735

MONETARY POLICY AND ECONOMIC OUTLOOK

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BEFORE THE

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MONETARY POLICY AND ECONOMIC OUTLOOK

WEDNESDAY, MAY 21, 1975

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

The committee met, pursuant to notice, at 10:15 a.m., in room 5302, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senator Humphrey; and Representatives Long and Brown of Ohio.

Also present: John R. Stark, executive director; Richard F. Kaufman, general counsel; Lucy A. Falcone, Jerry J. Jasinowski, L. Douglas Lee, Loughlin F. McHugh, Courtenay M. Slater, and George R. Tyler, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. First, may I take the privilege on behalf of the Joint Economic Committee of thanking our witnesses for their cooperation, and their willingness to appear and counsel and advise us. We have Gerard Adams of Wharton Econometric Forecasting Associates; we have Albert Ando of the University of Pennsylvania; and Robert Parks of Advest Co.

Might I add that on the 4th day of June, we will have the Secretary of the Treasury, Mr. William Simon, who will share his thoughts with us on monetary policies and the pace of economic recovery.

This morning our witnesses have been asked to discuss the economic outlook and give special attention to the impact which monetary policy will have in determining the pattern of recovery from the present recession.

I regret that I did not bring with me yesterday's Washington Star which has a banner headline at the top of page 1 that says, "Corporate Profits Drop"—I believe it was 24.7 percent—"Recession Deepens." And then, the news of a reduction in production in real terms of a little over 11 percent.

The budgetary decisions which Congress has now taken give us a pretty clear picture of the course which fiscal policy may be expected to follow over the coming year. I quickly add, however, that that budgetary policy is subject to review, I believe, by Congress in September—between September and October. There is a reconsideration or review of revenues and outlays. The Chairman of the Federal Reserve Board has, for the first time, announced the monetary policy which the Fed intends to pursue. Are the monetary policy intentions of the Federal Reserve consistent with the fiscal policy decisions of the Congress? And I believe that is a very basic question because the Fed is an agent of the Congress.

Do the two, taken together, add up to a program which will support a strong and—I emphasize—sustained recovery from the present recession? None of us can be sure what the future holds. Nonetheless, expert judgments about what is most likely to happen can be of great value, and that is what we hope to get here this morning.

If, in the judgment of the experts, there is still room for improvement in monetary or fiscal policy, then Congress must stay on the job until these improvements are made. The economic situation is too serious, the mistakes are too costly to allow us to tolerate any unnecessary mistakes.

This committee has already heard a good bit of testimony on monetary policy. In addition, as chairman of the committee, I have written to a large number of experts, asking their advice. However, all of our oral testimony and many of the written replies I have received were prepared prior to Mr. Burn's testimony before the Senate Banking Committee, in which he announced the Federal Reserve's monetary targets. Expert opinion on monetary policy is far from unanimous, but the definite preponderance of opinion among those that we have heard from, and those I consulted, was in favor of a more expansive monetary policy than the Fed subsequently announced.

Mr. Paul McCracken, who testified before this committee in the early part of the year testified at our annual hearings last February that an 8- to 10-percent rate of growth of the money supply would be needed.

I should also emphasize that most of the information that we get indicates that the major increase in what we call the money supply should be in the year 1975. There is an emphasis on what they call the up front economic stimulus.

Statements I have received on monetary policy more recently, include the following:

Mr. Eckstein of Harvard University:

> An accommodating monetary policy does mean that the money supply increase by at least 8 percent over the next 18 months.

Edward Gramlich, of Brookings:

> For two years or so, I would manage monetary policy so as not to let interest rates rise. This would entail rates of monetary expansion of about 10 or 12 percent over this time.

Robert Solow of MIT:

> Federal Reserve policy is now insufficiently expansionary. The notion of holding the growth of M_1 to an annual rate of 6 percent, while the hoped-for recovery is trying to push nominal GNP up at almost twice that rate, is madness.

That is a little more precise and distinctive statement than some of the others. Now, I could go on. In fact, for the information of our witnesses, and those who are attending this hearing, I placed most of these letters that we received in response to our questions in the Congressional Record so that they can be a matter of public notice.

I received statements from those who disagree. For example, Walter Hoadley of the Bank of America has written me that in his view, "the

Federal Reserve, after various aberrations, has been doing a superb job since the autumn of 1974."

And there are others that join in that expressed opinion, so the experts do disagree. It is not sufficient just to count noses and note that the majority seem to favor a more expansive policy. We in the Congress have the responsibility to analyze the arguments behind these statements, and then, hopefully, to have the ability and capacity to make up our own minds.

At the moment, I am certainly of the opinion that those who argue in favor of a more expansive policy are, at least in their statements, more persuasive. Think for a minute. To start bringing unemployment down at a reasonably rapid rate, real output needs to grow 8 or 9 percent over the next year.

I do not believe that there are very many people who disagree with that figure. In addition, even though the inflation rate has dropped rather dramatically, the rate of price increases is not going to be zero. It is more likely to be 4 or 5 percent. This means that the gross national product, measured in current dollars, needs to grow 12 or 13 percent over the next year—8 or 9 percent to allow for real output growth, and 4 or 5 percent to cover price increases. I do not see how that can happen with the money supply growing only the 5 to 7.5 percent at which the Fed is aiming.

So we are asking witnesses this morning, and we shall ask others, either to explain to us how a 5- to 7½-percent growth in the money supply can support a much higher growth of output, or else to suggest alternative targets, either for the money supply or for economic growth.

Our panel of witnesses today brings a wealth of expertise to this committee. And as I said before, I am most grateful that you have agreed to testify this morning. I hope that we will keep in mind that the problem of unemployment in this country is now becoming of major proportions, to a point where it could be an economic disaster. It is not remedying itself. The information thus far is not at all encouraging, and I, for one, think that the rate of unemployment which we presently have, and the rate which is projected for the next few years, is totally unacceptable.

I have to say what I said yesterday. That we seem to have, really, no effective policy to combat the high cost of unemployment, both to the budget on the one hand, and to the economy on the other.

Our first witness will be Mr. Gerard Adams of the Wharton Econometric Forecasting Associates. Mr. Adams has testified before us several times in the last few years, and we all have acquired a great respect for his ability as a forecaster and for the quality of his advice on questions of policy. And I believe he has a pretty good record, so it is a pleasure to welcome him again.

Our second witness will be Mr. Albert Ando, professor of economics at the University of Pennsylvania. Mr. Ando is also a well known, widely respected economic forecaster with particular expertise in the area of monetary policy.

The final member of this morning's panel—and we shall ask you to proceed as a panel, and then we shall question you—is Mr. Robert Parks, chief economist for Advest Institutional Services in New York. We are pleased to have Mr. Parks here, not only because he is well known and highly competent as an economic forecaster, but also because we hope that he can give us some insight into Wall Street attitudies toward the economy.

Mr. Adams, please go ahead with your statement. We will hear statements from each witness—as I have indicated—and then turn to the questioning and discussion.

Thank you.

STATEMENT OF F. GERARD ADAMS, ASSOCIATE, WHARTON ECONOMETRIC FORECASTING ASSOCIATES, AND PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA

Mr. ADAMS. Thank you, Senator. I am pleased to be here. The objective of my statement is to tell you something about our analysis of the impact of monetary policy on the economic outlook, using the Wharton model. Summarizing very briefly, the results of these calculations suggest that we should aline ourselves with those experts who favor an expansive monetary policy.

The latest Wharton forecast for the U.S. economy is guardedly optimistic. As many others, we are predicting a turnaround of economic activity, with moderate recovery at annual rates of 5- to 7-percent later in 1975, and throughout 1976.

Incidentally, attached to my statement are three summary tables. You may want to refer to them as I speak. The first one is what we call our control forecast. It is the latest forecast that we have presented to Wharton EFA members, dated May 1. Alternative one is a summary of a forecast assuming a 7½-percent rate of growth of money supply, and alternative two is a forecast which assumes growth of money supply of approximately 5 percent.

Chairman HUMPHREY. The first one is at what rate?

Mr. ADAMS. The control forecast is approximately 9- to 10-percent growth of money supply, which we assumed as reasonable, perhaps that is an optimistic word these days. At the time it seemed a reasonable measure of what the growth of money supply might be.

Chairman HUMPHREY. But that is on an annual basis averaged out over the year.

Mr. ADAMS. That is right.

The recovery, of course—the notion of a turnaround of economic activity—is based on that control forecast.

Another favorable dimension of the outlook in that forecast is that the inflation rate seems to be past its high water mark.

We are anticipating a much more modest inflation rate of 4 to 6 percent, far below last year's double digit inflation, though still high by historical standards. But, before I wax excessively optimistic, let me stress that there are still very substantial uncertainties in the economic outlook which are connected with the timing of the inventory readjustment, the potential further decline of business fixed investment, and the questions about the recovery of the greatly depressed housing industry.

And, unfortunately, the projected recovery begins from such a low level of production and from such a high level of unemployment, that economic activity will remain substantially below its full potential and that only modest improvement of unemployment can be anticipated over the forecast period which runs through the beginning of 1977.

Moreover, the prospects for economic recovery depend greatly on economic policy. The fiscal policy stimulus has now been put in place, and the issue of uncertainty that we face now is monetary policy. Let me say that we are convinced that money does matter. A look back at the consequences of last year's monetary tightness shows how great the impact of monetary policy can be. And money matters, not only in the past but also in the upswing of the cycle. It is important to provide sufficient liquidity to meet financial needs of consumers, investors, homebuilders, so as not to thwart their contribution to economic recovery.

The base forecast I have already indicated, assumes a growth of nominal GNP at the rate of 9 to 10 percent for the narrowly defined money supply, M_1, and approximately 11 percent for M_2. This is a little bit below the projected growth of nominal GNP, and consequently, it results in a gradual upward movement of the short-term interest rate to approximately 7½ percent toward the end of 1976.

But this increase does not stand in the way of substantial expansion of residential construction to approximately 2 million housing starts by the end of 1976.

Chairman HUMPHREY. Mr. Adams, would you excuse me just a moment. I have to help make a quorum in another committee, but I will be back in a very brief moment. But I want you to proceed, and Congressman Long will preside. And we have your statement, so we will be prepared to question.

I did not want to seem impolite, so please go ahead. I will be right back.

Mr. ADAMS. The other monetary policy alternatives can significantly change the picture of economic developments over the next 2 years. We have used the Wharton model to examine some alternatives in areas of slower monetary growth. The two alternative forecast simulations, which are presented below and which are attached, the first of these alternatives considers monetary growth at an average rate of some 7½ percent per year.

The second alternative assumes monetary growth at some 5 percent per year. And these, of course, are the limits recently proposed by Federal Reserve Board Chairman Burns.

It is clear from our analysis that such a policy stance is much too restrictive. We can look at some of the details, but I think this can be summarized very briefly by saying that the short-term rate would rise sharply to reach 10¾ percent by the end of 1976. In the 7½ percent money growth solution, in the 5 percent monetary growth solution, we see a bill rate that eventually rises to as high as 13 percent.

In the Wharton model, the short run real impact of this monetary policy is not as pronounced. And my feeling is that the Wharton model responds to money supply, but it is a perfectly reasonable thing to argue that the impact of monetary tightness may be more severe than the one which we show. If the model errs, it errs in the direction of too small a real impact.

But in fact, tight money does have substantial real impacts. And that impact would be more pronounced if we looked out beyond the forecast horizon—1975 and 1976—which is being considered here. An upsurge of interest rates would threaten the recovery of residential construction, and would tend to undermine business fixed investment. This is the real meaning of the term, crowding out.

By the end of 1976, slow monetary growth would reduce real GNP by approximately 2 percent as compared to the base forecast. The impact would be considerably more pronounced in 1977.

Inflation, of course, is a serious concern for policy. Fortunately, as I have said earlier, the inflation outlook is now somewhat improved.

The question is, what will be the impact of slow monetary growth on the inflation rate? Our calculations show little effects. Indeed, the inefficiencies related to operating well below the economy's optimum operating rate would tend to increase unit labor costs, and would tend to exert upward pressures on the price levels.

So, I want to conclude by saying that slowing the growth of money supply is not an effective counterinflationary tool in the present context.

[The prepared statement of Mr. Adams follows:]

PREPARED STATEMENT OF F. GERARD ADAMS

The latest Wharton forecast for the United States economy is guardedly optimistic. We are predicting a turnaround of economic activity around mid-year with moderate recovery at annual rates of 5 to 7 percent later in 1975 and throughout 1976. (The principal dimensions of the "control" forecast and of the alternatives are summarized in the tables attached.) Another favorable dimension of the outlook is that the inflation rate is past its high water mark. We are anticipating a much more modest inflation rate of 4 to 6 percent, far below last year's double digit inflation though still high by historical standards. But there are still substantial uncertainties connected with the readjustment of inventories, the decline in business fixed investment, and the recovery of the greatly depressed housing industry. And, unfortunately, the projected recovery period begins from such a low level of production and from such a high level of unemployment, approximately 9 percent, that economic activity will remain substantially below its full potential and that only modest improvement of unemployment can be anticipated.

The prospects for economic recovery depend greatly on economic policy. Fiscal policy stimulus has now been put in place but great uncertainty remains with regard to monetary policy. Money does matter. A look back at the consequences of last year's monetary tightness shows how great the impact of monetary policy can be. Money also matters at present, in the upswing of the cycle. It is important to provide sufficient liquidity to meet financial needs of consumers, investors, and homebuilders so as not to thwart their contribution to economic recovery.

One way to see whether the economy is obtaining sufficient liquidity is to consider the growth of money supply (preferably a broad money supply concept like M2) in relation to the expansion of nominal GNP. A rate of monetary expansion corresponding to the growth of nominal GNP, some to 12 percent per year, will assure a growth of monetary means in line with requirements. Looking at the other dimension of the money market, interest rates, such a rate of monetary expansion would permit short term rates to remain near their current levels and would permit gradual decline of long term rates. Our base forecast envisions growth of money supply only a little short of the growth of nominal GNP, a rate of 9 to 10 percent for M1 and approximately 11 percent for M2. This results in a gradual upward movement of the short rate to 7¼ percent to 8 percent toward the end of 1976 but does not stand in the way of substantial expansion of residential construction to approximately 2 million housing starts.

Other monetary policy alternatives can significantly change the picture of economic developments over the next two years. We have examined some alternative scenarios of slower monetary growth in two alternative forecast simulations presented below.

Alternative 1 considers growth of money supply at approximately 7½ percent annually and Alternative 2 assumes monetary growth at 5 percent per year. These are, of course, the limits of the brackets for monetary growth of 5 to 7½ percent recently proposed by Federal Reserve Board Chairman Burns. It is clear from our analysis that such a policy stance is too restrictive. Short term rates would rise sharply to reach 10¾ percent by the end of 1976 in the 7½ percent money growth solution. In the 5 percent money growth solution, the bill rate goes to an incredible 13 percent.

The impact on real output would be less pronounced in the short-run. But tight money now would have substantial real impact extending beyond the forecast period of 1975–76 examined here. An upsurge of interest rates would threaten the recovery of residential construction, and would undermine business fixed investment. This is the real meaning of "crowding out". By the end of 1976, slow monetary growth would reduce real GNP by approximately 2 percent, as compared to the base forecast. The impact would be considerably more pronounced in 1977. A tightening of monetary policy at this time would prolong what is already the longest lasting and deepest recession of the post-war period.

Inflation is also a serious concern for policy. Fortunately, the inflation outlook is somewhat improved, as we have noted above. The slow monetary growth alternatives show little improvement in the inflation rate. Indeed the inefficiencies related to operating well below the economy's optimum operating rate tend to increase unit labor costs and to exert upward pressures on the price level. Slowing the growth of money supply is not an effective counter inflationary tool in the present context. As we look ahead, toward a return to full employment, we must consequently look for other means to prevent a resurgence of inflationary pressures.

CONTROL FORECAST—MAY 1, 1975: PREMEETING CONTROL SOLUTION

WHARTON MARK IV QUARTERLY MODEL

TABLE 1.—SELECTED MAJOR ECONOMIC INDICATORS

Item	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1977.1	1975	1976
Gross national product	1,419.2	1,436.7	1,472.0	1,515.2	1,564.9	1,616.0	1,666.6	1,723.2	1,774.6	1,460.8	1,642.7
Percent change, gross national product	−3.23	5.03	10.19	12.27	13.77	13.71	13.13	14.31	12.45	4.53	12.45
Real gross national product	782.3	780.8	791.4	601.7	517.1	632.3	646.4	861.5	875.2	789.1	839.3
Percent change, real gross national product	−10.37	−0.74	5.54	5.30	7.91	7.66	6.93	7.31	6.55	−3.91	6.37
National income	1,150.0	1,162.0	1,193.0	1,233.0	1,277.6	1,322.1	1,365.4	1,414.1	1,457.2	1,184.7	1,344.8
Personal income	1,193.0	1,215.6	1,241.2	1,273.0	1,305.1	1,342.6	1,386.4	1,432.1	1,471.1	1,230.7	1,366.6
Implicit price deflator—GNP	181.4	184.0	186.0	189.0	191.5	194.1	196.9	200.0	202.6	185.1	195.7
Percent change, implicit GNP deflator	7.96	5.83	4.40	6.63	5.43	5.62	5.80	6.52	5.54	6.73	5.70
Implicit price deflator—Private GNP	174.3	176.8	178.8	181.3	183.8	186.5	189.3	192.1	194.6	177.8	187.9
Percent change, private GNP deflator	7.71	5.90	4.56	5.76	5.74	5.94	6.11	6.09	5.79	8.78	5.71
Percent change, Consumer Price Index	7.46	4.39	5.21	4.93	4.66	5.08	5.10	4.86	4.60	8.16	4.91
Percent change, Wholesale Price Index	−0.08	1.07	2.21	2.13	3.31	2.46	4.28	4.26	4.87	7.58	2.83
Private output per man-hour	5.79	5.85	5.93	6.00	6.08	6.14	6.19	6.23	6.25	5.89	6.16
Percent change, private output per man-hour	7.16	4.03	5.95	4.59	5.38	4.34	3.11	2.49	1.83	1.58	4.58
Private compensation per man-hour	5.81	5.92	6.02	6.14	6.27	6.40	6.53	6.67	6.81	5.97	6.47
Percent change, private compensation per man-hour	11.95	7.57	6.83	8.10	9.07	8.43	8.55	8.55	8.96	9.26	8.30
Unemployment rate (percent)	8.35	9.10	9.23	9.09	8.60	8.07	7.57	7.08	6.60	8.94	7.83
Net exports, current dollars	5.4	5.4	5.9	5.3	4.5	2.2	−2.1	−4.5	−5.7	5.2	5.8
Money supply—M1	284.3	288.6	294.7	301.1	308.5	315.9	323.8	331.7	339.4	292.2	320.0
Percent change, money supply—M1	1.23	6.09	8.76	8.98	10.26	9.86	10.38	10.12	9.70	4.77	9.51
Money supply—M2	621.5	637.8	656.3	673.9	691.3	708.5	727.5	745.2	762.3	647.4	718.1
Percent change, money supply—M2	6.45	10.95	12.08	11.19	10.74	10.34	11.06	10.20	9.49	8.47	10.93
3-mo Treasury bill rate	5.75	5.23	5.21	5.96	6.59	6.94	6.65	7.59	8.01	5.54	6.94
Corporate AAA utility bond rate	9.23	9.46	9.04	8.56	6.59	8.63	8.47	8.38	8.34	9.07	8.52
4–6-mo commercial paper rate	6.56	5.82	5.68	6.25	6.93	7.36	7.21	7.87	8.42	6.08	7.34
Moody's total corporate bond rate	9.39	9.52	9.42	9.17	9.03	8.96	8.86	8.76	8.68	9.38	8.90
Personal savings rate (percent)	7.35	9.86	10.59	9.56	9.23	9.18	9.24	9.24	9.00	9.34	9.22
Corporate profits before tax	100.1	101.3	116.3	129.1	145.5	158.1	168.5	177.9	184.9	111.7	162.5
Federal surplus, NIA basis	−54.9	−94.3	−107.8	−87.4	−75.0	−69.5	−68.0	−66.0	−57.9	−86.1	−69.6

ALTERNATIVE 1—MAY 20, 1975: ALTERNATE WITH 7.5 PERCENT MONEY SUPPLY GROWTH

Gross national product	1,419.2	1,435.7	1,470.9	1,513.3	1,561.6	1,608.7	1,653.7	1,704.2	1,749.4	1,459.8	1,631.1
Percent change, gross national product	—3.23	4.73	10.17	12.06	13.39	12.62	11.65	12.80	11.05	4.46	11.80
Real gross national product	782.3	780.0	790.5	800.2	814.7	827.6	828.3	849.7	860.0	788.3	832.6
Percent change, real gross national product	—10.37	—1.1	5.50	5.00	7.45	6.44	5.26	5.60	4.90	—4.01	5.62
National income	1,150.0	1,161.0	1,192.7	1,231.3	1,274.6	1,315.3	1,353.4	1,396.6	1,434.6	1,183.7	1,335.0
Personal income	1,193.0	1,215.3	1,241.2	1,273.2	1,305.7	1,342.8	1,385.0	1,429.3	1,466.8	1,230.7	1,365.7
Implicit price deflator—GNP	181.4	184.1	186.1	189.1	191.7	194.4	197.3	200.6	203.4	185.2	196.0
Percent change, implicit GNP deflator	7.96	5.97	4.42	6.72	5.53	5.80	6.06	6.82	5.86	8.76	5.84
Implicit price deflator—Private GNP	174.3	176.8	178.8	181.4	184.0	186.7	189.6	192.5	195.4	177.8	188.2
Percent change, private GNP deflator	7.71	6.04	4.58	5.85	5.83	6.10	6.34	6.34	6.08	8.82	5.84
Percent change, Consumer Price Index	7.46	4.56	5.35	5.07	4.91	5.48	5.70	5.57	5.41	8.23	5.22
Percent change, Wholesale Price Index	—0.08	1.08	2.20	2.14	3.31	2.47	4.29	4.27	4.89	7.59	2.84
Private output per man-hour	5.79	5.82	6.92	5.98	6.06	6.10	6.13	6.15	6.17	5.58	6.06
Percent change, private output per man-hour	7.16	1.98	7.15	4.30	5.13	3.06	1.66	1.80	1.24	264 44	8.72
Private compensation per man-hour	5.81	5.92	6.02	6.14	6.27	6.39	6.52	6.65	6.79	5.97	6.46
Percent change, private compensation per man-hour	11.95	7.51	6.87	8.10	9.00	8.12	8.14	8.20	8.69	9.26	8.15
Unemployment rate (percent)	8.35	9.11	9.25	9.12	8.64	8.16	7.72	7.30	6.92	8.96	7.96
Net exports, current dollars	5.4	5.5	6.0	5.4	4.7	2.8	—1.1	—2.9	—3.7	5.2	6.2
Money supply—M1	284.3	288.1	292.8	297.7	303.1	308.4	314.0	319.7	325.3	290.8	311.3
Percent change, money supply—M1	1.23	5.40	6.74	6.88	7.40	7.17	7.42	7.48	7.23	4.26	7.06
Money supply—M2	621.5	636.9	653.3	668.7	683.0	697.1	712.3	727.1	741.6	645.1	704.9
Percent change, money supply—M2	6.45	10.32	10.67	9.80	8.85	8.52	9.02	8.56	8.19	8.09	9.27
3-mo Treasury bill rate	5.75	5.52	5.97	7.09	8.55	9.32	9.44	10.76	11.43	6.08	9.52
Corporate AAA utility bond rate	9.23	9.61	9.23	8.80	9.02	9.31	9.52	9.74	10.08	9.21	9.40
4-6 mo commercial paper rate	6.56	6.05	6.35	7.32	8.72	9.67	9.94	11.01	11.84	6.57	9.83
Moody's total corporate bond rate	9.39	9.58	9.54	9.34	9.31	9.41	9.56	9.74	9.31	9.37	9.42
Personal savings rate	7.35	9.85	10.63	9.64	9.38	9.36	9.46	9.50	9.98	9.46	9.50
Corporate profits before tax	100.1	101.0	115.8	128.4	144.3	155.2	163.5	171.0	176.7	111.3	158.5
Federal surplus, NIA basis	—54.9	—94.6	—108.4	—88.6	—77.2	—73.7	—74.9	—75.8	—70.7	—86.6	—75.4

CONTROL FORECAST—MAY 1, 1975: PREMEETING CONTROL SOLUTION—Continued

WHARTON MARK IV QUARTERLY MODEL—Continued

TABLE 1.—SELECTED MAJOR ECONOMIC INDICATORS—Continued

ALTERNATIVE 2—MAY 20, 1975: ALTERNATE WITH 5 PERCENT MONEY SUPPLY GROWTH

Item	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1977.1	1975	1976
Gross national product	1,419.2	1,435.7	1,470.8	1,513.0	1,559.3	1,605.0	1,648.5	1,697.3	1,740.1	1,459.7	1,627.5
Percent change, gross national product	—3.23	4.73	10.14	11.99	12.82	12.25	11.29	12.39	10.47	4.45	11.50
Real gross national product	782.3	780.0	790.4	800.0	813.3	825.3	835.0	845.4	854.2	788.2	829.8
Percent change, real gross national product	—10.37	—1.17	5.46	4.91	6.85	6.00	4.82	5.07	4.19	—4.02	5.28
National income	1,150.0	1,161.0	1,192.6	1,231.0	1,272.4	1,311.8	1,348.7	1,390.5	1,426.3	1,183.6	1,330.8
Personal income	1,193.0	1,215.3	1,241.2	1,273.4	1,305.6	1,342.8	1,385.4	1,430.1	1,468.0	1,230.7	1,366.0
Implicit price deflation—GNP	181.4	184.1	186.1	189.1	191.7	194.5	197.4	200.8	203.7	185.2	196.1
Percent change, implicit GNP deflator	7.96	5.97	4.44	6.75	5.59	5.89	6.17	6.96	6.03	8.77	5.90
Implicit price deflator—private GNP	174.3	176.8	178.8	181.4	184.0	186.8	189.7	192.7	195.7	177.8	188.3
Percent change, private GNP deflator	7.71	6.04	4.60	5.88	5.87	6.18	6.44	6.48	6.24	8.82	5.89
Percent change, Consumer Price Index	7.46	4.56	5.38	5.14	5.08	5.72	6.04	6.04	5.90	8.23	5.40
Percent change, Wholesale Price Index	—0.08	1.08	2.21	2.14	3.32	2.47	4.30	4.28	4.90	7.59	2.84
Private output per man-hour	5.79	5.82	5.92	5.98	6.05	6.09	6.11	6.14	6.15	5.58	6.05
Percent change, private output per man-hour	7.16	1.98	7.11	4.23	4.69	2.87	1.50	1.62	0.94	264.49	8.52
Private compensation per man-hour	5.81	5.92	6.02	6.14	6.27	6.39	6.51	6.64	6.78	5.97	6.45
Percent change, private compensation per man-hour	11.95	7.51	6.87	8.10	8.80	8.04	8.11	8.16	8.60	9.26	8.08
Unemployment rate (percent)	8.35	9.11	9.25	9.12	8.66	8.20	7.78	7.39	7.04	8.96	8.01
Net exports, current dollars	5.4	5.5	6.0	5.5	4.9	3.1	—0.6	—2.3	—2.9	5.2	6.5
Money supply—M1	284.3	288.1	292.0	295.7	299.5	303.3	307.4	311.8	316.1	290.0	305.5
Percent change, money supply—M1	1.23	5.40	5.54	5.15	5.30	5.17	5.50	5.83	5.68	4.00	5.34
Money supply—M2	621.5	636.9	652.6	667.0	679.8	692.4	705.9	719.4	732.8	644.5	699.4
Percent change, money supply—M2	8.45	10.32	10.25	9.12	7.89	7.60	8.04	7.85	7.66	8.00	8.51
3-month Treasury bill rate	5.75	5.52	6.17	7.69	9.72	10.98	11.63	13.30	14.29	6.28	11.41
Corporate AAA utility fund rate	9.23	9.61	9.25	8.89	9.26	9.75	10.23	10.78	11.41	9.24	10.00
4-6-month commercial paper rate	6.56	6.05	6.50	7.83	9.79	11.24	12.04	13.49	14.67	6.73	11.64
Moody's total corporate bond rate	9.39	9.58	9.55	9.38	9.43	9.67	10.00	10.43	10.95	9.47	9.88
Personal savings rate (percent)	7.35	9.85	10.64	9.68	9.43	9.44	9.59	9.68	9.53	9.38	9.54
Corporate profits before tax	100.1	101.0	115.8	128.3	143.3	153.7	161.7	168.9	173.9	111.3	156.9
Federal surplus, NIA basis	—54.9	—94.6	—108.5	—88.9	—78.4	—75.8	—78.1	—80.4	—77.1	—86.7	—78.2

Representative LONG [presiding]. Thank you very much, Mr. Adams.

Senator Humphrey said what we will do is that we will go ahead with all of the members of the panel.

Mr. Ando, would you please proceed.

STATEMENT OF ALBERT ANDO, PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA

Mr. ANDO. Thank you.

I have already responded to Senator Humphrey's inquiry in the form of a letter. I would like to start out by saying that I think that a fair amount of concensus exists among the analysts about the course of the economy for about an 18 months to 2-year period, and they all appear to expect the GNP in 1958 dollars to be around 860 by the end of 1976.

Now this appears to be a fairly vigorous recovery on the face of it, because current GNP is only about 780 or so. So it appears that the rate of growth of real GNP is over 6 or 7 percent over the next year and a half.

However, I would like to remind everyone that the gross national product in the fourth quarter of 1973 was 845. So that we are, at the end of 3 years, finally recovering to where we were 3 years earlier.

Now what is the implication of such a policy? Well, just let us look at the unemployment situation. Our productivity has declined enormously in the last year and a half. We are quite unsure what happened to productivity. We are reasonably sure that we will have productivity recovery, but suppose there is no growth in productivity over the 3-year period of 1974–76, and suppose, extremely conservatively, that the labor force growth only at about 1½ percent per year.

That would mean that the labor force must grow at about 4½ to 5 percent over the 3-year period. And since unemployment in the fourth quarter of 1973 was roughly 4.8 percent, the implication of reaching the real GNP of about 860 at the end of 1976 is that, at the end of the 1976 we will still find ourselves with roughly 9 to 10 percent unemployment rate.

I can go through any number of alternative calculations, but whatever the calculation you use, I think you will come up with this conclusion unless you assume that the productivity will continue to decline.

Now I do not believe that anyone would be happy to maintain a somewhat higher employment, or lower unemployment rate at the cost of lower and lower productivity in the future, so I do not think that our current recovery is, by any means, sufficient recovery. The whole fiscal and monetary policy ought to be in a farther expansionary direction.

