These are two more enormous changes.

Did I understand you to say that you would revise the forecasts and projections in June or by June?

Mr. LYNN. Yes; that is required by law, Mr. Chairman.

Chairman PROXMIRE. And you will do that?

Mr. LYNN. Yes sir; I do not want to say people can be wrong on the down side but they can be wrong more pleasantly on the up side. I have heard Mr. Greenspan testify that, I think agreeing with you, as a matter of fact, that the economists tend to understate the severity of a decline but they also tend to understate the rapidity with which the economy can rebound, so my hope would be that if they have had some error with respect to exact figures at a particular time or for an average during the year, early part of the year, that we will have some degree of error on the up side.

Chairman PROXMIRE. I hope we understand what we are talking about. You may have been referring to the fact that the law requires that you revise your forecasts for 1976. How about the projections? That is what we would like to have. Would you give us a revision of your projections in view of the dramatic and substantial change.

Mr. LYNN. We will take another look at those, too, Mr. Chairman.

Chairman PROXMIRE. Take another look at them?

Mr. LYNN. Yes, sir. I would assume the two are related, of course. The forecasts for the 2 years are related to the projections. For example, one of the most important parts of the projection is GNP estimate. As you move month by month further in time, I would suppose you have to look at the next out year. You have to look at 1977 depending on what you came up with as to your latest and best estimate.

Chairman PROXMIRE. What I am getting at, we want more than another look, we would like a revised projection.

Mr. LYNN. I think we can do that and we will do that if revision is necessary.

Chairman PROXMIRE. My time is up. Congressman Long?

Representative LONG. Mr. Lynn, I have not had an opportunity to read your statement all the way through. I have been listening to you and giving it a cursory examination at this time.

Taking into consideration how difficult a time the economic community has had in coming up with any projections, and what Mr. Simon said yesterday in his statement with respect to the overall direction in which the U.S. free enterprise system is moving, are you familiar with his conclusions in that regard? In general what is your feeling about that? Are we developing a constituency that is so de-

pendent upon the Government that it becomes destructive of the free enterprise system, which is in effect what Mr. Simon concluded yesterday?

Mr. LYNN. I have to confess, Mr. Long, that I have not had an opportunity to read his testimony. I was out of the city yesterday. I have read excerpts of it.

But in answer to your specific question, do I have concern as to what may be happening to the competitive enterprise profit risk system that we have? Yes, indeed I do have concern.

Representative LONG. I share that too. But it goes back to talking about the C-5A and the double standard that has been established, sort of like the double standard between man and woman that we hear so much today. Men are expected to live by one standard and women by another—and it seems to me, having served one year as I did as the Assistant Director of OEO, that the standard of performance to which we were held in dealing with human problems which are more complicated and more difficult than the standards for more technical problems.

I think it was unfair that there was one standard of performance to which we were held if some program dealing with human beings was to cost \$100,000 and all of a sudden it became a national scandal—yet, we would have how much overrun on the C-5A program?

Mr. LYNN. \$2 billion.

Representative LONG. \$2 billion. And for this the attitude was well back to the drawing boards, boys, and let us look at the wing structure again. There really is a double standard here, and it concerns me that we can do this.

What can we do about that?

Mr. LYNN. Well, first of all let us talk about the double standard, which seems to be the key words that you and the chairman are using.

I do not believe there is any double standard. I have seen one kind of a double standard in the last 4 years and that has been to try to accommodate as much as we can our domestic assistance programs by cutting the defense budget.

Now, I would hope that those cuts in the defense budget are things that are not going to impair the defense of this Nation. I know you gentlemen most surely share that view.

I have heard the chairman of this at length and that would be the last thing he would want to do, I know, and I know you share that. But if you do look at our budget trends in the last 4 to 5 years, as I point out in my prepared statement, you find a decline in the defense budget that is of rather dramatic terms. In fact, if you look at defense levels compared to pre-Vietnam, we are at lower levels of personnel than we were before.

If you look at our Navy its number of ships, and I realize there is more capacity for ships, but we are in ships below Pearl Harbor, 1939.

So it is hard for me when we talk double standard to not think of that as perhaps a double standard.

Second, with respect to social programs as against the Defense. If we take a look at percentage of the total budget, if we take a look at percentage of GNP, the percentage represented by Defense had declined substantially from over half of the budget, from say, 20 years ago down into mid-20 range now, and just the reverse of that in our

domestic assistance programs ranging from somewhere in the mid-20's or maybe a little more than that up to now, where 50 percent or more of our budget is in the domestic assistance area.

Now coming to things like how we measure performance of programs. It is true there have been overruns in the Defense Department. There are certainly overruns, at least unexpected outlays in our domestic programs.

Our table that was referred to earlier on, table 4, shows some re-estimates of outlays in such things as the food stamp program, and overrun, if you will, from at least what our estimate was of cost.

Now, I am certainly not going to defend the Defense structure for all of their overruns. Undoubtedly some of them get into troubles that are their own fault that could have been predicted, could have been foreseen.

In that case we must within the Federal Government do everything we can do to put responsibility in the dollars where they belong but, on the other hand, we are asking a very difficult task of Defense contractors, particularly in the area of high technology. Every time they produce some new piece of hardware at the time they get the contract it is more or less a research contract and yet we insist on signing a fixed price contract with them. Now, I do not know enough about that business yet, but I am going to find out to know whether that makes sense. But in many of these things until you build a number of them, until they have flown for a period of time, no person knows what problems will develop.

