682

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

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CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

FIRST SESSION

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THE 1975 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 5, 1975

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

The committee met, pursuant to notice, at 10:20 a.m., in room 4232, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Sparkman, Proxmire, Kennedy, Percy, and Fannin; and Representatives Brown of Ohio and Brown of Michigan.

Also present: John R. Stark, executive director; Courtenay M. Slater, senior economist; William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Sarah Jackson, Jerry J. Jasinowski, L. Douglas Lee, Carl V. Sears, and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbhaar, Jr., minority counsel.

Senator PROXMIRE [presiding]. The committee will come to order. I apologize, the chairman has been delayed unexpectedly in executive sessions and is unable to be here. After you have completed your statement he will make his opening statement without having that run against his time.

Secretary Simon, we certainly welcome you to this committee. You have a well-earned reputation as a remarkable, deeply sincere man. There is a great deal of disagreement in the Congress with your policies and what you propose, but you certainly argue them very ably.

I had a little opening statement here and I will abbreviate as much as I can.

I deeply appreciate, as I am sure Members of the Congress do, almost all Members on both sides, the remarkable honesty of the President's budget statement and economic statement. It is a welcome relief from what we have had from administrations representing both parties in the past.

At the same time, many of us feel we simply cannot accept 7 million Americans out of work for the next 2 years, and perhaps more. Frankly, I personally agree with your reluctance about Federal spending, but I think this makes it essential for us to stimulate the private sector of the economy, particularly housing with monetary policy, with tax reduction, with policies that will insure us a vigorous activity in the private sector. If we don't and are unsuccessful, then it is inevitable, rightly or wrongly, for the Federal Government to move in and provide jobs.

While there is some question as to the waste involved in many Federal expenditures, there is no question whatsoever of the absolute loss and misery of unemployment. People who are idle, although they want to work—when you have 6 or 7 million Americans idle that is a loss we simply cannot tolerate and will not tolerate.

Just one other point. I am very concerned about the effect that the administration's projects and forecasts have had on the attitude here on the Hill and in the country with respect to our economic outlook. I know, for example, that they predict that we are going to have very heavy unemployment in the next 2 years and considerable inflation for the next 2 years and then they project figures like 1977 inflation at 6.6 percent, unemployment at 6.5 percent, and in other words they round it out to 0.10 percent. This gives an impression of precision and an impression of kind of inevitability which is a fake and I think the kind of people who offer the proposals know they are making wild guesses.

I would just like to quote from page 37 of the February 1975 Economic Report of the President: "Looking at the prospects for 1974 a year ago, the administration saw a weak first half and a recovery setting in by midyear,"—that was a year ago, in January of 1974—led by an upturn in housing and a recovery of the automobile industry from its depressed condition at the start of 1974. The administration also expected a slower rate of inflation after early 1974, associated with a deceleration of the price rise in petroleum and farm and food products. That prediction, of course, was 100 percent wrong.

There is every reason to suspect there has not been any improvement in forecasting for the last year. That was only for 1 year. We have a forecast in the budget document and the economic report not only for 1 year but 2 years, and then a projection for additional 4 years. I think with all of the uncertainties that we have facing us that that is the wrong impression to give. I think that a great deal of it depends on what we do, what the Congress does and the President recommends and forces that we can not predict or control.

I apologize again for taking more time than I should have.

I yield to Senator Percy.

Senator PERCY. Mr. Secretary, I will be very brief.

I would like to simply comment that I think the virtue of the President's budget, though I disagree with some of it, is that it does provide at least the bases for public discussion and the bases for restoration of public confidence in our economic future.

I simply believe very strongly there will be no basic economic recovery until there is a recovery of confidence.

I am not so sure that the projected deficit is going to give us that sense of confidence. I am not so sure that people given these tax rebates, are going to necessarily run out and spend them if they are worried about unemployment. I recall the debate that you and I had in the policy committee room when we were looking at the task force report as to whether the budget deficit was going to be $11 or $17 billion as I feared, and now we face one of $34 or $35 billion. These new figures are shaking public confidence in our ability to balance our budget without growth. I think we have to find some way to pull that together despite the fact that we do find ourselves battling both

inflation and the recession. I would like very much to have you address yourself at some appropriate time to how we can restore the confidence of the American public.

The benefit of the President's program is that we have now come out with a plan. It is now up to the Congress to respond constructively and urgently to that plan—either to provide something that is better or work with what we have, modifying it in some degree. We must get underway.

I would like to see stiff direct taxes on gasoline and on flexible rather than inflexible items such as fuel items or petroleum chemicals. The administration, through its regulatory power will, I believe, prevent the oil companies from imposing these increases on the inflationary areas and require they go into the flexible areas.

Lastly, I hope that we can find a way, as Senator Proxmire and I have long sought, to have labor and management on the same side of the table. Labor is terribly worried about job security. I am sure they are willing to sit down with management and find ways to increase our national productivity growth rate. That effort is something that involves every sector of the economy. If we can create a productivity center based on the World War II concept of employees working with management to find ways to stop the current economic downturn, I think that will bring people together and restore national confidence. I hope you would address yourself to the question of how we can restore that confidence.

We welcome you, Secretary Simon.

Chairman HUMPHREY [presiding]. Thank you very much.

May I say this hearing was called for 10:30 this morning. I had a meeting at the Committee on Agriculture and Forestry on the food stamp bill. I was there at 10:30 a.m. and I had to leave even before we had the vote.

I am glad to see you, Mr. Secretary. We had a little crossup in our signals.

I have a brief opening statement to make at this point.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Our witness this morning is the Secretary of the Treasury, William E. Simon. This is our first hearing since the President's Budget and Economic Report have become available. Those two documents have certainly provided much information that needs to be discussed. I have taken over the chairmanship of the Joint Economic Committee at a grave moment in our Nation's economic history. The forecast contained in the Budget and the Economic Report indicate that we are facing the most difficult year for the economy since the creation of this committee in 1946. In no previous year would we have believed that a combination of an 8-percent unemployment rate and an 11-percent inflation rate was even possible, much less probable.

Mr. Simon, you have been quoted as saying you are horrified by the size of the budget deficit. Let me take just a minute before you begin your testimony this morning to tell you about something which horrifies me.

I am not happy about the size of the budget deficit. Nobody is. I am not happy that inadequate economic policies have created the recession which will produce that deficit. However, the thing that really

horrifies me is the employment and unemployment outlook for the remainder of this decade.

The economic outlook presented by the Council of Economic Advisers in their annual report yesterday implies that the unemployment rate will be above 8.5 percent at the end of this year. That means 8 million persons unemployed. All kinds of people—old, young, black, white, male, and female. No group is going to escape.

Mr. Simon, what are we going to say to these 8 million unemployed? Will we give them battle ribbons for serving in the front lines of the battle against inflation? I would like to at least be able to say to these millions that their Government is now taking effective action; that the unemployment rate will be going back down just as fast as we know how to make it go. But the forecast given in the President's Budget and Economic Report does not offer any hope that we can honestly make such a statement. With the administration's policies the unemployment rate will be 8 percent this year, and it will still be 8 percent next year; 7½ percent the year after that.

Mr. Simon, you have responsibility for economic policy. I apologize if I seem a bit emotional, but I am not going to be satisfied with an economic policy which holds out so little hope for reducing unemployment. We must find something better.

Mr. Simon, Congress is more than ready to cooperate with the President in working out programs that will do the job of ending this recession. We also want to cooperate in developing long-term programs which will do the job of reducing our dependence on imported oil. However, we want to cut back our oil imports in ways which will not do damage to the economy; 14 members of this committee—Republicans and Democrats—wrote to the President last week asking that he defer any further increase in the import fees on oil and establish a joint congressional-executive task force to work out a mutually acceptable energy policy. In this way I would hope we can avoid the confrontation on energy policy which otherwise threatens to interfere with forceful action to end the recession.

Mr. Simon, I want to get your reaction to this proposal but first why don't you go ahead and present your statement.

Secretary SIMON. I enjoyed the first half hour.

Chairman HUMPHREY. I had a bill from the other committee which is a very important piece of legislature, and I cannot be in two places at once, and that is why I informed some people that you would be here at 10:30 a.m.

With that Mr. Secretary, I gather you have not read your statement as yet.

Secretary SIMON. No, sir, I have not.

Chairman HUMPHREY. I think we should await your opening statement and then we shall ask you questions.

I only want to indicate that the morning press seems to have some confusion as to just where we are. I notified the Washington Post, the President is more optimistic than his budget message, and I think that you were more optimistic than the Council of Economic Advisers. I hope that you and the President are right, but I gather that both of you had something to say about the budget message. Maybe you can kind of dispell the confusion which I sense, or maybe it was just a headline or just a brief opening paragraph that I misunderstood.

Secretary SIMON. No, I do not think so, Mr. Chairman, and this goes to what Senator Proxmire said in his brief opening comments—he was talking about forecasting. As you know, the results of forecasting over the years for the most part have really been pretty dismal. When I say that, I hasten to add that this is not the fault of the people who are making the forecasts, because you are making forecasts on literally thousands of events that have not occurred yet, making assumptions, so it is a precarious business at best.

A year ago all private as well as government economists were pretty much in line in saying that in the first half of 1974 our economy would begin to improve. All these things have turned out to be pretty much wrong.

Chairman HUMPHREY. That has been pretty much the pattern.

Let us hear what you have to say.

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ACCOMPANIED BY EDGAR R. FIEDLER, ASSISTANT SECRETARY, ECONOMIC POLICY; FREDERICK L. WEBBER, ASSISTANT SECRETARY, LEGISLATIVE AFFAIRS; FREDERIC W. HICKMAN, ASSISTANT SECRETARY, TAX POLICY

Secretary SIMON. I just want to say that we cannot use the term "forecast" with the Council of Economic Advisers report in the budget message, because Congress asked us to provide 5-year projections and there is a big difference between 5-year projections and forecasts, because the difficulty of forecasting even for 6 months in this very changing world of ours recognizes that it is absolutely impossible to forecast per se for 5 years.

I also kind of believed and had a personal feeling that forecasting was all right as long as you didn't look into the future.

It is a pleasure to appear again before your distinguished committee. These sessions provide a valuable opportunity to review the economic and financial developments of the recent past and to discuss appropriate policies for the future.

We have no shortage of problems to deal with this year. The economy is in recession while intolerably high rates of inflation still persist. At the same time, we must take drastic steps to reduce our dependence upon foreign oil. These same three problems of recession, inflation, and high-priced oil also dominate the international scene and we must continue to work with our friends abroad in search of acceptable solutions.

Our discussions today take place within the context of three recent events: The formulation and submission by President Ford of a comprehensive program to cope with the interrelated problems of the economy and energy; the submission by the President of the budget for the coming fiscal year; and the release yesterday of President Ford's first economic report. The main elements of the administration's program are familiar to you and I will not take your time this morning to review this program at any length. It does seen to me that your committee is uniquely equipped to take a broad view of our economic situation and possible remedies, and it is to these that I wish to turn initially.

DOMESTIC ECONOMIC OUTLOOK

We have an economy with a short-run problem of recession and a continuing problem of inflation. There is no doubt about the recession; it may very well turn out to be the longest and deepest decline since World War II. There is also no doubt about the inflation. It dwarfs anything that we have experienced in our peacetime history. Both of these conditions must be brought under control.

Much of the current discussion concentrates almost exclusively upon the recession. This is understandable. Falling output and rising unemployment create economic hardship, which would be intolerable if continued for too long a period. Real output declined at a 9 percent annual rate in the fourth quarter and is again falling sharply during the current quarter. Unemployment rose above 7 percent by the close of last year and will probably exceed 8 percent this year before beginning a gradual decline. For 1975 as a whole the unemployment rate is likely to average close to 8 percent, far above last year's 5.6 percent.

The trend through the year, however, should be distinctly better than last year. In 1974, output was falling rapidly by the end of the year. By the end of this year, output will be rising. In 1974, the rate of inflation was in double digits by the end of the year. By the end of this year, it will be well below 10 percent. The economic report provides our best estimates on output, prices, and employment. As in other recent years, our own estimates are close to the consensus of private economic forecasts.

The forecasts may not be altogether convincing. Last year's forecasts—our own and most others—called for output to rise and inflation to fall in the second half of the year. That was not the way it turned out. Now, with the good news once again scheduled for the second half of the year and the bad news here in the present, some skepticism is inevitable.

Our case for a recovery in the second half of this year rests primarily upon cyclical forces. Inflation caused the supply of mortgage credit to dry up and sent the housing industry into a tailspin. With inflation gradually receding now, and the economy soft, short-term interest rates have declined sharply. This has renewed the inflow of funds to the thrift institutions and provided the essential precondition for a housing upturn.

Inflation also cut deeply into the real income of consumers as prices transferred income from most consumers to growers of grain and sugar and to owners of oil both here and abroad. Inflation also cut indirectly into real disposable income through higher effective rates of taxation. As a consequence, real consumer purchases fell 3 percent in the past year. However, now that the pattern of wage settlements has accelerated and the rate of inflation is subsiding, the real income of workers should be on the upgrade again in 1975. This, in turn, should lead to an increase in consumer spending, providing another element of support for the general economic recovery.

A third cyclical element that should turn around during the year is inventory investment. Businessmen are liquidating excessive stocks now, not only in the automobile industry, but also in a wide range of other industries. Since final demands in the economy will not fall

away precipitously—for many reasons, including the automatic stabilizers built into our budget—the decline in inventory investment will end and will turn around and become a positive economic factor once again.

Thus housing, consumer spending, and inventory investment will all be contributing to a recovery from the recession during 1975.

There have been five cyclical contractions in the postwar period, 27 in the past 120 years. We have survived them all. From every indication, the present contraction will fall within the accustomed postwar pattern. I think there is no prospect whatsoever of a long- and deep-economic downturn on the scale of the 1930's.

Nonetheless, we are not prepared simply to let nature take its course. The Federal Reserve has already eased monetary condition substantially. Similarly, the President has recommended a $16 billion temporary tax rebate this calendar year to provide economic stimulus at a time when the economy is weak. This tax rebate is in addition to the estimated $17 to $18 billion that will be spent on unemployment compensation and public service employment programs in fiscal year 1976. We advocate the $16 billion temporary tax cut not because the economy would not recover without it, but because it will make the recovery in the second half of the year more solid and certain.

Even so, there are no instant cures. Our current economic troubles grew out of multiple causes reaching back a decade or more. While special factors, of which food and fuel are the most prominent, were important, the most fundamental sources of our difficulties have been overstimulative monetary and fiscal policies. It is unrealistic to except that the economic weakness can be cured overnight. A careful and balanced policy approach is required, and it will take time to yield its full results.

The worst policy of all, in my opinion, would be to both crank up Federal spending and cut back taxes in a massive and permanent way. Those are the very policies that got us where we are now. That sort of advice ignores or minimizes the fact that inflation remains a problem of the first magnitude. It also ignores or minimizes the fact that the enormous budget deficits have to be financed in capital markets that area already strained by a decade of inflation. The financial implications of a massive swing to fiscal ease are so disturbing that I want to discuss them with you subsequently at some length.

Even with a cyclical recovery beginning in the middle months of the year, the economic situation will remain difficult. Productivity has fallen. Gains in output later in the year should mean that productivity growth will resume. But prices, costs, and productivity will not quickly come into anything like the balanced noninflationary relationship that existed before the mid-1960's. Inflation has become deeply imbedded in the economic system and it will not be removed in a matter of a few quarters.

LONGER RUN CONSIDERATIONS

We must face up to the fact that under the best of circumstances we will finish this year with the rate of unemplovment and the rate of inflation far above acceptable long-term levels. From there, at least two paths branch out into the economic future. One choice would be

to attempt to push the economy back to full capacity operations at breakneck speed without regard to the inflationary consequences. That is the wrong path to travel, because it would not work. In a very short time, inflation would again be rampant. We would then retrace the same sequence of events we have just been through, tumbling into another recession and shaking public confidence even more severely than at present.

The other path requires patience on the part of the American people. There must be vigorous growth in the economy so that we can steadily reduce unemployment. But some margin of economic slack must remain for a period of years to insure that inflation can be squeezed out gradually. There must be no early return to conditions of excess demand. If this seems an overly cautious approach, it might be recalled that in early 1965, after 4 years of recovery from the 1960–61 recession, the unemployment rate was still only slightly below 5 percent but the economy was relatively free from inflation.

In the remote historical past, periods of rapid inflation were followed by financial panics and an ensuing deflation. Since the economic and financial trauma of the 1930's we have been unwilling to accept that result and, quite properly, we have built safeguards into the economic and financial system to prevent any deep cumulative downturn from occurring. But we have not yet learned any way of avoiding the inflationary consequences when the economy is pressed too far, too fast. Price controls are no solution at all. They would destroy our market economy if used permanently in peacetime. Therefore, we must hold the economy within the zone of acceptable price performance and apply such other policies as may be required to deal with any structural unemployment that remains.

As we look to the longer run, much greater emphasis also needs to be placed upon the central role of capital formation in economic growth. Our own ratio of private investment to gross national product is much lower than that of other major industrial nations. In turn, this is reflected in our much lower rate of growth in productivity.

In the future, we are going to have to do better. The capital requirements of the American economy over the next decade will be enormous. We will need up to $1 trillion for energy alone. Beyond that, we will need extremely large sums for control of pollution, urban transportation, and rebuilding some of our basic industries where new investment languished over the past decade. In addition, there are the more conventional, but still mammoth, requirements for capital to replace and add to the present stock of housing, factories, and machinery.

Yet in the face of these massive requirements, we are not providing adequate incentives for new investment. Over the past decade the inflation has led to high effective rates of business taxation and low rates of profitability, which in turn have greatly eroded the incentives for capital formation. It is not unfair to say that we are in a profits depression in this country. Nonfinancial corporations reported profits after taxes in 1974 of $65.5 billion as compared to $38.2 billion in 1965, an apparent 71-percent increase. But when depreciation is calculated on a basis that provides a more realistic accounting for the current value of the capital used in production and when the effect of

inflation on inventory values is eliminated, after-tax profits actually declined by 50 percent from $37.0 billion in 1965 to $20.6 billion in 1974. A major factor contributing to this decline is that income taxes were payable on these fictitious elements of profits. That resulted in a rise in the effective tax rate on true prifits from about 43 percent in 1965 to 69 percent in 1974. Thus, a realistic calculation shows that the sharp rise in reported profits was an optical illusion caused by inflation.

Since, in our economy, corporate profits are the major source of funds for new investment, and thus in the creation of new jobs, all of this has grave implications for capital formation and growth. That is perhaps seen best in the figures for retained earnings of nonfinancial corporations, restated on the same basis to account realistically for inventories and depreciation. It is the retained earnings that corporations have available to finance additional new capacity—as distinguished from the replacement of existing capacity. In 1965, there were $20 billion of retained earnings. By 1973, after 8 years in which real GNP had increased 36 percent, the retained earnings of nonfinancial corporations had dropped 70 percent to $6 billion. And for 1974, our preliminary estimate for retained earnings is a minus of nearly $10 billion. That means that there was not nearly enough even to replace existing capacity, and nothing to finance investment in additional new capacity.

It is a simple but compelling economic fact of life that increases in productive performance are required over time to support a rising standard of living. Yet, as a nation, we are rapidly expanding public payments to individuals but neglecting to provide adequate incentive for new investment. Since 1965, in real terms, economic output has increased by one-third while Government transfer payments to persons more than doubled. On the other hand, private investment expenditures—upon which the economic future of all of us inevitably depends—have failed to keep pace, rising by only a bit more than one-fourth.

It is imperative that we make better provision for the future. This means that we must place much greater emphasis upon saving and investment and much less upon consumption and Government expenditure. Today, recession, inflation, and energy policy dominate the discussion of economic events and policy. We must take determined action to deal with these interrelated problems At the same time, however, we must begin to shift the long-run balance of domestic priorities away from consumption and Government spending and toward investment and increased productivity. I believe history will judge us, not on how we handle our short-run problems such as recession, but on our ability to deal with the more fundamental problems of the allocation of resources and capital formation. If, as a nation, we fail to address these problems, we will fail to attain the prosperity and the rising standard of living that the American people can achieve. Our goal should be to enlarge the economic pie, not just to redistribute it.

FINANCING FEDERAL BUDGET DEFICITS

Federal budget deficits are estimated to total $87 billion in fiscal years 1975 and 1976—$35 billion this fiscal year and $52 billion next

year. I have made no secret of the fact that I feel that such deficits are large by any standard and that they pose a substantial problem. Let me make my conclusion on this issue quite clear. Although they present dangers and although they will inevitably impose strains on the financial markets, I believe those deficits will be manageable if—and I want to stress this—if they do not become significantly larger and if they are temporary in duration.

It is true that financial conditions normally ease substantially during a recession and normally they remain easy well into the period of recovery. There are two main reasons for this: First, some private demands for credit are closely related to the pace of business activity and decline sharply during a recession period. Short-term business borrowing to finance inventories is a prime example. Second, the Federal Reserve customarily "leans against the wind" during a period of recession and seeks to expand, or at least maintain, the rate of growth in money and credit. Therefore, interest rates can be expected to decline and the availability of credit to increase as a normal part of the cyclical process.

It must be considerations of this general nature which lead some observers to conclude, too readily in my opinion, that the financing of large Federal deficits in the current recession is a routine matter, largely devoid of any particular economic significance. I respectfully disagree.

The current recession is an outgrowth of a long period of inflation that has left private financing demands much heavier than usual. There has been the market decline in profits I mentioned earlier and a serious erosion of the liquidity base of households and businesses. The decline in the stock market has in many cases virtually ruled out the sale of new equity as a source of funds.

For these and other reasons, there has been an unusually large supply of private debt issues coming into the market. Our latest projections show that net new corporate bond issues, which rose from $12.5 billion in 1973 to $25 billion in 1974, will advance even faster to some $30 billion or more in 1975. While corporate capital spending programs are being cut back, there will still be a very heavy volume of corporate long-term borrowing. Furthermore, the State and local fiscal position has changed drastically. Their surpluses have melted away, tax receipts are affected by the recession, and State and local borrowing needs will be substantial.

Some slackening in private demands for short-term credit is underway and more can be expected. Yet by any previous recession standards, total private demands for credit—both short and long term—are likely to remain fairly large.

Federal requirements will, of course, have to be met. But there are risks in such a situation. First, if private demand does not fall back spontaneously to make room for the larger Federal borrowing, credit demand will outrun supply, interest rates will be driven higher, and some private borrowers will be crowded out. Judging from past experience, the housing industry would be likely to suffer. Indeed, its recovery might even be aborted. At the worst, financial factors might be such a binding constraint as to dampen the normal cyclical recovery that would otherwise occur.

The second risk is on the inflation side. Some observers suggest that in order to avoid any strains on the credit markets, the Federal Reserve should undertake whatever rate of growth in money and credit is required to insure that Federal and all other borrowing requirements are met at stable or declining interest rates. This approach, however, could be a sure formula for still higher inflation rates when the recovery gets into full swing—if not sooner.

The key to successful financing of the large Federal deficits lies in diligent restraint of Federal expenditures. Large as they are, the $85 billion in deficits projected for fiscal years 1975–76 can probably be accommodated, although they will produce some strains in the financial markets. However, if Congress were to push Federal expenditures much beyond the budgeted levels, it would not be possible to retain much optimism as to the result. Either the recovery would be delayed or more inflation would be experienced in the future.

In previous recessions one could be more relaxed about the financing of temporary Federal deficits. This recession began, however, with the financial markets under considerable pressure. If the Congress will work with us in a joint effort to restrain expenditures, we can probably move through the period ahead without undue difficulty, but it would be a mistake to ignore the possible adverse effects of having to finance large Federal deficits. In my opinion, the projected deficits for fiscal 1975–76 are—in the context of our expectations about the course of the economy—about as large as our financial system can tolerate without doing more harm than good for the economy.

THE DOMESTIC ECONOMY AND THE ENERGY PROGRAM

In addition to the temporary measures designed to cushion the impact of recession and promote recovery, President Ford is recommending a comprehensive program to achieve self-sufficiency in energy in 10 years. The essence of the program is the reduction of energy consumption through the use of the market mechanism. Under the President's program, energy price increases and other measures will enable us to achieve an estimated 1 million barrels per day saving on imported oil by the end of this year and another 1 million barrels per day by the end of 1977. From a macroeconomic point of view, the program is designed to be neutral in its impact on total demand. An additional $30 billion will be collected in the form of taxes and fees but it will then be returned to the economy, mostly in the form of permanent tax reductions and payments to nontaxpayers.

The introduction of such a program many of whose effects cannot be predicted with absolute precision, is bound to be controversial. There probably would never be an ideal time for such action. The plain fact of the matter is, however, that many noneconomic considerations dictate the necessity of prompt, credible action to move toward energy independence.

With our own economy in recession, it is important to insure that the energy program has as neutral an impact as possible on the overall economy. In particular, this requires that the timing of the economic impact be carefully considered. Taken in conjunction, the

temporary $16 billion tax cut to stimulate the economy and the various energy taxes are designed to exert their maximum stimulus in the second and third quarters of this year and then to taper off to a position of neutrality by the end of 1976. A table attached to my statement provides an estimate by quarters of the direct budget impact.[1]

One undesired, but unavoidable, impact of the energy program will be a temporary inflation effect. Our best estimate is a one-shot increase in the general price level of roughly 2 percent. It should be stressed that the rate of inflation is increased by this amount once only, not on a permanent basis.

It is a valid question whether any program seeking to reduce energy consumption through a sizable shift in relative prices can confidently be described as neutral in its impact. Its neutrality is, of course, only with respect to the net effect on economic activity. Energy intensive industries and higher income taxpayers—to mention only two examples—will feel a disproportionate impact. Furthermore, there are uncertainties and gaps in our knowledge which preclude a definite and precise estimate of all the effects. To the best of our ability, however, we have put together an energy program which should be neutral in its total impact on economic activity. At the same time, it represents a comprehensive and balanced national energy policy that will effectively reduce our reliance on insecure sources of energy.

FOREIGN ECONOMIC OUTLOOK

The picture I have given you of the U.S. economy also portrays only too well the economic situation in most other major industrial countries. As the industrialized nations have become more interdependent, their economies increasingly march in step together. In 1972–73, the industrialized nations experienced virtually simultaneous boom conditions. Now most have moved into a generalized condition of minimal or negative growth and substantial unemployment in the face of continuing price pressures.

The recession which most major countries are experiencing is the worst since World War II. Collectively, our partners in the Organization for Economic Cooperation and Development—OECD—saw their growth rate fall to 1.5 percent last year from 6.5 percent in 1973. Toward the end of last year the Secretariat of the OECD was predicting 2.25 percent growth for the area in 1975, again excluding the United States. From the reports I have heard from my colleagues abroad recently, however, I judge that this estimate will have to be revised downward.

Japan and Germany, like the United States, are experiencing a more pervasive slowdown in economic activity than expected only a few months ago. To a lesser degree, the outlook for the French, British, and Canadian economies has also weakened. There is considerable evidence of loss of confidence on the part of both consumers and investors, with consequent damage to investment and jobs. Reduced levels of consumer spending, along with high interest rates, have led to continued retrenchment in business plans for plant and equipment expenditure.

[1] See table, p. 335.

Unemployment has also become a problem abroad. Declines in average hours worked, increases in part-time work and actual declines in employment, particularly in the manufacturing and construction sectors, are characteristic. Unemployment rates in Europe are in many cases approaching postwar highs, and in the case of France, unemployment has already reached a postwar record. As in the United States, unemployment levels may well increase further before leveling off and starting down again toward the end of the year.

Intolerable inflation rates abroad have recently shown signs of easing. But for much of last year, far from abating, in most countries they climbed to even higher levels under the pressure of the oil price increases and escalating wage and salary demands. Double-digit inflation rates were recorded in 22 of the 24 OECD countries in 1974. Excluding the United States, the OECD inflation rate was over 15 percent for that year as compared with 8½ percent in 1973 and an average of 4¼ percent in the previous 10 years.

All of the OECD countries hope to bring down their inflation rates in 1975, but none expects to achieve a level which it would consider satisfactory. Of the other OECD countries, price increases of less than 10 percent are forecast for only Germany and Switzerland. Japan, Italy, and the United Kingdom still face the prospect of rates above 15 percent for 1975.

For the policymaker searching for the means to restore both price stability and growth, the difficulty has been compounded by record wage demands. In many countries, wage increases in 1974 averaged more than 20 percent—well above inflation rates— and in Japan they approached 30 percent. The extent to which these pressures can be moderated will be a key factor in determining the success of efforts to reduce inflation in 1975.

In my talks with other finance ministers, I find an acute awareness that economies are caught in a two-way stretch and that it would be dangerous to focus on only one source of the tension. Individually and together, governments are reappraising their policies as time passes and the situation changes. In several countries, government policies have shifted, just as they have in the United States. Most governments are moving cautiously, however, seeking to absorb slack gradually so as to avoid giving a new boost to inflationary pressures. Germany—which had the best record on inflation in 1974—has related previous restrictive policies significantly, and Britain has also moved progressively to stimulate its economy. Canada has moved modestly toward less restraint in both budget and monetary policy. France on the other hand, has sought to maintain restraints. Japan, laboring under a cost-of-living increase of 25 percent in 1974 and facing demands for another 30 percent increase in wages, has also kept restraints taut despite a 6.7 percent decline in output in the fourth quarter.

One implication of the depressed outlook for major economies this year is that foreign demand will not be of much assistance in achieving early recovery. The volume of international trade may well decline in 1975. Aonther, more heartening, implication is that there could be greater progress against inflation than earlier foreseen. There is a possibility that the worldwide slump may lead to more softness in the prices of basic commodities than has been incorporated

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into most forecasts. With higher unemployment rates, wage demands may turn out to be somewhat more modest than anticipated. Inflationary pressures could thus subside somewhat more rapidly than expected, if governments can resist pressures for excessively stimulative policies.

INTERNATIONAL PAYMENTS

Never in peacetime has the pattern of international payments shifted as sharply and as suddenly as it did last year under the impact of the OPEC cartel's quadrupling of oil prices. The OECD countries, which had a combined current account surplus of $2½ billion in 1973, raced a deficit of perhaps $37½ billion in 1974. Countries which had been accustomed to exporting capital and transferring real resources to the developing countries found themselves unable to pay for their own imports with their exports. They have been forced to become borrowers—on a scale of out of all proportion to previous experience.

The announcement that the United States had a $3 billion merchandise trade deficit in 1974—census basis—occasioned headlines here in Washington. This was a deterioration of less than $5 billion from the 1973 balance. With the trade surplus of the OPEC countries rising—in rough order of magnitude—$60 billion in 1974, there had to be an equivalent deterioration in the trade balances of the oil importing countries as a group. Since the United States was importing not much less than a quarter of the oil and our oil import bill rose $18 billion, our trade position clearly strengthened relative to most of the oil-importing world. Germany was the only important industrial nation to experience an increase in its surplus on trade account.

Record deficits in the oil importing countries had their counterpart in record surpluses of the oil exporters. We estimate that in 1974 the 13 OPEC countries received about $90 billion from oil exports, or roughly four times the amount they earned in 1973. In addition, their other exports amounted to about $5 billion, bringing their total receipts to $95 billion. During this same period the OPEC nations spent approximately $35 billion—or a little more than a third of their export receipts—on imports. This left a balance of approximately $60 billion available for investment abroad.

OPEC needed to find investment outlets for this balance, and oil importing countries needed to borrow these funds. Our rough and tentative estimates suggest that in 1974, the OPEC countries invested their surpluses as follows:

Some $21 billion, or about 35 percent of the surplus, apparently went into the Eurocurrency market, basically in the form of bank deposits.

Some $11 billion, or 18½ percent, flowed directly into the United States. Available figures suggest that of this amount, roughly $6 billion went into short and longer term U.S. Government securities, while some $4 billion were placed in bank deposits, negotiable certificates of deposit, bankers' acceptances, and other money market paper. As best we can tell, less than $1 billion was invested in property and equities in this country.

Some $7½ billion, or about 12½ percent, is believed to have been invested in pound sterling denominated assets in the United Kingdom, some of it in U.K. Government securities, some in bank deposits, some in other money market instruments and some in property and equities. This amount, I should note, is quite apart from the large Eurocurrency deposits there.

Some $5½ billion, or about 9 percent, may have been accounted for by direct lending by OPEC countries to official and quasi-official institutions in developed countries other than the United States and the United Kingdom.

About $4½ billion, or 6 percent of the total, represented OPEC investment in the obligations of official international financing institutions such as the World Bank and the IMF.

Perhaps $2½ billion, or 4 percent, has flowed from the OPEC countries to other developing countries. This includes funds channeled through various OPEC lending institutions such as the Kuwait Fund and the Arab Bank for Africa.

With regard to the remaining 15 percent, we have only limited information, but this residual would cover funds directed to investment management accounts as well as private sector loans and purchases of corporate securities in Europe and Japan. There are, of course, other transactions we simply know nothing about.

The rather wide distribution of OPEC capital flows among markets in the oil-importing nations explains in part why the massive shifts in financial assets did not lead to the financial crises that some envisioned. OPEC funds did not move to one or only a few attractive capital markets, as once was feared. The United States, with the largest capital markets, received directly only 18½ percent of the total, an amount substantially less than OPEC's increased receipts from oil sales to the United States. The United States also continued to export large volumes of capital to other areas abroad, and our net capital imports last year, as measured by our current account deficit, were probably in the range of only $3 billion.

It appears that something approaching half of the OPEC investments last year were placed through the commercial banking systems of the major industrialized countries. The banks redistributed these funds exercising their traditional intermediation role in meeting the needs of borrowers throughout the world. Admittedly, the sheer volume of OPEC funds placed some strains on the banking systems. Probably few banks expect to continue to increase international lending at the 1974 rate. Banks as a whole may not be able to accept as large a portion of the OPEC surplus in 1975.

Changes in the methods of channeling OPEC investments were already evident in the course of 1974. Banks were increasingly playing the role of broker and assisting their OPEC clients in arranging direct placements. OPEC countries were relying more heavily on government-to-government credits, investment in longer term securities of governmental and quasi-governmental agencies and lending to international institutions. There was also evidence of a small amount of OPEC funds being invested in corporate securities and real estate. As time passes, we are likely to see a

more varied pattern of investment as well as increasing disbursements under OPEC commitments of assistance to developing nations.

That last year's totally unexpected and unprecedented shift in international payments flows occurred without financial crisis and without disruption of trade says a great deal for the soundness of the international banking system and the international capital markets, the network of intergovernmental financial cooperation, and the system of floating exchange rates.

Nevertheless, I recognize that at times concern has been expressed about the magnitude of exchange rate fluctuations under the present regime. We recently witnessed a temporary episode of large fluctuations in individual rates, when the Swiss franc appreciated by about 5 percent against the dollar within a span of a few days. These abberations tend to reflect market reactions to specific, immediate developments—in this case probably to a bank failure and the decline in U.S. interest rates—but become subsumed as the market adapts to broader economic trends. As has generally been the case, this most recent experience has had only a minor impact on a broader measure of the dollar's exchange rate: The dollar's average value, relative to the currencies of all of the major industrial countries, declined by only about 1 percent before a reversal was set in motion. Taking a more relevant period of comparison, the dollar's average exchange rate is still at the level reached after the major exchange rate realinements of 1971 and 1973, despite nearly 2 years of generalized floating since the latter realinement. Throughout this period of generalized floating, our intervention policies have been directed to the avoidance of disorderly exchange market conditions and not to the achievement of maintenance of any particular rate.

INTERNATIONAL COOPERATION

The experience of the past year has served to reinforce our conviction that the financial aspects of the oil situation are manageable. Nonetheless, we have recognized the possibility that some countries might encounter particular difficulty in meeting their financial requirements and turn to restrictive actions which could disrupt the world economy. To reduce that risk the United States developed a comprehensive series of proposals involving expanded use of the resources of the International Monetary Fund, the establishment of a new solidarity fund to provide a safety net for members of the OECD, and a trust fund to provide the concessional assistance needed by the poorest of the developing countries. Other countries also had suggestions for new financing arrangements. These proposals have been the subject of intensive consultation and negotiation over the past months.

Finance ministers around the world have developed a whole family of committees and informal groupings in which they can meet periodically to consider the world's economic and financial needs. The great value of this network—including the Group of Ten, the Interim Committee of the IMF and the IMF/IBRD Development Committee, as well as smaller, less formal groups—was demonstrated by the agreements reached at a series of meetings here

in Washington in mid-January. In the course of these sessions, a consensus was reached on a number of measures, including the SS, which will provide additional financial security for the near future and strengthen the monetary system for the longer term:

Agreement was reached among the major OECD countries that a new solidarity fund, a financial support arrangement along the lines of the U.S. proposal for a $25 billion safety net, should be established at the earliest possible date. This arrangement is to be available to provide supplementary financing, if the need arises, to participating OECD countries which follow cooperative economic and energy policies. Detailed work on this new arrangement is to be completed promptly.

Agreement was reached among IMF countries that IMF resources would continue to play a role in 1975 to the extent needed. As one expression of this intent, it was agreed that the IMF oil facility should be continued on a limited basis during 1975. Borrowing from oil producers and others for this facility will be limited to about $6 billion—or $5 billion SDR's—less than some countries originally favored. This agreement was preceded by considerable discussion of different methods of using IMF resources. One approach is to use the fund's resources in effect as collateral for loans as is done for the special oil facility. A second approach is to mobilize the fund's resources directly for lending. In the end, it was agreed to do both. There will be some new borrowing and also increased direct use of IMF resources to meet the needs of nations in difficulty. Contributions from oil producers and industrial countries to subsidize interest costs of the IFM oil facility for the very poorest countries may also become a feature of the facility in 1975.

Agreement in principle was also reached to increase IMF quotas of member countries by approximately one-third, subject to agreement on a related package of amendments to the IMF Articles of Agreement. The major oil exporters' collective share of the total IMF quotas will be doubled in order to call for greater participation and a greater voice for these countries in the activities of the International Monetary Fund. Quota increases will be dependent upon the agreement of countries when such use is economically justified.

Agreement was also reached on the general lines of a number of other amendments to the IMF articles, with the particulars to be worked out over the months ahead. These amendments are designed to improve the structure of the IMF and bring it more in line with current realities. One amendment supported by the United States will provide that member countries are no longer required to maintain their exchange rates within narrowly fixed margins, but can float their currencies—a practice which is not legally permissible under the IMF articles as now written.

Considerable progress was also made toward narrowing differences with respect to the broader question of gold and its role in the international monetary system. It was agreed in principle that the official price of gold—and hence its central function as numeraire of the monetary system—should be abolished and that obligations on the part of members to pay the IMF in gold, and on the part of the IMF to receive gold, should be ended. Progress was also

made toward replacing the existing prohibition against members of the IMF buying gold in the private market with safeguards assuring that this freedom would not be used to return gold to the center of the monetary system. Our aim is to arrive at workable arrangements which will take gold out of the center of the international monetary system, while also allowing countries greater freedom to utilize their gold holdings. It is my hope that the entire package of quota provisions and amendments, including those relating to gold, will be ready for approval at the interim committee meetings scheduled for this June.

Less progress was made at these meetings than had been hoped in organizing assistance for developing countries, some of which face very serious difficulties. As I mentioned earlier, there was some support for measures to subsidize interest rates for loans to these countries from the IMF oil facility. The U.S. proposal for a new facility—a trust fund managed by the IMF which would channel funds to the poorest of the developing nations on concessional terms—remains under study. It continues to be our hope that adequate arrangements can be devised, and that the OPEC nations will provide an appropriate part of the contributions to this effort.

Oil consuming countries have also made considerable progress in concerting their energy policies. Last fall agreement was reached among a number of consuming countries on the international energy program which was an outgrowth of Washington energy conference in February of 1974. We have developed an unprecedented program to limit individual and collective vulnerability during emergencies created by supply interruptions. Under this arrangement, participating countries have agreed to:

Build a common level of emergency self-sufficiency, which would allow them to live without imports for a certain period.

Develop demand restraint programs to cut oil consumption by a common rate without delay if necessary.

Allocate available oil to spread shortfalls among participants should there be supply interruption.

Concrete plans are also now being laid to coordinate programs of energy conservation and longer term development of new sources of supply. The new solidarity fund, by providing financial assurance and promoting confidence, will support accelerated efforts in the energy field. And consumer solidarity in both energy and finance will prepare the way for a fruitful dialog with the oil producing countries.

U.S. participation in the solidarity fund will involve commitments requiring the endorsement of the Congress. I hope the Congress will recognize the importance of this arrangement in furthering our economic goals and, following presentation of the detailed agreement, endorse U.S. participation without delay.

With the passage of the Trade Act of 1974, the new round of multilateral trade negotiations can move into substantive bargaining. The February meeting of the Trade Negotiations Committee will open this stage of negotiations that are the most comprehensive ever attempted. They will deal not only with the traditional trade problems of tariffs and nontariff barriers, but also with overall reform of the international trading framework.

Getting the trade negotiations underway is more important now than ever because of current world economic conditions. These negotiations should help forestall unilateral measures which attempt to shift economic burdens to other countries, and which, if widespread, could have a depressing effect on the world economy.

THE CHALLENGES AHEAD

Mr. Chairman, the past year has seen the development of the high degree of consensus necessary for effective actions to deal with the multiple problems of recession, inflation, and a disruption in the world energy balance. While there still remains room for honest differences as to the course to be followed, I believe that the scope for disagreement has become increasingly smaller.

Certainly we cannot afford, either in this country or abroad, excessively stimulative policies which could only lead to further escalation of an already intolerable inflationary spiral.

Nor can any country afford not to take prompt steps to insure that the current recession does not deepen and is instead succeeded by a resumption of the sustainable growth of production and productivity so necessary to maintain the health of economies around the world.

And we cannot afford to delay programs of strong action to create a new energy balance.

The President has placed before the Congress an effective program to address all of these problems. He has expressed his desire and evidenced his willingness to work with the Congress in carrying out that program. We recognize that Members of the Congress have views of their own—views that are held with the same degree of conviction as we hold ours. Our hope is that we can find reasonable means of reconciling those differences, so that together we can provide America with the leadership it needs at this critical hour.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you, Mr. Secretary, and of course the table attached to your statement will be included as a part of the record at this point. We will have that done.

Secretary SIMON. Thank you, sir.

[The table follows:]

DIRECT BUDGET IMPACT OF THE PRESIDENT'S ECONOMIC AND ENERGY PROPOSALS

[In billions of dollars]

	Calendar years							
	1975				1976			
	I	II	III	IV	I	II	III	IV
Energy taxes	+0.2	+4.1	+12.6	+7.6	+7.6	+7.5	+7.5	+7.5
Return of energy tax revenues to economy:								
Tax reduction	0	−3.2	−9.0	−9.0	−5.6	−7.9	−6.3	−6.4
Nontaxpayers			−2.0				−2.0	
State and local governments	0	−.5	−.5	−.5	−.5	−.5	−.5	−.5
Federal Government	0	0	−.8	−.7	−.8	−.7	−.8	−.7
Temporary tax cut	0	−6.1	−7.9	−.6	−.8	−.9	0	0
Net effect	+.2	−5.7	−7.6	−3.2	−.1	−2.5	−2.1	−.1

Chairman HUMPHREY. Now, Mr. Secretary——

Secretary SIMON. I have my Assistant Secretary for Tax Policy, Fred Hickman, and Assistant Secretary for Economic Policy, Ed Fiedler, who will respond to any question, also.

Chairman HUMPHREY. We have had your testimony here today, and of course it comes at a time when we had two very important documents given to the Nation, the President's budget message and the Economic Report. The forecast that was contained in the budget message and in the Economic Report indicate that we are facing a most difficult year for the economy and possibly the most difficult since the creation of this committee in 1946. In no previous year, according to our estimates or our record, would we have believed that a combination of 8 percent unemployment and 11 percent inflation rate was even possible, much less probable. That, of course, is the forecast which is made for calendar year 1975.

You have been quoting that you are concerned by the size of the budget deficit, and I am sure all of us realize this budget deficit is indeed a very sizable one and that has been said the largest peacetime deficit in our history.

I don't think anybody is happy about the budget deficit, and I am not happy, particularly, about what I consider to be the inadequate policies which have created this recession which will produce such a deficit.

But the thing that really horrifies me, using your term, is not only the deficit, but more important, the employment and the unemployment outlook for the remainder of this decade, not just for the next year or 2 years, but for the remainder of the decade, and the economic outlook presented by the Council of Economic Advisers in the annual report implies that the unemployment rate will be above 8.5 percent at the end of this year. This means around 8 million persons unemployed, and all kinds of people, the old and the young and those that are scheduled and unscheduled. No group is going to escape.

Now, the question, I think, is, What are we going to say to these 8 million unemployed? Somebody might suggest that we give them battle ribbons for serving in the front lines of the battle against inflation. I would like to at least be able to say to these millions that their Government is now taking effective action, that the unemployment rate will be going down just as fast as we know how to make it go down.

But the forecasts given in the President's budget and Economic Report does not offer any hope that we can honestly make such a statement. With the administration's policies, the unemployment rate will be 8 percent this year, according to your own forecasts, and still 8 percent next year and 7.5 percent the year after that.

Now, you have responsibility, Mr. Secretary, for economic policy, and quite frankly I think I have to say that, speaking for myself, that we ought to be able to do better, and I just can not be satisfied with what we see.

I noticed some of the comments of others that have been before this committee. I have asked each witness as they have appeared before this committee in these recent weeks—Do you think the President's proposals will be adequate to halt the recession and reduce unemployment? And I have not found anyone yet who would give an

unequivocal answer to that question. Mr. Ackley said the President's proposal is not adequate. Paul McCracken said the President's program is adequate provided it is accompanied by an appropriate monetary policy. He also added that the tax cut should be made permanent and he advocated a very substantial increase in what we call the money supply.

Mr. Schultze said it is clearly not adequate, speaking of the President's program, in the sense of getting employment down rapidly enough.

Mr. Donald Regan, the chairman of Merrill Lynch, said "If I had my druthers, I think there is another road I would prefer to go."

On the one hand you are giving and on the other hand you are taking away.

Mr. Milton Stewart, president of the SBA, said the President's programs are not adequate as antirecession programs.

Now, Mr. Simon, there were others. I believe that we also have the testimony of Mr. Houthakker on this matter and what I found out was nobody was really of the mind that the program was adequate.

Can you explain to me how a one-time temporary tax cut partially offset by social security and other support programs is going to stimulate the economy the size of ours? May I correct that the administration revised its assessment of the economic outlook between the preparation of the state of the Union message and the budget, and how large is that revision and is there any disagreement yet in the administration over the forecast? Since your assessment of the outlook has been revised why have not you also revised your policy recommendations? In other words, there is clear evidence that in the last month or so there has been considerable revision of the administration's projections and forecasts, but there seems to have been no revision as to the treatment or policies that would be used to attack the problems of revision and unemployment.

I think we should ask you to address yourself to these comments. Many men of respect, highly respected in the economic profession just feel that the provisions of the President's program or the solutions offered are inadequate.

What do you have to say to it?

Secretary SIMON. Mr. Chairman, you are always going to find respected men in the economics profession who disagree. I think Gardner Ackley's disagreement is in order of magnitude. Mr. McCracken talked about the President's package being adequate provided monetary policy was eased, and I think that we have seen monetary policy eased quite substantially in the last 2 months.

Let me give you an illustration. We have had three cuts in the discount rate, it was cut only yesterday to 6¾ percent. We have had changes in the Federal Reserve——

Chairman HUMPHREY. The overall rate of money increase is very—it ran about 2 percent in December, and when you have a man like Mr. McCracken, he was talking 8 to 10 percent increase in the money supply.

Secretary SIMON. Well, I will allow the specifics of the target to be addressed to when you have Mr. Burns before this committee.

Chairman HUMPHREY. That is what is wrong here, you fellows have fiscal policy and over on the other side is monetary and never shall the between meet.

Secretary SIMON. That is not accurate, because the Secretary of the Treasury works very closely with the Chairman of the Federal Reserve Board, and I am constantly in discussion, more than daily, on exactly what the Federal Reserve is doing. So there is coördination, and my input is constant on this subject.

Chairman HUMPHREY. Well, Mr. Secretary, in my 10 minutes with you let me say that I heard nothing in the President's message about monetary policy, nothing.

Secretary SIMON. There is a section on monetary policy.

But anyway, let me try to answer——

Chairman HUMPHREY. In reference to what the past was, but not with reference to the needs of the future. I am speaking of his state of the Union message on the economy. This seems to be the problem bothering many Members of Congress, and I speak for myself in this instance, but there are many others that have spoken out that there is a lack of that fine tongue between fiscal stimulating policy on the one hand as well as budget expenditure policy, and then on the other side a whole section of what we call monetary policy and availability of reasonable interest rates.

Secretary SIMON. There is again, Mr. Chairman, constant daily coordination between the Secretary and the Chairman of the Federal Reserve Board. Arthur Burns sits on the executive committee meeting of the Economic Policy Board. Not only does he attend all our meetings on the fiscal policy side, but he makes his monetary policy injections at the same time.

Chairman HUMPHREY. There are 10 lines in the Economic Report on monetary policy, 10 lines in that book.

Secretary SIMON. Well, we let the Federal Reserve Board outline monetary policy, and Chairman Burns is personally capable of responding to questions. He obviously is in need of discussing this delicate subject of what expansion is. One cannot judge M-1, the narrowly defined money supply based on a 1 month increase.

Chairman HUMPHREY. The highest in 1974 was 4 percent.

Secretary SIMON. That is to be done on a longer term. This is a very elusive business, setting targets and being able to live by them. So many things change in our economy that it is extraordinarily difficult to target it and hit that target in the long run.

Your second question was about constantly revising economic policy. There has been a misunderstanding, and I guess it is understandable that when the President announces an economic policy designed to deal with this triple headed monster it is perceived that this policy will be put into place and will cure the problem ultimately. Unfortunately, that is not what happens. We are constantly revising economic policy as events occur that demand a change. We attempt to be as flexible in our approach as we can in an economy that has declined as sharply as this—primarily due to the complete destruction of consumer confidence that occurred in the final quarter of last year. There was a decline in real GNP from 3 to 2 percent. Therefore, it was necessary to take different measures and different shifts of emphasis.

We are constantly doing that. Mr. Chairman, to respond to changes in conditions.

As far as your first question is concerned as to whether our stimulus is adequate, private as well as Government forecasters are quite unanimous in the view that the economy is going to recover toward the end of this year. It is not a matter of whether it is going to recover. It is a matter of the extent of the recovery, whether it will be strong, and the exact timing of same. Most believe that sometime in the middle months of this year, third quarter to the beginning of the fourth quarter, we will see improvement in the economy.

The reason to give the one-time stimulative tax reduction is to make this more certain, and indeed stronger, when it does occur. The reason to make it 1 year is obvious because we cannot continue to build in this proportionate annual growth in Federal spending that has occurred, especially over the last decade. We do have a large budget deficit, as I have said quite often. It is not only unavoidable this year, though, it is also desirable for fiscal stimulative reasons.

In talking about budget deficits people tend to be a little bit simplistic. When we talk about balancing a budget you talk about it over a cycle. During periods of economic slack our revenues decline in the Treasury. Unemployment increases and we have to direct ourselves to the unemployment problem. A deficit occurs. During periods of high activity is the time we should have commensurate surpluses where we can contribute to the savings and investment process in this country. We have done just the opposite. During the very active periods in the sixties we ran massive budget deficits, and this brought us to the fundamental problem we have right now. I can retrace on many occasions the experience of 1966, and the credit crunch, and the 1969 increase. Each time we refused to pay the bills that were presented to us, and each time the bills were higher.

We talk about high unemployment and no one is more disturbed about unemployment than President Ford. But if we massively stimulate the economy at this point, in the shortrun, and I emphasize in the very shortrun, perhaps you will get some response by a lower unemployment rate. But in the longer run this is what caused our recession. This is what caused our high unemployment. It is inflation, and that is what we have to keep our eye on in the long run, Mr. Chairman.

Chairman HUMPHREY. I think it is something we need to keep an eye on. It is not something that you just stare at to the exclusion of what else has happened.

Secretary SIMON. No, we don't Mr. Chairman.

Chairman HUMPHREY. First of all, there was a fixation on the whole problem of inflation, even up to September and October of this past year about the problems of recession. For example, you said in your statement that the present contraction will fall within the accustomed postwar pattern. In previous postwar years did unemployment average 7 percent, much less 8 percent? There is absolutely no year. Which previously postwar recession year did we allow a drop of 3 percent? There is no such year. In which previous postwar year did prices rise 10 percent, none except 1946, 1947, immediately after.

Then you talk about the massive deficits of the 1960's. There were deficits, but I have the report of the Joint Economic Committee and

it shows the deficits of the 1960's, starting in 1963, fiscal 1963, $1.1 billion; fiscal 1964, $1.4 billion; fiscal 1965, a surplus of $2 billion; fiscal 1966, a surplus of $900 million; fiscal 1967, $7.3 billion deficit; fiscal 1968 was the big one, $11.9 billion; and then fiscal 1969, which was the last fiscal year of the sixties, a surplus of $4.7 billion.

So the massive deficits were not quite there, but there were deficits.

The point that I seek to make is that I do not see that there is a policy that is sufficient to the disease. I find that the doctors have looked at the patients and discovered a disease, but your prescription is not adequate. What are we going to do with the high rate of unemployment? Are we to be told by this Government, are the American people to be told that we have to become accustomed for the rest of this decade to an unemployment rate between 8.5 and 7.5 percent? Is that the word to go out to this country between now and 1980?

Secretary SIMON. Again, you are suggesting, Mr. Chairman, that that number is a forecast, and it is not. That number is what the Congress required in the Budget Reform Act—that the administration must provide a 5-year projection. A 5-year projection, as I said at the outset, is based on a thousand assumptions of events that have not yet occurred.

We all know how uncertain it is to predict what will happen in 6 months to a year, as I said at the outset, we all know how difficult forecasting has been in the past. Events happen. Forecasting is a dangerous business and there will be thousands of things that are going to happen that are going to change these forecasts constantly.

Chairman HUMPHREY. I will conclude because my time is up.

Let me read what it is. The assumptions for calendar year 1975 and 1976 are forecasts, probable economic conditions during these years. The longer range assumptions for the period of 1977 to 1980 are not forecasts of probable economic conditions, but rather projections consistent with moving gradually toward relatively stable prices and maximum feasible employment.

So you give yourselves the benefit of all the doubt and you still come up with assumptions that are really quite disturbing. I might say to this country, no one has put down the cost of this unemployment.

Now, I understand there is what they call the Arthur Okun rule or Arthur Okun law, and he estimates what the potential would be for this economy with what we would call not more than 4 percent unemployment, and for this year that potential which is lost is $175 billion. That is a national defiict of lost income that makes the $25 billion budget deficit not look too big.

I yield now to the Senator from Illinois, Mr. Percy.

Senator PERCY. Secretary Simon, I would like to commend you and the administration for the very things that Senator Humphrey has condemned you for. I think that when you label these subjects it would be false and misleading and dishonest if once again we base our assumptions on the rosiest outlook rather than the most negative. It is our job in the Congress—as well as in the executive branch and the private sector—to disprove these assumptions, turn them around and put a realistic outlook on the national economic forecast.

It is for that reason that I ask first about that factor that I think has a very important effect on our economy. President Roosevelt in

the thirties said it was fear. I would rephrase it as lack of confidence. It is that one ingredient that I think Americans share today: Lack of confidence in the growth of their real income. For the first time in our history they have seen real income drop despite wage increases, and that frightens them. They have a lack of confidence in the Government, Congress and the executive branch today.

The question I ask, then, is what needs to be done to restore confidence and how important is the restoration of confidence in picking up the economy?

Secretary SIMON. I think it is one of the most important elements as far as our overall recovery is concerned. Confidence is only going to be restored when it is perceived that we have the policies in place designed to provide real income growth and the future prosperity and standard of living of our Americans in the future as they have been accustomed to in the past. They must realize this is unfortunately going to take sometime, but getting into the mess we are in today took a good deal of time.

This confidence factor will be a difficult one to address, because it is not as a result of something that occurred last year or the year before, going back through the Harris poll, a decade, the student riots, the culture shocks of same, and of course Watergate. I think you will find the American people have lost confidence in really not only their Government, which they have some right to be quite skeptical of, yes. But they have lost confidence in all the institutions that you and I were brought up to respect, whether it be the church, or school, or military. It will be a damned hard job for we in Government to regain their trust.

When we talk about taking our eyes off and shifting them, and what have you, it is difficult to look simultaneously at three problems. But I assure you, I will never take my focus off the inflation problem as we attend the other economic problems we have because that has been the root cause of the problem we have as far as the economic malaise.

I think you will find, again, if you believe in polls, that the recent Harris survey shows that the majority of the people in this country still fear inflation over unemployment. People recognize that the inflation destroys their real income and that it will take time to cure. And yes, we can do it. That is how we build their confidence.

Senator PERCY. I agree with you completely. I do not think people will spend their tax rebate. They will save them, put them under the mattress, unless they have confidence in the future.

What if we did resolve this situation? Let us assume that the step-by-step program is going to work, as I believe it will, and we have peace and no threat of an embargo. What effect would that have on public confidence?

Secretary SIMON. I happen to believe that a peaceful settlement in the Middle East would have a very positive effect. We all share those goals, I know, and I think that that would be extremely positive.

Senator PERCY. Let me ask you about your views on taxation. Have you abandoned your thought of a gasoline tax or is there some way through regulation that you can see that the $1, $2, $3 goes on gasoline rather than fuel oil? Would this not put it on the flexible items

and, hopefully, cut consumption while at the same time raising desperately needed revenue in order not to increase the Federal deficit?

Secretary SIMON. The administration has the ability and desire to make sure there is not a disproportionate burden placed on the items in the crude barrel that have a relatively short-run low elasticity; and they intend to exercise this power in the $2 excise and import fee as far as the taxes are concerned.

But there is very large elasticity in the middle and long term, residual and heating oil. As people change their entire utilization habits in this country, and we cannot disregard that.

Senator PERCY. I would respectfully suggest—and I have talked with Mr. Zarb about this—the dollar excise and import fee is in effect now. Pricing policies are being made today in board rooms and sales departments by oil companies. The longer we wait in getting that guideline out the more the tendency will be to put the price increase where the demand is inflexible. That is what a good businessman would do. That is what you would do. We want the increase put where the public interest is best served. The administration has the power to act. We gave them that power. Every day that goes by adds to the confusion.

I would like to have your comments on investment in this country on OPEC surplus funds. You have been in the Middle East. I have just come back from 12 Arab countries. All of them want to see a U.S. policy established. They would rather invest in our country than any place else in the world, but they need a policy.

Let's take Iran, for example, a country that did not engage in the oil embargo and is now willing to help finance Pan-American Airlines. We will have a flying Penn Central on the floor of the Senate, adding to our national trade deficit, if we cannot save that airline from tragic failure.

What guidelines would you suggest should be adopted? Can Iran invest in a minority position, 10 percent. Can it be permitted to take over all the outstanding debt? Would we permit 1 out of 17 members to go on board—this one member cannot control the corporation, and certainly CAB remains the regulatory authority.

What guidelines has the Government established, and is this project underway?

Secretary SIMON. Yes, it is. We had a meeting on this subject at 8 o'clock this morning, Senator Percy.

Let me start with my overall answer.

I have an overall philosophy on an open trading and investment order in this world. I want to encourage as much investment in this country as we can. I look at the funds that are now going in such massive proportions to the Middle East as a pool of savings, and these pools of savings are going to be used for productive uses in many countries of the world, including the United States.

Six to nine months ago the Treasury Department was being scorned for saying that the international financial system was not going to collapse on the recycling problem, that it was indeed manageable and that there were various mechanisms in place then and others that would be created to help.

Also, the OPEC surplus is not going to be that large. It presents a tremendous opportunity for U.S. companies throughout this world to export large amounts of goods and services to these countries. We are seeing that occur right now, aside from national security and defense, Defense Department regulations, FEC, antitrust regulations, et cetera. Also we are working on a Commerce/Treasury study mandated by Congress. That was mandated a year from now. We are doing a shorter version of it right at the present so we can meet this problem immediately and urgently.

But I look very positively upon all the investment in this country. We need all we can get. People worry about X, Y, or Z's country coming in and buying up one of our large companies. Well, this is not the way they operate, nor does it meet the long-term desires of these countries to diversify. They wish to make investments in this country and with companies that are alined with other companies they will be building in their own countries, and with companies that make good profit sense from their point of view. They are extremely conservative and would not come in——

Senator PERCY. Do you see any danger in Iran taking a relatively minor equity position in Pan American if it means the company would not be placed on the public back like the hundreds of millions of dollars pouring into the Penn Central Railroad now?