However, let us take a look at the implication of the currently projected recovery leading to GNP of $860 billion by the end of 1976. Suppose that the fiscal policy is, indeed, more or less set by the recent tax reduction and expenditure programs. And let us see what kind of monetary policy it requires to get to this level of GNP. And I think that everything that has to be said has now been said. That what is really needed is to maintain interest rates at the more or less current level or lower for the next year to year and a half. And to do so, since the real GNP would be growing at 6 or 7 percent per year, and the prices cannot fail to increase at the less than 4 percent or so, even if we are extremely optimistic, money GNP must grow at the 12 or 13 percent. And the money supply growth, in order to maintain a reasonable level of interest rates, must be over 10 percent and cannot be anything like 5 or 7½ percent that Mr. Burns talks about.

We have a slightly different model than the Wharton model, and I have distributed this table. If you would refer to it, I have some alternative characterizations of the monetary policy. It contains four parts.

The first part shows more or less the forecast based on the current fiscal policy and the monetary policy that is accommodating in the sense that the monetary authority would be supplying whatever the money supply that is necessary to maintain roughly 6 percent short-term interest rates. This leads to the real GNP of roughly 860 by the end of 1976.

Alternatively, if you maintain 6 percent rate of growth of money supply, the real GNP will reach only 817 by the end of 1976. Unemployment showing roughly 10.2 percent and still rising rapidly at that point. If you go to a further extreme and maintain 5 percent rate of growth of money supply, then the result is shown in the fourth, and last part of the table, and the real GNP will essentially stay where it is now for the next 2 years. And the interest rate will rise to around 11 percent; unemployment will be close to 11 percent and rising rather rapidly at the end of 1976.

In all these experiments, the rate of inflation is roughly 4 percent, and the alternative monetary policy has very little impact on it. Now there are a number of divergent views on what pushes the prices up. But whatever the view we have—and I think the main difference among various people is whether or not an economist believes in the so-called Phillips Curve, which shows the relation between the rate of change of wages and unemployment.

Alternatively, one may believe in a concept called natural rate of unemployment, which is advocated by Professor Friedman. But whichever theory you believe in, I am reasonably confident that one has to come to the conclusion that so long as unemployment is much higher than some reasonable level—I would suggest, at this point, something like 5½ or slightly over as such a rate—any unemployment rate maintained higher than this rate, say, 6, 9, or 8 percent, is not going to make very much difference on the rate of inflation now.

If anyone wishes to pursue the matter, I am prepared to elaborate on it.

Representative LONG. Would you repeat that last thought, please.

Mr. ANDO. My proposition is that there is a rate of unemployment above which, if the rate of unemployment is much higher than that, it is not going to push the prices down any further than that. So at the rate of unemployment of let us say 6½ percent, you have a 4-percent inflation, you are not going to be able to buy lower inflation by pushing up unemployment any further than that.

So I think that it is perfectly safe as far as inflation is concerned to maintain the fiscal and monetary policy to push the unemployment rate down to something like 6 percent and at that point you can begin to discuss whether you wish to buy a further reduction in unemployment at the cost of somewhat higher inflation, or perhaps to initiate a variety of more microeconomic policies to reduce the unemployment and inflation. But microeconomic policy can certainly be pushed to reach the unemployment rate of much lower than it is currently prevailing down to, let's say, around 6 percent.

Furthermore, I believe that it is very important, as Senator Humphrey referred to it earlier, to have a very expansionary policy very, very soon and immediately so that we would push up the expansion very quickly now and then having gotten it started, then turn around the policy and try to reach, let us say, an unemployment rate of something like 6 percent very slowly rather than the usual pattern of starting very slowly and then gradually accelerating because if you reach the desired level of unemployment with an accelerating expansion, it is going to be very difficult to control the overshooting at that point. It is much more desirable to move very quickly and then turn around and try to reach the target more slowly at the end.

I would conclude with two remarks. One, with the question of why we have found ourselves in this rather difficult situation over the last 2 or 3 years and why are we needing so much fiscal stimulus to the economy to make a recovery and why is it that the monetary policy must be so expansionary for the next few months.

I think it would be easy to follow the argument if you translated what happened to the U.S. economy in the way of increases in food prices, increases in oil prices and the devaluation into the equivalent of having imposed a very large, indirect business tax on the U.S. economy. The total amount of such indirect business tax equivalent to oil price increases, the devaluation, and the fod price increases together is something between $40 billion and $70 billion. That is a very large tax that we have imposed on the U.S. economy.

Now if oil exporting countries bought a great deal of goods from the United States, then it is like the United States imposing a tax on itself and then expanding Government expenditure, and the net effect might be neutral. But oil exporting countries are not importing quite as much as they are collecting in revenues, and therefore have put on a very substantial restraining impact on the U.S. economy. One of the results of these external price increases is that we have had a very large price rise of all goods in the United States, and this, in turn, through standard, automatic stabilizer, increased the revenue of the U.S. Government. As a result, fiscal policy has become extremely tight. As an indicator of this tightness, we have been quoting the kind of numbers that I think the Joint Economic Committee staff people also came up with, something like full empoyment surplus of roughly $20 billion to $30 billion as of the fourth quarter of 1974, and therefore to offset that we need a substantial fiscal stimulus.

Also, in addition, when these external price increases are imposed on the U.S. economy, the Federal Reserve Authority last year absolutely refused to accommodate these externally induced price increases as a result of which the money supply is adjusted to either a much lower price level or much lower real output. Prices having gone up, we can slow the inflation but we cannot reduce the prices. We must now accom-

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modate that once and for all price rise by a once and for all increase in money supply to bring about the adequate money supply to finance the transactions need of the economy.

I think, finally, that if Mr. Burns wishes to pursue his policy, I really believe that he ought to be asked how it is that his announced intention of creating money supply of between 5 and 7 percent is consistent with any kind of a reasonable forecast of recovery that is expected during the next 1½ years. Does he really believe that a continual increase of velocity is consistent with a constant interest rate? I do not believe that any economist, monitarists or fiscalists, or whatever the label, would agree with the notion that a continual increase of velocity can be consistent with a constant level of interest rate. When the interest rate is raised, it must have depressing impact on the economy.

I wonder how Mr. Burns visualizes the economy working out satisfactorily with his policy, and I think that he ought to be asked to explain himself on that account.

Thank you.

[The table referred to by Mr. Ando follows:]

DIFFERENTIAL IMPACT OF ALTERNATIVE MONETARY POLICIES

	GNP in 1958 (dollars)		GNP deflator		Rate of change of compensation per manhour	Unemployment rate	Commercial paper rate	Rate of change of M1$	Federal Government deficit NIA account	Rate of change of output per manhour	Net exports current (dollars)	Corporate profits before tax plus IVA
	Level	Rate	Level	Rate								
A—Tax revision of March-April, 1975—Moderate monetary policy:												
1974: 4	803.8	−9.4	177.9	13.6	8.8	6.5	9.1	2.2	−22.8	−4.0	1.1	104.5
1975:												
1	782.6	−10.6	181.4	7.8	8.3	8.4	7.1	4.8	−46.1	−1.3	3.9	90.9
2	785.0	1.2	184.1	5.9	7.8	8.9	6.6	8.5	−83.5	5.9	5.4	105.4
3	799.6	7.5	186.1	4.4	7.8	8.8	6.6	14.7	−91.9	6.9	4.2	125.8
4	808.8	4.6	188.1	4.3	7.8	8.8	6.6	11.8	−87.6	3.7	−.7	132.2
1976:												
1	822.3	6.7	190.0	4.0	7.6	8.8	6.6	11.9	−75.0	5.4	.4	146.6
2	833.6	5.5	191.8	3.9	7.5	8.7	6.6	9.9	−75.8	4.0	−3.4	155.1
3	845.9	5.9	193.7	4.0	7.5	8.7	6.6	9.6	−82.3	5.0	−8.1	167.2
4	859.3	6.3	195.6	4.0	7.4	8.6	6.6	9.8	−82.5	5.1	−11.5	181.2
B—Tax revision of March-April, 1975—6 percent growth of M1$:												
1974: 4	803.8	−9.4	177.9	13.6	8.8	6.5	9.1	5.7	−22.8	−4.0	1.1	104.5
1975:												
1	782.7	−10.5	181.4	7.8	8.3	8.4	7.0	6.0	−46.0	−1.2	3.9	91.1
2	784.8	1.1	184.1	5.9	7.8	8.9	6.9	6.0	−83.6	5.8	5.5	105.1
3	797.1	6.3	186.1	4.5	7.7	8.9	8.5	6.0	−93.6	6.0	4.7	121.4
4	801.4	2.1	188.1	4.3	7.7	9.0	9.5	6.0	−92.7	2.2	1.1	119.9
1976:												
1	807.1	2.9	190.0	3.9	7.5	9.3	10.0	6.0	−85.6	3.3	4.3	122.0
2	809.8	1.3	191.7	3.7	7.2	9.5	10.0	6.0	−92.7	2.1	3.2	118.0
3	813.2	1.7	193.5	3.7	7.1	9.9	9.9	6.0	−105.6	3.2	1.3	118.1
4	817.9	2.3	195.3	3.7	6.9	10.2	9.8	6.0	−111.8	3.7	1.7	121.8

DIFFERENTIAL IMPACT OF ALTERNATIVE MONETARY POLICIES—Continued

	GNP in 1958 (dollars)		GNP deflator		Rate of change of compensation per manhour	Unemployment rate	Commercial paper rate	Rate of change of MI$	Federal Government deficit NIA account	Rate of change of output per manhour	Net exports current (dollars)	Corporate profits before tax plus IVA
	Level	Rate	Level	Rate								
C—Tax revision of March-April, 1975—7.5 percent growth of M1$:												
1974: 4	803.8	—9.4	177.9	13.6	8.8	6.5	9.1	5.7	—22.8	—4.0	1.1	104.5
1975:												
1	782.7	—10.5	181.4	7.8	8.3	8.4	7.0	7.5	—46.0	—1.2	3.9	91.1
2	785.1	1.2	184.1	5.9	7.8	8.9	6.6	7.5	—84.4	5.9	5.4	105.5
3	798.4	6.8	186.1	4.4	7.8	8.8	7.9	7.5	—92.7	6.3	4.4	123.6
4	804.9	3.2	188.1	4.3	7.8	8.9	8.7	7.5	—90.2	2.8	.2	125.6
1976:												
1	812.9	4.0	190.0	4.0	7.6	9.1	9.0	7.5	—81.6	3.8	2.7	131.0
2	817.6	2.3	191.8	3.8	7.3	9.2	8.9	7.5	—87.3	2.4	1.0	129.7
3	823.3	2.8	193.6	3.8	7.2	9.5	8.6	7.5	—98.5	3.8	—1.6	133.1
4	830.9	3.7	195.4	3.7	7.0	9.7	8.5	7.5	—102.7	4.4	—2.3	140.7
D—Tax revision of March-April, 1975—5 percent Growth of M1$:												
1974: 4	803.8	—9.4	177.9	13.6	8.8	6.5	9.1	5.7	—22.8	—4.0	1.1	104.5
1975:												
1	782.7	—10.5	181.4	7.8	8.3	8.4	7.0	5.0	—46.0	—1.2	3.9	91.1
2	784.4	.8	184.1	5.9	7.8	8.9	7.1	5.0	—83.9	5.6	5.6	104.3
3	795.3	5.6	186.1	4.4	7.7	8.9	8.9	5.0	—94.9	5.5	5.2	118.5
4	798.0	1.3	188.1	4.3	7.7	9.1	10.1	5.0	—95.2	1.8	2.0	114.6
1976:												
1	802.6	2.3	189.9	3.9	7.4	9.4	10.6	5.0	—88.9	3.1	5.5	115.4
2	804.3	.8	191.7	3.7	7.2	9.7	10.8	5.0	—96.5	1.9	4.8	110.1
3	806.6	1.1	193.4	3.7	7.1	10.1	10.8	5.0	—110.2	3.0	3.2	108.5
4	809.8	1.6	195.2	3.7	6.8	10.5	10.9	5.0	—117.4	3.4	4.1	110.3

Representative LONG. Thank you very much, Mr. Ando.
Mr. Parks, please proceed.

STATEMENT OF ROBERT H. PARKS, EXECUTIVE VICE PRESIDENT AND CHIEF ECONOMIST, ADVEST INSTITUTIONAL SERVICES

Mr. PARKS. Thank you. I am delighted to be here and should like to set out at the outset four overall conclusions and then fill in the detail.

I have passed out two essays, one entitled "A Chronology of Policy Failure," which incorporates in it my conclusions. The second essay is a detailed analysis of monetary policy.

The overall conclusions are, No. 1, this worst of all post-war recession was predictable. No. 2, it was manufactured in Washington. No. 3, the cost in lost output and employment is immense and unnecessary. No. 4, we still face the risk at this late stage that the administration will continue to overstate and misinterpret both the cause of inflation and its prospects, provide inadequate stimulus and cripple capital formation over the longer run, just as policies have killed capital formation cyclically.

Those are the four conclusions. Here are some pieces of evidence to support these conclusions. I would like to incorporate the first two together, namely that this recession, or this minidepression, I call it, was predicable and made in Washington way back there last summer and fall. There was enormous evidence then that this economy was headed into a major recession. One, the leading indicators were falling. They all fell down. I have always made a practice of deflating dollar series, particularly—using the economists' jargon—if "velocity" is quiet. I cannot find at that time any evidence that major sectors of the economy were poised to go on a major spending spree.

No. 2, forward investment commitments of major financial institutions were falling and falling rapidly, and deflated were falling at a faster pace than at any other time in postwar history.

No. 3, fiscal policy was already restrictive. Both state, local, and government expenditures in deflated or constant dollars were going nowhere. They were virtually flat and the full employment accounts, despite the difficulties with that concept, were in surplus the entire year.

No. 4, every monetary aggregate deflated was falling downhill. What is your preference—M_1, M_2, M_{16}, M_{18}, bank credit—they were all falling down.

No. 5, velocity, as I have indicated, was weak.

No. 6, special, brand new, unprecedented depressants were at work in this economy. High celestial oilprices served to divert buying power to fuel and away from other major sectors of the economy.

And No. 7, high food prices.

So there were seven forces at work at that time suggesting strongly by that the administration and the Federal Reserve together were pursuing one misguided policy of giant economic overkill. I am concerned right now that economic overkill may be replaced with inadequate stimulus. Or to put it another way, it appears to me that a wrong diagnosis was made. Yes, inflation was fierce but inflation was a product of food, special circumstances like oil. Inflation was a product of what was a furious cost-push, spillover, or carryover momentum of what was excess demand. But, in fact, excess demand was evaporating and evaporating quickly. The administration was, in effect, fighting the wrong war with the wrong tools at the wrong time. Cost-push was confused with demand-pull.

And so I repeat, this major, serious economic slide was predictable.

My third point: the cost in foregone output and employment has been immense and unnecessarily high. I made some calculations that indicate that in the years 1974 and (estimated) 1975, the lost production will approximate $200 billion. These are constant 1958 dollars. That, incidentally, was total national output in the year 1929; 1929 was not too bad a year.

But other objectives were lost, too. By making the wrong diagnosis, the administration lost about every objective they explicitly set forth. One, as you all recall, was that we were not supposed to have a recession at all, just a gradual slowdown. No. 2, we were supposed to have a balanced budget or something approximating balance. My own estimate is that the Federal deficit alone will approximate $75 billion this year.

In the main, that deficit is a consequence of economic overkill and a massive shortfall of revenues. I would dedicate the deficit to Mr. Simon, Mr. Burns, Mr. Greenspan, and Mr. Ford. I dedicate the deficit to all of them.

Another objective was lost. The Administration argued that its objective was to transfer resources from Government and consumption to capital formation, to plant and equipment expenditures. But you see, by killing consumption, what they succeeded in doing is killing the derived demand for capital. After all, the U.S. economy is two-thirds consumption. I do not know of any way in all of this world that you can get a vigorous growth of capital formation without a thoroughly vigorous growth of consumption.

The demand for steel, the demand for labor, the demand for basic resources, the demand for capital plant and equipment, are derived from the demand for housing, the demand for major appliances, the demand for construction generally.

Now there is another problem that grew out of this and it is not just the deficits at the Federal level.

I work in New York City, and what is the problem with New York City, or Newark or Philadelphia or other major cities around the country? A very large part of their problem, reflecting major recessions, reflecting major shortfalls of revenues, was manufactured in Washington. I am not suggesting that economy may not be useful at the local level. But I certainly would emphasize as strongly as I can that the difficulties our major cities face are in large measure a consequence of economical overkill manufactured in Washington.

Now where are we headed? I have argued for some time that the U.S. economy was facing a major cyclical decline with a turtle pace of recovery, given the present policies. I call this a skewed soup bowl.

Chairman HUMPHREY [presiding]. What?

Mr. PARKS. Soup bowl profile. That means that you go into it quickly and deeply and briskly but you have some difficulty getting out of it. I might suggest that the skewed soup bowl profile is in mighty conflict with what I think may be an emergent consensus of economists to the effect that we face a "V" recovery. In other words, we come out of this almost as quickly as we went into it.

Now what are the forces at work that persuade me, at least that this economy is going to have difficulty recovering at a satisfactory pace and that even if it does recover at a very brisk pace, I do not see any hope of reducing at all this year the level of unemployment.

Why do I call 1975 the year of the turtle, a year of slow recovery? First, construction is headed down almost across the board. That is a major sector of the economy. Second, economic overkill by the government has killed capital spending. I fully expect to see capital spending in constant dollars slide all of this year and well into 1976. Third relates to debt overhang and qualitative crowding. The overhang of debt is immense. It itself is a brake to quick recovery, but there is something else going on. Call it qualitative crowding or qualitative displacement, which bears on the impaired liquidity of both the corporate sector and, in many cases, the State and local sector. Soaring credit risk in a major recession is displacing those prospective borrowers.

Qualitative displacement, the inability to get credit, will exist this year even under the assumption that the Treasury were not required to borrow one dime. In other words, qualitative displacement, the inability to qualify as a good credit, in itself is a product of economic overkill and major recession.

No. 4. State and local retrenchment. The Joint Economic Committee itself has done some extraordinarily good work surveying State and local governments and the numbers you came up with suggest that tax increases and expenditure cuts this year add up to $8 billion. That, incidentally, just matches the size of the Federal tax rebate.

This is the first time in the postwar years that State and local governments appear to be headed for retrenchment. Typically, State and local expenditures for current output in real dollars rises, and moderately to briskly in a recession. In the postwar years to date, with the exception of the present economic decline, State and local outlays have cushioned economic decline.

No. 5, inventory investment. Let me just say this. My own persuasion for many reasons is that inventories are still high and that liquidation still has a substantial distance to go.

No. 6, money. Money growth is finally picking up in real terms. I am delighted. It is great news. But I think there is something more important here.

We have yet to see the lagged consequences of what has been the most precipitous and the longest slide in real money growth in postwar history.

Now we have some monetary experts here. These gentlemen are fond of talking about lag consequences running 3, 7, 9 months. I am delighted to see that money growth is picking up. But the lagged consequences of this unprecedented slide—and incidentally the lagged consequences of what was also the steepest and longest slide in the forward indicators in postwar years—have by no means run its course.

So I will stick for the moment at least to the skewed soup bowl profile. As relates to monetary policy, three errors were made. A simple rule of forecasting, I repeat, is this. When velocity is quiet, deflate. It seems to me that the deflated monetary aggregates were clearly calling for major recession

The second error, I would argue, made by the Fed is that they stuck too long with their short term interest rate targets. The third, a consequence of the second, was a drop in bank credit. Now this is something else unprecedented. Typically in recession bank credit—loans plus investment—soars in the early stages of recession. What happens is that the Federal Reserve supplies reserves to the commercial banking system, and the commercial banking system will buy (massively) governments to more than offset the decline in loan volume. Bank credit expansion, and by that I mean loans plus investments, have as their mirror image the growth of the money aggregates, the money stock. This time around the most incredible thing happened from August through January. Bank credit in total dropped. Not only did loans come down, C. & I. loans, real estate loans, loans to nonbank financial intermediaries, but the Federal Reserve was so niggardly in their stance that the commercial banking system sold or let run off their holdings of Governments.

I would argue that monetary policy over this period, in particular August through January, was a major reinforcing factor in this major recession.

Chairman HUMPHREY. Might I interrupt?

You say that the study of the Joint Economic Committee was released as a special study authorized by the Congress. That study which was released in December, corroborates and supports fully your statement here today. I do not recall the exact language of our report at that time but we were highly critical of the restrictive monetary policy that was being pursued in those months from the middle of the summer of 1974 right up to the period of December when our report was issued.

Mr. PARKS. Senator Humphrey, I came across that piece and it gave me some confidence that I was not talking to a wall. At least somebody agreed. Where are we headed for in monetary policy?

You used the expression, sir, up front. This seems to me that what is required here is vigorous, stepped up monetary growth to counter what is a major slide in this economy. I would argue also that perhaps the Federal Reserve and the Treasury should give prime attention to what I might dub a double-twist operation. If they want to increase the chances that this recovery will not be of a turtle-like character, then they might purchase on the open market—to the extent they can—intermediate and longer term government and agency issues. The idea is to bring long-term rates down more because long rates are still at celestial levels. The high levels represent a brake to fast recovery. I should think that the Treasury might focus its attention on selling short debt. So let's call this a double twist operation.

Chairman HUMPHREY. I think I would like to hear you emphasize that a little bit. If I understand what you are saying, it is that the Treasury should be in the short-term money market.

Is that correct?

Mr. PARKS. When the Treasury goes to market to borrow money, it should avoid like the plague selling long-term bonds.

Chairman HUMPHREY. But the Fed——

Mr. PARKS. The Fed should emphasize purchases of long-term bonds and intermediate bonds both in the agency and in the Treasury sectors.

I have one final comment. It has to do with philosophy. I really do believe that politics are important, economics are important, but so is philosophy. And it seems to me that we have in charge in Washington what I would call a Spencerian quadriad. A quadriad, that is four people—Ford, Simon, Greenspan, and Burns.

Chairman HUMPHREY. Who are the four there again?

Mr. PARKS. Ford, Simon, Greenspan, and Burns.

Chairman HUMPHREY. A quadriad? Yes, we have a triad for defense. This is the quadriad for recession.

Mr. PARKS. This is the Spencerian quadriad. Just a word on Mr. Spencer. Mr. Spencer might be described as the Charles Darwin of the social world. What he believed in was efficiency. What he believed in was the survival of the fittest, and he had a clear-cut objective to get rid of lazy rascals.

It seems to me that this recession was engineered in Washington, whether it was consciously engineered or not, I do not know. But I do know this. In talking with business economists, in talking with people in the administration, there is a feeling of success in the sense that by moving into a major and severe recession we will get the lazy rascals off their derrières, generate efficiency in the business sector, and pave the way for beautiful and harmonious growth forever thereafter.

Now I am not a total critic of Mr. Spencer. I think he had some fairly good ideas. All I am suggesting is that a new Spencerian philosophy exists in Washington, and exists today, which has already led to economic overkill. The new Spencerians now threaten stagflation by crippling capital formation over the longer pull in the absence of adequate stimulus.

I thank you.

[The prepared statement of Mr. Parks follows:]

PREPARED STATEMENT OF ROBERT H. PARKS

A CHRONOLOGY OF POLICY FAILURE

The United States has been shoved by Washington policymakers into the worst recession by far in postwar history. In order to understand better where we are and where we are going, it may be useful to outline just how we got into the present dismal state of affairs.

In this task, I have elected to quote from some twenty economic essays prepared for institutional investment clients beginning with September 9, 1974 (Economic Overkill?) and ending with May 15, 1975 (Outlook for Corporate Profits):

(1) *Economic Overkill*—September 9, 1974. The forward momentum of the U.S. economy in real terms is weak, and weakening further. The irony is that rapid inflation itself is further cutting into real buying power. The great irony is that governmental restrictive policies already in motion will likely further weaken demand. The greatest irony is that no early action on the policy front is being suggested by the Summit meetings. Next year is the word. In that case, the September 27–28 Summit session might just as well be held in the Coliseum in Rome, and the participants be provided with appropriate fiddles.

(2) *Mr. Ford and the New Intellectuals*.—September 16, 1974. We wonder whether Mr. Ford, Mr. Ash, Mr. Simon, or Mr. Greenspan may not be gearing policy to fight the wrong economic war with the wrong weapons at the wrong time. As we see it, the inflationary problem to be dealt with in the main is the cost-push legacy of what *was* excess total real demand. But that picture is changing rapidly.

(3) *Puncturing the Commodity Price Bubble?*—September 23, 1974. The price boom for industrial materials has just about run its course.

(4) *Velocity of Money and the Economic Outlook.*—September 30, 1974. What we see, in short, is a further slide in real demand ahead even as the thrust of economic policy seems to focus on getting demand down.

(5) *Capsule Summary of the Rinfret-Stein Debate.*—October 7, 1974. Contrary to the view we have expressed in past Perspectives (and the "flavor" of this long question), both Rinfret and Stein agreed that government restraint on demand was needed and just about on target. This suggests to us a most doleful and negative Spencerian syllogism, which we suggest is embraced by a great many business economists and governmental policymakers:

1. Recession is the only true cure for inflation.
2. Governmental restraint on aggregate demand—superimposed on an economy already showing unmistakable signs of a severe loss of real forward momentum—is a surefire way to get a recession.
3. The only acceptable policy is continued restraint on aggregate demand if the goal is to cure inflation.

(6) *Recession on Top of Recession.*—October 15, 1974. The economy is moving into recession on top of recession.

(7) *The Dismal Deflated Data.*—October 24, 1974. The real downhill momentum of the United States economy is gathering force and promises deepening recession ahead. As this becomes more apparent to the Administration, the present restrictive game plan will be abandoned. Among other things, we would bet that the Administration will be lobbying for a tax cut in 1975 rather than an increase.

(8) *Economic Arithmetic.*—October 29, 1974. The third quarter GNP statistics show virtually no strength anywhere for the United States economy.

(9) *Profile of Recession: A Skewed Soup Bowl.*—November 12, 1974. The recession ahead, in our judgment, will probably look more like a skewed soup bowl than either a "McCracken V" or a "shallow saucer."

(10) *Monetary Anemia and Farce Five.*—December 2, 1974. Even now it appears that the Administration objective to lift capital formation by rechanneling resources away from government consumption has failed. Real plant and equipment outlays are headed down, not up.

(11) *A Mini-Depression Ahead?*—December 18, 1974. We still hold to the view of a major and severe recession in 1975 even assuming that governmental policy shifts quickly to an expansionary stance through tax cuts and renewed monetary growth to counter the accelerating downhill momentum of the private economy. But the risks of some kind of moderate depression, with unemployment rates rising to low double-digit levels, can no longer be dismissed out-of-hand. Time is running out for the new "Spencerians" in Washington.

(12) *Debt Explosion in a Maxi-Recession.*—January 6, 1975. Mythology speaks of three Furies. But we count six Furies in the money and capital markets in 1975.

(13) *Investment Strategy in a Mini-Depression.*—January 21, 1975. The chances for a very mild depression have increased. Call this a mini-depression, if you will.

(14) *Mini-Depression: Made in Washington.*—February 6, 1975. The economy is smack in the middle of a mild depression. This depression was made in Washington.

(15) *Economic Strikeout.*—February 18, 1975. The fall in bank credit in the face of a precipitate cyclical fall in the economy is a worry to us.

(16) *Barriers to Early Economic Turnaround.*—March 10, 1975. Neither the private sector nor state and local governments can increase total liquidity or total cash flow for the community as a whole no matter how furious the cost economizing efforts. New liquidity can come only from the central bank (or the Treasury), but precious little of that is visible in the credit and monetary statistics to date.

(17) *Monetary Paradoxes in a Mini-Depression.*—March 18, 1975. Big government deficits and declining interest rates go with big recessions like ham goes with eggs. The forced borrowing is more a consequence of economic anemia than a causal force for rapid economic recovery.

(18) *Governmental Policy, Financial Hysteria and the Economy.*—April 8, 1975. The economic valley ahead that investors now look over is not going to be pleasant, given the economic storm which still rages. At least four thunderbolts are likely to knock some investors for a loop. These include further sharp advances in unemployment, a likely 30% to 35% fall in pretax profits, stepped up liquidity and bankruptcy developments at both the private and public levels, and the likely failure of housing and other "big ticket" consumer expenditures

to turn up at as briskly a pace as investors have become accustomed to in prior postwar economic recoveries.

(19) *From Mini-Depression to a Turtle Economic Turnaround in 1975.*—April 28, 1975. With a high caveat on inventory trends, we look for a turtle economic turnaround getting under way sometime in late 1975. The rabbit economic advance will have to wait for 1976.

(20) *Outlook for Corporate Profits.*—May 15, 1975. A key caveat releates to the Spencerian quadriad (Ford, Simon, Greenspan and Burns). They could choke and abort recovery through inadequate expansionary policies and kill capital formation secularly just as they have killed it cyclically. Inadequate stimulus based on an overstatement of inflation prospects risks chronic stagflation, continuing and massive unemployment, and a slump in profits beyond the dismal projections set forth here.

Overall conclusions

(1) This worst of all postwar recessions was predictable.

(2) It was made in Washington.

(3) The cost in foregone output and employment has been immense, and unnecessarily high.

(4) No one questions that inflation remains a serious problem. But the Administration and the Federal Reserve may overstate inflation prospects and cripple capital formation over the longer run, just as their policies have killed capital formation cyclically. This risks protracted stagflation.

FROM MINI-DEPRESSION TO A TURTLE ECONOMIC TURNAROUND IN 1975

A rabbit economic advance in 1976?

We have long held to a forecast of a deep and skewed soup bowl profile for the United States economy in 1975. We see no convincing reason to abandon that position despite the tax cut, despite the faster pace of Federal outlays ahead, despite the dramatic slowing of the pace of inflation and despite the army of analysts who now resuscitate the McCracken "V" profile for quick and brisk economic turnaround this year.

The Year of the Turtle.—A rabbit advance of the economy looks more likely sometime in 1976. But major turtle depressants are still at work this year to offset Federal stimulus and to create a precarious economic balance. The sinking side of this "seesaw" economy include the following depressants:

(1) *Construction.*—Spending for construction heads down almost across the board. Further declines are foreshadowed by the sustained fall in the forward indicators of construction (contracts, orders, forward investment commitments) and surveys of spending plans.

(2) *Capital Spending.*—Economic overkill by government produced recession and killed as well the derived demand for capital formation. High excess capacity, a precipitous slide in profits still ahead, relatively high interest rates on long debt and the depressed forward indicators all point to a drop in capital outlays in real dollars well into 1976.

(3) *Debt Overhang and Qualitative Crowding.*—Impaired liquidity and the massive overhang of debt will brake and negate business spending plans. Low-rated and smaller business units ordinarily regarded as satisfactory credit risks will be displaced from the credit markets. The "qualitative crowding" is a lagged consequence of governmental economic overkill which has produced soaring credit risk in a mini-depression. The qualitative crowding is itself a depressant to business recovery and would exist even if the Treasury were not required to borrow a dime.