I remember back when I practiced law we had a case involving the wing structure of one of the commercial airlines and they won that case at least in the trial court, the outfit that has designed the wing because experts got up and testified that given the state of the art at the time it was the reasonable approach to the problem, but with 20-20 hindsight for years later everybody agreed it was a horrible error.

So what I am saying is do not think these are terribly easy issues and as far as double standard is concerned I really do not believe there is any at all. I think we have one standard when it comes to Defense, two standards really, one to do whatever is necessary to protect this country, to preserve our liberty, and that is a very complex difficult but top priority thing, but the second part of it is to do it as cheaply as we possibly can both for the taxpayers in general and, secondly, to have as much money as possible for helping our own people in more tangible ways.

Representative LONG. When I am using the term "double standard", and I can not speak for Senator Proxmire, I do not mean to restrict it solely to the attitude of the Office of Management and Budget. I think this is true with respect to the American people in general. We have an attitude that has developed over the years that when it is a military situation, we have an absolutely different attitude with respect to it than when it develops in the human field. It is no fault of yours, and I am not blaming you. But I am saying that this is the way it tends to develop, and if this is how it comes out in the media once the thing has progressed to dealing with human beings, as distinguished from dealing with inanimate objects.

The other point I want to make is with respect to constant dollars as distinguished from a percentage of gross national product. I do not

think, nor am I suggesting you intend to do this. I do not think we ought to leave it with respect to the amount of dollars being spent for national Defense, that there is any decline in those figures because there has not been a decline.

Mr. LYNN. In what kind of dollars, sir?

Representative LONG. Well, in overall dollars during that period, over say 1974 actual. We go from 78 to 85 to 76 and at the same time off 94.

Mr. LYNN. Are you looking at table 2, Mr. Long?

Representative LONG. I am looking at the budgets. Do you have a copy of it, on page 71.

Mr. LYNN. All right.

Representative LONG. National defense by billions of dollars.

Mr. LYNN. Those are all right, of course, in current dollars.

I would draw your attention to table 2 of my prepared statement where you can see the decline but, of course, those figures are wrapped by the Vietnam effort. But if you take a look at a longer period perspective or let us say from the period of time when this was winding down as to our expenditures the last 4 years from 1970, you have quite a decline. If my recollection is right it may be somewhere around 40 percent. No, I think it is more like 20 percent. About 35 percent since 1970.

Now, again, I am not saying that some decline was not justified and Congress looked hard at those figures, but what I am saying is we should not leave an impression that the Defense budget has been over the years in recent past or in the past going back even 15 years or so and building part of our budget. It has been as a percentage of our budget something that is declining.

Representative LONG. Yes.

Mr. LYNN. Compared to 10 years ago.

Representative LONG. I do not argue that point. It is obvious from the figures you can not argue that point. All I am saying is that, conversely, you can not leave it as though that we were absolutely under-cutting Defense and that we are not spending comparably the same amount of money with respect to Defense that we did during the conduct of the war in Vietnam. There may be some reductions but it is not—

Mr. LYNN. It is \$40 billion less in constant dollars, Mr. Long, as table 2 shows.

Representative LONG [continuing]. Where?

Mr. LYNN. The first column in table 2 national defense, if you look at the peak expenditure of 1969 or so, these are constant dollars, mind you. You show 1968 was \$145 billion-plus; 1969, \$149 billion; and if you look at our 1976 statement is it \$94 billion.

Representative LONG. Do you know how much of that, say, \$69 billion was spent on the war in Vietnam?

Mr. LYNN. I assume a very good proportion of it.

Representative LONG. Thank you. My time has expired.

Chairman PROXMIER. Director Lynn, you properly highlight, and I am glad you do, the excess increases in overall Federal spending and what they tell as the burden on the taxpayer and future inflationary effect and so forth. I am very happy that you do that, and I think you

and the others in the administration have served a most useful purpose in doing so.

What I am concerned about, however, is a failure to come up with comprehensive, thoughtful ways of what we can do about it, how we can meet the needs that we have in our society and at the same time hold down spending. I think that is one way, of course, simply to put a ceiling, say on more spending above a certain level for any of these programs. I think you would agree that kind of approach has very definitely inequities, cruelties and limitations. What it seems to me we need is some kind of social security reform, income maintenance reform, reform in the whole area of spending, and alternative optional programs recommended to the Congress so we could consider what we can do about holding this under control.

As you know, the Chairman of the Budget Committee in the Senate, Senator Muskie, has said that we must hold down the deficit, it is getting up above \$70 billion, and much more than that is too stimulative on the basis of almost all estimates. Why is this? Why has not the administration come up with something like this? Why do you not tell us what you think we can do to have a more effective control of spending other than simply putting a ceiling on it.

Mr. LYNN. Well, I think the budget itself plus other messages from the President shows a way to this. I think one of the things that is essential to our carrying out the kinds of programs that we want for our people is to restore economic stability, a healthy economy. I think that is number one. We have the highest standard of living in the world. We have done things for our people over the years by having healthy economic growth. Provided in the main from the private sector. I want to see it continue.

Chairman PROXMIRE. Could I interrupt at this point? We all agree with that. I think we all see if we can get a bigger pie instead of having \$200 billion short of our potential. If we are near our potential. We would not be able to solve these problems more easily. But the thrust of my question is what can we do about the spending programs, how can we make them more cost effective, more rational?