Secretary SIMON. We are studying the situation in Iran, and it hinges on some Defense Department regulations, because they do get defense contracts and there are certain things that have to be looked at very closely as far as our national security is concerned.

If you look at what we need, the OPEC surpluses will be $200 billion to $300 billion by 1980. Based on our forecasts in the Treasury Department, though, we need $750 billion for energy alone. Our total capital needs for this country will be in excess of $3 trillion. This is money that is needed to increase our productive capacity in this country, to provide jobs.

I do not have to get to the hypocrisy of exclusion of investment in this country. For years our companies have gone abroad and made very large investments that have been very positive for our balance of payments.

As you can see, I am very positive on encouraging investment within the constraints of national security, because it is in the best interests of the American people.

Senator PERCY. I will skip over Pan Am, then, and come right to your principal problem. OPEC countries have invested $11 billion in this country, $6 billion, of which—over half—has been in U.S. securities.

Secretary SIMON. Yes.

Senator PERCY. Are you depending on OPEC countries to furnish the $25 billion Federal deficit that is being forecast?

Secretary SIMON. All I can say, Senator Percy, is that I hope they continue to look upon U.S. Government securities in a very favorable light.

Senator PERCY. What proportion are you aiming to have them furnish?

Secretary SIMON. I would not put a percentage number on it, but they are satisfied with the growth in investment in Government securities.

Also, I encourage their unity investment. I think the poor stock market of the past year and our poor economy has prohibited much investment in the equity area. But I also think that the stock market, when they look at many of these companies by any historical comparison present long-term investments, and I think that is recognized by many foreign investors around the world, and that is a good sign.

Chairman HUMPHREY. Thank you.

Congressman Hamilton.

Representative HAMILTON. Thank you, Mr. Chairman.

Mr. Secretary, the chairman mentioned several times the unemployment rate, and you know, of course, that is a major concern of ours.

My question is this: Is this projected unemployment rate that you have in the economic assumptions of 8.1 percent for 1975 and 7.9 percent for 1976 a matter of conscious choice on your part or have you reached the conclusion that no matter what you do you are going to have unemployment rates of that magnitude?

Secretary SIMON. It is not a plan to legislate through fiscal and monetary policies high unemployment, Mr. Hamilton, certainly not. As I said in response to a question a couple of minutes ago, if we massively stimulated the economy right now, vast injections of more deficit, more spending and a completely wide open monetary policy, that you might get in the shortrun an unemployment response. This unemployment response would be, in my opinion, quite small, because what would follow then would be the inflationary expectations that are so ingrained in the American people right now that there is where you destroy the confidence and prohibit people, actually as far as their behavior is concerned, from adding on to the employment roles in their companies or expanding, realizing they will go through this cycle over and over again.

So what we look for is moderate expansion which will achieve this recovery, realizing employment is a sticky thing.

I gave the illustration in my testimony about the experience of the recession in 60–61, where in 1965 unemployment was still around 5 percent. The inflation rate had been running out at that point.

Representative HAMILTON. Mr. Secretary, then, as I understand it you are saying to us that after you have looked at all of the options that are available to us you have come to the conclusion that it is best for this country in the next year or two, maybe longer, to have unemployment rates running 7.5, 8 percent?

Secretary SIMON. No, sir; what we are saying is what the unemployment will be in our judgment.

Representative HAMILTON. No matter what you do?

Secretary SIMON. I have qualified slightly, but only a slight qualification, because it is inflation that caused the unemployment.

Representative HAMILTON. One of the recommendations of the Joint Economic Committee last year was that we tie together the public employment program and the unemployment rate. For every half percentage point increase in the unemployment rate we would provide jobs for 250,000 more people. Would you and the administration be willing to support legislation to expand the public employment program and tie it to the unemployment rate?

Secretary SIMON. Well, of course, we embraced—the President proposed the public service unemployment service program that triggered this, and we have gotten together and that is now law. If additional assistance is needed in this area we will most certainly look at it.

Representative HAMILTON. What about the tie between the unemployment rate and the number of jobs?

Secretary SIMON. Yes.

Representative HAMILTON. You are willing to take a look at that?

Secretary SIMON. That is in what we have right now, Mr. Hamilton, and that is basically the thrust that we take in dealing with them.

Representative HAMILTON. Even though you have these tremendous increases projected for unemployment in the budget itself, you do not have any provision for this?

Secretary SIMON. I am sorry, I do not know where to trigger out as far as the budget expenditures are concerned.

Representative HAMILTON. As I recall the budget, there is a reduction for public service employment, about $50 million. Is that right?

Secretary SIMON. I would have to go back, and I will supply that for the record, what our assumptions are, Mr. Hamilton, because I do not have those numbers.

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

The budget recommends outlays of $17.5 billion in fiscal year 1976 for income support for the unemployed under the existing and expanded unemployment compensation programs. In addition, another $1.3 billion would be authorized for public service employment. Public service employment outlays are scheduled to decline by about $50 million between fiscal years 1975 and 1976. This results from offsetting changes in several programs as detailed in the following table. Outlays under the temporary employment assistance program, itself, are estimated at $350 million in fiscal year 1975 and $650 million in fiscal year 1976 on the assumption that funds would be available for obligation only until December 31, 1975. This assumption arises from the terms of the enabling legislation [Public Law 93-567].

TABLE J-6. PUBLIC SERVICE EMPLOYMENT

[Outlays in millions, individuals in thousands]

	Outlays			Individuals served					
				Man-years			New enrollees		
Program	1975 actual	1975 estimate	1976 estimate	1974 actual	1975 estimate	1976 estimate	1974 actual	1975 estimate	1976 estimate
Comprehensive manpower assistance		666	625		73	69		127	117
CMA/EEA		250			28			30	
Emergency employment assistance	516	58		59	21		66	11	
Temporary employment assistance		350	650		39	72		113	42
Work incentive program	34	31	29	5	5	4	11	3	4
Total	550	1,355	1,304	64	166	145	77	284	163

Source: Special Analyses, Budget of the U.S. Government, fiscal year 1976, p. 163.

Representative HAMILTON. Let me move on to other questions, then.

For a year or more we followed a policy in this country of trying to get the oil prices down. I think you yourself made predictions

that the prices would come down. Then last fall Mr. Enders, the Assistant Secretary of State for Economic and Business Affairs, gave a speech in which he advocated a kind of high price oil policy. We had a speech this week by the Secretary of State, Mr. Kissinger, in which he talked about a "floor price". It just seems to me in the past year we have been all over the place with regard to oil prices. We have followed a pattern of trying to get the oil prices down. We begged, cajoled, and pleaded and we failed to get those oil prices down. As a matter of fact, they actually went up.

Then Mr. Ender's speech indicated a very different direction from what the Secretary of State and others talked about. Now Secretary Kissinger is talking about a floor price. Can you comment on our policy and our attitude with regard to floor prices, please?

Secretary SIMON. Yes, I would like to, Mr. Hamilton, because there is obviously some confusion.

It is still and never has been any other policy than to have lower world prices. The IEA, and the Solidarity Fund, and the world conservation programs are designed to put additional pressures on international prices. They have over 8 million barrels a day shut in now. Any additional pressure in the short run will put additional pressure on them to decide who indeed makes these cut backs, and these are difficult decisions and this is the way the market works.

As far as begging or cajoling or pleading, I never begged or cajoled or pleaded. We visited these countries last summer and pointed out to them the economic results of their market, and why it was in their best interests as well as our best interests, the consuming nations of the world, for the market to operate.

Everyone accuses me of predicting that the price will come down. I will say two things about that. One, yes, and I will say it again, it is not whether prices come down, but when. Immediately they say Simon says that the price of oil is going to come down, and if it does not, you will open the Washington Post the next day and if you see that prices have not come down, I will have failed.

This is a political problem, though, as well as an economic one. I do know what is going on in the world as far as the world market, as far as supply and demand. Demand is down significantly, looking at the 8 million barrels a day that is shut in. It is going to go down further as we and other countries in the world continue to consume less.

Representative HAMILTON. Suppose it does come down and you have this floor——

Secretary SIMON. I will come to that. I think this is an important point, if I could just finish.

On the supply side these nations are well aware. They own 60 percent. Last year 30 million barrels of oil were found in non-OPEC, non-United States, and that is about 13½ million barrels a day by 1980. What do we have in the United States if we would get to work and remove the impediments—the Outer Continental Shelf, massive coal, nuclear capability, transatlantic pipelines, close to one-third of our imports before 1980, and additional drilling on the North Slope. There is great pressure on the prices of oil today.

We are seeing in ports that concessions are being made as far as oil—delayed payments of 1 month and 2 month and 3 months as

far as oil. That translates itself into a fair decrease in oil. If we continue to do a good job of conserving, yes, we can bring it down.

Let's talk about the international aspect and what we have to do to achieve sufficiency. With oil shale liquifaction, et cetera, and with a high inflation, as far as some of the more advanced nuclear facilities, that is a question mark.

Do we wish, in order to give the incentive to bring on all these alternate sources of energy, to provide some price assurance, some protection, if you will, for a period of time against a precipitous decline in oil prices? You know, the Arab nations have production costs of about 10 to 20 cents a barrel, and one can make a case that they could cut oil to what it was selling for in 1969.

Representative HAMILTON. What floor price do you have in mind?

Secretary SIMON. Well, it is not a matter of price. There are several options. It could be the fee system that we have in place right now, a flexible system that would make sure that imports from foreign countries would always be at a higher price than what our domestic price is. There are quite a few ways to do this and there is no American policy at this point. We are looking at all the alternatives to see which is the best way to bring on the alternate sources and to give this protection, because we would not get the necessary investment from companies if they are subject or afraid that the Government is not going to protect them against a precipitous decline in the market and destruction of their investment.

Also, we could use the synthetic rubber experience from back in the middle 1940's; build our own private plants in conjunction with oil shale and coal liquifaction, and so forth. These are the things Secretary Kissinger spoke of.

Chairman HUMPHREY. Congressman Brown of Ohio.

Representative BROWN of Ohio. Mr. Secretary, it might be helpful to talk about these oil impediments. I have a company in my area of Ohio, which advises me that currently about 32 percent of the oil is all that comes out of most wells, that you get 68 percent of the oil left in the ground after a well has been exhausted at the present economic levels at present economic price levels for oil. They have advised me they have a system which will get out up to 48 percent of the $12.50 barrel price. My junior high school mathematics tells me that is a 50-percent increase of what you can get out of wells, so we ought to increase using such mechanisms. secondary and tertiary removal. The supply of oil that you also bring in, a lot of other methods of energy products at that higher price. So I guess what they are really saying is that about $2 over whatever the current Persian Gulf price is would be enough to make a significant increase in the oil available from existing wells. Is that a fair conclusion?

Secretary SIMON. We cannot generally on secondary and tertiary recovery around this country. It all depends on the department, the technique that is used.

Representative BROWN of Ohio. Thirty-eight and 48 percent were average figures.

Secretary SIMON. You can use a rule of thumb that a third in the primary, a third in the secondary. While the wells in your area—

there are other wells that require $9 or $10 as well. It is difficult to generalize. But a free market would most certainly do a great deal to bring this out of the ground.

Natural gas is the same thing. We continue to deregulate gas at the wellhead at uneconomic prices. I have to continue to repeat this because we are continually penalizing people in New England and people in my State where they are unemployed where natural gas is cut off. What do we do instead? We import Arab oil at an equivalent of about $2.25 per Mcf and refuse to free up the price of new natural gas that might go to $1.25 or $1.50.

No. 1, we are making more to bring in these insecure supplies to our country, and No. 2, giving this larger amount of money to these OPEC producers instead of giving a lesser amount to our own producers at home which would bring on more production and eventually achieve the abundance of energy that will bring down prices.

Representative BROWN of Ohio. You were talking about the relationships between profit and energy. You said we were in a profit depression. The other day Mr. Paul McCracken said we were in a depression. Mr. Arthur Burns said it. I keep reading in the press that we have record profits in current dollar terms. So I think that folks are convinced that if we can just get those profits down perhaps everything will be cheaper for everybody we have on these public services jobs.

I am concerned what creates jobs, unless you are talking about these cosmetic public service jobs, what creates productive employment is some kind of a thing that creates the opportunity for the enhancement of wealth. In other words, for such jobs that do expand national wealth you need plant investments, and for plant investment you need risk capital, whether Kuwait or Springfield, Ohio. I do not suppose it makes any difference if you supply the job in this country in terms of what it does socially in the United States.

The budget predicts for 1976 a deficit of $52.7 billion, and the off-budget or additional deficit or secret debt additions, because they are not in this $52.7 billion, are estimated at $10 to $12 billion, these are borrowing or debt guarantees which must also be financed with an impact on the private money markets. They have to be either financed from the privated money market or reflected in funding money, the printing-press money that Uncle Sam undertakes. At any rate, that $65 billion deficit is the good news.

Yesterday one of my colleagues, who has been around Congress on the other side of the aisle, predicted that a more realistic figure for the deficit in the next fiscal year might be $117 billion. Given that kind of figure—his figure was based on the enthusiasm of the Congress for tax cuts and for new programs which would help provide jobs and do all these other things and spend Federal money to do it, and of course, the following year, the 1976 fiscal year is an election year and I cannot think that the Congress will be a great deal more responsible in an election year—can we really have such deficits and finance the expansion we need in the private

capital markets for the establishment of new plants and new jobs that we need in this country, or are we into sort of a perpetually federally financed job program?

Secretary SIMON. Well, you answered it, Congressman Brown. There is absolutely no doubt that we cannot. We have reached the outer limits of this. I have testified any number of times on the growth of Federal spending as a percentage of money raised in the capital markets. It is large by any historical comparison. I would like to comment on Paul McCracken's comments—I have talked to him about this a great deal—and about these disagreements we have on economic policy. McCracken said that if the financial community has been slow to appreciate the role of fiscal policy in the management of the economy, economists as a whole have been slow to realize and face fully the implications of the fact that the Treasury financing and private borrowing does compete for the funds in the same money and capital requirements. Further, Treasury requirements are large enough that their impacts in the private sector must be faced quite explicitly.

What happens when we have had a decade of high inflation and declining real profits in our economy? We have weakened our entire financial system; the liquidity of finance and the condition of financial companies is well known today. It is going on right now. All forecasts are for records to be broken in long-term capital funds raised.

Well, what do we do; crowd out borrowers when we go in. During 1976 the number is about 80 percent for all levels in the capital markets. That is a rather extraordinary number. Who becomes the disadvantaged? Housing becomes the disadvantaged, and of course all the lesser rated borrowers, perhaps the Xerox's and the IBM's of tomorrow. And we are creeping up the credit ladder where we have squeezed out the——

Representative BROWN of Ohio. The small businessman——

Secretary SIMON [continuing]. Small businessman and he is the one who truly suffers.

Your AAA-rated corporations today—they come in the market right after the U.S. Government. Then going down the quality ladder comes the AA's and A's. We have a risk premium in our credit markets because people demand quality and your high quality bonds are still around 9 percent. They take a look at the financing needs, they do not look at the short term. Interest rates will decline in the short term due to the monetary expansion and the lack in our economy.

What happens in 1976, and this is what we ought to think about for a few minutes. The economy turns around, private demands grow again, from business as well as consumers and individuals, and borrowing that is so desperately needed commences. This means expanded capacity, because that is sorrily lagging in an economy that will be growing. Well, just at that time we are financing these very large budget deficits in fiscal 1976. Well, some people are going to be crowded out and some are going to suffer even more seriously as a result, or the Fed can expand money to the extent

that it will accommodate not only the Treasury needs, but also private financial needs as well. We know the results of that—higher inflation. So either way you are looking at potentially higher interests rates and a big problem.

When this economy turns around—I am just attempting to sit here and explain we had better keep a close eye on this.

Representative BROWN of Ohio. This committee has been worrying about the fact that we have larger and larger corporations, that there is a tendency for consolidations to create monopoly circumstances, and in fact our fiscal policy also is contributing to that, is it not, by what you have just described? A little guy cannot get started in expanding a company and if he can get started he cannot get it financed. Those returns you talk about on the stock market are not such good investments after all if you are going to limit profits in the future.

Secretary SIMON. We cannot sit here as a government and continue to talk out of one side of our mouth and say capital investment, et cetera, that's what's good for our country, and at the same time have mass deficits that encroach upon the capital markets, the centerpiece of our free-enterprise economy. If we do, this will immediately remove all the savings from our private economy, from the productive sources of our economy, to the nonproductive sector.

I testified yesterday on allocation of credit. We are doing a super job of allocation of credit right now. We take all the funds out of the economy and do our priority. People are so concerned about housing. This year we have authorized billions of dollars for housing support; yet we have housing in one of the worse slumps in history. Well, I suggest that the market is the best indicator for housing. If we do the job against the battle of inflation properly, housing will prosper just as it always has.

Representative BROWN of Ohio. At that time we threw tea in the Boston Harbor in order to avoid control by our Government, and perhaps the American people are getting fed up with this business of federalized control of their future investment through the fiscal process, because once again Government is taking the right of people to make their own economic decisions about their own money. You are doing it with this massive deficit and I for one hope that deficit can be held under control. I hope George Mahon's prediction of $117 billion is not right, but given my vote yesterday to increase the tax reduction and avoid asking people to pay for the social benefits, that is closer to right than the $52.7 billion.

Chairman Humphrey. Senator Sparkman, we welcome your questions and participation.

Senator SPARKMAN. Thank you Senator.

I believe all the questions manageable have been asked, but I will try to ask some.

I have enjoyed your testimony very much, Mr. Secretary, as I always do. I think you do a tremendous job.

I want to ask you about the thing that you have just said in answer to a question of Congressman Brown that has to do with deficits. Now, I have been alarmed at these deficits that you talk about. How much is it for the next fiscal year?

Secretary SIMON. Well, on paper it is $52 billion, but I stress, Senator Sparkman, that is on paper and it depends on Congress' favorable action on $17 billion of deferrals and recisions, and also assuming Congress will not spend any more money for the next 18 months and that there will not be any slipage in revenues, et cetera. Some people have considered some of these assumptions ridiculous.

Representative BROWN of Ohio. Plus the $12 billion off-budget items.

Secretary SIMON. I never forget off-budget things. That has been one of my pet peeves. I warned everybody, but nobody listened.

Representative BROWN of Ohio. So it is $52.5 billion plus $12 billion, plus $17 billion, plus what ever else?

Secretary SIMON. Yes.

Senator SPARKMAN. Plus what we make rejected as deferrals and rescissions?

Secretary SIMON. Yes, that is right.

Senator SPARKMAN. Is it $29 billion?

Secretary SIMON. It is $3 billion this fiscal year and $17 billion the next fiscal year, and the off items that Congressman Brown mentioned as well.

Senator SPARKMAN. Do I understand that the projected deficit for the next year would be in the neighborhood of $80 billion?

Secretary SIMON. Well, no, sir; I think our number in the budget message was $30 billion in the next fiscal year.

Senator SPARKMAN. I have heard that $80 billion batted about.

Chairman HUMPHREY. That is for the 2 years.

Secretary SIMON. The number is $87 billion for this fiscal year—and the next fiscal year.

Senator SPARKMAN. Regardless of what it is, that is a considerable deficit.

Secretary SIMON. Yes, it is awful.

Senator SPARKMAN. Well, I agree I get shocked at these deficits. Now, you were down at the breakfast the other morning.

Secretary SIMON. Yes.

Senator SPARKMAN. You heard Mr. Ash explain the budget. I will say that I got one word of comfort, and that is when he was comparing the percentage of what we are spending with the gross national product as contrasted with what it was in former years. As I recall, he said the percentage was about the same, was it not?

Secretary SIMON. Yes, that is correct. It is slightly higher, but that, as I have said in my previous comments, totally ignores the financial implications of a deficit of this magnitude. As Mr. Ash did in his presentation, he went on to explain the growth of government at all levels as a percentage of our gross national product and how it has grown over the last few years, contrary to some testimony that has been given here. Then if we do not stop and continue along the same path, before the turn of the century or at the turn of the century, government expenditures at all levels as a percentage of GNP will be about 60 percent at that point, and you can effectively say Government will be running everything. May I submit a table, entitled "Federal Budget Surpluses and Deficits—1954–76," for the record at this point.

Chairman HUMPHREY. Without objection, so ordered.

[The table follows:]

FEDERAL BUDGET SURPLUSES AND DEFICITS—1954-76

[In billions of dollars]

Fiscal year	Budget surplus (+) or deficit (−)	Budget surplus (+) or deficit (−) as percent of GNP	
		Annual	3-year moving average (centered)
1954	−1.2	−0.3	
1955	−3.0	−.8	−0
1956	+4.1	1.0	−.3
1957	+3.2	.8	.3
1958	−2.9	−.7	−.9
1959	−12.9	−2.7	−1.1
1960	+.3	.1	−1.1
1961	−3.4	−.7	−.6
1962	−7.1	−1.3	−.9
1963	−4.8	−.8	−1.0
1964	−5.9	−1.0	−.6
1965	−1.6	−.2	−.5
1966	−3.8	−.5	−.6
1967	−8.7	−1.1	−1.6
1968	−25.2	−3.0	−1.2
1969	+3.2	.4	−.9
1970	−2.8	−.3	−.8
1971	−23.0	−2.3	−1.5
1972	−23.2	−2.1	−1.7
1973	−14.3	−1.2	−1.1
1974	−3.5	−.3	−1.3
1975 [1]	−35.0	−2.4	−2.0
1976 [1]	−52.0	−3.3	−2.3

[1] Estimate.

Senator SPARKMAN. Let me ask you this. In your statement you said, "we must hold the economy in this zone of acceptable price performance." Do you mean we should plan infinitely to hold the unemployment rate to 5.5 percent, which the budget assumes, I believe, for 1980?

Secretary SIMON. No, sir. That economic forecast going out to 1980 is a projection not a forecast. I have to correct myself on that. It makes a lot of assumptions on things where we do not know what is going to happen, but you make the assumptions anyway.

What we have to do is realize it will take time to get the real inflationary rate down and get the inflationary expectations which are equally important wrung out of the American people due to the excess of the past 10 years. Again, if we make the same errors as in the past we will end up with even higher unemployment and a higher inflation rate in the future, because that is what brought us to this problem today.

Senator SPARKMAN. I believe in your statement you recommended the establishment of a $25 billion safety net in connection with the importation of oil. That is an international fund.

Secretary SIMON. That is an international agreement that we have suggested, and that was accepted at a recent finance ministers meeting. It is an attempt to integrate the financial, economic, and energy policy of the participating countries in this safety net, this lender of last resort, and we will be working in the months ahead with the Congress on the details of this solidarity fund.

Senator SPARKMAN. If I remember correctly, when Prime Minister Wilson was here he referred to a safety net. I was under the impression he used the figure of $18 billion; am I wrong on that?

Secretary SIMON. No, I did not see Prime Minister Wilson's statement. Of course, I was in the United Kingdom when he was here, so I might have missed some of the things he said.

Senator SPARKMAN. I did not see it in a printed statement, I heard him speak.

Secretary SIMON. The United Kingdom is one of our biggest supporters on this solidarity fund.

Senator SPARKMAN. I was glad to hear you say what you did about allocations of credit. We hear a lot of talk, a lot of people advocate allocations of credit to different things. Of course, I must confess I have seen the time when I wish we might have an allocation of credit to housing, because it seems to get opinion much the worse.

But as I understand you to say, any allocations must be something that more or less falls in line as you plan your program, doesn't it, instead of setting up a definite figure and saying this is going here and this is going there?

Secretary SIMON. The suggestion is that the Federal Reserve shall allocate credit in the United States, and that is to my mind a mind-boggling assumption on the literally trillions of transactions that go on through our financial system—whether you want to buy a car, use your credit card, or whether corporations or State and local governments, who wish to borrow have to get in line behind the priorities established by bureaucracy.

I think the better way to attack some of the social problems is the way we have traditionally in this country and go at them with a rifle. If we believe housing is a priority, then let us set aside the money to assist housing through subsidy. We have been subsidizing 35.8 percent in this fiscal year. This is the way it should be done.

Chairman HUMPHREY. Is that 35.8 percent of units or the amounts.

Secretary SIMON. The amounts, Mr. Chairman, of farm and residential mortgages. The Federal share, as far as the long-term funds that are raised, is the 35.8 percent in fiscal 1975.

Senator SPARKMAN. Did you say farm——

Secretary SIMON. Farm and residential. It does not include commercial.

Senator SPARKMAN. Well, I was just thinking if different programs could be included in that——

Secretary SIMON. Sure, energy, pollution, there are all kinds of things we subsidize.

Senator SPARKMAN. Oh, not just the structure itself. You mentioned energy. That is an interesting figure.

Secretary SIMON. We give the ability on some questions for tax free bonds, for example, on pollution control. That is a form of subsidy where they are able to go into a marketplace reserved for State and local governments and borrow at a cheaper rate. So this is the way we ought to attack our special problems in the country.

Senator SPARKMAN. Well, thank you very much, Mr. Chairman, Mr. Secretary.

I am going to have to leave. I have another engagement I must look to.

Secretary SIMON. Thank you, Mr. Sparkman.

Chairman HUMPHREY. Thank you, Senator Sparkman.

Congressman BROWN of Michigan.

Representative BROWN of Michigan. Thank you Mr. Chairman.

Mr. Secretary, I have enjoyed your presentation this morning. It is always a pleasure to have you before a committee on which I serve. I enjoyed your testimony yesterday before the House Banking and Currency Committee on credit allocations. I said I thought you dramatized the subject a little bit, but it nevertheless was a very valid presentation.

One thing that bothers us, I think, is when we talk about figures such as $85, $87 billion deficit as manageable. Now, Mr. Regan of Merrill Lynch came up with a similar statement that this probably would not impose a severe strain upon the credit markets and so on.

Now, how do you arrive at that $87 billion as distinguished from $100 billion or maybe only $60 billion as manageable?

Secretary SIMON. The first thing a person does in the financial business is to take a look at the flow of funds and project what we call sources and uses, meaning the people than can supply the funds and the people that are going to demand the funds by sector.

As we look at the months ahead and the business slows down, we project that short-term demands will decline, but yet remain historically high due to the liquidity problem. Then the corporate sector, with housing the way it is you project the number of starts, so this is how you build them up. You do this on a near-term basis. This way I say it is manageable.

Then I also go on to say what happens when the private demands are given to rise. The commercial banking has finished the Treasury's deficit. When the private demands start again and the traditional customers of the commercial banks go to the commercial banks, the commercial banks will take care of these private demands and they will sell the Government securities. That is when our real problem starts.

All during this period what we have done is prevented interest rates from declining where they would normally decline during periods of severe recession, such as we are having right now, because of these exorbitant demands. And that means that we are starting another upward cycle and that if we do not keep it under control we are starting from a level even higher than the last one we started from, and that is where the trouble is, Congressman Brown.

Representative BROWN of Michigan. Well, I think these kinds of figures and conclusions cause Congressman Hamilton, for instance, to say you are, in effect, deciding that you can live with an 8 plus percent of unemployment rather than the unemployment figure being an unavoided result of valid policies.

We hear a lot about the real purchasing power of the earnings of the worker today. Why don't we ever talk about the real purchasing power of the earnings, the real purchasing power of profits, since it is your posture, I believe, that there has been this gradual decrease, significant decrease, which prevents the commercial sector from going forward and expanding plants and production, which would improve the economy generally.

Isn't there a corollary between the real purchasing power of individual earnings and corporate earnings?

Secretary SIMON. Boy, there sure is. You know, you asked me the question why don't we ever talk about it. I think it was my first

testimony as Secretary of Treasury last spring before Senator Bentsen's subcommittee, and two people came, Senator Percy and Senator Bentsen, if I recollect. That was the subject, capital information on savings investment, profitability, and the rest of it.

I have not given financial and economic testimony since we did not talk about the specific subject. But I have found you have to repeat yourself over and over again before you can finally get enough people to focus on this terrible problem we have now because it is a long-run problem, and we don't focus enough on long-run problems in this country. That is what we are going to have to do right now, because we are talking about the standard of living for us when we get a little bit older, and more importantly, for our children.

Representative BROWN of Michigan. Mr. Secretary, are you wrong, is this not an important item, or is Congress wrong in not really appreciating it, since I think you will agree that practically all of our legislating related to this area has been to impede, restrict, et cetera, profits?

Secretary SIMON. I think that the whole problem—and I get in trouble when I say this although I don't mean it in any snide way—is the level of economic literacy in the country—not only in the United States, but all over the world. I guess one out of every six high school students takes a course in economics. One out of every four takes a course in college. Unfortunately, today you can go through an economic course and never find out that a man named Adam Smith existed and that is pretty bad. It is a combination of these reasons.

It is my major job to be patient and repeat myself just as I did in the energy area, and show how important it is, and explain when we create deficits from this side, they are taking money from the productive side and moving it to us, which is a nonproductive sector.

Representative BROWN of Michigan. But we do not get the message across that inflation is the most cruel tax of all.

Secretary SIMON. I am trying.

Representative BROWN of Michigan. I don't think you are doing it very successfully.

Secretary SIMON. I agree with you.

Representative BROWN of Michigan. You know, I become quite discouraged about this. It seems a rather dismal future. It just seems that too often these hearings tend to deteriorate into a question of interrogating the witness and determining their economic theories, not for the purposes of establishing a viable alternative, but rather to determine the inadequacy of your proposal.

Secretary SIMON. Can I comment on that, please?

You know, it is very easy to get discouraged, and history might bear this out. Sometimes I question the ability of democracy to beat inflation and to have the courage and wisdom that is required for a long enough time to beat it. There is a statement— and I am not a Keynesian, I am not anything—but Keynes said back in 1919, and Lenin made a similar statement shortly before, about capitalism. Keynes' comment, I think, is especially appropriate today. He said that the fastest way to destroy a society is to debauch its currency. It is a process that is so subtle that only one person in a billion understands what is going on. This explains some of the complexities of the subject and the worldwide problems we have today. The

dialog must continue. We can not allow ourselves to be discouraged, because you and I know the American people are smarter than any government gives them credit for. They might not know the intricacies of all these things, but they know what's going on.

Representative BROWN of Michigan. I quite concur with you, and would add that it seems to me we have been engaging in a luxury we can't afford and that is letting our likes and dislikes become our judgmental rights and wrongs.

Getting back to more specific things, I was interested in your comments about the size of the budget with respect to GNP. A brief study that was done for us states that the budget, over the past two decades, has got changed significantly in its percentage of GNP in real dollars. Do you have a comment on that?

Secretary SIMON. I guess in 1949—I had this somewhere in my papers—all government as a percenetage of GNP was around 22 percent, and it is now 33 percent. So that is gone up. That is governments at all levels which I speak of, which is a true comparison because we are talking about productive——

Representative BROWN of Michigan. You would have to relate your statements to all of government.

Secretary SIMON. We can do the percentages for just the Federal Government as a percentage, but it is more realistic if we use the Government at all levels.

Representative BROWN of Michigan. I get the impression, Mr. Secretary, that you feel it would be desirable to have even more extensive investment in this country of OPEC dollars, OPEC money?

Secretary SIMON. Yes, I do.

Representative BROWN of Michigan. Mr. Regan, when he was before us the other day, said one of the reasons he feels there will be less investment than there could be of OPEC oil dollars is because of the taxation of remissions, earnings, and that possibly we should look at that question again.

Secretary SIMON. We almost had it in the bill last year, this withholding in the State tax on foreign investment in this country we have been trying to get removed for a period of years. This is a real barrier in his country and we ought to remove it.

Representative BROWN of Michigan. This, of course, has a budgetary impact.

Secretary SIMON. What is the budgetary impact, very small, $100 million? The investment comes into this country of the $100 million, give or take a little impact on our budget, and what is the product of our investment as far as jobs and employment and taxes and revenues to Treasury.

Representative BROWN of Michigan. Regardless of the nature of their investment, you would be losing, in effect, the revenue from the taxation of remissions, would you not?

Secretary SIMON. I am not sure I understand your question.

Representative BROWN of Michigan. I was saying that Mr. Regan thought there was a significant impact by the taxation of remissions of dollars invested by OPEC countries. You are saying it is not a significant figure. If it is not a significant figure on the revenue side, it cannot be a significant figure to the OPEC nations, I presume.

Secretary SIMON. Remittances are small in dollar total. The tax is——

Representative BROWN of Michigan. Then you are saying this tax does not have a significant impact on OPEC dollars coming into this country?

Mr. HICKMAN. I am sorry, we are confused about the question. It is a large item. It is a substantial inhibition on investment coming here. From our point of view it is a small revenue item in the Government budget, so we feel that there is a very large benefit in trading these things off.

Representative BROWN of Michigan. So you therefore quite concur with Mr. Regan that we should eliminate them or reduce them.

Secretary SIMON. We certainly should, because the managed impediment is just as great as the real one. I have talked to these people and they do not understand why they should be penalized to invest in our country, when at the same time it is good for our country.

Representative BROWN of Michigan. Thank you very much.

Chairman HUMPHREY. One of the purposes of a hearing like this is to accommodate the concerns Congressman Brown of Michigan and I have, which is; namely, economic education. It is a matter of controversy, but we do get a great deal out of it.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman. Secretary Simon, I too, enjoyed your testimony.

I share the troubled feeling that I know a number of the members of the committee also feel, and all Americans must feel, about the condition of the economy. Let me speak for the region that I come from. I think that the problems of recession are a much greater threat than the problems of inflation. But no one is speaking at this time in terms of ignoring inflation. But the recession is the matter that is most deeply bothering people in New England. There has been very little in what you have indicated here today that would give much hope to the 10 percent of the people who are unemployed in my State and the growing unemployment lines in many other parts of the country.

Quite frankly, it is inconceivable to me that the administration cannot develop a policy that provides a faster recovery from the recession without serious risk of inflation.

I am interested in the assumptions you have used in developing your own recommendations, in terms of budget deficits and rates of inflation. What are some of the other alternatives you have considered? Would you discuss those with us here today?

Secretary SIMON. Well, we crank in the economic policy for this year, and it can be done with a good deal more certainty for this year than in the future, because we know the problems we have today and we know we have the proper way to deal with the recession problem which was caused to a great degree by the inflation problem. Further, we recognize, as I said, that budget deficits are not only unavoidable, but desirable to provide the proper stimulus during this fiscal year, and indeed in the next fiscal year. At the same time we recognize we have to gain control over the explosive growth in Federal spending which has grown year to year at an

astronomical pace over the past 10 years. That is where we commence our policies, looking to the future as far as shifting our policies from ones that promote consumption to ones that promote savings and investment, because if we bring our policies into proper balance during periods of high economic activity, and indeed a surplus during those periods, this provides the necessary funds for our private economy to put to productive use. And that, broadly speaking, is it, Senator Kennedy.

Senator KENNEDY. But what are some of the other models that were considered? Did you consider alternative proposals for greater stimulation? How does it affect unemployment and at what risk of inflation? I think it would be useful for us to know what some of the alternatives were that you turned down.

Secretary SIMON. Well, you can look at the alternatives—we are looking at two prime areas, the energy area and the economic area as far as fiscal policy is concerned. You can look at the temporary tax cut or a permanent tax cut, as indeed some have suggested this tax cut should be permanent rather than temporary, and that was most certainly an option that we looked at.

Senator KENNEDY. Let me be more precise, then. In terms of a deficit, what possibilities did you consider in terms of the deficit and the impact that various sizes of deficit might have? Did you consider going to, say, $50 billion this year and $100 billion next year? If you did, what would be the projections in terms of unemployment and inflation?

Secretary SIMON. As far as additional spending is concerned, outright expenditures on the part of the Federal Government, our economy in the closing months of last year and the early weeks of January was declining, and our revenues were declining and the budget deficit was increasing, providing what we considered to be the needed stimulus when coupled with the tax reduction on a one-time basis, and with monetary policy, which is very important.

Senator KENNEDY. Well, did you at any time consider a different size of deficit for this next year?

Secretary SIMON. We did arrange in our tax reduction considerations of between $10 and $20 billion, and we previously discussed larger than $20 billion, which would have made it in excess of $25 billion.

The decision on the absolute number was held right up until the end. As you remember, there was a lot of speculation in the press as to what the President might finally determine. This was one of the last decisions made, the size of the tax reduction, because we were revising the number at that point, due to the declining activity that was occurring each day. So the answer is yes.

Senator KENNEDY. How high a tax cut were you considering?

Secretary SIMON. I would say the most serious discussion was held at the outside to $20 billion of reduction, which would have added another $4 to $5 billion to the deficit. We had discussed other numbers higher than that during the course of our week.

Senator KENNEDY. Tell us about that.

Secretary SIMON. We considered that undesirable on a temporary basis.

Senator KENNEDY. May we hear about those alternatives and the reasons you discounted them? Would you tell us what the figures were? Did you ever consider a $50-billion deficit? And if you did, what was the projections in terms of unemployment, and over what period of time?

Secretary SIMON. We discussed it first in the percentage of tax cut and what is required to turn the stimulus around and look at the fiscal impact. At the same time you continue to update your very precarious revenues—estimates which never make the mark, and never can because they are traditionally the most impractical things in the world to attempt to assess with any real precision. Anybody who thinks we can just sit down and say corporate profit and tax receipts are going to be this, has something to learn. There is a great margin for error in this.

Senator KENNEDY. Well, the Wharton model, for example, talks about a $30-billion tax cut now for 1975 and 1976, and produces better GNP and unemployment and inflation figures. Their model spells out different alternatives. You have spoken this morning about just one alternative, which is the administration's alternative, and you have given us the justification for that.

What I am interested in are the other models the administration considered and why they were discounted. All I have heard is that you were thinking about perhaps a $4 or $5 billion increase in the tax cut and its implications in terms of the deficit, but you have not really given us any clear indication of other models that were considered by the administration.

Secretary SIMON. It is not only this year, which had only 6 months to run, but the President was making ongoing spending discussions which had implications for this and next year and future years as spending continued to grow. As far as the absolute models and economic analysis for everything we did, that was done on an ongoing basis as each one of the assumptions was cranked into the model.

Senator KENNEDY. How was the unemployment level projected?

Secretary SIMON. You say alright, we have provided this much stimulus. If we provide that much for what is the temporary effect and the inflationary rate, where will we be looking 1 year from now or 1½ years from now?

Senator KENNEDY. What stimulus would you have had to provide in order to get unemployment down to say 6 or 6.5 percent?

Secretary SIMON. I would not horseback those numbers, Senator Kennedy. I will get you those numbers and file them for the record.[1]

Senator KENNEDY. In your consideration, you are talking primarily about the problems of inflation. I still have not heard very much about the problems of unemployment and the problems of recession.

Secretary SIMON. It is a prime consideration, otherwise the President would not be recommending the tax reduction at this time which provides a stimulus which creates a greater deficit for a

[1] See response, beginning on p. 360.

greater period of time. It is recognized it is required in our economy to begin to turn things around again.

Senator KENNEDY. Many Members in the Congress say you are taking the stimulus right back again with the various budget cuts that have been recommended. You have a $16 billion tax cut, and then you ask for a $17 billion budget cut.

Secretary SIMON. You are taking it, Senator Kennedy, back in real terms, sure, but you have also got massive Federal spending embodied in the fiscal proposals that we have and you would have even more stimulus if you allowed the $17 billion of deferrals and recissions to remain untouched. So that is just a matter of degree.

Mr. FIEDLER. We used various models in assessing the impact on inflation, on the capital market, et cetera. We used ecometric models, and finally an electric model. In the form of input we use economic indicators, surveys of plant and equipment, and the consumer center surveys, and everything we can lay our hands on. We did run some of those alternatives through the models and our combined assessment from the models and our own assessment was that larger stimulus would reduce the unemployment rate in 1975 and 1976 by a few tenths, maybe half a percentage point.

Senator KENNEDY. How much additional stimulation?

Mr. FIELDER. I don't remember the precise number. I know $20 billion was the maximum at one point, but these were also combinations that included a second year stimulus as well as a 1-year reduction.

Senator KENNEDY. You did not use $25 billion or $30 billion?

Mr. FIEDLER. Not specifically, that is correct. The decline that you can get in unemployment would be helpful. We would like to have that, but the risk that you take on the inflation side, not in that particular year 1975–76, but in the out years, grows disportionately large, and the final factor that the Secretary talked about was the problem of finding these deficits and aborting the recovery spiral in the extreme case, looking ahead a year or two.

Senator KENNEDY. I think it would be helpful for the committee to have the information on the $20 billion level.

Secretary SIMON. We will provide you with the material we had when we were making these plans.

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

The economic forecasts shown in the table below are submitted per request of Senator Kennedy during the testimony of Treasury Secretary William E. Simon before the Joint Economic Committee, February 5, 1975. The base case which assumes that the President's economic proposals are enacted, shows the published forecasts for real Gross National Product, the GNP price index, the unemployment rate and the unified budget deficit. Alternative 1 indicates how our forecasts might differ from the base case in the absence of the proposed $16 billion tax cut—i.e., assuming the same operation of the automatic stabilizers built into the budget and the same monetary policy as otherwise. Alternative 2 indicates how our forecasts might differ from the base case if a tax cut of $20 billion (instead of $16 billion) were enacted for two years (instead of one)—again with other policies unchanged.

There are several points to consider in assessing these forecasts. The first is the uncertainty surrounding them. For example, the probable range of error around the base-case forecasts is much larger than the differences between the base case and the alternatives. Second, one crucial factor that is not directly reflected in these numerical forecasts is the risk that these very large deficits

will create serious financial difficulties that either choke off some of the expected economic recovery, especially in housing, or (if accommodated by the Federal Reserve) reaccelerate the rate of inflation. We, like all forecasters, find it difficult to integrate the full financial impacts of policy alternatives into the forecasts of economic activity and prices. Beyond that, however, because the potential adverse financial effects are a matter of probability rather than simply a matter of how much impact they would have, this aspect of the present situation does not become an explicit part of the quantitative forecasts at all, but rather enters the policy-setting process as a qualitative consideration. This risk—that major difficulties will arise from financing the large deficits—would be reduced under Alternative 1 and increased under Alternative 2. Third, it is also important to consider the probable impact of alternative policy actions on unemployment, inflation and the financing of deficits in 1977 and 1978, i.e., the years beyond those covered in the forecasts below.

ECONOMIC FORECASTS UNDER ALTERNATIVE POLICIES

	Base case		Differences from base case			
			Alternative 1: No tax cut		Alternative 2: $20 billion tax cut for 2 yr	
	1975	1976	1975	1976	1975	1976
Real GNP, percent change	−3.3	4.8	−0.8	+0.4	+0.3	+1.0
Inflation rate (percent change in GNP deflator)	10.8	7.5	−.1	−.2	+.1	+.3
Unemployment rate, percent	8.1	7.9	+.3	+.2	−.1	−.3
Unified budget deficit, in billions of dollars, fiscal years	34.7	51.9	−5.0	−5.0	+1.0	+8.0

Senator KENNEDY. During the President's economic summit, which I had the opportunity to participate in, a clear theme that came through was that the individuals in our society who are bearing the real brunt of our economic situation are generally the poor, the working poor, and the lower and lower middle income groups. They are paying the highest additional burden for food and fuel. They are the ones being laid off and put in the unemployment lines. They are the ones whose aid programs are being cut back to the greatest extent.

Your figures are clear that substantial unemployment will continue over a period of time. Yet most of the cuts that you are recommending in the budget next year would affect the poor and the elderly and other groups already badly hurt. You would cut social security by $2.5 billion; food stamps, $217 million; medicare, $600 million; welfare, $500 million; social services, $548 million; education, $260 million; veterans benefits, civil service, railroad retirement, $116 million. Altogether, these cuts in social programs come to $9.4 billion of the $17 billion in total cuts. Yet these cuts are all in programs targeted for elderly people, young people and the poor people.

What is your thinking and why should these groups bear the burden of unemployment, inflation, and budget cuts as well?

Secretary SIMON. This is probably our most difficult problem, Senator Kennedy, and one where I don't think any President in history has ever gone through a more thorough and painful process of reviewing the budget item by item, hour after hour, to make the decisions that were required to send this $17 billion package of deferrals and rescissions.

When you say it is the poor and you recognize the poor, the middle income, the low- and middle-income people suffer the most from the fuel tax inflation, yes, that is true. You also recognize that close to

two-thirds of our growth in the budget has been in the areas of transfer payments.

It seems inhumane when one suggests, knowing we have to help these people, that we also have to figure out a way to pay for some of these programs.

Just take social security. Inflation has gone up slightly over 30 percent in the past 4 years and social security benefits are up 47 percent, so they are ahead of the game as far as cost of living is concerned.

Senator KENNEDY. Do you know where they started from, Mr. Secretary? I hope that you won't say that people on social security are ahead of the game in terms of the problems they face?

Secretary SIMON. As far as cost of living is concerned.

Senator KENNEDY. That is not a fair statement. The administration's program is clear, and I think it is unacceptable.

The major oil companies are not being asked to sacrifice very much. Other special interest groups in our society are not being asked to sacrifice very much.

But even talking about the deficit, the fact remains when we consider the deficit in relation to GNP, the deficit that you are suggesting for 1975, will not even be as high as in other recession years, and even for 1976 it is only a little higher.

We are talking about the development of a policy. We know the level of unemployment we are faced with in this country. We hear about the cutback of various programs affecting the poor and the young and the elderly, and we hear a lot of breast beating about the dangers of the deficit. But I have difficulty in justifying that in relationship to the statistics, the comparison of the deficit going over the past 20 or 25 years.

Secretary SIMON. If you take the combined deficits, rather than taking out 1 year against another year, it is much larger. Also, it ignores the financial aspects of the problem in the Treasury Department.

Senator KENNEDY. Is there any reason that is not manageable? Obviously if the Federal Reserve is going to act contrary to other governmental decisions, then some of the dangers posed here might be more real, but I don't see why that has to be the case.

In terms of percentage of GNP, the deficit would appear to be a rather small figure and rather easily managed.

Secretary SIMON. Again, just using the 2-year period, looking back from the period or the 3-year period, the recent deficits, 1975 and 1976 and 1977, they were almost double what they were—they are over double what they were in the late 1950's, triple what they were in the 1963–64 period.

Senator KENNEDY. But our GNP has also increased.

Secretary SIMON. That is what we are doing.

Senator KENNEDY. I would like to just come back.

I have taken more time.

Chairman HUMPHREY. Very good, Senator Kennedy. I think you have raised some points here that need to be given very careful consideration.

I join with you in where the burden of fiscal austerity needs to come in.

I have here the budget for fiscal 1976. It is very interesting to note. Let's take a look at foreign assistance, which I generally support and have given a great deal of attention to. The total amount of foreign assistance budget authority for fiscal 1976 is $6,864 million as compared to $756,077 million. In this instance, in other words, there has been approximately $800 million added. From the military assistance point of view it is up from $2,150 million in 1975, fiscal 1975, to $2,460 million in 1976. Insofar as outlays are concerned, it is up to $2,800 million. So we are not making the cuts there. I think the Congress is going to make some cuts there, but the cuts are not there in the budget.

Let's go on over to national defense, and I believe in strong national defense. I know our Defense Department has had some serious draindowns on its resource. I think it should be noted that the recommended budget authority for 1976 is $107,700 million as compared to fiscal 1975 at $19,314 million. So here again you see an increase of $16 billion in a budget recommended authority for 1976. And defense, which is about the same amount, Senator Kennedy, as the recession is, in foreign assistance you see that increase up approximately $800 million in fiscal 1976 over 1975.

Now, I think that shows the administration's priorities, and I thoroughly concur in what you have said about some of these cuts that are estimated in the budget on these social service or social programs.

I might add that I am confident that the administration knows that the Congress is not going to go along with some of those, and therefore the budget, while it is a recommendation from the President and the administration, is not a budget that faces up to the facts that people in this Government know. There is no one in this Government that really believes that the Congress is going to keep social security benefits at 5 percent. You just plain know that is not going to happen. Really, if you don't know that you won't know enough to come in out of the rain. After all, the present law says it will be on the basis of the cost-of-living increase. Why in the name of commonsense should we have a budget proposal come down here saying it will be at 5 percent, when it will be overwhelmingly voted against, regardless of party. Take a look at the food stamps in the House. The administration go 38 votes out of 425. How wrong can you be? It is impossible for me to assume that the budget that we have presented here, Mr. Secretary, is a budget that faces any kind of reality in these terms. I am not saying that all of these rescissions will all be overruled, but certain ones obviously are going to be overruled. The social security payments in this country for the aged are not excessive, and putting another burden as I heard Senator Kennedy say on medicare patients is just not in the ballpark. The Congress is not going to do it and it isn't just a bunch of Democrats. It is my colleagues on both sides of the aisle. I think we have to take a look at what the realities of the budget are, and the realities are there is a certain amount of fiction, flimflam in here that just doesn't relate to what sensible people are going to do. I don't think you can say that 4 or 390 Members of the House of Representatives are off their rocker when they overrule the food stamp increase.

Now, we know we need some changes in that.

Let me ask you this: There is a tax bill over in the House. The President has his tax bill. I want to concur, and I will join with Senator Kennnedy, and we ask for these models in relation to the stimulative effect of certain fiscal and budgetary policies as was outlined by Senator Kennedy. We will make that a formal request from the committee.

Let me ask you, will the President sign the tax cut bill which appears to be the type emerging from the Ways and Means Committee, partially a rebate on 1974 taxes, partially a reduction of withholding of 1975 taxes and total somewhat larger cut than the President recommended. What would you advise the President to do that, Mr. Secretary?

Secretary SIMON. I would want to wait until the Ways and Means Committee has completed their deliberations. I have only seen a partial tax bill in the Ways and Means Committee. They have further deliberations before I could make a judgment on what I would be recommending to the President.

Chairman HUMPHREY. There are some——

Secretary SIMON. I am told it is all a 1-year reduction in taxes. Some of it works on the tables and on the tax brackets, others on a low-income allowance. That might appear to be permanent, but it wouldn't require legislation.

Chairman HUMPHREY. How do you feel about what has happened thus far? Have you got any feel about it, Mr. Secretary?

Secretary SIMON. I would say, Mr. Chairman, that it is in the ballpark.

Chairman HUMPHREY. That is very good to hear. That is one of the notes of confidence this morning. I have been on the money supply situation, and of course we have had Mr. Burns here to talk on this. Isn't it a fact that if there is an easing of the money supply that it will also permit some easing of the budget requirements, because it all relates to the availability of money? If you have a tight money supply or less than what is considered to be adequate by most people, isn't this bound to have a constricting effect and an impeding effect upon the economy?

I have noticed in the report on the analysis of monetary and credit policies by the Council of Economic Advisors report that one conclusion seems to be pretty clear, that the administration supported a basically tight money policy by the Federal Reserve System throughout 1974. Did you or didn't you?

Secretary SIMON. I would say we supported the tight monetary policy, yes, in the absence of any real fiscal restraint or the balance that you spoke of, Mr. Chairman; and even recognizing as I have often said, that it is a blunt instrument that really causes some havoc in our economy when used in the absence of other measures. Yes, we supported the Federal Reserve.

Chairman HUMPHREY. I noticed in the year 1972, I believe in the last quarter, that we had a very heavy increase in the money supply and the other years the money supply was not particularly heavy. It rolled between 2 and 6 percent on a national average. Obviously money supply varies, even week-by-week and month-by-month, and it is very difficult to give what you call a good straight line of available money.

But in the election year of 1972 there was no hesitancy in pumping in a lot of money. That is when you had your big spurt of money supply; is that correct?

Secretary SIMON. Well, I was not down here at that particular time.

Chairman HUMPHREY. Well, I am sure that you had that information.

Secretary SIMON. We were moving out of a recession at that time and expansionary policies were being pursued.

Chairman HUMPHREY. Nine percent.

Secretary SIMON. Of course that is what we are talking about now.

What constitutes monetary expansion and what will bring us back into the same inflationary problem we were in. You will have some economists say it is safe to have 10 percent and 11 percent and others who say absolutely not, if you go above 6 percent you will pay the penalty 2 years from now with higher inflation rates. You have this great disagreement. There is no doubt about that, Mr. Chairman.

Chairman HUMPHREY. I think most of us feel the sensible position is to increase the money supply and then as you see the recession receding——

Secretary SIMON. I would agree with that. I think that is what the Fed has done when you look at M–1 requirements——

Chairman HUMPHREY [continuing]. As recently, and it is beginning to have a little effect.

What have you as the President's economic adviser told the Federal Reserve? We can't operate as separate members of the United Nations.

Secretary SIMON. I, as I said before, meet with Chairman Burns almost daily. I talk to him on the telephone certainly daily. We eat lunch each week and my input is there as to what we believe should be done. Arthur Burns always sits in on our economic policy board, the executive committee meetings. The economic aspects are coordinated and cranked in.

Chairman HUMPHREY. But when I look at the money supply in September, October, and November, the rate of easing money, I think you gave him some bad advice or he didn't take some good advice, because the rate of money increase was way below what the economic indicators required.

Secretary SIMON. There again, so many times in attempting to adjust M–1 you will set targets and due to thousands of decisions in our economy you are frustrated in your attempt to achieve that target. As a result, as many times in the past, you overshoot the target. This is a very inexact science.

Chairman HUMPHREY. That is exactly why we have you and the Federal Reserve Board, and it does require fine tuning, but that is what it is all about.

Secretary SIMON. Yes, sir.

Chairman HUMPHREY. I have yet to see or hear from the administration on any effective housing program other than what we presently have in which large amounts of money have been held back. Only recently was the release of extra mortgage money which we provided for last year. There is no way out of a recession when the housing industry is in trouble. All these public service jobs and so forth are band aids, aspirin tablets. What is important is the ramifications and the rippling effect of the housing industry.

Secretary SIMON. I agree with that, housing——

Chairman HUMPHREY. Why are you so paralyzed and immobile about this housing problem?

Secretary SIMON. During 1974 we pumped through the tandem plan and Ginnie Mae, and the various programs, about $20 million in to the subsidization of housing.

Chairman HUMPHREY. Not subsidization, part was subsidized but——

Secretary SIMON. The financial assistance, which is a form of subsidy, but all during that period we had extraordinary rates of inflation, which also accompany high interest rates.

Chairman HUMPHREY. But you had tight money during that period, too.

Secretary SIMON. We are not going to have any viable housing business as long as we have high interest rates in this country. So what has happened since the Fed turned to moderation, if you will. We have seen interest rates come down from close to 10 percent to now about 5¼, 5½ percent and what has happened, for 3 months a net inflow into thrift institutions. Last month the housing permits started back up again.

Chairman HUMPHREY. One of the problems, Mr. Secretary, is that even though your joint rate goes down and your prime rate goes down the folks don't get that rightaway. The average guy is paying out there——

Secretary SIMON. There is a lag.

Chairman HUMPHREY. There is a lag. It seems to me there is a need to close that gap.

I have one final point I want your comment on.

By the way, let me say I have appreciated very much your comments on the capital fund increase. And OPEC fund increase. I agree with you, and we have to take a look at our tax laws and all these means we have for capital formation. I have asked our staff give special attention this year to the whole subject of the relationship of investment to jobs. We need to take a look at this accumulated OPEC fund and how the U.S. economy can provide a suitable environment for that kind of investment. It is only renting the money. I am with you on that.

Now, one of the things about President Ford's policies that has puzzled me the most was the posture of confrontation over these energy policies. Without consultation with the Congress, advancing an energy package that experts before this committee say is both highly inflationary and will add to the recession. There is debate whether it is 2 percent of the cost of living or 4 percent. It is not less than 2 percent and most people think it is around 3 to 3½ percent. Well, whatever the figure is, it is an argument.

Increased oil import fees. Now, members of this committee and I and other members are so concerned about harm done by such confrontation that we sent a letter, a bypartisan document, to President Ford. Let me read portions:

We are writing to express our grave concern that the growing confrontation in Congress over your specific energy proposals would prevent the prompt and cooperative action on the tax reduction energy program that is vital to achieving renewed economic growth. Our first priority must be putting America's

capital and human resources back to work. Congressional leaders of both parties recognize this and they are acceptable to passing a tax bill. We point out a number of concerns raised about the President's enrgy proposals which I have indicated.

In light of these questions, Congress is seeking additional time to address your energy proposals in an informed and responsible way. Since our energy problems cannot be solved immediately in any event—and let me digress to say there is a good deal of thinking that we ought to proceed with deliberate speed, but also not breakneck speed. We would propose that you defer in proposing further decreases in import fees on petroleum products. We would urge the next 60 days you bring together another task force on energy policy and a bypartisan group of members of the House and Senate selected by the majority and minority leadership of both parties. This task force would be charged with developing a mutually agreeable energy policy upon which prompt Congressional action might be taken.

Now, I realize that maybe you won't agree on everything, but it is my judgment that unless something like this is done that there is going to be a battle around here for months, and the resolution of that struggling will not be, I think, very satisfactory, because if the bill that we have in mind passed, the President has indicated that he might veto that bill. If his proposition remains before the Congress unchanged, we will, as Lyndon Johnson used to say, that doing won't hunt, you know, that just isn't going to go.

What do you think about this proposal? Have you talked to the President about it?

Secretary SIMON. I wasn't aware of this letter. I was away last weekend. When I came home the President was in Atlanta. I will be talking with him this afternoon.

Chairman HUMPHREY. Fourteen members of this committee signed this and this was worked out after considerable consultation. I don't think it is a panacea. I think two things are needed. No. 1, I think we have to take tax reform as a second item. We need a clear, clean tax reduction bill.

No. 2, we need an energy program that is not based upon seeing how far we can get within the next 6 months or 3 months, but a long-term energy proposal.

I might add that I have been in a quandary as to where they picked this million-barrels-a-day figure from, where that came from. I know it sounds good, but has anybody ever taken a look to see what the ramifications of that would be upon this economy and whether or not it is even possible to do it?

Secretary SIMON. No. 1, we share the same goals for the future of our country that you do, Mr. Chairman. Neither the President nor any of his Cabinet wish to have a confrontation. The President is sincere when he talks about conciliation. When you say the President imposed a program upon you, you were home for Christmas when we were developing all these programs, so prior consultation was really quite difficult.

Chairman HUMPHREY. If I had had my way there would have been prior consultation on my part. We have been somewhat derelict here in Congress on that, and that is why I am trying to pick up the pieces here.

Secretary SIMON. Sure, I think that is a good idea. We want to work together, and we will work together.

Chairman HUMPHREY. Will you speak to the President about this letter?

Secretary SIMON. I will this afternoon.

Chairman HUMPHREY. Will you make sure that the material we have requested for the record be supplied in less than a week.

Secretary SIMON. Sure will. Yes.

Chairman HUMPHREY. Mr. Secretary, we have some other questions. I know Senator Kennedy has more.

I know that you have an appointment. Senator Kennedy wanted to get out of here between 12:30 and 1 p.m. It is now 5 after 1.

Senator KENNEDY. Now I can ask my question?

Chairman HUMPHREY. Sure. It is only lunch.

Senator KENNEDY. Senator Jackson and I have introduced a resolution along this same line, with 25 members of the Senate as cosponsors, which asks for a period of time to defer action on the President's program, and an opportunity for Congress to act on his recommendations. This is very similar to the resolution the chairman has mentioned. I would hope that you would mention it to the President.

It seems to me that the President's energy program is a victory of the State Department over the Treasury. I think all of us understand that we need a conservation program and we have to cut back on utilization. But what the administration is attempting to do is to add one more arrow to Henry Kissinger's bow in his travels to the Middle East, to show we are going to be energy independent in the future. It seems to me you can move toward a responsible energy policy that won't have the disruptive effect of this program, and also convince the Arabs that you mean business in terms of eliminating waste in our economy.

A number of different proposals have been made. I dare say, I don't think any of them would have the drastic economic impact of the one that has been suggested by the President.

Let me ask you whether, in the consideration of an energy policy, the President considered the economic impact of these alternative plans? I would like to see if they considered a rationing plan as Senators Weicker and Mansfield have suggested, or Senator Brooke's proposal of a 20-cent-a-gallon gasoline tax increase, or a mandatory allocation program? I have heard Mr. Zarb say if you had a 90-percent allocation program, you would save up to 700,000 barrels a day. The independent gasoline dealers have said that once they got over 86 percent last year, they didn't have any lines. If you put allocation level at 90 percent, you could hold the price virtually where it is now, without any enormous impact.

I think it would be helpful, Mr. Chairman, if we could have the studies that were made on the economic impact of these alternative programs in the energy area.

Do you think it is possible to get that?

Secretary SIMON. Yes, I will supply that.[1]

I would just like to make one comment on your remarks, Senator Kennedy.

No two Cabinet members work in closer cooperation and coordination than the Secretary of State and the Secretary of the Treasury.

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[1] This study is not yet complete; and will be forwarded to the committee as soon as it is ready.