(4) *State and Local Retrenchment.*—Real outlays were reported up a little in the first quarter. The various surveys we track, however, suggest little or no growth this year as states and municipalities frantically try to cut employment and capital outlays, chop operating budgets and raise taxes.

(5) *Inventory Investment.*—Who knows? The data are treacherous. Our guess is that inventory investment has a long way to go yet . . . down. One clue for this judgment is the Commerce study in the August 1974 *Survey of Current Business* and the update in figures reported for the first quarter 1975. What Commerce did was to calculate the stock to sales ratios (all in constant 1958 dollars). The norm is cited at about 30% and the last quarter actual figure was just reported at 32.5%, down a little from 32.9% in the fourth quarter 1974. Commerce

then multiplied these two percentages by final business sales for the last quarter ($705.6 billion in 1958 prices), subtracted the two products, and thus came up with a current figure of total real stocks above "norm" of almost $18 billion.

To get inventories back to "norm" by $18 billion would require, of course, $18 billion of liquidation, other things equal. To put this in perspective, the actual liquidation reported for the first quarter was a little over $2.5 billion for nonfarm stocks. This works out to a $10.2 annual rate. An $18 billion liquidation in total would entail $72 billion at an annual rate if all the liquidation were to take place in one quarter (4 times $18 billion), or $18 billion at an annual rate over four quarters.

We do not look for massive liquidation as implied in these calculations. Even a turtle advance in business sales the second half of this year would work against such a drastic decline. So would business expectations of faster real growth in sales in 1976. Still, we hold to the conclusion that the inventory decline has a big way to go before stocks are back to "norm".

(6) *Money.*—Monetary growth is finally picking up, even in real terms. Great news! This promises recovery ahead. However, more important, in our judgment, is the fact of the longest and steepest slide in the real monetary aggregates in postwar history (along with the deflated forward indicators). Put another way, we have witnessed a sustained subtraction of real buying power from the economy. The lagged depressant of negative money growth hardly promises a swift turnaround in consumer demand this year, at least for big-ticket durables.[1]

CONCLUSION

With a high caveat on inventory trends, we look for a turtle economic turnaround getting under way sometime in late 1975. The rabbit economic advance will have to wait for 1976.

USE AND ABUSE OF FINANCIAL AND MONETARY DATA*

Six ways to protect the investment strategist from the witch doctors in the analysis of money and capital markets

Every generation has its medicine men, its witch doctors. They exist today. They are called economists. So wrote the late John Strachey, himself an internationally recognized British economist. Add to this list monetary theorists, money and capital market specialists, and investment managers.

These experts are not involved in an inexact science, as economics is so often defined. Given the wretched forecasting and investment performance of late, economics and its first-cousin disciplines of monetary analysis and investment analysis might better be classified among the primitive arts.

Scientific method

But even artists and assorted witch doctors can at least try to be scientific. They can try to employ scientific method which, among other things, demands an integration of key disciplines. In the case of the investment strategist, he can at least take as key inputs the work of the money and capital market analyst. One is indispensable to the other, a key thesis of this essay. He can do more. He can demand a better input from the money expert, the second key thesis of this essay.

With these two points in mind, the present discussion can but treat some of the potentials and pitfalls involved in both monetary analysis and flow-of-funds analysis. What follows is meant to be illustrative and treated in the context of recent history and present experience. The hope is that the major caveats and dubious procedures of the money and credit experts will have been stressed sufficiently to put the investment strategist on perpetual guard.

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[1] The relationship of money and money velocity to the prospects for the economy are developed more fully in the attached article which appears in the Spring 1975 issue of the *Journal of Portfolio Management*. Peter Bernstein, the *Journal's* editor, gave us permission to reproduce this essay.

*Journal of Portfolio Management, Spring 1975.

Monetary analysis

Monetary analysis, which is defined here as analysis of the major monetary aggregates, can be treacherous. Three caveats come to mind:

1. *Beware the Narrow Money Watchers.* Surely the country's most popular economic indicator is the money stock defined narrowly as private demand deposits plus currency in the hands of the public. This is the famous M_1 which just about everybody must have before breakfast in order to think straight. But M_1 is in fact a treacherous and unreliable input to straight thinking.

Most important, and most overlooked, is his chameleon character. As the elementary student of banking knows, when the banking *system* creates credit, it also creates money. For the most part, the money creation takes the form of new demand deposits. They come into being as a mirror image to the creation of credit.

What the elementary student did not learn (or has forgotten) is that demand deposits *created* may not all show up statistically over time as growth of demand deposits *outstanding*. The reason is that the creation process is often simultaneously accompanied by conversion of new or existing demand deposits into bank time and savings deposits, including certificates of deposit. The point is that demand deposits in fact created need not show up (like that chameleon) in Federal Reserve statistics on growth of demand deposits outstanding.

To focus solely on M_1 is to run the risk of greatly understating the pace of monetary expansion. As a case in point, consider the decidedly faster growth of M_2 than M_1 in the years after 1965. (M_2 is M_1 plus commercial bank time and savings deposits, excluding large certificates of deposit.) This money explosion broadly defined fueled the giant inflation the economy subsequently experienced.

The devotees of M_1, by understanding actual monetary growth, proceeded to understate the potential for inflation as well. Indeed, those devotees of M_2 who still insist on subtracting large CD's from the money stock perpetuate the error. Neither theoretical nor practical justification exists for throwing large CD's out of M_2.*

2. *Beware Velocity.* More precisely, beware those who ignore velocity. Money matters (even M_1). But so does velocity. As Professor Irving Fisher taught early in the century, it is money times velocity (MV) that counts in any projection of expenditures. History is replete with monetary wrecks who failed to heed the powerful and sometimes unpredictable force of velocity. Two examples should make the point.

The first has to do with the astonishing projection by the Administration of a $1065 billion GNP for 1971. Remember? Why did the forecast of a fast rise of GNP that year, based on a fast rate of growth of money, fall flat on its face? Money growth did in fact speed up, starting as early as March, 1970. But the economy moved downhill in 1970 and recovered at a slow pace in 1971. The answer, of course, was that velocity remained under sedation of sorts. Velocity in fact fell over a good part of the year 1971.

Why was velocity under quasi-sedation in the year 1971? The reason was that, in lagged response to severe Federal Reserve restraint, the economy was still in a fairly illiquid position. It was "dehydrated." It acted very much like a giant liquidity sponge in mopping up new money growth once the Federal Reserve did embark on an expansionary program. Put another way, new money growth was channeled in great measure into liquidity repairs (debt repayment and addition to liquid assets), not into accelerating spending. The liquidity rebuilding had to run its course first before velocity could come from under sedation. Velocity did, in fact, regain some sparkle in 1972, which helps to explain the fast advance of the economy that year.

A second example is the present, the year 1975. The parallels with 1970–71, as they relate to the need for liquidity rebuilding are worth citing. If the economy were dehydrated in 1971, it is doubly dehydrated in 1975. The Sahara-dry state of illiquidity surely does not augur any early and vigorous upturn in the economy this year. The year 1976, maybe. But the year 1975 will go down in the history books as the year of liquidity rebuilding, assuming, of course, the Federal Reserve provides the needed new liquidity. We shall see.

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*For a technical explanation of the creation of money and close money substitutes see Appendixes.

3. *Beware the Undeflated Monetary Aggregates.* The analyst must take every pain to deflate the monetary aggregates whenever velocity is quiet. The celebrated debate among the monetarists in 1974 can be taken as a case in point. The First National City Bank of New York insisted on deflating the monetary data by the price data. They forecast recession, actually a recession on top of a recession. The Federal Reserve Bank of St. Louis stuck to its old God of an undeflated M_1 and proceeded to ignore velocity to boot. The St. Louis Bank forecast economic recovery.

Predictably, the First National City Bank won the debate hands down. It won because, among other reasons, it saw that price inflation more than offset the nominal growth of the money aggregates; the net result was to subtract real buying power from the economy. (As of this writing, the subtraction process still continues even as liquidity rebuilding has yet to begin for most major sectors of the economy.)

Money and capital market analysis

Money and capital market analysis is in a sense broader than monetary analysis. As defined here, it embraces analysis of the entire spectrum of funds raised and supplied in the money and capital markets. The broader approach, tagged also as flow-of-funds analysis or analysis of the sources and uses of funds, can be useful to the investment strategist. But it can be treacherous too in the wrong hands. Again, three caveats come to mind:

1. *Beware the Identities.* Purchases are always equal to sales *ex post* (historically or statistically). But people may try (*ex ante*) to buy less than people are willing to sell (*ex ante*) at the prevailing level of prices. The result is, of course, that prices tend to fall. Now consider these two distinctions in the context of the money and capital markets.

Look again at the present environment. Thus, as indicated in Exhibit 1, the total (net) funds to be raised in the money and capital markets this year is estimated to rise to a record one-quarter trillion dollars. The funds supplied are, of course, also estimated at exactly one-quarter trillion dollars. These are identities and even the identities are the roughest of estimates. In no way are these numbers to be taken as estimates of the actual demand for and supply of funds in the money and capital markets.

Demand and supply estimates, embracing desires and abilities, are, of course, extremely difficult to measure statistically. To the writer's knowledge, no one has ever succeeded in measuring demand and supply in the money and capital markets, or anywhere else. Yet the terms are thrown around by the most prestigious investment houses on Wall Street as if the resident witch doctors had, in fact, produced such measures.

EXHIBIT 1.—THE MONEY AND CAPITAL MARKETS

[Billions of dollars]

	1973	[1] 1974	[2] 1975
Total funds raised	239.4	216.7	250.0
Residential mortgages	50.2	37.4	38.0
Commercial and farm mortgages	21.7	16.2	15.0
Corporate bonds [3]	12.5	23.3	30.0
Corporate stocks [4]	8.0	6.1	7.0
Treasury issues [5]	7.7	13.1	75.0
State and local issues	13.7	17.0	19.0
Federal agencies [6]	21.6	20.9	16.0
Consumer credit	22.9	9.6	2.0
Bank loans, n.e.c.	46.7	34.1	18.0
Commercial paper, etc.	14.5	16.6	13.0
Security credit	—8.2	—5.6	2.0
Trade credit	23.7	27.5	15.0
All other credit	4.4	.5	0
Total funds supplied	239.4	216.7	250.0
Federal Reserve	9.2	6.2	12.0
Commercial banks	86.7	61.8	82.0
Life insurance companies	15.6	15.8	17.0
Pension funds	7.2	8.7	9.0
State and local funds	9.6	15.6	10.0
Fire and casualty companies	5.0	4.1	4.0
Savings and loan associations	27.1	21.4	28.0
Mutual savings banks	5.4	3.7	6.0
Credit unions	2.9	2.7	2.7
Miscellaneous financial units [7]	13.1	4.3	5.0
Company and Noncompany business [5]	9.2	6.4	4.0
U.S. Government and agency	23.3	29.9	30.0
Foreign	3.5	13.2	24.0
Households—Residual	21.5	22.8	16.3

[1] Preliminary.
[2] Estimated.
[3] Includes foreign.
[4] Includes investment companies.
[5] Excludes issues to U.S. Government investment account.
[6] Includes sponsored agencies.
[7] Includes finance companies, reits, open-end investment companies, and securities brokers and dealers.

Note: All figures are for calendar years and are "net". For example, the $23,300,000,000 corporate bond estimate for calendar 1974 represents gross new issues less repayments. The $82,000,000,000 estimate for the funds supplied by commercial banks in calendar 1975 represents gross loans and investments for the year less repayments and sales of securities, i.e., the net growth of bank credit.

Source: Federal Reserve and estimates by Robert H. Parks.

The experience of 1975 to date makes clear the distinction between *ex post* identities and demand and supply measures. Interest rates have in fact come down, sharply for short-term rates. Clearly, the *ex ante* demand for funds has tended to lag the *ex ante* supply of new lending power coming to the market. Given the ongoing maxi-recession (mini-depression?), given the slide in business borrowing for inventory, given the shift by the Federal Reserve toward an easier money stance, and given the slowing of inflation, the decline in rates comes as no surprise. The decline is perfectly consistent with the higher level of funds estimated to be raised for the year.

2. *Beware the Undeflated Data.* Data deflating of the basic monetary aggregates has become a popular pastime of late. But why not deflate the broader statistics on the money and capital markets as well? That is precisely what is done for the broad debt figures in Exhibit 2.

One can view the data there two ways. The total debt outstanding is estimated to rise $2.591 trillion dollars this year. Wow! That's a 10.3% advance. That's one way of looking at the statistics. But in real terms, the additional borrowing provides a miniscule 1.2% advance. That's another way of looking at it. In terms of trying to forecast the 1975 economy, the second approach may be more productive than the first. Put another way, the estimated 1.2% advance in real buying power does not look like much of a force to spur economic recovery.

EXHIBIT 2.—TOTAL OUTSTANDING DEBT

	1972	1973	1974 [1]	1975 [2]
Nominal dollars (billions)	1,909.4	2,139.5	2,348.0	2,591.0
GNP price deflator (1972=100)	100.0	105.6	116.4	126.9
Deflated (1972 dollars)	1,909.4	2,026.0	2,017.2	2,041.8
Percent change in nominal dollars		+12.1	+9.7	+10.3
Percent change in deflated (1972) dollars		+6.1	−.4	+1.2

[1] Preliminary.
[2] Estimated.

NOTES

The nominal dollar figures for 1972, 1973, and 1974 are reported in the Federal Reserve flow-of-funds accounts, and defined as the year-end outstanding for total credit market liabilities of consumers, business and governments in the nonfinancial and financial sectors. Equity claims are excluded from these totals.

The estimate of $2,591,000,000 for 1975 is derived from the flow estimates in exhibit 1. Thus, the $2,591,000,000 forecast is equal to the net credit funds estimated to be raised in 1975 of $243,000,000,000 ($250,000,000,000 total less $7,000,000,000 of equity) plus the total credit outstanding of $2,348,000,000 as of the end of 1974 ($2,591,000,000 equals $243,000,000,000 plus $2,348,000,000).

The rest of this table is self-explanatory. The price forecast for 1975 is 9 percent, down from 10.2 percent in 1974.

Source: Federal Reserve and estimated by Robert H. Parks.

3. *Beware the Furies.* Mythology speaks of three Furies. But the year 1975 should witness at least five Furies in the money and capital markets. One has already been noted. Call it the *Inflationary Fury* or the step-up in borrowing required merely to finance the rise in prices.

But there are four others. They, too, are forces that should lift the dollar level of funds to be financed, limit declines in long-term rates, but exert little *immediate* impact in bringing recession to an early end. Consider these Furies:

a) *The Funding Fury* (sales of intermediate-term and long-term debt in the attempt to pay off short) is designed to put corporate balance sheets in better order. It is part of the whole process of liquidity rebuilding, which must normally precede new and vigorous corporate expansion. As was the case in 1970, massive funding will be a force in 1975 to speed the drop in short rates even as it serves to limit the decline in long rates.

b) *The Emergency Fury* describes the frenetic struggles of sick business units to obtain new financing to cope with the crushing burden of short-term debt and recession. The year will surely witness as well a rash of mergers, bankruptcy reorganizations, and outright failures, and this will all make for headline news. The well-publicized troubles may be a force in 1975 keeping yields on low-rated credit instruments at close to their present celestial heights, or pushing some yet higher, even as yields on prime long-term debt instruments continue to decline moderately.

c) *The Governmental Fury* is merely intended to describe the massive borrowings in prospect by governments at all levels in consequence of a major recession and a shortfall in revenues. The estimate alone for the Federal sector of some $75 billion (excluding special issues to the U.S. government trust funds) is a case in point. The massive deficits in prospect will likely be misinterpreted as a major *casual* force for rapid expansion and new inflation. In fact, these deficits are in the main a *consequence* of major recession and the governmental policies of economic overkill which helped to produce recession.

d) *The Equity Substitute Fury* is simply borrowing by business units that no longer regard the equity market as an effective vehicle for raising new capital. They will tap the debt market instead, either voluntarily or because they are forced to do so. The fact that net new external equity financing (when deflated) has been negative for years is, of course, not unrelated to the difficulties corporations are experiencing in financing growth of capital formation.

The limited aide-de-camp

Monetary analysis and flow-of-funds analysis can serve as a useful aide-de-camp to the investment strategist provided, of course, he is forever alert to the kinds of caveats set forth here. Garbage in, garbage out, the saying goes. But even perfect input may be of limited value to the investment strategist. Again, consider the proposition in the context of the current economic downturn.

Despite the major cyclical decline, the strategist might very well decide to emphasize the positive and become guardedly optimistic. The major recession does not contradict the fact that stock prices are extremely low, whether related to earnings, or dividends, or book values. Interest rates are in fact falling. The back of inflation has at least been bent, if not broken. Equities again look more attractive relative to commodities, or money market instruments, or even gold. New governmental stimulus not as yet announced will, if necessary, be undertaken to spur economic recovery. It could come in transportation, or even in a modified Manhattan-style project in energy. Excess capacity should work against early demand-pull inflation.

Of the negatives, one might list the certainty that profits (a leading indicator) are going to head down, and sharply. The unemployment rate is headed up sharply, probably to 10% or more. Oil still continues as an economic depressant. The leading indicators still fall down. Forward investment commitments are way down. The deflated monetary aggregates are still negative. State and local government actions remain restrictive and serve as giant offsets to Federal stimulus. Political terrorism and violence, possibly associated in part with high unemployment, are also making headline news.

The listing is meant only to be illustrative; it surely is not exhaustive. A thousand and one other variables are at work as well to affect investor psychology and the prospects for the market. The only point to be made here is that even the best monetary analysis and the best money and capital market analysis may prove insufficient to make intelligent investment decisions. Necessary inputs, yes. Sufficient for complete analysis, certainly not.

Conclusions

We end just about where we began. Our objective was to gauge monetary analysis and flow-of-funds analysis in the context of recent history and present experience. We noted a number of caveats, a number of techniques of analysis that must be marked dubious at best. Two conclusions stand out:

(1) Monetary analysis and flow-of-funds analysis are indispensable inputs to effective investment strategy.

(2) What is passed off as trustworthy monetary analysis and flow-of-fund analysis is often of very dubious value.

Chairman HUMPHREY. Thank you very much. I am sorry, gentlemen, that I had to leave temporarily but I had to do a little work on the agriculture fund and I went over to the Committee on Agriculture. We are going to launch a major investigation into the grain scandal concerning our overseas shipments.

Mr. Parks, may I just ask for the record, your organization is known as Advest Institutional Services. Tell me a little bit about what your organization does. Who does it serve and what kind of clients do you have?

Mr. PARKS. It is, one, an amalgamation of some seven regional firms serving the retail Wall Street customers. By retail I mean individual customers. But there is another part of Advest which services solely the institutional, large institutional investment officers. My job is that of chief economist working with institutional investment clients.

Chairman HUMPHREY. You would not call your self a political radical as such then?

Mr. PARKS. No, I would not.

Chairman HUMPHREY. What I was trying to establish here is a line of credibility—if you do not mind my saying so, in the light of the preciseness of your testimony, which I thought was most informative and very stimulating. You have targeted in on certain matters that you think are of great concern, and you are the chief economist for the organization known as Advest Institutional Services; is that correct?

Mr. PARKS. Yes, sir.

Chairman HUMPHREY. And you do service and counseling and financial advice to large handlers and users of money?

Mr. PARKS. That is my sole job.

Chairman HUMPHREY. Do you work with Wall Street firms?

Mr. PARKS. This is a Wall Street firm; but in the main, I work with financial institutional clients: banks, insurance companies, pension funds.

Chairman HUMPHREY. Have you ever had a chance to talk with Secretary Simon?

Mr. PARKS. No. I would be delighted to some day.

Representative LONG. I would be interested in hearing the discussion.

Mr. PARKS. I am not sure that Mr. Simon would be interested in talking with me, but I would be delighted to talk with him.

Chairman HUMPHREY. Seriously, have you counseled with Mr. Greenspan or Mr. Burns or any of these men?

Mr. PARKS. I know them; I have talked with Alan on occasion. I do not think he thinks much of my counsel, particularly when I said: "Do you mind my having labeled you Spencerian?"

Sir, one comment—and you brought it up.

The conservative position taken by the administration, I would argue, has turned out to be anything but conservative. As a matter of fact, having killed construction, having killed capital formation, having generated or contributed toward generating a massive deficit, now they risk what could be the stop and go policy again. You see, by overkilling, it may be necessary at this point to take massive steps to rectify the situation, particularly at the monetary level.

I do not think that the proposals that the administration has recommended to date in any way is going to solve what is the major tragedy of the U.S. economy, and that is massive unemployment.

Chairman HUMPHREY. Well, what has disturbed this Senator, this member of the committee, is just what you have alluded to. We had this slamming on of the brakes, so to speak, in the year 1974 in the restrictive monetary policy after we had a tremendous flush of money in 1972; and now, we get this recession which continues to deepen. We have been told time after time that it is bottoming out, but each month it shows that it digs in a little deeper. There is a slippage at the bottom of the well, so to speak; what appeared to be the bottom is kind of like quicksand. Therefore, in order to get out of it, even for political purposes, much less economic purposes, may generate the feeling that you have to do massive things, and if you do not have some kind of sustained cruising speed, once you have started to move out you will be thrown into the ditch again.

It seems to be what we have here is either a driver who is unaccustomed to the machine or somebody who is drunk behind the wheel. We are in and out of ditches; we are on both sides of the road; one time we are on the restrictive side, on the righthand side, and another time we are on the expansion side, the lefthand side; occasionally, we are going down the middle and meeting a line of traffic. And every so often, somebody says why not try the ditch because it is so crowded down the road. And then we get into the ditch and find out that the ditch is deeper than we thought, and somebody says, hey, let us take a run for the road again and goes smashing up into the line of traffic once again. This is the symbolism that comes to my mind, It is exactly what I see in the economy.

I have given an analogy, again, where in Vietnam, we had 500,000 troops separated from the rest of the economy. The economy was barging along, and it was a war being fought by some. And the prosperity was enjoyed by many. And all at once we found out that what seemed to be a separate operation started to infect the body politic. The division, bitterness, dissension, cynicism, inflation—all of this started to come in. What appeared to be, from the standpoint of the major war, a minor action, started to infect us all.

The President said not long ago that unemployment is serious just to those that are unemployed. And I quote him accurately. But inflation affects all of us. Now, that is an oversimplification, as I see it, because the unemployment ultimately affects all of us. First of all, it gives us political disenchantment in this country. I hate to predict and think of what could happen with 42 percent of black teenagers unemployed in the inner cities. I hate to think what is going to happen to New York City when nobody is going to bail it out in terms of its financial problems. The fact is, 2 million poor people have moved into New York City in the last 4 or 5 years, while 2 million taxpayers moved out. And you have got an unbelievable economic problem there. And this is also true in Detroit and Cleveland.

I was on the phone just yesterday with the president of the school board of Cleveland, Ohio. We have an average unemployment rate of 8.9 percent; and surprisingly, it is not shocking very many people, particularly the policymakers, both in Government, in executive and legislative. But in some areas, the unemployment rate is 20, 30, 25 and 15 percent. And those areas are explosive. And one of two things happens. Either you get a rise in violent crime, which is a kind of moderated guerrilla warfare; or you have militant explosion. Possibly a third: total apathy, just rotting on the vine. And I do not think this country can long pursue this course.

My own judgment is that unless we are able to make a turnaround and start getting back to the work ethic and doing whatever is necessary to get them jobs, whatever the cost, we are headed for long-term trouble, serious, long-term trouble. This is not speechmaking. I want to tell you, I think the speechmaking days are all over. I think that this Government today is unaware of the time bomb on which it sits. The time bomb is the cesspool of economic infection that is bubbling up underneath us.

You are respected in the business world and I appreciate very much what you have had to say. I think the Congress and the executive branch need to listen to what you've said. We start talking about a few jobs, and people wonder if we are overspending. Nobody has figured out what two years of unemployment compensation is going to cost this Government, plus the food stamps, plus the welfare costs, plus the other social costs, plus the mortgage foreclosures, plus the furniture that had to be taken back, plus the unpaid bills in retail establishments.

Gillis, you go ahead and ask a question or two now.

Representative LONG. Mr. Parks, I have something I would like you to comment on.

Most of my adult life, I have been in the expression of political views as you have expressed your economic views here today. I have suffered substantial political losses and have not been in politics as much as I would like to have been. I have really been in the corporate and financial field more than I have been in the political field, dealing as the head of a corporate finance department of a listed firm in the New York Stock Exchange, putting financial deals together.

Over the years, I would express views that were perhaps as unsavory to the people with whom I was associating and working as yours would appear to me to be with the people with whom you are working.

What has been the reception of the views that you have expressed here today in the financial community in New York, and what do they say? Do they think you are some far out radical? How do they look at you?

Mr. PARKS. All I can do is forecast on the data. And the people who employed me simply said, write what you like; whatever you have to say, say it.

I do not know how to classify myself, other than eclectic. I have as much interest as anyone in a progressive, rapidly growing economy with inflation under control. But as a conservative, it seems to me that the policies that have been pursued are anything but conservative. I mentioned several failures, and to me it is not conservative policy to use sledge hammers and then run the risk of using, down the road, a hypo, a mammoth hypo, to undo your sledge hammer approach. I do not consider this to be consistent with what I would call conservative political philosophy. So, in that sense, I would classify myself as a conservative.

Representative LONG. But doctor, are we not in just about the terms of George Orwell, in 1984, where conservative means liberal and liberal means conservative; war means peace and peace means war? I mean, the terms are meaningless. Certainly, the conventional approach you have been suggesting here, at least with respect to outlining what the problem is and the direction in which it seems to be leading us, would not be generally accepted as a conservative approach to this problem.

Mr. PARKS. There is a semantic problem. Let me give you one illustration.

If there is inadequate stimulus in this economy to lift income production and employment, for one, I would consider forecasting next year, not a $75 billion deficit. I would have to start talking in terms of $135, $140 billion.

Representative LONG. But now you are talking about a full-scale depression, and you are going from a soup bowl to perhaps a funnel, and you are going from the Year of the Turtle to the Year of the Lemming.

Mr. PARKS. And I am saying that in the absence of inadequate stimulus now, you could push yourself into a much more severe economic decline, and this would generate radically explosive solutions that could change the very fabric of our political economy.

You know, there are two alternative theses. One gentleman, Frederick A. VonHayek, is still in charge, with his fellow Spencerians.

Now, John Maurise Clark wrote a book called "The Road to Reaction." And I will simply say this as a conservative, at this point in time, I will look more closely at "The Road to Reaction." If there are major earthquake problems that are not being solved, and they are not solved in what we call democratic traditional fashions, then you run the risk of the kind that Mr. Humphrey has spelled out here: crime, riots in the streets, everything. And you can get a solution that could be extremely radical and could change the entire fabric of the system which we call capitalism.

I guess my only point is this: The majority view—I will answer your question directly—Wall Street, the majority view among most of the economists I know—and I know most of the economists in this country—is that we run the risk of excessive stimulus. And all I am trying to suggest here is that there are two sides to this story. A whole set of depressants are still at work, and you run a high risk, I would argue, of inadequate stimulus by failure to get sufficient monetary, sufficient Federal stimulus.

Representative LONG. Mr. Adams, do you have a comment on this?

Mr. ADAMS. Well, I do not seem to express myself as well as Mr. Parks or Senator Humphrey in this regard, but I definitely want to ally myself with their views.

I think we have a very real problem, a problem which is, in some sense, summarized by the unemployment rate, but frankly, the unemployment rate does not give us an adequate measure of the social impact of unemployment in our society. People are dropping out of the labor force, that is why our unemployment rate beings to decline a little in our forecast because certain people find that there are no job opportunities and they drop out of the labor force.

Representative LONG. It makes those figures unrealistic, does it not?

Mr. ADAMS. It makes them unrealistic. The same thing is true if you take the numbers on black teenage unemployment—42 percent, that Senator Humphrey was talking about. There is another yea-many percent standing in the wings who are not even looking for jobs and who are stagnating, who are at a time in their lives when work opportunities would provide them the opportunity for social and economic advancement. So, these are very, very serious issues. And at a time like that, to talk about limiting the growth of money supply to 5 to 7½ percent, at a time when all reasonable estimates tell us that the growth of nominal GNP must be at least 12 percent, is simply a dangerous policy, a policy of restriction, a policy which will lead to increases in the interest rates, a policy which will lead to tight money—and our housing industry has suffered plenty from tight money—a policy which will increase the difficulties of financing our investment needs, a policy which will slow down the recovery.

I am talking a little more broadly now, but I will definitely ally myself with the opinions that have been expressed here.

Representative LONG. To comment on this general matter that we have been discussing—monetary policy and your concern about it—you stated in your prepared statement—and I might not be quoting you exactly—something to the effect that great uncertainty continues to exist. But with regard to the monetary policy—and I might take issue with you as to whether that is really true—Mr. Burns, by announcing 2 weeks ago his policy that he intends to pursue. It seems to me as though he spelled that out with considerable precision and that his pronouncements set forth the road that he is going to follow for a while—one, that the growth of the money supply was going to be a 5 to 7½ percent; and second, the growth of the money supply, plus time deposits, was going to be about 8½ to 10 percent, if I remember the figures correctly.

Now, I do not see any uncertainty in this. I see that leading us back to perhaps what Mr. Parks was speaking of. Do you think there is any uncertainty that remains in the monetary policy?

Mr. ADAMS. Well, you know, it may be sanguine on my part, particularly as we look back on past experience, to attribute a great degree of flexibility to Mr. Burns; but it does seem to me that a sensible analyst will not make a projection of his policy plans over a 1-year period and stick firmly by it, come what may.

And I suspect, regardless of our fears about Mr. Burns, that he is a sensible analyst and that he will not stick by this. Once Mr. Burns recognizes what the implications of his policy stance are, I am at least hopeful that he can be persuaded to ease monetary policy and at least beyond his professed numbers of 5 to 7½ percent monetary growth.

Representative LONG. Two comments with respect to that, Mr. Adams. One is that history does not bear you out with respect to the last year; and second, my daddy told me that it is awfully hard to make people who smoke pipes change their minds.

Mr. ADAMS. In any case, we have assumed what seems to us, a more realistic monetary growth path of 9 to 10 percent for the narrowly defined monetary supply of M_1, about 11 percent for the more broadly defined money supply of M_2, and while that does not exactly give us a more sparkling economy in 1976, it does give us a reasonable recovery path.

Representative LONG. Mr. Ando, we would appreciate your views on these. I have exceeded my time, but I am sure the Chairman will bear with me for a minute.

Chairman HUMPHREY. If Congressman Brown will; he has been waiting very patiently.

Representative BROWN of Ohio. Of course.