Mr. LYNN. I think there are a number of ways, as the President has said, he wants to join with the Congress in the course of the months ahead into the current year with some of the most perplexing and difficult problems we face. Certainly welfare reform is one of those. I have not been in this job very long. I dealt with one part of helping the needs of lower income people for 2 years at HUD but it is only one piece.

Chairman PROXMIRE. As you know, a subcommittee of this committee headed by Martha Griffiths came up with a very, very comprehensive welfare reform study, controversial in many areas, with which many of us may disagree, but at least the constructive positive change that would provide a greater degree of equity.

Why has not the administration come up with something of that kind that would give us some notion of how we can provide equity and fairness at the same time but hold down this greatly increasing burden?

Mr. LYNN. The administration will, Mr. Chairman. I think as I have gotten into this subject I do not know of anyone that is more complex. You first of all have to draw the area in which you want to accomplish reform.

Are you talking narrowly about two or three categorical programs?
 Chairman PROXMIRE. I am talking about the whole.

Mr. LYNN. I ask this rhetorically.

Chairman PROXMIRE. Social security, unemployment.

Mr. LYNN. I think you will see the administration coming forward in the months ahead with specific proposals in these areas. I think you will see us working with the Congress, the Senators, the Congressmen, and staffs as we try to develop options for the President.

You know the range of advice in this area that you get ranges all the way, say, look a little more carefully at the administration of these programs and they are not bad to the opposite end of junk just about everything there is and go totally to one transfer payment depending on need, and in between there are all kinds of variations of that. Change the eligibility and benefit level program by program so they mesh better. This is highly complex. It carries you over into SSI, it carries you over into international relationships with unemployment insurance, for example, you get into questions as to whether it should include housing or exclude housing. We have a President who has been in office not a terribly long time and what he wanted to be certain of was a fresh look at this extremely important issue. It was taken and carefully examined by the people giving advice to him before he makes up his mind, finally on them, but as he said in the budget, in this area of welfare reform in the area of health, we must do something and it deserves it and it needs it.

Chairman PROXMIRE. I hope that will be forthcoming. So far we have had rhetoric and condemnation and a ceiling on spending in certain areas but no constructive alternative.

Mr. LYNN. We have made some recommendations on some reforms. There may be people in the Congress who do not like them, but there are some that are in there. In looking at the social services program we propose some change in medicare, we propose some change. We have also proposed some change in the way we do transit, the way we do highways. I could list a number of these policy changes.

Chairman PROXMIRE. Those changes are simply to put a ceiling on it. I do not see any substantive change that you have recommended.

Mr. LYNN. Well there is—

Chairman PROXMIRE. You recommend reform.

Mr. LYNN [continuing]. There are numerous ones in the budget, Mr. Chairman, in the areas of health.

Chairman PROXMIRE. Our staff has been very, very, diligent in looking for them and they can not find any.

Mr. LYNN. We will be happy to list those for you. I have just mentioned some of them by way of reform. And as you go through—

Chairman PROXMIRE. There are a few minor changes but by and large the proposals are just to hold it down.

Mr. LYNN [continuing]. Will you define major for me other than welfare and health?

Chairman PROXMIRE. I would like to know where the major changes that you would make that would reduce spending without losing equity and justice, fairness, meeting our needs, of where those changes are. We can not find them.

Mr. LYNN. I have already mentioned some of them to you, Mr. Chairman, both as to the ones that we would expect to be coming

forward with and as to the ones that are in the budget, but I would like to say—

Chairman PROXMIRE. President Nixon did propose a major welfare reform but that has been retreated from.

Mr. LYNN [continuing]. What the President says in the budget is that we should work together in the months ahead in fiscal year 1976 to come up with the right answers to that area. Now, these things are not done—

Chairman PROXMIRE. Let me interrupt to say I am trying to get Mrs. Rivlin for a response.

Mrs. RIVLIN. What contributions will your office be able to make in this area? Do you see that the budget office and the Congress can make a contribution too?

Mrs. RIVLIN. I am in the enviable position of not having to defend anything we have already done. Yes, absolutely, Mr. Chairman, I think that our mandate is very clear to look at the major alternatives facing the Congress in all areas, and you have mentioned some of the most important ones. Clearly the income support problem has to be looked at and it is, as Director Lynn says it is, very difficult.

There is no getting around that and that is not history to this committee. One of the basic problems in the whole area of what we do for low income people is the current set of programs are very complicated and they aid some people rather generously and other people not at all, and the basic dilemma is how to make them more equitable without making them substantially more expensive. We will be looking at alternatives for health insurance, alternatives for income support, and alternatives in all sorts of different areas. I think the key to this really is that the Congress has to start thinking in longer-range terms and looking at not just the next year and how do we hold expenditures down but where do we want to be 2, 3, 5 years from now, and what are the options, and it is my hope that we can help in that.

Chairman PROXMIRE. All right, now, let us take a look at the numbers in the forecast and the projections. You forecast very high unemployment for all of this year and next and very little improvement in 1977. You forecast a rate of growth of 4.8 percent in 1976, and 5.6 percent in 1977. This year and next are supposed to be years of recovery from a very deep recession and the recovery you forecast is sluggish, very sluggish. Secretary Simon said yesterday he thought it was too sluggish and that the economy would do better, in his judgment. I might also point out that we have had much more rapid recoveries in the first year or two following recessions. Why do you forecast such a miserable, slow, sluggish recovery?