That has been correct for a little more than the 2 years that I have been here, and is necessary in recognition of the importance in this interdependent world and the coordination of financial and foreign policies.

Now back to the energy question. We have three choices—we can do nothing. The two other choices, go the Government route and ration and have a bureaucracy that would accomplish what we needed, and two, use the pricing mechanism.

Senator KENNEDY. With a less drastic program, we can still convince Middle East countries that 4 or 5 years from now we will be just about in the same place as under the President's program, but without any serious risk to the economy. You say the choice is rationing or a price increase, or else do nothing. That isn't the only choice.

There are other possible alternatives that should have been considered.

Secretary SIMON. We did this with the automobile companies and we have an agreement that gasoline efficiency will be 40 percent improved in 3 or 4 years.

Senator KENNEDY. I hope we might even mandate it, to carry the President's point through a little more firmly.

It seems to me that the risk, for the savings of the differences in the number of barrels of oil, is a risk of serious economic consequences. They may be absolutely devastating. I hope I am wrong. I have a feeling we will be sitting across the table a year from today and we will talk about the devastating impact the President's program had for New England and other parts of the country. We will be right back here reading your own testimony. I don't believe I am wrong. I have listened to economist after economist, thoughtful men and women who have served Democratic and Republican administrations. They have sat at that table and told us the problem.

I want to thank you very much for coming.

Chairman HUMPHREY. Thank you, Mr. Secretary.

Secretary SIMON. Thank you.

Chairman HUMPHREY. The committee stands adjourned.

[Whereupon, at 1:10 p.m., the committee adjourned, subject to the call of the Chair.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 6, 1975

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

The committee met, pursuant to notice, at 10 a.m., in room G-308, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

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

Also present: John R. Stark, executive director; Courtenay M. Slater, senior economist; William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Sarah Jackson, Jerry J. Jasinowski, L. Douglas Lee, Carl V. Sears, and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. We will call to order the meeting of the Joint Economic Committee. We are now holding our annual hearings concerning the report of the Council of Economic Advisers. And this morning we have as our witnesses the three members of the Council of Economic Advisers: The distinguished chairman, Mr. Alan Greenspan, Mr. William Fellner, and Mr. Gary Seevers.

As I said yesterday to Secretary Simon—and we had a good session with him—I have the responsibility and the opportunity of chairmanship of this committee at a very grave moment in our economic history. I am afraid the gravity of this situation may not be fully recognized. The prospect of 8 million unemployed this spring and summer, and almost that many still unemployed the summer after that, and unemployment above 6 million, as are the projections for the rest of this decade, is a very, very serious thing.

Yesterday, when I spoke with Secretary Simon I noted that he was horrified by the size of the deficit and I said I could not help but feel equally horrified by the size of the projected continuing unemployment, the tragic loss of human resources, income and gross national product. Secretary Simon spoke to us yesterday on the short-run problem of recession, but I happen to believe it is more than that. It is the very long-run problem of an enormous, tragic failure to utilize our available labor resources. I would hope that as we go through our testimony, that we can begin to get a better picture of the true loss of income, gross national product, Federal, State, and local revenues that accompany the degree of unemployment such as we are now experiencing.

We are constantly hearing about the cost of the programs that are designed to stimulate the economy, and obviously, the American people are greatly concerned about, and rightly so, deficit of the amount that is projected for fiscal 1976.

But I do not believe that the American public has at all been informed, or been informed in any reasonably accurate manner, as to the true cost in economic terms of unemployment. What is the loss of income? What is the loss of revenue to governmental structures? What is the loss in terms of gross national product because we have to put those losses on one side of the ledger as compared to what the costs may be for overcoming the losses, or at least a plan of action designed to overcome the losses.

I think this is the only way that we can have honest double-entry bookkeeping on our national economic problems, and I hope that our members of the Council of Economic Advisers can help us in this, if not today, in the days ahead. I say this because I believe there is a need of some very broad scale national education on the American economy and the problems that we face.

While we need to take immediate action on this problem of recession and unemployment, we must not kid ourselves and Government officials must not in any way kid or fool the public that this is a problem that will be overcome quickly or easily. In fact, I believe that the problem of providing jobs for all those who want and need to work may prove even more enduring and more intractable than the problem of inflation, although I know that inflation is also a very serious problem and contributes, of course, to the problems of recession.

I am distressed by what I think are the inadequate policies which have so far been proposed by the administration, but there is one respect in which I wish to commend the administration and particularly the Council of Economic Advisers. You have given us an honest statement of the problem. You have diagnosed the disease and made clear the seriousness of the stage to which it has progressed.

I want to just quote here a few sentences from the Council's report because you have put things very well. "Last year," you said, "was very difficult for the American economy. The decline in output and the rise in prices were the greatest for any peacetime year since the early post-World War II period. Unemployment rose and living standards fell."

"As 1975 begins, the unemployment rate stands at its highest level since 1958 and production and employment are declining sharply."

Continuing to quote from your report: "The most pressing concern of policy is to halt the decline in production and employment so that the growth of output can resume and unemployment can be reduced. The momentum of the decline is so great that a quick turnaround and a strong recovery in economic activity are not yet assured."

And those are the words of the report that you have given to the President and to the Congress. I must say that that is laying it on the line. It is telling it like it is. Unfortunately, it does not seem to be true that the most pressing concern of policy, however, is to halt the decline in production and employment.

You know I said to a group that was in my office the other day that I have joined with the press and others in respecting the Presi-

dent for his candor and respecting, particularly as it was in the budget and the state of the Union message, and also your candor. In other words, we now have a situation in Washington where people are willing to be frank and candid. But it is like having a doctor that comes in and tells you, "Man, you are sick. You just do not even know how sick you really are." And then the next day he tells you, "You are just sicker than than I thought you were yesterday." And the following week says, "You know, I did not realize how sick you were. You are in real trouble."

Now that doctor is laying it on the line but what I want to know is what is the cure and what are you going to prescribe? I think what we have got here are some honest doctors who are able to diagnose the disease and have no fear or hesitation in facing the patient and saying, "You are a sick man" or "You have really got yourself a case."

But then, when a prescription comes, it is a question as to whether or not the prescribed cure or remedy matches the virulence of the disease—and I doubt that it does.

I definitely got the impression from Secretary Simon yesterday that the most pressing concern of policy is to avoid reigniting inflation. And yet, you have said that the most pressing concern of policy is to halt the decline in production and employment.

I happen to agree with what you think is the most pressing concern. Nobody wants to reignite inflation. And quite obviously, whatever policies we adopt have to be carefully balanced. However, this economy is already operating 11 percent below its capacity, and the gap will still widen and I want someone in the Government that has the models and all of the printouts and statistical information to tell the American people what it means when this economy is operating 11 percent below capacity. What does that mean? What does that mean in dollars, what does it mean in production, what does it mean in revenues, what does it mean in gross national product? It is going to be a long time before we have to start worrying about touching off any excess demand which could reignite inflation. The thing to do about inflation at this particular point in our history is to grow, have our economy grow, as rapidly as we can, get the benefits of productivity gains which come with rapid growth during the recovery stage of the business cycle.

Now you have listened to me and gentleman, I want to listen to you.

Mr. Greenspan, we are glad to have your testimony and may I say we welcome you once again to the committee and appreciate your cooperation with this committee.

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

Mr. Greenspan. Thank you very much, Mr. Chairman. As always, it is a pleasure to be here, and we hope, as we confront the very serious problems which this nation has, that we will be able to jointly analyze what the nature of our difficulties are and hopefully come to solid conclusions on the best evidence we have as to the best methods to proceed.

This morning we would like to give you the results of our analysis and obviously we will try to confront the specific questions which you have just raised as well, and in as much detail as we now have available.

Chairman HUMPHREY. You think you can help us with the suggestion that I made in terms of, in real economic terms, what we call the 11-percent gap?

Mr. GREENSPAN. I would like to address that after my formal remarks on what the concept itself means and try to put it in some perspective, Senator.

Chairman HUMPHREY. Thank you.

Mr. GREENSPAN. I will not take up your time with a lengthy discussion of the content of the Economic Report itself. Instead I would like to make some brief remarks on behalf of the Council about current economic conditions and policy, our expectations for the balance of the year, and close by touching very briefly on some of the other issues which we have covered at greater length in the report.

In my testimony before this committee on January 6, I noted several of the salient characteristics of the outlook for 1975. I pointed out that the sharp decline in production must be expected to continue through the first quarter. The very suddenness of the decline has made developments beyond the first quarter very difficult to gage but essentially we foresee a bottoming out of economic activity at the end of the year. I noted further that the timing and the degree of strength of the ensuing recovery was still very uncertain. I would like to emphasize that thought again this morning.

There is obviously a much greater than usual degree of uncertainty in any forecast for 1975, and I might add for 1976, especially, and we do not believe that ours is any exception. As we note in the report, projections for 1975 are subject to an unusually wide margin of error, but we believe that ours are realistic and based upon the best information available to us at this time.

The most pressing concern of economic policy is to halt the decline in production and employment so that a sustainable growth of output can resume. So far in 1975 production and employment have experienced sharp declines while unemployment has risen markedly. There is enough momentum in the ongoing recession to suggest further declines in activity over the next several months. The rate of inflation has continued at an unacceptably high level. Nonetheless, one can observe significant declines in prices of crude industrial materials and a slowdown in the rate of price advance among many major categories of goods in the retail and wholesale markets. Farm product prices, instead of continuing the advance of the second half of last year, have instead softened substantially.

Although we have projected a decline of about 3 percent in real GNP from 1974 to 1975, it is important to call attention to the pattern of change within the year. We believe it very likely that real GNP will show another large decline during the current quarter but overall output should be reversing direction around the middle of the year and should turn decisively upward in the second half.

The change in inventory investment is having a major effort on economic activity right now and will continue to be a dominant influence on the course of production through the year. The fourth quarter of 1974 witnessed an involuntary accumulation of stocks and, at the end of 1974, the ratio of real nonfarm stocks to real GNP was the highest since the end of World War II. Businessmen are now trying to reduce stocks and they will probably be successful in these efforts in the current quarter. This shift—from a heavy buildup in the fourth quarter to liquidation in the first quarter—is the key factor in the current quarter's severe production decline. These developments are highly visible in the automobile industry but they are occurring, in a milder fashion—in many other industries as well. Stocks are likely to fall through the year because even with the recovery in the second half the ratio of stocks to output will remain high. Nonetheless, by midyear shifts in inventory investment should be contributing to rising overall production.

Business fixed investment in real terms is expected to show a substantial decrease from 1974 to 1975 but the proposed liberalization of the investment tax credit and the turnaround in economic activity should lead to a recovery in investment in the second half of the year. The decline in investment in the fourth quarter of last year centered in automobiles and trucks but businessmen began to reduce their orders for other types of machinery and equipment which will show up as reduced deliveries in the first year. Ordinarily the effects of the liberalization of the investment tax credit would not be felt to any appreciable extent for about a year. However, the administration's proposal for a 1-year increase in the tax credit gives a special incentive for business to undertake investment in 1975 and 1976.

With savings flowing back into thrift institutions and with improved conditions in mortgage markets, housing should contribute to rising economic activity after early 1975. The administration foresees starts approaching a range of 1.6 million to 1.7 million annual rate in the fourth quarter of 1975 as compared to a rate of about 1 million units at the end of last year.

The consumer holds the key to the strength of the economic recovery. If consumers respond as expected to the tax cuts proposed by the administration for the spring and summer, real GNP should register a good-sized advance in the second half of 1975. Although employment is now declining the loss of income is being partially offset by large increases in unemployment benefits. This year such benefits are expected to total more than $18 billion.

Consumers should be aided by a slower rate of inflation in the second half of 1975 as compared with the first. Although inflation is receding the rate of price increase, as measured in the various price indexes, will be highest at midyear but this will be a reflection of the impact of the higher energy costs embodied in the President's program. Even though the energy program will be adding to the level of prices throughout the year, the annual rate of price increase will taper off considerably to approximately a 7-percent rate by late 1975.

The slower rise in prices will occur at a time when personal income will be strengthening as a result of rising employment. This combination will yield rising real personal income. That improvement will be greatly reinforced by the tax cuts this spring and summer so that the second half of 1975 should witness a substantial increase in real disposable income following a decline that started in early 1974.

The President has proposed measures that will help end the decline in the economy and help initiate a recovery during the second half of the year. In our effort to provide support to the economy we must not forget, however, that inflation, and the urgent need to bring it under control, was a major cause of the recessions of 1974–75. In 1975 we must not remake past mistakes. We must support the economy but this must be done in a manner that will prevent another cycle of inflation-recession a year or two down the road.

The formulation of economic policy is complicated by the need for much stronger actions to deal with the Nation's energy problems. New policies have been proposed which would provide an enduring framework for the energy adjustments which began after the embargo. Both the energy problem and the policies proposed to deal with it are dealt with in various parts of the report. The energy problem will raise prices at a time when inflation, though declining, is serious. The higher costs, however, will be rebated to the economy through a series of offsetting tax reductions and increases in government expenditures, leaving total purchasing power pretty much the same.

On the other hand, to the extent that oil imports and hence, the transfer of purchasing power to foreign producers is reduced, the demand for domestic goods will be increased. Although the energy program has cut costs, it will also provide important benefits.

If the President's program is adopted and quickly implemented, our forecast implies the stabilization of the decline—grounded year and then a recovery which takes on fairly good proportions during the second half of this year.

In adopting an expansionary policy we must not overlook the need to turn the economy around in a way that will avoid sowing the seeds of a reacceleration of inflationary pressures during 1976 and beyond. We must be aware of the problems that will arise in financing both the very substantial deficit and the considerable volume of off-budget items. The evaluation of these problems is neither simple nor straightforward. The amount of Treasury financing in the period immediately ahead is, in fact, a good deal larger than implied by the actual deficit. Those who advocate a further increase in stimulus either through a larger tax reduction or a larger increase in expenditures are posing the risk of a severe financial strain. There is a point beyond which conventional stimulus, because of its impact on the financial markets, no longer leads to higher production and employment.

It is our view, as stated in the report, that the deficit as now estimated can be financed during 1975 without severe problems in the financial markets. I would be suggesting more to you than I actually know if I said that it was going to be easy. The reason is that despite the decline in the economy the rate of inflation is still high. It is the

nominal growth—that is the dollar growth in GNP—that must be financed and prices are still rising rapidly enough to prevent the credit demands of the private sector from declining as sharply as was the case during past recessions when the rate of inflation was much lower. The smaller than usual decline in the private demand for credit makes the large increase in Treasury borrowing especially worrisome, if not in 1975 then certainly in 1976 and thereafter. A further enlargement of Treasury borrowing either from a larger rise in expenditures or from a larger tax reduction would add considerably to the risk of higher interest rates, financial market pressures, and an eventual reigniting of inflationary pressures.

I cannot say that we or anybody else at this point have accurate answers to this question. One must make judgments about the size of the risks and the possible consequences. Obviously, both the risks and the consequences depend upon both the state of the economy and the private demands for credit. We can be sure, however, that both the risks of financial market pressures and the consequences for a reignition of inflationary pressures become progressively larger as the size of the budget deficits increase. This will be especially true when the economy recovers as we anticipate during the second half of 1975. The President's policies try to follow what we believe is the optimum path between the need for stimulus and the possible financial and inflationary consequences which such policies entail in the future.

Those who argue for more stimulus in 1975 are, in effect, proposing larger risks for 1976 and beyond than I believe are prudent if we are to achieve a further reduction in inflation. There is also the very basic question whether the relationship between the unemployment rate and stimulus, or measures to expand aggregate demand is the same as it used to be. In the largely noninflationary economy of the early 1960's, a significant increase in the amount of stimulus in current dollar terms was usually converted fairly completely into increases in production and employment and hence resulted in a declining unemployment rate. We no longer are in a situation where we can be sure that fiscal or monetary stimulus will have a corresponding effect in lifting production and reducing unemployment. As I evaluate the current trade-off between stimulus and unemployment, however, I do not give great credence to the idea that a significant and enduring reduction in unemployment will be caused by a stimulus greater than that proposed by the President—at least until we see clear and more compelling evidence that the forces that have caused inflation have indeed been brought under meaningful control. I do not say there would be no impact upon unemployment but we would be trading off some small short-term reduction in unemployment against much greater risks of significantly higher rates of inflation in the longer run and in turn for a higher average rate of unemployment in the future.

Elsewhere in our report we present our assessment of the background and the origin of the inflation of the past decade. We find these underlying causes in governmental policies that were overexpansionary on balance. There is also a discussion of how inflation has distorted the tax structure and has tended to offset or moderate the working of the automatic stabilizers. The unemployment chapter

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analyzes the meaning of the unemployment measures and decomposes in some detail the overall measures of unemployment into various categories, origins, and causes and also presents some international comparisons. The unemployment differentials that exist among various labor market groups and other aspects of this relationship are discussed.

The chapter on Government regulation deals with the problems and the cost of current regulations on several sectors of the economy and summarizes the administration's efforts to achieve a significant degree of regulatory reform. The chapter on food and agriculture reviews developments in 1974, analyzes longer-term developments and the policy issues they raise. The international economy in 1974 is examined in the final chapter of the report.

Mr. Chairman, we would be pleased to come to grips with any questions that you might have for us.

Chairman HUMPHREY. Thank you so much. Thank you for a statement that gives us an opportunity to discuss with you what may be some of the differences, if any, that we have; and also what we might do with reference to problems that you have cited that are very, very serious.

Mr. Greenspan, it is quite obvious from our testimony yesterday from Secretary Simon, and your testimony today, that within the months of November and December, as you were preparing—and January—preparing these reports, the Council of Economic Advisers report—and surely as the budget was being prepared—there were readjustments being made as the different facts that came in about employment and production came to your attention. Obviously, you have revised your economic forecasts to take account of some of the unfavorable economic developments which showed up when we saw the fourth quarter GNP numbers. As I see it, it was the fourth quarter that really was the banger, so to speak, that rang the bell and said, well, look, things are more serious than we had contemplated.

My question is, now that you have revised the economic forecast, why have you not also revised the policy to deal with the realities of that forecast? In other words, if there seems to be rather wide agreement in the Government, as there now seems to be, that unemployment will rise above 8 percent, should be not be taking more aggressive steps to try to do something about it?

Mr. GREENSPAN. Well, Mr. Chairman, let me distinguish between the actual revisions of the forecasts, and the actual timing of the policy implementation. While it is certainly true that certain elements of the fourth quarter GNP accounts, when finally revised, indicated that the outlook was indeed worse than it looked from our preliminary estimates, I would not want to indicate that the differences were of such a dimension that there was a radical change in our outlook. On the contrary, we were making adjustments and updating as part of a regular ongoing procedure. And I would think that, at the point when the final options were presented to the President for his decision on our economic policy, he was if not exactly numerically, certainly qualitatively fully aware of the content, and the types of forecast which we had been presenting.

Chairman HUMPHREY. I believe that you had an increase in the budget deficit in your projections of about $5 billion in that last quarter.

Mr. GREENSPAN. That is approximately correct, as I recall. The initial data that went in for budgetary analysis went in quite early.

Chairman HUMPHREY. Yes.

Mr. GREENSPAN. And well in advance, I might add, of the option planning on the part of the President. As you know, much of the budget material is prepared well in advance. However, if my recollection serves me to the best it can, the President, at the point of making his major decisions, was making them consistent with the data which are now published, or roughly so.

Chairman HUMPHREY. We have some concern about that. The budget and the Economic Report, and you this morning, Mr. Greenspan, have used the word "stimulus," or the concept of economic stimulus. Both the report and the budget talk about stimulus in the proposed tax rebate. I think there is a question that needs to be raised as to how much stimulus is really there.

For example, if personal taxes are cut by $12 billion, while at the same time, social security and other transfer payments are cut back some $7 billion to $8 billion, which is a projection in the budget, below what is needed to keep pace with inflation, is there enough stimulus left to be worth talking about?

Mr. GREENSPAN. Well, Mr. Chairman, I think we have to distinguish, so far as fiscal policy is concerned, between the so-called automatic stabilizers and discretionary actions. Now, it is quite possible in many respects to decide that there are certain types of fiscal measures which should be done as a general procedure. I mean, for example, items such as unemployment insurance, the question of the automatic stabilizing effects that are built into the tax structure. I think that when we think in terms of fiscal policy, the dividing line between what has already been built into our fiscal processes, and those which we add in any particular period, are not as clear cut as is ordinarily believed.

For example—now, I am certainly not advocating this, and I do not want it to be implied that I am—but just to give you sort of a distinction, we could think up a number of automatic fiscal policy measures which would not be discretionary, and these would then automatically be included with unemployment insurance among the so-called automatic stabilizers. Hence when one views the question of fiscal stimulus, I do not think it is appropriate merely to concentrate entirely upon the new actions without looking at the overall context of the effect of the budget upon the economy. In this respect, I think it does not make all that much difference. Whether in fact you are getting your stimulus from a specific new tax cut, or whether you are getting it as a consequence, for example, of previous legislation that has been embodied into the fiscal process from an economic point of view. So that I want to indicate that I would not rule out the fiscal stimulus which has automatically been entered into the system by the actions of other policies that have been built into the law itself. I might add the very important one, the most recent, is the extraordinary increase in unemployment compensation and the public jobs program, which is obviously contracyclical.

Chairman HUMPHREY. Well, I must say——

Senator SPARKMAN. May I break in right there?

Chairman HUMPHREY. Sure.

Senator SPARKMAN. Because I am going to have to leave. The President has asked some of us to come down and talk turkey with him, and I want to ask just a very brief question. I noted with interest your statement with reference to housing. You say that you expect the housing to approach a range of 1.6 million to 1.7 million in the fourth quarter of 1975. Is that an annual basis?

Mr. GREENSPAN. Yes, sir.

Senator SPARKMAN. As compared to a rate of about 1 million units at the end of last year.

Now, one thing that has disturbed me all along has been the terrific lag in housing. I cannot think of anything that can do more to the cause of production, using up unemployment—I mean, remedying to a big extent unemployment—than housing. Should there not be some plan in our program that would stimulate housing, could stimulate it? Goodness knows, it has been a sick industry now for a couple of years, and if we could have something that would get it back up to normal—1.6 million is a million shy of what it ought to be—we ought to be building, I think, all of the plans that we had in legislation, we ought to be building about 2.6 million units a year.

Mr. GREENSPAN. Senator, first of all——

Senator SPARKMAN. And by the way, the lowering interest rates have been coming down quite pleasantly, have they not?

Mr. GREENSPAN. Yes they have, sir.

Senator SPARKMAN. Do you think that trend is going to continue, or at least we will have normal interest rates?

Mr. GREENSPAN. Well, one of the reasons why we are concerned about the size of the deficit, and very heavy Treasury financing, and why we are so concerned about keeping it down, is precisely to avoid the problem of excessive Treasury borrowings crowding out the mortgage market itself, which would be the worst of all possible policies directed towards housing per se. We have gone over a large number of elements which affect the level of homebuilding in our economy, but when you wipe away the many things which have very little effect, what stares you in the face is interest rates. There is nothing that I can conceive of which would do more to raise the level of housing than for mortgage rates, and interest rates to come down and to stay down.

Now, it is very easy, as the Chairman of the Federal Reserve has indicated on many occasions, to push short-term interest rates down temporarily. But what we need is not a temporary decline in interest rates, one which gives us sort of a state of temporary expectation of improvement. What we need is an underlying financial condition which gets interest rates down and keeps them down, and the only way to do that is to defuse the inflationary pressures which are so destabilizing to our economy.

As far as I am concerned, the most important thing that will contribute to a recovery in housing—and I certainly subscribe to your comments with respect to how important housing is to employment and other elements in our economy. Senator—the most important thing by far is to get interest rates down. And I might say to you that, if we fail in that, then I would say all of the other ad hoc programs which we could concoct—and we can concoct many—really would not do the job. If I may just say parenthetically, even though

we are projecting 1.6 million to 1.7 million starts by the fourth quarter of this year, our projection does imply further increases in 1976.

Senator SPARKMAN. I am sorry to go. I will read your full testimony. I could not argue with you if I wanted to on your testimony. Thank you very much.

Chairman HUMPHREY. Mr. Greenspan, I just wanted to complete the matter on fiscal stimulus which we set aside to accommodate Senator Sparkman. By the way, your argument that you made on the matter of fiscal stimulus, and the so-called automatic stabilizers in our budget and in our tax structure, I could not disagree with. In fact, I think you made my point. What I was saying was that the President is recommending a tax cut of about $12 billion, and yet there will be at the same time, in the budget, social security and other transfer payments are cut back from $7 billion to $8 billion.

Now, these are automatic stabilizers, and what you are doing in the budget is removing or cutting back social security, and thereby removing an automatic stabilizer. And I have to also say that the automatic stabilizers have not been working too well, insofar as the tax structure is concerned, because incomes have gone up; that is, gross incomes have gone up. But because of the inflation factor, the purchasing power has been lowered, but the tax take has still gone up. I mean, you tax on the basis of your income, of course, your net income; and the net income was not affected particularly by how much you pay for food and what have you. That is not a deductible item, you understand, and I am sure we all do.

So I am concerned that what we see here is kind of a Mexican bean game over here on the one side, where you have got a $12 billion tax rebate, but built right into the budget for exactly the same year was a $7 billion to $8 billion reduction in transfer payments. And at the same time, the take on the workers is going up and up and up, because of whatever wage increase they get. That puts them in a new tax bracket, and this is particularly important for middle-income people.

Now, I noticed in the budget of the United States—and I do not think you have it; maybe you do have a copy of it there—on page 59, the table on that page shows the net effect of all enacted or proposed changes in tax laws since January 1, 1973. The net effect in fiscal 1975 that is occurring here is only $700 million. In fiscal 1976, it is $500 million. Now, I do not think there is much stimulus there. That does not provide you—that is not even a good peppermint lifesaver, as far as pickup is concerned.

Then you come down here, on page 24 in your own economic report, which shows the following amount of stimulus the second quarter of 1975—$2.1 billion. The third quarter, $11.4 billion; the fourth quarter, $4.8 billion. Federal budget receipts and expenditures associated with stimulus in energy programs, national income account basis for 1975–76. Quite frankly, I do not see there that the transfer payments that we are talking about, the reduction in transfer payments. Does that table include the restrictive impact of the limitation on social security and other transfer payments?

Mr. GREENSPAN. The table on page 24 of the economic report includes only those expenditures and receipts that would result from the President's fiscal and energy program, Mr. Chairman.

Chairman HUMPHREY. It does not include it. So you see, then, the economic report which shows in the second quarter $2.1 billion stimulus would have to be offset by what is the reduction in transfer payments, such as social security reductions. And the same thing would be true of the third quarter and the fourth quarter.

Mr. GREENSPAN. No, it does not.

Chairman HUMPHREY. All right.

Then why, therefore, do you put so much of the stimulus in the third quarter? Why not try to get at it a little bit sooner? Why do we have to use the stimulus remedy so late in the game, when the unemployment rates are so high?

Mr. GREENSPAN. Let me answer that question first, and then go back to the far more broad question which you are raising, which I think really is the brunt of where much of the disagreement is about the nature of——

Chairman HUMPHREY. Just a little louder, please.

Mr. GREENSPAN. I am sorry.

Let me preface my remarks by discussing the whole concept of stimulus, and why we came out the way we did, and then perhaps confront the very specific questions.

Chairman HUMPHREY. Well, just to get the economic facts correct, now.

Mr. GREENSPAN. I think what I would like to do, Mr. Chairman, is to, rather than get to the specific numbers, which I think are quite important, I would like to try to set up a context. I think that the basic disagreement really rests upon a much more fundamental question of the nature of stimulus itself, and the extent to which it will affect the economy.

As I indicated in my remarks, we have been essentially presuming that the more stimulus that we create, in dollar terms—let us just say by increasing the Federal deficit, and for the moment leave out whether it is coming from the tax side, or whether it is coming from the expenditure side—the greater will be the increase in the physical volume of GNP, the greater the level of employment, and the lower the level of unemployment. Now, I think that we are taking an oversimplistic view when we presume that there is no limit to this. Now, obviously, I think we all agree that there is, and let me just take an extreme case.

It is fairly obvious that if we were to create a huge budget deficit far beyond what is in the President's budget—there will be some extraordinary impacts upon the financial markets. Essentially the U.S. Treasury, because of its preferred borrowing capability would eventually crowd out of the capital markets all private borrowers, or a substantial proportion of them; or, far more importantly, the marginal borrowers, which are usually the mortgage borrowers themeslves. Under those conditions you have a tendency for those people, who are unable to borrow at anything but exorbitant interest rates in capital markets, to attempt to move to their banks to get accommodation. And then, this means that the banks, in attempting to meet the loan demands of their customers, try to get additional reserves from the Federal Reserve.

Now, if the Federal Reserve does not supply those reserves, then, in effect, that credit is not available. The housing market goes into a

severe crunch. The least credit-worthy people, largely small and marginal business, is not able to obtain financing, and we have severe difficulties in the business sector. As a consequence, almost invariably, we have the Federal Reserve attempting to finance these types of demands, at least in part, and past history suggests that this will inevitably create a situation in which the money supply increases inordinately during such periods.

Now, under present circumstances that would not lead immediately to inflation, because, as Chairman Burns has said on recent occasions, what happens is that you flood the market with money, but because confidence is not there, no one is using it. As a consequence, it is only when the economy turns around that that latent liquidity tends to become extremely inflationary. And I think we have seen that exact sequence of events now in this country; and in fact, abroad, in many countries around the world.

Now, clearly, it serves our Nation poorly if we, in an attempt to resolve current problems, merely displace them or postpone them into the longer term or into some not so distant future. Now, I do not find that inflation per se is something which is wrong just because it causes the price indexes to go up. The real, basic problem of inflation is that it creates huge distortions in the economy, and that in itself, as we have recently seen, is a very fundamental cause of both the huge disruption in the economy, and the tremendous rise in unemployment. In fact, it is my view that unless and until we are able to defuse the underlying inflationary forces that exist in our economy, we will not be able to maintain, over a longrun, a stable and low level of unemployment. In other words, we would be constantly fighting this type of stagflation, which in fact has very grave consequences for the level of employment.

Now, even though I might add we are forecasting unemployment levels which we consider quite high, they are not our goals. We would certainly hope to reduce them much further and much more rapidly. But I think we must recognize at this stage that our policies do not get us inadvertently hung up in excessive stimulus, which would then turn out to be counterproductive in its effects on employment. The policies that we have proposed attempt to find our way between these two dangers—and reasonable men could come to reasonably different judgments as to what the risks and the benefits are. It is our judgment that under our proposed programs the $52 billion deficit, plus off-budget financing of approximately $10 billion, puts us in the process of placing sufficient pressure on the financial markets that we can no longer be sure that significant additional stimulus will in and of itself provide a substantial and sustainable reduction in unemployment, over the longrun. And it is this basic problem with which we are confronted.

Now, to come very specifically to the numbers which you mentioned earlier—in fact, we looked and the President, in his evaluation, was looking at the expenditure side of the budget as a different element in the fiscal picture than the tax side. As the President has said on numerous occasions, if the underlying long-term rise on the expenditure side does not slow down, it will lead this country in a direction which I think none of us wish it to go. As a consequence, the actions which the President has taken on the expenditure side of the budget

are essentially longer term policy actions, which attempt to bring down the rate of long-term thrust in Federal outlays, so that they stabilize relative to the basic GNP accounts.

As a consequence of this, the President has chosen to look on the question of fiscal stimulus wholly on the tax side. And, as a consequence, we are looking at two different things. Now, as you know, Mr. Chairman, it is possible to generate pretty much all of the stimulus one needs and should have. In fact, there are reasons why it should be done on the tax side. At least, the tax side is the most effective way to get what stimulus we can.

Now, after evaluating what was on the expenditure side of the budget, including the effects of the rises in unemployment insurance and public service employment and the like, the choice was then made as to what size of tax cut would be appropriate; to confront very much the issue you raise, Mr. Chairman; namely, the effect that the automatic stabilizers are not working, because of the inflationary effect. And the President chose to come out with a tax package, which he did.

Chairman HUMPHREY. I will come back to you because there are other members here. I just want to say the facts are still there. The emphasis has been upon the economic stimulus of the tax cut as has been projected to the public. I think it ought to be clear that that tax cut has been severely limited by the reduction in transfer payments, particularly in social security, which has, by the way, social consequences as well as economic.

Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman.

Mr. Greenspan, I am deeply concerned about what seems to me to be an arbitrary figure that has been chosen by Secretary Kissinger on trying to cut down on the importation of oil of 1 million barrels a day in 1975, 2 million by the end of 1977. That is a nice, round number, but I do not believe that enough consideration has been given to the economic impact that that would have in trying to recover from the recession and what it would do in contributing to inflation.

And as I look at how meaningful it might be from the other side, I look at the Middle East countries having been able to accept an 8 million barrel a day reduction in the use of oil and still hold it at that price because you have countries such as Saudi Arabia who do not have the great demands of a large population who are able to cut back on production, and some of them would just as soon keep that oil in the ground for a substantial period of time.

Now, it seems to me that the cost-benefit ratio is not an acceptable one and that we should be trying to do—no one argues that we should cut down on the dependence on Middle East oil. I was making those speeches 5 years ago, and no one was paying any attention.

But it looks as though we have had an overreaction here, that we are trying to do too much of it in too short a period of time, and that we ought to be able to do it more on a gradual basis, on a long-term basis without having the kind of impact on the economy that I am concerned that this will have.

Now, when I look at the balance of trade, we had somewhere between $3 and $4 billion in deficit. That is not a pleasant one, but it is not a crisis-type imbalance, and the real serious major problem this

Nation faces today is trying to turn this economy around and get people back to work.

Would you comment on this?

Mr. GREENSPAN. Certainly. Senator, I think that unfortunately we are confronted with three problems, the inflation and unemployment problem—which I consider linked in the sense that they are interrelated, and because the elements are interrelated. The energy problem actually is not. It is caused by the fact that the United States ran out of excess capacity in the Texas gulf area, so far as crude was concerned, somewhere around 1970, which meant that we became vulnerable to arbitrary cutoffs of supply.

In effect, as I have said elsewhere on numerous occasions, the United States essentially controlled the level of supply throughout the world because it had this capability of supplying really at a moment's notice substantial amounts of crude oil, in the event of shutdowns of Middle East productions. It occurred during the 1967 war, and it occurred during the Suez crisis, and when they nationalized the oil fields.

Senator BENTSEN. Do I understand that you are saying that the United States can materially increase its production overnight?

Mr. GREENSPAN. We had the capability of excess supplies, and we drained our inventories and exported significant amounts of crude oil during those particular periods, and then we had the sources of oil, which we ran out of really about 1970.

Senator BENTSEN. Well, I would agree. We have our wells running open, for example, in Texas, at the maximum efficient production rate now, and we are on the decline.

Mr. GREENSPAN. But they were not, say——

Senator BENTSEN. No, the situation has materially changed.

Mr. GREENSPAN. Exactly, I think that is a fundamental change. I do not think we are as acutely aware of it as we should be because I think that effectively shifted the marginal pricing mechanism in world oil from the Texas Gulf to the Persian Gulf, and I think the consequences have been just extraordinary.

But to come more particularly to the basic question you raised, I think that many—and yourself included—have seen this problem emerging because the mere arithmetic of what was in the process of occurring and our dependence on Middle East crude oil is just something that everybody knew about who took a pencil to paper.

We have waited, I think, too long to really look closely at this problem, and there is no program that I know of which will not make this country vulnerable to an increasing extent to a foreign embargo during a period over the next several years, until perhaps the early 1980's.

Now, what the President's program attempts—and I should emphasize this because I think it is often misspecified—is to reduce consumption of oil in such a manner that imports, as the residual source of our needs, will decline.

Now, the particular program which has been constructed has been constructed to suppress the rise in consumption of oil, and what falls out of that analysis is a 1-million-barrel-a-day reduction in imports and 2 million at the end of 1975, and 2 million at the end of 1977.

Senator BENTSEN. Do you feel like that 1 million is an economic figure or a diplomatic figure? Is it used to impress the countries in the Middle East and our allies?

Mr. GREENSPAN. No, I think I would emphasize that it is both, and let me see if I can come to both sides of this issue.

In the first instance, we are attempting to reduce the normal level of consumption in this country, so that our vulnerability to a shutdown or embargo does not increase.

Senator BENTSEN. Mr. Greenspan, no one argues that. I think we are all in agreement, what we are trying to do is see if we reacted too fast.

Mr. GREENSPAN. I am sorry, I was taking a little more time than I should, but I think I would like to try to explain this in as full detail as I can.

You cannot get abrupt declines in consumption because consumption is slowed down, not so much by merely stopping gasoline or stopping people from driving things. Major uses of energy, like increasing insulation of homes, changing industrial processes by which fuel is used, changing utilities from oil to coal—these are very slow and difficult to accomplish. We have got to do it in a very gradual manner. We cannot do it abruptly.

Now, what we observe is a period in which the United States is exceptionally vulnerable. We were exceptionally vulnerable in the late 1970's, and that unless we start now in moving in that direction to reduce our consumption and our vulnerability, we are going to be under extreme pressure later on. If we do not get down to 1 million barrels a day in the short run and 2 million barrels, we will be off track. The 1 million barrels a day is essential to get on that track, and since we are doing it in a manner in which the moneys which are withdrawn from the system because of the lower consumption are rebated, our view is that the economic dislocation is really quite minimal.

I am sorry for that very long answer, but——

Senator BENTSEN. I think it is very much an overreaction, and I feel that it will not have had much of an impact on the Middle East countries. I think it will have a very serious impact on the recovery from the recession and add to the inflation, which is also a concern to us.

One more question—and I know other members are waiting—we were speaking about the formation of capital and how difficult it is going to be for business to create the jobs and to build the factories that are necessary, and the competition of the Government for those funds.

Now, I had Secretary Simon, your predecessor, before my Economic Growth subcommittee of the Joint Economic Committee as long as 8 months ago, and they were speaking of that same concern and sharing it with me, and advised me then that President Nixon had commissioned a study of long-term capital requirements of this country and that that would be a responsibility of the CEA.

Now, is that report now available?

Mr. GREENSPAN. No, sir, we have had to delay that report and the work on it because of the fact that with the change in the priorities that occurred with respect to economic policy, we were unable to find

adequate resources to get to that. That, however, is one of the very early things we want to get to because we think that is a terribly important problem confronting this country in the long run.

Senator BENTSEN. When can we anticipate that report?

Mr. GREENSPAN. I do not know when the original anticipation was. As I understand it, the original objective was to complete the study by the end of last year, and perhaps to include it in this Economic Report. We were unable to meet that schedule, considering the other events that were going on.

Senator BENTSEN. Thank you very much, Mr. Chairman.

Chairman HUMPHREY. Thank you.

Senator Javits, thank you for your patience here.

Senator JAVITS. Mr. Greenspan, I notice that you predict a very precipitous drop in inflation. In your statement you say that the annual rate of price increase will taper off considerably to approximately 7 percent by late 1975, and the assumptions in the President's budget, which I assume you are familiar with, say that the consumer price index assumed for the purpose of budget estimates goes up 11.3 percent in 1975 and drops to 7.8 percent in 1976.

Now, first, how do you account for so precipitous a drop; and, secondly, what are its economic consequences as they may affect our decisions on the President's budget?

Mr. GREENSPAN. Are you asking for a reconciliation of those?

Senator JAVITS. I am not challenging your estimates. That is your opinion. But it does sound quite inconsistent, but if you wish to explain it, fine.

Mr. GREENSPAN. I think I should, Senator.

Senator JAVITS. I am trying to get at the substance of it.

Mr. GREENSPAN. Yes. Now what happens, is, the 11.3 percent and the 7.8 percent are the increases in the average level of prices during 1 year over the previous year.

However, by December 1974, the price index was already 5.2 percent above the average for 1974 as a whole. In fact, excluding our energy estimates—which I will get to in a moment—our projections imply a little bit more than a 7-percent average increase in prices between December of 1974 and December of 1975. If you just add up those numbers, tacking on about a little under 1½ percent for our energy the level for 1975 is a little over 11 percent over the previous year.

But what I am saying is that almost one-half of that change has already occurred, Senator.

Senator JAVITS. Nevertheless, the staff points out that according to your figure all of 1976, 7.8 percent will be rising more rapidly than your prediction for late 1975 at 7 percent.

Mr. GREENSPAN. No, actually that is not the case. That is another statistical peculiarity.

Our estimate from December 1975 to December 1976 is roughly for a 7-percent rate of increase and, incidentally, this is wholly consistent with that 11.3 and 7.8.

Senator JAVITS. Well, now, again I say I was more interested in the substance than how you got at it, but here is a precipitous drop of about a third. Now, what are the implications—we ought to glean from that—in terms of economic policy? That is a very sharp drop.

It is sharper than anything in your whole setup here, except perhaps the rise from 1973 to 1974.

Mr. GREENSPAN. Well, a good deal of that is already underway, Senator, as is especially evident in the signs of softening in the structure of industrial prices. We should also recognize that the official published wholesale price indexes are in many areas the actual listed prices for a number of products and they do not fully pick up the discounts. Now, we have additional evidence beyond those numbers which have been published, which suggests that the rate of inflation in the industrial sector, has indeed improved quite measurably in the very recent period.

We are also observing, as you know, some fairly hopeful signs on the food price side. Agricultural prices have not been strong. In fact, quite contrary to our own expectations in recent months, they have been down quite significantly, and I think it is just a matter of time before that is reflected in lower rates of food-price increase. I think the earlier expectations of fairly substantial increases in food prices in the first half of this year are out of line with what has occurred in the farm commodity markets.

Senator JAVITS. Now, what would you say, in view of these figures, that in 1976, we will be facing only one difficulty, to wit, unemployment, and that the inflationary situation would have been brought under control?

Mr. GREENSPAN. No, I would not, and I would say this because of the fact that a good part of the price weakness is reflective of the recession. I do not think you can say that we have successfully curbed inflation until we get it well under 7-percent inflation rate, with circumstances that would enable that lower rate to continue during periods of prosperity—as it was, Senator, back in the 1960's.

So while I am comforted by our expectations of a good deal lower inflation rate, the real test of how successful we have been is going to be when we can keep inflation down during a period of economic expansion.

Senator JAVITS. Now, to me, the most alarming figure of all of our figures has been the diminution in the rate of growth, which you show at a high of 3.3 percent in 1975 and which I understand to be the worst figure in four decades. Now, does that not dictate on a broad scale, a very intensive productivity drive on the highest patriotic as well as economic basis, and why in your opinion has that not been launched by the administration, with so much notice?

Mr. GREENSPAN. I am sorry, you are talking about output per man-hour.

Senator JAVITS. Yes.

Mr. GREENSPAN. I think there is a commission in place, and productivity is certainly something which we think is very important. We are focusing on it and the mechanisms by which to improve that are related to this whole question of capital facilities and the like, and I think it is a terribly important issue.

Senator JAVITS. Well, Mr. Greenspan, let me tell you as one Senator, that that Productivity Commission is the biggest bust and the worst sham that ever was. They are very decent people. They are trying hard, but to swing a $1,350 billion economy, they have got $1½ million or maybe $2½ million. It is utterly ridiculous.

and in addition the President has not paid the remotest bit of attention to the fact that workers and management and public are champing at the bit to give productivity a boost on the local level.

We did it in World War II. This President and the preceding President have been asked to do it 20 times by me, by Senator Humphrey, by Senator Percy, by everybody else. Not a thing has been done. How can you explain it in terms of service for the country? You fellows are still studying. You have got a Commission. It has got no power, no resources, no program, nothing.

How can you explain that? How can you justify it to the American people, and then present them with this budget and say, we are down by over $50 billion?

Mr. GREENSPAN. Well, first of all I think we have to distinguish between the short-term decline in economic activity and productivity. Productivity is something which is an important long-term determinant of the standard of living of the American people. We are all aware of the fact that our growth in standards of living ar very closely tied to the increase in output per man-hour, and I think the focus should be on finding means to improve the rate of growth and the rate of efficiency in our system.

I would not, however, say that that is something which is directly tied to the short-term problems, but I would certainly think it is a major priority, and I think it always should be at all times. In fact, private industry itself is functioning all the time, attempting to find means to improve efficiency and to improve productivity, and that is what it is all about.

Senator JAVITS. I am rather surprised, Mr. Greenspan, by your statement that this would have no short-range effect. Here the whole problem of inflation is essentially not so much that goods are not available, but that it is a shortfall in the confidence that people place in the future. That is based very heavily upon the productivity of the American machine, the industrial machine. its decline in productivity and the fact therefore that the world is bearish instead of bullish on the United States. This is all in the brain.

So it is inconceivable to me that we have been so derelict in this regard. I am sorry to tax you this way. My time is up.

Thank you very much, Mr. Chairman.

Chairman HUMPHREY. Let me just underscore what Senator Javits has said. He has been a leader in this fight to get something going on this productivity matter. He has outlined it again and again with administration witnesses about what we did in the war periods, the local productivity councils, and you have complete congressional support. But, you know, Congressman can run around to the different factories and say, "Boys, we ought to produce more," but it takes more than that.

I hope you will take seriously what Senator Javits has said because we all join in it.

We would like to ask you, Mr. Greenspan, to take this message back to the administration, to the proper authorities and let us get with it. You know, there is a sense of urgency here.

Congressman Long.

Representative LONG. Mr. Greenspan, I primarily want to explore this question of the cost to the energy program that the President is advocating.

But before I do that, I agree with your statement where you say the most pressing concern of economic policy is to halt the decline in production and employment so that a substantial growth of output can resume. I certainly agree with that.

So far, though, you say in 1975 production and employment have experienced sharp declines while unemployment has risen markedly. You are talking about calendar year 1975. I have not seen any figures on calendar year 1975. The last figures I saw, particularly on unemployment —and maybe you have knowledge available that I do not—were for the fourth quarter of 1974. I have not seen any figures for 1975. I thought they were due in the next 2 or 3 days.

Mr. GREENSPAN. The official figure will be released I believe tomorrow. However, we have a great deal of information on a weekly basis.

Assured unemployment data shows a marked deterioration since the unemployment report that was issued for the month of December.

We also have a good deal of data on weekly production of a number of different things, so that even though we do not have any of the official monthly statistics for the month of January, we do have a considerable amount of weekly data. We do have access to fragmentary evidence of a qualitative nature from which we attempt to get a qualitative feel of what is going on before the data themselves are available.

Representative LONG. It would be your prediction that the report on unemployment figures which is due tomorrow is going to show a continuing increase in the unemployment rate?

Mr. GREENSPAN. Yes, sir.

Representative LONG. Going back to this question of the cost of the President's energy program and the varying estimates as to what the cost of this would be whether you are dealing in dollar figures, or whether you are dealing in precentage figures, there has been a great deal of disparity as to what effect this is going to have on the economy. The people in Chase Manhattan say, for example, that it is going to run perhaps 2.8 which is nearly 50 percent higher than what the administration is predicting, which is very substantial. The fact is, they even went so far as, if I recall correctly, to say that it was going to have such a detrimental effect upon the economic recovery of the Nation that perhaps we ought not to have any energy program at all.

Now, while I do not share that view, I think we do, I do think as has been voiced here and as is voiced by Chase Manhattan and others that it is really going to have a very substantial and serious effect upon it.

Now, the administration, as I understand it, estimates that the proposed taxes that we have and the higher prices of energy both combine to really add about 2 percentage points to the overall rate of inflation.

Is that correct?

Mr. GREENSPAN. Slightly more.

Representative LONG. How much more than that?

Mr. GREENSPAN. The reason I hesitate for a minute, I am thinking of 2.1 percent, perhaps 2.2 percent.

Representative LONG. But you are also saying, as I understand it, that this is both over 1975 and 1976, is that correct?

Mr. GREENSPAN. That is correct. Yes.

Representative LONG. And as I said others run much higher than that. I guess the highest one that I have looked at was the former chief of the Price Division of the Bureau of Labor Statistics, Mr. Plotkin, who says 3.5 during that period. Someone else had said about 3 percent, if I recall correctly.

But it seemed to me as though all of the figures have been consistently higher than what the administration has been saying these figures will be. The Library of Congress, as Senator Humphrey points out, is one of the ones that says it will be substantially higher.

Mr. GREENSPAN. Let me just suggest possible one problem that has emerged.

The Council on Wage and Price Stability had a very elaborate outside study done on the price effects of this program. The estimated effect was higher than ours, but when we looked at the underlying assumptions it turned out that the $2 a barrel in the program for crude and import fees figure was incorrectly specified in the program. That study has now been redone for the Council on Wage and Price Stability, and it estimates effects which are very close to ours.

Representative LONG. Who did that study, Mr. Greenspan?

Mr. GREENSPAN. I would much prefer to let the Council on Wage and Price Stability discuss it because it is their basic study.

Representative LONG. We could inquire of them as to who did the study and whether or not a copy of it might be available rather than coming through you.

Mr. GREENSPAN. I believe a copy will be made available to you if you request it.

Representative LONG. Fine. We would appreciate having it.

In addition to the built-in increases under the President's program with respect to this whole energy problem, I think that it is fairly well recognized that there is going to be an increase in the price of intrastate gas. There is also going to be probably an increase over and above that imposed by the program in coal, and it seems as though there will from the evidence that I have.

Have you included that in your estimates in your 2.1 percent figure, in coming up with your 2.1 figure that these price increases will be a part of it?

Mr. GREENSPAN. I think the answer is yes.

I'm sorry, did you say coal?

Representative LONG. I would think if we are going to, let us say, for example, we had it under consideration in Congress last year, and I think coming back soon now is the strip coal mining bill. There is no question but what the resolution of this problem between disturbing the energy and taking it out is going to raise the price to some degree.

Mr. GREENSPAN. Let me say this. The 2 percent slightly plus includes the natural gas. It does not include coal. But we did analyze the impact on coal prices of the higher price of crude oil. Largely because of the fact that a substantial proportion of these coal contracts—I believe the number is 8 percent—are under significant long-term contracts, and the escalators in these contracts are essentially cost determined escalators and not competing fuel escalators, we came to the general conclusion that the net impact of our energy program on the price of coal will be quite small.

There are other estimates, and I think you will find one in the Council on Wage and Price Stability study, which suggests that the coal price effect is quite significant. We disagree with that because we think that looking at the details of——

Representative LONG. That might be a part of what the difference between the 2.1 percent that you are projecting as to the economic impact, or at least a substantial part of it might be the 2.1 percent that you are projecting and what pretty darn near everybody else is projecting.

Mr. GREENSPAN. No. I think there is another element involved.

One of the elements is called the ripple effect; namely, the extent to which once you initiate a series of price increases in a system you generate a sequence of events which will affect wages which in turn will affect prices, which in turn will affect wages. It is through such a sequence of events that the original price effect is multiplied by further effects upon wages and profits as it passes through the system.

Representative LONG. I am familiar with the ripple effect. I have about decided they ought to stop calling it a ripple effect, and call it a tidal wave effect, particularly when it relates to the basic energy problem.

Mr. GREENSPAN. We have looked at that in some detail, and especially in the context of the period during the time of the embargo and immediately thereafter, when we had a very significant rise in oil prices. We found it very difficult to make a case for any significant ripple effect. In fact, one element of this ripple effect is the presumption that profit margins are supposed to rise, or at least hold stable, during the period in which these prices take hold. The increase in oil and gas prices, in and of themselves, is supposed to generate a further increase in the general level of prices.

We looked at the figures after the embargo, and we concluded that, excluding the profits of the oil companies the profits and profit margins went down quite significantly, and this suggested that there was very considerable difficulty in passing through the whole system the full effect of the price increase. In that sense, the ripple was a negative ripple and not a positive ripple—so that we concluded, after looking at our numbers in some considerable detail, that this process is something which is unlikely to occur at this time.

Representative LONG. Yes. I have used my time. Thank you, Mr. Greenspan.

Chairman HUMPHREY. Thank you, Mr. Greenspan.

Congresswoman Heckler.

Representative HECKLER. Thank you, Mr. Chairman.

Mr. Greenspan, I have for some time enjoyed your articles which always contain a wealth of information. But today I am much more concerned with the issues as they relate to Main Street in my district. So, rather than exploring the theoretical implications of an issue, I would like to have you suggest responses for me to questions commonly asked.

To begin with, the issue of the new phenomenon in advertising merchandise, which is designed to lure the customer to purchase—and I hope it works—known as the cash rebate. For example, we see cash rebates offered in auto advertising. In probing beyond that policy, I have been told that the purpose of the cash rebate is really to keep the list price at its present high, and provide an incentive for new sales, at the same time protecting business. In some cases, businesses that felt they were injured by the earlier wage and price control program, protecting business by having the high list price as the potential basis for a wage and price control program to be enacted in the future.

Now, there is a great deal of uncertainty in the business sector as to whether or not a wage and price control program will actually be our next resort. I would like to know what your attitude would be toward this program, toward such a proposal—or the administration attitude might be at this time; whether or not you have any contingency plans along these lines, and also whether or not the subterfuge of having a high list price combined with a cash rebate would actually work in terms of a controlled program. Would the controlled price be the list price, or would it be discounted by the amount of a cash rebate, or some portion of it?

Mr. GREENSPAN. Let me answer your last question first. The President has stated on numerous occasions, unequivocally, that wage and price controls are not the answer to our problems, and that he has no intention whatsoever of moving in that direction. It is very difficult to know, and to be able to suggest, what particular reasons certain business practices are used for. I do not know firsthand. But I am going to tell you what my secondhand interpretation is.

There is a difference, incidentally, between a cash rebate and a reduction in a particular list price; and I think it has to do largely with the question of who finances inventories in the distributor channels. My understanding is that the producer is required to finance a list price cut, whereas if it is a strict rebate, what happens is that the inventories are financed largely by those who own them—the distributors—rather than across the board.

I think the cash rebate in itself, which is effectively, of course, a discount, suggests that the market is working and that the market pressures are beginning to create price weakness and obviously, it is the equivalent of a price cut. And as I understand it, the Bureau of Labor Statistics, in endeavoring to estimate what the actual prices are and to embody these rebates in the price indexes, so that they truly reflected actual prices paid.

It is conceivable to me, although I have no evidence, that the other motive which you suggest may be relevant. But I have no knowledge of that, and I think that in view of what the President has said, and in terms of my own judgment if that is what they are doing, it is a futile exercise.

Representative HECKLER. Mr. Greenspan, in terms of housing projections in your statement, you have given us some good news, in that you foresee an increase in housing starts. But Paul McCracken told this committee that the Treasury borrowing requirements are now large enough so that their impact on financing the private sector must be faced quite explicitly. In view of the strong corporate demand for financing and record budget deficits, what would your prediction be for interest rates, for the short term and for the long term; how high will they go? And if interest rates do increase, how can you meet the housing start predictions that you have offered?

Mr. GREENSPAN. Well, Mrs. Heckler, I did deal with that question on an earlier issue. If in effect the Treasury is required to finance significantly debt than is implicit in the budget at this stage, including off-budget financing requirements, then I think we do run the risk of engendering upward pressure on long-term interest rates. And that would certainly be detrimental to recovery in housing. While there may be some financial strains in financing the deficit as presently projected, we see no real difficulties and no real evidence that this would produce a sharp increase in interest rates in the short run.

We continue to believe that long-term interest rates will probably continue to ease. The major uncertainty with respect to interest rates is the recovery that we project during the second half of this year. And the effects of the recovery upon interest rates are very difficult to forecast at this stage. But we hope that interest rates will remain at levels which will enable flows of funds into savings and loans to continue at a very good rate, so that the effect on the mortgage market would not be sufficient to choke off the recovery in housing.

Representative HECKLER. So that I might be able to have a little bit more precise understanding of your terminology, would you define the short run and the long run for me?

Mr. GREENSPAN. I was referring to short-term interest rates, as meaning interest rates with maturities of less than 1 year, and longer rates as meaning interest rates in excess of 5 years maturity.

Representative HECKLER. Then you are saying that you would not predict interest rates to increase within this year?

Mr. GREENSPAN. No. I am sorry; I am trying to make the distinction between short-term rates being instruments which mature in a very short period of time, and longer term maturities. What I am basically saying is that I expect that long-term interest rates—that is, those which mature in 5 years or more—probably will decline in the period immediately ahead. That will depend to a very substantial extent on the total financing requirements of the private sector, and the Treasury—as well as the degree and the extent to which inflationary pressures continue to subside. If inflation subsides faster than we are projecting, we may turn out with a much better interest rate picture than we are now envisaging.

Representative HECKLER. Obviously, all Members of Congress are concerned with both inflation and recession. But I have to confess that, coming from a State in which the last published figure on our unemployment rate was 9.9 percent, and the rate of increase is at 1 percent a month in Massachusetts, my greatest stress is coming to the question of recession and unemployment. Now, since I had another

committee meeting earlier, and had to be in two places at once, as I came in today, I think I heard you respond to someone else's question along the lines that you did not feel that the administration had found the right stimulus to deal with the growing unemployment.

Now, perhaps that is a misconstruction of your statement. But my concern is, how long do you expect the recession to continue? How long will we face the growing unemployment rate? What particular stimuli would be effective in dealing with it? I do not think that the American people can quite wait until 1976 to face the question of unemployment.

Mr. GREENSPAN. Well first, I do not recall saying that we had not found the appropriate stimulus. What I was trying to suggest is that in deciding what the appropriate amount of stimulus is we have to balance the rate of increase in physical production and employment against the risk of going so far that the stimulus becomes counterproductive both for employment and inflation. That is a very difficult judgment to make. Our judgment is that the President's program strikes a good balance between these two factors.

Now I might add that there has been some discussion of the types of unemployment figures which we have projected. These are not levels of unemployment that we are planning on.

We hope to confront the joint problem of inflation and unemployment and to improve the conditions that underlie each of these problems as quickly and as efficaciously as possible.

It is difficult to know precisely how rapid that rate of improvement can be. In other words, to use the Chairman's analogy about the medical diagnosis with which he opened the hearing, we recognize the illness, we know the right direction or the correct prescription, and we know what we want to happen. But what we cannot say with any assurance, and I think no one can, is how much medicine should be prescribed, or how quick a recovery can safely be sought.

If the patient's temperature is supposed to go down as the disease essentially dissipates, it is not always easy to know in advance how fast it is going to go down, although you know that what you are doing will get it down. The most important thing is to be moving in the right direction.

But I think that we do ourselves a disservice if we adopt certain particular goals to be met at particular points in time if these goals are achievable only by policies that in and by themselves will create future problems of an even worse dimension. I do not think that is a sensible way to proceed. The projections in our Economic Report are largely those which we would expect to occur in the event that there is no significant improvement in the confidence, or no significant changes in a number of other things, which are very difficult to fit into our forecasting techniques.

Let me start again in this sense. Forecasting techniques can only be very approximate, and we are forced to add our judgment as to what is in the process of happening. But those are not our goals. Our goals are to do the best we can.

Representative HECKLER. My time has expired, but I would like to say, Mr. Greenspan, that I share the goals of the administration, but I would restate them to stress as my first priority fighting recession and unemployment, and second, fighting inflation.

Chairman HUMPHREY. Thank you very much Congresswoman Heckler.

Senator Proxmire, we are always glad to have you here. I feel better when you are here.

Senator PROXMIRE. Thank you, Hubert. I feel better being here, too. I also feel better with you in the Chair.

Mr. Greenspan, your report has been greeted as one which is very realistic and honest and straightforward, and I think those adjectives apply to it. However, I think that the really reliable forecasting is probably confined to the first 3 or 4 or 5 or 6 months. After that we get out pretty far.

We look at what has happened before and I would like to quote you, what was said in the Economic Report of the President on page 37.

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

One hundred percent wrong on every count, completely wrong.

Now I think that what that should do to us is not to indicate that you are going to be wrong this time, necessarily. But to be very cautious about any prediction you make after the first half of the year. You put a lot of reliance in your statement I notice on housing recovering to 1.6 to 1.7 million housing starts, annual rate, by the fourth quarter. It is quite a recovery. It is down below a million now, as we all know, and the consumer resumption of purchasing—I would like to challenge both of those, unless we have different policies than we have now.

As far as housing is concerned, we have a record over the last 2 years of almost no initiative in the area of government-assisted housing. This is the one area where the Federal government can have direct, positive, comprehensive, sure impact. Now, as you know, there has been a moratorium on government-assisted housing. There have been no new starts under the Government's section 8 program since it was made possible on August 8, so that first with respect to housing, let me ask you, do you base this confidence of recovery on what is going to happen perhaps in the conventional market on the basis of the lower interest rates, or is there likely to be a more vigorous Government-assisted housing program?

Mr. GREENSPAN. Senator, before you came in, I was answering Senator Sparkman's comments pretty much along this line, and basically our view is that interest rates are the major forces underlying the housing markets.