Mr. ANDO. Well, I indicated before that even the kind of recovery that Mr. Adams was talking about, will still involve a 9-percent unemployment by the end of 1976 even with the money supply growing at 10 percent, and I do not think that is satisfactory in any case. I do not believe that Mr. Burns is as reasonable a man as Mr. Adams says he is, because I give him much more credit for his intelligence. He is a very able economist. He knows perfectly well where his policy is leading. It is not that he is making a mistake, that he feels that his policy will be consistent with satisfactory recovery. He knows that if a 6 percent money supply growth is maintained, it is going to lead the economy into further recession, and that somehow he apparently feels that it will keep the inflation down.

This last point, I would not know why he reached that conclusion.

Chairman HUMPHREY. In other words, he is so deeply concerned about inflation.

Mr. ANDO. That is my only interpretation of his behavior, Senator.

Chairman HUMPHREY. Congressman Brown.

Representative BROWN of Ohio. Thank you, Mr. Chairman. Mr. Parks spoke of the quadriad, and without intending to be partisan or anything else, it just appears to me—and I reflected upon it after hearing his remarks, and I do not know a single major policy request that the President has made to the Congress that he has had fulfilled—and I put into that all of those who had input into his request, Mr. Greenspan and Mr. Burns, to the extent that his policies are administration policies. And, Mr. Simon to the contrary, there has been an opportunity for 100 percent policy fulfillment by the Congress through its override of the Presidential vetos.

Now, I think it is time that we stopped looking back and placing the blame, and begin looking forward. Mr. Parks, you have spoken of economic overkill. There is presently inadequate stimulus. I would like to know what you think, specifically, should be done to provide the proper stimulus; and I do not think we should just say it in terms of budget deficits like $135 billion. I do not think you would say that just throwing money on the problem resolves it. Do we not have to be a little bit more precise on how we provide the stimulus?

Mr. Parks. Well, let me make the first point. That does relate to what economists call an aggregate stimulus. I am very, very sympathetic to the views expressed here that we need more rapid growth of money than indicated by Mr. Burns, and let me indicate why. A tax cut, in and of itself, unless financed through the monetary route, is simply one major reshuffling of cash balances. Let me explain that in just one way. I am sure you are aware of this, but let us suppose that the Treasury were to borrow the money to pay the proceeds for the tax cut from the public at large. All that happens there is that the institutions and individuals buying the bonds would give up cash balances, and in exchange get a bond or some kind of debt instrument. The recipient of the tax rebate would get the cash.

Now, that does not add one penny to the growth of money. It does not necessarily add one penny to the growth of total spending. So I would argue, in line with these judments here, that we need rapid growth of money, at least for some span; that the only way that you get stimulus from the tax cut to be at all satisfactory, to be at all adequate, is to finance that largely through the banking system. My own judgment—I would hope this turns out to be correct—is that the banking system, the commercial banking system may end up this year acquiring $35 billion of this deficit of Government bonds; acquiring bushel basketfuls of agencies, and I hope municipal issues to boot. This would be, I think, a major force making for recovery.

Now, more specifically in response to your question, I am not persuaded that monetary policy by itself can give sufficient growth to this economy to get unemployment down. And so, I think there are some other steps that have to be taken, and which could be very specific. You could make a list a mile long, as I can. We do not have to dig holes in the ground and provide make-work projects, but our railroads are in rough shape. Maybe we need a few victory buses. Perhaps Congress and the administration could let out private contracts to private entrepreneurs on a competitive bid basis to build some new railcars, and perhaps some additional attention could be directed to what is a massive abandonment of housing throughout city after city in this country. I sometimes wonder why more attention is not being paid to what you might call a modified Manhattan-style project on energy.

I realize that it takes time to get these things started, and you want to have a cutoff point so that you do not once again move into a situation of protracted excess demand. But these things have not been done, and it does take time. There are always lags, and as far as I am concerned, at this point, the major recession is already in place.

I tried to respond to your question on two counts. One requires monetary expansion to make the tax cut effective in lifting demand. Two, possibly some additional programs enacted by Congress in the attempt to deal with the immediate problem of massive unemployment.

By the way, as a forecaster, let me make a forecast. I am looking for something approaching a 10 percent unemployment rate this year. If you include the involuntary part-time workers, and you include the discouraged workers, the estimates probably get into the 13-percent range. It seems to me that regardless of your philosophies, and regardless of your economic theories, that massive continuing pressure is going to be placed upon the administration, the Fed and the Congress to take brandnew steps to tackle the job of unemployment.

Representative BROWN of Ohio. Let me just ask you, as an aside—which proposal do you think, for the same number of dollars spent or number of dollars lost in revenue, do you think would have had the greatest impact on economic recovery: the tax-cut proposal recommended by the President or the tax-cut proposal that was passed by the Congress?

Mr. PARKS. I have always argued the proposal recommended by the administration was inadequate; that something additional in the way of stimulus was required.

Representative BROWN of Ohio. That it was inadequate?

Mr. PARKS. Yes.

Representative BROWN of Ohio. So you consider the one that the Congress passed as adequate?

Mr. PARKS. I am persuaded at this point that it may turn out to be inadequate. That is another way of saying that even now, I do not look for anything other than a turtle pace of recovery this year with these other major sectors of the economy moving downhill. I am concerned about consumer durable expenditures. I am concerned about housing. I think housing is in a disaster area.

Representative BROWN of Ohio. But, Mr. Parks, I think the main difference between the program recommended by the administration and that passed by the Congress was that the administration's proposal contemplated much greater, much more significant rebates, et cetera, in the hands of those who probably would spend that money; whereas that was significantly watered down by the congressional proposal. And you still nevertheless prefer, apparently, because you are not quite as critical of it, prefer the congressional proposal to the President's proposal. Have I assessed your opinion correctly?

Mr. PARKS. I was thinking more of the total size of the recommended cut.

Representative BROWN of Ohio. Well, I am saying, if you put the same number of dollars along the thrust of the administration proposal, vis-a-vis the congressional proposal, there were larger rebates, more significant reductions immediately.

Mr. PARKS. I would have to go back and look at both programs before I tried to answer that.

Mr. ANDO. May I comment on that?

Representative BROWN of Ohio. Yes, certainly.

Mr. ANDO. I think that it does not make very much difference, because both of them are so inadequate that it is altogether unsatisfactory. Such minor differences cannot be of any significance at this point. What we need is something like another $30 billion to $40 billion additional fiscal stimulus at the minimum.

Representative BROWN of Ohio. But once again, Mr. Ando, you do not suggest to us specific ways.

Mr. ANDO. Yes, I can suggest to you much more specifically some more spending programs, such as what Mr. Parks suggested would be particularly useful.

Representative BROWN of Ohio. In which ones do you concur? You said such as Mr. Parks had mentioned.

Mr. ANDO. Well, for instance, additional social investments of various kinds on railroads and pollution controls—any social programs that we would have liked to have undertaken, but could not, because the resources were inadequate for it. Now is the time to undertake them. There are all sorts of unemployed resources in the economy; using unemployed resources for the social purposes is by no means costing us any amount of resources at all. It is simply creating additional resources.

Representative BROWN of Ohio. But let me remind you that in the field of energy and in the field of these many different areas, that there have been administration proposals going back to the quadriad. Many administration proposals have not been enacted by this Congress. Trying to develop an energy policy took months after it was submitted by the administration. We presently in the House just gave up yesterday the idea of getting out an energy bill, an energy conservation measure.

Mr. ANDO. But the energy conservation measure proposed by the administration is extraordinarily deflationary. It is of no help to us.

Representative BROWN of Ohio. Well, do you consider the one that the Ways and Means Committee reported out yesterday as being a terribly big stimulus?

Mr. ANDO. No. But I do not at the present time presume to judge which is a better energy policy. But we need a policy that is more expansionary at this point, until we manage to bring down unemployment to something like 6 percent. I do not consider 6 percent a satisfactory level of unemployment, but it certainly is better than 9 percent, and until then, what we need is a measure to stimulate the economy. What Mr. Ford is proposing is a measure to deflate the economy.

Representative BROWN of Ohio. Well, of course, the Ways and Means bill does also.

Mr. ANDO. It does so somewhat more moderately, and from that point of view of maintaining slightly more adequate stimulus to the economy—the Ways and Means measure is desirable, relatively speaking.

Representative BROWN of Ohio. Well, the reason I asked the question about what you recommend specifically is because I quite concur with the chairman that it is high time we stopped talking about the conclusions and find out how we get at the problem and do something about them. That is why we hold these hearings, because we hope to have legislation.

Mr. Ando. One helpful measure is to reduce the social security contribution. This is of couse a tax cut, but it also has a nice feature of reducing costs and therefore prices at the same time, and it also redistributes income in a somewhat more desirable direction. Then when the economy recovers and further revenue can be raised, we can contribute to the social security system from general revenue to maintain the social security system in adequate condition.

Representative Brown of Ohio. In other words, you are saying that basically, that the system, the funding of the social security system deteriorates—I do not mean to use that in a negative way.

Mr. Ando. For the moment.

Representative Brown of Ohio. And reduce your intake, and then in effect use general revenues to supplant the funds that you have turned out during this period. Is that right?

Mr. Ando. Correct. But we should work on the expenditure side also. Any social program that we can currently undertake using unemployed resources is pure benefits for the economy.

Mr. Parks. May I make one comment? I did not answer your question too well. I argued that I think policy overall may be inadequate. There is something that can be done, and that is to get some kind of an immediate legislation to help city governments. If half of Manhattan Island were to slide into the ocean, I am sure that the Federal sector would be there helping out. Some of us are persuaded that New York City has manufactured its own problems to a considerable degree; but at the same time it has been hit with an economic earthquake, to a considerable degree—I have argued—manufactured in Washington.

Now, if New York City falls, or if New York City is forced to chop employment, including chopping into the meat, such as police—if New York City is forced to freeze salaries, this is all very nice in the name of economy. But as an economist, whether it is the private sector or the government sector, when you economize—say by chopping employment—that costs somebody else his job and his income; and as you are saving on your own side, it shows up as loss elsewhere. When you defer capital expansion programs in the name of economy to get your own budget in better balance, this costs someone else his manufacturing sales. So what I am suggesting here is this; I will use the word Spencerian again—this Spencerian objective, to generate efficiency and economy in the private sector and at the city level, is all right as an objective looked at by itself. But for the community as a whole, it does not solve the problem. One man's expenditure is another man's income. One man's cost economizing is another man's job.

Right now an immediate emergency exists in some of our city governments. The emergency demands attention by the Congress and by the administration. I would argue that of the major shortfall of revenues in New York City, a good part of the shortfall is the responsibility of Washington, both morally and in the sense that they helped to bring it about.

Representative Brown of Ohio. Mr. Parks, the recession that we are suffering is being pretty much suffered throughout the world. Did Washington manufacture it throughout the world?

Mr. PARKS. No, of course not. I think there are a whole set of forces here—the fish, the food, the anchovies, the bad weather, and then the oil hikes.

Representative BROWN of Ohio. I trust you are not saying the bad weather was manufactured in Washington?

Mr. PARKS. No, I do not think it was. Nation after nation around this world pursued a deflationary—gigantically deflationary—policy. This helped generate world recession, and we were among the leaders in that deflationary policy; and being a giant, I would say on balance contributed more than any other single nation to worldwide recession.

Mr. ADAMS. May I comment on that? I, too, do not want to put the entire blame on Washington. But I think the comment is appropriate that had the phenomenon of inflation and the incipient phenomenon of recession been properly analyzed a year ago, our policy may have been different. And had our policy been different—and specifically, I am thinking of differences in monetary policy to some extent, and fiscal policy a year ago—we would not be nearly in the recession in which we are in now. So I think it is a point.

Representative BROWN of Ohio. Mr. Adams, let me just ask you then, why, during the summit meeting this last year—I participated in them and so on—there was a summit of economists, as well as business and industry, local government, et cetera, et cetera. Why was it that there were only rare voices that were speaking out with respect to the problem of recession, and that the great majority of those concerned in the fall of last year were concerned about inflation?

Mr. ADAMS. Let me say that I happen to find myself in the enviable position—I think if you will look back a year or so on the record, you will see that that far back, I advocated a tax cut. But let us lay that aside. Even I did not appreciate, as most economists did not appreciate, the full dimensions of the recession that was coming. It is not an easy job, but at least we were saying more than a year and some back that the U.S. economy was in a recession, that unemployment was building up. We did not see the dropoff that occurred, and most economists did not, so there was a real question of analysis and understanding.

The signals were very mixed. It was very hard, in a period of time when prices were rising rapidly—it is very hard in a period of time when the resources of the Bureau of Economic Analysis are inadequate. And consequently, we got a bad reading on how high the level of inventories was until some time last July or August.

Nevertheless, I will agree that there were many economists, as well as other analysts, who were somewhat misled in the last year, and did not appreciate the full dimensions of what happened. I think that is the only explanation.

Representative BROWN of Ohio. Mr. Parks, one final question—and you have been most patient, Mr. Chairman. You have made two statements which I would like to have you expand upon, in view of what I have observed as a concern of the administration about capital formation and recovery. We keep hearing that profits are down. There is no way that we can expect recovery without getting back better capital formation and recovery. You said this administration cripples capital formation, and then you also said capital investment will continue to slide down throughout this year. Now, since they are somewhat tied together, would you expand upon them?

Mr. PARKS. Well, let me comment on the last point first. I am saying simply that the surveys, the contracts, the orders, the appropriations, the forward investment commitments, the whole set of forward indicators, indicate a continued slide in capital formation in real dollars this year—12, 15 percent, continuing into 1976. Now, there is another forward indicator, another leading indicator of business activities called profits. My own expectation is that profits will slide some 30 to 35 percent this year. This slide in profits, coupled with celestial interest rates on long-term debt, coupled with unprecedentedly low operating rates in manufacturing, all work against capital formation reviving.

But there is something else—expressed eloquently as long ago as 1890—by Alfred Marshall in his monumental work, "Principles of Economics." He said that demand for capital is derived from the demand for final consumption. You can pass legislation in this Congress liberalizing depreciation further, providing additional investment tax credits, you can think of a whole bag of incentives—and unless you find a way to get two-thirds of the economy moving up, and that is consumption, you are not going to stimulate adequately a recovery of capital formation this year, next year, 1977, or 1978.

The prerequisite for a vigorous growth of capital formation in the kind of economy we live in here is to stimulate recovery of final consumption.

Representative BROWN of Ohio. Well, I think I substantially concur with you. But it seems to me, in our economy, that final consumption—the consumer is the one who can do the most for the recovery. Now, we seem to have had consumer credit. Outstanding credit has been going down, down, down. We have had the greatest inflow of funds into thrift institutions and other savings accounts that we have had in many, many months. Now, is it that this purchasing power is in the wrong hands, or is it that there is just such a poor consumer confidence that it is not being used; and how do we explain this rather strange phenomenon? I mean, the ability to purchase apparently is there, because of savings, because of unused credit that obviously is available, and it has been there before. It has been extended before, so it is there now. Why is it not being utilized?

Mr. PARKS. In some cases, liquidity rebuilding is running at a rapid pace, and you mention specifically the savings and loan and mutual savings banks. But I think for the economy at large that the job of liquidity rebuilding is just beginning. I am thinking, in many cases, of the corporate sector. I am thinking most dramatically of the State and local sector. I am saying that even rapid money growth will continue to be diverted in good part to liquidity rebuilding rather than into fast acceleration of spending. This is another way of saying, by the way, that our friend velocity is quiet. It is another way of saying, in simple English, that the forward indicators do not indicate any major propensity for major sectors to go on a spending spree. It is another way of indicating, as you suggested, that the unemployment rate is headed for 10 percent, and adjusted correctly to 13 percent. A lot of people are worried about losing their job.

Now, we have some history to support the theory. Let's go back to 1971–72. I have mentioned that monetary expansion has come very, very, very late in this recession. I recall in the 1971 experience, monetary growth got underway at a rapid clip in May 1970, and continued at a rapid clip; and the administration at that time forecast—and you may recall this—a $1,065 billion GNP. We did not get a $1,065 billion GNP. Over a good part of 1971, velocity was very quiet, and declining a good part of that year. There was a massive job that had to take place first, and that was liquidity rebuilding.

In 1972 velocity came from under sedation, which is another way of saying that liquidity rebuilding was on course. Velocity stepped up briskly in 1972. It had a vigorous advance, and that is why I have suggested that unless the Federal Reserve chokes money growth, you could sometime in 1976 have a rabbit—r-a-b-b-i-t—growth of this economy. I hope you get that. But the risk is still with us that you will not.

Representative BROWN of Ohio. One final question. Do you see any problem of overstimulus?

Mr. PARKS. No, I do not see any problem over the next 2 years, 2½ years, of overstimulus. There is such an unprecedented cushion of unemployed labor, idle factories, that I would expect this—I would expect to see a growth of aggregate demand, bringing with it a companion growth of output without reintroducing generalized demand-pull pressures for the economy at large for a long time to come.

Second—and this is a paradox of sorts—productivity was mentioned here earlier, productivity having gone to hell. Of course it has gone to hell, because output is down, and output per man hour is principally a function of output. If we could get a vigorous growth of out put, this would be a mighty force slowing the rise in unit costs, and would serve to minimize cost-push inflation, even as rapid recovery does not bring any time soon new, generalized demand-pull inflation. Now, once there is evidence—and I would like to see it—once there is evidence of a rise in the forward indicators and a rise in aggregate demand, I am sure that down the road we could slow the degree of stimulus. But I will stick with Mr. Humphrey's term, the front-end thesis. It sems to me that if you want to get ahead in this world, you had better concentrate at this point on the front end.

Representative BROWN of Ohio. Thank you, Mr. Chairman.

Chairman HUMPHREY. We are not going to keep you much longer. This is very valuable testimony that we have received from you. As Congressman Brown has said we are really looking not only for an argument, which we always get, but basically for some answers.

Am I correct that there has been no net increase in M_1 over the last 9 months, which is, as I understand it, currency in hand and time deposits?

Mr. ANDO. It has been growing at roughly for 9 months it has been growing——

Chairman HUMPHREY. Held by consumers that——

Mr. ANDO. Held by consumers? That I do not know. This is total. Total has been growing at about a rate of 4 percent on the average during the past 9 months. But I do not know exactly.

The measure of short run fluctuation in money supply is extraordinarily unreliable. Money supply covers both the member banks and nonmember banks and the Federal Reserve does not really have adequate monthly numbers on the banks that are not members of the Federal Reserve System. On top of which it has a rather large seasonal factor which varies over the course of a business cycle. And when you seasonally adjust these time series by standard methods, the resulting seasonally adjusted series are a relatively unsatisfactory indicator of anything and that is why, in some sense, particularly under the present circumstances, I think that the policy of maintaining a reasonable level of interest rate is a much more sensible policy. Under some other circumstances it is not necessarily so, but under the current circumstances, I think that is the much more sensible thing to do.

Chairman HUMPHREY. I noticed this morning in the press that, the President of France has declared, in a sense, a national emergency because of unemployment, which in France is under 5 percent. And we are talking this morning about maybe getting unemployment down to 6 percent.

Thank goodness that you said it was still unacceptable. But what bothers me are these well-heeled advisers and Government officials that are constantly talking about these unemployment figures as if they were sheer statistics and not human beings. They do not seem to understand that repercussions in the economy. It just absolutely baffles me. I just lose my sense of proportion. I guess every my sense of decorum when I think of it.

Up to December of this year, the President was still calling for a tax increase. That indicates a failure to understand that for a year the recession was underway, regardless of what happened at the summit meetings. I can take some justifiable pride in saying that as one of the members of the summit meeting I said we have twin evils and the biggest evil is the recession. We had the evil of inflation and recession. We were talking about raising taxes and the President was telling people to cut buying, this was the advice that the President was receiving.

Mr. Adams, you said you have recommended tax cuts. So did I. As a matter of fact, in June of last year I recommended a tax cut. At that time only $10 billion because then a $10 billion tax cut could have had some effect. By the month of September I had raised that to $20 billion and by February of this year I introduced a tax cut bill for $30 billion. I want to state my agreement with what Mr. Ando said. I think that the tax cut that we put through here was for another period of time. The $24 billion tax cut, $23 billion to $24 billion, does not relate to the forward indicators that we now see. It may be far too little. And if it is not coupled with monetary expansion, it is a zilch.

Mr. PARKS. Senator, it is worse than zilch. The growth of money over the last 52 weeks—that is 1 year—is 4 percent. Now inflation has far exceeded that. So what has happened is you have had a basic subtraction of real buying power in the economy over the past year. It is worse than zilch.

Chairman HUMPHREY. The report today, May 21, from the Department of Labor on real earnings in April, shows that real gross earnings decreased one-tenth of 1 percent from March to April after allowance for usual seasonal changes. And they give the reason for all of that. Real spendable earnings are down 4.1 percent since January, going to a 3.4 percent decline in real weekly earnings and an 8 percent increase in effective taxes.

So you have a situation where your real purchasing power is continuing to decline and production is continuing to decline. I must say that your views on what happens to our cities strike me as being very relevant to our current problems. It is a fact, for example, in my part of the country we have snowstorms that kill cattle. We have emergency assistance. In my part of the country we had floods on the farmlands. I was in the Congress with a bill to make sure that farmers got some help, a grant of money up to $5,000 and an interest rate not to exceed 3 percent on what they needed to restore their capital.

Now I think that is fair because those farmers are producers, but here in the city of New York that has become the nursing home for the poor, the unemployed, the elderly and the sick and a lot of people have moved out that could have paid the taxes. And now it is going bankrupt.

I must say that if I was the mayor of the city of New York, I think I would ask the President to declare a national disaster. We had a big snowstorm in my State in April. The Governor asked for the Secretary of Agriculture to declare it a disaster area, and it was. The Government is pretty slow to do anything about it. They have not got the money out there yet, but as least they got around to declaring it a disaster.

Now that is an act of nature. It is a disaster if a tornado hits. But if a human earthquake hits, well that is bad management.

Representative Brown of Ohio. Gentlemen, I am going to have to leave. There is one thing I forgot about, Mr. Adams, that I wanted to ask you.

The very last sentence of your statement, I noticed you insert a little word of caution. You say, "As we look ahead, toward a return to full employment, we must consequently look for other means to prevent a resurgence of inflationary pressures." And not only is that a little word of caution but you raise in my mind the question of what are these other means to prevent a resurgence of inflationary pressure?

In other words, you are saying that you do not want to use monetary policy but we should look to other means. I presume that is what you mean, other than restricting monetary policy.

Mr. Adams. Other than restricting monetary policy. If possible, we would like to achieve full employment consistent with as much price stability as possible.

Now there are a number of directions in which we can go. I did not feel that they were approriate for this hearing. But the kinds of things I have in mind are, one, something that pretty much everyone agreed on, in the summit meetings last fall, which was an encouragement to competition and an attempt to keep the regulatory commissions from maintaining high prices. Two, I think we have to study at much greater depth the whole question of price-wage guidelines and similar mechanisms which will allow us to achieve full employment without undue inflationary pressure.

Representative Brown of Ohio. Then I would presume that you would support at least conceptually, although not with respect to the specifics of the proposal that which the President just sent up the other day on the reorganization of the rails.

Mr. ADAMS. Precisely.

Chairman HUMPHREY. We are going to tie this down.

One of the things that we noticed is that the administration in its testimony from Mr. Greenspan here recently said that he thought it would be a mistake to set specific targets or objectives for economic policy.

How do you feel about that, Mr. Ando?

Mr. ANDO. I do not recall the context, but clearly some kind of intermediate target at the moment would be certainly helpful. I suggested the 6 percent unemployment.

Now I personally believe that one can operate the economy at something less than 4 percent unemployment and we would like to get there. But to begin with, you can get the consensus on a much more moderate target; one can worry about doing better once we get to 6 percent.

I think if you do not have some kind of a basic objective, one can always more or less move along without doing anything saying that, well, unemployment is 9 percent. Perhaps next quarter it will be 8½. And I think one has to be prepared with a fairly definite program at this point. I would very much like to urge the Congress not to postpone their review of fiscal activities until September but to proceed immediately because I do not think that the fiscal policy that has been taken so far is by any means adequate to bring the unemployment down to anywhere near 6 percent by next year.

Chairman HUMPHREY. We are going to do just that. I want the staff and the public to know that we are going to review this fiscal policy.

You know, is it not interesting that we have budget targets. We have a budget now and we have budget ceilings. But we have never told the American people that we are going to set an unemployment target. Everybody just talks about it but there is no official policy.

For example, if we set a goal for unemployment to not exceed 6 percent by the first quarter of 1976, then you can hold the Federal Reserve Board and every other agency of Government accountable and then when you call in Mr. Burns, you do not ask him what the money supply is. You say, "Mr. Burns, when are you going to do your share and pull the load to get this economy down to a 6 percent unemployment by April of 1976?"

That is the way I would like to operate.

Mr. ANDO. I think when you were away I concluded my discussion by saying that it would be very important to ask Mr. Burns to relate what he is doing to overall economic objectives, and I would think that he would find it extremely difficult.

Chairman HUMPHREY. We did do this in our annual report that we released to the public and presented to the Budget Committee and the Congress. We set targets in terms of unemployment, the trend of the unemployment rate, and GNP, and we compared it with the administration proposals and we laid out what we thought were reasonable targets to bring down unemployment. But the problem that I see in government is the lack of coordination of our efforts.

Now I am going to conclude here. I just want to say that I am very grateful to the members of the media that have attended today.

When we had Mr. Greenspan here we had every radio and television network present and we had these two tables loaded with the economic reporters. When we have Secretary Simon it is exactly the same thing. When we have the Director of the Budget, Mr. Lynn, it is exactly the same thing. When we have Mr. Burns, it is exactly the same thing. And they put out to this country through the media their story, including, may I say, their false predictions. That goes out, a story about being horrified by the size of the Federal deficit, the story that you cannot finance both the Federal deficit and the private borrowings at the same time. They say that you have got to watch out, if you do too much this year you are going to have wild, runaway inflation.

I sit in the Democratic caucus, that great, liberal group here in the Congress, quote, end quote, who are themselves horrified by the size of the deficit, who really reluctantly approved the tax bill of a reduction of $23 billion to $24 billion. They thought they were really venturing upon the precipice of unbelievable economic radicalism. And I will tell you why they feel this way—because it is ground into them day after day.

Here you are, brilliant men representing great universities, representing private investment, people that are looked to with great respect. And we have had two or three of the better people of the media here today who have covered it, for which I am exceedingly grateful. But there has not been radio coverage, there has not been a television camera.

Now I want to say that I have told the media this and I am going to tell them again, that they have an obligation to help educate this country, because even newspapers can go broke and maybe networks can too, despite Federal regulation.

And with that, the benediction has been pronounced, thank you very much.

[Whereupon, at 12:25 p.m., the committee adjourned, subject to the call of the Chair.]

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MONETARY POLICY AND ECONOMIC OUTLOOK

WEDNESDAY, JUNE 4, 1975

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

The committee met, pursuant to notice, at 10:10 a.m., in room 5302, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, and Javits; and Representatives Long and Heckler.

Also present: John R. Stark, executive director; Richard F. Kaufman, general counsel; Lucy A. Falcone, Jerry J. Jasinowski, L. Douglas Lee, Loughlin F. McHugh, Courtenay M. Slater, and George R. Tyler, professional staff members; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and M. Catherine Miller, minority economist.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Mr. Secretary, I thank you for coming, and I appreciate your patience here. I said both in seriousness and in jest that you had to take a back seat for a while to a group of educators who came in from my State, who came down here with some very serious problems, and they gave me the advance warning of calling me at 10 minutes to 10, and I spent a little time with them.

Now, you are kind enough to spend some time with us.

This morning, the Joint Economic Committee is privileged to have the Secretary of the Treasury, Mr. Simon, meet with us to discuss the economic situation in light of the revised budget estimates and the monetary policy targets recently announced by the Federal Reserve Chairman, Mr. Burns.

Mr. Secretary, let me say at the outset that I come to this hearing this morning in a very concerned attitude, and even at times, almost an angry mood. Ordinarily I have the reputation of being rather optimistic and sometimes people have said relatively good natured, and I want to maintain that. My comments this morning are not at all personal, but they are directed toward some of the policy positions that have been taken. I am going to speak very, very frankly.

I am very much upset over the lack of concern of this administration with respect to the staggering problem of unemployment which this country presently faces, and which, from all the indications and forecasts, we will face for the next few years.

I find no reason to be encouraged by the staggering figures of unemployment that are on the economic terrain today. I also am very much concerned and upset about what I consider to be budget estimates that are less than candid, and which we continue to receive from the administration. To put it right on the line, the veto of significant legislation which Congress has managed to pass which would be of help to distressed citizens of this country, I think, is uncalled for.

Now, let me spell out some of these charges.

First, high unemployment. By the administration's latest estimates, we face unemployment rates of 8.7 percent as an average in 1975; 7.9 percent in 1976; 7.2 percent in 1977; and 6.5 percent in 1978.

Now, no one can take comfort from those figures. Regardless of what the rate of economic growth is or what the gross national product adds up to, when you have a rate of unemployment in the figures that the administration has forecast, it is unacceptable politically, economically, and morally.

In my opinion, and in the opinion of many expert observers, present policies pursued by the Government will not produce even this much improvement in the unemployment situation in the next 3 years. Now that, of course, is debatable. There are many unknowns in the economy; but many of the witnesses who have appeared before this committee—and they have been a wide selection—tell us that the present policies being pursued by the administration will not bring down the unemployment rate, even to the unacceptable level of 7.2 percent in 1977, or 6.5 percent in 1978.

However, even if we are fortunate enough to achieve a relatively strong recovery, and I hope that we will, and there are some signs that the recovery is moving, we still face 3 long, hard years during which unemployment will be at or above what we call an emergency level.

I could not help but note last week, or about 10 days ago, Mr. Secretary, that the President of France declared an emergency in France because they have 4.5 percent unemployment. That is a national emergency. We run around here condoning 5 percent unemployment, people telling us that we think that is full employment.

When I came to Washington, unemployment was considered full employment at 2 percent. That was in 1950. By 1956 it had gone up to 3 percent. That is what we called full employment. By the 1960's, it had gone to 4 percent—that is what we called full employment. Now, we have been edged up to where, if you have 5 percent unemployment, that is full employment. Might I say it is full employment except for the 5 percent that are without work; and the terrible waste of resources, the incredible waste of productivity that we are condoning to me is much more horrendous than any budget deficit that this Government has. It is the unbelievable waste of human resources in unemployment, which is pushing this country into ever more serious long-term problems.

Now, the President has just vetoed the emergency employment bill which the Congress passed. Funds and personnel for manpower programs have been cutback; even funds for research into employment problems have been drastically cutback.

I want to say that I consider that veto totally out of context in terms of the economic facts that face the country today. I am sure you will have something to say about it. But, if there is anybody in the administration that can assure us that the rate of unemployment is going to be substantially reduced this year, we have yet to hear from them. This program of emergency employment was designed for this year—which the President vetoed. We are going to override that veto. I make a positive statement. We are going to override it because the Congress of the United States cannot accept that kind of thinking.