Mr. LYNN. First of all, you used the word forecast.

Chairman PROXMIRE. You do in 1976.

Mr. LYNN. Well, because when you look at our overall situation, when you look at the amount of stimulus that the economy can not afford to take without killing the patient with kindness, I use the example, taking aspirin is good for a headache, but if you take a whole bottle you know what happens to you.

That this was our best forecast at the time for calendar year 1975 and 1976.

Now when you get out beyond that, as I say in my testimony, these are simply projections, trend lines, that you are really building from GNP.

Chairman PROXMIRE. What you have just said indicates the President's program is not enough, it just would not provide enough recovery. You just say that as you look at the present outlook under the present circumstances with the present policy we are going to get this kind of very high unemployment, very far short of our potential, producing far less than we should, because the President's program is not doing the job does not that mean that we need more, we need to do more, we need a more stimulative program?

Mr. LYNN. It certainly does not mean that at all. In fact, I have been rather interested in seeing the projections to the extent projections are made by the various people that are working on this in the Congress.

They do not show even with quite a bit of additional stimulus, that worries me. You indicated earlier when you get up to the \$70 billion range you are getting into a danger zone by way of financial markets, by way of recovery, housing, whatever it may be, and by way of implications for longer-term inflation.

When I look at the estimates to the extent we are on given comparable figures from various groups working on the Hill and, it is not in this kind of detail, I might say generally, generally, it is not, in some quarters we get it, I do not see much better predictions up here. We are just trying to be honest about it.

Now, as far as what it means as to the 1976, 1977, and 1978, I always have to repeat based on prior economic forecasting you would like to hope that these figures are going to be wrong, but it is going to be better than this. As we say again with candor in our statement, we assume for those figures a $6\frac{1}{2}$ percent annual real GNP increase each year as an average out there and that is highly optimistic, as I also say in my statement.

If you look at any nonwartime period in our country, those figures would be high. Now how do you get from here to there? I had one figure given to me to get the unemployment rate down to 6 percent in 1976 it would take \$85 billion more of stimulus.

Chairman PROXMIRE. I hope you took a look at what this committee has recommended. We have an alternative proposal which would get us to the level of potential GNP more rapidly, we would not have a growth of $6\frac{1}{2}$ percent in 1980, we do not want it in 1980, we want to grow more rapidly in 1975 and 1976, and when we have these very large pools of unused resources, both manpower and factory capacity. We think that now is the time to move ahead. Our program would achieve that. I would hope that you and the President would take a look at that.

Mr. LYNN. We most certainly will take a hard look at the work of this committee, Mr. Chairman. I will point out, if I understand the report correctly, that you were anticipating some or that the proposal was for \$34 to \$38 billion more in spending and tax cuts for 1976 than is provided in the President's budget. But then by estimating stimulus effects of that extra \$34 to \$38 billion you increase the net deficit for 1976 budget only \$16 to \$18 billion over the President's—

Chairman PROXMIRE. You are looking at higher receipts.

Mr. LYNN. Yes; but I am saying to you when we work those numbers through the models and the rest, without knowing more as to your assumptions, at least, we do not see how you can have that kind of an offset of the revenues. The reasonableness—

Chairman PROXMIRE. This is a council of defeat. This means that the President cannot solve the problems. This means, it seems to me, that we ought to give far more consideration to a program that would put us on a path toward reaching our potential more rapidly.

Mr. LYNN. All right, Mr. Chairman, you said a little earlier in the day that you believed that \$70 billion gets you over into a dangerous area. With respect to deficit—

Chairman PROXMIRE. I said above.

Mr. LYNN [continuing]. If we look at the Joint Economic Report you are most surely there and above it. You are at \$52 billion plus \$18 billion. You are at 70 right there even if you take your very optimistic forecast that that report has on the amount of feedback by way of what the stimulus produces in revenue, and if you are wrong on that statement you have got a deficit of upwards of around \$80 billion, and as I have said often, if you are wrong it will be too late to do anything about it because you will have choked off the recovery in the form of higher interest rates and we never will get out of this recession in the foreseeable future. This is kind of like approaching the edge of the cliff, once you are off and start falling you can see you were a little too high but it is not going to do you any good.

Chairman PROXMIRE. There are no magic numbers here.

Mr. LYNN. I have said that for a long time.

Chairman PROXMIRE. We say 70. There is no notion that with \$70 billion you are off the cliff. When you have this kind of colossal unemployment, much higher, as you know, in March than it was in February, we will have a report on that in half an hour, a big increase. We have as I say an opportunity to use our resources more extensively with some stimulus. We want to use that deficit to put us back on a path of recovery.

Now, I did say, and I would stand by it, that \$70 billion is about as high as we want to go, \$60 billion, and \$70 billion is a difference there. And that additional stimulus we think would be desirable and useful to provide more jobs, more rapid recovery.

Mr. LYNN. I would—

Chairman PROXMIRE. Put our economy in operation more swiftly.

Mr. LYNN. [continuing]. I would point out to you, Mr. Chairman, if the Congress does nothing you are at \$70 billion. By that I mean if the Congress turns the other way.