Senator PROXMIRE. That is in the conventional sector?

Mr. GREENSPAN. Yes, and our projection covers conventional starts. We are projecting lower mortgage rates, increased flows into the S & L's and a recovery in starts. I would also add that the really incredibly depressed present rates of starts is to a substantial extent a function of an overhang of unsold homes and a lot of units under construction.

Senator PROXMIRE. I understand that, but let me just point out to you that in the Government-assisted area, we have had a record in

1970–71, in that recession, where the Government, under Secretary Romney's pressure, moved ahead vigorously and provided stimulation for the whole economy, as well as housing for low-income people.

In this recession we have not had that done at all. I am not talking about the conventional area, the impact of interest rates. I am talking about what the Government can do if it has the force and will to do it, on something like the program that Congressman Reuss has proposed and that some of us are proposing in the Senate of a shallower subsidy, say down to a 6-percent-effective rate, so that those incomes of $10,000 to $16,000 who cannot afford to buy a home now could buy a home.

This would be a minimum cost to the taxpayer, compared to some of the other programs we have had in the past, and would result in a great deal of activity in the private sector.

Mr. GREENSPAN. I would not want to comment on the specific proposals.

Senator PROXMIRE. Why not?

Mr. GREENSPAN. I am not particularly knowledgeable on the particular aspects of the program itself, and I think that would be more to the point for HUD to comment on.

Senator PROXMIRE. I do not want to be unfair. HUD's position is negative on this. That is not their program. They want something that is likely to take longer.

Let me just ask you what the economic effect, if we did go ahead with the program, a more vigorous program, and got the 600,000 housing starts in the Government-assisted area, which is what the goals provided in the 1968 Housing Act, would that not have a desirable effect, not inflationary, because these resources are available and stimulative because there is heavy unemployment in the construction trades?

Mr. GREENSPAN. Well, Senator, first of all I think that requires an analysis of the extent to which any of these programs displace or fully add to the private starts. I think as you know there was a considerable amount of discussion on the effect of the 235, 236 programs.

Senator PROXMIRE. Well, you are bringing in a displacement when you realize that people with incomes of less than $15,000 today with 10-percent mortgage rates just cannot buy anything but a trailer, maybe. Maybe they can buy a used home, but if they are going to buy a new home, they have got to have assistance.

Mr. GREENSPAN. Let me say this. I honestly cannot say in advance what the displacement effects, if any, will be without looking at it, but I want to indicate the various elements which I think should be thought through. The displacement effect is over, and the second is that there are budgetary effects, both in the immediate and in the long term. I think that one of the major long-run problems which we confront is to try to cut down on the long-term commitments in the Federal budget. Many of these programs, while their initial costs are small, create substantial commitments against the budget in the years ahead.

So I think that also should be studied with respect to any impact.

Senator PROXMIRE. Well, let me just get into something else now. You do forecast an average unemployment rate of 8.1 percent for this coming year. Obviously that means the unemployment rate is going

to have to be substantially higher than that at some time during the year, the peak unemployment rate.

In view of the fact that it was 7.1 percent in December, it is likely to be maybe 7.5 percent in January. We hope it will be less than 8.1 percent in December, and so forth.

What is the peak unemployment rate that you expect?

Mr. GREENSPAN. Let me just say that the annual revision of the unemployment rate, which incorporates revised seasonal factors, which now places the December rate of unemployment at 7.2 percent.

I would not like to comment on the specific peaks involved, but obviously with an average rate of 8.1 percent there have got to be a number of months above that. We do expect, however, that the unemployment rate will be declining from its peaks at the end of the year.

Senator PROXMIRE. Let me try out some figures on you. Data Resources forecast projects a real GNP of 1975 within $2 billion of the Council's projections so that their production is about in the same area. They have projected a peak unemployment rate of 8.6 percent. Do you think that is about right?

Mr. GREENSPAN. Senator, I would just as soon not estimate that sort of number. All I will say is, obviously it has got to be above 8.1 percent.

Senator PROXMIRE. Well, you fellows have given us an average rate, and it seems to me that in order to understand that and evaluate it and appraise it, we should know roughly what your estimates are as to what it will be during the year, if we are going to have an intelligent economic policy.

Mr. GREENSPAN. If I were going to give you a rough number, I would say 8½ percent.

Senator PROXMIRE. 8½ percent. Now, one of the elements here that would help us greatly is to retard inflation because consumer confidence depends on a feeling that inflation is not going to get out of line. There are so many elements here that are likely to set off inflation, although you are quite optimistic about what is going to happen to prices after the middle of the year, pessimistic for the short run.

War in the Middle East, that many people think is likely—that certainly would be aggravating there. The wage-cost push that many people feel is likely to come on—and certainly a big increase in the wage cost. Crop failures—we have been awfully lucky in crops, by and large, a little bad luck last year to some extent, but it could be a lot worse.

The very large deficit may be a lot larger. Psychologically and for other reasons, it might lead to that.

So given that kind of situation it seems to me it is quite possible you could have a worse inflationary situation towards the end of the year. For that reason why does not the administration support what Arthur Burns is calling for, which is a very moderate degree of power on the part of the monitoring Wage-Price Board, so we can hold up wage and price increases, which are inflationary; take a look at them, give the President an opportunity to jawbone them, give the Congress an opportunity to act on them, without comprehensive wage-price controls, but give us some way of moderating inflation so that

the Federal Reserve Board could adapt a more generous and stimulative monetary policy without the fear that you are going to have aggravating inflation.

Mr. GREENSPAN. Well first, let me just say, Senator, while obviously the conditions which you indicate are possible—or your comments earlier about how far off any forecast can really be to which I fully subscribe—I do not foresee at this particular stage the same types of problems, either on wages or crops. Developments in these areas are looking better so that at this particular stage I do not believe that this is where our problem lies.

I do think, however—and the President has stated this on numerous occasions—that he sees no particular virtue in going in this direction.

Senator PROXMIRE. I am not suggesting comprehensive wage-price controls.

Mr. GREENSPAN. I understand that.

Senator PROXMIRE. Though the majority of people are for them, and the leadership is for it in the Senate and the House.

Mr. GREENSPAN. I realize that.

Senator PROXMIRE. I am just talking about a very modest, limited approach.

Mr. GREENSPAN. I realize that, Senator. Obviously many different viewpoints have been presented to the President. One of the areas that have clearly concerned many people is that if we start with policies that people perceive as a move towards a more rigid system of controls, then I think Mrs. Heckler's concern about anticipatory price and wage increases might emerge as a much more important factor and this would be very self-defeating.

But the far more fundamental question is that the President sees no virtue in the type of program which has been considered in this area.

Senator PROXMIRE. Well, my time is up. Thank you, Mr. Chairman.

Chairman HUMPHREY. Mr. Greenspan, I have got some questions, and I would like to keep our answers right down as close to them as we can. Let us just shorten up our reply.

I want to go back to the fiscal stimulus, because I repeat what I said earlier—the tax cut that is proposed and the reduction in transfer payments of anywhere from $7 billion to $8 billion leaves the fiscal stimulus at a very limited rate, if any at all.

Now taking the President's entire program, including the expenditure ceiling on social security, including also the increased costs of energy which are inevitable under the President's program—I mean the rates of increase on gasoline, on fuel oil, diesel fuel, all of these rates are very high in terms of percentage increases, and it includes taking a look at what might happen to the price of coal and natural gas, which are not considered in the so-called windfall tax reclaim. Can you honestly say to me that the administration's program really contains any effective stimulus at all? Yes or no.

Mr. GREENSPAN. Yes, and I merely indicate that on the national income accounts basis, Government expenditures are up 15 percent for this calendar year. That is a very substantial number.

Chairman HUMPHREY. How much is the inflation rate?

Mr. GREENSPAN. Significantly less than that.

Chairman HUMPHREY. About 2 percent less, 2 to 3 percent less?

Mr. GREENSPAN. Four percent less.

Chairman HUMPHREY. And much of the Government expenditures increase in that are in military, $8 billion net, which is a nonproductive expenditure, and another almost $1 billion in foreign assistance, $17 billion cut out of public works programs, highway production, highway construction, and $8 billion of that $17 billion—almost $9 billion of the $17 billion cut out of human resources programs, all of which goes directly to people.

Mr. GREENSPAN. By far the largest increase is in payments to individuals in calendar 1975.

Chairman HUMPHREY. Payments to individuals in 1975. There may be an increase in the payments, but not commensurate, sir, with the cost of living, and that is what we have got to talk about. What has happened to the people—you know, this is what bothers me. I do not see in this proposal of the budget and in your report, with all respect to its clarity and to its factual accuracies, any real program to do as Congresswoman Heckler said here, to wage war on unemployment.

Every time we start getting up the hill to wage war on unemployment, you look out on the horizon and run down the hill because you are afraid of inflation.

Mr. GREENSPAN. Senator, the reason we are afraid of inflation is because inflation itself in the longer run is the major contributor to unemployment in this country, and I think our focus on one and not the other is a mistake. We have to look at them both simultaneously.

Chairman HUMPHREY. That inflation has not been a demand inflation. There has been some inflation that has been on because of energy, and you add to that by the President's program. You do not reduce it.

Nobody denies that there is going to be an increase in the cost of living with the President's program on inflation. What you do say is there will be tax rebates, but to whom? Not necessarily to the very same people who use all of the product that is going to be touched by the cost of oil products, and when you say to me that there is no ripple effect, no ascertainable ripple effect on account of these increases in crude oil prices, I just have got to tell you that we have had testimony just the other day before the Committee on Agriculture as to what is going to happen to fertilizer.

It is going to be—to use the words of Mr. Simon—it horrifies me. It is not only that, but it horrifies the farmers.

Now, I think we just simply have to face the facts, Mr. Greenspan, that there is very little stimulus in this budget. Now, you say, well we cannot go any further. We have got to worry about the inflationary impact, and I am not unaware of the fact of inflation, but really part of the problem in the past on inflation has been the cost of money and tight credit, which promoted controlled prices, and when I hear your response to Senator Proxmire about Wage Price Stability Council and your unwillingness to support even a modest proposal of subpoena power or the power of the Wage Price Stability Council to withhold price increases and wage increases for a short period of time of 60 or 90 days until you can take a look at them, I do not really believe you want to fight inflation, and I am sure that what you have got here is not enough to do anything about unemployment.

How can we call it a program for economic recovery when you predict—the budget report and your report predict that in 1976 we will still have over 8 percent unemployment, and in 1977 we will have about 7.5 percent, and then after that you start—the guestimates start coming in, but in no way is anybody predicting below 7 percent between now and the year 1980.

I do not call that a program. All I call that is a chart of one's deaths and fever. That is not a program.

Mr. GREENSPAN. Senator, with respect to the amount of stimulus, I merely call your attention to the fact that the size of the deficit, including off-budget items, is well in excess of $60 billion.

Chairman HUMPHREY. Yes.

Mr. GREENSPAN. Now, it may be that you can argue that we should have a larger budget deficit than that, but that is what is implicit in your argument.

Chairman HUMPHREY. No, I did not say that. Maybe we ought to change some of the priorities in the program. I do not believe that you aid the purchasing power of the American people to give them some economic stimulus by cutting back social security payments to 5 percent because those people that get that social security, they are going to spend it. I do not care if they are Grandpa or Grandma, they still are going to spend it. You do not have to be a teenager to spend money, and that is as good to them as a tax reduction. That is maybe the only tax reduction they are going to get.

And what are you doing? You are saying that your program would give some people up to $1,000 that do not need it and will not spend it, and you know it, and I know it. You know, if you have got a $50,000 a year income or $60,000 a year income, you do not need a $1,000 tax reduction. Everybody knows that. Oh, it is nice to have. It would be pleasant, give you another week down in Jamaica or something, but it is not going to really help anybody.

But if you give the social security recipient the cost-of-living increase, you know and I know that that will be spent within the month. That is exactly the same thing as decreasing the withholding tax for a worker.

Mr. GREENSPAN. The real question, Mr. Chairman, of how much stimulus is appropriate, cannot be decided independently of what is going on in the financial system. We have very stringent corporate liquidity problems, and numbers of other factors also suggest there will be a private demand for funds. Heavy borrowing going on in the private sector, far more than is usually the case.

Chairman HUMPHREY. Now, wait a minute. On that we had testimony here just 2 weeks ago that the rate of private borrowing today is very, very low. We had Paul McCracken that was with us, who indicated, for example, that there ought to be an increase in the money supply from anywhere from 8 to 10 percent. Let me just add to my comment here what I think this budget deficit reveals is the kind of action that has been taken based upon the kind of recommendations and analysis that we received in last year's Economic Report, which as Senator Proxmire said, was 100 percent wrong. And we kept getting this stuff. There was a reliance upon the Federal Reserve System to control the money supply, except in 1972 in the fourth quarter, in the election year, they got it up to 9 percent.

And they quickly got out of that after the balance account, and then we went out right on back, and let us take a look at its last year.

Despite the economic indicators, which you know and which the Federal Reserve Board knows, there has never been much over 4 percent in the money supply of this past year, despite the fact that there was a need, a great need of stimulus in the economy. I do not think you get very much stimulus out of this program, unless you tie in the money supply; and I want to ask you pointblank, what do you think is a reasonable growth in the money supply, and what kind of recommendations do you make, if any, in your conversations to Chairman Burns? Mr. Simon says that he visited with Chairman Burns regularly, and that he gave Chairman Burns his ideas. But Mr. Simon did not give us his ideas on what the monetary policy should be. What do you think it should be? You are the Chairman of the Council of Economic Advisers.

Mr. GREENSPAN. The Council of Economic Advisers and I think appropriately, has eschewed commenting directly on what monetary policy should be, and I will continue to do that. However, I do communicate with Chairman Burns quite extensively, and particularly in the area of indicating to him what I think is going on in the economy in the short run. The Federal funds rate is coming down, and this is one of the interest rates over which the Federal Reserve has most influence. The degree to which Federal Reserve actions create increases in the money supply in the immediate short run is in a sense beyond the control of the Federal Reserve. That is, the Federal Reserve essentially controls the so-called monetary base. It has a very profound effect upon the Federal funds rate, and as I look at these two items, I would say that the Fed has obviously moved in the direction of ease in the most recent period.

Chairman HUMPHREY. There has not been any case lately. I think you know it, Mr. Greenspan, as I know it. The money supply increase rate in December, I think, was less than 1 percent.

Mr. GREENSPAN. Why do we not let Mr. Fellner—he has looked at this recently, so why does he not make a few comments?

Mr. FELLNER. May I make just one comment on this? The commercial banks have been repaying their debts to the Fed at a very rapid rate. Those debts were several billions of dollars worth later this summer and earlier this spring. Now the rate of reserve growth created by the Fed was for a while offset by the repayment of debts to the Federal Reserve system. This has now come to an end. I think that those debts to the Federal Reserve system were down to about $150 million the last time I looked at those figures, and that was a short while ago. So that now, the reserve creation will indeed get into the money supply.

In addition to that, the Fed has also reduced reserve requirements.

Chairman HUMPHREY. Yes, I saw that.

Mr. FELLNER. So I think that a lot is involved in this process. As Mr. Greenspan said a moment ago, the Fed does not have this precisely under control. It can create the reserves, but it cannot prevent the banks from improving their liquidity when that liquidity position is very poor, as they have done so far. This process has come to an end now, and I think from now on, you will see that reserve growth will be reflected in money creation.

Chairman HUMPHREY. I just wanted to make sure we were learning some lessons out of this. I have long felt that we have an overreliance on the Federal Reserve, as we have not really had any other mechanisms to manage the economy and to control what was then the inflation. I want to repeat what I have said 101 times—I know of nothing that has contributed more to the inflation, outside of the cost of energy, than the rent on money, which has been unbelievably high, unscrupulously high, and thank God it is coming down now. But I do not think we ought to get ourselves now in the position where we say that, when it comes down, and the Fed increases its money supply, that this is going to put such pressures upon the financial markets with the Government borrowing, that we are not to move ahead to do something about this unemployment.

I want to tell you that you have got a problem, a political problem, in the country as well as an economic problem. People just do not like to be out of work; and more importantly, they are not satisfied with a little unemployment compensation. I think we have got to get off this kick of providing just public service jobs and unemployment compensation, which are nothing more or less than a new form of—well, they are kind of political Excedrin. They are a little stronger than aspirin; they really do not do much else. We have got to get back to where people can get credit, and where we can start to build something; and I still have not heard any good answers on housing. I will not believe, gentlemen, that this Government is so intellectually paralyzed or morbid that it cannot figure out something to do for the housing industry beyond what has been done. When I hear that the Government is going to come down here to Congress in this next week, and ask for $7 billion to be put in a reserve fund on oil—that is the next one. We are going to have a bill coming before the Foreign Relations Committee, the new form of international economic assistance, which we may have to do. Secretary Kissinger says we have got to do it. Maybe he is right. But why, in the name of commonsense, does somebody not say, we have got to build some houses, and why do we not get the machinery going to do it?

We had the Secretary of Defense telling us, we just had to build 10 Trident submarines, and we had to get them ahead of time, 2 years ahead of schedule. They won in the Congress by a couple of votes, because we had to do it. We got the President saying, we have got to bail out Vietnam with $300 million; we have got to do it. We have got to do something about Turkey. Well, when are we going to have somebody in the Government say, we are going to do something about getting interest rates down, if we have to subsidize and whatever else has to be done, to build some housing? When is somebody going to get their blood pressure up? Everybody seems so lackadaisical when we are talking about this—except me, apparently. I am not very lackadaisical about it. But we are looking at it as a kind of economic message over here—now, if we do this, you have got to do this, and you have got to be sure what is going to happen here.

In the meantime, Mr. Greenspan, I explode. Yes, I do; because, frankly, I have heard the bad news. There is a lot of bad news, and everybody has been reporting that, and everybody is getting little gold stars for being honest now. Well, I do not want somebody

that is honest and stupid. I prefer to have them a little shifty and smart. But I think what we need now is not only somebody that is honest in telling us how bad off we are, but somebody that is a little clever telling us how good we can make it.

Now, I do not want to imply you, sir, are anything but that. You are an honest man, and you are a very intelligent man. That is why I want you to give us the answers.

Mr. GREENSPAN. I am as close to becoming speechless as I am ever to become. I would merely reiterate that the most efficacious way to get housing up is to get interest rates down.

Chairman HUMPHREY. Okay, how do you want to do it?

Mr. GREENSPAN. The most efficacious way to get interest rates down, and to keep them down, is to get the inflation down and to get the inflation out of premium long-term interest rates. And the only way that is going to be done is to defuse the inflationary bias which confronts our system; and the only way to defuse——

Chairman HUMPHREY. No, that is not the only way. Get productivity going.

Mr. GREENSPAN. We need both, Mr. Chairman.

Chairman HUMPHREY. I thought we had had the other one. That is what makes the medicine palatable.

Mr. GREENSPAN. I accept that caveat. I think it is appropriate, and I would agree with that most certainly.

Now, the one thing that will be the most detrimental to the housing industry in this country is if we allow this deficit and this financing problem which we now have, which are difficult, to get out of hand. And I submit to you, Mr. Chairman, that if the budget deficit goes very substantially above the level which we are now projecting, the most immediate victim of that will be the housing industry, and I think that would be a sad condition for this country.

Chairman HUMPHREY. I want to come back to you on that.

Congresswoman Heckler.

Representative HECKLER. Mr. Greenspan, I am horrified at the size of the projected budget deficit, and even more so by your own elaborations on it, and its potential for further expansion. At the same time, I am concerned about unemployment, and I do not think that to set facing the unemployment problem in the country as a priority means necessarily that you want to expand the deficit. I think it means that you want to perhaps shift the priorities of spending, and remain within what is manageable and bearable.

At the moment, the $52 billion deficit is frightening, and will be devastating if it goes beyond that. I question how wise a policy is which produces unemployment, increases welfare costs, increases food stamp costs, increases temporary job supplies, or the need for temporary employment, such as the CETA program, which we in the Congress urge, and so forth. It is again operation catchup.

Now, you have discussed an 8.1 percent unemployment rate. But what does this imply in terms of the percent of the labor force, which at one time or the other will be unemployed? Charles Schultze has given the figure that—well, he has given an approximation of 20 percent of the labor force that would be unemployed at one time or another, simply because the people who are unemployed in December might not be the people who are unemployed in May, et

cetera. Now, would you confirm or deny his assessment and his approximation; and since you have been so responsive to Senator Humphrey on the question of housing, which is a concern of mine. I would like to have you give me the benefit of your wisdom on the most efficacious route to aid our unemployment rate at the moment. Because, frankly speaking, the projections for 1976 of 8.1 percent are as frightening, or more so, than the budget deficit; and what is even less consoling is the potential prediction that this will go on, not really for 2 years, but potentially for 5 or 10 years.

So what is the most efficacious method to deal with all of this?

Mr. GREENSPAN. First of all, let me work backwards on that. Those numbers that we project beyond 1977, I can assure you, are not the goal of economic policy. They are merely projections and, as Senator Proxmire points out, we are treading on very thin ground when we get out beyond 6 months. I think public policy should focus on achieving the lowest compatible combination of inflation and unemployment over the longrun; but I would submit these are interrelated goals—in fact we have seen that they tend to go together.

Second, I would maintain that the problems that we are seeing now including the very high 8.1 percent unemployment rate we project for 1977, are consequences of the distortions which we have created in previous years. We are now experiencing the unfortunate consequences. We are attempting to set up a set of programs which tends to counter the destabilizing effects that have occurred in the economy, because of the past inflationary pressures.

Finally, Charles Schultze's comments are something which are well known to people who analyze unemployment. That is, there is a tendency—and I think, perhaps, an incorrect one—to presume that when we look at a particular unemployment rate, to somehow presume that those people are the same people continuously unemployed all year long. I would recommend to you the chapter in the economic report on unemployment, which attempts to disaggregate those numbers, and to examine carefully the nature of unemployment, and who is unemployed, and what the various characteristics are. There is a great deal of dynamism in our labor markets.

It is certainly true that, because most people are unemployed for reasonably short periods of time, and few have more than one spell of unemployment during any particular year, the actual number of people at some time during the year who were unemployed is very substantially above the average level of unemployment during the year.

Representative. HECKLER. Would you agree that 20 percent of the labor force—would you agree with what Mr. Schultze has suggested?

Mr. GREENSPAN. I do not know. That is an official published number of the Department of Labor. I do not know whether we show this in the report specifically itself, but it is released annually by the Department of Labor. That is not his guess; it is a number that is published.

Mr. FELLNER. But if that number is higher, and the duration is shorter for any given overall rate of unemployment, the larger the number of people who are somehow affected by it, the shorter is the duration of the unemployment. That is, you could describe a situation in which you have a high unemployment rate, and a very

large number of people are affected by it, but everybody is unemployed only for a very short while. So, I think one needs to be careful in interpreting those, and I think that the chapter on unemployment, the chapter in the economic report, is really very helpful in looking into this and interpreting it.

Representative. HECKLER. It would seem to me that the 8 percent unemployment figure which you have suggested is absolutely unacceptable, and I can only imagine the consequences in Massachusetts and New England, where we have mature economies and are at a competitive disadvantage in terms of energy and transportation costs, and a number of other factors. If you are talking about 8 percent for the country, I dread to think of what the figure would be for Massachusetts. I think I agree with Senator Humphrey, in the sense that we applied the honesty and integrity, but the bad news is not bearable. It is truly unbearable. It is like Secretary Butz' announcement to the consumers that food prices will increase, and I can tell you the response in Massachusetts.

Now, in this case, you go beyond food prices. You get into the economy itself, and unemployment, and I feel it is really incumbent upon the administration to develop a strategy to deal with this, so that these dire predictions will not be fulfilled, because it will be unendurable unless we are willing to accept a revolution in this country.

Mr. GREENSPAN. Mrs. Heckler, I find 8 percent unemployment as unendurable as you do.

Mr. FELLNER. Yes, we all do.

Mr. GREENSPAN. I know of no one who is of a different opinion.

Representative. HECKLER. Yes, but on the other hand, will you also commit yourself to developing a strategy from the depths of your wisdom to deal with this, rather than the ability to predict it?

Mr. GREENSPAN. All I can suggest to you is that we are endeavoring to embark upon programs which, given the considerations that exist in the world, will enable the lowest level of unemployment which is sustainable over the longer run. There is not a question here of differences in goals. I must also add, that the thought that somehow seems to pop up all the time, that high unemployment is desirable to bring inflation down, but this is not an economic policy. I do not even think it is very sound economic theory, because I do not believe that high unemployment in and of itself does much to suppress inflation; and as recent experience certainly confirms.

Representative HECKLER. Thank you, Mr. Chairman.

Chairman HUMPHREY. Senator Proxmire.

Senator PROXMIRE. Mr. Greenspan, I think what you said about unemployment at 8 percent being unendurable is certainly sincere, and I would accept that you feel that way. Let us set aside for the moment—I realize that you do not like to do that, but—your concern over inflation, and tell me this. Suppose policy went all out to stimulate the economy. Supposing we had a $30 billion or $40 billion or $50 billion tax reduction, a big program—and I mean a really big program—of public service employment, a big increase in the monetary supply. How quickly could, in fact, unemployment be reduced?

This morning in the paper, Hobart Rowen had a column in which he said we should try to get the unemployment rate down to 5.5

percent by the end of 1976. Now, never mind whether you think it is wise to do that, or what the long-term consequences would be. Can it be done? Is it possible, in your view?

Mr. GREENSPAN. I could not answer that easily—let me express to you why I am have difficulty answering it. One of the things we know is that any given stimulus in recent years—and let us take the tax cut—has caused a progressively smaller effect upon production, real GNP and employment. Now, there are a number of countries in this world in which I would suspect that stimulus no longer has any effective significance for real GNP. It does increase the nominal GNP, so that my suspicion is that no matter what the stimulus was in other countries, it would not generate any improvement in unemployment. I do not believe the United States is anywhere near that particular state of affairs, so consequently let us take something which I am not advocating, and I want to emphasize that—let us take the $100 billion deficit. It is a staggering number. But that confronts the question you are raising. I am not sure that even under those conditions, because of the significant offsetting side effects of that amount of stimulus and the disruptions which would occur, that you would be able to get the unemployment rate down to 5.5 percent. Certainly, let us say, on an average by 1976.

Now, I am leaving out the whole question of the subsequent consequences——

Senator PROXMIRE. You say you are not sure? You say that maybe it is possible, but you do not know whether it is or not?

Mr. GREENSPAN. The reason I do not want to be very positive, Senator, is that that is not something that one can or should do off the top of his head. I have not looked at that.

Senator PROXMIRE. I think it is very important to get that kind of determination, because we would like to know what, in your view as a professional economist, is possible for us to do. I feel, and I am sure many feel, that while waste in Government is appalling, that we simply, as you say, cannot accept the terrible waste of people being unemployed; because once they are unemployed for 6 months, you could never recover that. It is a loss to the economic system, and of course it is a terrible personal tragedy. But it is a loss to the economic system that we can never recover.

With 6 million or 7 million or 8 million people who want to work, who want to be productive, who want to contribute to our society, we will lose $100 billion to $150 billion of production that we should have each year, and it is a loss forever.

Mr. GREENSPAN. Well, you know, one other thing we must be clear on is the fact that these losses that we are talking about are available—we must not presume that the unattainable can be achieved.

Senator PROXMIRE. Presuppose what, sir?

Mr. GREENSPAN. Presuppose that we can, in fact—now, let us see. The numbers you are referring to, I assume, refer to the GNP potential at a 4-percent unemployment rate. Am I correct, sir? That is what the usual numbers are.

Senator PROXMIRE. All right.

Mr. GREENSPAN. Now, the question that we have to ask ourselves is, when we are talking about a statistical calculation of capacity of that sort, are there constraints or bottlenecks to achieve that? And I would say that, at this particular point, there is no policy

that I can envision, and that is why I would hedge on the other number. There is no policy that I think can be initiated at this point that will get us down to 4 percent in 1976.

Senator PROXMIRE. No, no. I know that, I accept it. That was not my original question, getting down to 4½ percent. The question is, How much progress can we make? Now, can we get down to, say, 6-percent unemployment? I am not talking, again, about the inflation. Your judgment is we cannot get down below, much below 8-percent unemployment without unacceptable inflationary impact? I am asking if we can get down, if you are fairly confident we could get down to, say, 6, 6½ percent?

Mr. GREENSPAN. Let me make a comment which really reflects the nature of the forecast itself. We usually presume, and take as given when we analyze governmental policies and the effects of stimulus on the economy, that we are dealing with a passive private sector, which essentially can be easily adjusted by different types of governmental policies. Now, what we have found is, it is a highly dynamic system, quite independently of what Government does. In fact, one way in which this is brought strikingly home to us is what happens to our forecasts when you try to trace what is going on.

Now, I think, for example, there is a very good chance that unemployment could be very much lower than the 7.9 percent figure which we show in the very preliminary forecast for 1976. But I think that the major issue there is not what governmental policy is, but the elements and the interactions within the private sector. Remember, there are natural recuperative powers in our society and our system is very dynamic, as you know; and it is not by any means outside the realm of possibility that elements other than Government policy will make actual performance very substantially better than indicated by those figures.

Senator PROXMIRE. Here is what is bothering me. You are forecasting 7.9 percent unemployment. We have had a long history now since World War II of unemployment substantially lower than that, averaging in the 1960's at around, even before the Vietnam war, at around 5 or 6 percent or less. There is no country in the world, no developed country in the world, that has unemployment that high. I asked the Bureau of Labor and Statistics to make the comparisons as accurately and as fairly as they could and they did that for us.

In Europe, unemployment is less than half of what it is here. In Japan, it is about one-fifth or one-sixth of what it is going to be here. There is something very much wrong with our policies when we cannot do the job that we did for years in the 1950's and 1960's, we cannot begin to do the job that other countries are doing, for us to have to face and accept a policy of 7 or 8 percent unemployment over a couple of years in view of our history and in view of the experience of other countries is something that is just plain wrong. There is something wrong with that policy. But we have to find out what it is and to act on it and to correct it.

Mr. GREENSPAN. I think one can answer that in two ways. There is either something wrong with the current policy or something wrong with the past policy.

In my judgment what has happened is the latter. I think excessively expansionary policies have built an inflation bias into our

economy, which I think is going to be quite difficult to defuse, and has caused the very difficult situation in which we find ourselves. I can assure you, Senator, I do not enjoy looking at the numbers any more than you do. However, I think that is essentially the consequence of policies which have produced an inflation biased system, and I think it is absolutely essential that our present and future policies do not repeat the mistakes we have made in the past.

I certainly hope that the performance of the economy will be significantly better than indicated by our forecasts. Whatever policies we choose, they must be focused not only on the short run, but must consider the longer term because I would say this Nation is really ill-served if we attempt to resolve our present problems with policies which will eventually worsen the situation that has been emerging over recent years.

Senator PROXMIRE. You see, what bothers me is the staff of this committee informs me that the President's program, which expects unemployment around 7.9 percent more than a year from now, has no net stimulus. After continuing into 1976, so that any recovery that begins next summer on the basis of Government policies is very likely to fall flat.

Now there may be some kind of development in the private sector, as you say, that we do not know about, something may happen. It may come along and pull us out of it. But there is no planned Government policy, no conscious action on our part that is going to help stimulate the economy.

Is that correct?

Mr. GREENSPAN. Let me say this, Senator. I agree with the technical analysis of your staff and I do not say that the present policy is frozen unalterably. In the event that it appears that further policy actions are required later this year after we have seen what has happened to the rate of inflation and what has happened to interest rates. But I do say this, that for present circumstances and for the immediate future that the judgment of the President is that these are the policies which make the most sense, that if later in the year it turns out that the conditions are somewhat different than we now foresee, he has by no means said that we will not take another look at different policies. In fact, I think that economic policy is a continuous process. I think one is always looking at what is going on in the day-by-day operation of the economy.

Not to audit what is going on is to stick one's head in the sand and hope for the best. That is not the way things happen or the way they should happen.

On the other hand, it is very important to focus policies at all times upon objectives which are achievable and not on things either next week or next month. I think responsible policies should stand the test of analysis of their effects both in the short and in the very long term as well.

Senator PROXMIRE. Thank you. My time is up. Thank you, Mr. Chairman.

Chairman HUMPHREY. We are going to come to our conclusion of this hearing, Mr. Greenspan. Let me just join in with what Senator Proxmire has said.

Repeatedly in these committee hearings I have said that I felt that there was no continuity in economic policy and I do not think there

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has been. We have gone through years of uncertainty that has surely affected the investment community, the industrial community, and it has taken its toll both in inflation and in unemployment. And there has been a steady rise with some gyrations, to be sure, in the unemployment rates for years now. As has been indicated here, this rate is so much higher than any other industrialized country, that it tells us one of two things, or possibly both. Either the structural organization of the American economy is wrong or in trouble, or the Government policies are inadequate.

It may be some of both, and I think it is the duty of this committee to look into both and we shall. I think we need to take a good, hard look over the whole pricing practice of the American economy. We need to take a good, hard look at the relationships of labor and management in terms of the pricing practices of the American economy. And we will have to do it.

We surely have had very little of what you would call demand inflation. Most of it has been of the administered price kind except in some areas. That is for sure.

Now you have said that one of the reasons, if not the main reason for our present difficulty, is excessive expansionary policies that have been pursued. May I say most respectfully that they have been pursued in part but not totally. There was not a great deal of excessive expansionary policy when you could not borrow a dime, when small business enterprises were literally choked to death because there was no money. There was not any expansionary policy when you had such high interest rates and tight money that the construction industry in this country, in housing in particular, went flat on its face, and I think we also are to ask what is wrong here as compared to Japan, Germany, and Sweden. The rate of economic growth in these countries has been appreciably higher than ours, appreciably higher, and their rate of unemployment has been appreciably lower.

Now it is a fact that their rate of inflation, particularly in Japan, has been higher but in the Federal Republic of Germany it is below both in inflation and in unemployment. In Sweden, a highly industrialized country, the rate of unemployment is negligible. The rate of inflation is about, I think about the same as ours.

So I do not think we can just leave it on expansionary policies, Mr. Greenspan. I happen to believe that we are designing short-run policies for long-run recession, and I think that is what has been wrong more than anything else.

I noticed you came down for a 1-year investment tax credit. I do not think that is what we need at all. I think we need to assure American industry that they should plan ahead. We are not going to recover this country in a year. You have said that yourself and I think the study of this committee in the inflation study said pretty much what you are saying in the Economic Report, in part, that the ravages of recession and unemployment would be hanging over us for years to come. It takes a long time to get out of the gulley and the bottom of the canyon, so to speak, of unemployment. We saw that in 1960, 1961, 1962, 1963, and so on. I just think that when the administration sends a budget down here, or the Report of the Council of Economic Advisers comes here, it has to have

some quality of planning in it, and not be worrying about whether or not there is going to be a $52 billion deficit this year that scares little children and grandmothers.

What I think we have to be willing to do is to face up to some of the other economic facts. We are facing up to the economic facts today, the hard facts of the current economic situation. What is it going to take to get out of it? What kind of policies do we need?

Now I looked at—and by the way, I must say here in my soliloquoy for you that I am disappointed in what I have read of your wage-price policy in your report. It is negligible, negligible, and very little on monetary policy.

Quite honestly, gentlemen of the Council of Economic Advisers, it is this man's point of view and it is surely not as educated as yours or as professional as yours, to talk about a program of economic recovery without adequate emphasis upon wage-price policy and upon monetary policy is to deceive yourself and ourselves. It is just impossible, absolutely impossible, and I am weary of hearing that the Federal Reserve Board is so sanitized over there that it cannot be touched by the human hand or the human mind. There is no way in God's green earth that we can get economic recovery in this country if we are going to have Congress and the executive branch going down this road and off over here in a sterilized atmosphere of fiscal and monetary purity, as the Federal Reserve Board. No way. They have got to sing a little too. They have got to get with the boys. They have got to get with the folks, to put it in the vernacular.

Here are two of you prominent officials, Secretary Simon, the minute I said, "Now what did you suggest to Mr. Burns?," well let me tell you that was more than an atomic secret. We cannot talk about that here. And yet, may I say the Federal Reserve Board is an instrument of the Congress.

I ask you what do you think is a reasonably good rate? What is going to be the rate of money supply increase? What do we need to have in order to finance what we have ahead of us, both government borrowing and private financing, and at the same time get those interest rates down?

And you kind of smile at me and you are a generous and kindly and a decent, friendly man, but that is not what I like. I wish you would be a little meaner.

What do you suggest, Mr. Greenspan? Now just what is it—4 percent? 6 percent? 8 percent? I know it varies month by month. I know this is a finely tuned instrument, you know. It is sort of like directing an orchestra. But what would you suggest? What kind of music do you think we ought to hear, the 8-percent music or the 4-percent or the 6-percent?

What do you think? What is needed for the stimulus?

Mr. Greenspan. I indicated the particular orchestration I have in mind to Chairman Burns and if he is willing to——

Chairman Humphrey. Well, we are part of the Government. Tell us your secret. Who do you think set up the Federal Reserve Board? Not God Almighty. It was the sinful Congress that did it. There were no saints that did that.

Mr. Greenspan. Mr. Chairman, one of the problems that really does exist in this context is that disclosure of that sort of policy I

think has marked effects, and one of the reasons that it is not done is that its announcement in the marketplace or its discussion does not adequately serve the best interest of monetary policy. If I were a private citizen I would give you every opinion in the world, as you well know.

Chairman HUMPHREY. We are going to ask Mr. Burns what he thinks.

Mr. GREENSPAN. To the extent that my views are embodied in his views, you will hear them.

Chairman HUMPHREY. Well now look, I do not buy that and I say this most respectfully. We are part of the Government here and do you want this Congress to go stumbling along making mistakes or do you want to give us some of your professional advice? We need advice. This is where we get it. We cannot have executive sessions around here. We have got what we call the sunshine law, and we are going to talk out loud. The people have a right to know, and I have a right to know, and this committee has a right to know what kind of counsel are you giving to the Federal Reserve Board? How can we properly interrogate the Chairman of the Federal Reserve Board unless we know what kind of counsel you have been giving him?

What have you suggested?

Mr. GREENSPAN. Well, that presupposes that the old professor of mine is subject to my counsel, where it is more likely to be the other way around.

Chairman HUMPHREY. Then maybe you ought to tell me what he counseled you. Your problem, Mr. Greenspan, is that you do not have the power that Mr. Burns has. Now we have a high regard for Mr. Burns here, as you know, as we do for you, and I know this sounds somewhat jocular what we are doing here but it is not; it is dead serious business.

I think that when the Secretary of the Treasury comes up here, or you come up here, before, not necessarily this committee but maybe it is Mr. Proxmire's Committee on Banking and Housing, you do have an obligation to share with us what your counsel and advice is.

The Council of Economic Advisers was established under the Employment Act of 1946. Now we did not expect you just to tell secrets to the President. We want to get in on some of the folklore of our time.

Mr. GREENSPAN. Well, all I can indicate to you, Mr. Chairman, is that my view is that monetary policy should be a relatively steady policy and, as we have indicated in our economic report, it should be consistent both with the short-term requirements without it being overly contributing to reigniting inflation.

Now that may seem very vague but you know——

Chairman HUMPHREY. Do you think Paul McCracken was in the ball park? Let me ask you that.

Mr. GREENSPAN. I do not know what he said.

Chairman HUMPHREY. He said between 8 and 10 percent.

Mr. GREENSPAN. I would not want to comment on that, Mr. Chairman.

Chairman HUMPHREY. You would not? Well, how do we know whether to believe Paul McCracken?

We know very well the Congress can legislate what the monetary policy ought to be. The Constitution says something about this. We have put it over in the Federal Reserve Board because we have been told, you know, that money is too intricate and complicated a matter for ordinary people that have to pay their bills to handle, so we put it over here with a group of experts. We have the power over the currency, this Congress has.

Now what about it? I am going to be as tough on this as Wright Patman because let me tell you something. I think that we have gone around here long enough just talking fiscal policy and budget policy and we forget the third leg of the stool, and as an old farm boy, you sit on a three-legged stool with two legs and you fall on what the country is falling on right now.

Mr. GREENSPAN. First of all, I would not say that monetary policy encompasses only rates of growth in either M_1, M_2, or M_3 or a variety of other monetary aggregates.

Chairman HUMPHREY. People do not know what you are talking about when you say M_1, M_2, and M_3. They think it is a gun in Vietnam.

Now really, we are going to make this committee talk to the people.

Mr. GREENSPAN. The question really gets down to how does one describe the appropriate nature of monetary policy.

Now you could either describe it in very general terms, as we have, in fact, described it in the economic report, or you can get very specific on monetary aggregates.

Now I think it is a disservice to somehow imply that there is a particular series which is really going to capture the effect of what monetary policy is. Let me just go back, for example, to an earlier point that you were making with respect to the nature of expansionary policies.

What caused the exceptional tightness in the money markets, high interest rates and very difficult problems for many borrowers in most recent years, is essentially a question of what the demands of the system were relative to what the growth of the monetary aggregates.

Now as you know, Mr. Chairman, the monetary aggregates were increasing at a fairly substantial rate. Even so, we were in a situation in which money appeared to be tight.

Now this gets to a very tricky question of how you define the question of whether monetary policy is tight, loose, or what it is, and one of the difficulties that we have in suggesting or characterizing what monetary policy is or should be is that it requires you to get into a number of fairly technical questions with respect to these various monetary aggregates, the Federal funds rate targets, the question of the monetary base and a few other things, and if we are interested in the question of financing levels of economic activity, which is really what it is all about——

Chairman HUMPHREY. Correct.

Mr. GREENSPAN [continuing]. Then the nature of what those particular policy goals should be or how they are implemented is technically a very complex problem.

Chairman HUMPHREY. Now, Mr. Greenspan, after you said all of that, and I do think I now understand that, I have spent a little time both as a student and now learning a good deal in my many

years of public life about this. I claim no expert knowledge, but I do know if the President sets out a goal here, we see the problem and the problem has been described in these horrendous details to us, and we want to lower that rate of unemployment and we feel there are certain ways to do it, such as a tax stimulus, a rebate plan, or an increase in certain budgetary outlays or restrictions. There are lots of things which go into designing a program to accomplish an objective. One of the most important things of all, more important than tax rebates or more important than even budgetary policy, is monetary policy because the guy that controls the flow of money and its availability and at what interest rate, he is in charge. The rest of us are playing ring-around-the-rosey.

That is why I keep saying that we have got to come to grips with what is an effective balance of monetary policy with budgetary and fiscal policy. I do not think I am stupid about it. I have tried to be somewhat sensitive to it. I know you cannot say it has got to be 8 percent every month or 6 percent. That is what we have got the Federal Reserve Board for, and they have got banks all over this country. They have got their regional banks.

I know what is happening down in our Federal Reserve district. I go out there and meet with those people and I know what they say are the needs out there.

Now all of that is supposedly brought into the Federal Reserve Board and up through its mechanisms, its experts and its professional people. But I felt for a long period of time that we overrelied on the Federal Reserve as the control mechanism in our economy and underplayed both fiscal and budgetary policy.

And now I see us playing with the budgetary and fiscal policy and not hearing very much about what is going to happen in monetary policy because you are the Chairman of the Council of Economic Advisers. Mr. Simon is the chief economic counselor to the President. He is the chief economic man in the Cabinet level of the administration.

Now here we find two of our most respected officials and permanent officials that for purposes of the Congress are unable to tell us, except in the broadest general terms, which, may I say, a senior in economics could say the same thing, and I say that respectfully, that there has to be a balance and you can be rather general about it.

Would you not get, for example, any real impact—let me give you an example here. Staff gives me this.

It appears as though the peak unemployment that occurred this summer—I think that is generally agreed upon—perhaps, let us say, between 8 and 8½ percent, yet the package before us in the budget has a total of only $6 billion in stimulus effect through August.

Now is that not a shockingly small stimulus? With such high and rising unemployment, what kind of extra stimulus could we have?

Now if you do not want to reduce the taxes any more, there is another way—increase the credit. If we have faith in this economy, and I do—I agree with you that there is great vitality in this economy and I think it responds frankly a whole lot more to interest rates and availability of credit than it does to something we put in the budget, much more so from the point of view of productivity and industrial growth and expansion.

Would you like to make a comment?

Mr. GREENSPAN. First of all, Mr. Chairman, the stimulus is actually a great deal greater than the unemployment insurance.

Chairman HUMPHREY. That is not a stimulus. Those are stabilizers. You cannot really call that a stimulus, somebody getting $75 a week.

Mr. GREENSPAN. No, no. The point at issue is that when one is measuring the nature of stimulus in a system, unless you look at those elements, I think, you are just not looking at the total picture.

Chairman HUMPHREY. May I say that we have not considered those factors. Well, if you want to use that argument on unemployment compensation, let me go back to what I said a moment ago. When you cut the social security payments, then you are really knocking the stimulus out because you have got more people on social security than you have on unemployment compensation.

Mr. GREENSPAN. Mr. Chairman, it is very difficult for me to envisage that the type of deficits we are creating would not be described as a stimulus.

Granted, it depends on whose figures you use, whether you use this figure or that figure. It is just not, frankly, credible to me.

Chairman HUMPHREY. I am talking about the economic stimulus of the tax package per se.

Mr. GREENSPAN. I must say I agree with you on the question that monetary policy is obviously a very relevant and a very difficult issue to deal with and a very major element in economic policy, and am I correct in assuming, I think you do have Chairman Burns coming up here?

Chairman HUMPHREY. Yes.

Mr. GREENSPAN. I think that it would be best, since he is in charge of all of the data, the analysis, and knows far more about it than I do—in fact, I think, you know, in one respect, his knowledge of the subject, granted what he is looking at and what he has access to, I think is a far more valuable contribution to your knowledge than anything I could say.

Chairman HUMPHREY. Well, I just noted here that the German Bundesbank has decided to tell the folks what they think is important. They have said, they have already announced the money supply growth target for 1975 at 8 percent, and you know they have been doing pretty well with their currency. They have been doing pretty well.

Now, why is it that we spend 2 months around here trying to get some answer about what the money supply rate is going to be in this country? You know if I were a big man that was going to do some investing, I would kind of like to know what the Federal Reserve System is going to do, but equally important, I would like to know what my President thinks about it. I would like to know what the President's top economic adviser thinks about it.

Maybe we cannot get the bank to respond. I mean they have got a kind of independence that has grown over the years. Maybe they will not respond, but I would like to know—the people that are advising the President of the United States have said, Mr. President, I want to tell you something. If we are going to get out of this business, we cannot only have a tax program, and we cannot only have a budgetary policy, and we will argue about its merits.

But we have got to talk about this money supply and the interest rate, because you yourself have just said the only answer to the housing problem—and the answer, the best answer, I guess, is the way you put it—was a lower interest rate.

There is no lower interest rate without better money supply.

Mr. GREENSPAN. Mr. Chairman, let me suggest to you that excessive money supply growth will eventually cause more inflation and mean higher interest rates, not lower.

Chairman HUMPHREY. Look, you can kill yourself drinking water. Nobody is asking you that, but it does not hurt to take a bath and gargle and occasionally drink two or three glasses a day and particularly if you have got a little fever, you ought to drink some. We all know that.

Now, I am not talking about an excessive money supply. I presume that the Federal Reserve Board has got sufficient intelligence to know when to come out of the rain and keep out of the blizzards and also not to get excessive sunburn.

But somewhere along the line somebody ought to be able to tell somebody in this country what they think we ought to have for a money supply rate. You are telling us what you think we ought to have in taxes. You do not hesitate on that. You predict what we ought to have on unemployment. You just come right on out and say, folks, hunker up, here it comes.

Mr. GREENSPAN. I am not predicting that. That is not our goal.

Chairman HUMPHREY. I know that is not your goal, you are predicting——

Mr. GREENSPAN. The money supply policy is a goal policy.

Chairman HUMPHREY. All right, you have got a goal in budgets. Now, we have been told about these deficits. I just looked over something else, and then we are going to close off.

The year 1959 was one of the great recessions that we have had since the postwar. The GNP at that time was $484 billion. The budget deficit was approximately $13 billion. That is between 3 and 4 percent of the GNP. The budget deficit this year, estimated for fiscal 1976 is $52 billion, as compared to a GNP of $1,500 billion. That is between 3 and 4 percent of the GNP.

Now, everything is relative because you remember what Secretary Schlesinger says about the defense budget. He relates that, and tells us up here, we want a little more money. After all, related to the GNP, the requirements of defense are going down and down and down, and do not pinch us anymore.

Now, you cannot have it both ways. If you are going to come up and say that we have got to look at the defense expenditures related to the GNP—and I think that is a reasonably good yardstick—I do not think we ought to scare little children and renew Halloween every month by looking at a budget deficit of $52 billion with $1,500 billion economy, as if somehow or other this is going to blow us out of the park. It is not going to do that.

Mr. GREENSPAN. Mr. Chairman, I think the particular denominator which is appropriate for looking at the budget deficit and hence financing is not the GNP but the total savings in the system, because where it is critical is not as a percent of GNP, but rather its preemption of the flows of private savings.

Chairman HUMPHREY. I understand that.

Mr. GREENSPAN. That is a different concept.

Chairman HUMPHREY. And that relates again to money supply.

Mr. GREENSPAN. True enough, and all I can indicate is that, one, the presumption that—let me come at it in this way. Obviously, I think we agree than an excessive money supply expansion would be counterproductive to interest rates and housing, so we are talking about what is that rate of monetary policy which essentially gives us a path which is——

Chairman HUMPHREY. Right. You and I are in thorough agreement. Now, Mr. Greenspan, what do you think it ought to be?

Mr. GREENSPAN. I wish I knew.

Chairman HUMPHREY. You wish you knew.

Mr. GREENSPAN. Let me put it to you why I do not at the moment, because there is a specific amount of information which I do not have available to me at the moment, which is largely an analysis which the Federal Reserve is doing, which enables them to take that particular concept and be able to bone it to a point you could put a number on it.

Now, I am not saying that I cannot do the same sort of analysis. It is a very detailed thing that they do. As you know, they have some elaborate flows of funds analyses basically related to various money supply analyses and the like. As I understand it, their policy is precisely to do what we are suggesting.

That number is a number which comes out of a specific, very detailed type of analysis with some ranges, as they must be. I have not seen, nor have I done, that particular type of analysis very recently. I know how it is done.

Chairman HUMPHREY. I understand.

Mr. GREENSPAN. So that I probably at some point will be reproducing that, because in a certain sense I think one of the major difficulties we are going to have in the next year is in the financial markets, and I think that as far as the Council of Economic Advisers is concerned. we are going to be looking very extensively at this whole financial process to get a much better feel than, in fact, anyone has.

There are some who feel that the Government is deficient or the profession is deficient, the economics profession.

Chairman HUMPHREY. We are all struggling to get some answers, and what I was trying to get at, is I am sure the proper policy was not for you to dominate the Federal Reserve or for the President to dictate to the Federal Reserve, neither of which I am sure has happened, but it is the kind of consultative process which I am sure you must have, like a triangle of the Secretary of the Treasury and yourself and the Chairman of the Federal Reserve Board, who try to put this mix together properly.

Now, one just quick question: The President's budget on public service employment was limited just to this year. There was no further projection. This committee had a report that proposed that something be done to help these unemployed, and the President recommended that there be a program of public service jobs tied to the unemployment rate, with an additional 250,000 jobs for each one-half percent increase in the unemployment rate.

Would you support a larger program of public service employment tied to the unemployment rate? Or did you recommend any such thing to the President?

Mr. GREENSPAN. I think, as I recall—and I just happened to open up to this, page 125 of the budget of the U.S. Government, fiscal year 1976—there is a line at the very bottom of the page that says, "Continuation of this program in its present form after December 31, 1975, depends upon an analysis of its success."

So I would say—I would not go beyond that because I think it pretty much states what the policy is. It is the type of program which is new, as you well know, Mr. Chairman. It is complex; and subscribing to its continuance in advance of knowing its efficacy, I think, is not appropriate policy.

Chairman HUMPHREY. We want to make a requst of you, and I bring this to your attention and read it now into our record.

The President has challenged the Congress to see if they can come up with a better set of economic policies than he has proposed. The Congress intends to accept that challenge because certainly we have got to come up with some policies to get what we believe is an unacceptable unemployment rate down, as well as to conserve energy and reduce inflation.

Congress wants to come up with a sensible, carefully formulated set of policies. There is one respect in which you and the Council could be a great help to us. You have available economic models which can be used to study the effects of different policies. Although the Joint Economic Committee has, I consider, a good professional staff, we do not have all of the models and the technical expertise of the executive branch.

We would like to give you some of our assumptions about economic policy and have you analyze them with the aid of your economic model, and then tell us how our policy assumptions compare with those of the administration in terms of their estimated effect on prices, employment, and growth.

If you can do this for us, the staff will get together with you or with anyone you so desingate later on to give the Council the details of our assumptions. In general, our assumptions will include such things as a permanent tax cut, the repeal of the proposed 5 percent ceiling on social security, some recommendations concerning larger public service employment programs, and obviously some assumptions on the energy issue.

These will be some different assumptions than are in the President's budget. My question is, would the Council be willing to do this for us? Would it be possible to get this done in a reasonably short period of time? The question is just whether or not we can have the professional cooperation of the Couucil.

Mr. GREENSPAN. Well, most certainly. Let me, however, indicate that—about the nature of models per se.

We will certainly cooperate with you in any way you would like and the best we can. However, what we will do is give you our judgments as we change these models because remember one of the problems that economic forecasting and analysis has had in recent years is that despite really extraordinary, major events, we have made—in econometric techniques and the models—we have found we have not quite captured reality in its most dynamic sense.

So what we certainly offer you is to the best extent we can employing both models and judgment where we see it as appropriate.

Chairman HUMPHREY. And the results of your studies.

Mr. GREENSPAN. Yes, most certainly we will give you our judgments to the best of our ability on the consequences of various policies.

Chairman HUMPHREY. That is very good. Thank you very much.

Now, we have had Mr. Fellner here today. Do you have any comment, Mr. Fellner, that you would like to offer for us? I understand that you are going to be leaving; is that correct?

Mr. Fellner. Yes, I am going to be leaving at the end of this month and returning to the work I was doing before I came here.

Chairman HUMPHREY. You were at Yale before?

Mr. FELLNER. I was at Yale for more than two decades. Then when I retired from Yale, I was working at the American Enterprise Institute and was engaged in research there, and I am on a leave of absence from there, and I am going to return there and continue to work.

Chairman HUMPHREY. I did a television program for the American Enterprises Institute recently on United States-Japanese trade. It was very, very interesting.

Mr. FELLNER. Thank you, Mr. Chairman.

Chairman HUMPHREY. Let me just quickly say on behalf of the committee how much we appreciated your cooperation to the committee and your service as a member of the Council, and I most assuredly want to wish you well.

Mr. FELLNER. Thank you very much, Mr. Chairman.

Chairman HUMPHREY. Maybe you do want to leave us with a little benediction, a little advice before you leave?

Mr. FELLNER. Well, I do not know how I should phrase that, but I do think that the problem which Mr. Greenspan was emphasizing again and again does exist, that we should get out of this recession as fast as we can, but without creating the same problem which we did do after coming out of the 1970 recession—mainly the method by which we came out of that recession left an inflationary heritage and then led to more unemployment than the unemployment we were trying to get rid of, by moving too fast.

So unfortunately we have this past of 10 years of inflation which have led to this very difficult situation. We should do all we can to get out of it. We should certainly abstain from using methods that will create the same problem again in a year or 2, and that unfortunately is the past heritage that we are rushing out of these situations by methods that just move to sustain the growth.

I also have the impression that with a little bit of luck those unpleasant figures in the forecast will turn out to be less bad than we have in these forecasts. One can hope for that, but I think that we should not use excessive expansionary methods for trying to get there. I think we have a good chance of getting better results than we had forecasted without trying to do something that will get us at a worse level after a year.

Chairman HUMPHREY. I do thank you. I want you to know that I am well aware of the fact that previous recessions with high unemployment rates were not accompanied by the same high inflationary rate.

Mr. FELLNER. But the methods by which we got out of these continued to produce a lot of inflation.

Chairman HUMPHREY. In the 1958 period, for example, we had a very low rate of inflation, and even in the 1960 period. This time we are sort of like—again I use my medical analogy, trying to cure a patient that has got high blood pressure at the same time he needs some surgery, and it is a very delicate operation.

I understand that, and I think that both you and Mr. Greenspan today have made this very clear to us, and I believe this kind of caution is much needed as we proceed on any budgetary or tax policy that we may pursue our monetary policy.

Mr. Seevers, you brought to this committee, expertise and professional competence and knowledge in the field of agricultural economics, particularly. I think we are indebted to you for that, and I understand you will be leaving; is that correct?

Mr. SEEVERS. Yes, it is.

Chairman HUMPHREY. When will that be?

Mr. SEEVERS. Well, the details of exactly when I leave are not set, but it would be a few weeks after Mr. Fellner departs from the Council.

Chairman HUMPHREY. We do not want you to leave without at least getting your whack in there, and you do not even have to be polite, but you are always.

Mr. SEEVERS. At this hour I think my major contributions would just be to say I appreciate having worked with you while I was at the Council, and I have enjoyed the discussion today.

Chairman HUMPHREY. I think you should know that the staff has had very high marks for all of you here, despite our questions, many of which are prepared by the staff, they always tell us that you have been very cooperative and we have had a good working relationship, which is exactly the way it ought to be.

No one knows what all the answers are. We have just got to fight it out. Maybe if I can get my good friend Alan Greenspan to tell me about that monetary policy in a little more clear tones and clear words, we will get it all worked out.

Can I thank you? You have been most patient and most cooperative.

The hearing will start tomorrow morning at 9:30. We will have Chairman Burns here from the Federal Reserve System, and the reason at 9:30 is that Mr. Julius Shiskin from the Bureau of Labor Statistics will be coming in at 11:30. That is when the unemployment figures are released, so we will have a twin-bill tomorrow.

Thank you. The committee stands recessed.

[Whereupon, at 1:22 p.m., the committee recessed, to reconvene at 9:30 a.m., Friday, February 7, 1975.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 7, 1975

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

The committee met, pursuant to recess, at 9:40 a.m., in room G–308, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Sparkman, Proxmire, Kennedy, and Javits; and Representative Brown of Michigan.

Also present: John R. Stark, executive director; Courtenay M. Slater, senior economist; William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Sarah Jackson, Jerry J. Jasinowski, L. Douglas Lee, Carl V. Sears, and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. We will call our Joint Economic Committee to order, and we, of course, welcome our distinguished Chairman of the Federal Reserve Board of Governors, Mr. Arthur Burns, who comes to us whenever we ask him and always in a very helpful and cooperative manner.

Mr. Burns, we are glad to see you this morning because we need your counsel and we need your advice. You know the news this morning is anything but cheerful. The economic news on the unemployment rate is indeed shocking, disturbing, and I think maybe one of the most challenging bits of economic information that we have had since the days of World War II. We will direct our attention to this matter today. We will be hearing from Mr. Shiskin from the Bureau of Labor Statistics a little later.

If there is one message that has come through loud and clear in every single one of the hearings that we have had so far, it is this: Monetary policy is absolutely of fundamental importance in getting our economy out of this recession, back on the road to healthy growth and a lower level of unemployment, and those statistics that have been indicated this morning on the unemployment rate emphasize even more so the importance of a much more active and a much stronger economic recovery program than has been planned or projected thus far.

Everybody says that monetary policy is important, but so far no one will tell us what it should be. Our private witnesses, of course,

have given us their opinons, and we value this advice very highly. Mr. Paul McCracken has said that he felt the money supply should grow 8 to 10 percent this year.

Mr. Gardner Ackley expressed a similar view, as did some other witnesses. But it is the high officials of the U.S. Government, the people with responsibility for economic policy, who thus far have been unwilling to say what they think monetary policy ought to be, except in the most general terms. The President did not discuss monetary policy in his State of the Union address, even though I must say from my point of view, it is impossible to discuss a national economic recovery program without proper emphasis upon the monetary policy that must accompany both budgetary and fiscal policy.

The Secretary of the Treasury refused to state before this committee what he thought monetary policy should be, and yesterday the Chairman of the Council of Economic Advisers also refused, although I think I pressed him very hard.

Both Mr. Simon and Mr. Greenspan say we would have to ask you, Mr. Burns. That is why we are so particularly pleased to have you here. You are the only spokesman that we have on monetary policy. I gather the only one who is willing to talk about this magical, mystical subject. Of course, I do not think that is the way it ought to be. But we value your views and, of course, respect them on many areas of our economy and particularly monetary policy, and we respect your skill in the execution of this policy.