I have yet to hear one administration official stand up and say that they feel that unemployment is the major issue. They are constantly worried about the issue of inflation, and there are going to be 75 million persons in this country who will experience unemployment somewhere in their families this year.

I think that figure is not well know, Mr. Secretary, but it is estimated that some time during this year, 75 million people will experience unemployment somewhere in their families this year.

Now, I have heard plently of concern expressed about inflation, and rightly so. It is a difficult problem, and a compelling one, and I am pleased to note that progress is being made against inflation, although primarily at the cost of high unemployment. I was pleased to see the administration's new forecast which shows inflation coming down faster than had previously been expected.

It is just that I do not believe an important contribution to further reducing inflation is made by vetoing bills which would provide summer employment for our young people. Now, how in the name of common sense, with 40-some percent of black teenagers in our inner cities that are crying for work—and by the way, they have just got to have some work, they just have to have some work—how can you justify a veto of a bill for summer employment and other emergency programs to deal with economic distress? The notion that we can control inflation only by imposing a long period of high unemployment on millions and millions of our citizens is ridiculous. It is tragically misguided. It is unacceptable. And, as I repeat, it is unacceptable politically, morally, and economically, and I do not intend, as one Senator, to stand for it. I intend to raise cain about it until we get some action.

Now, let me turn to the more specific question of budget estimates. The night the President signed the tax bill, he went on a nationwide television show and drew a line at a $60 billion budget deficit. How convenient for him that when the technicians at the Office of Management and Budget revised their estimates of the deficit, they came up with exactly $59.9 billion. My, they are very expert.

Now, what would the President had done if, through some computer error, let us say, they had produced an estimate of $60.1 billion instead of $59.9 billion? Suppose the technicians had been free to be somewhat more honest with their estimates? Suppose they had reduced the expected receipts from offshore oil leases by $4 billion, as the congressional Budget Committees have done? I want to point out that those Congressional Budget Committees took exactly the same figures as the Office of Management and Budget, and the Office of Management and Budget comes up with a figure of $4 billion more from offshore oil leases than two committees of the Congress with expert staff. I suggest that they at least get together and find out who has the right figures. Suppose the OMB's estimates had allowed for the extension of the tax cuts in 1976, which certainly would be a realistic allowance? These two adjustments alone would bring the budget deficit estimate to $68 or $69 billion; but of course, a more honest estimate such as that could not be presented because it would have conflicted with the line that the President had to draw for that television broadcast.

I suggest they get rid of all those gimmicks of tearing off sheets of paper on calendars and all of that nonsense.

Mr. Secretary, as well you know, this committee—and you know it well—has held hearings on the financial aspects of the budget deficit, and we have consulted by letter a very large number of experts on this subject. The overwhelming majority of these experts have agreed with me, that our credit markets can handle a budget deficit of $70 or $75 billion in fiscal 1976—not that that is desirable, but that it can be handled.

It is a good thing that the credit markets can handle this deficit because it is my judgment that we will have a deficit of that size. I think we have got to just start facing up to the degree of the sickness of this economy and quit going around sucking on peppermint lifesavers as if it is going to save us. We will have the deficit, by your estimates, once they are adjusted for obvious realism, we will have it by the estimates of the Senate Budget Committee. The deficit is unavoidable if we are going to do the job of supporting the economy.

If we do a good job in 1976, rapid economic growth will steadily reduce the budget deficit in future years. There is no reason not to expect a balanced budget or even a surplus once we are even close to full employment—and I mean by full employment, between 4 and 5 percent.

The trouble is, unless we improve our present policies, we will never get back to full employment, and just as surely as you and I are looking at each other, Mr. Simon, we are going to have continued budget deficits unless we get this country back to work. The word needs to be driven into the mind of this administration—work, jobs, jobs, jobs. That is what we have got to get, and I am just fed up to the ears with listening to nice words and hearing that everything is just popping great.

On the very day that the administration said that we have got a recovery underway, they announced the twin cities of Minneapolis and St. Paul to have an emergency unemployment situation. I am home. I pick up one paper over here and it says you are doing great. All of a sudden I pick it up over there and it says now you are over 6 percent unemployment. We surely have enjoyed the benefit of recovery.

Now, Mr. Secretary, your chance—equal time.

Thank you.

Secretary SIMON. Mr. Chairman, I am at a loss to know how to begin.

Chairman HUMPHREY. Just begin by telling us how to bring the unemployment down.

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ACCOMPANIED BY EDGAR R. FIEDLER, ASSISTANT SECRETARY FOR ECONOMIC POLICY: AND EDWARD P. SNYDER, DIRECTOR, OFFICE OF DEBT ANALYSIS

Secretary SIMON. I want to begin first and foremost by saying I have some disagreement. When you say that we do not have any concern, or imply that we are adopting policies that foster high unemployment——

Chairman HUMPHREY. No, that is not what I said; I said your policies are not directed toward reducing the unemployment at a sufficient rate. I did not say you had no concern.

Secretary SIMON. Intelligent men can disagree, and I can assure you that we share your concern, Mr. Chairman, about unemployment. The figures are obviously staggering, that is why we have proposed—you know, we are going to have the largest deficit in history; the biggest peacetime deficit not only in absolute terms, but also as a percent of total economy. That is why we proposed last summer a very large expansion of public service employment and expanded unemployment benefits.

Chairman HUMPHREY. Now, how big a job program did you propose, Mr. Secretary? That is the problem here, you know; you say that you have got a big problem——

Secretary SIMON. The total for aid to the unemployed in fiscal 1976 will be in excess of $18 billion, Mr. Chairman.

Chairman HUMPHREY. Now, wait a minute. That is unemployment compensation you are talking about.

Secretary SIMON. That is public service employment—expanded unemployment programs, I was talking about.

Chairman HUMPHREY. Now, unemployment compensation is not a job program.

Secretary SIMON. I was talking comprehensively about all of the programs that we are proposing to meet this problem.

Chairman HUMPHREY. Well, I want you to specify that.

Secretary SIMON. All right, sir.

Chairman HUMPHREY. I want you to give me the details.

Secretary SIMON. I will supply for the record the details and the amounts to be spent in fiscal 1976.

Chairman HUMPHREY. How many public service jobs did this administration propose in its budget for fiscal 1976?

Secretary SIMON. I will provide that list for the record.

[The information referred to follows:]

According to current estimates, outlays for aid to the unemployed are expected to total $18 billion in 1976. This includes $15 billion for unemployment insurance and $3 billion for Public Service Employment (PSE) from all sources. The PSE funds could finance about 350,000 jobs at an average annual cost of $8,500 per job. Three hundred and ten thousand of these jobs would be financed in large measure by the $1,625 million requested by the President but not yet enacted by the Congress.

Secretary SIMON. We would also like to find, Mr. Chairman, additional ways to improve the unemployment picture more rapidly. Unfortunately, neither we nor anyone else have been able to find ways to achieve that goal, except by producing in the end more difficulties that would bring back the inflation—the inflation that caused the recession, and would indeed do it again—only with more unemployment than we have now. What we have to recognize is that we have to have patience, that we have to deal with the unemployment issue in such a way that we are going to bring down permanently the rate of unemployment and be able to provide sustained and durable noninflationary growth in this country.

Now, the bill that you referred to that the President vetoed, I would just like to comment on that briefly, and also our budget. Let me talk about the budget, because that will not take me too long.

We are not trying to fool anybody, Mr. Chairman, about the $60 billion. His $60 billion is just based on different assumptions than you made, as far as the budget is concerned. And they are honest assumptions on our part—honest assumptions plus a determination to keep the level at the $60 billion which the President has announced in his speech. And if we have a difference of opinion on Outer Continental Shelf revenue, all we have to do is look at the recent Texas experience. The amount of money we received—$2.7 billion was budgeted, approximately, and we received about $300 million for the leases. And I can go into that later, why I think we received less. So therefore, on actual experience, we had to drop our estimates for the future. There was no reason for us to believe the situation was going to improve.

Chairman HUMPHREY. Maybe you did not understand me, Mr. Simon. I said that the administration had indicated a figure that was $4 billion more in revenues from offshore oil than the two committees on the budget of the House and the Senate.

Secretary SIMON. I was explaining why we were lower, based on our experience.

Chairman HUMPHREY. You were higher, in terms of our revenues.

Secretary SIMON. This time we were higher? In the recent ones?

Chairman HUMPHREY. Yes.

I am talking budget——

Secretary SIMON. In 1975 and 1976?

Chairman HUMPHREY. Yes. We are talking 1976; that is the budget we are working on now in the Congress.

Secretary SIMON. Well, as I say, you make a useful suggestion and that we ought to get together and iron them out. But my overriding point is that we made an honest appraisal of where we thought—and where we were determined—to keep the budget limit in 1976, and if there is a difference of opinion, it is an honest difference of opinion and not an attempt to fool anybody.

Chairman HUMPHREY. I do not deny that; I am not accusing the administration of nefarious practices, but I will tell you what I am saying. I think you get these figures up there and the American people are led to believe that this is what it is all about. I am a Senator and I have got to go home and talk to and see these people, and all at once my calculations on the deficit are different from yours; and they say, why is that? And my answer simply is that your figures are not accurate. First of all, your figures——

Secretary SIMON. My answer to that would be that is your opinion.

Chairman HUMPHREY. No, not at all, because I think the evidence proves it.

First of all, your calculations on revenues have been dead wrong because you underestimate unemployment.

Secretary SIMON. Well, let us be sure of one thing, our calculations and estimates on revenues in the Treasury Department are wrong every year, and so are everyone else's. It is a most imprecise measure as far as attempting to gauge what the Treasury will collect. It is just a matter of degree, and I think our estimates were only off about 2 percent.

Chairman HUMPHREY. All right, fine; my point is, therefore, that when the President gets on that television and starts telling the world how the Congress is going dilly-dallying around on all of this spending, I think that we ought to have it clear that when the President is talking to us that he really has got to say this is just a guess, that we really do not know what we are talking about. It is a guess; the Secretary of the Treasury says it is a guess. But that is not what he says at all.

Secretary SIMON. Well, all estimates are imprecise, and that is what I have always said.

Chairman HUMPHREY. Well, get the President to say it, then.

Secretary SIMON. All right, I will speak to him about it.

Now, as far as the Emergency Employment Appropriations Act, there again, we have a difference of opinion and, unfortunately, the presumption as far as the American people are concerned, is that this, indeed, is going to create jobs. And the bill has got a very attractive title. Sure, everybody wants to get people back to work and nobody wants to get people back to work more than we do, but in our judgment it would just contribute to choking off the very economic growth that it is supposedly intended to stimulate.

Chairman HUMPHREY. Why?

Secretary SIMON. The spending under this bill—a lot of it would not occur soon enough to accelerate the economic recovery; over half of it comes after fiscal 1976. You know, it is as if you say, who can be not in favor of summer employment. Well, the President favored $2 billion. We agreed on the summer employment. It is important, and the President's proposal of $2 billion covers this. You know we have done so much that I elaborated before in terms of the deficit; and here, again, reasonable men can disagree. We have done a great deal between the deficit and the tax cut and all of the rest of the stimulus, particularly the expansion of monetary policy. We think that is sufficient at this time to assure stable growth. To continue to promote programs whose spending impact is going to have a lag as the economy is moving back to full capacity would indeed in our judgment bring greater problems later on through a resurgence of inflation and just a repeat of the same cycle again. And that is our difference of opinion, obviously, on the degree of stimulus, if you will.

Chairman HUMPHREY. Mr. Secretary, the bill the President vetoed had $5,300 million in new budget authority for emergency employment; most of it was accelerating the emergency employment for projects that are ongoing, so there could be a step-up in activities. There was $1,600 million for 310,000 public service jobs. Now those people can be put to work. That is not a matter of long-term planning. There are $456 million for 840,000 9-week summer jobs for youth.

Secretary SIMON. We are talking about being in total agreement on the $1,600 million and the $400-and-some-odd million for youth summer employment.

Chairman HUMPHREY. Yes.

Secretary SIMON. The point is that the balance of it is just expenditures that are not going to do a thing, in our judgment, as far as increasing jobs. It is under the guise of aid that this bill contains a conglomeration of increases that are extremely expensive and are not going to do anything as far as solving the unemployment is concerned.

And half of that, as I said, occurs after fiscal 1976 when the economy is moving back or will have moved back at that point close to capacity.

Chairman HUMPHREY. Well, we will have to fight it out in the Congress, and I just simply say that the situation where you have got 9 percent unemployment, official figures—really 12 percent real unemployment—and that is a figure that needs to be recorded because it is not 9 percent. You have got 3.5 million workers that are on part-time jobs who want fulltime work. You have lost a million and a quarter in the labor market that have just dropped out because they have given up. And so you have got—the official figure is 9 percent unemployment. You have got 12 percent true unemployment. And here is a program that comes out—sure it may have some weaknesses in it—like many of the estimates, they are not always precise—but I will tell you this, that if we dilly-dally around, the summer is going to be over and you are going to have hundreds of thousands of kids on the streets with no work.

Secretary SIMON. We do not want hundreds of thousands of kids on the streets—

Chairman HUMPHREY. Then you ought to sign the bill.

Secretary SIMON. The President agrees with the $2 billion proposal, not the $5.3 billion that just legislates unnecessary spending, which is going to exacerbate our problems in the future. And that is the one thing we have to fight to avoid.

Chairman HUMPHREY. Mr. Secretary, this is where we disagree.

Secretary SIMON. Yes, sir.

Chairman HUMPHREY. The point is that money that is spent for jobs is not just spending. Money that is spent for food stamps and unemployment compensation, which is necessary, is spending but it does not produce a thing except a headache. When you produce jobs to repair hospitals, Civilian Conservation Corps, job camps, summer youth jobs where kids are out doing something they ought to be doing, and when you have loans for SBA and loans for EDA for job opportunities programs, when you have Corps of Engineer projects, you have farm operating loans—and all of that is in this program—these are things that produce something. I want to tell you I am amazed that this administration gets on the kick of being willing to be kind of generous over here, even though we have to push them a little bit on unemployment compensation, but are unwilling to put people to work. I have been around; people want work. The country wants the people to go to work. We have got to have jobs. That is what my message is, and I am going to keep pounding away at it until we get some action.

Secretary SIMON. I think the country wants a sustainable prosperity, and that is what we are trying to do, recognizing how we have overheated the economy twice in the last decade in coming out of a recession.

Chairman HUMPHREY. It has been cooled.

Secretary SIMON. Yes, it has. And what caused the recession? The major factor was the inflation, the double-digit inflation.

Chairman HUMPHREY. We are going to the causes, Mr. Secretary. I have had Mr. Burns up here, and I personally think this recession was trademarked, made and designed in Washington, D.C.; there is no doubt about that. But to go ahead with your——

Secretary SIMON. I would agree with that.

Chairman HUMPHREY. Go ahead with your statement here, and let us hear about that budget estimate business that you have got.

Secretary SIMON. All right, let me start on my statement.

I think there is fairly general agreement today—away from you and I, Mr. Chairman—that the economy is poised for recovery after having experienced the first prolonged period of peacetime inflation in our history and the deepest recession since the 1930's. There is much less agreement on the exact path that the economic recovery will or should take, and on the risks that will be encountered along the way. Yet, now is the time when many of the crucial decisions on economic policy have to be made. Therefore, I welcome the opportunity to give you my appraisal of the situation and also to hear more of yours, sir.

A wide range of evidence suggests that the current recession is now in the process of reversing direction. But recovery from this point on will not quickly be evident in all of the measures of economic activity. For example, further increases in the rate of unemployment cannot be ruled out. As history tells us, unemployment tends to lag on the upside of the cycle. Employers were slow to resort to layoffs when the economy turned down in 1974 and may now be slow to rehire until the recovery is well underway.

Real growth will be resuming in an underemployed economy, but one that still has an underlying, built-in rate of inflation that is unacceptably high. Our immediate need is to reduce the rate of unemployment to a much more tolerable level. But we must go about this essential task in such a way that the rates of inflation are not quickly recreated. Instead, we should do all that we can to direct the economy onto a path of recovery that can be sustained over a long period of time. There is only one way that we can possibly achieve and maintain low rates of unemployment and that is in an environment of reasonably stable prices.

In my opinion, there are at least two major constraints on how far and how fast the current recovery can go. One is the state of our financial markets and their ability to handle large Federal deficits along with the credit requirements of the private sector. The other is the state of our industrial capacity and its ability to support a strong recovery without encountering serious bottlenecks. I would like to examine with you this morning these potential financial and industrial limitations on economic recovery and consider what their influence is likely to be.

On the surface, it may seem premature to be concerned now about potential limitations on an expansion that is not yet a statistical reality. But now is the time to examine these and other possible barriers to a healthy economic recovery, rather than later when it will be too late to adjust our policies. Events over the past decade indicate all too clearly the need to anticipate the economic effects of our policies well in advance, if we are to avoid overdoing them and thereby creating a new boom-and-bust roller coaster for our economy.

There has been considerable discussion in recent months of the potential impact of large Federal deficits on the prospects for economic recovery. I think Paul McCracken put the matter succinctly when he noted before your committee earlier this year that:

If the financial community has been slow to appreciate the role of fiscal policy in the management of the economy, economists have been slow to face fully the implications of the fact that Treasury financing and private borrowing do compete for funds in the same money and capital markets. And Treasury requirements are now large enough so that their impact on financing in the private sector must be faced quite explicitly.

As I have said on many occasions, it is the timing of the Federal deficit that is the key to a proper understanding of the problem. My concern all along has not been with calendar 1975. I expect some strains, but basically I think the financing of our Federal deficits will be manageable this year. Serious problems are not likely to appear near the bottom of a recession when monetary policy is easing and when private short-term demands for credit are falling.

For example, short-term business borrowing at banks and in the commercial paper market has fallen by $5 billion thus far this year, in contrast to increases of $10 billion and $12 billion in the comparable periods of 1973 and 1974. This does make room temporarily for the financing of Federal deficits, although it does not rule out periods of temporary market congestion, particularly since long-term corporate demands on the bond markets have not followed the pattern of recession decline. For example, corporations have brought to market a record $15 billion of long-term securities so far this year, up sharply from $4 billion and $8.5 billion in the comparable periods of 1973 and 1974. On balance, however, although there have been some financial strains, the weakness of the economy makes the Federal financing task for this year manageable, and to date our outsized Federal deficits have not created serious new problems.

Chairman HUMPHREY. Now, is that not kind of a change of position, Mr. Secretary?

Secretary SIMON. No, sir. If you will go back to my testimonies—and I am pulling quotes out of former testimonies on this subject—where I warn, not predict, of the dangers of these deficits—not during the period of slack, but as the recovery commences and on into the future.

Chairman HUMPHREY. Well, as the recovery commences, Mr. Secretary, good Lord, we ought to be eliminating deficits; that is the whole purpose of a recovery.

Secretary SIMON. We ought to be eliminating deficits but what was the danger? If we look back on the danger at that time, we presented—the President presented—in the initial budget a $52 billion deficit. Well, subsequent debates in the Congress during the ensuing months suggested that we would have $80 billion, $100 billion—some Congressmen were saying $125 billion to $150 billion budget deficits. Some economists and others were saying $100 billion to $125 billion was indeed desirable. Well, that was the fear that was present at that time, and we would clearly move, if we moved into the $80 billion to $100 billion deficit range during fiscal 1976, and the anticipated recovery, that is the danger zone and those are my exact words from 3 and 4 months ago when I testified on this subject the first time.

Chairman HUMPHREY. Now, nobody that I know has been of the opinion that if you got to $100 billion or $125 billion budget deficit you would not have serious pressures in the money market. But I think there has been a feeling that, from the testimony presented in the past, and I have been watching it pretty carefully, that you have been deeply concerned over the ability to finance a budget deficit of maybe $75 billion.

Secretary SIMON. In 1976?

Chairman HUMPHREY. In 1976.

Secretary SIMON. Yes, indeed, I am.

Chairman HUMPHREY. You had better get ready for it; it is apt to happen.

Secretary SIMON. If you notice, as I quote here in my testimony, your 20 of 28 experts as they are called, who responded to your questions were pretty much split on 1976, not the way you described as 20 to 5 on this calendar year. But looking ahead, if you looked ahead, you had two schools; it became almost 50–50 with people who thought there would be a problem during the economic recovery period—we are talking about next year, now. And the ones who did not think it was a problem, Mr. Chairman, were making the assumption that this was because of what the Federal Reserve was going to do and should do by expanding the money supply. Now, this is a very fundamental difference of opinion that we have, because I do not believe this. And if that is what they believe, that is their privilege. It is risky to expand too fast in order to accommodate and not have the crowding out and the attendant problems that occur with rising interest rates. Monetary expansion cannot accommodate excessive demands.

The degree of optimism was interesting to me that was expressed on this issue. It seemed to vary inversely with actual experience in the financial markets. But there again, these were matters of judgment based on experience, and they are not predictions, because no one can make predictions on this issue.

Shall I continue?

Chairman HUMPHREY. Please go right ahead, yes, sir.

Secretary SIMON. However, we should not forget the continuing problems of high inflation, high inflationary expectations and high interest rates. All are still very much with us, and it is disconcerting that we are starting this economic recovery at levels well above those of any previous postwar recession.

Chairman HUMPHREY. Now, Mr. Secretary, again you say the rate of inflation is high in this recession. Is that right?

Secretary SIMON. Yes.

Chairman HUMPHREY. The rate of unemployment is higher, too. I just wanted to constantly keep reminding you of the problems that we find in the closest, you know; not the ones in the front room, the ones back there in the kitchen.

Secretary SIMON. There again, I want to emphasize that we share your concern about unemployment, and recognize how difficult it is to attempt to explain a concern and not cure a problem instantly. But it is our desire to provide all of this instant prosperity over the years that have gotten us into the problems we are in right now, and we want to attempt to avoid that in the future so we can have——

Chairman HUMPHREY [continuing]. I do not agree with that at all. We will come back to that later.

Secretary SIMON. Sure.

But what happens next year and the year after, as the economic recovery progresses? We can take little comfort from getting through

1975 without difficulty, if problems develop in 1976 or 1977. The important thing is to prevent the problems from developing at any time.

We cannot be sure that they will not. There is a growing awareness among market participants and economists that there is a danger of serious financial trouble once the economic recovery gets well underway. Short-time private credit demand could turn around rapidly and add to total credit demands rather than subtracting from them. In such a setting, there is a strong possibility that an imbalance will develop between the total of Government plus private borrowing and the prospective supply of funds at any feasible rate of monetary expansion. As a result, interest rates may rise sharply and not all private borrowers will obtain credit; some will be so-called crowded out of the market.

This issue of crowding out has a number of different facets, which we should try to keep separate for a full understanding of the issue. A few observers have attached the crowding out label to the decisions in recent months by some high-quality borrowers to defer their bond issues. In fact, those actions are not really crowding out, since the companies involved will obtain credit from alternative sources, probably from the banking system. What they have done is to temporarily opt out of the long-term market on their business judgment that the terms of their borrowing will be better later.

Nor is crowding out something that happens only on special occasions with a bell going off to announce the fact. It is, rather, a permanent condition of the credit markets in the sense that demand always exceeds supply, and thus some would-be borrowers—financially shaky companies or municipalities that are at the bottom of the quality list—are constantly being crowded out at the margin.

But that is not the issue here. What we are talking about here is the impact of large, and more importantly cumulative, Federal deficits on the availability of credit to private borrowers who would otherwise be able to obtain and use those funds. Federal debt always has the highest credit rating, so when the Treasury comes into the credit market for funds, it does so at the head of the line and, inevitably, some private borrowers get pushed out of the line at the other end. The larger total demand for credit raises the level of interest rates and makes many otherwise viable projects—sometimes whole industries, such as housing or utilities—unprofitable.

There is no escape from this outcome. We are sometimes advised to avoid competing with private borrowers in the long-term markets by concentrating all Treasury issues in short maturities. It is not generally understood to what extent we have been doing just that over the years. As the attached chart shows, the average maturity of outstanding privately held marketable Treasury debt has fallen from 5 years and 9 months in 1965 to 2 years and 8 months currently. So far this year, we have done 81 percent of our borrowing at short-term—that is, 0 to 2 years—15 percent in the intermediate markets—2 to 7 years—and only 4 percent in long maturities. It is clear, therefore, that our borrowing activities have been heavily concentrated at the short end of the maturity spectrum. And with what results? Has it prevented long-term interest rates from rising over the past decade? Hardly.

Some people say too much short Treasury debt creates inflation, but that notion is often disputed, and we really cannot be sure one way or the other. One point on which there is no controversy, however, is that a constant Treasury presence in the marketplace, rolling over one large issue of short-term debt after another, is highly disruptive to all the financial markets.

For this and other reasons, we receive a great deal of advice to borrow in all parts of the market. For example, the Government and Federal Agencies Securities Committee of the Securities Industry Association advised us in their report of February 24, 1975, as follows: "The Treasury should tap all maturity areas, including the untouched 9 to 15 year sector . . .", and "Treasury offerings should be designed to create and build an upsloping yield curve, even in the 0–1 year bill market. This is fundamental to accomplishing any desirable ownership or maturity structure that will get this financing job done."

We have not followed the recommendations of our advisory committees in all respects, for the ultimate judgments have been ours, as they should be. But I agree completely with the wisdom of their consistent advice that to raise the tremendous sums we require, without extreme disturbance to our financial structure, we must issue securities in all the different maturity ranges; and we must do our best to halt the long, continued concentration of our debt in short-dated securities.

I also agree that the Treasury should design its offerings to create and build an upward-sloping yield curve to appeal to nonbank investors, and to improve the maturity structure of the debt. The importance of an upward-sloping yield curve should not be underestimated. As the Securities Industry Association committee put it:

> Because the majority of institutional investors borrow short-term funds and invest them longer—this is true of commercial banks, of savings institutions and others—anything that raises short-term rates destroys the incentive to invest longer term, be it in mortgages, corporate bonds or stocks. This is because any action that makes short rates higher than otherwise simply increases the risks of investing long, and destroys the incentive or need to extend investment maturities.

Similarly, the weight of practical and experienced market advice, as I have already indicated, is that we should offer securities in all maturity areas to minimize the risk of an adverse impact on any particular sector. Indeed, unless we can offer securities in all the maturity ranges where demand exists, debt management is complicated and the ultimate cost of financing our deficits is likely to be increased.

In this connection, I should mention the sometimes erroneous conclusions about the impact of Treasury financing operations on particular sectors of the economy. There is a tendency, for example, to think of housing in terms of permanent, 30-year mortgage financing, but as every homebuilder knows, the availability of construction financing is as important to getting a job started as the permanent financing is to getting the job completed. We also know the deposit flow to financial institutions, such as the savings and loan associations, is far more sensitive to the competition of shorter term Treasury obligations than to the competition of longer term obligations.

Indeed, every sector of the economy, every aspect of our financial markets, is so interrelated that the undue weighting of Treasury financing in any particular maturity area can have adverse effects throughout the whole market—which could largely have been avoided by a better choice of new securities.

As we move forward into the recovery phase, there is an additional reason for concern with our debt structure. It is obvious that a substantial portion of our financing in the future, as in the past, will have to be handled in the short and intermediate area. But if we concentrate our new offerings entirely in the short and intermediate-term areas, then, the economy has achieved a substantial measure of recovery, the problems of the Federal Reserve would be greatly complicated. Short-term Treasury debt is very near to money, and it can be liquidated to provide funds for other purposes at small cost, unless there is a substantial rise in interest rates. In my judgment, and I believe this is a judgment shared by other market professionals, excessive amounts of short-term Treasury debt could contribute to another situation in which we could get an excessive rise in short-term interest rates, with the whole panoply of adverse economic and financial consequences such as developed in 1966, 1969–70, and again in 1973.

A further reason why there is no escape from the process by which large and cumulative deficits lead to rising interest rates is the fact that excessive borrowing at short-term is perceived in the credit markets as a portent of inflation. And when inflationary expectations are intensified, borrowers increase their demands for long-term funds because they expect future shortages and higher rates, but at the same time lenders are reluctant to make commitments for long periods. Thus, demand in the long-term market is increased and supply is reduced. The inevitable result is a crowding out of some private borrowers at the margin, and a rise in interest rates in the long-term markets as well as for short-term instruments. The sheer size of the cumulative deficits is the basic force, and there is no escape from their effects.

Of course, some see an escape in the form of a Federal Reserve policy that leads to a rapid expansion in money and credit. Such action might postpone the problem for a while, but only for a while. In the end, we would only have still more rapid inflation, still higher interest rates and still another severe recession.

As I have repeatedly emphasized, this result—the crowding out and the new explosion of prices—is not inevitable. But as we look ahead to the prospect of continuing large deficits. I believe the risk is a very serious one. It can be limited, however. The exercise of close restraint over Federal expenditures, which in turn would keep our deficits and our borrowing requirements in check, can minimize the danger that the economy will encounter any binding financial constraints over the next couple of years.

There are three closely related factors that explain why a potential financial constraint to the recovery of the economy exists in the current situation, where none has shown up in previous postwar recoveries. First, a decade of inflation has begun to limit the absorptive capacity of our financial markets, and seriously affected their functioning. Second, the Federal Government, through its deficit financing and rapidly expanding credit programs, has preempted a very large share of the total securities markets in recent years. Third, and most crucial of all, there is an enormous forward momentum in Federal expenditures. Unless we check that runaway growth, there is a serious risk, in my opinion, that the Federal Government itself may clog the financial markets and choke off economic recovery.

We must not be lulled into a false sense of security by the improvement in financial markets and the very successful recent Treasury financings. From January through June of this year, we will have raised some $36 billion in a slack economy while monetary policy was easing. Another $70 billion to $75 billion or more will need to be raised in the coming fiscal year while the economy is recovering, and private credit demands are rising.

Ideally, the Federal budget would then begin to move back toward balance, but we delude ourselves if we assume that such a benign state of affairs is going to develop automatically. Over the past decade, Federal expenditures have shown a consistent tendency to outrun receipts. We must take effective steps to restrain that tendency. Otherwise, some future session of this committee will be examining on an even more urgent basis the same problems we face today.

Because I have tried to point out the risks of unsound fiscal policy, and ways that we might minimize that risk, a number of critics have accused me of crying wolf and creating a climate of doubt and apprehension in the credit markets. I would like to make two points about these accusations.

First, it is the responsibility of the Secretary of the Treasury to maintain the U.S. Government's financial integrity. Speaking out on developments that endanger that integrity is a necessary and vital part of the job, though it will win no popularity contests. Surely I would be criticized still more vehemently if I were to refrain from speaking out when, in my judgment, there was a risk of the Government pursuing harmful policies.