Chairman PROXMIRE. We are going to cut defense spending by at least \$5 billion or closer to \$7 billion. We are going to cut foreign aid spending by \$1 or \$2 billion. There is a matter of priorities and there is a matter of our being able to do quite a bit and stay within the \$70 billion limit.

Mr. LYNN. I was going to point out that you have to add about \$12 billion to where we are.

Chairman PROXMIRE. Also energy proposal.

Mr. LYNN. Do what?

Chairman PROXMIRE. Reject the energy proposal in my view.

Mr. LYNN. That may be one way of getting the deficit down but I would not want to answer to the American people 2 years from now if there is another boycott as to what would happen in this country. I would not want that responsibility.

Chairman PROXMIRE. Well, we accept that responsibility. We think there is plenty of fat that we can live off of if we have to.

Mr. LYNN. In the amount of oil that we use in this country?

Chairman PROXMIRE. If we have to do it. It would seem to me the worst policy is to follow an energy program that is bound to increase unemployment and to slow the economy down. We can reject that.

Mr. LYNN. Well, I have been very interested in seeing the figures as they come out in that regard and I believe that that is more smoke than it is realism in that area, sir, with all deferences.

I think if you look at the President's energy package you will see that it does not have the kind of economic impact that some people have attributed to it. The President's proposal is one that would return to the American people the total amount of taxes that were taken out in the form of the tariffs, the \$2 tax on the oil, and so on, and certainly now that Congress has given a tax cut, much larger than the President had proposed, at least larger than the President proposed, you have even more room in there with respect to adoption of the President's energy package.

Chairman PROXMIRE. The President's energy package would (a) be inflationary and (b) would widen the recession.

Let me say before I yield to Mr. Long, because my time is up, that our estimates of the favorable effect of our program really are conservative. We made them carefully, several ways, we have had them independently simulated by outside experts and they agree.

Mr. Long.

Representative LONG. Thank you, Mr. Chairman.

On table 1, Mr. Lynn, of your prepared statement, you list categories as a percentage of the total budget. In 1956, natural resources, environment and energy constituted 1.5 percent. In 1960, it went to 1.8 percent, in 1964 42.3, in 1968 it fell back to 2, and then in 1972 it was 2.2. Now, in the 4-year period being projected, it is only a 2.9 program. This suggests to me that in so far as a developmental program for energy is concerned, for 1976 you are really not considering a very substantive one during that period. Is that correct?

Mr. LYNN. No; that is not correct, Mr. Long. The first thing that I would point out is that that table 1 is percentage distribution of outlays. And therefore, when you have the very large increases that are brought about by growth in our domestic assistance programs, primarily, the slice of the totals represented by natural resources, environment and energy goes down.

As you know, our total expenditure level is a curve like this.

Now, secondly, I would like to point out its outlays, its not budget authority as far as our recommendation is concerned, and I believe if I can find it here we have a chart in the budget that shows a very dramatic increase in the program of the President for energy, and the President has said on more than one occasion, on many occasions, indeed that every dollar that we think can be usefully spent on energy programs to obtain energy self-sufficiency will be spent. It has to be one of our highest priorities in this country.

Representative LONG. In that regard, if you go to your table 3, and look at the same item, which is natural resources, environment, and energy, actual 1974 went from \$6.4 billion to \$9.6 billion in 1975,

then you estimate it to \$10.2 billion in 1976. That is an estimate given. So you say there is fairly substantial increase in dollars?

Mr. LYNN. And that is outlays again, because as you know, particularly in research, in this kind of area, as you move from research to prototype to demonstration, to on stream, you may sign up now this year and the actual means from that kind of budget authority now really gets expended 2 years out. I think if you look at the energy alone on page 342 of the budget, do you have the budget itself?

Representative LONG. I do.

Mr. LYNN. Look at the budget authority, in the item that says energy, it shows \$709 million, 1974 actual, \$1.9 billion in 1975, almost \$2.5 billion in 1976. I think that gives you a more accurate reflection of the priority that is given to this item.

Representative LONG. I think the point is well taken that there is a substantial increase in the number of dollars here over that period of time.

Let's return to the philosophical considerations of the free enterprise system. You are very aware that the development of coal gasification, the development of crude oil from shale, and the tertiary methods of energy recovery, are extremely expensive, relatively speaking.

If the Government sets a price base for oil recovered from those expensive methods of producing oil, what would be your view on that with respect to the relationship of the free enterprise system and the government's ability to help provide the great capital investments that are going to have to be made here?

Mr. LYNN. I would not foreclose that point, Mr. Long. It depends on the priority that you give to this particular area. The President has asked as part of his energy proposal for flexible authority with respect to this kind of thing. It would include the authority to enter into contracts with people that are willing to tackle this kind of a problem, gasification, for example, so that they were assured that there would be enough cash flow that they would not go broke at the end given what the current prices of competing fuels or fuel sources would be. It is a device that has been used in the private sector as a financial tool for a long time.

When I practiced law we had a thing called the throughput agreement where the coal company or as a matter of fact coal slurry would enter into an agreement to take so much of the product and it was called a take or pay agreement. Whether you took the product or not you paid for it. That enabled, with that contract from good credit sources, they were able to go to the bank and borrow the money to build the pipeline. What we are saying here is this is one of our high priorities and if they look like they have real promise this is one tool that can be used. Whether or not it should definitely be used, I would like to ask the experts. But certainly that tool should be there to be used assuming that that looks like a practical efficient way to learn more about those production techniques and as against a day when those costs, looking at the efficiency that may be achieved, are not too unfavorable in relation to other costs.