It seems to me that all of this ought to be freed to say in general terms what that policy should be. Mr. Burns, you often speak out on other aspects of economic policy. You tell us how you feel about the budget, about wage-price policy, and about public service employment, and much of what you have to say has met with a very favorable response. You have not hesitated to disagree with the President on some of these questions, although you have done so, I am sure, only after much careful thought and consideration.

We admire you for your candor and for speaking out. You indeed ought to do it, and you do do it. Your advice on all these questions is a great help to the Congress and to the country. I am reminded again, of course, that the Federal Reserve Board was created by the Congress of the United States and in a sense is an instrument of the Congress of the United States.

My point is this: The Secretary of the Treasury and the Chairman of the Economic Advisers should feel just as free to speak out on monetary policy as the Chairman of the Federal Reserve System. I am going to press you for a fuller and more open discussion in this area because I happen to believe with other witnesses who have testified as to the great importance of our monetary policy.

I also feel, Mr. Burns, that you should speak out a little more on monetary policy. I understand, for example, that in the Federal Republic of Germany the central bank has just announced its money supply targets for 1975. I do not know why they should be kept a deep, dark secret in this country.

By the way, I gather that the Federal Republic of Germany is doing rather well with its economy and that its deutsche mark is a good and valuable currency, and they had a very favorable balance of trade despite the high cost of energy.

We attribute most of our problems here to the high cost of energy, and yet we have a much larger domestic supply of energy than any of the other industrialized countries of the world, and we find the Federal Republic of Germany, that has to import about 70 percent of its energy, having a very good trade balance. Its currency is considered if not the best, one of the best in the world. While it has some increase in unemployment, its rates of unemployment are considerably below ours and its rate of inflation is substantially below ours. So I do not believe we can attribute all of our ills simply to oil policy.

I believe that has become a convenient scapegoat, and not one that ought to have us held in bondage, as we probe around for remedies to what is coming, an ever more serious economic situation.

I certainly understand the money supply fluctuates and must from month to month and that too much fine tuning would be a mistake. Obviously, too much of anything causes trouble. I understand that the money supply is not the only major measure of economic policy. We also have to take a look at interest rates and a good many other things, to say the least, as you have taught us here many times, that is complicated.

All the same I think Congress could be let in on the secret, just a little bit more than it has up to the present. We will return to this in the questioning, but right now, Mr. Burns, because we always learn when we are with you—we welcome you to this committee, and we ask you to proceed with your statement.

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

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

Our Nation today is suffering from a serious economic recession. It is also in the midst of an inflation that is threatening the very fabric of our society.

Public policy is thus confronted with a grave and profoundly difficult problem. There is an immediate need for measures to cushion the recession. Yet, we cannot ignore the longer run implications of our actions for the rate of inflation or for the other adverse trends that in recent years have hampered the Nation's economic performance.

Let me turn, first, to the immediate economic situation and then move to some of our longer range economic problems.

Since last fall, general business activity has deteriorated. The decline in the real gross national product in the fourth quarter was unusually large. Reductions in production and employment over recent months have been about as rapid as at any time in the postwar period. Cutbacks in activity have been especially sharp in the auto industry, but they have been substantial also in the production of other consumer goods, business equipment, construction products, and industrial materials.

Total employment increased during the first 10 months of 1974; but there has been a marked decline in recent months, and unem-

ployment has risen sharply. Overtime work has also been reduced and an increasing number of workers have been able to find only part-time employment.

As so often happens in a recession, consumer demands for autos, furniture, household appliances, and other durable goods have declined sharply. Sales of domestic-type autos in January—although up from December— were at an annual rate of only 6.6 million units, nearly one-fourth below last summer's pace. Weakness in consumer demand has extended also to clothing and other nondurable goods. Total retail sales expressed in current dollars fell more than 3 percent from the third to the fourth quarter of last year, and the decline in real terms was even larger. Actually, the physical volume of retail trade has been moving on a downward trend since the spring of 1973.

Residential construction was notably weak throughout 1974. New housing starts in December were at an annual rate of only 870,000 units, the lowest rate since 1966. However, conditions in the mortgage credit markets are rapidly improving, and there has been some tendency for new building permits to stabilize recently. Thus, we may reasonably expect some upturn in homebuilding before very long.

Business capital spending, on the other hand, will probably decline this year in real terms—although dollar outlays may be rising moderately further. Of late, business firms have been cancelling or postponing plans for construction of new facilities and for the purchase of new machinery and equipment. This has resulted in a drop of new orders for capital equipment, and of contracts for commercial and industrial construction.

The decline in final sales during recent months has been unusually large—when we allow for the advance in prices—so that inventories continued to pile up despite substantial cutbacks in production. However, business firms are working strenuously to cut back excess stocks—through further curtailments of output, special promotions, and price concessions—and it appears that we are now moving into a period of inventory liquidation. This adjustment of inventories will have a temporary depressing effect on production and employment, but it is an essential precondition for an upturn in business activity later on.

As the economy weakened during the course of 1974, the behavior of prices began to reflect it. Sensitive prices of industrial raw materials started to decline in the spring of last year. Last fall, the effects of declining business activity began to show up in wholesale prices of intermediate materials, supplies, and components, and later on in prices of finished goods. In December, wholesale prices of industrial commodities were unchanged, agricultural prices declined, and the overall wholesale price index turned down.

The rise in consumer prices has also slowed, partly because the runup prices of energy items associated with the rise in the cost of imported crude oil has been tapering off. There have also been substantial price concessions by automobile dealers and other retailers to help stimulate sales and thus bring inventories down.

It would be premature to conclude, however, that the menace of inflation is, or soon will be, behind us. Agricultural products are still in short supply, in large part because of a series of disappoint-

ing crop harvests both here and abroad. Also, in some sectors of the economy, such as the service area, prices are continuing to respond to past increases in costs. A major source of inflationary pressure now is the runup of wage rates. Recent increases in wages greatly exceed the long-run growth trend of productivity. To make matters worse, productivity has declined substantially over the past year, and unit labor costs consequently rose by almost 15 percent in 1974.

Other industrial countries have also been beset by the dual problem of recession and inflation. With the notable exception of Germany, the rate of inflation in other industrial nations has been about the same or higher than in the United States. Most major countries also experienced a leveling off or decline in employment and output last year, and these tendencies were increasingly apparent as the year progressed.

Despite the weakening in economic activity around the world, our export markets held up well last year. Merchandise exports increased considerably, even after allowance for the rise in prices. Our trade balance would have improved, had it not been for the higher price of imported oil, which moved it into substantial deficit. And the exchange value of the dollar has slipped in recent months, due in some measure to capital flows caused by the sharper decline of market interest rates here than abroad.

Mainly because of higher oil prices, most oil-importing countries have had large current deficits during the past year, and some have experienced difficulty in obtaining needed financing. For poorer countries, financing problems have become particularly acute. Recent international understandings to extend the oil facility of the International Monetary Fund, to increase Fund quotas, and to create a $25 billion safety net among member countries of the Organization for Economic Cooperation and Development will help to cope with the international financial problems of 1975. But new strains could develop in international financial markets. Private banking systems handled a huge volume of international financing last year, and it is unlikely that they can repeat this performance in 1975.

Both here and in other industrial countries, monetary policy has responded to the weakening in economic activity by encouraging easier conditions in financial markets. In the United States, that easing has proceeded somewhat faster than has generally been the case abroad. Federal Reserve open market operations began to be more accommodative last summer, and short-term market interest rates began to move down from the exceptionally high levels reached in July. As the year progressed, evidence accumulated that economic activity was weakening and that advances in commodity prices were, therefore, steadily directed towards a more ample provision of reserves to the banking system.

More recently, open market policy has been reinforced by other monetary instruments. The discount rate was reduced on three occasions—in early December, early January, and again this week—from 8 percent to 6¾ percent. Reductions in member bank reserve requirements were also ordered—in September, November, and January, releasing a total of nearly $2½ billion of reserves and thus helping to improve the liquidity position of the banking system.

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Since last July, these policy actions—together with weaker demands for credit by businesses and consumers—have resulted in a sharp decline of short-term market interest rates. Downward movements have continued in recent weeks, even though Treasury financing needs have grown and market participants have begun to anticipate massive Federal deficits that, unhappily, are now in prospect.

Long-term interest rates have also declined, but much less than short-term rates. Lenders are still demanding a sizable inflationary premium to supply long-term funds. Moreover, corporations have issued in recent months exceptionally large amounts of long-term bonds—in part reflecting their need to lengthen debt and thereby improve their liquidity position. Demands for long-term capital by State and local governments have also been well sustained.

The beneficial effects of easier conditions in financial markets are not all registered in the movement of interest rates. For example, member banks responded initially to the greater availability of reserves by repaying their borrowings from the Federal Reserve and by taking other steps that improved their liquidity. Banks became overextended during the 1971–74 credit expansion, and an improvement of their financial position was needed to lay the basis for subsequent expansion of lending. Reductions in the prime rate of interest, therefore, have lagged behind the decline in open-market rates, as banks encouraged businesses to meet their credit needs in the open market.

Growth of the monetary aggregates has reflected this cautious behavior on the part of banks. Despite a series of expansion monetary actions, the narrowly defined money stock—M1—grew at an annual rate of only 1½ percent in the third quarter of 1974 and 4¼ percent in the fourth quarter. In January of this year, moreover, a decline occurred in M1, probably because demands for bank credit were unusually weak during the month.

Broader measures of money have shown more strength than has M1. With interest rates declining, net inflows of consumer-type time and savings deposits at banks and at nonbank thrift institutions have improved markedly. Growth in M2—which includes consumer-type time and savings deposits at commercial banks—rose at an annual rate of about 7 percent in the fourth quarter, compared with a 4½ percent rate in the third. Expansion in M3—a still broader measure of money that includes also deposits at nonbank thrift institutions—showed similar acceleration. Furthermore, the volume of large denomination certificates of deposit and other liquid instruments bought by major investors has continued to increase at a brisk pace.

Enlarged inflows of deposits to savings and loan associations have permitted these suppliers of home mortgage funds to reduce their borrowing and to replenish assets, thereby laying the base for renewed expansion in mortgage lending. The full benefits of these developments will not be felt for some time, but the improved deposit inflows have already had an effect on mortgage interest rates. Rates on new conventional home mortgages have declined by almost a full percentage point from the peaks of early autumn, and lenders are also more active now in seeking out borrowers.

In short, financial conditions have eased in a variety of ways over recent months. The liquidity of banks and other thrift institutions has improved; short-term interest rates have dropped sharply; a large volume of long-term securities has been successfully marketed; uncertainties afflicting financial markets earlier last year have diminished, and stock prices of late have been rising again.

Despite this marked improvement in financial markets, some further decline in economic activity has to be expected. Consumer willingness to spend is likely to be held back by the effects of widespread unemployment on personal incomes; business spending for fixed capital and inventories will be adversely influenced by the deterioration in sales, profits, and internal cash flows; even residential construction activity may remain depressed for a short time in view of the continuing decline in housing starts.

Evidence is accumulating, however, that the corrective forces needed to lay the basis for economic recovery are already underway. Price rebates on autos and other products are helping to stimulate sales. Consumer incomes are being sustained by enlarged unemployment compensation as well as an expanded public service employment program. The adjustments in financial markets to which I have referred should be of major benefit in supplying funds for housing and for other purposes. And the upturn in the stock market is serving to improve the state of confidence.

For their part, businessmen have responded to declining sales and profits by making strenuous efforts to work off excessive inventories, by concentrating production in more efficient plants, and by economizing on labor and materials. In the manufacturing sector, productivity actually improved somewhat during the last quarter of 1974, despite a sharp decline in output. This is a most encouraging development.

Thus, while business activity is likely to slide off further in the months immediately ahead, there is reason to expect an upturn later this year. The stimulative fiscal actions proposed by the President would serve to increase the likelihood of a turnaround in the course of the economy. The personal tax rebate, if enacted promptly, should have a stimulative effect on spending by late spring or summer, and the effects on business capital expenditures of a liberalized investment tax credit should soon follow. The resulting expansion in investment would help to provide more jobs later this year, and would also contribute to moderating inflation over the longer run by improving the capacity and efficiency of our industrial plant.

I cannot stress strongly enough the importance of measures to increase productivity at our Nation's business enterprises. This is the first of several longer range problems to which I want to direct the committee's attention.

For some time now, the trend of productivity in the private nonfarm economy has tended to flatten out. During the past decade, the average annual increase in output per man-hour was less than 2 percent, compared with nearly 3 percent in the previous 10 years. Within the past decade, the rate of improvement in productivity has diminished also. This development has a significant bearing on the living standards of our people, and also on the impact that rising wage rates have on costs of production and prices.

The unsatisfactory record of productivity improvement stems in large part from inadequate investment by business firms in new plant and equipment. Business profits have fallen increasingly short of the amounts needed to finance the growth and modernization of our Nation's industrial plant. Environmental and safety regulations, while desirable in their own right, have often delayed fulfillment of capital spending plans and at times have forced adoption of less efficient methods of production. Productivity improvement has also been hampered by changes in the attitude of the labor force and some laxity in management. Workers nowadays are well trained, but many of them work with less energy than they should, and absenteeism has become a more serious problem.

These changed attitudes toward work are to some degree the outgrowth of a second disturbing trend in our economy—namely the fact that taxes have progressively reduced the rewards for working, while government at the same time has increased the share of national output going to persons who are not productively employed. Twenty-five years ago, a typical worker with three dependents gave up about 1 percent of his gross weekly earnings in Federal income and social security taxes. Since then, that fraction has risen steadily and reached 13 percent in 1974.

Any large increase in the absorption of private incomes by Government poses a threat to individual incentives—all the more so when taxes are levied on persons who work and produce, and the funds are then transferred to others who remain idle. Over the past 25 years, transfer payments by all governmental units—in such forms as public welfare, social security benefits, unemployment insurance, and other public assistance—have risen about twice as fast as total wages and salaries. These transfer payments now amount to almost one-fifth of the aggregate of wage and salary disbursements, and the fraction is steadily increasing. A society as affluent as ours can ill afford to neglect the poor, the elderly, the unemployed, or other disadvantaged persons. But neither can it afford to neglect the fundamental precept that there must be adequate rewards to stimulate individual effort.

Besides weakening individual enterprise, massive increases in governmental expenditures—for social welfare, defense, and whatnot—have been a major cause of intensifying inflationary pressures. This is the third of the longer run problems that our Nation must confront. Inflation has been a problem in this country through most of the postwar period; however, the upward march of prices began to accelerate during the middle 1960's, when our Government embarked on a highly expansionary fiscal policy. Since 1965, total Federal expenditures have risen about 50 percent faster than the gross national product; budget deficits have become chronic; interest rates have soared to unprecedented heights; expectations of rising prices have gotten built into wages and other contracts; and inflation has emerged as the most dangerous economic ailment of our time.

There can be little doubt that inflation is the principal cause of the decline in economic activity in which we now find ourselves. The havoc wrought in our economy by inflation, however, goes well beyond the immediate loss of production and employment. Because of its capricious incidence on income and wealth, inflation has caused disillusionment and discontent among our citizens. And because of

its distorting effects on business decisions, inflation has brought into question the liquidity of some major business and financial institutions.

There is no easy way out of the inflationary morass into which we have allowed ourselves to sink. Unwinding from an inflationary process built up over a decade will take time, and will cause further hardships for our people. But defeat of inflationary forces must remain a major goal of public policy. We cannot realistically expect to regain lasting prosperity until businesses and consumers glimpse some end to the inflation that has been damaging our economy.

Lasting prosperity will also require steps to reverse the deterioration in corporate profits that has taken place over the past decade or more. This is another longer run problem of major importance.

The condition of business profits is widely misunderstood. Profits are thought by some observers to be ample, or even overabundant. The fact is, however, that profit margins of nonfinancial businesses have been declining rather steadily for many years, and profits in the aggregate have been far too low in recent years to supply the financing needed for a vigorous expansion in capital investment.

The major source of confusion about the recent behavior of corporate profits is not hard to find. Last year, the estimated pretax profits of all nonfinancial corporations from their domestic operations were 16 percent higher than in 1973 and 46 percent higher than in 1972. The dominant factor in this rise, however, was an enormous increase in inventory profits—an element of earnings that is illusory. It stems from the fact that the accounting practices of many corporations still do not allow for the fact that inventories used up in production must be replaced at higher prices during a period of inflation. As a consequence, costs of operation have been understated, and fictitious profits have been created that are being taxed by the Federal Government.

Excluding this illusory inventory profit, the after-tax domestic profits of nonfinancial corporations did not rise last year. On the contrary, they declined by 20 percent, and were smaller than 8 or 10 years earlier—when the dollar value of the output of these corporations was about half what it is today.

Last year, in fact, the aftertax profits of nonfinancial business corporations—adjusted for inventory gains—were no larger than the amount of dividends these firms paid to their stockholders. Worse still, when allowance is made for the fact that depreciation schedules for fixed capital are also based on historical costs—rather than replacement costs—and thus contribute yet another illusory element to book profits, these firms actually paid out more in dividends to their stockholders than they earned from current production.

As I noted earlier, this slump in corporate profits is a major reason why business capital investment has been impeded and why the rate of productivity improvement has been sluggish. But there has been another ominous consequence of deteriorating business profits—namely, some decline in the financial strength of our Nation's business firms. This is the fifth longrun problem to which this committee's attention should be directed.

Years ago, when their profit positions were more adequate, our Nation's major business corporations financed much of their capital investment from internal sources rather than from borrowed funds.

However, dependence on borrowed funds has been rising steadily for more than a decade. In the past 5 years, funds borrowed in the money and capital markets by all nonfinancial corporations averaged nearly 70 percent of the amount raised internally, and in 1974 their borrowings appear to have exceeded their internal funds.

This growing reliance on borrowed money has brought with it a steep rise in the amount of debt owed by business firms relative to their equity positions. In 1950, total liabilities of manufacturing corporations amounted to less than half of the book value of stockholders' equity. Today, the magnitude of debt and equity for manufacturing corporations are almost equal. Moreover, a large part of the indebtedness piled up by business firms has been in the form of short-term debts, and these in turn have grown much more rapidly than holdings of current assets. The liquidity position of nonfinancial businesses has thus been weakened.

These are disturbing trends. The balance sheets of many of our business corporations have become distorted by the need to finance capital investment from external sources. Moreover, the issuance of new stock has been inhibited by unreceptive markets and by tax considerations. The consequence has been that margins of equity have been significantly reduced, and many large businesses no longer have the resiliency they once had to resist economic and financial adversity.

The sixth longer range problem of major concern to the Nation is the foreign exchange value of the dollar. Actually, the dollar began weakening many years before its formal devaluation in 1971. Earlier, there had been an enormous rise in the dollar holdings of foreign central banks, because our balance of payments was in deficit for a prolonged period. Capital outflows—some of them speculative—were large, and they were offset by surpluses in our current account because costs and prices in the United States were rising rapidly. The devaluation of 1971 and also that of 1973 were thus a consequence of trends that had been underway for many years.

Following the second devaluation in 1973, the foreign exchange value of the dollar has fluctuated fairly widely, but without much net change. Such fluctuations make it more difficult for foreign traders and investors to make rational plans for the future. We must bear this in mind, and also the fact that any appreciable decline in the external value of the dollar would add to our domestic inflationary problem. The Federal Reserve and other central banks can and occasionally do intervene to smooth out movements in exchange rates. But a substantially greater degree of exchange rate stability will not be achieved until underlying economic and financial conditions have been put in better order.

Let me now turn in conclusion, to the implications for public policy of our immediate and longer range economic difficulties. The most urgent need at the present time is for measures to cushion recessionary forces. But great care must be taken to avoid aggravating the underlying inflationary forces that have produced our present problems.

Action to reduce income taxes temporarily is an appropriate course at the present time. Because of inflation, many individuals have moved into higher tax brackets, even though their real incomes have declined or remained unchanged. Unless personal tax rates are

reduced, that trend will continue and the automatic budgetary stabilizers we normally count on to moderate recessionary tendencies will therefore not function effectively. Also, action is needed to reduce business taxes in view of the serious deterioration in corporate profits, and the taxing of illusory profits by the Federal Government.

The President's fiscal program recognizes the need to deal with the current recession and yet avoid releasing a new wave of inflation. Both the tax rebate to individuals and the increase in the investment tax credit will provide a temporary boost to aggregate demand without adding to Federal deficits over the longer run. Moreover, increases in Federal expenditures are to be limited in several ways—by postponing new program initiatives apart from the energy area, by various rescissions and deferrals of spending for existing programs, and by ceilings on increases in social security benefits and on Federal pensions and salaries. Even so, Federal expenditures should be scrutinized with special care in an effort to hold spending well below the levels in the President's budget message. Such a step would improve the prospects for moderating the rate of inflation, and would also bolster the confidence of our people by indicating the clear intent of the Congress to stick to a course of fiscal prudence.

These same considerations must guide the course of monetary policy in the months ahead. The Federal Reserve intends to encourage recovery by providing for an adequate expansion in supplies of money and bank credit. Relatively soon, growth in the monetary aggregates—including the narrowly defined money supply—should strengthen. Let me assure this committee, however, that we have no intention of permitting an explosion in money and credit no matter how large private or public financing demands may become. Such a reckless course of action might hold short-term interest rates down for a time, but it would before long plunge our economy into deeper trouble.

This committee would be well advised to focus a large part of its attention on the course of public policy needed to cope with the serious longer range problems facing the Nation. The issues at stake are large and complex, and solutions will not be readily found. Besides a major national program to deal with the critical problem of energy—which I have not discussed—it seems clear that efforts to gain a better measure of discipline in Federal finances have become a matter of great urgency. Ways must be found to curb the ever increasing share of the national income absorbed by governmental programs—especially programs that transfer funds from persons who work to those who are not productively employed. Ways must be found also to strengthen business profits and the state of business finances, and to increase the incentives for expansion of productive capacity and for modernization of our Nation's industrial plant.

Above all, ways must be found to bring an end to inflation, and thus lay the basis for a lasting prosperity at home and a strengthening of our position in international markets. Our people are weary of inflation; they are confused and disturbed by the huge budget deficits that are in the making this fiscal year and next; and they are anxiously awaiting evidence that their Government can and will take the necessary steps to restore economic and financial stability.

Thank you.

Chairman HUMPHREY. Mr. Burns, we are very much indebted to you for a very comprehensive statement and for some positive and constructive proposals for this committee.

May I assure you that in reference to the last page of your statement, your final comments, that this committee will endeavor to concentrate its attention not only on the immediate, but also on some of the longer-term ramifications of current Federal policy and the changes that may be needed in reference to Federal financing.

You have given us a great deal to think about here, and I am sure that we will need your counsel on these ideas more than just today. We have to deal with the immediate problems, and therefore I am going to concentrate my questioning upon those of a contemporary nature but let me say for the record that I recognize as a member of this committee the need for capital formation in this economy of ours. I know it is not easy for a Member of Congress to talk about the necessity of adequate profits for business but it is a necessity, and particularly as we move into a more technologically advanced society where the cost of the equipment increases very rapidly. We will be looking into this whole matter of the relationship of our tax structure to the formulation of capital and to the relationships of profits to capital structure, and hopefully, to find some better way to provide for the capital formation.

I am deeply concerned about this as one Member of Congress. What does disturb me about some of the more immediate developments is what has happened to the rate of money supply, as you have discussed it with us today.

At the December 16 meeting, that meeting has now been made public, the proceedings of the meeting of the Federal Reserve Market Committee. The Federal Open Market Committee agreed in December of 1974, January of this year, the money supply would grow at a rate of about 5 to 7 percent.

To achieve that, the committee agreed to let the Federal funds rate go as low as 7½ percent. Subsequently, this was moved down to 7⅛ percent. You achieved, by this action, your interest rate target. The Federal funds rate averaged 7.2 percent, as I understand it, in January, but the money supply which is so vital did not grow at all.

The fact is, according to our staff analysis here, the money supply declined from mid-December to mid-January. My question is, and you can enlighten us on this, why did the money supply fail to respond to the substantial drop in interest rates during this period? An auxiliary to that, or a supplemental, is the economy in your mind so weak that there is simply no demand for loans?

I understand that business loans fell substantially during December and January. Also, consumer credit outstanding fell.

During the remainder of the year do you expect the money supply to grow in response to lower interest rates? Does not the siutation of very weak credit demand point to the need for more rate routes for easier money and lower interest rates?

That is a complex question but you have the thrust of it, I am sure.

Mr. BURNS. Let me comment on these questions. But before I do that, Mr. Chairman——

Chairman HUMPHREY. May I interrupt a moment? Senator Sparkman has to leave to go to the Appropriations Committee.

Do you have any comments?

Senator SPARKMAN. I could make many. I enjoyed your statement, as I always do. I have the same faith and confidence and interest that you stated.

Chairman HUMPHREY. Mr. Burns, proceed on the basis of the question that I have placed before you.

Mr. BURNS. Let me say first of all that I feel deeply encouraged by the constructive comments that you have made about the needs of our economy, and about your own intention to concern yourself—and have your committees concern itself—not only with the immediate problems but with some of the longer-range difficulties that our Nation is facing. I find your approach most encouraging.

Let me comment next on money supply growth in recent months. There is a tendency, Senator, nowadays on the part of many economists, members of my profession, and on the part of other citizens, to focus on one concept of the money supply; namely, demand deposits plus currency in public circulation. The fact of the matter is that financial technology in our country has been changing dramatically. All you have to do is talk to an alert corporate treasurer who is in charge of the finances of one of our great and enterprising corporations. He is likely to tell you that the checking account that he keeps at his bank, or series of banks, is a necessary convenience, but that it no longer adequately represents his corporation's need for transactions or precautionary balances.

Corporate treasurers have learned that they can hold their transactions and precautionary balances in the form of interest-earning assets, and this trend has been very rapid in our country. All that a corporate treasurer has to do nowadays is take any of a number of large certificates of deposit that he happens to have and telephone his bank; the bank will immediately, through processes that take almost no time, convert that certificate of deposit into a checking account balance.

I think the economics profession, if I may say so, or many members of the economic profession are behind the times. They are still focusing on M1, but M1 has lost much of the significance that it had in earlier times.

Chairman HUMPHREY. Mr. Burns, because you are both the Chairman of the Federal Reserve Board and essentially and basically a great teacher, when you say M1, will you define that for us again for the public because we are going to try to do some economic education for our society?

Mr. BURNS. I am very glad to hear you say that, Senator. M1 simply means the volume of demand deposits—that is, checking accounts of our business firms, individuals, families—plus currency that people have in their pocketbooks and in their cashboxes.

Chairman HUMPHREY. That is, in a sense, a minor part of the total financial assets of the country.

Mr. BURNS. Exactly.

I can make my statement more concrete. Let us look first at currency in public circulation. In the last quarter in 1974 that went up very rapidly, at an annual rate of 11.6 percent. With prices rising as they have, people have to keep more currency in their pocketbooks in order to carry out their transactions. For demand deposits of

commercial banks, the rate of growth was only 2 percent in the last quarter. On the other hand, time and savings deposits at commercial banks grew at an annual rate of 9 percent. The deposits of non-bank thrift institutions—that is, savings banks and savings and loan associations—grew at an annual rate of 6.9 percent. CD's—negotiable certificates of deposit in denominations of $100,000 and over—grew at an annual rate of 25.9 percent. Credit union shares grew at an annual rate of 9 percent. And so forth and so on. You see, if you focus just on demand deposits plus currency in circulation—and currency in circulation is a small fraction of M1—you really miss what has been happening to the money supply.

I think that the economics profession is behind the times. Financial technology has been exploding and people still talk about M1 as they did 20 years ago.

I work now with about eight measures of the money supply and I need to do that. Even that is a simplification of what is happening to the money supply.

Chairman HUMPHREY. Let me ask a question very directly.

Do you feel, Mr. Burns, after this discussion about what we call M1, and you went into what we call M2 and M3 and you pointed out there is a strata of about eight layers here of different types of money supplies and mechanisms that you work with, the question I have, do you feel that the present rate of money supply is adequate in light of the current economic conditions?

If not, what do you contemplate to do about it?

Mr. BURNS. I would like to see the narrowly defined money supply, on which so much interest is focused, grow more rapidly. But in the aggregate the money supply, I think, is growing at a very satisfactory, possibly even an excessive, rate.

Chairman HUMPHREY. What would you say is the rate now of the totality of money supply as you work with it?

Mr. BURNS. For that measure—I can supply a precise description for the record—the rate of growth in the fourth quarter was 7.8 percent.

Chairman HUMPHREY. What would you say is the total of the increase in the money supply.?

It is not true, Mr. Burns, that for most of the economy, the so-called M1 equation is the one that is looked to and on which we base much of our judgment as to money supply?

Mr. BURNS. That is just what I was saying. I think it is a mistake, Senator. If I do nothing else at this hearing, I hope that I can interest your committee and your staff in paying closer attention to monetary and credit aggregates at large, and not simply to the narowly defined money supply, which is a carry-over from an earlier and much simpler financial age.

I want to make one more comment, Senator, which I think is very important to keep in mind. My judgment is—and I believe that any student of financial history who has studied these matters in any depth at all will agree—that the difficulty we face at the present time, and it is a difficulty that our country has faced repeatedly during recessions, is not that the money supply is inadequate. This country has plenty of money. In fact, this country is awash with liquidity. The difficulty is that the velocity of money, the willingness to use the existing stock of money, just is not there.

The stock of money is a rather steady variable. The fluctuating, dynamic variable in our economy is not the stock of money but the velocity, or the turnover of money, the willingness to use the money that exists, and that depends, Senator, on the state of confidence.

Chairman HUMPHREY. I do not disagree with that. I surely agree that the turnover in use of supply is even possibly as significant or more significant that what is the alleged supply.

I want to read a brief statement and turn the questioning over to Senator Javits. The statement relates to what information we have this morning concerning the unemployment rate and undoubtedly it will provide some comment from you, which I would appreciate.

I have just been informed by the Bureau of Labor Statistics that the national unemployment rate for the month of January reached an incredible 8.2 percent, the highest level since the end of the depression. The number of unemployed workers jumped by nearly 1 million in the month of January alone to a total of 7.5 million unemployed workers. Furthermore, the total employment dropped for the fourth straight month.

As frightening as the national rate of 8.2 percent is, it, in fact, hides a much worse situation for millions of Americans; the rate for blacks in January was a whopping 13.4 percent; that is for adult blacks. For teenagers the rate was 20.8 percent. And among blue collar workers the rate jumped to 11 percent.

The President's program, as I see it, is clearly inadequate to deal with these near-depression levels of unemployment, levels that continue to grow and not to recede.

The President and the Congress must respond to this tragic rise in unemployment with actions and policies, some of which you have mentioned this morning, Mr. Burns, but others that I would like to get you to comment upon as you answer questions today.

First, an immediate reduction in taxes for individuals and businesses and at a much larger rate than the President has proposed in light of the new evidence on recession that is before us.

I happen to believe that there ought to be a rebate of $10 million in 1974 taxes for individuals and corporations and approximately a $20 billion tax cut for 1975 through a reduction in withholding rates and some tax credit for workers with incomes under $14,000 a year to compensate for their heavy social security taxes.

Secondly, adequate income support payments for the elderly, the disabled, the unemployed, and others who have great need.

And thirdly, a much larger program of public service employment that is provided for in the President's budget. I think that we need a job program that would vary with the level of unemployment rate and provides a minimum of 1 million jobs immediately.

Finally, relating directly to your responsibilities, which, I am sure, will be discussed here today, vigorous action by the Federal Reserve System to make credit available at reasonable interest rates and to see that no essential sector, such as housing, is squeezed out of the credit market.

I just state this and we will come back to it. And I turn the questioning over to Senator Javits.

Senator JAVITS. Thank you very much, Mr. Chairman. Mr. Chairman, I so thoroughly agree with you. I introduced with 13 sponsors

yesterday a bill for a million public service jobs. I think you are on it.

Chairman HUMPHREY. Yes, I am.

We have looked to Senator Javits and his colleague, Senator Williams from New Jersey, as the leader in this public service job area. I have joined with you on others.

Senator JAVITS. We are in a very serious emergency. The one thing I would like your comments on, Mr. Burns, is this drop which has been unbelievably precipitant. Even in your own statement, you recognize the major difference between November and December in 1974. Because we do respect you so much, I do not need to attest to that; we all feel that very deeply. What do we draw from that as a way of instruction in applying remedies?

Is the precipitousness of the drop, which is so vivid, is it instructive in any way to us, or should it be?

Mr. BURNS. I will give you an interpretation of it which may or may not be right. During the greater part of 1974—until approximately October—the overall demand for goods and services was weak and was tending to dwindle. Nevertheless, employment kept increasing gradually. I think what happened during that period was that our business firms, misled by inflation, looking at dollar volumes, failed to read the economic signs accurately. They hoarded labor. But eventually economic facts catch up. The declines of employment that otherwise would have occurred earlier have been concentrated in these very recent 3 or 4 months.

Now, how do we interpret this decline? There are two interpretations, and I wish that I could be certain which of these interpretations is correct. I will give you a judgment. I must warn you that there are great uncertainties in interpreting matters of this kind. My own judgment of what is happening now is that the economy has moved from a high rate of inventory accumulation into a phase of inventory liquidation and that inventory liquidation is now proceeding at a rapid rate. A rapid rate of inventory liquidation, providing final sales hold up pretty well, means that the decline in economic activity must come to an end very soon. If the rate of final sales were entirely steady, a decline in the rate of inventory liquidation alone would suffice to give you an immediate upturn in production and employment.I believe that something like that is going on, but it is not that simple, because final sales have not been steady. If final sales slump then you can move into a very serious economic decline.

My judgment is that some of the automatic stabilizers are beginning to work, with unemployment compensation expanding in response to congressional action. There has also been some increase in Federal service employment, although that has been inadequate, Senator. If the Congress moves promptly on a tax reduction, I think that final sales are likely to stabilize. That is a judgment that may be proved wrong, but if it happens, this recession will not last much longer, and the rapidity of the decline will make for a faster upturn in the economy. But there are great uncertainties here. We must keep these uncertainties, as well as the kind of judgment that I have expressed, very much in mind.

Senator JAVITS. Mr. Burns, I think that is critically important, what you have said. Do I interpret it correctly to mean that the first priority must be given, therefore, in the Congress to whatever will put tax money back into the pockets of the consumer, and, of course, parallel with it, the relief of the problems of the unemployed through unemployment compensation and public service jobs? And must the programs dealing with the energy problem now follow that first priority rather than proceed it or be joined with it?

Mr. BURNS. I agree entirely.

Senator JAVITS. That leads me to another question that I would like to raise with you. I listened with the greatest interest to your statement where you said, "We have no intention of permitting an explosion in money and credit no matter how large private or public financing demands may become."

I ask you this question. There is a great deal of feeling, that I share very devotedly, that the action proposed by the administration is far too timorous. It is not bold enough. Aside from raising serious social questions of proceeding to ration by price, which hardly seems egalitarian in this kind of a society, there is a lot of feeling that we have to telescope Project Independence on a war basis in 3 years instead of 10 years. That would mean a war demand for credit, perhaps an additional $100 billion.

Suppose the Congress should act that way, the Congress this time taking the bit in its teeth. What would be, in your judgment, the monetary and economic consequences?

Mr. BURNS. Senator, I wish I knew more about the energy problem than I do. It is not an area which I have studied with any thoroughness so far. I find the President's program extremely complicated. There are some parts of it I think are hazardous at a time like this. I think the President's objectives are fine. He is seeking to conserve oil, and I think we all recognize that need. He is seeking to stimulate alternative sources of supply, so the fate of our Nation will not be in the hands of Arab sheiks, and I think we would all agree to that. But I, for one, would want to phase in that kind of a program, and not concentrate it in the manner that the President has suggested.

My advice to the Congress would be to talk very frankly to the President, and try to work out a compromise with him; and I would be surprised if you could not achieve that. I may be oversimplifying the facts of life, but I feel there is great sincerity all around.

Senator JAVITS. I do not think you are overdoing it at all. Senator Humphrey and I and the majority of the committee made exactly that overture to the President.

My time is up, Mr. Burns. I do not want to press you unduly. I ask unanimous consent to include a response of Mr. Burns to questions I will put to him in writing as to how the lending guidelines which the Federal Reserve, in brilliance, in my judgment, has laid out for the banks.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you, Senator Javits.

Without objection, the information requested by Senator Javits of Mr. Burns will be placed in the record at this point.

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

RESPONSE OF HON. ARTHUR F. BURNS TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR JAVITS

Question 1a. Last year in a Joint Economic Committee hearing you and I (Senator Javits) discussed the possible need for lending guidelines for banks. Shortly after that lending guidelines were promulgated by the Federal Reserve Advisory Board. *Since that time banks have been asked to report on their compliance with these voluntary guidelines.* Please bring us up to date on Fed action since the promulgation of the guidelines, and whether you have plans to go further in this direction.

Answer. The Federal Reserve Board sent the guidelines promulgated by the Federal Advisory Council to all member banks of the System (press release attached). As follow-up, a questionnaire was sent to a sample of banks in December to determine how they accommodated their policies to the suggested guidelines, taking into account the change in economic and credit conditions since the guidelines were first formulated. A copy of the questionnaire is attached for your information, and a summary of responses will be sent to you when tabulations are completed. Finally, we are currently planning to resurvey the sample of banks in early spring, and will probably modify the questionnaire to some extent in light of changed conditions and to take account of experience with the initial survey.

Question 1b. The House Banking Committee is considering legislation to require mandatory credit allocation, and Andrew Brimmer, formerly a governor of the Federal Reserve, has suggested that a mandatory credit allocation program could operate along the same lines as the recently terminated *Federal Reserve Voluntary Credit Restraint Program,* which limited bank lending to foreigners, and without large numbers of employees to staff the operation. How would these proposals differ from the present guidelines? Would you favor either proposal, and why?

Answer. The attached letter to Congressman Reuss of February 18, 1975, discusses the issues raised by credit allocation programs, and is, I believe, responsive to your question. The Board remains opposed to any program of mandatory credit allocation. As the letter points out, the VFCR was a far simpler program with much more limited objectives than would be involved in a domestic credit allocation program.

Question 1c. Would you agree that a combination of a continued slow growth in the money supply and large Federal deficits might well require a rationing of credit? If you do not agree, do you agree with Secretary Simon's assessment that large Federal deficit financing will seriously impair private borrowing?

Answer. The extraordinarily large budgetary deficits that loom ahead will very likely, as time goes on, exert upward pressure on the interest rate structure and affect the cost and availability of funds to private borrowers. The degree of pressure will, of course, depend on the strength of economic recovery and of related private credit demands, as well as on the course of monetary policy. Growth in the money supply (narrowly defined to include only currency and demand deposits) may begin to pick up in the months ahead, given the degree of easing already put in place by monetary policy actions. But so long as growth rates of the monetary aggregates—whether narrowly or broadly defined—are kept within non-inflationary bounds, an enlarged budget deficit inevitably runs the risk of diverting credit resources from needed productive and socially desirable private investment. Moreover, this risk would not be reduced by a very large expansion in money, since excessive monetary growth would generate additional inflationary pressures and thereby add to upward pressures on interest rates, especially longer-term rates.

Credit rationing is not a workable alternative to a more restrained fiscal policy. For reasons that I have discussed at length with Congressional committees, credit rationing—particularly as it becomes mandatory and comprehensive—is simply unmanageable, inevitably leads to gray markets, substitutes governmental decisions for the efficient functioning of private markets, and is in the end self-defeating. I do not mean that there is no role for governmental programs, such as in the housing and small business area, that supplement the private market, particularly in periods of credit market pressure. But I do want to stress that the best means of assuring a continued flow of productive private credit is to limit Federal expenditures, and to work toward a responsible budgetary posture.

Question 2a. A recent article in Business Week argued that the Federal Reserve Board will shape economic recovery in this country through its monetary policy. It pointed out the very slow growth in the money supply since last June, and concluded that while there may be certain technical problems the slow growth of the money supply has grown so slowly in spite of such actions as reductions in the federal funds rate, cuts in the discount rate, and a reduction in reserve requirements.

Answer. No single measure of money supply is a satisfactory representation of the course of monetary policy because of the rapidly shifting public preferences for various types of highly liquid assets. Moreover, growth rates in money supply vary widely over time.

It is true that over the seven-month period from June 1974 through January 1975 growth in the most narrowly defined money supply—currency and demand deposits held by the public (M_1)—has been at only a 1.3 percent annual rate. Other more broadly defined measures of money have, however, grown more rapidly. In addition, their growth rates have tended to accelerate as the easing actions noted in your statement above have been taken. And it is very likely that growth in M_1 will pick up in the months ahead partly in reflection of the cumulative impact of recent easing actions. The table below shows recent growth rates in selected measures of money supply.

	M_1	M_2	M_3	M_3	M'_3
3d quarter 1974	1.6	4.5	6.0	4.0	5.1
4th quarter 1974	4.6	7.0	9.2	6.9	8.6
7 mo from June 1974 thru January 1975	1.3	5.4	7.7	5.5	7.1

Note.—M_1 represents currency and demand deposits in the hands of the public. $M_2=M_1$ plus time and savings depos its at banks other than money market certificates of deposit issued by banks. $M_3=M_2$ plus deposits at savings and loan associations and mutual savings banks. $M'_2=M_2$ plus money market CD's issued by banks. $M'_3=M_3$ plus money market CD's and credit union shares (i.e., all bank and thrift institution deposits).

Economic recovery will be shaped by much more than monetary policy or trends in the money supply, whether narrowly or broadly defined. A very important factor, often overlooked in monetarist analysis, is the state of confidence in the economy. This affects the rate of turnover of money—i.e., the public's willingness to utilize the cash or liquid assets on hand for spending—which has had as much, or more, influence than the stock of money on cyclical fluctuations in the economy. Without confidence, increasing injections of liquidity can be offset by reductions in turnover as the public holds back on spending. With confidence, the existing stock of money can be used more intensively and generate economic recovery.

Question 2b. If Congress should enact tax cuts larger than those proposed by the President or appropriations larger than those recommended by the President, what would be the response of the Fed? Would you attempt to slow the growth of the money supply to compensate, and what effect would this have on economic recovery? Is there a mechanism for closer consultation among the Executive, Congress and the Fed so that moves in one direction are not thwarted by opposite actions from one of the three?

Answer. There is close, and continuous, consultation between the Federal Reserve and the Executive and the Congress. Thus, I do not believe that public policy is being impeded by any gaps in the consultative process. We do stand ready, of course, to work with the Congress to the fullest extent necessary to enhance mutual understanding. With respect to the Executive branch, I have been kept fully informed of policies as they have developed.

It is not possible to predict in advance, however, how the Federal Reserve would respond to changes in tax and expenditure policies from those recommended by the President. The response would, naturally, depend on how the new policies affected economic activity, prices, and employment. Needless to say, though, it is placing too much stress on the influence of monetary policy to believe that the Federal Reserve can take actions that would fully offset the impact on the economy of changes in so powerful an economic tool as fiscal policy. Fiscal policies will have a strong influence on the economy, particularly in the short run, independently of monetary actions. Thus, the Federal Reserve does not have it within its power fully to compensate—whether it wanted to or not—for the effects on economic activity and prices of other governmental policies or of shifts in confidence and demands generated within the private economy.

Question 2c. Would you be willing to make a commitment to a relatively fixed level of monetary growth in return for a Congressional commitment to hold the deficit to a fixed level? In particular, I am thinking of the example of the German Central Bank and its commitment to 8 percent monetary growth.

Answer. I believe it would be a mistake for the Federal Reserve to commit itself to a relatively fixed rate of monetary growth under any circumstances. Our economy is far too complex and economic and credit conditions far too changeable, including the effects of external factors, to limit monetary policy to a fixed rule of behavior. Monetary policy is generally formulated with longer-run growth rates for a variety of monetary aggregates in mind, but such growth rates are continuously re-evaluated in light of changing conditions. Thus, I would not think it is in the public interest to trade a relatively fixed monetary rule for a Congressional commitment to hold the deficit to a fixed level—no matter how desirable is a Congressional commitment to limiting the deficit in a period when there is a real threat of excessive Federal spending.

With regard to the German Central Bank and its commitment to an 8 percent growth target for central bank money in 1975, it must be recognized that economic and other conditions differ greatly between our two countries and that the Bundesbank's announcement of a growth target reflected rather special concerns given their particular economic environment. It should be noted that the Bundesbank's target is expressed in terms of its own particular definition of money, and the Bundesbank has called attention to the irregularity of the short-term connection between the money supply and central bank money. Finally, the German Central Bank commitment was not tied to a commitment to maintain a fixed level of the government budget deficit.

Attachments.

September 16, 1974.

The Board of Governors of the Federal Reserve System today released the attached statement on bank lending policies that was received from the Federal Advisory Council, a statutory body established under the Federal Reserve Act. The statement suggests how banks can effectively adapt lending policies in the current period of credit restraint.

The Board believes the Council's statement can be helpful to commercial banks in formulating their lending policies under current circumstances.

The Board regards restraint in lending policies as essential to the national effort to control inflation. Restraint best serves the public interest when limited credit resources are used in ways that encourage expansion of productive capacity, sustain key sectors of national and local economies, provide liquidity for sound businesses in temporary difficulty, and take account of the legitimate needs of individuals and of small as well as large businesses.

The Board noted particularly that the Council in its statement recognized "the special vulnerability of the home-building industry." An active home-building industry is vital to the well-being of local communities as well as of the nation as a whole, and it is to the interest of banks and other financial institutions to give reasonable support to the financial needs of that industry.

The Federal Advisory Council is composed of twelve leading bankers, one from each Federal Reserve District. It was created by the Federal Reserve Act and under law is required to meet with the Board of Governors at least four times a year. The attached statement stems from a discussion of bank lending policies during a recent FAC meeting with the Board.

The FAC statement, together with the Board's covering statement, is being mailed to all member banks in the Federal Reserve System.

Statement of the Federal Advisory Council on Commercial Bank Lending Policies

The members of the Federal Advisory Council firmly believe that inflation remains our most acute domestic problem and that the effort to reduce it deserves the full dedication of all Americans. We have been pleased recently to observe the renewed efforts of the Administration and other segments of our national government, in consultation with a broad representation of interested groups in the private sector, to identify appropriate and effective policies to deal with this problem.

As bankers we are acutely aware of the disproportionate role which a restrictive monetary policy has had to bear thus far in the fight against

inflation. We are particularly hopeful that fiscal and other measures will be adopted which will soon alleviate this excessive reliance on monetary restraint and high interest rates, because government spending and budget deficits are a major cause of inflation.

We recognize, however, that regardless of the measures adopted, money and credit will necessarily remain limited in supply as long as inflationary pressures persist. We are confident that sufficient money will be made available to assure orderly operation of credit markets and to provide for the resumption of real growth in the economy. However, we foresee a period of considerable duration when the supply of lendable funds will be limited, and when, therefore, it will be necessary for banks to restrict the growth in their loan portfolios by selecting carefully and responsibly the uses to which they put their loanable funds.

It is also clear that this process contributes to the very desirable objective of reducing interest rates, a development banks welcome. Relief from the present unprecedentedly high rates would be particularly beneficial to those segments of the economy that are by their nature heavily dependent on borrowed money, such as housing and public utilities.

In view, therefore, of the extreme importance of bank lending policies in today's environment, we should like to describe those policies which we believe are appropriate in present circumstances and which, we feel, are already being followed by many banks.

The basic credit needs for normal operations of all established business customers should, of course, be met to assure the production and distribution of goods and services.

Loans to finance capital investment by business are also appropriate, where access to capital markets is not available and where the investment is reasonable in size and necessary to maintain or improve productivity, or to increase capacity to meet existing or clearly anticipated demand. In considering such loans, banks should weigh the relative importance of the particular business with respect to such factors as the nature of its product or service and its significance as an employer in the local area.

Particular consideration should be given to the needs of established businesses which are basically sound but which suffer a temporary lack of liquidity because of present conditions.

Loans for purely financial activities, such as acquisitions or the purchase of a company's own shares, would normally not be appropriate uses of limited bank funds.

Loans for speculative purposes, such as purchasing securities or commodities other than in the ordinary course of business, excessive inventory accumulation, or investing in land without well-defined plans for its useful development, are not generally suitable.

A regrettable aspect of restrictive monetary policy is that it tends to produce an uneven impact, bearing more heavily on some sectors of the economy than others. Therefore, banks should make an effort to utilize their limited funds equitably, giving consideration, for instance, to the special vulnerability of the home-building industry.

Similarly, consumer credit should receive its share of bank funds. The basic requirements of individuals for household needs and automobiles should be accommodated, but discretionary spending which might be deferred should not be encouraged.

Loans to foreigners which are funded from domestic sources should also be weighed against the above criteria. In addition, banks should give careful consideration to the diversion of loan funds from United States customers through such loans.

Implicit in these policies is a need for close communication and counseling between bankers and their customers to agree on ways to reduce or defer borrowing needs or to identify alternate sources of financing.

The Council recognizes that it is impossible to prescribe a precise and particular list of priorities for proper bank lending. We do feel, however, that the policies outlined describe a responsible posture that is appropriate to present circumstances. We believe that governmental credit allocations are not needed and that they would be counter-productive.

We are confident that the nation's banks will continue to cooperate with our government and all sectors of the economic community in implementing sound and necessary national policy.

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QUARTERLY SURVEY OF BANK RESPONSE TO FAC STATEMENT ON LENDING POLICIES

December 1974

On September 16, 1974, the Board of Governors of the Federal Reserve System mailed to each member bank a statement on bank lending policies developed by the Federal Advisory Council (FAC) suggesting how banks could effectively adapt lending policies in a period of credit restraint. The enclosed survey was developed for the purpose of ascertaining current bank response to the FAC statement, a copy of which is attached.

The questionnaire should be completed by a senior officer familiar with the bank's lending practices in the areas covered. Please return one copy of the completed report by February 10, 1975 to:

Banking Section
Federal Reserve Board
Washington, D.C. 20551

A. General questions.

1. Has your bank transmitted to its loan officers the contents of the FAC statement on commercial bank lending policies?

   Yes ☐ No ☐

2. Has your bank issued specific guidelines to its loan officers to implement the loan policies in the FAC statement?

   Yes ☐ No ☐

3. It is recognized that over-all credit conditions and the position of individual banks change. Either because of changes in credit demands, changes in fund availability, or changes in the over-all economic situation, how would you evaluate the urgency of credit allocation at your bank as compared with the situation prevailing in mid-September 1974, when the FAC statement was published (check one)—

   Significantly greater ☐

   Essentially unchanged ☐

   Significantly less ☐

B. Questions relating to the specific loan policies outlined in the FAC statement. Please check the appropriate box in both parts "a" and "b" for each question.

1. With respect to *loans to meet basic credit needs for normal operations of established domestic business customers* —

a. Was the number of applications or requests for such loans or loan commitments received during December, as compared with the usual experience for the same month in recent years—

Significantly larger ☐

Essentially unchanged ☐

Significantly smaller ☐

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in December

Significantly larger than usual ☐

Essentially unchanged ☐

Significantly smaller than usual ☐

2. With respect to *loans to domestic customers to finance capital investment where access to capital markets is not available and where the investment is reasonable in size and necessary to maintain or improve productivity, or to increase capacity to meet existing or clearly anticipated demand* —

a. Was the number of applications or requests for such loans or loan commitments received during December, as compared with the usual experience for the same month in recent years

Significantly larger ☐

Essentially unchanged ☐

Significantly smaller ☐

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in December

Significantly larger than usual ☐

Essentially unchanged ☐

Significantly smaller than usual ☐

3. With respect to *loans to basically sound, established domestic businesses suffering temporary lack of liquidity because of present conditions* —

a. Was the number of applications or requests for such loans or loan commitments received during December, as compared with the usual experience for this period in recent years

Significantly larger ☐ Significantly smaller ☐

Essentially unchanged ☐ None received ☐

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in December

Significantly larger than usual ☐ Significantly smaller than usual ☐

Essentially unchanged ☐ None approved ☐

4. With respect to *loans to finance the home-building industry* (residential financing and mortgage loans)* —

a. Was the number of applications or requests for such loans or loan commitments received during December as compared with the usual experience for the same month in recent years

Significantly larger ☐

Essentially unchanged ☐

Significantly smaller ☐

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* Please include in your answer, to the extent possible, the activities of your mortgage finance subsidiaries.

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in December

Significantly larger than usual ☐

Essentially unchanged ☐

Significantly smaller than usual ☐

5. With respect to *loans to individuals extended to meet their basic requirements for household needs and automobiles* –

a. Was the number of applications or requests for such loans or loan commitments received during December as compared with the usual experience for the same month in recent years

Significantly larger ☐

Essentially unchanged ☐

Significantly smaller ☐

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in December

Significantly larger than usual ☐

Essentially unchanged ☐

Significantly smaller than usual ☐

6. With respect to *loans to domestic customers for purely financial activities, such as acquisitions or the purchase of a company's own shares* –

a. Was the number of applications or requests for such loans or loan commitments received during December as compared with the usual experience for the same month in recent years

Significantly larger ☐ Significantly smaller ☐

Essentially unchanged ☐ None received ☐

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in December

Significantly larger than usual ☐ Significantly smaller than usual ☐

Essentially unchanged ☐ None approved ☐

7. With respect to *loans to domestic customers for speculative purposes, such as purchasing securities or commodities other than in the ordinary course of business, excessive inventory accumulation, or investing in land without well-defined plans for its useful development* –

a. Was the number of applications or requests for such loans or loan commitments received during December as compared with the usual experience for the same month in recent years

Significantly larger ☐ Significantly smaller ☐

Essentially unchanged ☐ None received ☐

b. In processing applications for loans of the types covered in "a" above, was the proportion approved in December

Significantly larger than usual ☐ Significantly smaller than usual ☐

Essentially unchanged ☐ None approved ☐

C. Memorandum Items. With respect to each of the items listed below, please report the dollar amounts outstanding (to the nearest thousand) for the dates specified. These items generally relate to specific loan categories in Schedule A of the Call Report or in the Weekly Report of Condition, and the footnotes identify the applicable line numbers in those Reports.

	AMOUNT OUTSTANDING (in thousands of dollars)	
	October 16, 1974	January 15, 1975
1. Commercial and industrial loans 1/		
a. Loans for residential construction included in above 2/		
b. Loans to foreign businesses included in above 3/		
2. Real estate loans secured primarily by residential properties 4/		
3. Loans to nonbank financial institutions 5/		
a. Finance companies 6/		
b. Other 7/		
4. Loans to individuals 8/		
5. Loans to foreign commercial banks, foreign governments and foreign official institutions 9/		
6. Foreign claims.		
a. Demand and time deposits due to foreign banks, foreign governments, and foreign official institutions 10/		
b. All other deposits 11/		
c. Gross liabilities to own foreign branches 12/		

1/ Weekly Report of Condition, item 2(h).
2/ For those banks that file the 416a (Commercial and Industrial Loans by Industry), all construction loans are reported separately as a line item in that report. For the purposes of memorandum item 1a in this survey, include *only* residential construction loans. If the data are not readily available, please estimate. For those banks that do not file the FR 416a, please make estimates of this item.
3/ For those banks that file the 416a, these loans are reported separately as a line item in that report. For those banks that do not file the 416a, please estimate.
4/ Call Report, Schedule A, items 1(b) and 1(c).
5/ Weekly Report of Condition, item 2(d).
6/ Weekly Report of Condition, item 2(d) (1).
7/ Weekly Report of Condition, item 2(d) (2).
8/ Call Report, Schedule A, item 6.
9/ Weekly Report of Condition, items 2(c) and 2(j) (1).
10/ Weekly Report of Condition, items 7(d), 7(g), 8(c), and 8(h).
11/ All other foreign demand and time deposits not included in Memorandum item 6a above. If data are not readily available, please estimate.
12/ Total dollar amounts due by all offices of the reporting bank in the states of the United States and the District of Columbia to the reporting bank's own branches located outside all of the following: the states of the U.S., the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, the Canal Zone, American Samoa, and Midway, Wake, or Guam Islands. Include in this total, sale of assets under repurchase agreements to own foreign branches. All liabilities should be reported gross, not offset by claims on foreign branches.

The space below is for any explanation or comment you wish to make regarding the information reported. Please indicate for each comment the number of the item to which it applies:

Name and address of bank

____

____

____

Signature | Title

CHAIRMAN OF THE BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., February 18, 1975.

Hon. HENRY S. REUSS,
Chairman, Committee on Banking, Currency and Housing, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed is material requested by your staff relating to the Voluntary Foreign Credit Restraint program which the Board of Governors administered through the end of January 1974.

I assume your staff's inquiry was prompted by the statement of Andrew Brimmer on February 5 in which he recommended to the Subcommittee on Domestic Monetary Policy that the VFCR serve as a model for the comprehensive credit allocation program envisioned in H.R. 212. While Brimmer, who was delegated the responsibility of overseeing the program during much of the time that it was in effect, may well feel it can serve as a useful model, it seems to me that the dissimilarities with H.R. 212 far outnumber the similarities.

Basically, the VFCR program was a modest program with a simple objective: to restrain foreign lending and other foreign investments by U.S. bank and U.S. nonbank financial institutions in order to aid the U.S. balance of payments. It applied only to lending and investment by U.S. banks' domestic offices and exempted their foreign branches. Also, the program involved only bank credit extended to foreigners. Moreover, it involved very little differentiation among social goals or among corresponding categories of credit use.

There was never a need in the administration of the VFCR to compare or relate foreign credit to domestic credit (despite the possibility that the existence of the program may have altered the relationship between these two broad areas). More importantly, there was little need to distinguish among subcategories of foreign credit. Where that need did emerge, the determining factors in most cases were not competing domestic policy goals but, rather, foreign policy considerations. For example, one distinction made at the inception of the program among subcategories of foreign credit was an exhortation that priority attention be given to the financing needs of developing countries. Another distinction, which was introduced in 1968, was to exempt Canada from restraints. The only other important differentiation, and one not based essentially on foreign policy considerations, was to reduce and later to remove the restraints on export credits.

The program ran in only one direction: to restrain lending. Other than by occasional upward adjustments of ceilings applicable to foreign lending as a whole or by partially or fully exempting a few subcategories of foreign credit, such as for exports, the program did not seek to induce loans that the banks and other financial institutions might not have desired to make.

Given the nature of the VFCR program, it is difficult for me to share Brimmer's views that it can serve as a model for a comprehensive program of credit allocation. In only one area did the program entail any significant determination of priorities among domestic policy objectives—that of financing exports—and in that area experience was unsatisfactory. The controversy that raged so long about whether a full exemption should be accorded was ultimately resolved by a legislative directive. Subsequently, there was no clear evidence that the objective of promoting exports was actually achieved. In contrast to the VFCR, the credit allocation proposed by H.R. 212 would call for a full-scale effort to monitor banks' lending activities. It would also call for the setting of priorities to ensure an allocation among many and diverse categories of domestic and foreign credits.

In sum, it is not clear to me how useful the VFCR experience is in assessing the credit allocation idea in H.R. 212. It is one thing to administer a modest program with a limited objective that affects a small number of banking institutions. It is quite a different matter to launch a massive effort to channel credit by all U.S. banking institutions into particular priority areas.

Sincerely yours,

ARTHUR F. BURNS.

FOREIGN ASSETS OF U.S. BANKS

Item	Dec. 31, 1973	1974 Quarterly changes 1	2	3	4	Dec. 31, 1974
Number of reporting banks	230	+11	+1	+4	−3	241
	Millions of dollars					
Total assets	19,392	+4,066	+5,674	+1,855	+3,465	34,452
Assets held for account of customers	2,314	+632	+58	−157	+503	3,350
Assets held for own account	17,078	+3,434	+5,616	+2,012	+2,962	31,102
Export credits	[1] 6,252	−411	+20	+52	+466	6,379
Financial leases	170	+27	+4	+12	+5	218
Investments in foreign subsidiaries	1,629	+99	+129	+93	+275	2,225

[1] Partly estimated.

FOREIGN ASSETS AND FOREIGN LIABILITIES OF U.S. AGENCIES AND BRANCHES OF FOREIGN BANKS

Item	Dec. 31, 1973	1974 Quarterly changes 1	2	3	4	Dec. 31, 1974
Number of reporting banks	75	+4	+5	+3	+1	88
	Millions of dollars					
Total assets	8,906	+1,142	+1,642	+106	+942	12,738
Assets held for account of customers	399	+123	+296	−137	+93	774
Assets held for own account	8,507	+1,019	+1,346	+243	+849	11,964
Export credits	2,303	+123	+158	+308	+85	2,977
Financial leases						
Investments in foreign subsidiaries						
Foreign liabilities	10,812	+1,276	+710	+2,067	+618	15,483
Net foreign position: Assets held for own account less liabilities	−2,305	−258	+636	−1,283	+230	−3,520

Balance of Payments Program—Revised Guidelines for Banks and Nonbank Financial Institutions

The Voluntary Foreign Credit Restraint (VFCR) Guidelines as revised and reissued by the Board of Governors of the Federal Reserve System with effect as of January 1, 1974, are as follows:

I. GENERAL PURPOSE

In order to help to strengthen the U.S. balance of payments, U.S. financial institutions are asked to restrain their foreign credit and investments, except credit that finances U.S. exports. Within these restraints, they are asked to give priority to meeting the credit needs of developing countries.