Second, even allowing for the shaky state of public confidence in the Government's ability to manage the economy in this uncertain world, it is nonsense to contend that my comments on the subject are going to create chaos in the credit markets. Could anyone possibly think that participants in the financial markets do not have the sense to recognize these dangers by themselves, in the absence of comments from Washington? They know what is going on, because every financial house of any size in this country has analysts assigned to keep track of the Federal budget. They know how important it is to conditions in the financial markets, and that it can cause severe difficulties.

They knew, for example, of the heavy demands by both corporations and State and local governments for long-term funds this year—and they knew it back at the beginning of this year, long before the enormous size of our deficits became general knowledge and long before crowding out became a popular debating topic. These huge demands were not caused by rhetoric from Washington or anywhere else. And it was those huge demands that kept long-term interest rates as high as they are. To me, therefore, it seems naive to blame the debate on the debaters for what has been happening.

There is, in fact, very little, if any, lasting market effect from a statement by the Secretary of the Treasury or any other person regarding the course of future market rates, unless the facts support his conclusions. Those who make decisions in markets do not survive for long by acting on statements that are not based on fact. Market reactions to statements which are not based on facts are temporary and self-correcting. The key determinant of market moves is what the participants perceive as the realities of current and prospective financial conditions. These are based on current actual conditions in the market, and on anticipated conditions of the supply and demand for savings, which includes the present and prospective deficits. Unfortunately, the cause of the problem is too frequently attributed to the messenger rather than to the message itself. Or, as the Wall Street Journal so aptly stated, that is like blaming the obstetricians for rising birth rates.

Furthermore, it is not as though this crowding out debate has been purely one sided. While I and others have been warning of the dangers of excessive budget deficits, many others have been publicly disparaging those warnings.

The press release issued by this committee on May 15 is a case in point. It reports on a survey of 28 economists and financial people about the impact of the budget deficits on the credit markets. A poll was made of the responses and the results were announced as 20 who felt the deficits could be financed easily, 5 who dissented and 3 who were uncertain.

You, Mr. Chairman, very fairly included in the full texts the letters from the 28 individuals in the Congressional Record. Our examination of those letters suggests that the real unanimity reported in the press release applies only to the current financing of the deficit, that is or close to the bottom of the recession. That is not, however, what I have been focusing on. What I have said repeatedly is that a $60 billion deficit for fiscal year 1976, although it will involve some financial strains, is manageable; but that a deficit in the range of $80 billion to $100 billion will clearly move us into the zone of serious danger—not this year but in calendar 1976 and beyond, when the economic recovery gets into full swing and private credit demands are strongly on the rise again. If we analyze the letters from your survey for what they say about this alternative question, a very different view emerges. Much of the optimism evaporates, and about half of your respondents express varying degrees of apprehension.

For example, in your remarks on this survey in the Senate on May 15, you quote Jack Noyes of Morgan Guaranty Trust on fiscal 1975—I will sort of skip ahead; I am running out of voice. And then I quote the remainder of this letter; it goes on to talk about what Fed policy should be, and then he says—they perceive a danger if the budget deficit should grow to this degree—and it goes on for 2½ pages.

Thus, Mr. Noyes' full letter carries a rather different message from what is suggested. His conclusion that Treasury borrowings will not congest the financial markets pertains only to calendar 1975. The remainder of his letter, however, raises serious questions about the consequences of continuing large deficits in 1976 and 1977.

There is a further point about this survey that deserves emphasis. Almost all of the respondents who do not anticipate difficulty in financing—and this is important—either this year or later, qualify their position with comments such as "provided the Federal Reserve is sufficiently accommodative." This is a vital facet of the issue; it gets to the heart of the matter. It represents exactly what we are opposed to.

Of course, the Federal Reserve can temporarily avoid a financial confrontation brought on by excessive public and private credit demands. All the Federal Reserve has to do is to be "sufficiently accommodative." But should it be? The answer has to be no, because in this situation sufficiently accommodative is very likely to mean that money and credit will be created in excessive amounts.

In turn, too much money and credit will set in motion the same unhappy boom-and-bust roller coaster that we are suffering from now. First, an expansion that goes too fast and carries too far, then shortages and an acceleration of inflation back to double-digit rates again, and finally, another recession and even higher unemployment. In the process, we are almost sure to have another increase in the proportion of our total economic income that is channeled through Government. The point I believe most people miss here is this: Although excessive credit creation can postpone for awhile the financial difficulties caused by excessive Federal credit demands, it cannot escape them permanently.

In some ways the concern I have about excessive Federal borrowing possibly crowding out private credit requirements extends also to the possibility of our running into shortages of industrial capacity too early in the expansion. I then, Mr. Chairman, go on and talk about the so-called GNP gap, the capacity shortfall. Our Government figures, which have been suspect for many years, some of the private figures on capacity utilization in this country; the Wharton School, the conference board, and most recently Rinfret-Boston Associates; the experience of 1971 and 1972 about how we all thought there was plenty of room for economic expansion. We were basically saying the same thing then that we are today; full speed ahead on monetary and fiscal policies, because it will be a long time before we get back to full utilization of our resources.

Well, it did not turn out that way. The limits of our capacity to expand showed up in the first half of 1973, long before we thought possible, in 1971 and 1972. So, we should heed these lessons of capacity, especially in many of our basic industries; and of course this goes to the whole topic which I have testified before on capital formation, and the need for promoting further investment for increased productive capacity in this country.

Even if we do not run into bottlenecks of any sort, Mr. Chairman, financial or industrial, that would choke off the expansion too early, we still have to worry about the possibility of excessive fiscal stimulus in fiscal year 1976. The reason for that concern is the strong tendency for Federal spending programs to gather momentum over the years. It is very difficult to turn off any Federal spending programs, and all too easy to begin new ones. Decisions on Federal spending programs that will produce a large deficit in fiscal 1976 are almost sure also to produce large deficits in fiscal 1977 and beyond. What that means is that right now we are sowing the needs of future trouble, even if that trouble is several years down the road. Politically, most people here in Washington will not want to worry about 1977 and 1978. But if we want to achieve a sustainable prosperity—if we want to avoid a new boom-and-bust cycle—then we must set the stage for it now by curbing the excessive momentum of growth in Federal spending.

My associates, Ed Snyder, Director of the Office of Debt Analysis, and Ed Fiedler, my Assistant Secretary for Economic Policy and I will be happy to respond to questions.

Mr. FIEDLER. Mr. Chairman, just one thing. The copy of the statement that you had did not contain the chart. We have distributed that since. I hope you have a copy now of the chart that was referred to.

Chairman HUMPHREY. Yes, we have; and by the way, the portions of your testimony, Mr. Secretary, that you glossed over for purposes of time, we want to include the entire testimony in the record.

Secretary SIMON. I wish you would, especially the capacity portions. They are very important, Mr. Chairman.

Chairman HUMPHREY. Yes. That is new material, and we will surely include it.

[The prepared statement of Secretary Simon and the chart referred to in the colloquy follow:]

PREPARED STATEMENT OF HON. WILLIAM E. SIMON

Mr. Chairman and members of the committee; It is a pleasure to be here today and to participate in your review of the economic and financial situation. These are always valuable sessions. That is particularly the case this year.

There is fairly general agreement that the economy is poised for recovery after having experienced the first prolonged period of peacetime inflation in our history and the deepest recession since the 1930's. There is much less agreement on the exact path that the economic recovery will or should take, and on the risks that will be encountered along the way. Yet, now is the time when many of the crucial decisions on economic policy must be made. Therefore, I welcome the opportunity to give you my appraisal of the situation and to hear yours.

THE ECONOMIC OUTLOOK

A wide range of evidence suggests that the current recession is now in the process of reversing direction. But recovery from this low point will not quickly be evident in all of the measures of economic activity. For example, further increases in the rate of unemployment cannot be ruled out. As history tells us unemployment tends to lag on the upside of the cycle. Employers were slow to resort to layoffs when the economy turned down in 1974 and may now be slow to rehire until the recovery is well underway.

Real growth will be resuming in an underemployed economy, but one that still has an underlying, built-in rate of inflation that is unacceptably high. Our immediate need is to reduce the rate of unemployment to much more tolerable levels. But we must go about this essential task in such a way that the recovery of the economy is not soon chocked off, and higher rates of inflation are not quickly recreated. Instead, we should do all that we can to direct the economy onto a path of recovery that can be sustained over a long period of time. There is only one way that we can possibly achieve and maintain low rates of unemployment and that is in an environment of reasonably stable prices.

In my opinion, there are at least two major constraints on how far and how fast the current recovery can go. One is the state of our financial markets and their ability to handle large Federal deficits along with the credit requirements of the private sector. The other is the state of our industrial capacity and its ability to support a strong recovery without encountering serious bottlenecks. I would like to examine with you this morning these potential financial and industrial limitations on economic recovery and consider what their influence is likely to be.

On the surface it may seem premature to be concerned now about potential limitations on an expansion that is not yet a statistical reality. But now is the time to examine these and other possible barriers to the healthy economic recovery we all desire, rather than later when it will be too late to adjust our policies. Events over the past decade indicate all too clearly the need to anticipate the economic effects of our policies well in advance, if we are to avoid overdoing them and thereby creating a new boom-and-bust roller coaster for the economy.

FEDERAL DEFICITS AND FINANCIAL MARKETS

There has been considerable discussion in recent months of the potential impact of large Federal deficits on the prospects for economic recovery. I think Paul McCracken put the matter succinctly when he noted before your Committee earlier this year that: If the financial community has been slow to appreciate the role of fiscal policy in the management of the economy, economists have been slow to face fully the implications of the fact that Treasury financing and private borrowing do compete for funds in the same money and capital markets. And Treasury requirements are now large enough so that there impact on financing in the private sector must be faced quite explicity.

As I have said on many occasions, it is the timing of the Federal deficits that is the key to a proper understanding of the problem. My concern all along has not been with calendar 1975. I expect some strains, but basically I think the financing of our Federal deficits will be manageable this year. Serious problems are not likely to appear near the bottom of a recession when monetary policy is easing and when private short-term demands for credit are falling.

For example, short-term business borrowing at banks and in the commercial paper market has fallen by $5 billion thus far this year, in contrast to increases of $10 billion and $12 billion in the comparable periods of 1973 and 1974. This does make room temporarily for the financing of Federal deficits, although it does not rule out periods of temporary market congestion, particularly since long-term corporate demands on the bond markets have not followed the pattern of recession decline. For example, corporations have brought to market a record $15 billion of long-term securities this year up sharply from $4 billion and $8½ billion in the comparable periods of 1973 and 1974. On balance, however, although there have been some financial strains, the weakness of the economy makes the Federal financing task for this year manageable, and to date our outsized Federal deficits have not created serious new problems.

However, we should not forget the continuing problems of high inflation, high inflationary expectations and high interest rates. All are still very much with us and it is disconcerting that we are starting this economic recovery at levels well above those of any previous postwar recessions.

But what happens next year and the year after, as the economic recovery progresses? We can take little comfort from getting through 1975 without difficulty, if problems develop in 1976 or 1977. The important thing is to prevent the problems from developing at any time.

We cannot be sure that they will not. There is a growing awareness among market participants and economists that there is a danger of serious financial trouble once the economic recovery gets well underway. Short-term private credit demand could turn around rapidly and add to total credit demands rather than subtracting from them. In such a setting, there is a strong possibility that an imbalance will develop between the total of government plus private borrowing and the prospective supply of funds at any feasible rate of monetary expansion. As a result, interest rates may rise sharply and not all private borrowers will obtain credit; some will be crowded out of the market.

This issue of "crowding out" has a number of different facets, which we should try to keep separate for a full understanding of the issue. A few observers have attached the "crowding out" label to the decisions in recent months by some high-quality borrowers to defer their bond issues. In fact, those actions are not really crowding out, since the companies involved will obtain credit from alternative sources, probably from the banking system. What they have done is to temporarily "opt out" (rather than being "crowded out") of the long-term market on their business judgment that the terms of their borrowing will be better later.

Nor is "crowding out" something that happens only on special occasions with a bell going on to announce the fact. It is, rather, a permanent condition of the credit markets in the sense that demand always exceeds supply and thus some would-be borrowers—financially shaky companies or municipalities that are at the bottom of the quality list—are constantly being crowded out at the margin.

But that is not the issue here. What we are talking about here is the impact of large and cumulative Federal deficits on the availability of credit to private borrowers who would otherwise be able to obtain and use those funds. Federal debt always has the highest credit rating, so when the Treasury comes into the

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credit market for funds it does so at the head of the line and, inevitably, some private borrowers get pushed out of the line at the other end. The larger total demand for credit raises the level of interest rates and makes many otherwise viable projects—sometimes whole industries, such as housing or utilities—unprofitable.

There is no escape from this outcome. We are sometimes advised to avoid competing with private borrowers in the long-term markets by concentrating all Treasury issues in short maturities. It is not generally understood to what extent we have been doing just that over the years. As the attached chart shows, the average maturity of outstanding privately held marketable Treasury debt has fallen from 5 years and 9 months in 1965 to 2 years and 8 months currently. So far this year we have done 81 percent of our borrowing at short-term (0–2 years), 15 percent in the intermediate markets (2–7 years) and only 4 percent in long maturities. It is clear, therefore, that our borrowing activities have been heavily concentrated at the short end of the maturity spectrum. And with what results? Has it prevented long-term interest rates from rising over the past decade? Hardly!

Some people say too much short Treasury debt creates inflation, but that idea is often disputed and we cannot be sure one way or the other. One point on which there is no controversy, however, is that a constant Treasury presence in the market place, rolling over one large issue of short-term debt after another, is highly disruptive to all the financial markets.

For this and other reasons, we receive a great deal of advice to borrow in all parts of the market. For example, the Government and Federal Agencies Securities Committee of the Securities Industry Association advised us in their report of February 24, 1975, as follows: The Treasury should tap all maturity areas, including the untouched 9 to 15 year sector . . . and Treasury offerings should be designed to create and build an upsloping yield curve, even in the 0–1 year bill market. This is fundamental to accomplishing any desirable "ownership" or "maturity structure" that will get this financing job done.

We have not followed the recommendations of our advisory committees in all respects, for the ultimate judgments have been ours, as they should be. But I agree completely with the wisdom of their consistent advice that to raise the tremendous sums we require, without extreme disturbance to our financial structure, we must issue securities in all the different maturity ranges, and we must do our best to halt the long, continued concentration of our debt in short-dated securities.

I also agree that the Treasury should design its offerings to create and build an upward sloping yield curve to appeal to nonbank investors and to improve the maturity structure of the debt. The importance of an upward sloping yield curve should not be underestimated. As the Securities Industry Association committee put it: Because the majority of institutional investors borrow short-term funds and invest them longer—this is true of commercial banks, of savings institutions and others—anything that raises short-term rates destroys the incentive to invest longer term, be it in mortgages, corporate bonds, or stocks. This is because any action that makes short rates higher than otherwise simply increases the risks of investing long, and destroys the incentive or need to extend investment maturities.

Similarly, the weight of practical and experienced market advice, as I have already indicated, is that we should offer securities in all maturity areas to minimize the risk of an adverse impact on any particular sector. Indeed, unless we can offer securities in all the maturity ranges where demand exists, debt management is complicated and the ultimate cost of financing our deficits is likely to be increased.

In this connection, I should mention the sometimes erroneous conclusions about the impact of Treasury financing operations on particular sectors of the economy. There is a tendency, for example, to think of housing in terms of permanent, 30-year mortgage financing, but as every home builder knows, the availability of construction financing is as important to getting a job started as the permanent financing is to getting the job completed. We also know the deposit flow to financial institutions, such as the savings and loan associations, is far more sensitive to the competition of shorter-term Treasury obligations than to the competition of longer-term obligations. Indeed, every sector of the economy, every aspect of our financial markets, is to interrelated that the undue weighting of Treasury financing in any particular maturity area can have adverse effects throughout the whole market—which could largely have been avoided by a better choice of new securities.

As we move forward into the recovery phase, there is an additional reason for concern with our debt structure. It is obvious that a substantial portion of our financing in the future, as in the past, will have to be handled in the short and intermediate area. But if we concentrate our new offerings entirely in the short- and intermediate-term areas, then, when the economy has achieved a substantial measure of recovery, the problems of the Federal Reserve would be greatly complicated. Short-term Treasury debt is very near to money and can be liquidated to provide funds for other purposes at small cost unless there is a substantial rise in interest rates. In my judgment, and I believe this is a judgment shared by other market professionals, excessive amounts of short-term Treasury debt could contribute to another situation in which we could get an excessive rise in short-term interest rates, with the whole panoply of adverse economic and financial consequences such as developed in 1966, 1969–70, and again in 1973.

A further reason why there is no escape from the process by which large and cumulative deficits lead to rising interest rates is the fact that excessive borrowing at short term is perceived in the credit markets as a portent of inflation. And when inflationary expectations are intensified, borrowers increase their demands for long-term funds because they expect future shortages and higher rates, but at the same time lenders are reluctant to make commitments for long periods. Thus demand in the long-term market is increased and supply is reduced. The inevitable result is a crowding out of some private borrowers at the margin and a rise in interest rates in the long-term markets as well as for short-term instruments. The sheer size of the cumulative deficits is the basic force, and there is no escape from their effects.

Of course, some see an escape in the form of a Federal Reserve policy that leads to a rapid expansion in money and credit. Such action might postpone the problem for a while, but only for a while. In the end, we would only have still more rapid inflation, still higher interest rates and still another severe recession.

As I have repeatedly emphasized, this result—the crowding out and the new explosion of prices—is not inevitable. But as we look ahead to the prospect of continuing large deficits, I believe the risk is a very serious one. It can be limited, however. The exercise of close restraint over Federal expenditures, which in turn would keep our deficits and our borrowing requirements in check, can minimize the danger that the economy will encounter any binding financial constraints over the next couple of years.

There are three closely related factors that explain why a potential financial constraint to the recovery of the economy exists in the current situation, where none has shown up in previous postwar recoveries. First, a decade of inflation has begun to limit the absorptive capacity of our financial markets and seriously affected their functioning. Second, the Federal Government through its deficit financing and rapidly expanding credit programs has preempted a very large share of the total securities markets in recent years. Third, and most crucial of all, there is an enormous forward momentum in Federal expenditures. Unless we check that runaway growth, there is a serious risk in my opinion that the Federal Government itself may clog the financial markets and choke off economic recovery.

We must not be lulled into a false sense of security by the improvement in financial markets and the very successful recent Treasury financings. From January through June of this year we will have raised some $36 billion in a slack economy while monetary policy was easing. Another $70 to $75 billion or more will need to be raised in the coming fiscal year while the economy is recovering and private credit demands are rising.

Ideally, the Federal budget would then begin to move back toward balance, but we delude ourselves if we assume that such a benign state of affairs will develop automatically. Over the past decade, Federal expenditures have shown a consistent tendency to outrun receipts. We must take effective steps to restrain that tendency. Otherwise, some future session of this Committee will be examining on an even more urgent basis the same problems we face today.

The effect of discussion

Because I have tried to point out the risks of unsound fiscal policy, and ways to minimize that risk, a number of critics have accused me of crying wolf and creating a climate of doubt and apprehension in the credit markets. I would like to make two points about these accusations.

First, it is the responsibility of the Secretary of the Treasury to maintain the U.S. Government's financial integrity. Speaking out on developments that endanger that integrity is a necessary and vital part of the job, though it will win no popularity contests. Surely I would be criticized still more vehemently if I were to refrain from speaking out when in my judgment there was a risk of the government pursuing harmful policies.

Second, even allowing for the shaky state of public confidence in the Government's abiilty to manage the economy in this uncertain world, it is nonsense to contend that my comments on the subject are going to create chaos in the credit markets. Could anyone possibly think that participants in the financial markets do not have the sense to recognize these dangers by themselves, i.e., in the absence of comments from Washington? They know what is going on, because every financial house of any size in the country has analysts assigned to keep track of the Federal budget. They know how important it is to conditions in the financial markets, and that it can cause severe difficulties.

They knew, for example, of the heavy demands by both corporations and state and local governments for long-term funds this year—and they knew it back at the beginning of the year, long before the enormous size of our deficits became general knowledge and long before "crowding out" became a popular debating topic. These huge demands were not caused by rhetoric from Washington or anywhere else. And it was those huge demands that kept long-term interest rates as high as they are. To me, therefore, it seems naive to blame the debate or the debaters for what has been happening.

There is, in fact, very little, if any, lasting market effect from a statement by the Secretary of the Treasury or any other person regarding the course of future market rates unless the facts support his conclusions. Those who make decisions in markets do not survive for long by acting on statements that are not based on fact. Market reactions to statements which are not based on facts are temporary and self-correcting. The key determinant of market moves is what the participants perceive as the realities of current and prospective financial conditions. These are based on current actual conditions in the market and on anticipated conditions of the supply and demand for savings, which includes the present and prospective deficits. Unfortunately, the cause of a problem is too frequently attributed to the messenger rather than to the message itself. Or, as the Wall Street Journal so aptly stated, that's like blaming the obstetricians for rising birth rates.

Furthermore, it is not as though this crowding out debate has been purely one sided. While I and others have been warning of the dangers of excessive budget deficits, many others have been publicly disparaging those warnings.

The press release issued by this Committee on May 15 is a case in point. It reports on a survey of 28 economists and financial people about the impact of the budget deficits on the credit markets. A poll was made of the responses and the results were announced as 20 who felt the deficits could be financed easily, 5 who dissented and 3 who were uncertain.

You, Mr. Chairman, very fairly included in the full texts of the letters from the 28 individuals in the *Congressional Record* (April 30 and May 15). Our examination of those letters suggests that the real unanimity reported in the press release applies only to the current financing of the deficit, i.e., at or close to the bottom of the recession. That is not, however, what I have been focusing on. What I have said repeatedly is that a $60 billion deficit for FY 1976, although it will involve some financial strains, is manageable but that a deficit in the range of $80 to $100 billion will clearly move us into the zone of serious danger—not this year but in calendar 1976 and beyond when the economic recovery gets into full swing and private credit demands are strongly on the rise again. If we analyze the letters from your survey for what they say about this alternative question, a very different view emerges. Much of the optimism evaporates and about half of your respondents express varying degrees of apprehension.

For example, in your remarks on this survey in the Senate on May 15 you quote Guy Noyes of Morgan Guaranty Trust as saying: Based on our analysis of prospective demands for credit from the private sector in calendar 1975, it is our tentative judgment that there will not literally be any "crowding out" of private borrowings this year as a consequence of Treasury debt offerings, even if the Treasury's new money needs in 1975 total $75 billion to $80 billion, as now seems likely. Room for the large volume of Treasury financing seems likely to exist because of the marked softening now in evidence in private credit demands.

Let me go on, however, to quote the remainder of his letter, which reads as follows (continuing directly on from the quotation above): I would stress that this is something we cannot be certain about, but it is our working assumption as of the moment. Such an accommodation of combined Treasury-private financing needs seems possible without any radical shift by the Federal Reserve from the sort of monetary policy it is now pursuing. This is not to say, however, that the task of the Federal Reserve in the months ahead will be an easy one. Credit markets are very fragile and nervous and can react adversity to a policy stance on the part of the Fed that they sense to be less accommodative or, on the other hand, too accommodative, i.e., inflationary.

Major questions do exist, however, about the possible occurrence of serious frictions in money and capital markets beyond calendar 1975 if the Treasury's needs for new money remain as large as is implied by the deficit figure of $75 billion for fiscal 1976, which you cite in your letter. We are assuming that calendar year 1976 will witness a fairly strong expansion of private credit demands, and such an expansion—it seems to us—can be accommodated without outsized increases in monetary aggregates and without steep escalation of interest rates only if the Treasury's money needs are in the process of diminishing. This again is a matter of judgment, but in shaping the budget for fiscal year 1976 and fiscal year 1977, we would be strongly inclined to lean as far as possible in the direction of limiting the size of the budget deficit. Otherwise, an uncomfortably large risk will prevail that interest rates will again climb steeply and weaken or abort the recovery or that to prevent such weakening or abortion the Federal Reserve will have to be excessively accommodative to a degree that nurtures inflation. We would put a high premium on fiscal restraint by the Congress and the Administration from this point on and would particularly urge that new programs with indefinite life spans be avoided in responding to the current recession problem. Keeping stimulus temporary and measured is critically important if we are to avoid a repetition of the national bias toward excessive pressure on real resources that has been so destabilizing in the past decade.

Finally, it seems to us highly important that both monetary policy and debt-management policy remain flexible to adapt to changing conditions. The Federal Reserve seems intent on trying to accommodate recovery without recreating sloppy money conditions. We applaud that objective and believe that the Board and the Federal Open Market Committee should retain full discretion in deciding how to shift policy to the changing signals transmitted by money and capital markets and the economy. Likewise, the Treasury should tailor particular offerings to the changing technical conditions of markets. This will undoubtedly mean a very heavy volume of short-term debt offerings, but we would certainly urge that the Treasury be left to tap the intermediate-term and longer-term markets if that seems appropriate from time to time.

Thus, Mr. Noyes' full letter carries a rather different message from what is suggested by the sentences you quote. His conclusion that Treasury borrowings will not congest the financial markets pertains only to calendar 1975. The remainder of his letter, raises serious questions about the consequences of continuing large deficits in 1976 and 1977.

There is a further point about this survey that deserves emphasis. Almost all of the respondents who do not anticipate difficulty in financing the deficit, either this year or later, qualify their position with comments such as "provided the Federal Reserve is sufficiently accommodative." This is a vital facet of the issue; it gets to the heart of the matter. It represents exactly what we are opposed to.

Of course the Federal Reserve can temporarily avoid a financial confrontation brought on by excessive public and private credit demands. All the Federal Reserve has to do is to be "sufficiently accommodative." But should it be? The answer has to be "no", because in this situation "sufficiently accommodative" is very likely to mean that money and credit will be created in excessive amounts. In turn, too much money and credit will set in motion the same unhappy boom-and-bust rollercoaster that we're suffering from now: First, an expansion that goes too fast and carries too far, then shortages and an acceleration of inflation back to double-digit rates again and, finally, another recession and rising unemployment. In the process we are almost sure to have another increase in the proportion of or total economic income that is channeled through government. The point I believe most people miss here is this: although excessive credit creation can postpone for awhile the financial difficulties caused by excessive Federal credit demands, it cannot escape them permanently.

THE ROOM FOR ECONOMIC EXPANSION

In some ways the concern I have about excessive Federal borrowing possibly crowding out private credit requirements extends also to the possibility of our running into shortages of industrial capacity too early in the expansion. Unfortunately, while the ability to restrain Federal spending and reduce the resulting financial pressures does presumably lie within our power, there are not many things that can be done which would quickly expand our industrial capacity. But the issue of the adequacy of industrial capacity is an important one, not only in terms of our policies for cyclical expansion, but also in terms of its implications for long-run growth.

Superficially, there would appear to be an extremely large margin of unutilized resources, both material and human, at the present time. For example, the total unemployment rate has risen sharply and is at a postwar high. The so-called GNP "gap" expressed as a percentage of potential output also suggests that there is a very large margin for expansion. Indeed, no one doubts that we need and must have a strong expansion of real output over a long period of time. However, all of the aggregate measures of unutilized resources may be seriously defective as a guide to how far and how fast the economic recovery can safely proceed.

I am inclined to believe that there are serious measurement problems in determining just how much effective economic capacity we actually have. There have been sweeping changes in recent years, inadequately reflected in the available statistics, for which we may not be making suitable allowance in our economic policies. In some cases we have gained improved understanding of the problems we face. Research by George Perry of the Brookings Institution and others has, for example, pointed up the implications of demographic change in the labor force for full employment policy. It is questionable in my opinion whether we have enlarged our understanding of capital investment in any comparable way.

It is possible, for example, that the sharp change in the relative price of energy combined with government-mandated increases in safety and pollution requirements may have rendered some significant part of our economic structure technologically obsolete. This may even have left the economy in such a position that we will begin to encounter difficulties in expanding output at a much earlier stage of the cyclical process than we expect. This is only a possibility, not a certainty. Such a situation would only be temporary. But until the adjustments to a new equilibrium had been made—and this might be a matter of years rather than months—there could be important effects on output and employment. At times we may be too ready to view all of our problems simply in terms of pumping in or siphoning out a certain amount of purchasing power. However, where our economic problems are deep-seated and structural, no such easy remedies are available.

A more specific possibility is that the economy may run into the same kind of economic bottleneck that constrained us so severely in 1973: the shortage of capacity in the basic materials processing industries, such as steel, non-ferrous metals, paper, cement, fertilizer, and some chemicals. Indexes of capacity utilization in these areas and for manufacturing as a whole compiled by the Federal Reserve and the Department of Commerce seem to show that a rather substantial degree of excess capacity has now emerged.

Other indexes, however, show much smaller margins of unutilized capacity in manufacturing, although all the series show sizable declines in utilization over the past six months as one would expect. For example, the measures of capacity utilization maintained by the Wharton School at the University of Pennsylvania and by the Conference Board, both of which have historically run at substantially higher levels than the two government series, suggest that the slack in our manufacturing facilities is not all that extensive.

I recall very clearly in 1971 and 1972 how we all thought there was room for plenty of economic expansion. We were saying the same thing then that many are saying now: full speed ahead on monetary and fiscal policy because it will be a long time before we get back to full utilization of our resources. Well, it didn't turn out that way; the limits of our capacity to expand showed up in the first half of 1973—long before we thought possible in 1971 and 1972. We have to be careful about repeating that error in the next couple of years.

Another lesson of our experience in the early 1970s is that we have to watch the availability of capacity in key individual industries as well as for the economy or the manufacturing sector as a whole. We found that shortages in a few key areas—the basic materials processors in 1973—can set the limits on expansion even when considerable slack exists elsewhere.

In April, for example, one survey (Rinfret-Boston) shows the iron and steel industry with a capacity utilization rate of 86 percent, down some 10 percentage points from last fall but still relatively high. Suppose that the economic recovery now getting under way carries the steel industry—or one or more of the other basic materials industries—back to full capacity operations before the rest of the economy is there. In such a situation increases in economic output would be slow in coming from there on out and the improvement in unemployment would stop far short of what we all desire. Simultaneously, if fiscal and monetary policy were still expansionary, widespread inflationary pressures would soon develop.

I am not saying this is going to happen. We know that the basic materials industries have increased their capital spending plans sharply since 1973—and especially since the end of the price controls (which increased their profit margins and thus gave them both the incentive and the wherewithal to make new investment). Whether this new investment will be adequate, and whether it will come on stream early enough to avoid capacity bottlenecks of this sort remains to be seen. But it is something we must take fully into account as we set economic policy now and in the period ahead.