One of the things that has happened with fuel cost going up, largely because of the cost of imported fuel, but also our gas prices,

has been some of the technology that looked less attractive even 3 years ago is looking more attractive today.

Representative LONG. Thank you.

Chairman PROXMIRE. You say in your prepared statement, with respect to the forecast for 1975 and 1976, "we know the direction in which to move and the range of speeds that are safe." Are you saying that for the economy to be growing at a faster rate than 4.8 percent this year and 5.6 percent next, and reducing unemployment below 7.5 percent for 1977 would be unsafe? I grant that you and your predecessors have had a lot of experience with recessions, but as far as recoveries go how do you know what the safe range of speeds are? How did you make that determination?

Mr. LYNN. We also have some experience at least in my own time that I have been in government with recoveries, to, Mr. Chairman.

Chairman PROXMIRE. That was before you became associated with me.

Mr. LYNN. Well, we would go into that one way or the other. I found the relationship a very interesting one. Let us put it that way. But what we are saying is I think two things.

If you read the next sentence it says we also notice that conditions will change and require adjustment in both directions and speed. Let me elaborate a little more.

I have to agree with you totally that no one knows for certain what the fail safe line is as to the amount of stimulus you can give before it becomes counterproductive in terms of short-term capital markets or in terms of long-range inflation. No one knows that for sure. But what I am saying is we have applied in this these estimates and in the forecasts the economic assumptions and in the budget and the programs of the President the best judgment we can as to how much stimulus we can safely afford to put into the economy and still have it be counterproof.

Chairman PROXMIRE. Here is the problem on the basis of the experience of other industrial countries. This is an extraordinarily high rate of unemployment compared to any of the European countries, Japan, any other comparable country. Comparing it with our own history since the end of World War II, of course, we can not compare it with the Great Depression because the situation has changed enormously since then. But any previous experience we have had, 7½ percent is a very, very high level of unemployment. As I pointed out our recoveries in the past have at times been swifter than you are forecasting here. So for all of those reasons it seems to me this is far too little a program to do the job that we must do to get this country moving.

Mr. LYNN. Mr. Chairman, first of all, whether you are talking to the President of the United States or to me or to other advisers to the President of the United States, we want to get that unemployment figure down just as fast as possible. The suffering that is involved in this kind of a figure, the disruptions of families, the dampening of hopes and dreams of people in fact, even the things that they own is a real tragedy.

Chairman PROXMIRE. Let me say one more thing because I think this is something that goes to the heart of it with many people who are advising the President.

The potential of a free economic system is in danger by this. If you have unemployment for a couple of years at this level, you are going to get some very dramatic changes, it seems to me in the attitude of Members of Congress and the public. There is no coincidence that the Socialist Party and the Communist Party pull far higher votes in this country in a period of recession and depression and the kind of change which I am sure you and the President would strongly oppose are far more likely, if we permit unemployment to continue at this kind of rate.

Mr. LYNN. I am sure, sir, that you oppose them too. I am saying that you can promise too much. What worries me is that in the effort to help, in the effort to show that we care, we can put in a lot more stimulus. We can have committee by committee in the Congress, subcommittee by subcommittee, doing its own thing, to show that it cares in its own particular subcommittees or committees jurisdiction.

Chairman PROXMIRE. Why do you not realize 7½ is unsafe?

Mr. LYNN. Suppose you add another \$50 billion of borrowing to do something that dramatic, what do you think unemployment would be in this country a year from now? I am saying to you that you never would have a housing recovery, you never would have a real recovery at all, and if a miracle happened and you would be back in double-digit inflation within 12 months followed by an even worse recession.

Chairman PROXMIRE. In view of that response I want to take you into an area in which you are a true expert. You have had a great deal of experience, more than I think anybody in the executive branch, and more than most persons in the country in housing. This is an area where we can really do a job without a great deal of increased spending. You know and I know one of the great problems that we face in economic and budget matters is that the economists almost entirely want to deal with the macroeconomics and the big picture, shunning like the plague any detailed criticism of specific programs.

And both the budgetmakers in the agencies and in Congress almost never ask fundamental questions—is this program really needed, are there alternatives which would do the job better, could it be done better in the private sector.

Once a program has begun, it has a life of its own and goes on forever. What I am getting at is the fact they are not taking a look at what we can do in the housing sector to provide jobs.

Mr. LYNN. Congress has already spoken on this. You provided up to \$2,000 per home.

Chairman PROXMIRE. We have not already spoken. That is only a small part of it and only relates to a home under construction before March 26.

Mr. LYNN. It is \$700 million worth.

Chairman PROXMIRE. Well, I opposed that part of it.

Mr. LYNN. But it is now—

Chairman PROXMIRE. Let me point out you are releasing \$2 billion in the highway funds which creates only 125,000 jobs at a cost of \$16,000 a job.

Why not back our emergency housing bill. It meets all your requirements.

First, it turns on and it turns off on the basis of the unemployment level or on the basis of the private housing starts. So it is phased out automatically.

Second, for very, very small Government outlays—very big private sector outlays are induced.

Third, the cost per job is about \$450—instead of \$8,000 or \$9,000 for public service jobs and \$16,000 for highway jobs.

Fourth, unlike some programs, it meets real needs. It is not a leaf raking program or a marginal program.