II. BANKS

A. Ceilings for Nonexport Financing

1. Basic Restraint on Nonexport Financing

A bank is requested not to hold claims on foreigners or other foreign assets in excess of its ceiling.

2. Banks Previously with Ceilings

A bank that a ceiling under the guidelines in force December 31, 1973 (hereinafter, "the previous guidelines") shall have a ceiling equal to the greater of:

a. 104 per cent of its ceiling under the previous guidelines, or
b. $10,000,000.

3. Banks Previously without Ceilings

a. A bank that did not have a ceiling under the previous guidelines may adopt a ceiling equal to (a) 2 per cent of its total assets, as of December 31, 1970 or (b) $10,000,000, whichever is the larger. A bank established subsequent to December 31, 1973 may adopt a ceiling equal to 2 per cent of its total assets, month by month. A bank established between December 31, 1970, and December 31, 1973 may adopt a ceiling equal to 2 per cent of its total assets as of the end of the first year of operation.

b. The purpose of making a ceiling available to a bank that did not have one is to enable the bank to engage directly in foreign financing. The ceiling should not be used to purchase from other U.S. financial institutions loans that the latter have already extended to foreigners. The ceiling should be used only where the bank (a) takes the initiative to arrange credit that it extends, (b) assumes the principal burden of judging the creditworthiness of the borrower, and (c) bears responsibility for the administrative details concerning the extension and the repayment of the credit.

c. Before adopting a ceiling under this subparagraph, a bank should consult with the Federal Reserve Bank in the district in which it is located to apprise itself of the guidelines and reporting requirements and to notify the Federal Reserve Bank of the amount of its ceiling.

4. Sales of Foreign Assets

a. *Sales without recourse.*—Banks are requested not to sell foreign assets that are subject to the guideline ceilings, without recourse, to a U.S. resident other than a financial institution participating in the Federal Reserve Foreign Credit Restraint Program or other than a direct investor subject to the Foreign Direct Investment Program administered by the Department of Commerce.

b. *Sales with recourse.*—A bank that sells a foreign asset that is subject to its ceiling, with recourse, to a U.S. resident should continue to report that asset under its ceiling, unless the U.S. resident is a financial institution participating in the Federal Reserve Foreign Credit Restraint Program or is a direct invester subject to the Foreign Direct Investment Progarm administered by the Department of Commerce.

5. Foreign Borrowings

In principle, the restraints under these guidelines are imposed on gross foreign assets, including gross claims on foreigners. However, certain liabilities to foreigners may be counted as offsets to foreign assets, provided that the liabilities arise from borrowings abroad that substitute for direct investment capital outflow from the United States. Such offsetting may be done in the manner described below.

a. *Banks, bank holding companies, edge act corporations, and agreement corporations.*—A bank, a bank holding company, an "Edge Act" Corporation, or an "Agreement" Corporation may not count its borrowings from, or its other liabilities to, foreigners as offsets to its claims on foreigners and other foreign assets.

b. *Domestic subsidiaries.*—A domestically chartered nonbank subsidiary (for example, a so-called Delaware subsidiary) of a bank holding company, of an Edge Act Corporation or of an Agreement Corporation may count the outstanding amount of its borrowings from foreigners as offsets to its claims on foreigners and to its other foreign assets, provided those borrowings are of an original maturity of 3 years or more. Such borrowings would include debentures, promissory notes, or other debt obligations of the domestic subsidiary to a foreigner. The amount of the offset at any time would be equal to the amount of the outstandings after deducting (i) any repayments of principal and (ii) in the case of convertible debt issues, any conversions. This offsetting principle may be used to reduce the value of foreign assets of the subsidiary in computing the value of foreign assets to be consolidated for reporting purposes with those of the parent institution; any excess of outstanding borrowings of the subsidiary over foreign assets of the subsidiary may not be used to reduce the reportable value of foreign assets of the parent institution.

NOTE.—The present version of the guidelines is based in the text of the previous guidelines, issued November 11, 1971, and amended March 9, November 7, and December 1, 1972, and July 19 and December 26, 1973. It replaces a consolidated text issued upon adoption of the December 26, 1973 amendments.

6. Total Assets

For the purpose of calculating the ceiling, total assets are those shown in the Official Report of Condition submitted to the relevant supervisory agency as of December 31, 1970.

7. U.S. Agencies and Branches of Foreign Banks

a. An agency or branch of a foreign bank will be acting in accordance with the spirit of the guidelines if its holdings of foreign assets of types subject to restraint do not exceed $10,000,000 and if its foreign lending and investments otherwise correspond to the provisions of the guidelines that U.S. banks are requested to observe.

b. A U.S. agency or branch of a foreign bank holding more than $10,000,000 in foreign assets of types subject to restraint ("covered assets") should not incur a "net foreign position" greater than its "base net foreign position," as explained in "d" below.

c. The "base net foreign position" is the value resulting from subtracting from "covered assets," as of June 30, 1973, 96 percent of total liabilities to non-U.S. residents as of June 30, 1973. However, for an agency or branch that started operating after June 30, 1973, the "base net foreign position" shall be zero.

d. An agency or branch with a "base net foreign position" that showed an excess of the respective liabilities over "covered assets" should maintain at least an equal excess of total foreign liabilities over "covered assets;" an agency or branch with a "base net foreign position" that showed an excess of "covered assets" over the respective liabilities should not hold a greater excess of "covered assets" over the respective liabilities should not hold a greater excess of "covered assets" over total foreign liabilities.

e. For the purpose of calculating liabilities under (a) through (d), residents of Puerto Rico, the Virgin Islands and other territories and possessions included in the definition of the United States for Treasury Foreign Exchange Reports should be treated as residents of the United States.

B. Exclusions

1. Export Credits

a. *Basic exemption.*—Export credits, defined in Part IV–3, are exempted from restraint under these guidelines. These include credits of the type previously subject to General and Export Term-Loan Ceilings. Banks should maintain adequate information and otherwise take all reasonable measures to provide assurance that credits meet the definition before treating them as exempted.

b. *Acquisition of previous foreign export credits.*—The purpose of the exemption for export credits is to ensure that, as of November 11, 1971, no restraint is applied to the granting of credit that will finance U.S. exports. A bank should report under its ceiling any outstanding loans that it purchases or repurchases from a foreigner, including its own branch, if that loan financed U.S. exports shipped (or financed U.S. services performed abroad) prior to November 11, 1971.

2. Canada

The extension of credit to residents of Canada or other acquisition of Canadian assets is exempted from restraint under these guidelines.

3. Securities of Certain International Institutions

All direct obligations of international institutions of which the United States is a member are exempted from a bank's ceiling.

4. Insurance and Guaranty Settlements of OPIC

A foreign asset acquired directly or through purchase of a participation in a pool of foreign assets, provided the foreign asset or the participation is covered by a payment guarantee issued by the U.S. Overseas Private Investment Corporation (OPIC) under its insurance and guaranty claims settlement authority, is exempted from an institution's ceiling.

C. Banks Over Ceilings

Banks are expected to observe their ceilings throughout the monthly reporting periods. Banks are not expected routinely to sell foreign assets immediately prior to the reporting date or otherwise engage in "windowdressing" activities.

A bank whose foreign assets are in excess of its ceiling or otherwise conflict with these restraints and which does not show improvement will be expected

periodically to discuss with the Federal Reserve Bank in its district the steps it has taken and that it proposes to take to bring the amount of its foreign assets into conformity with these guidelines.

D. Applicability To Banks and Bank-Related Financial Institutions

1. General

The guidelines are applicable to all U.S. banks (exclusive of trust departments of commercial banks, which should follow the guidelines for nonbank financial institutions in Part III), to their domestically chartered subsidiaries at any level, and to bank holding companies and their domestically chartered subsidiaries at any level, except where those subsidiaries are covered by other U.S. capital restraint programs as noted in subparagraph 3b and to U.S. agencies and branches of foreign banks.

2. Edge Act and Agreement Corporations

a. *Policy of limting aggregate ceilings.*—It is intended that the establishment of new Edge Act Corporations or Agreement Corporations not result in the expansion of aggregate ceilings under these guidelines.

b. *One-bank-owned corporations.*—An Edge Act or Agreement Corporation that is owned by one bank and that, under the previous guidelines, had a ceiling separate from that of its parent bank may continue to have a ceiling separate from that of its parent or may combine its ceiling with that of its parent.

(i) The ceiling to which it would be entitled if it did not combine would be calculated as under Section A-2 for the corporation as a separate entity.

(ii) An Edge Act or Agreement Corporation that is owned by one bank and that was established after March 3, 1965, should share the ceiling of its parent bank.

c. *Multibank-owned corporations.*—

(i) *Separate Ceilings.*—An Edge Act or Agreement Corporation that is owned by more than one bank or by a multibank holding company will have a ceiling separate from that of its parent and from those of the banks in its parent holding company. The corporation's ceiling is to be determined in accordance with Section A–2 or, as appropriate, A–3.

(ii) *Transfer of Parent's Ceiling.*—To acquire or to increase a ceiling, such an Edge Act or Agreement Corporation may receive from one or more of its parent banks (including banks of its parent holding company) a share of the ceilings of the parent parents. Once transferred to the corporation, the ceiling should not be transferred in whole or in part back to the parent or parents, except to meet unforeseen and overriding developments. If any such exceptional need for transfer should arise, the corporation and its parent or parents should consult in advance with the Federal Reserve Banks in their respective districts.

d. *Domestic subsidiaries of Edge Act and agreement corporations.*—The foreign assets of domestically chartered subsidiaries of Edge Act and Agreement Corporations (net of foreign borrowings offset under Section A–5b, above) should be consolidated with the foreign assets of the parent corporation for the purposes of the guidelines.

3. Bank Holding Companies

a. *Holding companies as banks.*—A bank holding company is to be treated as a bank for the purpose of these guidelines.

b. *Holding companies with one bank.*—A holding company with one bank, which bank subsidiary has a ceiling under these guidelines, together with that bank subsidiary and any nonbank subsidiary should report on a consolidated basis. However, the ceiling is to be calculated on the basis of the ceiling of the bank subsidiary. Furthermore, to minimize changes from earlier established procelures, any nonbank subsidiary that was reporting prior to December 1, 1969, to the Department of Commerce under the Foreign Direct Invest ment Program or to a Federal Reserve Bank under the nonbank financial institution part of the guidelines should not report under these bank guidelines.

c. *Holding companies with more than one bank.*—A multibank holding company should share the ceiling of one or more of its banks.

d. *Consolidation of ceilings of bank subsidiaries of holding companies.*—A bank subsidiary (including a bank, Edge Act Corporation, or Agreement Corporation) of a bank holding company may elect to consolidate its ceiling with

that of one or more of the holding company's other bank subsidiaries only if each bank subsidiary involed in the contemplated consolidation had a ceiling under the guidelines in effect prior to November 11, 1971. Such election should be made known in advance to the respective Federal Reserve Banks. Ceilings adopted under subsequent guidelines should not be consolidated. Ceilings that were consolidated before March 9, 1972, in conformity with the guidelines may remain consolidated.

4. Foreign Branches and Foreign Subsidiaries of U.S. Banks and Banking Institutions

a. The guidelines are not intended to restrict the extension of foreign credit by foreign branches, or foreign subsidiaries, of (i) U.S. banks, (ii) Edge Act Corporations, or (iii) Agreement Corporations, except as the result of the restraints on banks, and on Edge and Agreement Corporations (and their domestic subsidiaries), with respect to foreign credit to, or foreign investment in, such foreign branches or foreign subsidiaries.

b. Claims of a bank's, or banking institution's, domestic offices on its foreign branches and foreign subsidiaries (including permanent capital invested in, as well as balances due from, such foreign branches and foreign subsidiaries) represent foreign assets subject to the guidelines.

E. Conformity with Objectives of Guidelines

1. Department of Commerce Program and Nonbank Financial Institution Guidelines

Banks should avoid making loans that would directly or indirectly enable borrowers to use funds abroad in a manner inconsistent with the Department of Commerce Foreign Direct Investment Program or with the guidelines for nonbank financial institutions.

2. Substitute Loans

Banks should not extend to U.S. resident subsidiaries, or branches, of foreign companies, loans that otherwise might have been made by the banks to the foreign parent or other affiliate of the company or that normally would have been obtained abroad.

3. Management of Liquid Assets

A bank should not hold its own funds abroad in liquid form for short-term investment purposes whether such investments are payable in foreign currencies or in U.S. dollars. This is not intended to preclude its maintaining necessary working balances held with its own foreign branches or with foreign correspondents.

4. Transactions for Customers

While recognizing that it must follow a customer's instruction, a bank should discourage customers from placing liquid funds outside the United States. A bank should not place with a customer foreign obligations that, in the absence of the guidelines, it would have acquired or held for its own account.

5. U.S. Branches and Agencies of Foreign Banks

Branches and agencies of foreign banks located in the United States are requested to act in accordance with the spirit of these guidelines and, as they may be requested from time to time, to consult with the Federal Reserve Bank in the district in which they are located.

A U.S. agency or branch of a foreign bank that holds $10,000,000 or more of foreign assets of types subject to restraint should make every reasonable effort to ensure that its foreign assets and foreign liabilities are kept throughout the monthly reporting periods, as well as on the end-of-the month reporting dates, at levels consistent with its "base net foreign position." Each agency and branch of a foreign bank may adopt an individual "base net foreign position." Alternatively, one or more agencies or branches of a particular foreign bank may consolidate positions to which they would be entitled. Once consolidated, they should henceforth report as a unit under the guidelines.

6. Banks without Ceilings

A bank that has not adopted a ceiling will be acting in conformity with the objectives of the guidelines (a) if its foreign assets of types subject to restraint do not exceed the lesser of (i) $500,000 or (ii) 2 per cent of its end-of-

1970 total assets and (b) if those foreign assets are otherwise in conformity with the guidelines, for example, with the request against holding funds abroad in liquid form except for necessary working balances.

F. Reporting

Each U.S. bank (whether or not it has a ceiling), and each U.S. agency and branch of a foreign bank, that on a reporting date had $500,000 or more in foreign assets (whether or not subject to restraint under the guidelines) should file a Monthly Report on Foreign Assets (for U.S. Banks or for U.S. Agencies and Branches of Foreign Banks, as appropriate) with the Federal Reserve Bank in the district in which the institution is located within 15 days after the end of the reporting period. (Forms are available at the Federal Reserve Banks.)

III. NONBANK FINANCIAL INSTITUTIONS

A. Applicabiliy to financial institutions

This part of the guidelines applies to all U.S. nonbank financial institutions, including: trust companies, trust departments of commercial banks; mutual savings banks; insurance companies; investment companies; financial companies; employee retirement and pension funds; college endowment funds; charitable foundations; U.S. branches or foreign insurance companies and of other foreign nonbank financial corporations; and holding companies (other than bank holding companies) whose domestic assets consist primarily of the stock of operating nonbank financial institutions. Investment underwriting firms, securities brokers and dealers, and investment counseling firms also are covered with respect to foreign financial assets held for their own account and are requested to inform their customers of the program in those cases where it appears applicable.

Businesses whose principal activity is the leading of property and equipment, and which are not owned or controlled by a financial institution, are not defined as financial institutions. Real estate investment trusts whose assets consist primarily of real property as contrasted with fiinancial assets (such as mortgages) also are not covered by these Guidelines.

B. Ceiling and priorities

1. Ceiling

Each institution is requested to limit its aggregate holdings of foreign assets covered by the program to no more than its ceiling as described in Section C, except for special situations discussed in Section J, below.

2. Liquid Foreign Balance

Institutions generally are expected to hold no foreign deposits or foreign money market instruments, except such minimum working balances abroad as are needed for the efficient conduct of its foreign business activities.

3. Developing Countries

Among the foreign assets that are subject to the guideline ceiling ("covered assets"), institutions are asked to give priority to credits which directly benefit the economies of developing countries.

4. Conformity with Objectives of Guidelines

Institutions may invest in noncovered foreign assets generally as desired. However, they are requested to refrain from making any nonexport loans or investments, noncovered as well as covered, that appear to be inconsistent with other aspects of the U.S. balance of payments program. Among these are the following:

a. Noncovered credits under this program that substitute directly for loans that commercial banks would have made in the absence of that part of the program applicable to them.

b. Noncovered credits to developing country subsidiaries of U.S. corporations that would not have been permitted under the Department of Commerce Foreign Direct Investment Program if made by the U.S. parent directly.

c. Credits to U.S. borrowers that would enable them to make foreign loans and investments inconsistent with the Foreign Direct Investment Program.

d. Credits to U.S. subsidiaries and branches of foreign companies that other-

wise would have been made to the foreign parent or that would substitute for funds normally obtained from foreign sources.

C. Calculation of Ceiling

The ceiling for each nonbank financial institution will be:
1. The greater of:
a. 105 per cent of its ceiling as of December 31, 1972, or
b. $2,000,000.
2. Minus equity securities of companies established in developed countries (except Canada) that are included in Section C-1 but had been sold to American investors after December 31, 1972.
3. Plus, or minus, the difference between sales proceeds and "carrying" value of covered equities sold after December 31, 1972, to other than American investors or in other than U.S. markets. On each reporting date, "carrying" value should be the value reflected in the institution's report (on Form FR 392R-68) for December 31, 1967, in the case of equities held on that date, and it should be cost in the case of equities purchased after that date.

D. Covered Assets—Subject To Ceiling

Foreign financial assets subject to the ceiling (covered assets) include investments of the following types (but see exclusions in Section E):
1. Liquid funds in all foreign countries. This category comprises foreign bank deposits, including deposits in foreign branches of U.S. banks, and liquid money market claims on foreign obligors, generally defined to include marketable negotiable instruments maturing in one year or less.
2. All other claims on foreign obligors written, at date of acquisition, to mature in 10 years or less. This category includes bonds, notes, mortgages, loans, and other credits.
3. Net financial investment in foreign branches, subsidiaries, and affiliates located in developed countries other than Canada. Such financial investment includes payments into equity and other capital accounts of, and net loans and advances to, any foreign business in which the U.S. institution has an ownership interest of 10 percent or more. Excluded are earnings of such a foreign business if they are directly retained in its capital accounts.
4. Long-term credits entered into after Novmber 11, 1971, to finance the construction or operation of foreign-built vessels unless the financing involves a corresponding transfer of capital by a direct investor under the Foreign Direct Investment Program. Included in this category are bonds, notes, mortgages, loans, leases, and other credits. A credit is long-term if at least 10 per cent of the amount to be repaid to the lender is scheduled, at the time of acquisition, to be repaid after 10 years.
5. Long-term credits of foreign obligors established in developed countries other than Canada. (Long-term credits are as defined in paragraph 4.)
6. Equity securities (including American Depository Receipts) of foreign corporations established in developed countries other than Canada, except those acquired after September 30, 1965, in U.S. markets from American investors. Exclusion from ceiling normally will be indicated if, in acquiring an equity security that otherwise would be covered, the purchasing institution receives a certificate of prior American ownership or brokerage confirmation thereof. Securities acquired from a broker who purchased them from a foreigner in anticipation of early resale are not deemed to be acquisitions from a prior American investor.
7. Investments made by trust departments of commercial banks or by trust companies with trust funds over which the trustee (or co-trustee) has at least some influence over investment policy and not separately reported by another financial institution.

E. Noncovered Assets—Exclusions

The following foreign financial assets are excluded from the guideline ceiling:
1. Export credits, as defined in Part IV-3. Institutions should maintain adequate information and otherwise take all reasonable measures to provide assurance that credits meet the definition before treating them as exempted.

2. All financial assets in, or claims on residents of, Canada.
3. All direct obligations of international institutions of which the United States is a member.
4. Long-term investments in all developing countries (except as noted in Section D-4), including direct investment in subsidiaries and affiliates, credit instruments of the types and maturity described in Section D-4, and all equity securities issued by firms established in these countries.
5. Equity securities of firms in developed countries other than Canada that have been acquired in U.S. markets from American investors. (See Section D-6.)
6. Foreign assets of types subject to ceiling but acquired after December 31, 1967, as "free delivery" items—that is, acquired as gifts or, in the case of trust companies or trust departments of commercial banks, deposited with the institution in new accounts.
7. A foreign asset acquired directly or through purchase of a participation in a pool of foreign assets, provided the foreign asset or the participation is covered by a payment guarantee issued by the U.S. Overseas Private Investment Corporation (OPIC) under its insurance and guaranty claims settlement authority, is exempted from an institution's ceiling.

F. Credits to Certain U.S. Corporations

1. Any loan or investment acquired by a nonbank financial institution after June 30, 1968, that involves the advance of funds to a domestic corporation which is simply a financing conduit (commonly known as a "Delaware subsidiary") and that in turn will transmit the funds to a foreign business is a foreign asset if one or more foreigners own a majority of the domestic corporation. The amounts of such foreign loans or investments should be classified according to the country where the funds are actually to be used, not according to the residence of the owners of the domestic corporation.
2. If U.S. residents, other than the lending institution, hold a majority ownership interest in the domestic corporation, no part of a loan or of an investment in such a corporation is to be regarded as a foreign asset of the institution.

G. Leasing of Physical Goods

The foreign leasing activities of firms that engage primarily in the leasing of physical assets (e.g., computers, real property, ships, aircraft) and that are not owned or controlled by a U.S. financial institution are not subject to these guidelines. However, such activities are subject to these guidelines when they are undertaken by nonbank financial institutions.

H. Investment in Certain Foreign Insurance Ventures

Net investment in foreign insurance ventures should be reported. In the case only of a foreign insurance venture in which a U.S. nonbank financial institution had an investment before 1965, if it is not feasible to segregate the net investment of the U.S. nonbank financial institution, the latter may exclude from its foreign assets subject to ceiling the aggregate of the larger of the folowing in each foreign country in which a foreign affiliate sells insurance: (a) 110 per cent of assets held in the foreign country as reserve against insurance sold to residents of that country by the foreign affiliate or (b) the minimum deposit of cash or securities required by foreign authorities as a condition of doing insurance business in that country.

I. Reporting Requirement

Each nonbank financial institution holding, on any quarterly reporting date, covered assets of $500,000 or more, or total foreign financial assets of $5 million or more, should file a statistical report covering its total holdings on that date with the Federal Reserve Bank of the Federal Reserve district in which its principal office is located. The reports are due within 20 days following the close of each calendar quarter, and forms may be obtained from the Federal Reserve Bank. (See also Section J-2.)

J. Covered Assets in Excess of Ceiling

1. In view of the balance-of-payments objectives of the program, covered investments of nonbank financial institutions may be permitted to exceed the

guideline ceiling to the extent that the funds for such investment are (a) borrowed abroad for investment in the same country or in countries that are subject to the same or more liberal guideline restraint or (b) derived from equity securities issued by the nonbank financial institution and sold to residents of foreign developed countries (other than Canada), provided that the nonbank financial institution promptly treats as a charge against its ceiling the amount of any such equity securities at any moment it is unable to assure itself fully that any such securities continue in the possession of such foreigners. (For reporting purposes, the amount of such securities held by foreigners should be included with borrowings in foreign countries.) Thus, for the purpose of the offset provision, funds borrowed in the developed countries may be used to finance investments in these countries and elsewhere, but funds borrowed in the developing countries should not be used to finance investment in the developed countries. Any institution desiring to offset foreign borrowing against foreign investment, however, should discuss its plans with the Federal Reserve $2,000,000 if its investments are consistent with guideline restraints (a) with Bank before entering into such an arrangement.

2. An institution without a guideline ceiling may hold covered assets up to respect to liquid funds and (b) concerning possible conflict with program objectives, as noted in Section III-B-2 and B-4.

The institution is expected to file an initial statement of its holdings with its Federal Reserve Bank and thereafter to file a statement with the Bank within 20 days after the end of any calendar quarter when its total holdings of covered foreign assets have changed by as much as $100,000 since its previous report even though its total holdings remain below the minimum reporting levels stipulated in the guidelines.

IV. DEFINITIONS

The following definitions apply to both the bank and nonbank financial institution parts of the guidelines.

1. "Claims on foreigners" are claims on foreigners held for an institution's own account. For banks, they include: foreign long-term securities; deferred payment letters of credit described in Treasury Department Supplemental Reporting Instruction No. 1 (Revised), Treasury Foreign Exchange Reports, Banking Forms, September 25, 1972; participations purchased in loans to foreigners; loans to financial conduits incorporated in the United States, 50 per cent or more owned by foreigners; and foreign assets sold, with recourse, to U.S. residents other than financial institutions participating in the Federal Reserve Credit Restraint Program or other than direct investors subject to the controls administered by the Department of Commerce. They also include foreign customers' liability for the acceptances executed, whether or not the accepted drafts are held by the accepting bank. "Claims on foreigners" exclude: contingent claims; unutilized credits; claims held for account of customers; and acceptances executed by other U.S. banks.

2. "Foreigners" include: individuals, partnerships, and corporations domiciled outside the United States, irrespective of citizenship, except their agencies o branches located within the United States; branches, subsidiaries, and affiliates of U.S. banks and other U.S. corporations that are located in foreign countries, and any government of a foreign country or official agency thereof and any official international or regional institution created by intergovernmental agreement, irrespective of location.

3. "Export Credit" means any claim on a foreigner for the demonstrable financing (a) of the export of U.S. goods or (b) of the performance abroad of U.S. services. (Items (a) and (b) are hereinafter referred to as "exports.") To be demonstrable, the financing must relate to a specific, individual, identifiable export for which shipping documents or other documents evidencing the export are obtainable.

Export credit may be direct or indirect. Direct credit is a credit that results in the direct acquisition of a debt obligation of a foreign obligor. An indirect credit is a credit extended to a foreign financial institution which, in consequence, itself acquires debt obligations of obligors resident outside the United States. Therefore, credit extended by a U.S. financial institution to a foreign buyer of U.S. exports directly or through a foreign financial institution may be an export credit. Also, an export credit may be extended through purchase of documented loan paper.

The cost of freight in connection with exportation, the cost of transport insurance in connection with exportation, and the cost of export credit guarantees and export credit insurance borne by the foreign buyer or the foreign financial institution may be included in the cost of export for the purpose of determining the amount of credit that is to be considered export credit. Any element of foreign duty is to be excluded for this purpose.

U.S. goods grown, produced, or manufactured in the United States.

U.S. services performed abroad should be services performed outside the United States by U.S. domiciled or U.S. incorporated companies or by U.S. nationals temporarily resident abroad.

A particular credit should be regarded as an export credit only if 85 percent or more of its total amount finances U.S. exports. However, a single credit agreement exclusively for the services may be broken down to exclude non-U.S. services. The export credit may thereby be identified as that portion of credit financing the performance of services by U.S. firms and U.S. nationals, as well as financing the purchase (or lease) of U.S. goods incidental to the performance of those services.

A participation in export credits should be regarded as export credit of the financial institution purchasing the participation. However, a participation in a pool of loans would not be considered export credit by the institution purchasing the participation.

A credit that is of substantially longer maturity than is customary in international export financing practice for the type of transaction in question should not be regarded as an export credit.

4. "Developing countries" are all foreign countries other than: Abu Dhabi, Australia, Austria, the Bahamas, Bahrain, Belgium, Bermuda, Canada, Denmark, France, Germany (Federal Republic), Hong Kong, Iran, Iraq, Ireland, Italy, Japan, Kuwait, Kuwait-Saudi Arabia Neutral Zone, Libya, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Portugal, Qatar, Republic of South Africa, San Marino, Saudi Arabia, Spain, Sweden, Switzerland, and the United Kingdom; and other than: Albania, Bulgaria, the People's Republic of China, Cuba, Czechoslovakia, East Germany, Estonia, Hungary, Communist-controlled Korea, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Romania, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia that are under the provisional administration of the Union of Soviet Socialist Republics, and Communist-controlled Vietnam.

Annual Report for 1973—Voluntary Foreign Credit Restraint Program

During 1973 the level of restraint asked of U.S. banks and U.S. nonbank financial institutions under the Voluntary Foreign Credit Restraint (VFCR) guidelines remained unchanged. On December 26, 1973, however, it was announced that the level of restraint would be substantially relaxed, effective January 1, 1974, as part of the general relaxation of the U.S. capital controls programs.

The guidelines were amended only once during the year. That amendment—July 19, 1973—formalized the method of restraint that had been applied to U.S. agencies and branches of foreign banks since the last substantial revision of the guidelines in late 1971. According to that amendment, agencies and branches could increase their claims on non-U.S. residents to the extent that they increased the funds they borrowed from their own parent banks and from other non-U.S. sources. June 30, 1973, was set as the base for calculating changes in foreign assets of types subject to restraint and changes in offsetting foreign liabilities. The amendment did not, and was not intended to, change the degree of restraint that U.S. agencies and branches of foreign banks were asked to observe.

FOREIGN ASSETS OF U.S. BANKS

Item	Dec. 31, 1972	1973 Mar. 31	1973 June 30	1973 Sept. 30	1973 Dec. 31
Number of reporting banks	222	227	226	229	229
	Millions of dollars				
Aggregate ceiling	10, 276	10, 328	10, 316	10, 351	10, 367
Assets held for own account subject to restraint	9, 189	9, 630	9, 425	9, 186	9, 382
Aggregate leeway	1, 087	698	890	1, 165	985
Assets exempted from VFCR	5, 339	5, 908	6, 962	6, 559	7, 637
Canadian assets	927	855	807	713	1, 134
Export credits other than to residents of Canada	4, 213	4, 843	5, 930	5, 585	6, 252
Other	199	210	225	261	251
Total assets held for own account	14, 529	15, 538	16, 387	15, 745	17, 019

Aggregate VFCR ceilings of commercial banks participating in the program reached a level of $10.4 billion at the end of 1973. This was approximately $100 million above the end-of-1972 level, an increase attributable to adoption of guideline ceilings by banks that were expanding their foreign activities. The degree of ceiling utilization remained steady throughout the year. Assets subject to restraint rose by only $193 million during the year, and the aggregate leeway was $102 million lower on December 31, 1973, than it had been a year earlier.

However, during periods of exceptional activity in international money markets, U.S. banks experienced substantial pressures on their lending restraints. Most notably in February and in May, unanticipated drawings on lines of credit established by foreign customers caused many banks to go temporarily over their VFCR ceilings. In most cases the banks were able to correct their positions rapidly.

U.S. banks were active in the field of export financing, which is exempt from restraint. In 1973, export credits to others than residents of Canada increased by $2 billion, an increase of nearly 50 per cent.

FOREIGN ASSETS OF U.S. AGENCIES AND BRANCHES OF FOREIGN BANKS

Item	Dec. 31, 1972	1973 July 31	1973 Aug. 31	1973 Sept. 30	1973 Oct. 31	1973 Nov. 30	1973 Dec. 31
Number of reporting institutions	62	67	65	68	69	71	72
	Millions of dollars						
Assets held for own account subject to restraint	2, 994	4, 256	4, 489	4, 587	4, 991	5, 179	5, 839
Foreign liabilities	(1)	9, 134	9, 332	9, 549	10, 193	10, 442	10, 812
Net foreign position	(1)	−4, 878	−4, 843	−4, 962	−5, 202	−5, 264	−4, 973
Base net foreign position on 6/30/73	(1)	−4, 623	−4, 550	−4, 551	−4, 551	−4, 605	−4, 605
Aggregate leeway	(1)	255	293	410	650	659	368
Assets exempt from VFCR	1, 819	2, 743	2, 665	2, 706	2, 639	2, 724	2, 688
Canadian assets	409	543	473	440	464	432	385
Export credits other than to residents of Canada	1, 410	2, 200	2, 192	2, 266	2, 175	2, 292	2, 303
Total assets held for own account	4, 812	7, 000	7, 155	7, 293	7, 630	7, 902	8, 527

[1] Not available.

U.S. agencies and branches of foreign banks started reporting in July under the system described earlier for netting increased foreign liabilities against increased foreign assets. For the year, their holdings of assets of the types subject

to restraint nearly doubled. In the period July–December, the increase in their foreign liabilities outstripped the increase of assets subject to restraint by $368 million. This figure represented leeway available to the agencies and branches for further lending.

Like U.S. banks, the agencies and branches vigorously expanded their export financing activities to others than residents of Canada. However, their holdings of such credits increased even faster than those of U.S. banks—that is, by 63 per cent.

Foreign asset holdings of U.S. nonbank financial institutions changed little in 1973. As of the end of the year, their holdings of foreign assets subject to restraint stood at $1,149 million, $20 million less than at the end of 1972. With aggregate ceilings remaining unchanged, the institutions had an aggregate leeway of $800 million as of the end of 1973.

The holdings of assets exempt from restraint increased by more than $800 million. Here too, export credits showed a large relative increase—63 per cent. However, at the end of the year total holdings of export credits of the VFCR-reporting nonbank financial institutions were only $158 million.

On December 26, 1973, the Board announced several amendments to the guidelines. The amendments represented a relaxation in restraint effective January 1, 1974, and were announced simultaneously with the reduction in the rate of the Interest Equalization Tax and with the relaxation of the Foreign Direct Investment Program, which are administered by the Treasury Department and the Department of Commerce, respectively.

FOREIGN ASSETS OF U.S. NONBANK FINANCIAL INSTITUTIONS AND NONPROFIT ORGANIZATIONS

Item	Dec. 31, 1972	1973			
		Mar. 31	June 30	Sept. 30	Dec. 31[1]
Number of reporting institutions	317	321	322	317	327
	Millions of dollars				
Assets subject to restraint	1,169	1,145	1,164	1,150	1,149
Deposits and money market instruments	69	69	87	92	99
Short- and intermediate-term credits	141	141	142	145	147
Long-term investments	961	935	935	913	903
Ceiling	1,732	1,728	1,732	1,703	1,722
Foreign borrowing offset	159	187	200	206	233
Aggregate leeway	721	770	768	759	806
Assets exempted from VFCR	15,572	15,861	16,033	16,223	16,414
Export credits	97	131	139	140	158
Investments in Canada, other than export credits	11,864	12,020	12,118	12,177	12,226
Direct obligations of international institutions	1,232	1,219	1,218	1,193	1,174
Long-term investments in developing countries other than export credits	1,312	1,328	1,310	1,370	1,405
Other nonexport investments	1,066	1,164	1,248	1,344	1,451
Total assets held for own account	16,741	17,006	17,197	17,372	17,563

[1] Preliminary.

For the VFCR-participating financial institutions, one element of relaxation was a rise in the minimum ceiling applicable to foreign assets of the types subject to restraint. These minimums were raised from $500,000 to $10 million for banks; from $1 million to $10 million for U.S. agencies and branches of foreign banks; and from $500,000 to $2 million for U.S. nonbank financial institutions.

For institutions with ceilings higher than the new minimum ceilings, the ceilings were raised by 4 per cent for U.S. banks and for U.S. agencies and branches of foreign banks, and by 5 per cent for U.S. nonbank financial institutions.

For all financial institutions participating in the VFCR program, subsidiary restraints regarding loans to residents of developed countries of continental Western Europe were abolished.

On January 29, 1974, the Board announced termination of the VFCR program, effective immediately. This action was coordinated with the simultaneous lifting of the capital outflow restraint programs administered by the Treasury and Commerce Departments.

ANNUAL REPORT FOR 1972—VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM

The Voluntary Foreign Credit Restraint (VFCR) program continued without major change during 1972, on the basis of the guidelines as revised in November 1971. Most of the amendments adopted by the Board during 1972 were designed to clarify existing provisions or to simplify reporting procedures. However, one amendment extended to one class of bank affiliates the same limited foreign-borrowing-offset provision that had already been made available to other bank affiliates, and another exempted foreign assets acquired in connection with acts taken by the Overseas Private Investment Corporation to settle claims. As intended, the impact of the 1972 amendments on the general level of restraint was negligible.

Since November 1971, banks previously without VFCR ceilings could adopt a ceiling for nonexport foreign lending and investing equal to 2 per cent of their total assets as of December 31, 1970. During 1972, 87 commercial banks adopted such ceilings, amounting in the aggregate to $406 million. However, some of these "new-comer" banks either did not engage in foreign lending during the year or did not acquire enough foreign assets to report them. The total number of banks actively participating in the VFCR program increased in 1972 by 25—to a total of 219—and the aggregate ceilings by $220 million, to $10,252 million.

FOREIGN ASSETS OF U.S. BANKS

Item	Dec. 31, 1971	1972			
		Mar. 31	June 30	Sept. 30	Dec. 31
Number of reporting banks	194	200	205	203	219
	Millions of dollars				
Aggregate ceiling	10,032	10,069	10,103	10,121	10,252
Assets held for own account subject to restraint	8,955	8,835	8,684	8,807	9,109
Aggregate net leeway	1,078	1,254	1,419	1,314	1,143
Assets exempted from VFCR	3,347	4,516	4,751	4,765	5,348
Canadian assets	536	799	830	876	927
Export credit other than to residents of Canada	3,299	3,586	3,546	3,690	4,222
Other	112	131	195	199	199
Total assets held for own account	12,372	13,351	13,255	13,572	14,457

FOREIGN ASSETS OF U.S. AGENCIES AND BRANCHES OF FOREIGN BANKS

Item	Dec. 31, 1971	1972			
		Mar. 31	June 30	Sept. 30	Dec. 31
Number of reporting institutions	51	53	53	57	60
	Millions of dollars				
Assets of the types subject to restraint	1,943	2,183	2,110	2,277	2,878
Assets of the types not subject to restraint	1,066	1,213	1,290	1,458	1,799
Canadian assets	273	335	315	335	389
Export credits	793	878	975	1,123	1,410
Total assets held for own account	3,009	3,396	3,400	3,735	4,676

The volume of foreign lending and investment by U.S. banks that was subject to VFCR ceilings remained little changed during 1972. At the end of 1972 banks' foreign assets held for their own account and subject to restraint were $154 million more than the $8,955 million held at the end of 1971; however, because of the entry of additional banks into the program, the aggregate net leeway at the end of 1972 was $65 million above the end-of-1971 level of $1,078 million.

Of the foreign assets not subject to restraint, banks' holdings of Canadian claims rose by $391 million. Following the removal of all export credits from restraint in November 1971, banks substantially expanded their lending activity

in that field. At the end of 1972, export credits outstanding (other than to residents of Canada) were $923 million, or 28 per cent, above the December 1971 level. While banks' own foreign assets (including those exempt from the VFCR) rose by $2.155 million from the end of 1971 to December 31, 1972, their foreign assets subject to restraint rose by $154 million, as mentioned earlier.

U.S. agencies and branches of foreign banks were requested to continue to act in accordance with the spirit of the VFCR guidelines throughout 1972. In addition, they were asked for the first time to submit monthly reports on their foreign asset positions. Because these institutions rely on foreign sources of funds to a much higher degree than do U.S. commercial banks and because they operate differently from U.S. banks in other respects, they have been treated in a special category under the program. During 1972 the number of these institutions reporting increased by 9 to a total of 60, as shown in the table on page 192. The agencies and branches that reported at the end of 1972 showed holdings of foreign assets of the types subject to restraint of $2,878 million; this was $935 million above their holdings at the end of 1971, an increase of more than 48 per cent. As was true of U.S. commercial banks, export credits granted by agencies and branches of foreign banks increased rapidly; on December 31, 1972, these credit were $617 million above the 1971 level—an increase of 80 per cent.

FOREIGN ASSETS OF U.S. NONBANK FINANCIAL INSTITUTIONS AND NONPROFIT ORGANIZATIONS REPORTING UNDER VFCR GUIDELINES

[Amounts shown in millions of dollars]

Item	Amount Dec. 31, 1972	Changes from Dec. 31, 1971	
		Amount	Percent
ASSETS SUBJECT TO CEILING			
Deposits and money market instruments, foreign countries except Canada	69	+48	+228.6
Short- and intermediate-term credits, foreign countries except Canada [1]	140	−10	−6.7
Long-term investments, developed countries except Canada:			
Net investment in subsidiaries, affiliates, and branches [2]	189	+21	+12.5
Long-term bonds and credits	445	−83	−15.7
Stocks [3]	224	−208	−48.1
Total holdings of assets subject to ceiling	1,067	−232	−17.9
Foreign-borrowing offset	156	+79	+102.6
Total holdings less offset	911	−311	−25.5
Ceiling	1,556	−226	−12.7
Net leeway	645	+85	+15.2
ASSETS NOT SUBJECT TO CEILING			
Export credits	96	+16	20.0
Investments in Canada:			
Deposits and money market instruments	325	−20	−5.8
Short- and intermediate-term credits [1]	185	−8	−4.1
Net investment in subsidiaries, affiliates, and branches [2]	952	+80	+9.2
Long-term bonds and credits	9,121	+582	+6.8
Stocks	982	305	−23.7
Direct obligations of international institutions of which U.S. is a member	1,199	+159	+15.3
Long-term investments in developing countries:			
Net investment in subsidiaries, affiliates, and branches [2]	59	+19	+47.5
Long-term bonds and credits	1,118	+222	+24.8
Stocks	109	−23	−17.4
Otherwise "covered" stocks acquired after Sept. 30, 1965, in U.S. markets from U.S. investors	904	+20	+2.3
Otherwise "covered" assets acquired after Dec. 31, 1967, as "free delivery" items	34	−3	−8.1
Total holdings of assets not subject to ceiling	15,083	+737	+5.1
Memo: Total holdings of foreign assets	16,149	+503	+3.2

[1] Bonds and credits with final maturities of 10 years or less at date of acquisition.
[2] Net investment in foreign branches, subsidiaries, or affiliates in which the U.S. institution has an ownership interest of 10 percent or more.
[3] Except those acquired after Sept. 30, 1965, in U.S. markets from U.S. investors.

By the end of 1972, holdings by nonbank financial institutions of assets subject to ceilings had declined by nearly $250 million—or 18 per cent—from the level of $1,300 million at the end of 1971. This development left the

VFCR reporting institutions with a net leeway of about $650 million after adjustment for the foreign borrowing offset. On the other hand, holdings of assets not subject to restraint increased by about $750 million. About $200 million of this increase resulted from new investment in developing countries, about $160 million represented increased investment in direct obligations of international institutions of which the United States is a member, and the $360 million remaining reflected increased investments in Canada.

The VFCR Today and Over the Year Ahead

(Remarks of Bernard Norwood, Adviser, Division of International Finance, Board of Governors of the Federal Reserve System)

I. Introduction

The Administration's February announcement for the phase-out of the Voluntary Foreign Credit Restraint (VFCR) Program left to the Federal Reserve Board the decisions on the development of implementing steps. Yet, created and administered by the Federal Reserve on behalf of the Administration, the VFCR Program remains an instrument of Administration balance-of-payments policy, and any changes to be introduced by the Board must await the Administration's formulation of new policy directives.

No specific new directives have yet been indicated, and I shall not attempt to anticipate what those directives might be. Instead, I shall try: to describe the Program as it is in place today, to indicate current issues of Program administration, and to delineate the situation as it appears to those of us who must ensure an orderly application of the controls so long as they are needed. I shall, indeed, expect many of you—who furnish or consume the services of the international financial community—to tell me your assessment of transitional problems and of probable effects on the U.S. balance of payments of any changes.

II. The VFCR Today

A. The request of U.S. financial institutions

The VFCR remains today, in its ninth year, a request by the Federal Reserve System that all U.S. financial institutions keep their loans to foreigners and other foreign financial assets within particular levels. To reinforce this restraint, they are also asked to observe other limitations on lending and investing abroad. The level for each bank or nonbank financial institution is related either to the amount of foreign assets held by the institution at the inception of the Program or, in the case of some banks, to the size of the institution at the end of 1970. I did use the elastic term "related to", since there have been many adjustments in the formulas and in the subsidiary restraints over the years. Those adjustments have sometimes led to decreases and more frequently to increases in the ceilings or in the flexibility for lending and investing abroad and to some alteration in the relative position of institutions under the Program.

B. Today's ceilings and what is under them

The approximately 225 commercial banks that each have half a million dollars or more of foreign assets and that therefore file regular reports under the Program have ceilings that aggregate over $10 billion. Under those ceilings, they have $9½ billion in foreign assets of the types that are subject to restraint. Outside their ceilings, they have over $6 billion in foreign assets that are not restrained, mainly export credits. Their total foreign assets therefore are almost $16 billion.

The 300-odd nonbank financial institutions have, in the aggregate, ceilings of less than $2 billion, but their total foreign assets are over $16½ billion, slightly greater than those of banks. In the case of the nonbank financial institutions, the bulk of their foreign assets that are outside restraint are investments in Canada, the only foreign country fully exempt from the Program. Canada has been exempt from the VFCR and the other two U.S. capital restraint programs since early 1968. Canada imposes restraints intended to prevent U.S.-source funds from being passed freely through that country to third countries.

The 60 or more U.S. agencies and branches of foreign banks account for an additional significant amount of foreign assets. But one must be careful in making statistical comparisons between them and U.S. commercial banks. The agencies and branches, as I shall discuss later, have no formally set ceilings but are asked to act in accordance with the spirit of the Guidelines. They have over $6 billion in foreign assets, and almost $4 billion are of types subject to restraint.

C. The intensity of the restraint

What do these figures mean in terms of restraints on capital outflow?

First, they apply only to capital outflow through U.S. private financial institutions and for the account of the institutions themselves and not of their customers. Other capital outflow may occur wihout VFCR restraint—in some cases restrained by the Interest Equalization Tax (IET) or by the Foreign Direct Investment Program or not restrained at all. An example of possible unrestrained flows are placement of funds in interest-bearing deposits in foreign banks by U.S. individuals or by U.S. corporations that are not covered by the Foreign Direct Investment Program. Under the VFCR, banks are expected to help limit such flows by discouraging their customers from placing funds abroad in liquid form.

In calendar 1972, total foreign assets of all U.S. private financial institutions rose by over $4 billion, but less than one quarter of that amount was accounted for by foreign assets subject to restraint. Looking at data for U.S. commercial banks and U.S. agencies and branches of foreign banks in the first four months of this year, we see a somewhat more rapid rate of growth and a slightly higher proportion of restrained to total foreign assets—an increase in total foreign assets of almost $2¾ billion and an increase in types subject to restraint of about two fifths of that amount.

Second, the leeway that banks have under their ceilings gives little elbow-room to the larger banks—those that account for the overwhelming bulk of U.S. bank foreign lending and investment activity. Figures for April 30 show that almost 8 per cent of aggregate ceilings of $10¼ billion remain unused. But a breakdown according to size of bank reveals that the 20 largest banks, which account for four fifths of the VFCR-type activity of all banks, are working with a leeway of about three or four per cent of their ceilings.

These data provide the basis both for many of today's operating problems and for the estimates—or speculation—about the impact of changes that may be made in the Program over the next year or so.

III. CURRENT ADMINISTRATIVE ISSUES

A. Observance of ceilings

Seeing that U.S. financial institutions keep within their ceilings and otherwise observe the several subsidiary requests remains the top priority task in Program administration. It is the first *issue* of those I shall talk about, but it is *not* a number one *problem*. And I believe there are three reasons for its not being a serious problem: first, the Guidelines do offer some latitude for institutions to expand their foreign business without having it show up adversely in the U.S. balance of payments; second, the U.S. financial community has generally acknowledged the need for the restraints and has recognized that the burden that they entail is being reasonably, if not perfectly, distributed, and, lastly, Governor Brimmer, the Board Member who has been delegated responsibility for administering the Program, in the rare cases in which the need arises, is quick to remind institutions of the Federal Reserve System's unqualified expectation of meticulous response to its request for volunteered cooperation.

When the Administration, in mid-February, announced its intention to phase out capital controls in a little less than two years, reporting institutions were asked to continue to give close attention to the Guideline requests throughout that ensuing period. There appears to have been a good understanding of the need to keep in check any capital flows that would jeopardize achievement of that objective.

Activity in foreign exchange markets this year has caused some banks to run over their ceilings, but these overages have almost always been quickly corrected. The task of keeping within ceilings proved most troublesome at the ends of February and March, when foreign correspondent banks, and to a

lesser extent other foreign customers, drew heavily on outstanding lines of credit. I should report at this point that, based on information gathered on the six weeks up to mid-February, the drawings appeared to have been accounted for by foreign banks rather than by speculative actions either by U.S. customers or foreign nonbank customers. Information is not adequate to draw conclusions about possible demands by foreign customers acting through foreign banks.

Many banks discovered the day after the end of February reporting date that the safety margins they normally maintain were obliterated by unanticipated, last minute actions of their customers.

For the most part, these overages were quickly corrected.

In a few cases, banks reported to the Federal Reserve that they would correct—or, expressing it passively, that they expected to see a correction—by the end of the next month or the next, or at the latest, the next. Our answer was an immediate notice that any correction had to be made much more quickly.

We recognize that, in order to correct a ceiling overage, a bank may have to incur inconvenience, expense, and even financial loss. The most common form of adjustment is the sale of foreign assets to a foreign branch. The foreign branch may have to finance the acquisition from its U.S. parent bank by obtaining funds in the Eurodollar markets. The cost involved may make the adjustment uncomfortable. However, banks are expected to keep within ceilings and, if unforeseen overages nevertheless occur, to correct them immediately. Fair treatment precludes our allowing one bank to stretch out the adjustment to avoid extra cost.

B. Liquid foreign balances

While looking at observance of ceilings, we should not lose sight of the request that financial institutions not keep funds abroad in liquid form in amounts greater than necessary to meet working capital needs. Banks, for example, are not to hold short-term balance in London merely because Eurodollar interest rates will yield them greater earnings than they can obtain in the United States or because the acquisition of certain foreign currency balances will enable them to speculate on exchange rate changes.

Between bankers' professional antipathy to getting enmeshed in speculative activity and the clearly stated Guideline principle, liquid balances—even during the recent periods of foreign exchange trading commotion—have been a problem only in the sense that occasional rumors understandably make responsible banks fear that they are being taken advantage of by less public spirited competitors. While we do from time to time hear reports about such placements, generally these reports fail to check out.

C. Export credit

Exempting all export credits from the VFCR following Congressional directive in late 1971 added an area of administrative issues that continues to keep us busy. Until that time, export credits that were extended by VFCR reporting institutions in conjunction with export credits extended by the Export-Import Bank, or that were Eximbank- or Department of Defense-guaranteed, or that were insured by Eximbank's adjunct agency, the Foreign Credit Insurance Association, were exempt; subsequently, *all* export credits were exempt (save for those then outstanding on foreign branches' books, which might otherwise have been shifted to U.S. head office books). The exemption did not cut off a chunk of the Program that had to be administered. On the contrary, not at all unexpectedly, we had to start answering questions whether this or that credit was an export credit and thereby fell outside an institution's ceiling. A credit to finance the sale of an airplane with French air frame but U.S. engines? A credit that was twice the terms of the useful life of the goods being exported? A credit to finance the sale to a foreign airline of a computer to be installed as part of its passenger reservation system at Kennedy Airport? A credit to finance the ocean freight, in foreign vessels or in U.S.-flag ships, on grains sold to the USSR?

In assessing the meaning of the exemption for the future of the VFCR, of probably more interest than the answers to these questions is an appreciation of how the export credit exemption has shifted the pressure of ceilings on the financial institutions.

First, unable to find a formula that allowed simply for export credits to be set aside and new ceilings calculated for non-export financing, three options were given to recalculate ceilings and these allowed for some incidental increase in ceilings in terms of non-export foreign assets. Thus, the export credit exemption greatly expanded an existing exemption and gave some new leeway, at least to some institutions, for non-export financing.

The latest data (April 30, 1973) shows that bank export credit outstanding (to foreigners other than Canadians) has risen since November 30, 1971 from $2.8 billion (of which about half was exempt under the Eximbank-Department of Defense exemption) to $5.2 billion (all of which is exempt). Over the same period: for U.S. agencies and branches of foreign banks, export credit has risen from $0.7 billion to $2.0 billion; for nonbank financial institutions (NBFI's) (end of 1971 to end of 1972), the change has been only $16 million to relatively low total of $96 million—NBFI's evidently not being greatly interested in this category of foreign lending.

An incidental—but still notable—aspect of the increase in export financing for U.S. financial institutions as a group is the connection between Eximbank (and DOD)-related and non-Eximbank (and non-DOD)-related export financing. Whereas the former grew by 32 per cent (from November 1971 to April 1973), the latter rose by 142 per cent. An assertion often made before the present full exemption was created, that Eximbank financing was sometimes obtained, not because it was critical to effect export sale, but because it made a bank credit eligible for exemption, seems to be supported by these data although other factors may also have affected the trend.

D. Tanker financing

Without a question, the most complex questions put to the Federal Reserve Banks and to us at the Board for interpretation have involved U.S. banks and U.S. life insurance companies, together with other U.S. financial institutions, financing the acquisition and lease of foreign-built oil tankers. I believe these questions are being phased out, for a reason I shall state—regardless of where we are with any phase-out of the Program.

Typically, U.S. banks and U.S. NBFI's put up, respectively, 20 per cent and 80 per cent of the $40 million or so cost of a Norwegian, Dutch, or Japanese built tanker. Construction abroad may have been financed by credits from foreign sources. When the foreign shipyard is ready to deliver the vessel, a U.S. trustee arranges for the acquisition and for the subsequent leasing of these vessels to shipping companies. In some cases, the lessee is a Liberian or Panamanian subsidiary of a U.S. oil company; at other times, a U.S. subsidiary of a U.S. or foreign oil company. In some cases the vessels are put on 25-year financial-type leases; at other times, there have been additional, short-term operating-type leases to affiliated or unaffiliated firms.

One reason for the complexity has been the involvement of many, and differing types of, financial backers to handle these large transactions (several such high-cost vessels often being acquired under a particular financing plan). Another reason is the use of many intermediary organizations that in some way share the risks that are inherent in the operation of large ocean vessels, particularly those carrying oil or natural gas.

We have wended our way through these transactions with the VFCR Guidelines and U.S. balance-of-payments reporting instructions in hand, as well as with—we believe—our common sense, in order to analyze their economic effects. We have also consulted with the Commerce Department's Office of Foreign Direct Investments to ensure that the U.S. financial institutions and such U.S. foreign direct investors as may be involved carry their respective responsibilities to accept charges against their VFCR ceilings or FDIP "allowables".

In late 1971, the Board amended the Guidelines to prevent NBFI's from using a VFCR developing country exemption where the beneficiary was not to any significant extent the economy of Liberia or Panama, in which an oil company may have incorporated a shipping subsidiary, but was the oil company itself or the countries producing or consuming the oil.

Early this year, the Interest Equalization Tax was amended with purpose and effect the same as the Guideline amendment, that is, to withhold an exemption on credits made by U.S. residents to Liberian or other developing country shipping companies (including leases of vessels to those companies) in situations of the type I have described. The tax amendment has detracted further—and perhaps crucially—from the attractiveness of the U.S. refinancing in these large transactions.

E. Agencies and branches

In a public address last April, Governor Brimmer acknowledged that a troublesome area of VFCR administration has been its application to U.S. agencies and branches of foreign banks. The principal difficulty has been—not in their willingness to "act in accordance with the spirit" of the VFCR Guidelines, but our ability to adapt the concept of gross claims on foreigners to their activities. Whereas U.S. banks acquire most of their assets with funds obtained from domestic sources (basically, with domestic deposits), agencies and branches rely typically on foreign sources of funds—some branches of foreign banks confronting difficulties in attracting deposits in competition with indigenous U.S. banks and all U.S. agencies being barred by State laws from accepting deposits.

The issue confronting us has been highlighted by the rapid growth in numbers and dollar size of this category of institution and by their now appreciable share of U.S. banking business. For example, in the foreign lending area, they account for 28 per cent of the total foreign assets of all banking institutions reporting under the VFCR.

One step taken to exert more specific restraint was to introduce, in late 1971, a monthly reporting system similar to the one used for U.S. banks. It yields data and presumably makes the agencies and branches more attentive to their actions against the background of the Guidelines.

Another change was to provide for fuller and more frequent consultation with the Federal Reserve Banks—primarily in New York and San Francisco, the two districts in which all the 64 reporting agencies and branches are now located.

Some reference points have been established and some guidance has been given to individual institutions to ensure that any increases in assets of types subject to restraint are not financed with U.S.-source funds.

We are interested, naturally, in learning the role these institutions played in the outflows that occurred in February and March. However, from the data available, it appeared that the outflow entailed a reversal of foreign source funds previously brought in by these institutions.

We intend to consult further with these institutions to adapt the Guideline principles to their special situation.

Here I might note that—apart from the VFCR and of capital outflow—the Federal Reserve Board has recently asked agencies and branches to accept a system of reserves against additional funds they bring into the country (calculated as a net inflow), as well as against increases in certain domestic liabilities. That request was made in connection with parallel steps applicable to U.S. banks in order to prevent an increase in domestic bank credit and, consequently, in domestic inflation.

IV. THE COMING YEAR

A. Policy determinations to be made

The VFCR Program, we should keep in mind, is one of three elements in an overall program to protect the balance of payments by restraining capital outflow. Any major change in intensity—or possibly in character—has to be related to the administration of the other programs. Moreover, the VFCR Program is being carried out by the Federal Reserve within a policy directive laid down by the Executive. Again, any major change in the level of restraints depends on a policy decision by the Executive.

Since the February 12 statement by the Secretary of the Treasury of the ultimate objective of phase-out, the Administration has noted that implementing decisions during the interim period would have to take account of exchange market conditions and trends in the balance of payments. This requirement was generally recognized in a communique of a March meeting in Paris of U.S. and foreign officials engaged in talks following the February 12 devaluation of the dollar. The Administration has not yet announced any steps. I will not speculate on the timing or nature of those steps, but I will try to look at the situation that might influence those steps and that may figure in the reactions of the U.S. financial community.

B. Balance of payments prospects

The U.S. balance of payments position is already improving and should improve further by year end. The moves toward realistic exchange rates that have occurred over the past year and a half are having a favorable effect.

An expected continuation in the rise in our exports, although still leaving a sizeable trade deficit, should reduce the trade deficit from the year before. Interest payments to foreign official holders of dollar reserves will grow as rates increase and U.S. liabilities expand. These interest payments will be an adverse, but probably not fully offsetting, factor to the improvement in trade. The net flow of long-term private capital may not be far out of balance; last year it was in balance.

Any projections here involve the effects of possible changes in capital controls, the area on which I am not making specific predictions. While short-term capital outflow—involving short-term export credit from U.S. banks and from U.S. exporters—may be large, there may be a reflow of funds that moved abroad during the foreign exchange speculation earlier this year.

C. International monetary reform and disequilibrating capital flows

Another factor bearing on any changes this year in the VFCR is the negotiation for international monetary reform particularly as it concerns possible means of influencing what are referred to as disequilibrating capital flows.

There is not a great deal to be said about this factor other than to note that it exists and may be discussed here or abroad as plans for the future of the VFCR are discussed. I mention it because I might be charged with forgetfulness or oversight if I did not.

Foreign governments have taken many steps to moderate capital inflows—some of the inflows coming directly from the United States, other from other countries. The joint float of several European Community currencies has moderated dollar inflows. Presently, with participants willing to see their currencies appreciate against the dollar, any capital inflows into their official reserves would presumably come only from other countries engaged in the joint float. However, the Germans have not wished to receive large inflows, and direct controls on inflows are also a factor for Community members and many other countries.

Whatever may be agreed internationally, the VFCR is not regarded as a system for dealing *principally* with speculative flows—speculative flows apparently being what people have in mind when they talk about disequilibrating flows.

D. The loans that may come home—a new outflow

The figures on loans that U.S. banks' foreign branches have extended to non-U.S. residents contain a large part of the answer to the question of how much new foreign credit will be extended by U.S. banks as the VFCR is phased out. But I find it impossible to decide how to use these figures to determine how much will remain on foreign branch books and how much will be shifted to U.S. parents' head offices or how much will be paid off and replaced by loans at lower interest rates from the U.S. head offices—the new dollar outflow.

As of the end of February, the foreign branches had on their books $42 billion in claims on non-U.S. banks (excluding other branches of their parent) and another $25 billion on non-U.S. nonbanks, or a total of $67 billion.

How much would be refinanced if those foreign borrowers could pay off and re-borrow from the U.S. banks' head offices (or from other U.S. sources)?

The most probable area of early movement would be the loans having one year or less remaining to maturity and perhaps some term loans that have small spread.