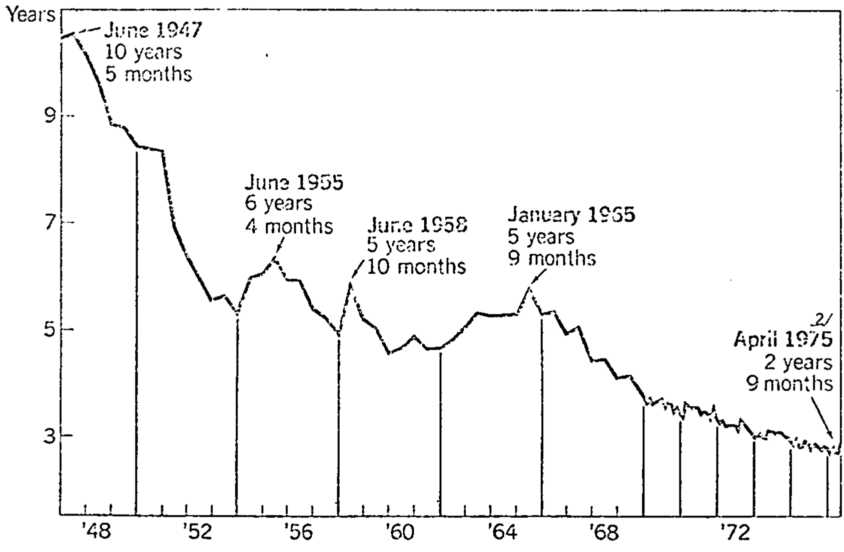
In some ways, the concern I expressed earlier in this paper about excessive Federal borrowing possibly "crowding out" private credit needs is very similar to this possibility of running into shortages of basic materials too early in the expansion. In other words, a bottleneck could develop in the financial markets that would choke off the general economic expansion, even though unused resources—both men and machines—were readily available throughout the economy.

CONCLUSION

Even if we don't run into bottlenecks of any sort—financial or industrial—that would choke off the expansion too early, we still have to worry about the possibility of excessive fiscal stimulus in FY 1976. The reason for that concern is the strong tendency for Federal spending programs to gather momentum over the years. It is very difficult to turn off any Federal spending program and all too easy to begin new ones. Decisions on Federal spending programs that will produce a large deficit in fiscal 1976 are almost sure also to produce large deficits in fiscal 1977 and beyond. What that means is that *right now* we are sowing the seeds of future trouble, even if that trouble is several years down the road. Politically, most people in this town will not want to worry about 1977 and 1978. But if we want to achieve a sustainable prosperity—if we want to avoid a new boom-and-bust cycle—then we must set the stage for it now by curbing the excessive momentum of growth in Federal spending.

AVERAGE LENGTH OF THE MARKETABLE DEBT 1/

Privately Held



1/ Semi-annual plots, calendar years 1946-1969, monthly thereafter.
2/ Partly estimated.

Chairman HUMPHREY. First I want to say, Mr. Secretary, that when I placed in the Congressional Record the letters from the 28 respondents to our letter of inquiry, I concluded my statement as follows: "Congress must not be captive to those fears." I was speaking about those fears of the inability to finance the deficit. I then went on to say, "first, we must provide enough temporary fiscal stimulus to put this recession firmly behind us."

Now, it is my judgment that what we call the up-front money, or stimulus, is what is important. It takes the big push, the big shove, to get this economy out of the ditch, so to speak. And then I said, "Second, we must maintain a control over the budget which will insure a balance of the budget as full employment is regained."

I am not unaware of what we call the long-term effect. My difference with you, Mr. Secretary, is that I am afraid that you are unwilling to take the leap, or the jump, that is necessary; or to put on the push that is necessary to get some rapid movement in the economy. That is a fundamental difference of perspective. It is arguable, but it is my judgment that the time for what we call Federal Reserve accommodation is now. It is in this year, right now, to get some movement, because this is what will provide for expansion. This is what will help the housing industry, and this is what can bring industrial capacity to better utilization. Then, anybody that is worthy of having a position of public trust knows that you watch this rate of recovery, which we hope will be substantial; and if there seem to be pressures building up, then you ease, or you start restraining, your money supply situation. That is what the Federal Reserve Board is for—that is what it is about.

Now, most of the witnesses we have had before this committee—and we have not picked them as a garden variety of so-called liberal economists, we have had them here from all walks of life—have said that the important time for the Federal Reserve Board to accommodate the needs of Treasury borrowing and private borrowing—in other words, to increase the money supply and make available larger amounts of credit, hopefully at lower interest rates, is in the next few months, right here in the period of the third and fourth quarters of 1975, and moving into the first quarter of 1976 to give it some momentum. This is where I think you have a fear, a prevailing fear, of an accommodating position on the Federal Reserve.

Secretary SIMON. That is not correct.

Chairman HUMPHREY. It is not correct?

Secretary SIMON. Let me say, Mr. Chairman, I am basically in full agreement with what you are just saying, but let me just extend it a little bit, and we can have a difference of opinion on the amount of stimulus. We believe we have already taken that leap. A $60 billion deficit, monetary expansion as Arthur Burns announced in the range of 5 to 7½ percent, which we think sufficient. Well, if we have a difference of opinion on that, that is, perhaps, understandable.

Chairman HUMPHREY. Well, could I just correct you there. As Arthur Burns said recently that he was talking about 5½ to 7 percent as of now; he is not talking about sustained. He came back with clarification.

Secretary SIMON. And he exercises understandable caution, because the open market committee meets every three to four weeks, and they review the events that had occurred in the interim and they adjust their prices and attempt to keep them flexible. Understandably, he does not want to lock himself in and say, we are going to expand at x rate for the next 2 years.

Chairman HUMPHREY. I question that, and I say most respectfully, I realize the importance of caution. I find in you and Mr. Burns, two of my favorite people in this city, the same kind of caution we had in General McClellan in the War Between the States. He was an attractive looking man. He made a very dashing figure, and he had all of the appearances of a great general, but he did not want to fight, you know, he was cautious, and what worries me about it is, I do not think you really see the dimensions of the enemy, which I consider to be primarily today the recession, much more than the inflation. It is a matter of emphasis.

Secretary SIMON. As an old Infantry man, Mr. Chairman, I resent that comparison. [General laughter.]

Chairman HUMPHREY. Well, I accept that, and I apologize to you on that basis. Let me get around it with whatever kind of analogy you want to use. You are not putting enough gusto to it. Now, let us go ahead and listen to what you have to say about that.

Secretary SIMON. Well, I agree with you on much of what you said. As far as what is needed right now, we think we are doing sufficiently to support the economic recovery. We also believe it is underway at the present, and the danger exists when a recovery is fully underway and visible to everyone, when private demands again are the upswing. At that time I agree again that the Fed has to moderate monetary policy, and it is at that point when we have the danger as far as the economic recovery.

Chairman HUMPHREY. Well, you see Mr. Secretary——

Secretary SIMON. Well, you know, this happened in 1966 in the so-called famous "credit crunch period," the day the money dried up, because the Fed at that time was concerned with inflation, the demands in the marketplace.

Chairman HUMPHREY. I think the rate of inflation was about 2½ to 3 percent then. Boy, let me tell you, they sure——

Secretary SIMON. We have gone from one level to another in successive bites.

Chairman HUMPHREY. We did not have 4-percent inflation until 1969.

Secretary SIMON. We have never had double digit inflation in peacetime before, either.

Chairman HUMPHREY. I am just making the point. I think the Fed gets frightened very quickly if somebody says boo. They get very frightened. Now, the one point——

Secretary SIMON. I think we all have a tendency to learn from past mistakes.

Chairman HUMPHREY. I just want you to define for me what you believe is economic recovery, because when you speak of economic recovery, I do not hear anything about those jobs, and I am a jobs man. I mean, I do not know very much about banking, I admit that, except one thing that bankers are generally able to keep interest rates up, and they are a little bit cautious about money, and their record is not much better than the rest of us. So that I am not overly impressed. I want to be frank about it.

They got themselves into all kinds of jams with these REIT's and the Federal Reserve System has been bailing out banks before they have been bailing out anybody else in this country. As a matter of fact, they spent the last year and half bailing out banks that were poorly managed. Is that correct, Mr. Secretary?

Secretary SIMON. No, sir.

Chairman HUMPHREY. It is not?

Secretary SIMON. Let me explain why——

Chairman HUMPHREY. I thought we had Arthur Burns here telling us here not long ago that they had to spend a good deal of time trying to get the bank situation cleared up.

Secretary SIMON. I spent a good deal of time with Arthur Burns on this problem, and his function was not to bail out banks and reward inefficiency. What the Fed's responsibility is there is to protect the depositor in the bank, and in most instances——

Chairman HUMPHREY. Protect him from what?

Secretary SIMON. From his deposits that were put in——

Chairman HUMPHREY. To protect him from mismanagement in overextension of credit by banks.

Secretary SIMON. That is fine; I would agree with that, but——

Chairman HUMPHREY. OK.

Secretary SIMON [continuing]. But the Fed lent them the money. Collateralized loans are not a bailout. A collateralized loan builds a bridge so the bank could be merged with another bank and sell whatever assets were salable. And at that point the depositor's money was protected, which is important.

Chairman HUMPHREY. Do not misunderstand me. I am not arguing about what its purpose was; I am simply saying I know what they did first.

Secretary SIMON. They did not bail them out. The stockholders got zero.

Chairman HUMPHREY. I know what they did first, and they were playing a footloose and fancyfree game for a long time.

Secretary SIMON. Who, the bank?

Chairman HUMPHREY. The banks.

Secretary SIMON. Banks?

Chairman HUMPHREY. Banks, real estate investment trusts. I am aware of it and, if there was a full-scale investigation of the banks during that period of time, there would be a lot of people around here asking questions.

Mr. Secretary, what do you mean by recovery? I think we have got to have some definitions here.

Secretary SIMON. In the short term, we have to look both short term and long term, we are looking at an economic recovery that is going to appear, perhaps, at the outset to be more vigorous than it actually is because of the severe decline that we have had, and this is where the difference of opinion rests, both in the private and the Government sector, among the analysts, and the ranges are anywhere from 6 to 9 percent or, perhaps, 5 to 9 percent real growth in the near term.

Chairman HUMPHREY. When do you see that? What is your projection on that now?

Secretary SIMON. I would stand by the projections, and Ed Fiedler, who works in the Troika, who prepares for the economic advisers all of the economic projections that were made, I will ask him to respond to you on what assumptions were put in there. When we go beyond, and you talk about the forecast of 1977, 1978, 1979, and 1980, I must admit I do not subscribe much to that exercise. We really do not know what is going to happen in 1976 with any precision; 1977 we have absolutely no notion.

Chairman HUMPHREY. I tend to agree with you on that, Mr. Secretary. Let me ask, what are your projections, let us say, for the coming two quarters?

Secretary SIMON. I did not answer your question about what recovery means. It means more jobs, restoration of real earning power, as is happening right now with the reduction of interest rates and the increased wage settlements this year, higher sales profits. That is a return to prosperity, and, as I said in my prepared statement, unfortunately, and this has happened after every recession, there is a delay before the unemployment rates begins to decline. It is a sticky rate; it declines, it begins its decline several months after the recovery is underway.

Chairman HUMPHREY. That is correct. Now, Mr. Secretary, I am going to quit, because my colleague here has plenty of questions. This is where you and I do not see eye to eye, and I say this respectfully; you are looking for the normal market processes in recovery to bring about ultimately the gain in employment that we need. I understand that, and that is a position that can be defended by a man of your political persuasion, economic persuasion.

Now, my point is that during that time, while this economic recovery of sales, profits, of GNP, is improving and unemployment is lagging, that is the point where Senator Humphrey says the Government steps in with job programs, with accelerated public works or public service jobs, to pick up the difference, instead of just hanging around here, passing out unemployment compensation checks. I get no joy out of saying that we are going to spend $20 billion in unemployment compensation. I would rather spend $50 billion on jobs, having people do something; have them build something in this country. We have got a lot of things that need to be done. All you get on an unemployment compensation check is a third of what you need to live. You do not pay any taxes, you do not produce anything, and you find out that the Government is handing you a check. What good is that? If the Government is going to hand out a check, I want them to hand out a check for something the people are doing.

I am a work ethic man, strictly jobs. Now, I am perfectly willing to have that little period of time until you get a man on the job, but some kind of a job, public or private, preferably private, but he ought to go to work, and she ought to go to work and the kids ought to go to work. This country needs to go to work. I am tired of hearing about people who are not at work. We have got a lot of things that need to be done in America.

Secretary SIMON. So am I, so am I, and the only difference of opinion is how we get there, Mr. Chairman.

Chairman HUMPHREY. Well, I figure we ought to be able to figure out how to get there. We got to the moon.

Secretary SIMON. We think we have.

Chairman HUMPHREY. Congressman Long.

Representative LONG. Thank you, Senator. Following along this line, Mr. Secretary, the basic question of difference here seems to be one of degree—of what really is an acceptable rate of unemployment, and what we are shooting at as a target. How soon are we going to arrive at that target?

It seems to me as though——

Secretary SIMON. The acceptable rate of unemployment—and I subscribe to this standard definition—is one where everybody who desires to have a job has a job, again, looking beyond as far as we can see—and we talk about making projections into 1977, 1978, 1979, and 1980, where these simple arithmetic extrapolations project unreasonably and unacceptably high unemployment rates—even moving out that far are nothing more than projections. There is no precision in those forecasts, and what is more, I do not subscribe to them, and I have not.

Representative LONG. Well, what I think concerns us, and certainly concerns me, is that the extrapolations that are set forth seem to be based upon a willingness to accept those as a level of unemployment.

Secretary SIMON. Absolutely not.

Representative LONG. That would create economic recovery, and that has got all of us here on Capitol Hill very much concerned.

Secretary SIMON. Let me make that very clear, Mr. Long, that is not our policy, or an illustration of a willingness to accept something that obviously, as I say, is totally unacceptable and totally unreasonable. What we are trying to do is put this economy on a permanent basis and bring it back to a sustained growth and to bring unemployment down permanently through the prudent, proper balance between fiscal and monetary policies and running our economy properly for a sustained period of time.

And the problem with the whole notion is that it does take time. It took us a long time to get into this problem to begin with, and if we attempt once again to explode ourselves out of this recession, as we have in the past, 1972 being the last time, then we are just going to find ourselves 2 or 3 years from now back in the same high-inflation boat again, followed by the recession and even larger unemployment.

You see, the problem is, Mr. Long, you know we talk about it and, again, my concern is great, as is the President's, over the present unemployment rate; but the inflation rate rate also exacts a heavy toll on the American people.

Representative LONG. Sure.

Secretary SIMON. Inflation hurts in many ways, and that hits all of the American people—the unemployed as well as the employed. We know the causes. I have said the major factor causing the recession was the high rate of inflation. We have to guard against that, and we have to bring and keep inflation rates down to what you and I might call acceptable levels, and, unfortunately, that cannot be done in a hurry.

We have been, indeed, fortunate in our battle against inflation. The rates have come down farther and faster than anyone predicted, but we still have got an unacceptably high base rate of inflation.

Representative LONG. Let me see if I can get it down to where we can outline the specific area of what I think is the disagreement between the administration and the majority of us here on Capitol Hill.

I basically recognize the desirability of getting our economic cycles out of this type of a pattern, and I well recognize that to do that it is going to require some rather stringent types of remedies. Even though I might differ with you as to a matter of degrees. I respect your courage in taking the pressure that you have taken because of your firm conviction in your views. Going back to what seems to be the policy of the administration as to what constitutes economic recovery and given the current structure of the U.S. economy, how low do you think we can get unemployment without creating these inflationary pressures.

Everything that I have seen with respect to the administration's projections, as inexact as they are, indicates that the administration is willing to accept a rate of unemployment of 6½ or 7 percent or 7½ percent long range, and that they are willing to live with that in order to not create these inflationary pressures.

Secretary SIMON. Well, the point is—and there, again, we go back to the creation of the inflationary pressures, and I would underline that, because it is that chronic inflation that causes the high unemployment in the final analysis—the real problem, Mr. Long, is how to achieve the unemployment reduction. The only suggestions are those from our critics. We hear that they would like to bring unemployment down a little faster, and, of course, the manner in which people want to attempt to bring down unemployment faster requires massive expenditures which would, based on past experience, become somewhat permanent, if not permanent.

Now, that would only cause unemployment to go right back up again, and would not give us the sustained improvement that we need, and I know how difficult it is. It gives us the incorrect appearance of not being concerned with what is going on, and I want to emphasize to you that we do concern ourselves. You know, it has been said, and correctly so, that recession is a price that society pays for the sins of inflation, and I subscribe to that thought, and we are paying for the sins of that, but do we want to pay for sins and attempt to cure it by adopting the very policy that brought on the inflation and all of the results, the attendant results, once again? No.

Representative LONG. Well, I am inclined to agree with Senator Humphrey that if we could put the emphasis on the need for a jobs program and, therefore, stimulate the economy, that consequently it ought to reduce the inflationary pressures.

Secretary SIMON. Mr. Long, that is exactly what we believe we have done and, there again, the difference of opinion—and I recognize it is a matter of degree——

Representative LONG. That is the point I was about to make, it is a matter of degree. It seems that what is acceptable to you as a matter of long-range policy for a period of 3 to 5 years is generally not acceptable to us.

Secretary SIMON. No, I will not go that far because it is not a matter of 3 or 4 or 5 years because nobody knows what is going to happen 3 or 4 or 5 years from now. The point is the decisions that we are taking today in the fiscal and monetary area are going to affect the recovery and the inflation that evolves during calendar year 1976, and that is what we have to guard against.

Representative LONG. Well, obviously we have succeeded, at least in outlining the area of disagreement, but again it is one I think that gives us a great deal of concern.

Let me ask you a couple of technical questions with respect to monetary policy, if I may. One of the things that I understood you to say is that you had a different assumption about monetary policy than did those who responded to the survey that was made by the Joint Economic Committee.

We have explored this problem of monetary policy at some length. What is your specific assumption with respect to it? As you know, we have had a lingering debate with Mr. Burns about this—and we finally came up with some information which is, in our opinion, not all that we are entitled to have especially in view of what information you had to base your decisions and predictions on.

How can you enlighten us and what can you tell us about the specific assumptions about monetary supply and growth?

Secretary SIMON. Well, there are those today—and these are the schools and the ones that I take great disagreement with—are the ones who say that we can expand the money supply now at 8, 9, 10 percent. I happen to totally agree with Arthur Burns on the range that he set right in here between 5 and 7½ percent, and I do that, Mr. Long, because I look back at what has happened in the past few years when we were presented with the same bills for the sins of the past, and each time we refused to pay them, and the Fed could have beaten inflation in 1967, when it was 2.8 percent, and it gave up the battle prematurely. It could have beaten it in 1971, although with greater difficulty, when it was close to 5 percent at that time and repeated the mistake with premature stimulation that I talked about just a few minutes ago, and in 1974 the battle became even more difficult with inflation at that time, as we well remember, in the double-digit area. And, if the Fed fails again, I will suggest to you that the bill that is going to be presented to us is going to be socially and politically unacceptable, and we just continue not to recognize that there is a penalty, as I said before, and it bears repeating, that recession is the payment of the sin for all of the inflation that has been created, and it is just going to get worse and worse as we continue to make the same mistakes of the past.

Representative LONG. Going back to this assumption with respect to the monetary supply and looking at the Data Resources Review, which is a respectable publication—they talked about the money supply available for the third quarter of 1975, and based on these projections, they talked about the third quarter of 1975, the fourth quarter of 1975, the first quarter of 1976, and the second quarter of 1976. In order to come up with these types of projections, you have got to talk about an increase in the monetary supply of 7.6, 9.7, 7.1, and 9.5 percent.

Now, this seems to our economists who have studied this a more realistic figure than the 5 to 7½ percent that you and Mr. Burns keep talking about.

Secretary SIMON. Given the normal differences of opinion among economists, that is not a very wide range. You know the old saying, you put five economists in a room and you will get six opinions. I believe, as I say, in the short term, monetary growth of 5 to 7½ percent is proper, depending on the vigor of the recovery. The Fed should begin to moderate at that point, again, depending on the vigor of the recovery, and for long-term growth somewhere in the area or range of around 4 percent, taking them on as a——

Representative LONG. I am sorry. Would you repeat that?

Secretary SIMON. Through the long run, as we achieve full capacity and a high economy, full utilization, when we once again have restored prosperity, as I defined this before, the long-range growth should be in the area of 4 percent, plus or minus.

Representative LONG. On this monetary supply question, if you take the so-called troika of the Treasury, OMB, and the CEA, are the figures that you are using in your forecast there from a 5- to 7½-percent range? Are those the figures that yours are based upon?

Secretary SIMON. Yes.

Mr. FIEDLER. We consider them a system within that range, yes.

Representative LONG. Say that again, if you would, please.

Mr. FIEDLER. We consider our forecasts for this year and the next year to be consistent with the monetary growth target of 5 to 7½ percent, expressed by the Federal Reserve.

Secretary SIMON. But let us remember one important thing in that regard, and that is that these forecasts, just as events occur that no one had any idea were going to occur, then we would be redoing these forecasts and monetary policy. As I said to the chairman a little while ago, they meet every 3 or 4 weeks and take these new events into consideration, and adjust the M_1 and M_2 targets at that time. That, of course, changes all of the economic assumptions in the future; and then, when we extrapolate even beyond that, then the long-term projections change as well, and that is what I suggest is going to happen in the future. So, no one can say this with any certainty.

Representative LONG. Go back to the statement that you made, if you would. You said consistent. I asked you to repeat it once because I was not sure that I understood what you meant, and I asked you to repeat it again because I understood the words, but I still do not understand the meaning.

Mr. FIELDER. The forecasts that have been published in the budget review document, for example——

Representative LONG. Right.

Mr. FIELDER [continuing]. Were made in the belief that they are consistent. They are logically consistent.

Representative LONG. They are consistent with 5 to 7½ percent? What does that mean?

What do you mean consistent with 5 to 7½ percent?

Mr. FIEDLER. We think that 5- to 7½-percent growth in narrowly defined money supply is of an appropriate rate—is an appropriate rate to produce a——

Representative LONG. Gross national product of the type which you are projecting?

Mr. FIEDLER. That is correct.

Representative LONG. That gives you a 50 percent leeway there with a difference between 5 and 7½ percent.

Is that correct?

Mr. FIEDLER. That is correct. The relationship between monetary growth and GNP growth is a very loose one.

Representative LONG. It was in that 50 percent of the difference between 5 and 7½ percent, you feel that that will give you the projections that you have made with respect to what the gross national product will be, and consequently a reflection of the recovery.

Mr. FIELDER. That is correct. But, let me emphasize that we do not start with the simple growth in the narrowly defined money supply and go from there to the growth in GNP. There are many factors influencing the growth in GNP, including the cyclical forces that are operating in the private economy and fiscal policy, the size of the deficit, and the growth in Government spending.

Representative LONG. And, of course, the degree to which we do attain any recovery at all.

Mr. FIEDLER. Yes, sir.

Representative LONG. Mr. Secretary, if I may go back, my time has expired, but I do have one additional question.

The story in the Wall Street Journal this morning said that capital outlay plans were cut 9.4 percent in the first quarter by major corporations in the United States, and included in that are a couple of things that worry me. One is that your statement is based upon the assumption that we have bottomed out, so to speak, in this economic recession, and that we have started at least on the gradual road of improvement. Is that a fair statement?

Secretary SIMON. Yes, sir.

Representative LONG. Does this figure on cutbacks in capital outlay plans, which evidently was not available to you at the time you prepared your statement, cause you in any way to reassess your statement? Is that important enough in your overall look at things to cause you some concern?

Secretary SIMON. It is important, Mr. Long, but it does not change our projection at all. I believe that the consumer spending, as evidenced by retail sales being up about 10 percent in the first quarter, which matches a similar decline in the fourth quarter of 1974, is one of the stronger elements. Inventory liquidation, which has gone on at startling rates in the past several months, is going to mean that we are going to have increased production looking into the future. Housing is also going to help. We have permits that go up 27 percent in the most recent statistics that were announced.

And, ultimately as the economy is visibly stronger, when production recommences, retail sales will grow because of the restoration of real income, that helps. As the inflation rate has gone down, then the natural response on the part of business is to increase their plans in the future, and I think that that is a critical point. I believe it is just going to come at a later time, Congressman Long.

Representative LONG. One of the things in this article that relates to another problem facing this country, and one with which I think all of us are struggling, is this whole question of an adequate supply of energy at some reasonable price. It causes me some concern. The story said that the petroleum industry canceled a record $968 million as a part of this 9.4 percent; they evidently led the pack with respect to the amount of cutback that they have done.

To what do you attribute that, when we find oil prices constantly going up?

Senator PROXMIRE. For whom? The Arabs. That is who is getting all of those price increases, the OPEC nations.

Representative LONG. Well, we have had some increases with respect to the domestic price to the extent that it has been allowable.

Secretary SIMON. That is right.

Representative LONG. But still this causes me great concern, not only from an economic point of view, but from an energy point of view in the exploration and production of petroleum products. A cutback at this stage, and of that severity, both from the economic picture and from the picture of becoming more energy independent, seems to me to have a two-pronged effect.

Do you have any comment on that?

Secretary SIMON. I do.

I want to start out by saying that I do not come from an oil-producing state, as you all know, nor have I been involved in the oil business. I have taken what I guess is an unpopular stance in Washington. Down to the last day of the conference committee in the Ways and Means I was arguing against the removal of the depletion allowance, not on the merits of the depletion allowance—let us debate that together, any time you wish—but, in the absence of a free market in this country. In the oil business, a removal of the depletion allowance, in my opinion, was going to result in just what has resulted, in a decline in the investment in exploration, and obviously ultimate production.

As you know, we had an explosion in oil prices a year ago last December. At that time, anyone holding inventories of oil made large windfall profits, just as a price increase in eggs would cause a windfall for producers in the egg market. Well, the oil industry had an inventory, and they also got a good deal of their oil from Arab nations. Since then what has occurred? We have had the nations nationalize their companies, take away a growing percentage of their profits, and if one wants to look ahead in international oil operations in Saudi Arabia, Aramco is making approximately 22 cents on lifting a barrel of oil. Well, it is profitable; but it is nothing as if they owned the oil themselves. They are just beginning to gradually get squeezed. So, the profit outlook is pretty dismal.

You take depletion away, and your independent producers that drill about 70 or 75 percent of the wells in this country are not, obviously, going to be able to raise the money to do that.

Then, what else is occurring at the same time here in the United States? Well, people are talking about nationalizing or regulating the oil industry, like a public utility. They are talking about more windfall profits. They are talking about a Federal oil and gas corporation. That is a novel name. I think that the fellow who invented that has a good sense of humor. It is FOGCO, and if indeed, the Outer Continental Shelf is going to be leased with preference to the Federal Government, and all of the good lands devoted to an oil and gas corporation—you know, any time you have uncertainty in the marketplace, it is going to act as a disincentive to investment.

Representative LONG. Mr. Simon, I must say, with respect to the depletion allowance, insofar as the independents are concerned, we

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were successful in retaining that. I say successful because I felt that the effort, particularly to remove it from the independents who do about 75 to 80 percent of the exploration in this country, was self-defeating insofar as making this country more self-reliant in the production of oil. We were successful to some degree in that regard.

Secretary SIMON. Well, I am glad you added to some degree. There is still a problem with the unitization of leases. There is still a problem with the transfer of wells, and there are going to be restrictions put on that. From a point of view of equity, I see no reason why we should exempt an independent, and not exempt whatever he may be, because it is based on so many barrels a day.

Representative LONG. I did. I thought frankly there were some anti-trust problems with respect to the other that——

Secretary SIMON. I think sometimes what we do, and then I will wind up, Mr. Long, is——

Representative LONG. I restricted my support to the action of the independents.

Secretary SIMON. I would rather look from the typical Treasury purist point of view when it comes to tax policy and adopt it—that if it is a good program, then it ought to be available for everybody. If it is not any good, then they ought to do away with it for everybody.

I think that that is a matter of equity that people happen to understand. But on the whole issue of oil, and I guess I probably spent more time talking on that down here—or up here, than anybody else—I think sometimes that we adopt policies in the United States as a result of emotions that are built up and not by a complete grasp of all of the facts, and we do it for short-term pleasure and the satisfaction of sometimes being punitive to somebody. In the long run it comes back and bites us, and I suggest that is just what we are doing right now.

Representative LONG. Thank you, Mr. Chairman. I have no further questions.

Chairman HUMPHREY. Mr. Secretary, I know you have to depart, as I understand it, close to the noon hour. Is that right, Mr. Secretary?

Secretary SIMON. Yes, sir, I do, Mr. Chairman. But I will be glad to leave my associates.

Chairman HUMPHREY. Yes; I understand that Mr. Fiedler and Mr. Snyder will remain.

I want to place in the record at this point, because of the discussion of Congressman Long, some extrapolations and projections by Data Resources and the University of Pennsylvania-MIT model on the relationship of the growth in the money supply, M_1, at the rate of unemployment.

The projections show that monetary growth within the Fed's target range will leave a very high rate of unemployment. I will tell you flat out that we have got to see a faster growth in credit, or the level of unemployment will be above 8 percent at the end of 1976, and that will be the Christmas present that this economy and this Government will give to a little over 8 million workers, 8-percent unemployment. I place in the record this material which shows money supply growth at 5 percent, growth at 7½ percent, growth at 6 percent. If the money growth rate remains between 5 and 6 percent at the end of 1976, unemployment is projected at between 9 and 10 percent, depending on which model you take, Data Resources, Mr. Otto Eckstein, or the University of Pennsylvania-MIT model by Mr. Albert Ando. That is a totally unacceptable rate for unemployment. I certainly have to keep pounding away that we cannot accept it, at least I cannot.

[The information referred to follows:]

	Annual increase in money supply	
	5 percent	7½ percent
Data Resources (Mr. Otto Eckstein):		
Unemployment rate at—		
End of 1975	8.9	8.9
End of 1976	9.1	8.1
University of Pennsylvania-MIT model (Mr. Albert Ando):		
Unemployment rate at—		
End of 1975	9.0	8.9
End of 1976	10.2	9.7

Secretary SIMON. Could I just respond to that. On the money supply, we just cannot look at 1 month or 2 months, we have to look at a target, as we have already said, over a long period of time. In the most recent 3 months the money supply growth was about 8½ percent. What they are trying to do is keep it in that 5- to 7½-percent range that the Fed has set for a target.

Chairman HUMPHREY. Yes. And you accept that range, as I understand it.

Secretary SIMON. Yes, sir. I do.

Chairman HUMPHREY. All of the estimates that we have been able to get indicate that it will leave the unemployment at the most optimistic figure at 8.1 percent at the end of 1976, and the MIT model shows it leaving it at 9.7 percent. So, I hope and pray that both of these econometric models are wrong. However, they are used, as you know, by the Fed, and I gather you use some of the same data.

Secretary SIMON. Yes, sir, we do.

Chairman HUMPHREY. So, it is at least sufficiently reliable to have a general use.

Congresswoman Heckler.