Under these circumstances why not seriously study the program, the kind that has been passed by the House of Representatives. We are going to mark up that legislation, beginning Wednesday in the Senate Banking Committee.

We can have it on the floor within 2 weeks. With administration support it will go through and be enacted into law and beginning in May we can put people back to work very substantially. We estimate that at least a million jobs at a cost of below \$1 billion to be put into effect with this program and the effect of the budget would be to reduce the deficit because the stimulus to the economy would be so much greater than the cost of the program.

Mr. LYNN. Let me just say, first that you make this strong statement with respect to housing. As members of the administration, including myself, go before each committee of this Congress we hear exactly the same thing claimed for their programs, whether it is public works programs—

Chairman PROXMIRE. For?

Mr. LYNN. Whether it is a public works program for \$5 billion, whether it is an assistance to State and local governments.

Chairman PROXMIRE. There is not a program that can come close to this in terms of the minimum cost to the budget in terms of the enormous amount of leverage that you get here. There is no program for less than \$1,000 and this is less than \$500 a job. You can get it down, because 95 percent as you know, you know very well 95 percent of the funding is in the private sector where there is a discipline.

Mr. O'NEILL. Senator, I think it might be useful if you would inquire of the Director of the Congressional Budget Office whether that office would support the claim of induced employment you have just cited for your program.

Senator PROXMIRE. Since Mrs. Rivlin has been called on by OMB—

Mrs. RIVLIN. That is an unfair question. I do not have a staff to make those assessments. That is the kind of thing we will be looking at in the future.

Mr. LYNN. The more I get into claims of employment for one program or another the more I realize that at least we know very little about it. I am inclined to think from talking to my friends on the staffs on the Hill they agree they know a little about it, people can take one set of figures or another and—

Chairman PROXMIRE. You are a housing expert.

Mr. LYNN [continuing.] Let me tell you one of the things I learned as a housing expert, to try to calculate what the substitution effect is on any subsidy program is almost impossible. How many net new housing starts will that program produce? No expert that I have talked to in my two years at HUD or since has been able to give me any good figures as to how many of those homes would be built anyway. We have money flooding the bank into the savings and loans, the interest rates have been coming down in this connection. We have had some modera-

tion of the rate of inflation in the housing and the cost of land, goods such as lumber that is used to produce it, we see some signs that this thing is going to turn around and turn around shortly.

Chairman PROXMIRE. You have been looking around the corner now for 2 years; almost as long as Herbert Hoover did. Prosperity is always just around the corner. It never shows up.

Mr. LYNN. The only thing I am staying, Mr. Chairman, is that I see all of these figures thrown around and I ask one basic question, what substitution rate are you assuming? What net incremental for housing are you going to get?

Chairman PROXMIRE. We have had for the last several months new housing starts below an annual rate of 1 million. You know how deplorable that is; 2.6 million housing starts is our annual goal. I have seen no estimate that without a change, substantial change in our housing policy, that we are going to get more than 1.4, maybe 1.5 million housing starts. With this program we can get a million in addition to what we have now. There is no reason why there should be a big drastic substitution effect here.

Mr. LYNN. Do you want to go from 1 million to 2 million in a 6 or 8 month period?

Chairman PROXMIRE. In housing, yes, indeed. We have the manpower available. We have had disclosed to us this morning that unemployment in construction is 18 percent. We have immense supplies of lumber available. We were operating at more than a 2 million rate, as you know, about 18 months ago or 2 years ago.

Mr. LYNN. Mr. Chairman, the only thing I would say again is to repeat, one, show me, show the President of the United States where those priorities are as judged by Congress as a whole, not by the Chairman of a particular committee. Show us how many billions he is going to get out of that \$30 billion that we refer to and Senator Muskie refers to.

What total amounts are you working within and then maybe we can consider the housing component on its own. But one of the things that scares me about this whole exercise, as I have said, no matter what committee we go before on the Hill these days, each one of them is saying it has got the best programs.

Now you may disagree but when I add up those figures it is \$30 billion-plus, and I do have to say respectfully on the housing side, I think it is just the wrong time.

Chairman PROXMIRE. It has always been the wrong time for you, Mr. Lynn.

Mr. LYNN. We have put out a fair amount of money you read about in the papers on Sundays and Saturdays and 7¾ percent, 8 percent money. Talking to some of the builders they say they see some revising of consumer confidence that there is more interest on the buy side. It would seem to me that this is not the time to add still another program. There are tools on the books. If we want to do more in this regard you can do it by way of more tandem assistance.

Chairman PROXMIRE. Here you are talking about a substitution effect and what I am talking about is the effect of having 70 percent of the American people not able to afford to buy a new home. The fact is when you have 8½ and 9 percent interest, 9 percent in most of the

country at the present time, on mortgage interest, that this cuts out of the market a very large portion of the people. The housing bill would get that down to 6 and 7 percent, that is we in the Senate would move forward. This opens up housing to hundreds and hundreds of thousands of families that otherwise are not in the market. It is not a substitution, it is an entirely new market at a very low cost. It is bound to reduce the deficit and also bound to —

Mr. LYNN. What is the runout cost?

Chairman PROXMIRE. You should be pounding a desk saying Mr. President, you have to go ahead with this program.

Mr. LYNN. What is the runout cost of your proposed cost, not first year?

Chairman PROXMIRE. We have triggers in this program.