This amount might be further narrowed by excluding the claims payable in currencies other than dollars although there is good reason to say that the currency of denomination is not an important factor in categorizing loans likely to be replaced with U.S. head office loans and those not likely to be so replaced. Nevertheless, with this further modification in number, we would be looking only at claims of foreign branches of U.S. banks on banks in other foreign countries (other than affiliated branches), of a remaining maturity of not over one year, and payable in dollars.

The category of foreign branch loans might be narrowed further by eliminating the interbank loans (foreign branch loans to other foreign banks) although I find it specially difficult to judge how much would remain, how much would be replaced from U.S. head office, and how much of this interbank lending (and borrowing, of course) would dry up. But if, for purposes of estimation, all the interbank dollar-denominated loans were considered

as not likely to be refinanced from the United States, we would come down to dollar-denominated, short term loans by U.S. bank foreign branches to foreign branches on unaffiliated non-U.S. residents.

Among the restraints against bringing foreign branch loans to the United States are (a) penalties sometimes to be borne by the borrower for payment prior to maturity and (b) the tendency for rates to decline abroad and to increase in the United States as the demand for funds shifts from one area to the other.

I emphasize that the residual figure that emerges at this incomplete stage of analysis in no way represents an estimate of flow out of the United States. Any estimate would also have to take account of changes in foreign liabilities and possibly exchange rates. The residual calculation only suggests the magnitudes of the outer limits.

Before drawing any conclusion from this sketch of calculations, let me make an observation on the often-asked question about the effectiveness of the overall Guideline restraints. If, as is sometimes asserted, the Program is not very effective, its phase-out will not have much impact on capital flows and thereby on the balance of payments.

But let us look back at the figures I have mentioned. Whereas outflow through banks and agencies and branches—both increased assets and reduced liabilities—was $6 billion in the first four months of the year, over 70 per cent was in foreign assets exempt from restraint. If the restraints were removed, how much additional increase would occur in items now restrained?

My feeling is that the phase-out should be done gradually, without a full, advance schedule, and with an eye constantly on the effects of each step.

E. Effect on competitive relationships

At times there has been a view that the VFCR has been more limiting on small banks than on big banks. Many times when we have modified the Guidelines, we have been specially attentive to the smaller institutions.

In any control program that is based on an allocation of quotas rather than on market forces, one has increasing difficulty as time passes in judging whether the competitive relationships among participants truly represent the pattern that would prevail in the absence of restraints.

My own judgment in this case is that the big banks have effective means of preserving or promoting their business consistently with the program—principally by using foreign branches to service customers—and that our attentiveness to the smaller banks has been warranted. However, I am inclined to believe that the restraints have favored the smaller institutions—not in absolute terms but in terms of their relation to big banks—and that removal of the restraints will allow the bigger banks to increase their present share of U.S. bank foreign lending and investment—probably even if the foreign branches are included in calculating shares.

F. Effect on foreign branches

Banks that have established full-service or "shell" branches in whole or in part to relieve the pressure of VFCR ceilings will have to decide how far they want to cut back their foreign offices. Certainly, some business will revert to head office. The impact of that shift on the foreign branch will depend, of course, on how much other business is being done by that branch, on how important a "presence abroad" is, and on how much it costs to maintain a stand-by facility.

I expect no bank wants to be the first to close down its branch in a large foreign financial center, but I believe a few banks would have no difficulty in being the second or third to do so.

V. CONCLUSIONS

My principal conclusions are:

(1) cooperation by U.S. banks, by U.S. agencies and branches of foreign banks, and by U.S. nonbank financial institutions has been and remains commendable and accounts to a very great extent for the light touch that has been possible generally in its administration;

(2) some important administrative issues still require attention to ensure the effectiveness and the equity that are critical to the voluntary character of the Program;

(3) The Federal Reserve and, as the Secretary of the Treasury has indicated, the Executive will want to feel their way in deciding step-by-step on any phase-out of the Program;

(4) the controls foreign governments now, or in the future, impose on capital inflow may moderate the U.S. balance-of-payments effects of any lessening of controls on U.S. outflow; and finally,

(5) judgments about probable impact of any phase-out measures depend heavily on assessments and plans of the business and financial community.

Commercial Bank Lending Abroad and the U.S. Balance of Payments

(By Andrew F. Brimmer[1])

Last month, on February 10, an anniversary was passed with little or no notice: on that date, the Voluntary Foreign Credit Restraint Program passed its seventh birthday. Perhaps it is just as well that the date arrived and departed without fanfare, since most of us associated with these restraints on commercial bank lending abroad from the earliest days of their existence expected to see them removed long before now.

Of course, our expectation regarding the longevity of the program have been disappointed because of one simple fact; the program was one of several instruments designed in 1965 to help moderate the deficit in the U.S. balance of payments. (The others were the Interest Equalization Tax adopted in 1963 and the restraints on direct investment adopted in 1965 and administered by the U.S. Department of Commerce.)

We obviously have not managed to eliminate—or even to reduce—the balance of payments deficit itself. Last year, the United States incurred a balance of payments deficit of $30 billion, measured on an official settlements basis. While some improvement is expected in the current year, it appears likely that a short-fall in our international payments will continue for some time.

The recent record and outlook for the U.S. balance of payments are not news. Even the most casual observers of international finance have been aware of the situation for quite a while. However, the role which commercial banks played with respect to the balance of payments deficit last year is far less appreciated. In 1971, foreign loans and investments of U.S. commercial banks rose by $2.1 billion to a total of $12.9 billion. Measured by the previous annual changes in such assets since the Voluntary Foreign Credit Restraint Program (VFCR) was launched, the increase recorded last year was extremely large. It represented one-fifth of the total outflow of U.S. private capital which amounted to $10 billion in 1971. In 1970, the outflow of private capital totaled about $7 billion, and the banks' share was $627 million, or only 9 per cent. During the six years the VFCR Program had been in effect prior to 1971, foreign assets of reporting banks had increased by roughly $900 million, an annual average gain of $150 million. During the same six years, the average annual outflow of private capital was about $5.2 billion. Thus, the proportion attributable to the commercial banks was only 3 per cent.

Consequently, the spurt in commercial bank lending last year requires an explanation. It is especially important to analyze this sizable increase in bank claims on foreigners, because the VFCR Program is aimed largely at limiting the outflow of capital in the form of commercial bank lending. On the other hand, several major revisions were made in the VFCR Program last year, and these had considerable bearing on the foreign lending and investment behavior of the banks in the closing months of 1971. This behavior of the banks in the foreign lending area is examined in some detail in the following remarks.

In the following sections, I will review recent trends in commercial bank lending to foreign borrowers. The major revisions in the VFCR Program last

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[1] Member, Board of Governors of the Federal Reserve System. I am indebted to several members of the Board's staff for assistance in the preparation of these remarks. Mr. Bernard Norwood, who has principal staff responsibility for the administration of the Voluntary Foreign Credit Restraint Program (VFRC), provided overall supervision of the staff work and also helped with the analysis. Mr. Henry S. Terrell made the analysis of recent trends in commercial bank lending to foreigners, including an assessment of their response to recent revisions in the VFCR. Mr. Jan W. Karcz helped to trace the development of U.S. branch banking abroad since the mid-1960's.

November (and the banks' response to those changes) are also discussed. The sizable expansion in the network of U.S. branch banking abroad since the mid-1960's is traced in broad outline. It is also shown that the banks relied on such branches much less—and relied on their head offices much more—in 1971 than was the case in recent years. The highlights of the discussion can be summarized here.

Commercial banks (for the first time since the early 1960's) were major contributors to the deficit in the U.S. balance of payments in 1971. They expanded their foreign assets by $2.1 billion last year. Thus, they were responsible for about one-fifth of the outflow of private capital and for about 7 per cent of the balance of payments deficit measured on the official settlements basis.

With the exemption of export credits from the VFCR Guidelines last November, nearly one-third of banks' lending abroad is no longer subject to the restraints on capital outflow. As this and previously existing exemptions are used more intensively in the future, the proportion of the banks' foreign lending covered by capital controls may decline further.

In 1971, for the first time since the VFCR Guidelines were adopted, the banks recorded a sizable expansion in foreign credits held for themselves and their customers at their head offices in the U.S.—an increase of $2.4 billion. This represented one-sixth of the growth in such credits at banking offices in this country and at U.S. banks' foreign branches. In recent years, virtually all of the rise in such credit had occurred at the foreign branches whose activities are exempt from the VFCR Guidelines. Nevertheless, the enormous growth of the banks' network of foreign branches was by no means checked.

RECENT REVISIONS OF THE VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM

On November 11, 1971, the Federal Reserve Board issued revised Guidelines to implement legislation that exempted export credits from restraint under the VFCR Guidelines. In addition, the revised Guidelines permitted each bank the option of computing a new ceiling as the highest of: (1) 85 per cent of its General Ceiling as of September 30, 1971, (2) its General Ceiling less any export credit thereunder on September 30, 1971, or (3) 2 per cent of its end of 1970 total assets.

Aside from exempting export credits, the major modification in the VFCR was the new option available to any bank to adopt a ceiling of 2 per cent of its total assets for *nonexport* foreign lending and investing. Prior to this revision, any bank without a ceiling was permitted to adopt a ceiling equal to 1 per cent of its end-of-1968 total assets. However, that ceiling was to be utilized predominantly for credits which financed U.S. exports. Consequently, under the previous Guidelines, both the type and amount of activity of banks entering the foreign lending field was constrained.

The desire to reduce inequity among banks was the principal reason for the revision of the formula by which ceilings for banks are calculated. In several previous Guideline revisions, efforts had been made to modify the distribution of ceilings prevailing at the time the VFCR was promulgated in early 1965. Essentially foreign lending patterns had been frozen as they were at the end of 1964. This action gave a preferred position to those banks that had established themselves early in the field of foreign lending. However, despite the modifications designed to reduce inequities, the 20 largest banks still accounted for four-fifths of the foreign assets on the books of the VFCR reporting banks at the end of October last year.

The recent revisions in the VFCR allow a larger number of banks to become active internationally, but so far the response has been quite moderate. The majority of the nearly 200 reporting banks have elected to compute their ceilings on the basis of 2 per cent of their total assets. Since the November revision, 22 banks have adopted ceilings aggregating about $160 million—a total increase in ceilings of 1.6 per cent. To date the newcomer banks have only $10 million outstanding under these ceilings, which represents a minor addition to the total outstanding stock of foreign claims reported by U.S. banks.

However, as indicated above, the principal purpose of permitting newcomer banks to adopt ceilings is to reduce inequities under the program. The new entrants are expected to engage directly in foreign finance. They are not to act passively by merely purchasing foreign credits that are extended by other U.S.

commercial banks that may sell them in order to utilize the smaller banks' lending leeway. While we do not expect the newcomer provision to be abused, the Board amended the Guidelines earlier this month to assure that the provision is used as originally intended.

As a result of the decision to exempt export credits from the restraints on capital outflow, the proportion of the banks' foreign assets subject to the VFCR Guidelines shrank further. As can be seen from Table 1 (attached) at the end of December, 1971, VFCR-covered assets were 61 per cent of total foreign assets outstanding at U.S. commercial banks compared with 78 per cent a year earlier. In 1964 (not shown in the table), the ratio was 85 percent. In the case of foreign assets held for the banks' own account, the decline in the proportion subject to VFCR restraints has been even sharper. At the end of last year, the ratio had dropped to 69 per cent—from 90 per cent in December, 1970, and 98 percent at the end of 1964.

The decrease last year in the percentage of the banks' foreign assets covered by the VFCR was due mainly to the specific exemption of export credits by commercial banks. However, it also partly reflected the expanded use of previously existing exemptions, particularly the exemption of credits to Canadian borrowers and credits guaranteed, participated in, or insured by the Export-Import Bank. For example, in the case of the Export-Import Bank-related credits, as recently as December, 1969, the volume outstanding amounted to $522 million, or 5.2 per cent of the foreign assets held by banks for their own account. By October last year (the last date for which figures are available), the Export-Import Bank-related credits had risen to $1,303 million, or 13.5 per cent of the banks' holdings of foreign assets for their own account. By the end of last December, it is estimated that the proportion had risen further to 15½ per cent.

This shrinkage in the proportion of the banks' assets subject to VFCR Guidelines should be kept in mind. It seems that a sizable share of the foreign lending over which the banks have discretion (currently representing nearly one-third of the foreign assets held for their own account) is already outside the restraints on capital outflow. As the various exemptions are used more intensively in the future, the proportion may be expected to rise further.

EXPANSION OF FOREIGN ASSETS IN 1971

We can now focus on an explanation of the extremely large increase of $2.1 billion in commercial banks' own holdings of foreign assets in 1971. To provide such an explanation is more difficult than it might appear on the surface. Some of the difficulty arises because of conceptual problems in defining foreign assets while others are posed by problems of statistical measurement. In the first place, banks hold foreign assets for their customers as well as for their own account. Among the latter, as indicated above, some of their foreign assets are covered by the VFCR Guidelines while some of the categories are exempt. Nevertheless, despite the impossibility of achieving precision in the analysis of commercial bank lending abroad, the principal sources of the growth in their holdings of foreign assets in recent years can be traced.

The components of the changes in the three years 1969-71 are shown in Table 1. It will be noted that total foreign assets held by commercial banks in the United States amounted to $14.7 billion at the end of 1971. Assets held for the banks' customers amounted to $1.8 billion, leaving $12.9 billion held by the banks for their own account. Total outstandings rose by $2.4 billion last year, with $274 million of the increase representing customers claims and $2.1 billion occurring in the banks' own assets. In 1970, the total expansion amounted to $649 million, of which $22 million was for customers and $627 million was for the banks themselves. Thus, the growth in the banks' foreign credits last year was about three times that recorded in the preceding twelve months.

Of the total rise of $2.1 billion, about $270 million represented increases in claims on residents of Canada. Since early 1968, bank lending to Canada has not been subject to the VFCR restraints. About $630 million of the expansion occurred in loans backed by the Export-Import Bank or the Department of Defense. Both types of credits have been exempted from the Guidelines for quite some time. Just over $100 million of the increase centered in foreign loans offset by borrowings abroad through Delaware subsidiaries. These four categories of assets—all previously exempted from the VFCR Guidelines—accounted for $1,021 million (or about half) of the total rise in foreign assets held for the banks' own account.

In addition, the banks' export credits which were exempted from the restraints by the revisions adopted last November undoubtedly also expanded during the year. The volume of such credits outstanding amounted to $1,864 million in December, 1971. While no comparable figures exist for year-end, 1970, an estimate for September of that year placed the level at $1.4 billion. Thus, by December, 1970, the level may have been around $1.5 billion. Thus, the increase in 1971 may have been in the neighborhood of $300-$400 million. So, asset categories exempt from VFCR Guidelines apparently accounted for about three-fifths of the increase in the banks' foreign assets last year.

This would still leave a sizable part ($700-800 million) of the increase to be explained. Some of the remainder (exactly how much cannot be estimated with precision) undoubtedly represents a rise in bank lending in response to foreigners' demands for funds associated with the speculative movements of short-term capital in May and August, 1971. Some idea of the magnitude of these outflows of bank funds can be gotten from the data in Tables 3a and 3b, showing selected foreign assets held by about 350 large banks which report weekly to the Federal Reserve Board. Table 3a lists annual changes in these assets during 1970 and 1971 and also for the November-March months of the last two years. Table 3b shows the same data for May and August last year.

The increases were as follows (millions of dollars):

Type of foreign loan	Full year		May		August	
	1970	1971	1970	1971	1970	1971
Balances with foreign banks	61	136	26	−39	36	69
Loans to foreign commercial banks	113	1,393	93	378	−28	1,005
Foreign commercial and industrial loans	117	820	49	168	11	397
Subtotal	345	2,349	168	507	19	1,441
Loans to foreign government and official institutions	−101	48	−5	9	−65	9
Grand total	244	2,397	163	516	−46	1,450

Several observations can be made regarding these statistics. The increase in the banks' foreign assets in 1971 ($2.4 billion) is roughly of the same magnitude indicated by the first set of data presented above. The rise was nearly ten times that recorded in the preceding year. During the month of May, 1971, when the decision of the West German Government to allow the mark to float touched off a sizable shift out of dollars, the foreign assets of the weekly reporting banks rose by $516 million. In August of last year, both before and after the adoption of the New Economic Policy in the United States, commercial banks in this country were confronted with an enormous foreign demand for credit. In responding, they expanded their foreign assets by $1,450 million. This was the largest monthly gain in bank reported foreign assets since the VFCR Program was instituted. In fact, the VFCR reporting banks increased their assets subject to the restraints by $1,206 million during the month of August. They collectively exhausted the leeway of $912 million which they had at the end of July and ran over their general ceilings by about $250 million.

There were a number of factors which led to this unusually large rise in foreign assets last May and August. Probably most important was the use by foreign banks and other borrowers (especially Japanese trading companies) of the credit lines that had been established with U.S. banks in earlier periods. Drawings on these credit lines may have represented a hedge by the foreign borrowers against exchange rate changes, but since the loans were primarily in dollars they did not represent foreign exchange activity for the U.S. banks involved. The increase in balances held with foreign banks was also unusually large in May, and the level was reduced only moderately in the following months. In this case, banks may have been acting both on their own account and in order to position themselves to meet the demands of their customers.

These data help to delineate the role of the commercial banks in the large international capital flows that occurred in the Spring and Summer of 1971. While a modest amount of repayments of some of the foreign loans occurred in the later months of last year, the net effect of the expansion in the banks' foreign assets last May and August was to provide a significant boost to their total foreign lending in 1971 as a whole.

Aside from the role of U.S. domestic institutions, a sizable part of the outflow of funds last year reflected increases in claims reported by agencies and branches of foreign banks operating in the United States. Agencies and branches of foreign banks had been asked previously to act in accordance with the spirit of the VFCR Guidelines. Partly because of the activities of these institutions last summer, the revised Guidelines issued on November 11, 1971, requested that agencies and branches of foreign banks file monthly reports with the Federal Reserve Banks covering their foreign activity. This step was necessary to enable the Board to follow the activities of the foreign branches and agencies more closely. In August, 1971, during the height of speculative outflows of funds in the midst of foreign exchange crisis, these institutions were instrumental in moving abroad a substantial volume of dollars.

BANKS' RESPONSE TO VFCR PROGRAM REVISIONS

The experience of banks under the VFCR since the Guidelines were revised last November is shown in Table 2. The number of reporting banks has increased slightly, and this number should be expected to increase as more small and medium-sized banks take advantage of the liberalized newcomer provision. The revision of the VFCR Guidelines permitted an expansion in the aggregate ceilings for nonexport foreign lending and investing which amounted to roughly $1 billion. About three-fourths of the expansion in aggregate ceilings was directed toward the smaller and medium-sized banks—whose ceilings constituted a small fraction of their total assets. Undoubtedly some (but probably only a minor part) of this increase in aggregate ceilings has resulted in an increased level of foreign claims.

The figures in Table 2 also indicate that the banks' total foreign assets rose by $1.2 billion between November 30, 1971, and January 31, 1972. Approximately $225 million represented growth in claims held by the banks for account of customers. Therefore, over the same period, foreign assets held by banks for their own account increased by $979 million. About one-quarter ($266 million) of this expansion was accounted for by an increase in claims on Canada. Again, neither of these classes of assets—customers' claims and claims on Canadian residents—was covered by the revised nor by the previous Guidelines. Assets subject to restraint under the VFCR ceilings rose by $151 million during the three months.

As already mentioned, a second revision in the Guidelines was the total exemption of export credits from any form of restraint following the enactment of legislation requiring the Federal Reserve to exempt these credits. As of November 30, export credits on the books of VFCR reporting banks amounted to $2,789 million. These credit expanded by $505 million in December; a further rise of $48 million in January of this year lifted the total to $3,342 million at the end of that month. A portion of the $553 million increase in export credits to foreigners other than residents of Canada that occurred in December and January is not attributable to the Guideline revision. Some portion of these export credits would have been exempt under the previous Guidelines by virtue of guarantees or participation by the Eximbank, insurance by the FCIA, or the guarantee of the Department of Defense.

Overall, the record since November, 1971, indicates that the revisions in the VFCR Guidelines have not themselves led to a significant capital outflow through the banking system. At the same time, however, the total flow of funds abroad through U.S. commercial banks remains significant.

THE VFCR AND THE GROWTH OF OVERSEAS OPERATIONS OF U.S. BANKS

At this point, I would like to review the foreign lending behavior of U.S. commercial banks in a broader context. As is generally known, the introduction of the VFCR Program gave impetus to a development that will have lasting effects on the scope and character of U.S. international banking. I refer here to the phenomenal expansion of foreign branches of U.S. banks. Prior to the introduction of the VFCR in 1965, only a handful of banks (11) had foreign branches, although collectively they operated about 200 such branches. (See Table 4.) By the end of 1971, the number of banks with foreign branches had increased seven-fold (to 91), and among them they controlled 583 foreign branches.

Given increased foreign activity of the banks' clients, some increase in foreign branching could have been expected. But this extremely rapid growth

undoubtedly was due partly to the banks' desire to keep within their VFCR ceilings by raising funds abroad and lending them to foreigners from the banks' overseas branches. Under the VFCR Guidelines, assets on the books of foreign branches are not counted against the ceilings of the parent banks. Also, the restraints on U.S. direct investors, under the Foreign Direct Investment Program, caused U.S. companies to turn to the foreign branches of U.S. banks for alternative offshore financing.

Originally, the expansion of foreign banking was primarily centered in London, where a bank with a foreign branch could find a convenient way to tap the Euro-dollar market in times of domestic monetary stringency. By the end of 1971, 41 U.S. banks had branches in London, and at times Euro-dollar borrowings from these branches were very large indeed—over $13 billion in 1969. Since early 1969, however, most of the increase in the number of U.S. banks with foreign branches was accounted for by banks opening branches in Nassau, Bahamas.

Foreign branches of U.S. banks have recorded an enormous growth in assets as well as in number. In 1964, before the introduction of the VFCR Program, the assets of foreign branches amounted to only $7 billion. By 1971, when the number of branches had expanded three-fold, the assets totaled over $60 billion—a six-fold growth.

In addition to the rapid expansion of foreign branching, U.S. banks have accelerated the formation of Edge Act and Agreement Corporations, As is generally known, these are domestically organized subsidiaries that serve as vehicles for foreign banking and investment. Since the introduction of the VFCR Program, the number of such corporations has doubled and stood at 84 in June of 1971 while their assets grew from $1 billion to over $7 billion. The growth of these subsidiaries (except where they have established foreign branches) cannot be attributed specifically to the VFCR, since they are subject to the VFCR in common with U.S. banks. Rather, their expansion is evidence of a growing effort by U.S. banks to compete for foreign banking business and to exploit foreign investment opportunities.

As domestic monetary conditions became easier in 1970–71, most banks liquidated their Euro-dollar borrowings, largely by repaying overseas branches in financial centers such as London—but also in other areas, such as Nassau. Currently, borrowings by head offices from foreign branches are currently under $1 billion, a dramatic decline from the nearly $14 billion high reached in 1969. On balance, however, the continuing existence of the VFCR Program, the possibility that there may once again be an advantage to sourcing dollars abroad for domestic use, and the low costs connected with the maintenance of a Nassau branch, will probably prompt many banks to continue to maintain these shell branches, even if on a stand-by basis.

A particularly useful insight into the reliance U.S. banks have placed on their foreign branches in recent years is provided by the data in Table 5. These figures show credits outstanding at the banks' domestic offices and foreign branches. In one sense, the figures can be interpreted as indicating the extent to which the banks choose to service their foreign customers from their domestic offices as opposed to their foreign branches.

The spectacular growth of their total foreign loans is clear—a jump from $13.3 billion in 1964 to $52.3 billion at the end of last year. The overwhelming share of the rise has occurred in the foreign branches, where the amount outstanding climbed from $3.9 billion to $40.2 billion during the same period. While the foreign branches held less than one-third of the foreign loans of the domestic offices and foreign branches combined in 1964, they held three-quarters in 1971.

Last year, however, for the first time since the VFCR Guidelines were adopted, a sizable share (one-sixth) of the rise in bank-reported foreign credits occurred in the United States. So, while their foreign branches had been used extensively by the banks to keep within the VFCR Guidelines (and many of the banks continue to use them in this way), the exemption of exports from the ceiling apparently created leeway for the banks to handle a larger fraction of their foreign business from their headquarters in the United States.

CONCLUDING OBSERVATIONS

From this survey of the recent foreign lending experience of U.S. commercial banks, several conclusions stand out: the banks still face a strong demand for funds on the part of their foreign customers—many of whom are the sub-

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sidiaries of American multinational corporations. In responding to these demands, U.S. banks have pursued a vigorous policy of establishing and extending a network of foreign branches. In fact, from the mid-1960's until last year, the growth in the banks' foreign lending had been heavily concentrated in their offices abroad. Thus, the banks' foreign lending activity imposed little net burden on our balance of payments.

Last year, however, that situation was reversed. For the first time since the early 1960's, a substantial outflow of funds occurred through the commercial banks. To a considerable extent, the result represented a shift of a significant part of the banks' foreign lending from their branches abroad to their offices in the United States. While it is impossible to predict the course of the banks' foreign lending in the current year, the further rise in the outflow of bank funds during the last few months suggests that U.S. commercial banks could again be important contributors to the continuing deficit in our balance of payments.

Such a prospect does not seem to me to argue for the frequently-heard suggestion that the Federal Reserve Board give the banks even greater leeway under the VFCR—if not dismantle the program altogether.

TABLE 1.—FOREIGN ASSETS OF U.S. COMMERCIAL BANKS REPORTING UNDER VFCR GUIDELINES, 1969-71

[Amounts in millions of dollars]

Category	1969	1970	1971	Change 1969-70	Change 1970-71
Total: All foreign assets	11,719	12,368	14,736	649	2,368
Less: Customers' claims	1,541	1,563	1,837	22	274
Foreign assets held for own account	10,178	10,805	12,899	627	2,094
Loans, acceptances, deposits and other claims [1]	9,289	9,628	11,697	339	2,069
Foreign long-term securities	161	141	119	−20	−22
Investment in foreign subsidiaries	628	781	1,021	153	240
Export term loans [2]	19	190		171	
Other long-term holdings	81	65	62	−16	−3
Less: VFCR exempt assets	794	1,120	3,942	326	2,822
Claims on Canadian borrowers (change since February 1968) [3]	164	266	536	102	270
Export-Import Bank-related [4]	522	791	[5] 1,400	269	609
Department of Defense-related			[5] 30		30
Certain deferred payment letters of credit	108	63		−45	−63
Delivery subsidiaries liability offset			112		112
Export credits [6]			3,294		3,294
Assets subject to VFCR	9,384	9,685	8,957	301	−728

[1] Assets reported on Treasury Forms B-2 and B-3, minus amounts held for customers.
[2] Export-term loans were exempt from the VFCR Guidelines as of Nov. 11, 1971.
[3] Beginning in Mar. 1968, claims on residents of Canada held for the bank's own account were exempt from the VFCR Guidelines.
[4] Credits guaranteed or participated in by the Export-Import Bank or insured by FCIA or guaranteed by the Department of Defense were previously exempted from the VFCR Guidelines. These types of claims are included in export credit as of year-end 1971. Data for such claims for 1971 were estimated, since figures are no longer collected separately.
[5] Estimated.
[6] Export credits were exempt from the VFCR Guidelines as of Nov. 11, 1971, in accordance with legislation.

Source: U.S. Treasury Foreign Exchange Forms B-2 and B-3 and reports to the Federal Reserve Board under the VFCR program.

TABLE 2.—CHANGES IN FOREIGN ASSETS OF U.S. COMMERCIAL BANKS REPORTING UNDER THE VFCR GUIDELINES, NOVEMBER 1971-JANUARY 1972

[Amounts in millions of dollars]

Category	November 1971	December 1971	January 1972	Change: November-December 1971	Change: December 71-January 72	Change: November 71-January 72
Total: All foreign assets	13,422	14,736	14,626	1,314	−110	1,204
Less: Customers' claims	1,737	1,837	1,962	100	125	225
Foreign assets held for own account	11,685	12,899	12,664	1,214	−235	979
Loans, acceptances, deposits, and other claims	10,502	11,697	11,448	1,195	−249	946
Foreign long-term securities	116	119	120	3	1	4
Investment in foreign subsidiaries	1,005	1,021	1,032	16	11	27
Other long-term holdings	62	62	64		2	2
Less: VFCR exempt assets	3,110	3,942	3,938	832	−4	838
Claims on Canadian borrowers (change since February 1968)	218	536	484	318	−52	266
Delivery subsidiaries liability offset	103	112	112	9	—	9
Export credits	2,789	3,294	3,342	505	48	553
Assets subject to VFCR	8,575	8,957	8,726	382	−231	151
Ceiling	9,851	9,982	9,996	131	14	145
Aggregate leeway	1,276	1,025	1,270	−251	245	−6
Number of reporting banks	181	188	191	7	3	10

Source: U.S. Treasury Foreign Exchange Forms B-3 and B-1 and reports to the Federal Reserve Board under the VFCR program.

TABLE 3a.—SELECTED FOREIGN ASSETS OF U.S. BANKS

[Amounts in millions of dollars]

	Dec. 31, 1969	Dec. 30, 1970	Change	Dec. 30, 1970	Dec. 29, 1971	Change	Nov. 25, 1970	Mar. 3, 1971	Change	Nov. 4, 1971	Mar. 1, 1972	Change
A. Loans to foreign commercial banks	1, 496	1, 609	+113	1, 609	3, 002	+1, 393	1, 590	1, 504	—86	2, 570	2, 482	—88
Foreign commercial and industrial loans	2, 238	2, 409	+171	2, 409	2, 229	+820	2, 330	2, 420	+90	2, 983	3, 204	+221
Balances with foreign banks	297	358	+61	358	494	+136	311	380	+69	376	466	+90
Total	4, 031	4, 376	+345	4, 376	6, 725	+2, 349	4, 231	4, 304	+73	5, 929	6, 152	+223
B. Loans to foreign governments and official institutions	971	870	—101	870	918	+48	887	760	—127	806	915	+109
Grand total	5, 002	5, 246	+244	5, 246	7, 643	+2, 397	5, 118	5, 064	—54	6, 735	7, 067	+332

Source: Loans to and balances with foreign banks and loans to foreign governments and official institutions are Weekly Condition Report data; foreign commercial and industrial loans are from weekly (Federal Reserve) Commercial and Industrial Loan series.

TABLE 3b.—SELECTED FOREIGN ASSETS OF U.S. BANKS

[Amounts in millions of dollars]

	Apr. 29, 1970	May 27, 1970	Change	Apr. 28, 1971	May 26, 1971	Change	July 29, 1970	Aug. 26, 1970	Change	July 28, 1971	Aug. 25, 1971	Change
A. Loans to foreign commercial banks	1, 327	1, 420	+93	1, 488	1, 877	+378	1, 445	1, 417	—27	1, 790	2, 795	+1, 005
Foreign commercial and industrial loans	2, 189	2, 238	+49	2, 535	2, 703	+168	2, 149	2, 160	+11	2, 682	3, 049	+367
Balances with foreign banks	260	286	+26	584	545	—39	268	304	+36	403	472	+69
Total	3, 776	3, 944	+168	4, 607	5, 114	+507	3, 862	3, 881	+19	4, 875	6, 316	+1, 441
B. Loans to foreign governments and official institutions	996	991	—5	805	814	+9	986	921	—65	815	824	+9
Grand total	4, 772	4, 935	+163	5, 412	5, 928	+516	4, 848	4, 802	—46	5, 690	7, 140	+1, 450

Source: Loans to and balances with foreign banks and loans to foreign governments and offical institutions are Weekly Conditions Report data; foreign commercial and industrial loans are from weekly (Federal Reserve) Commercial and Industrial Loans series.

TABLE 4.—INTERNATIONAL OPERATIONS OF U.S BANKS: SELECTED INDICATORS, 1960–71

[Monetary magnitudes are in billions of dollars]

	1960	1964	1965	1966	1967	1968	1969	1970	1971
U.S. offices:[1]									
Bank credit to foreigners[2]	$4.2	$9.4	$9.7	$9.6	$9.8	$9.2	$9.3	$9.7	$12.1
Foreign deposits[2,3] (other than due to foreign branches)	$9.1	$13.4	$13.6	$12.6	$14.4	$14.7	$16.5	$16.5	$17.7
Due to foreign branches[4]		$1.2	$1.3	$4.0	$4.2	$6.0	$12.8	$7.7	$.9
Overseas branches of banks:[5]									
Number of banks with overseas branches	8	11	13	13	15	26	53	79	91
Number of overseas branches	131	181	211	244	295	375	459	536	583
Assets of overseas branches[6]	$3.5	$6.9	$9.1	$12.4	$15.7	$23.0	$41.1	$52.6	[7] $63.0
Edge and agreement corporations:									
Number	15	38	42	49	53	63	71	77	[8] 84
Assets	[9]	$.9	$1.0	$1.4	$1.5	$2.5	$3.5	$4.6	[8] $7.3

[1] All data for U S. offices are on a balance-of-payments basis.
[2] Bank credit to foreigners and foreign deposits relate to all commercial banks reporting on the Treasury foreign exchange forms, and include credits and deposits of branches and agencies of foreign banks as well as U.S. banks. Bank credit includes short- and long-term loans and acceptance credits denominated in dollars; for 1960, some other short- and long-term claims are also included.
[3] Foreign deposits include demand and time deposits of one year of less maturity, and, beginning in 1964, include negotiable certificates of deposit issued to foreigners and international institutions.
[4] Due to branches refers to the gross liabilities due to foreign branches of large U.S. weekly-reporting banks.
[5] Overseas branches include branches of member banks in U.S. possessions and territories as well as in foreign countries.
[6] Branch assets include interbranch balances.
[7] Partly estimated.
[8] Which indicates end of June.
[9] Not available.

Sources: Treasury forms B-2 and B-3; Division of Supervision and Regulations, Board of Governors of the Federal Reserve System.

TABLE 5.—FOREIGN CREDIT OUTSTANDING AT DOMESTIC BANKING OFFICES AND AT FOREIGN BRANCHES OF U.S. COMMERCIAL BANKS, 1960–71

[Amounts in billions of dollars]

Year	Foreign credits				Annual percentage change		
	Total	Held by domestic offices for own account[1]	Held by foreign branches		Total	Domestic offices	Foreign branches
			Amount	Percent of total			
1960	6.6	4.2	[2] 2.4	36.3			
1964	13.3	9.4	[2] 3.9	29.3			
1965	15.2	9.7	5.5	36.1	14.3	3.2	41.0
1966	15.6	9.6	6.0	38.4	2.6	−1.0	9.1
1967	17.5	9.8	7.7	44.0	12.2	2.1	28.3
1968	19.4	9.2	10.2	52.5	10.9	−6.5	32.5
1969	25.4	9.3	16.1	63.3	30.9	1.1	57.8
1970	37.3	9.7	27.6	73.9	46.9	4.3	71.4
1971	[2] 52.3	12.1	[2] 40.2	76.9	40.2	24.7	45.7

[1] All commercial banks reporting on Treasury Forms B-2 and B-3; includes credits of U.S. branches and agencies of foreign banks, as well as U.S. banks. Covers short- and long-term loans and acceptance credits denominated in dollars. For 1960, a minor amount of other short- and long-term claims (not denominated in dollars) is also included. For domestic offices, totals include loans to own foreign branches. Branch totals exclude interbranch balances and amounts due from head offices.
[2] Estimated.

Voluntary Restraints in a Market-Oriented Economy

RESTRAINING FOREIGN CREDIT: SIX YEAR TEST

For almost six years, the Federal Reserve System has maintained a request to U.S. banks and other nonbank financial institutions such as insurance companies that, on a temporary basis, they voluntarily restrict their lending and investment overseas to a level tied closely to the amount outstanding at the end of 1964.

As one of a triumvirate of U.S. Government programs to protect the balance of payments by restraining capital outflow, the Federal Reserve program is the only one that is voluntary. The Interest Equalization Tax (IET), the

responsibility of the Treasury Department, is applied in the same manner as are other Federal taxes. The Foreign Direct Investment Program (FDIP) is administered by the Department of Commerce through comprehensive regulatory machinery. Both the Federal Reserve and Commerce Department programs stated on a voluntary basis. On New Year's Day 1968, through an order of the President, the Commerce program was shifted immediately to a mandatory basis, but the Federal Reserve, given a choice, decided against doing so.

How has the Federal Reserve been able to get financial institutions voluntarily to forego exploiting a profitable part of their lending and investment? Have the institutions behaved as requested? Have they found ways around the program—acceptably, or against program objectives? After such a long temporary period, is the Federal Reserve likely to continue to get the cooperation of the financial community?

In the early 1960's, the U.S. Government was studying ever more closely the country's balance-of-payments difficulties. The rising outflow of private capital was becoming one of the special objects of worry. In order to reduce the attractiveness of the U.S. capital market to borrowers in Europe and elsewhere, and thereby to cut down the outflow of dollars, the Interest Equalization Tax (IET) was proposed in mid-1963 and adopted a year later.

In the final months of 1964, there was a sharp deterioration in the balance of payments. The IET had not been applied to bank lending, and this exemption caused many foreigners who had raised funds in the U.S. securities market to shift to borrowing from U.S. banks.

To stem the swelling outflow of funds, a voluntary balance-of-payments program was announced in February 1965. Limits were to be placed on capital outflow from corporations for their own direct investment abroad and from banks and other financial institutions for lending and investment in foreign countries. The programs were to serve as alternatives to the traditional remedy of adopting a restrictive monetary policy. That, it was feared, would have aggrevated the problems of a slackening economy. The new measures were innovative and regarded as temporary.

The request for voluntary cooperation was made initially by the President. He asked the System's Board of Governors to administer a program for financial institutions, and, on March 3, 1965, it issued guidelines for banks and for nonbank financial institutions. Ever since, the program has been a "Fed" responsibility, but carried out to implement a policy laid down by the Executive.

The "Fed" Program

Banks were requested, generally speaking, to hold loans and other "foreign assets" to 105 per cent of the amount they held on December 31, 1964. This formula would have permitted an increase of about a half billion over the approximately $10 billion of such end-of-1964 holdings. The request applied to all U.S. banks, regardless of whether they were members of the Federal Reserve System. Banks holding a half million dollars or more of such assets were to report regularly to the Federal Reserve Banks. Early reports revealed that there were about 150 banks (out of about 14,000 in the country) having foreign assets above that dollar amount.

Nonbank financial institutions—including insurance companies, mutual funds, endowment funds, pension funds, and trust departments of commercial banks—were asked, on a tentative basis, to exercise similar restraining effort. The indications of the degree and type of restraints requested were tentative, since the Board knew less about the holdings and practices of these financial institutions than it did about those of banks. Deposits held in foreign banks by these institutions were to be reduced gradually to end-of-1963 levels, except for necessary working balances. Short- and medium-term loans and investments were to be held to 105 per cent of end-of-1964 levels.

The Impact

Banks and other financial institutions quickly revised their plans. Some that were on the verge of expanding their foreign lending activity had to drop plans completely. Others slowed or even cut back their operations.

For the banks, the figures for the rest of 1965 showed that their foreign assets—principally loans to foreigners—that were subject to the restraints increased by only $168 mfillion. In the preceding year, their foreign assets had grown by about $2.5 billion. One of the forces behind the expansion that year was the rush to lend in anticipation of government controls.

For the nonbank financial institutions, data collected in the course of the year revealed a new and generally unexpected picture. It was discovered that nonbank institutions held $12 billion of foreign assets, or more than the foreign assets held by banks. In the middle of the year, the guidelines were revised to extend the coverage of the 105 per cent ceiling to include, loans up to 10 years maturity and to request certain additional restraints on loans to some developed countries.

During the first year, the "nonbanks" increased their holdings of foreign assets of all types, but they did cut back, from $1.7 billion to $1.5 billion, their holdings of those foreign assets for which restraint had been asked.

Restraints, Later Years

Several changes were made between 1965 and 1968. Most of these changes were aimed at reducing the discriminatory effect of a fixed base date by increasing the ceilings of banks with low base date holdings. These changes had the effect of raising ceilings of financial institutions in the aggregate. However, on New Year's Day 1968, the aggregate ceiling was cut back for the first time. The reduction was announced along with other restrictive actions determined by the President to be necessary to tighten all U.S. balance-of-payments programs. It came only a few weeks after guidelines for 1968 had been published that had permitted some loosening.

In early 1968, Canada was exempted from the restraints, as well as from the other balance-of-payment programs. In turn, Canada undertook to maintain safeguards that would prevent Canada from being used as a "pass through" for funds to flow from U.S. financial institutions to third countries.

There were other changes made in both directions in the bank guidelines regarding certain types of credits and particular geographic areas. Special principles were introduced for loans to residents of the developed countries of continental western Europe. Changes were also made in the treatment of export credits. Most important of the latter changes was the creation in December 1969 of a separate ceiling for export term loans. These loans, which had a maturity of one year or more, could be charged against the new ceiling, which was additional to the "General Ceiling" for all other credits.

Revisions in the provisions for nonbank financial institutions have been fewer than in the bank guidelines. The exemption of Canada from the several balance-of-payments programs in the spring of 1968 was of special importance to the nonbank financial institutions, since a high proportion of their total foreign investments were in Canada and any further investment there was freed from the VFCR.

Pressure Points

A. *Slack apparently has been persistent.*—Throughout most of the period since the program's inception in early 1965, monthly reports have indicated a comfortable airspace under the ceilings. For example, at the end of the first year, there was about $300 million of leeway under a ceiling of almost $10 billion. At the end of each succeeding year, there has been a leeway of more than that.

B. *But it conceals the squeeze.*—The apparent aggregate leeway figures for all 165 or so banks conceal periods of extreme stringency and obscure the positions of many individual banks.

In the early period, the program had an especially big impact by abruptly serving notice to banks which were cranking up to enter the field of foreign lending as well as to those which had just entered it or which had been rapidly increasing their foreign lending business in the last quarter of 1964. In 1968, along with the President's New Year's Day message on the balance of payments, the Federal Reserve announced the first cutback in all bank ceilings.

Generally, on the monthly reporting dates, banks here and there discover themselves over their ceilings. The vast majority of banks have had exemplary records of observance. However, sudden and unexpected end-of-the-month drawdowns by foreign customers sometimes have caused a bank with a good record of cooperation to report that its holdings on that date were above its ceiling and have emphasized the narrow safety margin—or, alternatively, have revealed the pressure—exerted on these banks by the ceilings.

The attention given to the position of banks under the General Ceiling ($10 billion in the aggregate)—and, since December 1969, under the Export Term-Loan Ceiling ($1.4 billion in the aggregate)—has kept attention from being

given to subceilings on certain lending to developed countries of continental western Europe. But at times a large number of banks have had trouble in keeping under those sub-ceilings. They call for no new loans of over a year maturity to this area, except for exports, and ask for short-term credits to this area to be held to a fraction of end-of-1967 levels. One difficulty, some banks complain, is that the amount of the latter is infinitesimal in the aggregate when compared to the General and Export-Term-Loan Ceiling and hard to observe when dealing in fast-moving Euro-dollar transactions that are so common today.

C. *Reins on the international departments.*—When the guideline restraints were proclaimed, many banks were just expanding their foreign banking activities. One might say this was why the restraints were imposed—to control a ballooning of foreign lending. But, say the bankers, the restraints show up in more than the trend line for lending. It has been to some of them, they say, conspicuous and painful in "stultifying" the growth of the banks' international departments and thus of the careers of the outstanding bright, young men in those departments.

Counter-pressure Demanded

Within the several sets of restraints that are supposed to exert pressures downward on lending and investment, the banks and the "nonbanks" are asked to exert upward pressure in two areas. They are requested, within their ceilings, to give priority to loans for financing U.S. exports and for meeting the credit needs of developing countries.

The export area has been a specially controversial one throughout the life of the program. Some people say that the program limits export financing and consequently exports, which they regard as a self-defeating policy, whereas others note the absence of hard evidence to support the contention.

Regardless of the validity of these arguments, the guidelines do call for a conscious effort to shift the emphasis from nonexport to export lending. There is no clear distinction in practice among many loans with respect to their export or nonexport use. Therefore, available data are little help in checking on trends in export financing. The widespread lack of internal bank control programs to direct their foreign lending away from nonexport use and the enormous room that remains for making term loans for exports might make one ask whether the priority is being given.

Figures (for 1964 through late 1969) show a shift in the proportion of lending for the developing countries and toward the long-term lending which is the form of lending specially important to them. Part of the shift is presumably attributable to the subceilings that were introduced to limit, and in fact, cut back lending to the developed countries of continental western Europe.

Reliefs from Pressures?

A. *"Tight money."*—Perhaps one of the most important factors that has seemed to ease the pressure of the VFCR from time to time has been a restrictive monetary policy. During periods of stringency, banks have exerted themselves strenuously in meeting loan demands—keeping one jump ahead of monetary authorities in searching for permisible devices to obtain funds for making loans. But for some time, funds have been so scarce that the top management officials of banks have rationed funds among their international and other departments. Today, if one can segregate the factors contributing to the lack of use of over $1 billion dollars under the General Ceilings (not to speak of the almost untouched latitude under the Export Term-Loan Ceiling), the factor of chief importance has been "tight money." It would be simply not right to call "tight money" a means of "relief" from the VFCR ceilings, but it does have a bearing in the explanation of the situation.

B. *Exemptions.*—Relief has been given in the guidelines through several exemptions from the ceilings. One exempts loans to Canadians. Another exempts any loan made by a commercial bank and guaranteed by the Export-Import Bank, or "participated in" by the Export-Import Bank (that is, made in conjunction with a direct loan from Ex-Im), or insured by the FICA (an Ex-Im affiliate). There are still other exemptions.

C. *Export Term Loans.*—Because of the large leeway that persists under the ceiling created last December for export term loans (a leeway of $1.2 billion under a ceiling of $1.4 billion), that ceiling constitutes today a virtual exemption for such loans. Banks give different reasons for its lack of use—the fact

that it does not cover short-term loans, which are the bulk of export financing, and the fact that funds have been scarce for some time for any type of foreign lending. Whatever the reason, there is no guideline pinch here.

D. *Foreign branches.*—U.S. balance-of-payments accounting draws a line between a bank's head office—New York, San Francisco, Little Rock, or other U.S. site—and its foreign branch—such as, London, Paris, or Nassau. Any loan made by a bank from its London office to a foreign customer is not subject to the guidelines. A transfer of funds from the head office to the foreign branch to enable it to make loans or investments would be subject to the restraints. But the branch can acquire funds from foreign sources—by borrowing or attracting deposits—and thereby operate free of the restraints.

E. *Changes in the guidelines.*—Relief has been given several times to small and medium-size banks by changing the formula for calculating guideline ceilings. For the most part, these changes have offered these banks a ceiling based on a standard other than their foreign lending position at the end of 1964, a date on which they may have lagged the rapid move of big banks into the field of foreign lending.

Policy of No Exceptions

Banks do come in occasionally to request that consideration be given to their "special" position and that some exception be made. A particular bank may not have had a management in 1964 that was alert to the potential of foreign lending, and it now wants to develop this phase of its business. Or it may have absorbed by merger other banks which had no ceilings but which have increased the bank's resources for foreign lending. May it be granted a new ceiling?

One opportunity for change is for such a bank to adopt a ceiling in accordance with a formula that applies to newcomers. If the formula does not offer it as large a ceiling as it would like, it can get no higher ceiling. If it already has a ceiling and wishes to increase it, the newcomer provison is no help. The answer in both cases is "no."

If the appeal is convincing—for the instant case or as typical of a class of meritorious cases—the guidelines may be amended for all banks. For example, a principle was brought into the guidelines in May 1970 to allow certain foreign borrowings to be used to offset foreign assets in computing loans chargeable to a bank's ceiling.

But the program's administrator's Governor J. L. Robertson in its early period and Governor Andrew F. Brimmer since then, have been firm against adopting any procedure for case-by-case approvals. This attitude manifests the philosophy of the program—that it be based on general, simple, and universally applicable principles that the financial institutions may easily understand and readily respect. It also is an important reason that the entire administrative complement has been able to be kept to a handful of Federal Reserve representatives—two or three Board officials plus generally only one officer at each Federal Reserve Bank—none of them devoting more than part time to the program.

Observance vs. Enforcement

A. *The delicacy of the text.*—Banks are "requested," not ordered, to observe the restraints. The restraints are embodied in "guidelines," not in regulations. A bank without ceilings may "discuss" with its Federal Reserve Bank the possibility of "adopting" ceilings; ceilings are not granted. A bank which is persistently over its ceilings "will be invited periodically to discuss" with its Federal Reserve Bank the bank's remedial plans. A bank "should" or "should not" do this or that; it is "asked" to do or is "requested to refrain from" doing certain things. Nowhere is the word "shall" used.

Under such polite and seemingly pliant language, there may be failures to observe but never "violations."

B. *The principal understanding.*—The policy of imposing qualified restraints on actual or potential capital outflows has been widely—but by no means universally—accepted by U.S. banks and by other U.S. financial institutions as representing a valid effort to protect the country's international financial position. The acceptance over the past few years of the idea of restraints, with important techniques of relief, has been one of the most important factors explaining the observance of the voluntary measures.

C. *The reminders.*—On infrequent occasions, the Federal Reserve System has reminded financial institutions of the continuing need for the measures. It has rarely seemed necessary to issue any strong exhortations.

D. *The invocation of mandatory authority.*—After two years of voluntary restrictions on foreign direct investment and on capital outflow through financial institutions, and after a further weakening of the balance of payments in the closing months of 1967, the President, in an Executive order issued January 1, 1968, authorized the Department of Commerce and the Board of Governors of the Federal Reserve System to shift their respective programs from a voluntary to a mandatory basis. The Commerce program was immediately transformed to a mandatory program. The Board announced, upon receiving the power, that it had enjoyed strong cooperation from the financial institutions through the life of the program and that it did not intend to invoke the authority for mandatory controls. The Board has had no reason to change that position in the subsequent years. If it should have such reason because of indifference, negligence, or poor cooperation, it could resort to the authority it has to initiate mandatory measures.

E. *Sending nonbanks to Commerce.*—The line of demarcation between the Commerce Department's Foreign Direct Investment Program and the Federal Reserve's VFCR is not always sharp. It is sometimes hard to wend one's way through corporate lines running to nonbank financial institutions. For example, mergers between nonbank financial institutions and nonfinancial companies sometimes cause problems of interfacing the two programs.

There is a margin for determining under whose jurisdiction a certain company comes, and there are attendant advantages or disadvantages to the firm from being under one program or the other. In these situations, a company manager may be aware that any deficiencies in volunteering cooperation with the Federal Reserve program may lead to his being shifted—by being put in a category "delineated for exemption" under Executive order authority—to the mandatory, and perhaps for him less congenial, Direct Investment Program.

F. *The prospect of other techniques.*—Intimations infrequently made that the present restraints might be superseded by new techniques may also have reinforced the satisfaction of financial institutions with the VFCR.

Given the inequities that are inherent in the VFCR, as in any government control program that is essentially a system of allocated quotas, and given the stretchout in the need for what was intended as a temporary measure, Federal Reserve administrators have tried to elicit reactions to other techniques for limiting capital outflow. In particular, Governor Robertson suggested possible authority for a tax on loans, along the lines of the Interest Equalization Tax that applied to a small portion of bank loans and to other loans and equity investments abroad. Governor Brimmer endorsed this as a technique worth considering and also put forward ideas for a system of auctioning permits to make loans to foreigners, and a requirement for supplemental reserves against foreign loans and investments. Despite the fact that each device would get away from an element of arbitrary administrative determination and substitute "market" techniques, bankers have failed to welcome the ideas.

One reason for their lack of sympathy has been, presumably, the belief that a better technique would be a more long-lasting—indeed, permanent—technique. Better to stick it out with the VFCR a while longer, they seem to say.

G. *The bearing of the VFCR on other programs.*—Some bankers may feel a bit reluctant to be volunteering. However, the task of getting a bank to agree to keep a particular phase of its profitable business within determined bounds has been given to none other than a bank regulatory agency.

For the banks, membership means there is an ever-present reminder that deficient behavior may be troublesome. The Board does have power under the 1968 Executive order to make the restraints mandatory for any individual bank or nonbank financial institution. Also, banks often must request the Board of Governors of the Federal Reserve System for approval of certain actions—to establish bank branches abroad, to acquire foreign banks as subsidiaries, to have a domestic subsidiary invest beyond certain modest levels in any variety of foreign financial or even nonfinancial ventures. The Board generally has discretion in considering whether to grant approval. It will look at the position of the bank under the VFCR. For example, in reviewing a bank's request for permission to invest abroad, it will want to know whether the bank has room left under its VFCR ceiling to make the investment.

Not all the VFCR respondents are members of the Federal Reserve System. About one tenth (17 or 18) of the banks are nonmembers, as well as, of course, virtually all 340 or so nonbank financial institutions. Compliance by nonmember banks has compared very well with that of members.

Continued Voluntariness

A. *New market conditions.*—A pervasive influence buttressing the VFCR in the recent period has been the tightness of money. If banks were to find "liquidity pressures" greatly eased—for example, if the Federal Reserve authorities should loosen further the reins of monetary policy substantially—and if banks found it profitable to invest heavily in the foreign market, would they continue to be as free of blemish in their VFCR observance as they are today? Clearly, the change would strain the program.

B. *Drawing out the temporary period.*—As a "temporary expedient," the guidelines have aged remarkably well. Yet, they do tend to freeze a pattern of lending relationships that reflected a day in history almost six years ago. Banks which were latecomers, banks which are specially aggressive, and banks which chafe at restraints on particular competitive relationships may well be expected to become increasingly impatient with a system that asks that, as a matter of public expediency, all banks keep their relative positions in this race or strive to find some relief by developing a foreign branch operation.

C. *The recurring question.*—In the face of a persistent deficit in the balance of payments and of a reasonable case for the continuation of restraints on capital outflow, do banks and nonbank financial institutions wish for the immediate future to continue the present type of cooperation or would they prefer to see a mandatory program and perhaps different techniques? This is one policy choice which the subjects of an official program can determine.

Chairman HUMPHREY. Senator Proxmire, we are waiting for your questions.

Senator PROXMIRE. Mr. Burns, as the chairman has said, we have just had a tragic word that unemployment is now at 8.2 percent, 7½ million Americans out of work, the sharpest rise in unemployment in any 3 months since we started taking statistics, the staff just told me.

In October we had 6 percent unemployment. In November, 6.5; December, 7.1; and now 8.2.

Mr. BURNS. December has been revised to 7.2 percent.

Senator PROXMIRE. That is correct.

At any rate, it is a very sharp increase, the sharpest increase I say ever.

Now, you have just replied briefly to Senator Javits and made a reply which I think is most significant. Coming from you, it is particularly important because it contradicts the administration's position, and it is one that has divided the Congress.

You said, as I understood it, that any program to restrain energy in a substantial way should await some degree of recovery from the recession. Did I understand you to say that or not?

Mr. BURNS. Let me put my thoughts, the essentials as I see them, very briefly.

I think the Congress should attend first to a stimulative tax cut. You cannot be discussing all of these problems simultaneously. Then I hope you will turn promptly to the energy problem, and there I would say that an energy program should be enacted by the Congress at as early a date as possible. Measures to increase conservation and measure to stimulate alternative sources should be taken up. I would have a different timetable than has been proposed by the administration.

Senator PROXMIRE. Do you think that it is proper for us to relate this to the unemployment level and the level of business activity and the production level in the economy, if it does not improve or continues to decline, to try to put off any restraint that would hold down the economy further until we get some better news for the economy?

Mr. BURNS. I think it would be wise to proceed cautiously. I would not put it off. I would proceed cautiously, partly because of the unemployment problem and partly because of the price problem. There are all kinds of uncertainties about the consequences for the average price level of the kind of program that the President has recommended. Rather than take the full effect of that in the next year or two, I think I would stretch it out over a longer period.

Senator PROXMIRE. The administration's economists, and most of the economists testifying before this committee, seem to disagree with what I understood, and perhaps unfairly, to be your optimistic notion of how we might recover. As you know, the administration's economists predict a level of unemployment in 1976 of 7.9 percent on the average, 1977, 7½ percent. Other economists have indicated that that may be a little pessimistic, but not too far off. In other words, they project a very slow recovery, not a rapid recovery.

Do you feel that this is too pessimistic, unrealistic, that it is likely that we will recover more rapidly?

Mr. BURNS. I will tell you exactly what I think. I do not know what my profession is coming to, really. In ancient and medieval times, kings would have around them soothsayers, necromancers, and they would prophesy and they would sing. Now we have economists performing the same function for Presidents and Congress, and for business executives, and I think the efficacy of the one group is perhaps no larger than the efficacy of the other.

These figures that you read off are ground out by a machine, the modern computer, and if you put gloomy assumptions into the computer, you will get a gloomy result. When I study history what do I find? I find recovery from some recessions has been extraordinarily rapid, and the recovery from others has been very slow and sluggish.

In the recovery from the recession of 1948–49, 1953–54, 1957–58, if my memory serves me correctly, within a period of some 9 months or so, the unemployment rate fell by a full 2 percentage points. On the other hand, the recovery after the recession of 1960–61, and 1969 and 1970 was sluggish.

What kind of a recovery will we have this time? I find it very difficult to predict. All that I can say is that a touch of optimism would not be a bad thing for some of the gloomy practitioners of the dismal science.

Senator PROXMIRE. I agree with that. What I am trying to press for is to determine whether we can help that optimism along with constructive and expansive policies.

The President's chief economic adviser admitted to this committee yesterday that after the third quarter of this year the President's program has no expansive impact. It will not restore recovery, and he said if we are not recovering rapidly enough, the President may recommend additional expansion measures. He admitted that we do not have anything now in the President's program that will help move us out of the recession. That is why I come to the point that Chairman Humphrey and I are about to take, and I would like to read you the resolve here because it affects you very directly.

We are introducing this measure into the Senate today, and we resolve:

That the Congress of the United States hereby directs its agent, the Federal Reserve Board, to one, take appropriate action in the first half of 1975 to increase the money supply at rates substantially higher than the recent experience, and to actively promote economic recovery; second, maintain long-run growth of the money supply commensurate with the economy's long-run potential to increase production so as to effectively achieve a goal of maximum employment and stable prices.

Pursuant to this directive, the Federal Reserve shall consult with Congress at its semiannual hearings before the Committees on Banking about the money supply growth targets and other monetary policy actions required in the upcoming 6 months.

We do not set a figure. We do not say 5 percent or 6 percent or 8 percent. We simply say that we should take appropriate action to increase the money supply at a rate that will do the job.

We feel it is our responsibility under the Constitution to exert the money power that the Constitution gives to us, and to tell you what our position is, and to ask you to cooperate.

How do you feel about that resolution?

Mr. BURNS. Well, let me make two or three comments first.

My understanding was that I would be testifying on that resolution on February 25.

Senator PROXMIRE. That is right.

Mr. BURNS. I would be glad to do so at length on that occasion. However, since you asked the question now, I will comment very briefly.

First, I must quarrel with you just a little. You have a paragraph in that resolution—I read it hastily yesterday afternoon when it came to my attention—putting all the blame for the inflation that we have had over the years, and all the blame for the recession we are having now, on the Federal Reserve. I hope you will carefully reconsider that paragraph in your resolution, Senator.

Chairman HUMPHREY. Where do you see that?

Mr. BURNS. I do not have the resolution before me.

Senator PROXMIRE. May I read the part?

It says:

Whereas Congress has received expert evidence that money supply growth of nearly 9 percent per year in mid-1972 and mid-1973 contributed to the present inflation and the barely 2 percent per year in the second half of 1974 as contributing to the recession and increase in unemployment and the decline in the gross national product.

We said the Fed contributed to it. We did not even say you were the leading factor. We say you did make a contribution.

I submit that the big increase in 1972 in the money supply, and the very limited increase recently has been a contributing factor on both those occasions.

Mr. BURNS. I remember testifying before the Joint Economic Committee in early 1973 and being congratulated by Congressman Reuss, I believe, and possibly by you—I would have to examine the record—for what we did in 1972, being congratulated because, as I remember the language, we went beyond the committee's recommendations as far as the rate of growth in the money supply was concerned.

Senator PROXMIRE. I do not think I joined in that. I took a different position at that time.

Mr. BURNS. I understand that you were seriously concerned about unemployment, which was still very large in 1972.

Unemployment in 1972 started at a rate of 5.9 percent. In June it came down to 5.5 or 5.6 percent. It remained at that level for about 5 months, and you did not have a decline until the end of last year.

Senator PROXMIRE. The point is, now we have unemployment at a rate of 8.2 percent, and a money supply growth at 1 or 2 or 3 percent.