Representative HECKLER. Thank you, Mr. Chairman. Mr. Secretary, in your statement today, you have stated that the economy is poised for recovery. I see you do not commit yourself to forecasting a recovery. You say we are poised for it.

Secretary SIMON. Well, you know, the statement was long as it was and I did not think I would go into everything. That is, you can take that as a prediction, the consistent prediction that we have made that the economy will bottom out in the middle months of this year and in the second half 19——

Representative HECKLER. You mean the economy has not bottomed out according to your judgment right now?

Secretary SIMON. There is no one who is going to know with any certainty until well afterward that the economy bottomed out in a certain month.

My associate, Ed Fiedler, happens to believe that it already has, but there again, nobody knows with any certainty.

Representative HECKLER. May I ask what you believe, Mr. Secretary?

Secretary SIMON. I believe we are going to have positive real growth in the second half of fiscal 1975. And, so therefore the exact time when the economy was at bottom to me at this point is immaterial. The statistical evidence that we have to date, gives us enough confidence—and this is a pretty unanimous view—the only difference of opinion, private forecaster or government forecaster, is the degree of real growth in the second half. And that goes for most of the finance ministers whom I met with in Paris just last week. And their real concern—and Senator Humphrey and I have been talking about a difference of opinion that we have on the matter of degree in our stimulation at this point—and the real concern that these people have, viewing it from, perhaps, a farther distance from the forest, is that we are perhaps overstimulating and there is a danger that we will have inflation again in 1975 and 1977 at an intolerable rate.

Representative HECKLER. Well, Mr. Secretary, what do you feel are the reasons for the recovery of the economy, to what will we attribute this recovery?

Secretary SIMON. Well, I think that every recession sows the seeds of its own recovery, and this one is no exception. Let us look at the two weakest sectors: housing and consumers retail sales. Retail sales have been increasing in the first quarter of this year at approximately a 10-percent rate. And that equals the 10-percent decline in the fourth quarter of last year. Consumer confidence has been on the upturn. It is still terribly low, but it is beginning to show on all polls an increase. The inflation rate, I think, has a great deal to do with this consumer confidence. It has come down farther and faster than anyone had forecast.

This does something very real to consumers. It restores real earning power, as the wage settlements in the past 7 months have been approximately 7.4 percent. So, we can be fairly confident about retail sales looking ahead. Inventory liquidation has been extraordinarily sharp this year, which means that when the liquidation has ceased, that production once again commences. And when production again begins to increase, obviously the recovery is underway. Durable goods orders increased in the latest statistic at the largest rate in many years. The same with factory orders and housing permits, as I have already said.

We are not leaving it just to these statistics. We are not leaving the recovery to chance. To support and strengthen the economic recovery, we have the largest Federal deficit in our history, the largest tax boost in our history. That, coupled with monetary expansion in the area of

5 to $7\frac{1}{2}$ percent, we sincerely believe is going to provide us with a recovery that will not bring us back into the boom-bust cycle of the past. And we will have sustained a durable noninflationary growth, which is the only way to have a sustained, low unemployment rate.

Representative HECKLER. Would you say that the tax boost and the monetary expansion were the primary Government policies which prompted or inspired the recovery?

Secretary SIMON. No, I would not say that the tax——

Representative HECKLER. What policies would you say——

Secretary SIMON. Let me say that I think monetary expansion played and is playing a significant role, yes. I think the tax boost is too early for it to have played a major part. I testified several months ago that our economy would recover with or without a tax boost. That is correct. But the tax boost is going to support and make the recovery, certainly more vigorous than it otherwise would have been. But I certainly would have to say that monetary expansion would be the critical component, to answer your question.

Representative HECKLER. Do you believe that that Government policy was the major factor in terms of stemming the tide of recession and turning the economy around? Or were there other forces?

Secretary SIMON. I would say the normal cyclical forces probably played the greatest role. I would have difficulty in saying whether it is 75–25 or two-thirds–one-third. But, I would say that the normal, natural cyclical forces probably played the largest role. But they were strengthened and supported by the Government policies, yes.

Representative HECKLER. Well, is there any lesson that we have learned, is there anything that we can extract in terms of avoiding future downturns of the economy from the recent experience?

Secretary SIMON. I would certainly hope that we have learned a lesson. I am not confident of that yet. And I think the history should give us all some concern that we have not learned. We have seen this happen three times in the past 10 years.

We feel. and there again, it is a difference of opinion, that the best way to solve the boom-bust cycle is to avoid repeating the mistakes of the past and this requires maintenance of a steady growth in monetary aggregates, not excessive growth of Federal spending and cumulative deficits that we have experienced for a sustained period of time. And I would hope that we have learned, yes, Mrs. Heckler.

Representative HECKLER. Mr. Secretary, I know something of your background, but I do not know whether you are a trained economist. Is that your academic background?

Secretary SIMON. I am not. I majored in economics but I was primarily in pre-law.

Representative HECKLER. But you also did study economics. Well, it seems to me that listening to some of the witnesses we have heard in this committee, that there is a lack of dialog between financial economists and money market managers and other economists. We have often heard from academic economists. We have very impressive testimony from the economists at MIT, particularly. Their point of view was that it would be healthy to have a very large deficit this year, that whatever we are doing now is, really, not enough to stimulate the economy. I then mentioned the fact that I had heard a recent paper delivered by David Babson. who is well known in the financial field, in which he said that he did not have an opportunity to exchange views with financial economists and people in the money market sector.

Now, the fact is that I think that there is that kind of an impasse for whatever reason, and that sitting in this committee, we listen to economists from the financial sector, economists from all other areas, and the chasm between these groups is positively enormous.

Do you see a need for a greater dialog between the financial community and our economists, particularly academic economists?

Secretary SIMON. Well, I think very definitely I do and I think I put in my statement here the statement that Paul McCracken made before this very committee that if the financial community has been slow to appreciate the role of fiscal policy in the role of the economy, economists have been slow to face fully the implications of the fact that Treasury borrowing competes with private borrowing. And I went on. And, yes, there is an awareness now of the financial implications and the weakness that has been inflicted in our financial sector because of 10 years of inflation and our excessive policies.

So, I would say, yes, it is encouraging; there is a greater dialog.

Representative HECKLER. Well, I did not say that. I said there is not much of a dialog at all, at least if I am to judge by the witnesses that we have heard from.

Secretary SIMON. By dialog, I do not mean, necessarily agreement.

Representative HECKLER. Well, I would even say dialog. We hear from people who sound as if they have come from another world, each insulated in its own preserve and confident of the wisdom of its own point of view.

Now, for all of these experts, it would be very helpful to have a little cross-fertilization of ideas among yourseleves.

It would make it a little easier for us.

Secretary SIMON. We have a consultants group I will be meeting with this afternoon in the Treasury Department. And, that includes academic as well as financial economists, the so-called experts. But, I must admit, having been a person who operated in the banking world all of my adult life, I prefer those judgments but find that economists' judgments in their historical perspectives and prerogatives are very important. They are an ingredient in the decision that the decisionmaker makes in the marketplace.

I do not know many economists who are decisionmakers in the marketplace.

Representative HECKLER. Mr. Secretary, in the concluding paragraph of your statement, you state that politically, most people in this town will not want to worry about 1977 and 1978. Well, I think that is really a misstatement.

I do think that we are worried about 1977 and 1978, and if we are not, indeed, we are, I think, violating the public trust. Because obviously the problem down the road are our problems as much today as they will be tomorrow. But the fact is that we are concerned about unemployment. And I have a 14-percent unemployment rate in two major cities in my district. And I am deeply concerned because I simply do not find that Congress has the answers. And as concerned as I am with the forecasts in a statement such as yours, and it presents a great deal of material that I have heard from other reputable sources, at the same time the human suffering which this particular unemployment rate actually means. translated into individual terms in my own district, for example, is intolerable.

Now, I want to know what employment program or policies, you advocate. I can see that you are concerned with a bulging deficit. And I am concerned with that as well. But I am also concerned about how this Government responds to the question of unemployment in which you would have confidence in, because obviously the most effective employment is going to be in the private sector. But, at the same time, with the private sector not responding and not recovering as quickly as we would like, Government is going to have to do something. Now, what should Government do and what proposals would you make?

Secretary SIMON. Well, this is the point. And right at the testimony, Mrs. Heckler, before you arrived, I responded in some detail to a similar question from Chairman Humphrey and we share your concern about unemployment, because the figures are indeed unacceptably high.

But how can we bring unemployment down quickly and for a sustained period? It would do no good for us to bring unemployment down as rapidly as possible, that is if we thought we could do it, only to have it rise back up again to even higher levels later on. If inflation, and we believe it did and most people believe it did too, was the major factor in causing the recession and subsequently the high unemployment, then we have to be careful not to make the mistakes in the past, apropos your earlier question, that we do not blow ourselves out of this recession, overstimulate and overheat the economy, thereby bringing inflation back next year at an even higher level because we are starting from a higher level moving into a period of recovery than ever before. And then another recession and even higher unemployment.

So, we believe that the policies that we have adopted: The expansionary policy on the part of the Fed, the large tax cut, the large deficit and all of the other factors we have discussed are sufficient. And I think again, the only difference of opinion rests here that there is some feeling that it is not sufficient because it is not happening fast enough.

Well, our problems did not come upon us that quickly either. They came because of years of not paying attention to the fundamental problems. And it is going to take us some time to work out of it. And if we do not exercise a great deal of patience, we are going to be doing a great injustice to the many people that are unemployed today, because they would just be back on the unemployment roll 2 or 3 years from now.

And I know how hard a statement like that is to sell to people who are unemployed. And I have great compassion for them. And what I would like to do is deal with the unemployed with a rifle and take care of the unemployed, as best as possible. Therefore, we budgeted $20 billion for unemployment and expanded unemployment programs in the balance.

But, what I meant just now by dealing specifically with a rifle with this problem, is rather than just spending money through the entire economy to create greater demand which would just exacerbate the problem 2 years from now for everybody. That would be wrong.

Representative HECKLER. Mr. Chairman, I have been told my time has expired. Thank you, Mr. Secretary.

Chairman HUMPHREY. Senator Proxmire.

Senator PROXMIRE. Secretary Simon, you and I agree on a lot of things. We certainly agree on holding down Federal spending. And I think, at least, you and I agree we should have as much of this recovery as possible in the private sector.

Nevertheless, we disagree very strongly, I think, on what we have to do to get that recovery. I think that the best refutation to your position comes not from an academic economist or anyone else. It is by what the administration itself has told us: What they expect the performance of our economy to be over the next 5 years, which they have told us in a publication by the Office of Management and Budget that came out on May 30th.

Now, what they say is that if their very rosy and optimistic assumptions about growth are true, and they do not have any program to make these things come true, we will have unemployment this year of 8.7 percent which is worse than they expected in the past.

Second, we will have unemployment next year of 7.9 percent. It will be 7.2 percent in 1977. Two full years from now it will average 7.2 percent. This is an optimistic outlook. 6.5 percent in 1978. It will be 5.8 percent, then 5.1 percent.

Now, the difficulty with these projections is that No. 1, for the first 2 years, they are based on the assumption that you have a growth in the money supply within the limits that Mr. Burns set, that is, between 5 and 7½ percent, averaging 6½ percent, something of that kind.

Now, the projections that we have seen are that you are not going to get unemployment down to an average of 8.7 percent this year, and certainly not 7.9 percent next year unless you have about an 8½-percent growth in the money supply.

No. 2, you are taking a position that the tax cut of 1975 will not be extended in 1976. And they say that you have got to get that extension if you are going to get this kind of growth.

Third, they say that the cap on the Civil Service pay should remain at a 5-percent increase and we say it should be somewhat higher than that and that would provide more stimulus.

But the biggest area of difference is that you project in these years: 1977, 1978, 1979, 1980, a growth of 6½ percent. Now, that is 20 percent greater than any growth we have enjoyed in the last 35 years. It is much greater than the growth we enjoyed between 1962 and 1966 when we had an excellent growth in the economy. And it is a growth that is projected, not based on any kind of a program, based on a relatively limited monetary stimulus, and no fiscal stimulus that I can see.

Now, how can you justify a program that even on the rosiest assumptions would seem unrealistic, would give us unemployment to 1977 of about 7 percent?

Secretary SIMON. Well, that is lots of questions, Senator Proxmire. And again, I think our only difference of opinion is as to the degree.

But let us talk, first of all, about your growth rate of 6½ percent.

Senator PROXMIRE. About what?

Secretary SIMON. About the growth rate, the 6½ percent that has been projected and extrapolated arithmetically, which does not mean very much, as far as I am concerned, moving into 1977, and maybe it does not mean much in late 1976 either. Nobody has the ability to forecast or even project, other than just in that simple arithmetic extrapolation. I do not subscribe to that exercise and I never have. Our economy is more dynamic than that, and it is going to improve a lot more rapidly than that. But that just happens to be Bill Simon's judgment and I think it is also Arthur Burns' judgment, and I think he has testified in that regard.

But from early 1961 to 1964—and in doing this from memory, I think I am pretty close to right—I think you will find that the average growth rate for the 3-year period was 5.8 percent, pulling out of the recession at that time. And that is a pretty high rate of growth. Well, how can we sustain—if that is the highest, how can we sustain a projection of 6½ percent? Well, we have gone down a lot further in this recession than at that period, and so I happen to think that is reasonable.

Senator PROXMIRE. Now, let me just say that we had a number of advantages at that point, too. We had an inflation rate that was not as stifling as the inflation rate we have right now. We had a longer term momentum in our economy, a situation that was more favorable in my view toward growth under those circumstances. But I am not arguing that you will not get a substantial improvement coming right out of this deep recession. I think that probably is right. I think you may get 6.3 percent in 1976. What I am concerned about is in 1977, 1978, 1979, and 1980 that you are much less likely to get that kind of sustained and even greater growth in the economy without some kind of a more stimulative monetary and fiscal policy.

Secretary SIMON. No one, again, knows. And I would venture that if events occur that have been unforeseen, which all of them are, that these policies and these projections are going to be revised every quarter and every half-year, as economic policy is also always changing to meet the changing circumstances.

I would like to provide for the record the full employment surplus and deficit revenues, which are important at this time, to comment on your fiscal stimulus remarks, Senator Proxmire, because at what some would now consider, again, private and Government economists, that full employment is not at the 4 percent that we set, but due to the changing components in the labor force since 1946, it really is at 5 percent or even slightly higher; that there is a substantial full employment deficit at certain levels of actual budget deficit at this point. So I believe there is stimulus right now, and I believe that 5 to 7½ percent monetary growth that the Fed announced is also sufficient to do the job, to lead us out of this problem.

Senator PROXMIRE. We will welcome that, Mr. Secretary.

[The following table was subsequenlty supplied for the record:]

TABLE 1.—BUDGET TOTALS

[Fiscal years; in billions of dollars]

Description	1974 Actual	1975 February estimate	1975 Current estimate	1976 February estimate	1976 Current estimate	Transition quarter February estimate	Transition quarter Current estimate
Budget receipts	264.9	278.8	281.0	297.5	299.0	84.4	86.8
Budget outlays	268.4	313.4	323.6	349.4	358.9	94.3	95.8
Deficit (−)	−3.5	−34.7	−42.6	−51.9	−59.9	−9.8	−9.0
Full employment receipts	282.2	323.1	323.0	351.8	357.0	98.4	100.0
Full employment outlays	267.3	306.5	316.7	340.2	349.8	91.9	94.2
Full-employment surplus or deficit (−)	14.9	16.6	6.3	11.6	7.2	6.5	5.8
Budget authority	313.9	395.1	408.9	385.8	383.8	88.2	88.8
Outstanding debt, end of year:							
Gross Federal debt	486.2	538.5	544.5	605.9	617.5	616.8	627.6
Debt held by the public	346.1	389.6	396.9	453.1	470.9	465.6	482.8
Debt subject to limit	476.0	528.9	534.0	596.4	607.1	607.3	617.2

Senator PROXMIRE. Well, in table 1 we have the full employment deficit on surplus and it is a study of full-employment surplus throughout the period 1975 and 1976. That is all they give us, but through that period—and as I understand it, it was projected by our staff here, the full employment surplus was over $50 billion as you get into the 1978, 1979 period.

But—I only have a minute or two left, because Senator Javits wants to ask some questions—but let me point out that what troubles me is not so much this overall macroeconomic perspective—I agree with you, it is very hard to predict on this basis—but looking at the specific industries that have tended to lead us out of the recessions in the past, housing and automobiles, both in very serious trouble. Because of the fuel situation, the energy situation, automobiles are likely to be in some difficulty for several years.

Interest rates on long-term buying, mortgage rates, are both very high. And it seems to me those two industries are in most serious trouble. And certainly housing, it seems to me, would require some sort of initiative and leadership on the part of our Government, both in Congress and in the administration. We have an emergency housing bill that we were very hopeful you can approve, but if you cannot approve it, that you will come back with something that would give us some housing starts. Without that, it is very hard for me to understand what industries are going to be able to provide the employment we are going to have to have.

Secretary SIMON. As I said in response to a similar question, Senator Proxmire, a little while ago, that consumer spending, we believe, is going to be a leader in the strength leading us out of this present recession, coupled with inventory reduction, which means resumption of production in our economy.

Housing is also going to help because the necessary financial preconditions have been established. Short-term rates have declined dramatically since last August. Money has flowed back in record levels into thrift institutions. The permits last month went up 200,000, that is 27 percent—still at low levels.

Senator PROXMIRE. Very low levels.

Secretary SIMON. But still that is a million and that augurs more housing starts than in the past. We look for improvement; I think most people expect housing at an annual rate this year to be about 1½ million units, which is not the 2½ million. It is not going to be as robust as we would like; it is going to be slow.

Senator PROXMIRE. Well, there have been some revisions and home builders are very concerned about this, and the others are concerned because of the stickiness of long-term mortgage money, and unless we can do something about that——

Secretary SIMON. I could not agree with you more. I have always been an advocate, and I have debated this with the economists—I had one housing expert in the Treasury some time ago, and he gave us his housing forecast and I asked him, in your forecast, what do you presume mortgage interest rates to be and what is the impact of rates on housing starts? And he said, it is not in there. And I said, well, I know that there is controversy, but I happen to believe that a 9 percent mortgage, which costs $100 more a month than a 5 percent mortgage, is an impediment when one considers the explosion in land, material, labor that has occurred, the inflation that has occurred in the last few years. And I think as a result we are going to have problems until—the only way to bring interest rates down is to have a sustained reduction in the rate of inflation and expectations.

Senator PROXMIRE. Secretary Simon, I want to give Senator Javits a chance, so let me just conclude by saying I hope that you will take a long and as favorable as possible a look at that emergency housing bill. I realize there are troubles with anything, but this bill has the advantage of relatively small cost to the Federal Government, great stimulus of the economy, a probable net reduction in the deficit rather than an increase in the deficit because of the inflow of revenues from the stimulated activity. And I do hope that you can find your way clear to making a favorable recommendation to President Ford on that.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Very good.

Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman.

Mr. Secretary, I hope you will not mind if I ask you a somewhat parochial question right now.

Secretary SIMON. Uh-oh.

Senator JAVITS. Our parochial problems have been very well advertised, and you are quoted as saying that you do not believe that a default by New York City on its short-term debt would materially undermine the municipal bond market. Has the Treasury done any studies in this regard, or is it more or less an off-the-cuff opinion?

Secretary SIMON. I was asked—there were studies done and presented the market impacts to the President at the time of the discussions of the New York City problem. My discussions and my response, that was similar to that, Senator Javits, were based on that and my long experience in the State and local financial market. People have access to markets who have financial integrity, and the credibility of running their municipalities or corporations in a correct fashion. And people with good credit ratings, because that is how they are measured in the market, are going to continue to have access. They are going to be a couple of areas of concern. New York State municipals will share some concern here, because recent New York State financing has suffered. But it has not suffered because of the reason of New York City; it has suffered because of a growing feeling in the market that New York State is going to have to do more financing to help the city, and that would place a natural upward bias on interest rates.

The second concern is with the so-called moral obligation, which we all believed and so did Arthur Levitt for many years, someday would come under test. What is a moral obligation, is it truly an obligation? They have now been set up all around the country and they are getting the test, starting with the Urban Development Corporation. But overall I do not believe—and it is being demonstrated in the market today, people are financing, assuming again that they have the integrity to enter the market, which they do with a good credit rating, they are having not any problem raising their moneys. The rates are too high, but the rates are too high across the board.

Senator JAVITS. Well, your opinion is based, is it not, on the fact that a default by New York City has been a non-event ever? When has New York City defaulted? Not even in LaGuardia's day.

Secretary SIMON. New York City has never defaulted. There have been other defaults that have occurred, in the 1930's in many States; yes, sir.

Senator JAVITS. There are no New York Cities in the country, other than New York City, is that correct?

Secretary SIMON. That is correct, but what we do, Senator, is we jump immediately from the beginning to the end and we say what happens if New York City is going to default? And I must admit, I do not subscribe to jumping from here to there, because there is lots New York City could do right now to prevent a default and I believe that is what is occurring right with the group that reported to me yesterday, Felix Rohatyn and Dick Shinn and the balance of them who were working on this problem with Mayor Beame and with Governor Carey.

Senator JAVITS. Well, I would like to come to that, and I might as well do so now, but I am still not content with the previous answer. There is no question about the fact that the national interest in what happens to New York must have many components, including the fact that New York is to the world a symbol of the United States of America and our own success or lack of it as a Nation. But the important point now is, what you are leading to is what is to be done about it, so I will ask you my second question, then come back to the first.

Is the fact that the United States will be of some help to New York out of the question, or is it still fair to hope that we will be able to develop a proper package with the city itself and the State, but including some Federal backup?

Secretary SIMON. Well, let us look at what we have the ability to do—and the one thing I would not do would be to attempt to prejudge a Presidential decision. He made a decision a month ago, after great detailed discussion, not only with his financial and economic people here in Washington, but also with Governor Carey and Mayor Beame, and their associates as well. Our options are limited. We have an option to advance Medicare and Medicaid, which was a very small amount of money when one compares it to their fiscal problems. It came to about $200 million, which is small when one looks at the $3 billion that they have to finance between now and August of this year.

Too, the Federal Reserve could, in their capacity as a lender of last resort, go in and provide them with the financial relief, purchase their securities or otherwise. This would require five of the seven Governors for approval, and that is to put it mildly, not there as far as the Fed is concerned. It would set a very, very dangerous precedent.

We have no ability in the Treasury Department to purchase their securities, and as we all know or we believe anyway, I should say, that if legislation was passed to rescue New York City, the legislation, I could not subscribe to. Senator Javits, No. 1, and No. 2, it would not just apply to New York City; it would apply to what I would call the nationalization of State and local debt in the United States, which I would consider extremely dangerous.

You know there are an awful lot of mayors and Governors all over the country that have made all of the tough decisions living through this recession and even before that, to run their city and State governments properly. Well, do we penalize those people who made those very difficult political decisions by going in and, whether it is New York City or 12 other cities—one, New York City has the ability right now to put forth, and they are going to, in my judgment, a credible budget that will be in balance, which has to be by their constitution.

New York State can help build the bridge between here and there, and they will have their integrity restored, and they will have entrance into the credit markets again.

Senator JAVITS. Well, now, you just said you would not favor legislation, or what? I did not get your point on legislation. Are you going to oppose legislation to help the big cities?

Secretary SIMON. It is not going to help the big cities. I do not know any other big cities that need help.

Senator JAVITS. I thoroughly disagree with you—Philadelphia, Newark, Detroit, are very much such big cities that need help, and the bill that I introduced——

Secretary SIMON. How do they need help, Senator Javits?

Senator JAVITS. If I might just finish. The guarantee bill that I introduced covers any city over 100,000, and there is an enormous outpouring of sentiment from cities who feel they are in grave jeopardy, like New York is. The fact that they have not defaulted is not the answer. New York has not defaulted either, for that matter.

Secretary SIMON. And they are not, in my judgment, in need of going into default if they do what is right right now.

Senator JAVITS. Well, they are not going to raise $3 billion by August, no matter what they do. That presupposes, does it not, the restoration of their credit standing or some assistance from the State and Federal Government.

Secretary SIMON. I would not accept the statement that they will not be able to enter the markets in August, with a plan that is being worked on right now. It hinges upon the fiscal credibility of New

York City in presenting a truly balanced budget and the ability to reenter the marketplace, and I just think that I could not subscribe to that.

Senator JAVITS. Well, I still do not get your answer to what legislation you would oppose. Would you oppose any legislation to help the cities in this particular crisis?

Secretary SIMON. Any legislation to help the cities, Senator Javits—again, I have received no word from Newark or Philadelphia or any other city that they are experiencing any difficulties that would require Federal financing of their general obligation bonds.

Senator JAVITS. I think that if they had any idea that you are awaiting word from them, they would be here, very fast.

Secretary SIMON. They usually do not have to wait to come down with their hands out to Washington. Some years ago Newark did have a problem——

Senator JAVITS. I know, the hands-off attitude is exactly what you expressed, Mr. Secretary. I must say I find it highly unpleasant. and I will tell you why. Over 70 percent of all people live in the big cities, and the big cities are decaying. It is no picnic for New York that one out of eight citizens is on the welfare rolls, and that the Federal Government has been unable to come through with what it should do, which is to take off a great deal if not all of that welfare load, or in some other way to do something else in this field which will be realistic for the cities. There are tens of millions of people out there. Mr. Secretary, and for the stability of this country we do not want them to get very mad, and that goes for the 30 percent that do not live in the cities. So frankly, I think——

Secretary SIMON. I agree with that, but——

Senator JAVITS. If I may just finish, even if you disagree with us, and even if you think that we have to measure up. By the way, I happen to agree with you on that. The fact is that we had better be a little more sympathetic and understanding and not so categoric about it and absolutely exclude or bar any role by the United States in trying to resolve this dilemma. We did not do it in revenue sharing: we provided $30 billion over 5 years—we could have made it $60 or $90, and we may again.

But I must say, it does make me rather unhappy to feel this kind of flinty attitude, the answer is not at the cash window——

Secretary SIMON. I am not excluding, nor am I ignoring, I am attempting to look at the problem of New York City, and the city has been living beyond its means for too long, with expenditures rising at a rate of 15 percent a year and their revenues increasing at a rate of 7 percent and the results of that are predictable. When they have a $1.7 billion capital budget, where over $700 million of that is operating expenses that have been transferred into the capital budget with the obvious impact of about 20 percent increase in the interests costs, the explosion in their debt service requirements.

Finally, they have lost access to the markets. How can they restore their financial integrity? Well, this is what has to be done. This is the solution to the problem. Is there a matter of equity, Senator Javits? Do I, as the chief financial officer of the United States, have a responsibility to all taxpayers, to the people who, as I said before, made the tough decisions, the mayor of Duluth and any city you want to mention, the people who have not lived beyond their means for so long? Yes, I think I do, and I truly believe that the American people support this notion.

Now, in the absence of the New York City or any other city being able to help themselves, then I would like to sit down and discuss the problem, but they have the tools, they have the ability to put their financial and fiscal house in order and that is what they are going to have to do, because it is the only long-term solution to New York City's problems.

Senator JAVITS. Well, now, suppose they do, and that is the only basic point I am making. Suppose they do make the tough decisions and make the tough sacrifices and—you know, I was widely advertised to have considered myself running for mayor in 1973, which I need like a big gaping hole in the head—only because of my deep worry and concern about the great city in which I believe so deeply and in which I was born and in which I have served, as well as my State, all of my life.

You know I know our troubles, and our troubles are very deep, but we are in a momentary crunch, and even if we did everything the Secretary thinks we ought to do, we might still not have access to these credit markets, credit markets with which both you and I have had a good deal of experience, and I am sure you more than I— but I think you will agree I am not exactly an amateur in this business. It is very uncertain as to whether New York could even get the credit if it did everything without causing widespread riots in the streets.

So again I come back to my question, because I think it is very important, and I do not think that you and I fail to understand each other on that score—and you said it yourself just a minute ago, the fact is that the United States could play a role, if the configuration was right. That is the only thing I think New York City ought to know, that the door down here is not absolutely flatly shut.

Secretary SIMON. I have already told them that, but at the same time, Senator Javits, I said now, by that I am not saying that we are looking favorably upon it, but I will promise you this. When they have done everything and have come down to keep us posted on every couple of day basis that could humanly be done, and if there is a gap at that point, if that should exist, I will promise you it will be taken immediately to the President who will make the ultimate decision on this.

Senator JAVITS. I am sorry, Mr. Chairman, to take so much time.

I just had one other observation, Mr. Secretary. I have a feeling, as a politician of long standing, that even those people who say well, should you be fair or unfair to the mayor of Duluth or the people of Duluth, and I think you named that city, who have made the harder decisions, and that happens to be in my colleague's State——

Secretary SIMON. I did not do that on purpose.

Senator JAVITS. I just have the feeling that even the attitude towards New York City is changing a bit in the country, because of this crisis, and that there is a commonality of interest among the cities, respecting their relation to the United States, as well as to their own State. And I feel a somewhat broader sympathy for the people of New York, who are in such a jam. Sure, I think the people of the country expect New York to measure up, and I will knock myself out in the process and not ask for something that we do not deserve. But I am glad to hear you say, finally, after this little colloquy, that it cannot be considered that the United States is a disinterested observer.

Secretary SIMON. Absolutely not.

Senator JAVITS. I thank you. I thank my colleagues.

Chairman HUMPHREY. Well, I am afraid we have kept you a long time, Mr. Secretary. We will send you a note from now on, from time to time, to ask you for a little more information. I think you have gotten the point of view of the committee this morning. I hope that you will convey that, particularly in reference to the unemployment problem, as Congresswoman Heckler I think, stated it maybe as succinctly as anyone. And Senator Proxmire gave you his view, and he surely expressed mine, in terms of what we call the money supply and the Federal Reserve Board's relationship to the economy.

I think I should point out to you just as you depart that our analysis here—one of the staff people brought to my attention the fact the rate of money growth from January through May, up to May, was 2.9, averaged out 2.9. That is just incredibly low. It has its variations, but what counts is the overall average. And I want you to take into consideration the economic projection that I called to your attention. In fact, I am going to have the staff send you a comment on it from data resources and from the Wharton School and MIT models that we have had, and I am very much interested in how the administration documented or proved to have any credible economic source which supports your projection of 7.9 percent unemployment in 1976. I will not bother you today with those. I mention them for the record so that the staff can prepare an appropriate communication to you and your people in Treasury.

Senator JAVITS. Mr. Chairman, may I do the same respecting the room for economic expansion in the Secretary's presentation?

Chairman HUMPHREY. Yes.

Mr. Secretary, we want you to know that while our questions and our statements may seem rather harsh, that there is a high regard for you amongst all of us, and speaking personally, a very warm affection for you. I just pray for your economic philosophy, that is all.

Secretary SIMON. Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you.

[Whereupon, at 12:27 p.m., the committee adjourned, subject to the call of the Chair.]

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