Mr. LYNN. No, sir, you sign the credit the first year and that money continues because you have signed the credit for years out in the future, so you will be paying 4 or 5 years.

Chairman PROXMIRE. Take a look at the flexible mortgage rate that reduces runout cost very, very sharply. It goes to market within 6 years.

Mr. LYNN. What happens if the people cannot afford the extra interest payment at that point, do we get them in defaulted properties in HUD? What happens if the family in the fourth year cannot pay additional monthly payment on the mortgage, does he then default or does Congress now pass another law extending it for 3 more years or 5 more years?

Chairman PROXMIRE. This program recognizes that the mortgages are paid in money terms and as money income goes up.

Mr. LYNN. What if that particular family's income has not gone up that much?

Chairman PROXMIRE. They will be able to meet this increased costs. Furthermore, the housing bill has an option to buy at 7 percent which would be a longer term and would be established at 6 percent and would be flexible.

Mr. O'NEILL. Seven percent of the 30 year runout for the Federal Government, is that not correct?

Mr. LYNN. He can get 7 percent for 30 years.

Mr. O'NEILL. It seems to me two important things. One bears on Director Rivlin's testimony yesterday. I thought she made the case quite well. We come to the point where we cannot take individual committee actions and not pay attention to what that does to the total in response to Director Lynn's inquiry about the \$700 million that has been voted in the tax bill for housing. Your response was I voted against it. But that seems to me that does not make very much difference, it is a law of the land and, secondly, while I agree with Director Rivlin, she does not have a professional staff and, therefore, I must say I would be very impressed if you could find a professional economist who would stand up among their peers and be willing to say what you said about the stimulus that we could expect from the bill that has been passed by the House.

Chairman PROXMIRE. As I understand it, you indicated the Congress had not been responsible or has not made recommendations for reducing spending; is that right, did I misunderstand you?

Mr. LYNN. I did not say that. I said was what has me scared is that I have not seen as yet any overall plan adopted by the Congress of the United States as to what its totals will be, what its expected deficits will be, and the thing that is being urged upon us and that we perform on page 41, the economic assumptions that are behind those forecasts, so that if we care to disagree—

Chairman PROXMIRE. We have a great deal of that. I hope you do have a chance to take a look at it because I have in my hand the recommendations of the House.

Mr. LYNN [continuing]. That is a recommendation?

Chairman PROXMIRE. After all, we have not finished yet, we have not adjourned sine die. These are recommendations by the Budget Committee that is the way we proceed at this stage and the beginning. I think we are pretty far advanced in doing that and we see here a recommendation that the national defense be cut by \$7 billion, that national affairs, foreign aid, be cut \$1.3 billion. There are a number of reductions—natural resources, environment will be cut \$1.5 billion. I am talking about the cuts below the recommendations of the committees. An overall cut here of some \$30 billion. And comparing with the President's recommendations only a little above \$6 or \$7 billion above, little in terms of total amount involved. The President adjusted \$358 billion. The committee recommended \$366.

Mr. LYNN. Deficit is \$73 billion. And with a very healthy feedback effect for the extra stimulus which frankly at least based on the figures that we have been given to operate with, we do not have the benefit of the kind on page 41 that was given in the President's budget, but from the best we can tell, with a very, very much over optimistic view of the feedback by way of additional revenues, so a minimum of \$73 billion deficit by the documents, and in all probability something substantially more than that if the feedback figures were more realistic.

Now, having said that I welcome the work of the House and Senate Budget Committees. As I have said many times before, we will do everything in our power to help them with that work in any way we can because we want that process to work. But while they are working it seems other people are working in the other committees on their own track with their own bills, including things like the housing component tucked into the tax bill before the budget committees have even had a chance to go to the floor with their proposals. So we are getting the housing proposal. You are right it is passed the House of Representatives, it will be marked up in the Senate. We get a \$5.9 billion bill called an emergency employment assistance, although it is almost in every category in the book of additional spending, which is now in the Senate of the United States. We get a number of \$5 billion public works programs that you want to add on top of that. We see support for another \$5 billion going to the local communities. By the time the Budget Committees get to the floor you are going to be three-quarters of the way through if not all the way through a number of these particular programs.

Chairman PROXMIRE. I want to thank you very much for your testimony this morning. You are an extraordinarily articulate and vigorous witness and we appreciate very much what you have told us this morning. I am very disturbed, however, about the fact that it seem to

this Senator that you simply are relying on a rhetoric that is not substantiated.

More vigorous stimulation in your view would result in some kind of a horrendous double digit inflation at some vague time in the future. With all due respect what we have here today is the worst kind of defeatism with regard to the President and future unemployment. What you are saying is that this administration just can not cut mustard, you can not solve the problem of unemployment, you have no way to reduce unemployment to a reasonable level, next year, the year after, or in 1980. This Government is committed to a goal of full employment by law. We passed that law and you say we can not get there from here. You are in my judgment working toward an economy of high unemployment and sluggish growth. I cannot accept that. I want to help put America back to work, that is what the people want, and you have convinced me more than ever Congress has to take the initiative to do that.

I want to thank you, Director Lynn, for your answers this morning. You are a candid and open witness and although I disagree with some of what you say, I appreciate your honesty.

Mr. LYNN. Thank you, Mr. Chairman.

[Whereupon, at 11 a.m., the subcommittee adjourned, subject to the call of the Chair.]