Mr. BURNS. The trouble with what you say, Senator, is that you are taking an arbitrary definition of the money supply, a definition that served a purpose in the past. You are ignoring the fact that financial technology has changed dramatically, that today working balances in checking accounts of our corporations very often represent merely the compensating balances that the banks require these corporations to keep.

Senator PROXMIRE. Mr. Burns, I think there is a lot to that. I think you are right. I think it is wrong to take M1 alone. It is far too simple. You are absolutely right to take a number of measures of money supply. We should also consider interest rate levels, what has happened to them. Short-term interest rates have come down, but the stickier, long-term rates that play such a vital part in housing have not moved.

Mr. BURNS. Now we are getting somewhere. Let us discuss that. Let us discuss that very realistically. Let us start with a certain simple fact: The Federal Reserve has rather close control over one interest rate, and one interest rate only; namely, the interbank lending rate, which is known technically as the Federal funds rate. Other short-term market rates will tend to move in response to the behavior of the Federal funds rate, so the Federal Reserve has an indirect influence on short-term money rates. When it comes to long-term rates, our influence is negligible. Now, let us see what has happened to interest rates; let's examine them.

Senator PROXMIRE. May I interrupt at that point and ask you if it is negligible or a matter of time. You have a profound effect on long-term rates over a period of a year or so, is that not right?

As short-term rates come down, they are obviously going to have some effect on longer term rates because of the fact that we have a mobility of our capital.

Mr. BURNS. I will discuss that question, but let me continue.

Chairman HUMPHREY. Mr. Burns, may I interrupt for a moment? I temporarily have to leave, but I will be back. Let me tell you why I have to leave. I have a band of irate Minnesota farmers up in the Agriculture Committee, and yesterday Mr. Greenspan spoke to us that things were getting better because farm prices were coming down. I want Mr. Greenspan to know that is not a sign of good times out in Minnesota. I will be back very promptly. I just want to let them know that their Senator is concerned.

If you will excuse me, I will ask Senator Proxmire to take the Chair here, and I will be right back. We will come back and discuss farms in a minute.

Mr. BURNS. The Federal funds rate, in early July, was at a level a little over 13½ percent. The Federal funds rate has dropped, and dropped steadily, and is now approximately between 6¼ and 6½. It has fallen by more than half. It has fallen by more than 7 percent-

age points. Other short-term rates—commercial paper rates, CD rates—have also declined, and declined very significantly. Even the prime rate, which tends to be a little more sluggish, has fallen from a level of 12 percent to 8¾, 9 or 9¼ percent.

Short-term rates have moved, and they have moved in response to very vigorous action by the Federal Reserve. When the Federal funds rate reaches the level of 6¼ percent, it has traveled a very long distance, and it does not have very much further to go.

True, we could go further; as far as our power is concerned, technically, we could knock down the Federal funds rate to 5, 4, 3, and even 2 percent, and other short-term rates would tend to respond.

Let us examine what would then happen to long-term rates. As you pointed out, there is a link between short-term rates and long-term rates. If, let us say, an investor can only get 5 percent or 4 percent on short-term money, then longer term securities with a maturity of 3 to 5 years, or 10 years, or 20 years would begin to look more attractive, and that there would be some shifting of funds on the part of investors. Long-term rates also would tend to decline.

However, there is a flaw in that analysis. You have to watch it, and you have to watch it with the utmost care. In the process of knocking down very short-term rates, you would produce, not immediately perhaps, but eventually with a lag, an explosion in the rate of growth of money supply, no matter what your concept of the money supply may be. When that happens, perhaps the Federal Reserve might not care about inflation. But, you can rest assured, Senator, that business and financial people, and ordinary consumers around the country, still care and care a great deal about inflation. Once they see the money supply exploding, long-term rates would begin moving up in response to anticipations of a new wave of inflation. This is the world I live in; I have to think not only of today, I also have to think of tomorrow. And if you did get—as you could get by this process—a sharp increase, or even any increase, in long-term rates, all of us could forget about an early recovery in housing, a stepping up in public utility construction, and so forth.

These are the facts of life, and I think that your committee should recognize that. This is a very responsible committee. You should recognize that the Federal Reserve no longer has good options available to it. We can serve this country well, constructively, as I think we are doing; or we can join the inflationists, knock short-term rates down—which we are perfectly capable of doing—release a new wave of inflation on the country, send long-term rates soaring, and wreck prospects for economic recovery in this country.

Senator PROXMIRE [presiding]. Mr. Burns, my time is up. I am going to yield to Congressman Brown of Michigan.

Before I do that, I cannot resist, however, saying that I hope you are not telling us that there is no way that the Federal Reserve can adopt policies that would help reduce mortgage rates without setting off an absolutely unacceptable inflation. I do not buy that and I do not think that is what you would need.

Mr. BURNS. Senator, we are traveling a very narrow path trying to avoid just that. Actually, as I pointed out in my statement, mortgage rates have been moving down. I wish they had moved down more. They are always sluggish, sluggish on the rise, sluggish on the

decline. In the primary mortgage markets we have had a decline of about 80 basis points on the average, and in the secondary mortgage markets we have had a decline of approximately 1.25 percentage points. A healthy trend is developing, and I do not want to see that trend interrupted any more than you do. I want to encourage it.

Senator PROXMIRE. My time is up. I will be back.

Representative BROWN of Michigan. Thank you, Senator Proxmire.

Mr. Burns, you said this morning that what you said before the Ways and Means Committee the other day, that we are awash with liquidity, I am only paraphrasing you here, there is a severe shortfall in confidence, consumer confidence.

What do you think would have the greatest impact on restoring the economic stability that would lead to the restoring of consumer confidence?

Mr. BURNS. That is a very difficult question to answer. I think that the country is deeply concerned about government; there has been, as you know, one investigation after another. I think that confidence in all of our institutions has been diminishing—in our churches, in the Congress, probably in the Federal Reserve, and so on.

We have a terribly serious budgetary problem in this country, and the way that the Congress deals with that budgetary problem I think will have consequences for the state of confidence in our country. I do not know whether you have had an opportunity to study the President's budget message. I have not had adequate opportunity to study the details. I think I know the highlights and they are as follows:

For fiscal 1976 the budget deficit is projected at $52 billion. That budgetary figure does not include the off-budget outlays, new development in our congressional procedure. Off-budget outlays were unknown 3 or 4 years ago. They started small; I believe in fiscal 1974 they came to something like $2½ billion. For fiscal 1976, off-budget outlays are estimated at a level in excess of $10 billion. Also, the budget deficit figure of $52 billion does not include the outlays by government sponsored corporations.

If you add off-budget outlays and the outlays by government sponsored corporations to the budgetary total, you come out with a budget deficit of approximately $69 billion, as I remember the figures. That is not the end of the story. The President's budget proceeds on the assumption that the Congress will adopt his legislative recommendations for cuts coming in the aggregate of $17½ billion. If that assumption of the budget is not fulfilled, you would have to add another large sum. If the Congress were to reject the President's legislative recommendations with regard to budgetary cuts entirely, you would have to add $17½ billion to $69 billion or $70 billion.

Now, this is the financial picture that our country faces, and it is a very serious one. Evidence that Congress takes this financial position of the country seriously would, I think, help to restore the state of confidence. That does not mean that the Congress should ignore the recession. You cannot do that. You would not do that. You must not do that. But to enlarge outlays without regard to the state of the budget, to erode the tax base by passing laws that reduce taxes per-

manently instead of having a tax reduction for, let us say, 1 year—I think that if the Congress were to move in that direction you would be weakening confidence even further.

And, of course, this has implications for monetary policy and interest rates, inevitably. There are people who think that we in the Federal Reserve could solve all this by just letting the money supply grow explosively. Well, as I stated earlier in response to Senator Proxmire's question, we can knock down short-term rates. But if we permit the money supply to grow very rapidly, long-term rates would rise, and that I think would seriously impede prospects for recovery.

Representative BROWN of Michigan. I substantially concur with you. I think we are expecting too much of the solution of our present problems to come from the monetary side rather than the fiscal and marketplace side.

There is general agreement about rebate of some 1974 taxes. There is agreement of some adjustments with respect to lower and middle income taxpayers on deductibles, things of that nature. Do you not agree, or is it not your feeling that the major portion of any tax relief should come in the area of almost a one-shot thing, a rebate, that type of a tax-relief measure, rather than, as I think you said, build it in into your tax program for the future?

Mr. BURNS. At this time, I would certainly not go beyond a tax reduction for this calendar year.

Representative BROWN of Michigan. Mr. Burns, you mean a rebate possibly and then any other adjustment just for calendar year 1975?

Mr. BURNS. Whatever the Congress does in the way of reducing taxes I think should be done for this calendar year. I do not want to rule out the possibility of later action, but I think it would be a great mistake to go further than that at this time.

Representative BROWN of Michigan. Mr. Burns, the greatest impact that has occurred in recent weeks in respect to improvement in the economy would appear to have occurred in the automobile industry where there has been a rebating of prices to customers. The automobile manufacturers rebated $200 on this car, $500 on that one.

That has, according to the people I have talked with, that has brought people in the showrooms. There are many who have purchased the smaller vehicles, yet others are purchasing other vehicles. But I think that is the thing that has had the greatest impact. That is not providing greater purchasing power in the consumer, but rather it is in effect reducing the price resistance that the consumer has been reflecting.

Now, I just happen to be one who does not believe that the rebate of taxes—I think it should be done, but I do not think it is going to find its way into consumer goods, durable goods, automobiles, appliances, et cetera, to the extent that we would like to have it.

Mr. BURNS. That could well be, but no one can be sure about that. Even if you make an extreme assumption that very little—let us say none—of it will find its way into larger consumer spending, there would be that much more money available in the money and capital markets, and that would help to keep interest rates down. The financing needs, public and private, this year are enormous.

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I think there will be some response, but I certainly agree with you that action on the private economic front is far more important, and I rejoice in seeing automobile manufacturers in your State rediscover the values of competition.

Representative BROWN of Michigan. Mr. Burns, both in talking with homebuilders and automobile manufacturers, both industries seem to point to the inventory problem as being one of the big problems. They say, if we can in some way get our inventories moving, whether they be inventories of built but unoccupied houses, built but unsold automobiles, if we get the inventories moving, then the problem of employment will take care of itself.

Mr. BURNS. I think that is a sound judgment.

Representative BROWN of Michigan. Is there any way to do it other than the way the automobile manufacturers are doing it?

Mr. BURNS. Well, there are two things that business people can do, and I think they are doing both now. They are cutting production. That is unfortunate while it takes place because it means that men are put out of jobs, but it does help clear the shelves and does tend to lay the basis for an early recovery. They are doing that now on a vigorous scale. They are also beginning to compete on a price basis in a way that they have not in many a year. That is a healthy development, but it is still in its early stages, and many more of our business people have to rediscover the values of price competition.

Representative BROWN of Michigan. My time has expired, Mr. Burns. It is a pleasure having the opportunity to meet with you. I have always been a part of your audience.

Mr. BURNS. Thank you.

Senator PROXMIRE. Mr. Burns, I am looking forward to a far more thorough and comprehensive discussion with you on February 25, of our resolution respecting monetary policies. I think you will agree with us that this is a very significant resolution.

I would like to get into something else, however. The problems of the extent to which the Federal Reserve Board will cooperate in providing the funds available in the event that the deficit continues at a very high rate, $51 billion as projected, as you know, for 1976. It may be bigger than that. It may be substantially bigger than that, and it seems to me that that is the time when the Federal Reserve policy is going to make the difference as to the degree to which we recover and how rapidly we recover.

In the first half of this year, as I understand it, all borrowers, aside from the Federal Government, will be hitting the market for $60 billion less than they did at the peak of the first half of 1974. The pickup later in the year is estimated to be slow. In this half-year period, the rate of Federal borrowing may average around $40 billion a year ago. The rate will rise $50 billion or more in the second half.

Nevertheless, the total use of funds by all sectors, including the Federal Government and the private sector, is to be the lowest since 1970 in relation to GNP, and that will moderate tensions in the market, as well as the fact that the lull is temporary. The outlook is much more favorable than that awesome Federal budget might indicate.

But if the deficit continues at that pace into 1976, colliding with the rising private demands, which you expect and which we may very well get, it could cause serious problems for the inflation rate and for recovery.

Let me ask you this: If unemployment is still high, as some people argue that it is likely to be, if housing is still, say, improved, but at the 1.5 million starts a year level, if interest rates are starting to rise again, inflation is at a 7 or 8 percent rate, and the defiicit is still at $50 billion, all of which assumptions I think are somewhat likely, could and should monetary policy be expansive?

Mr. BURNS. Senator, you have so many ifs there—and you have not exhausted the ifs that we at the Federal Reserve have to take into account—that I cannot really give you a responsible judgment. Obviously, we will watch these developments. Obviously, not only as Government officials, but as human beings, we are deeply concerned and will continue to be deeply concerned about unemployment.

Senator PROXMIRE. Let me put this a little bit differently. Suppose we pass a resolution of this kind, which obviously would be in force for only a short time, 6 months. We would take a look at the situation later on. Why would it not be desirable for the Congress to have a voice in the kind of monetary policy that we would have in view of the fact that every witness who has testified, conservative and liberal, has told us that the effectiveness of fiscal policy and of other stimulative policies depends on what happens to monetary policy?

Mr. BURNS. I hope the Congress will concern itself with monetary policy.

Senator PROXMIRE. Is it not the most helpful way to do that is by having resolutions of this kind enacted? I can speak out, Henry Reuss can speak out, Garry Brown can speak out, Wright Patman can speak out, but if we pass a resolution, so you know the position of the majority of Congress, do you not have an understanding there and directive that you can operate on?

Mr. BURNS. In my judgment, Senator, this committee and the two Banking Committees should request the Federal Reserve Board to review its policies periodically. We should—and I assure you we will—pay the closest attention to the advice that you give us, and I hope you in turn will understand that we are doing our very best to meet our country's needs. We have to communicate with one another.

As for your resolution, it struck an unhappy note when I read it yesterday afternoon. I will examine it more carefully and will testify fully at a later point.

Senator PROXMIRE. The reason we want you to testify is so you can suggest how we can improve the resolution.

Mr. BURNS. I can do that right now. I think it is most unfortunate, and if I may say so, short-sighted and even unfair on your part, Senator, to suggest, as the resolution does, that the Federal Reserve is largely responsible for the ills of this country.

Senator PROXMIRE. As I have said, we do not say that. We say "contributed."

Mr. BURNS. You do not mention anybody else. You do not mention what the Congress has contributed, or what the President has contributed, or what business firms have contributed.

Senator PROXMIRE. We are not telling the President what to do in this resolution. We often do that, but not in this resolution.

Mr. BURNS. That Senate resolution when examined by people over the country will be interpreted in the way in which I have interpreted it.

Senator PROXMIRE. That is a perfectly proper criticism. We certainly want to make it clear that we do not mean to imply that there is anything like sole blame or necessarily predominant blame. We think there is some.

Mr. BURNS. You can make that clearer by either dropping or drastically revising that paragraph, Senator.

Senator PROXMIRE. Very good.

In the absence of the Chairman, I am asked by the staff to make this request. This was made of Mr. Greenspan yesterday.

The President has challenged the Congress to see if we can come up with a better set of economic policies than he has proposed. Congress intends to accept that challenge. Certainly, we have to come up with some policies to get this unemployment rate down as well as to conserve energy and reduce inflation.

Congress has to come up with a sensible, carefully formulated set of policies. There is one respect in which the Federal Reserve could be of great help to us in that you have available economic models which can be used to study the effects of different policies. Although the Joint Economic Committee has a very good staff, we do not have your models and technical expertise.

We would like to give you some assumptions about economic policy. We would like you to analyze them with the aid of your economic model and tell us how our policy assumptions compare with those of the administration in terms of their estimated effect on prices, on unemployment, and growth.

If you can do this for us, the staff will get together with you later and give you details of our assumptions.

In general our assumptions would include a permanent tax cut, repeal of the proposed 5-percent ceiling on social security, a larger public service employment program, as provided in the President's budget. Can you do that for us?

Mr. BURNS. I will be very glad to assist.

Senator PROXMIRE. Would it be possible to get this done within the next week or so?

Mr. BURNS. I hesitate to answer firmly. I would think that the answer is in the affirmative, but this is a matter involving our staff, and I am not qualified to give you a judgment on that. I will do everything that I can to expedite staff attention.

Senator PROXMIRE. We are not asking you to tell us whether you like or dislike policies.

Mr. BURNS. You are asking for technical assistance, and I will do what I can, and my staff will, to take care of your request. We will be glad to.

Senator PROXMIRE. Consumer credit outstanding fell almost $900 million in December, the largest drop on record.

Mr. BURNS. We have had two successive drops, Senator, as I recall.

Senator PROXMIRE. Right.

Mr. BURNS. November and December.

Senator PROXMIRE. Coming on top of the November decline of $400 million, this makes the first 2-month decline since 1958. The decline was in all types of credit, not just automobile loans. Do you regard this as a temporary occurrence rather than a symptom of a lack of confidence that may continue for some time?

Mr. BURNS. Undoubtedly, it is linked to consumer confidence. I would hope that consumer confidence would be restored before very long. I cannot be sure of that. All of us should bend our efforts in that direction.

Senator PROXMIRE. May I say I am going to call on Congressman Brown of Michigan. We have another witness, Mr. Shiskin, who is going to testify, but go right ahead.

Representative BROWN of Michigan. Very briefly, Mr. Burns, there is something that bothers me. We look at rebates. We look at reduction in taxes as being the kind of panacea to economic recovery, when really it is apparent, it seems to me, from the facts that Senator Proxmire has just pointed out that there is obviously a potential capacity to purchase in consumers. Consumer debt is the least it has been in years. It is not the ability to purchase. It is the willingness to purchase.

Mr. BURNS. Exactly.

Representative BROWN of Michigan. It is price resistance, and lack of confidence in what is going to happen tomorrow.

Mr. BURNS. I think you are describing the state of the consumer mind accurately. That is the way I see it.

Representative BROWN of Michigan. This brings up a point that I have a little bit of disagreement on. Earlier in your testimony you said that you feel that we should work on the problem of recession, and that it should have a higher priority than the problem of energy, and that therefore the administration and the Congress should compromise some way on the problem of recession and compromise on energy.

At the same time, you do not consider yourself an expert in the energy field. It seems to me it is difficult for you to say that recession is a greater problem today than the problem of energy, both in the short run and the long run, when you do not consider yourself an expert in that regard. The administration obviously thinks that doing something about energy is a very important thing, and to somewhat substantiate what the administration would say, I think you would agree that energy played a very important role in our present recession.

I have a difficult time reconciling what the Congress' alternative is, what Senator Proxmire's alternative is. I do not see how you can compromise a volumetric approach to energy, the problem of energy, with an econometric approach to the problem of energy. Either you go to quotas, allocation, or rationing, or you have the marketplace do it. I do not see how you can combine the two. It seems to me conceptually that this is a place where never the twain shall meet.

Mr. BURNS. I do not think there is much disagreement between us. When I advised the Congress to attend to a stimulative tax cut promptly, I proceeded on the assumption that this is something that the Congress can do, and I believe it is a very reasonable assumption.

When you get into the energy area, the President's program is, I think, a well-considered and carefully worked out program. It is nevertheless so complicated, so intricate, and so inherently controversial a measure, I think the Congress should take its time about that program. I think you should hold very extensive hearings. I think you should examine the President's program sympathetically. But I think you should examine alternative proposals as well, and this is inevitably a time-consuming process. So, if you attack the energy problem first, you would be at it 3 or 4 months at least.

Representative BROWN of Michigan. Mr. Burns, I do not think there is any question that you can always conceptually agree on how to give something away, that we can, for instance in respect to tax relief, we can conceptually agree, and, you will have the votes for tax relief, though we may have a little bit of difference of opinion as to how it should be done.

I do not think the votes are in this Congress to basically support the concept of energy conservation or the imposition of a burden on energy utilization. I do not think the votes are here, and that is the problem. There is not even support of the concept, I believe.

Mr. BURNS. I hope——

Representative BROWN of Michigan. Nobody wants to impose a burden on the public, whether it be with respect to taxes and developing surpluses or developing energy self-sufficiency.

Mr. BURNS. I certainly hope, Congressman Brown, that the Congress will attend to the energy problem, and I do not quite see the matter the way you do. Of course, you know the sentiment of the Congress far better than I do. I think every Congressman, every Senator I have talked to is deeply concerned about the energy problem, and understands that this is basic to our Nation's future.

There are so many ways of looking at the problem. The President's proposal, being a well-worked-out, well-rounded proposal, is so complicated and the implications are so large—obviously a proposal of that sort stirs questions, stirs doubts. Many people have been thinking about this problem, and there are other ideas that are being proposed.

We discussed one briefly—possibly taking the President's proposal as a starting point and phasing it in—rather than having it work at the speed that the President has suggested. That is one approach.

Another approach would be, instead of imposing a new tariff on imported oil and doing away with two-tier pricing and so on, you could confine yourself to a tax on gasoline. That could be combined with a system under which poor people, or people generally, would receive a certain number of tax-free coupons.

There are many ideas in this field, and Congress will, I think, simply have to take the time that is necessary to winnow these ideas, to sift them carefully. It is a time-consuming process at best, but if by June Congress has not gotten around to this energy problem seriously, I would be terribly disappointed, and I would be somewhat gloomy about the future, as I know you would be.

One reason I would like to see the tax cut gotten out of the way is because then your committee, the Committee on Ways and Means, could go to work on the energy problem. It will take a great deal of

time; there are so many different opinions on that subject on the part of earnest men who want to solve the problem but see it differently.

Representative Brown of Michigan. Mr. Burns, I am pessimistic. If you are before us as of June, you will find we have done very little other than possibly pass on to the President some kind of standby authority to do something which now by the resolution passed the other day, he cannot do. If he wants a quota system, he cannot do it.

Thank you very much.

Mr. Burns. Thank you, sir.

Chairman Humphrey [presiding]. Mr. Burns, I have returned to the struggle here.

I want to kind of summarize this morning with you. Do I understand from what I heard during your testimony that you are of the opinion that the Council of Economic Advisers forecast and the budget forecast is too gloomy in terms of economic outlook?

Mr. Burns. I look at those figures in a mood of astonishment. Why do people put down figures like that when they do not quite know what they are talking about? That is my honest reaction.

Chairman Humphrey. You say that despite the fact that this morning's unemployment rate is 8.2 percent?

Mr. Burns. I am well aware of that. That is my opinion, Senator.

Of course, these projections may turn out to be right. But I do not like to make up numbers; I think we have played this numbers game too long, and it does not do us any good. I prefer to adjust to conditions as they develop and go as far as we reasonably can. In the field of unemployment, you know how we have debated over the years what full employment means. Does it mean an unemployment rate of 4 percent or 4.5 percent or 5 percent, or does it really mean an unemployment rate of 3 percent? I will tell you what it means to me, and one of these days I would like to sit down with you and try to convince you. The goal ought to be—and I think this can be done literally—the goal ought to be zero.

Chairman Humphrey. That is correct. You do not have to convince me. I am with you.

Mr. Burns. I want to convince you about my way of getting there.

Chairman Humphrey. As you know, we can agree on the goal. We may have a little different road map. I am willing to sit down and talk that out with you. I always learn a great deal from you, Mr. Burns. It is sort of like going to a graduate seminar, and I appreciate it very much.

Let me ask you some specific questions. The decline in the interest rates to which you have alluded, is not much of this due to U.S. borrowing, or to put to bluntly, just the recession?

Mr. Burns. That is certainly part of it, yes, but you must not underestimate what we at the Federal Reserve have done.

Chairman Humphrey. I want you to do a little more.

Mr. Burns. I am not sure that you do.

Chairman Humphrey. I think I do.

Mr. Burns. I am not sure, Senator, if you and I sat down and examined the actual evidence, that you would. You are a very careful and responsible thinker.

Chairman Humphrey. You know how to handle me. I want to thank you. There are some things on which we agree.

Mr. BURNS. I meant that most sincerely, Senator. I have admired you over the years.

Here is the Federal Reserve. How do we influence the monetary measures? We influence them by adding to or subtracting from the reserves of commercial banks, or more precisely, member banks of the Federal Reserve System. We accomplish this addition to or subtraction from reserves by buying or selling government securities. We have put reserves into the banking system during the last 4 months—making some technical allowance for reserve requirement changes—at an annual rate of 31 percent. That is mighty fast.

This could be a somewhat misleading figure; I cannot explain that adequately at the moment, because there is a certain distortion which was caused by the Franklin National Bank problem. But this is the figure I have. The figure for January is free from distortion, and that figure was 20 percent.

What happened? We put in the reserves and the banks, in turn, proceeded to repay their debt to the Federal Reserve System. They wanted to become more liquid, to get out of debt; that was their response. Total reserves, because of these repayments of debt, grew much less rapidly.

Chairman HUMPHREY. Sort of like a rebate, whether or not you are going to spend it or use it to pay off old bills.

Mr. BURNS. The analogy is perfect, Senator. The rate at which they repay their loans is a matter, in very large part, of discretion on the part of the banks. Not entirely, because here and there we put certain pressure on the banks. As good bankers we have to. But in large part it is discretionary.

So I think we have been attempting to deal with the problem. There is greater prudence on the part of bankers, you see. There is a certain legacy of the great financial strains of last year, when we had two massive bank failures, the two largest in our Nation's history. We also had failures abroad. Also, instances began to appear of speculation on the part of the foreign exchange departments of various banks, including Franklin National in our country, and doubts began to spread about the banking system. Bankers, in consequence, became more prudent.

That was not the only factor. We have had an extraordinary expansion of banking activity in the last few years and meanwhile, the banks have added very little to their capital. So there has been a certain erosion in their capital position, and there is not very much that we can do about that.

But we can do something about the general credit situation and we are doing it. Possibly we ought to do more. We reexamine these matters day by day, I assure you, and we have already done a great deal. We had three reductions in reserve requirements, three reductions in the discount rate, and we have influenced greatly the one interest rate; namely, the Federal funds rate, that we virtually control.

I think you were out of the room when I talked about that.

Chairman HUMPHREY. I recall. That is down to 7⅛.

Mr. BURNS. We have now got the Federal funds rate down to 6¼ or 6½.

Chairman HUMPHREY. May I say, first of all, I surely understand the prudence—I hope it is the prudence—of our banking system in reference to some of the problems we had this last year. I think the worst thing that could happen to this country, and indeed, in international money markets, would be for a number of large banks to crash, as we say. That would spread panic. That would make a recession into a wild depression.

Mr. BURNS. Let me tell you something, Senator. We prevented that last year. I am going to come before the Banking Committee. Senator Proxmire is not listening. This is of interest to you, Senator.

Senator PROXMIRE. I am not listening to what, sir?

Mr. BURNS. I have not said anything yet.

I am going to come before the Banking Committee with legislative proposals that will enable the regulatory agencies to deal much more efficiently and much more expeditiously with the Franklin-type problem. In that case no depositor lost a penny and business went on as usual. If I wanted to, I could praise the Federal Reserve for its accomplishment and also the FDIC, et cetera. But I want to tell you in all honesty that while I think we did our jobs well and skillfully, we were basically lucky. The country was saved by good luck.

If the deposits of Franklin National had fallen more rapidly than they did, then the chances are that we would have had to close that bank, and the failure, the closing, the liquidation of a $5 billion bank would have sent shockwaves not only around this country but around the entire world. Next time we may not be that lucky.

Therefore, the legislation we will be proposing to your committee, Senator Proxmire, is something that I hope your committee will look at rather promptly. Improve it as best you can, but let's get it on the books. Give us the tools to do the job that we may need to do.

Senator PROXMIRE. If the gentleman would yield, I could not agree with you more. You told us last year you were working on this and meanwhile, I want you to know that we have not been idle. The staff of the Banking Committee has been working hard to get the recommendations of other experts around the country and we compiled some good material that we can work with you on to develop more effective controls.

Mr. BURNS. In due course I hope you will let us see those materials because they could stimulate our thinking and perhaps rechannel some of our thinking.

Chairman HUMPHREY. Mr. Burns, the $100 question, or I guess they used to call it the $64 question, but inflation got it up to $100, will our banking system and our financial structure, of course, the Federal Reserve System being at the very heart of it, be able to finance the Government refinancing and the Government deficit which is projected and which I presently think, Mr. Burns, is going to be substantially larger?

I really feel that we owe it to the country to say what the facts may very well be, not largely because expenditures may be so much higher, but because I think revenues may fall off considerably more than has been anticipated.

Will we be able to finance this without starving the private market on the one hand and reigniting, as was said yesterday—the phrase "reigniting" inflation.

Will we be able to do it?

Mr. BURNS. Certainly the Government will get all the money it needs. No question about that. The heart of your question is will the private sector be squeezed out? Will interest rates rise and rise sharply?

I am not concerned about short-term rates, but I must say that there is a good deal of uncertainty in my mind about the behavior of long-term rates.

Chairman HUMPHREY. Mine, too, to be frank about it.

I am concerned, despite my so-called political liberal tendencies, about not what happens in 1976, or maybe even the first part of 1977, but what will we be able to do if these deficits continue to mount in 1977, fiscal 1977, fiscal 1978?

Mr. Burns. You know it is precisely for that reason that I think that it is so important that the Congress limit any tax reduction that it may pass at the present time just to this year. Later on you may need to take further action.

Chairman HUMPHREY. You mean this fiscal year?

Mr. BURNS. This calendar year.

Chairman HUMPHREY. The calendar year of 1975?

Mr. BURNS. That is right. You see, we have permitted our tax base to erode. To go back to the legislation—to the Revenue Acts of 1962, 1964, 1969, 1971—the consequence of that legislation has been to erode our tax base. That is why even in very good years we have run large deficits, and the deficits we have run are even larger than the budget document reports them to be because of our peculiar system of accounting.

I cannot overemphasize the importance of limiting the tax reduction to this year. We cannot permit our tax base to be eroded further at this time.

Chairman HUMPHREY. You pointed out something that has been of concern, and it must be to anyone.

As far as I can recall, since 1954 we have not had any tax increases. We have had a series of tax rate decreases in Congress. No one has ever had to bite the bullet, so to speak. I guess there was an increase, yes, that we had.

Mr. BURNS. A temporary one.

Chairman HUMPHREY. 1969, was that it, in that period?

Mr. BURNS. 1968.

Chairman HUMPHREY. 1968–69 period. I think that this is the place where the Joint Economic Committee, and indeed, the House Ways and Means Committee and Finance Committee of the Senate, should concentrate some of its potential and take a look at this economic theory of constantly reducing the tax rate.

I think that is about the only thing that we can do this year with both the rebate and the tax reduction for the calendar year of 1975. I personally believe that is what we have to do. I do think that, as you have indicated, that there has to be a real good looksee as to what is happening to our tax system and tax base.

Mr. BURNS. I have some calculations before me showing how the changes in our tax laws, since 1960, have eroded our tax base. According to these calculations, at 1974 income levels the revenue

from the individual income tax would have been $39 billion larger if that legislation had not been passed and the revenue from the corporate income tax would have been $10 billion larger. There you have a total of nearly $50 billion. In the case of excises, there is another $6 billion.

But in the case of the social security tax, we have added very heavily to our people's burden.

Chairman HUMPHREY. That is a big bite.

Mr. BURNS. Particularly for poor people.

Chairman HUMPHREY. Mr. Burns, to kind of move along here, you mentioned the investment tax credit, the President's proposals for 1 year.

I have to be frank with you. I think that it ought to be for more than 1 year. What is your view?

Mr. BURNS. I find this difficult because I am in great sympathy with your views. But I want to be a strict constructionist this year and confine that tax reduction as well to this year. A little later, after this legislation is out of the way, I hope that the Congress will consider permanent legislation in this area. But I would not do it now. It would reopen the question of what to do about the individual income taxes. You understand this matter very thoroughly.

In short, I would confine the tax reduction for individuals and for businesses just to 1 year at this time.

Chairman HUMPHREY. How do you feel about the rebate plan on 1974 taxes, Mr Burns?

Mr. BURNS. I find the President's proposal a reasonable one.

Chairman HUMPHREY. The rebate proposal as well.

Mr. BURNS. Yes.

Chairman HUMPHREY. One other matter. You mentioned the automatic stabilizers that are at work in our economy. Of course this is a very significant part of the protections that we have against both inflation and recession. One of those economic stabilizers is the cost-of-living increase in social security. The President has said that should be limited to a 5-percent increase.

I think it is quite obvious that most of us in the legislative branch in the Government feel that this group of beneficiaries has suffered possibly more than any other group from the ravages of inflation. They have very little income coming in so they get no benefit from any wage increases.

How do we justify depending upon these automatic stabilizers doing their job if you cut the social security benefits to the elderly, who are not only old but most of them poor, down to 5 percent?

What is your judgment about that 5 percent?

Mr. BURNS. Let me comment on that, Senator. As I understand the President's recommendation, he has recommended that a ceiling of 5 percent be placed on increases in social security benefits, on Federal pensions, and on Federal employees' pay. I favor that recommendation, and I favor it for two reasons. First, these things have become very large in the Federal budget and we have to look at them now with a financial eye to a larger degree than we could in earlier years when they were a small part of our Federal budget. There is another thought that I have in mind. I do not know to what extent

this has influenced the President's judgment, but it has influenced mine. If you set a ceiling you are setting an example for the private sector of the economy, so that wage increases could also be held within reasonable bounds.

When you say, Senator, that the people on social security have suffered most from inflation—I believe that was your thought—I have the impression that social security benefits in recent years have increased more rapidly than the rate of inflation.

Chairman HUMPHREY. From a totally low base.

Mr. BURNS. That is entirely correct. This is a very difficult question, in my judgment, Senator. The trouble is when you try to find places in the budget to economize, you have to look at expenditures on these huge programs because they have become such a large part of the budget.

Chairman HUMPHREY. I realize that. I think that is right.

I noted yesterday and I will again say it, when I looked at the budget and saw, for example, that the increase in the budget from last year on what we call budget estimates or defense, was up from $91 billion to $107 billion, and foreign aid, foreign assistance and military assistance was up from about $6 billion to $6.8 billion. When you put that together that represents a third of the entire budget and there is an actual net increase in defense expenditures of $8 billion.

If we are going to set some examples, I do not think we should set the examples on those least able to protect themselves. That is my judgment. I am not saying that just to get the crying towel out for the elderly. But when I get home, as I have and do regularly, and attend senior citizen meetings and see what is happening to their rent, their fuel bill, their food bill, and they pay even now a larger share of their medicare bill, and then take a look at what their income is, and you do not necessarily need much less when you are 68 years old or 70 or 72 than you do when you are 50 years of age—when I see that, I must say that I believe of all the places that we ought not to set an example for frugality, for financial discipline, is on that particular group.

Do not misunderstand me. I know there are limits to what you can do in any budget. But I think that is one of the areas that I have a very strong feeling about. I understand your point of view on it. You have been very fair in your statement.

I have taken my time. I wanted to ask about this comment. I know that you have a high regard for some of these advisers that we have had before us here. As I recollect, we had Paul McCracken, who suggested to us that there ought to be—and I went back on this once before—a money supply rate increase on the average for the coming year of about 8 to 10 percent. However you wish to define that money supply is another matter.

What is your view about that? Is that too much? Is it too little? What do you intend to do about it?

Mr. BURNS. I have not seen Professor McCracken's testimony. If he is thinking of M1, the narrowly defined money supply, I think it is far too much.

Chairman HUMPHREY. I think he was thinking of at least a combination of what we call M1 and M2. He said 10 to 12 percent of M2 and 8 to 10 percent on M1, I believe that is correct.

Mr. BURNS. I would consider these figures too large but we at the Federal Reserve keep rethinking our position constantly, Senator. We have to. It is so hard to visualize circumstances, you see.

Take, for example, the foreign sector. It is something that we at the Federal Reserve have to pay very close attention to. Short-term interest rates have declined more rapidly in this country than elsewhere around the world. And that is one reason why the foreign exchange value of the dollar has depreciated since last September. That has consequences not only for our price level and rate of inflation. It also has consequences for our foreign relations, for our nation's prestige and political power around the world.

Actually, in spite of the difficult schedule that I have, I recently made a trip to London, which I felt I had to do, to meet with other central bankers to talk over this problem. Of course we have to focus attention on our own domestic economy. But what happens in the foreign exchange sector has implications for our economy. Therefore, that can slow down the Federal Reserve at times.

On the other hand, during 1970 at the time of the Penn Central failure, we did something that was unprecedented. All of our monetary objectives went out of the window for the time being. We informed banks around the country that the discount window was open. We changed some of our regulations to help in the process of converting commercial paper into other types of credit. I did not care then whether the money supply, no matter how you define it, grew at 5 percent or 15 or 25 percent. My objective was to prevent a financial crisis. That was the central objective. A little later we got over that. The reserves we had pumped into the commercial banks we pulled out, and got back on path.

So my answer to your question is that it is very difficult, really, to state responsibly what the rate of growth of money, no matter how you define it, should be. The specific figures that you mentioned look too high to me at the present time; I think that if we were to pursue such an objective right now, we would intensify the financing problems that the Government and the private sector will have to face.

Chairman Humphrey. Do you feel without that kind of increase that we can finance the deficit and the refinancing of the Government debt?

Mr. BURNS. Here is our problem at the Federal Reserve. We can influence short-term rates—we can knock them down indirectly, and we can have an enormous effect on them in a short period of time. But that will have consequences for the rate of growth of the money supply. And if the money supply begins rising very rapidly, then long-term rates, instead of responding to the decline in short-term rates, would move the other way. If that happens, prospects for recovery in homebuilding and for large commercial and industrial developments may well be frustrated.

That is our dilemma, and that is why it is so difficult, really, to lay down a numerical guideline that makes much sense in practice.

Chairman HUMPHREY. I will conclude my part of this questioning today, my participation, Mr. Burns, by saying what I said to other witnesses. Whatever one may think about the President's program, and it is obviously, particularly on the energy part—controversial,

as far as the tax part of it is concerned, much less so—it has seemed to me that there is no possibility of any substantial recovery from the growing recession of this country without a very careful balance between our budget and fiscal policy on the one hand, and our so-called monetary on the other.

I gather from what we have heard from Mr. Greenspan and Secretary Simon that you are in consultation with these gentlemen on a regular basis, and may I say that those of us in the Congress that have to accept some responsibility for legislation simply have to know a good deal more about this kind of consultation that takes place because ultimately we are going to be held responsible for the legislative policy that is passed. We may go off the deep end here or we may do the right thing. It depends upon, I think, the kind of economic information we have.

I hope during the weeks ahead that we can feel free to consult with you, as we will with others, and more so than we have in the past. For example, I believe in light of what you said about the money supply and I recognize the different areas or elements in that, that maybe in the next couple of months that we ought to get back together again to kind of review this.

I think the Congress, Mr. Burns, needs to be kept very much abreast of what is developing at the Federal Reserve levels, otherwise we are going to see things happen over here that maybe ought not to happen. We cannot afford to be foolish or reckless in any way. We are dealing with the life of this country. I really believe that we are in a very critical situation.

Mr. BURNS. Senator, I want to congratulate you on your statement. I will be only too glad to meet with the members of this committee at any time that you specify, no matter what my other obligations may be. Not only that, but I will welcome the opportunity of sitting down with you, Senator Proxmire, Congressman Brown and others, to answer your questions. I think that it is terribly important that that be done. Otherwise, unfortunate misunderstandings could arise.

I respect our Constitution and I respect our laws, and no one knows better than I that the Federal Reserve is a creature of the Congress. It is responsible to the Congress. If we communicate imperfectly, then it is partly the fault of the Federal Reserve and it is partly the fault of the Congress. You do not follow the course of monetary policy as closely as you should. I hope that will be corrected. I am with you completely.

Chairman HUMPHREY. Do you call on the presidents of the Federal Reserve regional banks for regular consultation?

Mr. BURNS. We have a monthly meeting, regularly scheduled monthly meeting and we consult between meetings as needed as well.

Chairman HUMPHREY. I was hoping that would be the case because each of our respective geographical areas seems to have different sets of problems.

For instance, the unemployment rate in my State is considerably less than it is in Michigan, considerably less than some areas in New England. But our problems on credit are slightly different than they are some place else.

So there is this regular consultation.

Mr. BURNS. Yes, very thorough.

Chairman HUMPHREY. We thank you very much, Mr. Burns, Professor Burns. We find both hats that you wear to be very engaging and interesting.

Mr. BURNS. Thank you, Senator.

Chairman HUMPHREY. The committee stands adjourned.

[Whereupon, at 12 noon, the committee adjourned, subject to the call of the Chair.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 14, 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 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senator Humphrey; and Representatives Bolling and Long.

Also present: John R. Stark, executive director; Courtenay M. Slater, senior economist; William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Sarah Jackson, Jerry J. Jasinowski, L. Douglas Lee, Carl V. Sears, and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. This morning the Joint Economic Committee continues its hearings evaluating the Economic Report of the President and the fiscal 1976 budget. We are pleased to have with us three most distinguished economists to present their evaluation of the President's proposals, and also to evaluate some alternatives to the President's proposals.

It is in that area of alternatives in particular that we have interest. The President and his advisers have been unusually candid in spelling out their projections for the course of the U.S. economy over the remainder of this decade. But the course that they have laid out, to me at least, as I have listened to its explanation, is unacceptable. The President has told this Congress and the country that the unemployment rate will be at least 8 percent during the next 2 years and will not fall below 6 percent before the end of the decade if we adopt his economic proposals.

But, as gloomy as the President's outlook seemed 10 days ago, recently released statistics have made conditions look even worse. The unemployment rate already stands at 8.2 percent, and George Meany was quoted this week as saying he expects it to be 10 percent by July. I should note here that since preparing these remarks, the morning press carries the story of a very substantial and rather precipitous drop again in our industrial production. This is why I regard the President's program as clearly inadequate to deal with this recession. I might add that in recent years Mr. Meany has been

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a better forecaster than any of the administration's economists. I make a suggestion that before they come up here with these reports they ought to consult with George Meany and at least get the input. They could put a footnote down at the base of the testimony and say that this testimony, while it has been cleared with George, we have not followed his advice.

This morning we are going to look at the President's proposals, but we are also going to examine some alternatives to those proposals. Specifically, we have asked our witnesses to examine the implications of a $30 billion tax cut and enough spending for public service employment to hire 1 million people. I want to say that that is not all that we want you to look at because there are obviously many other alternatives. We have also asked our witnesses to tell us what they regard as the maximum targets in real growth and reductions in unemployment that we can realistically expect to achieve over the next 2 years.

Our first witness this morning will be Mr. Michael Evans, president of Chase Econometrics. The second witness will be Mr. David M. Rowe, economist for the Wharton Econometric Forecasting Associates. And the third witness will be Mr. Franco Modigliani, professor of economics, Massachusetts Institute of Technology. Mr. Evans, we would like to have your statement, and it might be desirable if we go through these statements and then come back for questioning after the witnesses have completed their statements, please.

STATEMENT OF MICHAEL K. EVANS, PRESIDENT, CHASE ECONOMETRIC ASSOCIATES, INC.

Mr. Evans. Thank you very much, Mr. Chairman. I am very pleased to be here this morning. I have several copies of my prepared statement. I will not read all of that; it is rather long, but I will summarize my views.

Chairman Humphrey. We will include the full text of your prepared statement in the body of our record at the end of your oral summation.

Mr. Evans. In my brief statement I would like first to discuss the program which President Ford has suggested to the Nation. I would then like to offer my comments on the suggestion by Senator Humphrey of a $30 billion tax cut, and finally end up with a few comments about the maximum attainable rate of growth for 1975 and 1976.

Chairman Humphrey. On the $30 billion cut we are talking about a $10 billion rebate and a $20 billion in the withholding and others for the calendar year 1975, and for some time after.

Mr. Evans. Yes. And I have also included the $3 billion investment tax credit that you have just mentioned.

The President's tax program has been largely discredited already, and the legislation by the Ways and Means Committee which has been reported has made several alterations in it so I will not go into his original program in great detail because I do not think it will be implemented. I will say that in my personal opinion, the tax rebate which was originally suggested was not a very good idea in the

sense that it provided too much money to the upper income groups which have a relatively small propensity to spend in the short run, and I believe that the plan offered by the Ways and Means Committee has pretty much taken care of this problem. My own personal suggestion was a per capita tax grant to everyone up to an income of $25,000, with a phaseout above $30,000, but I believe that the grant proposed by the Ways and Means Committee is sufficiently close to this that I would have no serious quarrels with their particular version.

Chairman HUMPHREY. And that grant is in the sum of $200?

Mr. EVANS. $200, and then it tails off $100 over $30,000 I believe. As far as the other legislation which was in the President's tax program, I believe that we should have an increase in the investment tax credit to a 10 percent rate, and I will say more about the problems of per capita formations in my comments.

I believe that the President's energy program has no redeeming features, and I think that particularly loading the price of energy for all users on all types of energy is a serious mistake.

I would be in favor of a gasoline tax increase and some sort of horsepower taxing credit which would penalize gas guzzling automobiles and reward those who purchase automobiles that were more efficient on fuels, but I see no advantage in putting the price increase on all sorts of uses and different types of energy.

The only reason I do not criticize this in greater detail is that I understand it has very little chance of being passed.

I have prepared a number of simulations comparing what would happen under no program at all, in other words, no tax cuts and no energy program at all, under the complete Ford program, under the program which is likely to be passed by the Congress, and finally, under the Joint Economic Committee proposal which has been suggested by Senator Humphrey. These are found in a number of tables in my prepared statement; table 1 contains a breakdown for real gross national product, for industrial production, and for the rate of unemployment.

Turning perhaps first to the rate of unemployment, since this is obviously a key variable for economic policymakers, we find that the unemployment rate remains at unacceptably high levels for each of these four alternatives. We expect that the unemployment rate will reach 9 percent later in the year. It might get there sooner rather than later, but we expect the average for calendar 1975 to be approximately 9 percent.

Chairman HUMPHREY. The average?

Mr. EVANS. The average, yes. It will be close to 9 percent. Even under the Joint Economic Committee proposal there is no early downturn in the rate of unemployment. The reason for this is that even if the tax rebate were to be granted immediately, or at the beginning of the second quarter, it takes time for the money to enter the mainstream of spending and it takes even longer for firms to make decisions to produce more because even if consumers were to increase their spending immediately, a large amount of this, at least at first, will come out of inventories, and so it will be a while before production picks up, and therefore employment increases and unemployment decreases.

The unemployment rate under the so-called do nothing program, in other words, no tax cuts, would average approximately 8.7 percent for 1976. The partial and complete Ford programs would make very little difference in the unemployment rate. In particular, the complete Ford program turns restrictive in 1976 for the simple reason that the increases in energy prices more than offset the decreases which would come from the tax. The partial Ford program would reduce unemployment somewhat, but is an insufficient stimulus to make much difference

The Joint Economic Committee plan would reduce the unemployment rate to 7.9 percent next year compared to 8.7 percent in 1976, and the unemployment rate would reach 7½ percent by the end of 1976. This is assuming that the $10 billion rebate and the $20 billion permanent personal income tax cut which would continue through 1976.

If we turn to the figures for inflation which are given in table 2 of my prepared statement, we find that the rate of inflation will decline substantially but will still remain in a zone which used to be considered unsatisfactory. We expect that the rate of inflation will decline from its present level substantially in the first quarter to about 9 percent, and then continue down to about 6 percent in the latter half of 1975 and throughout 1976.

The figures shown in table 2 show a much higher rate of inflation for the complete Ford program. This is, of course, due to the price hikes which would occur because of higher energy prices, and we have estimated that the consumer price index would be 2.8 percent higher and the wholesale price index would be 5 percent higher under the complete Ford program than would be the case if no price increases were introduced into energy costs.

The Joint Economic Committee program does result in a somewhat higher rate of inflation in 1976, and the rate of inflation is about a half a percent higher under the Joint Economic Committee program than under no program at all.

A number of commentators have raised questions about what might be the effect on money in capital markets, and in table 3 of my prepared statement I have prepared some summary figures which discuss this particular problem. It is clear, looking at these figures, that the deficits will be large, both in terms of actual magnitude, and in terms of a percentage of GNP. Even if we do nothing we will have a substantial deficit in 1975 of approximately $40 billion. Under the Ford program we might have a deficit of somewhat more than that, perhaps $50 to $6: billion, and under the Joint Economic Committee program the deficit for calendar 1975 and also fiscal 1976 would be approximately $60 billion.

I am not particularly bothered by these deficits because of the great dropoff in credit market demands by the private sector. In particular, the demand for funds for inventories will have declined approximately $50 billion from the middle of 1974 to the middle of 1975, thereby almost entirely offsetting the increase in the Government deficit. Thus, for this reason, looking at my forecast of two key interest rates, commercial paper rate, and the Aa corporate bond yield, we find that there are relatively small differences in interest rates under any of the existing programs.

The complete Ford program has the highest interest rates, not because it has the highest deficits, but because it has a higher rate of inflation, and we learn from experience that the corporate bond yield certainly reflects the rate of inflation as well as other factors in capital markets.

I think the slack that exists in this economy today, particularly in view of the latest figures on the unemployment rate and the industrial production index, indicates we could have a substantial tax cut, larger than the one that has been proposed by the President, without running into any problems in 1975. However, I would like to add a word of caution here which is that basically the overall economy is not in very good shape due to the policies which were followed during the last 3 or 4 years. In particular, it was only about 1 year ago that we were worried about shortages. Nobody wanted to hear about recessions, nobody wanted to hear about tax cuts. Everyone was talking about shortages and how we were going to get enough. And one of the reasons that this occurred was because we had not increased our productive capital stock in the economy over the last 3 to 4 years, and I believe that we should have a balanced approach which would certainly stimulate consumers and which would also stimulate businesses into increasing their productive capital stock. If we do nothing about this we will reach a point in 1977 when we will return to the previous levels of demand and we will get shortages once again.

There has been a very serious fact in American life which is that the unemployment rate tends to drift upwards over time, that even at cyclical peaks the unemployment rate is higher than it has been in previous years. This was particularly true for the 1973 peak. Some people have argued that this occurs because of differences in demographic shifts and different methods of defining unemployment, the fact that we have more secondary workers in the labor force and things of this sort. This is part of the story, but it is not the complete story, and I think that one of the reasons that we had a relatively high rate of unemployment at the 1973 peak, even though we had shortages, was that we had run out of capital, that we had a lack of productive capital in the economy, and I think that this problem needs to be rectified alongside with stimulating the consumer demand.

We definitely need a tax cut to increase the level of real disposal income back to where it was in 1973. As we know, the average take-home pay of the worker has declined now 7 percent over the last 18 months. This is unprecedented. It has never happened in the postwar period. We need to return the workers' income to its previous level and a tax cut is the best way of doing this in the short run.

I would just caution, however, about overheating the economy, trying to push to a 9-percent growth rate without providing the incentive to business to stimulate their productive capacity so that we do not run into shortages. And this is the serious reservation I have, and I would like to see a tax bill enacted which would include a tax cut of the size you mentioned, $20 billion, that would also provide greater incentives for business through tax legislation.

Chairman HUMPHREY. Would you spell that out a little bit more at this point?

I am in full sympathy with what you say, and I want to know what you have in mind.

Mr. EVANS. Okay, very good. I would make two major changes. First of all, I feel that the investment tax credit is a powerful tool, and as I have mentioned, I think it should be increased to 10 percent, but I think the credit should be made variable in the sense that it should apply more heavily to some types of investments than other types of investments. The tax credit is used for new cars and office furniture; things of this sort do not deserve the credit. Credits for types of investment which are energy saving, for example, in nature, or create larger job pools or create greater increases in efficiency, I believe that these should receive a higher tax credit rate, perhaps as high as 15 percent, but I think that the credit should be restructured, and it should not be given across the board on all types of investment whether they improve productivity, energy efficiency, or not. The other factor is, I think we should have a reduction in the corporate income tax rate, and in this sense I am in avor of the President's proposal.

I am also in favor of closing the loopholes, by the way, and I do think that for example, that the depletion allowance should be phased out. The only problem is, I hesitate to see this tied to the tax cut bill for 1975 because it will become bogged down in this controversy. But I do believe that the reduction in the corporate income tax rate and the closing of the corporate loopholes which would not add to investment should definitely be considered.

Chairman HUMPHREY. Should that be done now, promptly?

Mr. EVANS. I think this should be considered as part of the permanent legislation, in other words, the pressing order of business is to get through the rebate and the tax cut for 1975 because the economy is in such terrible shape. In making the taxes permanent, I believe that the variable investment tax credit, the reduction of corporate income tax rates, the closing of the loopholes should be considered as one separate package.

Chairman HUMPHREY. As a separate package?

Mr. EVANS. That is right.

Now, I think these two factors would go far in reorienting investment to a more productive vein, but also ease some of the liquidity problems which many businesses have become afflicted with in the last few years.

Thank you.

Chairman HUMPHREY. Thank you for your very helpful and constructive testimony, Mr. Evans.

[The prepared statement of Mr. Evans follows:]

PREPARED STATEMENT OF MICHAEL K. EVANS[1]

In this statement we first discuss the strengths and weaknesses of the Ford program, taking into account legislation which is already in progress. We then turn to an examination of business conditions under four alternative scenarios: no new legislation at all, the complete Ford package the most likely new program as indicated by current legislative progress, and the JEC proposals. Doing so will enable us to estimate both the probable impact of the entire Ford program and the most likely course of the economy during the next two years. We present this analysis for real growth, inflation, and financial markets.

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[1] The views expressed are those of the author only and do not necessarily reflect the views of the Chase Manhattan Bank, N. A.

THE TAX PROGRAM

The general idea of a quick tax rebate deserves to be implemented, but the plan offered by the Ford administration has one glaring flaw which is both political and economic in nature. That is the extension of the rebate up to a maximum of $1000. From a political point of view, a tax which is so regressive will not be accepted by a majority of Congress. From an economic point of view, it is clear that at least the short-term marginal propensity to consume is much smaller for upper-income groups than for poor people. Thus consumers at the lower end of the income scale will spend most of their rebate; consumers at the upper end will save most of theirs. This distribution is suboptimal for a plan designed to provide a short-term stimulus to consumption and production.

My own personal plan is that a flat per capita credit be given to all individuals with 1974 income of less than $25,000. The credit could be gradually reduced in the $25-30,000 range, with no credit at all for those whose incomes exceeded the $30,000 figure last year. In order to maximize the effect of such a refund, it should occur as early in the year as possible and should be distributed in one lump sum. In particular, a payment of $320 may serve as a down payment or purchase of a big-ticket item, whereas $6/week would have a smaller short-run impact on consumer spending. This plan would raise consumption more than other plans without any greater disruption of financial markets. Furthermore, it would occur during the first half of the year, when the need to furnish stimulus to the economy is most important. The 10% rebate and accompanying plan which has been reported fits this suggestion fairly closely, and in my opinion could well be adopted without further adjustment.

I am also in favor of the increases in the minimum standard deduction and exemption which have been proposed for low-income people, and believe these should be made permanent. However, I think more should be done to restore our tax schedule to its previous function of acting as an automatic stabilizer in times of recession. In order to do this, I suggest that the tax tables be denominated in terms of real income rather than nominal income. Then an increase in income due only to inflation would not result in a taxpayer moving to a higher tax bracket.

The issue of the expansion of the investment tax credit is clouded by the question of whether to make such an extension temporary or permanent. The idea of a one-year increase in the credit, of course, is to get businessmen to commit orders now, when the economic climate is poor, rather than wait until the capital goods industry is once again at full capacity. However, even if the tax credit is made retroactive to the beginning of the year, business decisions will not be; a temporary tax credit increase would have a very limited stimulative effect on the economy. I definitely favor an increase to the 10% level on a permanent basis.

The possibility of a variable investment tax credit, which has been raised by allowing a higher rate for those utilities investing in facilities which do not use oil or gas, is indeed an excellent idea. This tax credit could be expanded to permit a higher rate on any class of investment which increased fuel efficiency significantly; it could also be eliminated entirely for those investments which did not increase labor productivity or fuel efficiency.

We will need stimulus and incentive to increase supply if we are to increase demand through fiscal policy, and an expansion of the investment tax credit will not prove sufficient. Thus I believe that the reduction in the corporate income tax rate from 48% to 42% is both a necessary and powerful tool to accomplish this increase in productive capacity. In addition to providing $7 billion this year and $9 billion next year in additional cash flow, it should result in a lower rate of inflation in the longer run, since the pretax rate of return required on invested capital can fall for the same after-tax rate of return. In addition, it will lessen the dependence of most corporations on the bond markets, which have already had trouble absorbing the full amount of debt issues. If this reduction is not included as part of the overall tax package, inflationary pressures during 1976 will reemerge, and the CPI increase will return to an 7% rate by the end of next year.

THE ENERGY PROGRAM

Unlike the Ford tax program, the recently proposed energy program has no redeeming features. It is even more puzzling because the basic aims which the President says he would like to pursue are reasonable and agreeable to wide seg-

ments of the population. Yet his program simply does not meet these aims. If I understand correctly what Mr. Ford has recently said, he would like to accomplish with his energy policy:

(1) Reduce our long-term dependence on imported oil, both by using less petroleum products and by switching from foreign to domestic sources of oil.

(2) Provide a total package which would be at least mildly stimulative in view of the present severe recession.

(3) Avoid worsening the plight of the automobile industry, which is in its worst slump in seventeen years.

(4) Keep the additional inflation engendered by higher petroleum prices to a minimum, since while inflation may no longer be Public Enemy Number One, it is still extremely unpopular.

(5) Perform all this with the minimum amount of disruption of capital markets and increases in interest rates.

As I have mentioned on several previous occasions, the way to meet these five goals is to place a 30¢/gallon tax on gasoline, coupled by a personal and corporate income tax cut, increased expenditures on mass transit, and a horsepower tax and credit which would discriminate against cars with low fuel efficiency and in favor of those with high fuel efficiency. Such a move would raise consumer prices only 1.0% above baseline levels, compared to 2.8% for the complete Ford package. We have estimated that a 30¢ increase in the gasoline tax would reduce oil usage by one million barrels per day instead of the 500,000 barrel-a-day reduction which would occur under the Ford program, since our estimate of the short-run price elasticity for gasoline is —0.2, compared to —0.1 for all petroleum products. Furthermore, a massive shift to smaller cars could reduce total use of gasoline by 10% the first year and as much as 50% over a ten-year period; this cannot be accomplished nearly as effectively by simply raising petroleum prices. The loss to consumers through higher gas taxes would be $25 billion, which contrasts with almost $40 billion resulting from the proposed excise taxes and deregulation of oil and new natural gas.

The deregulation of oil and new natural gas is an attractive feature of the Ford program and one which should have been undertaken earlier. However, the chief benefit of the bill is eliminated under the proposed terms of the windfall profits tax, which does not allow firms to reduce their tax burden if they invest more in exploration, drilling, and production facilities. The increase in price is not only supposed to blunt demand; it is supposed to increase domestic supply. The investment off-set, which was included in the October version of an energy program, should definitely be reintroduced if the Ford program is to be implemented. However, I still believe that a tax at the gasoline pump is far preferable to one at the oil well.

This view is shared by a large number of economists and even politicians. Hence in my opinion there is virtually no chance that President Ford's energy bill will pass intact. A large tax on gasoline is not very popular with consumers, and could be passed only if it were to receive a strong endorsement from the executive branch, which is obviously not forthcoming. As a result we will get no energy package this year, except for a possible phaseout of the depletion allowance. The President has evidently decided to impose an excise tax of $1, 2, and $3/bbl. on imported crude oil in February, March and April, but that will be all. Excise taxes on oil and gas will not be increased, and prices will not be deregulated. We will thus continue to rely more and more heavily on imported oil. Eventually, I hope that the country will figure out that a gasoline tax is the best answer to this dilemma, but that will not happen before the next election.

FISCAL STIMULUS OF FORD PACKAGE

We now consider the economic implications of (a) no Ford package at all, (b) what we consider to be the most likely Ford package, (c) the complete Ford package, and (d) the Joint Economic Committee proposal. The assumptions for case (b) are listed below.

(1) Congress will pass a tax rebate of 10%, with the maximum cutoff at $200 rather than $1000. The minimum rebate will equal the lesser of $100 or the taxpayer's 1974 income tax liability. The maximum rebate will be $200 and will be reduced by $1 per every $100 of adjusted gross income between $20,000 and $30,000, with taxpayers above this level receiving a rebate of $100.

(2) The personal income tax table will be revised at the low end, with the net effective cut equal to $8.4 billion. This will be passed by midyear but will not be made retroactive to the beginning of the year. Subsequent legislation will make these changes permanent.

(3) The investment tax credit will be increased to 10% on a permanent basis, including utilities and will also be effective at midyear. No special distinction will be made between new plants which use oil and gas and those that do not, and the offset will be 50% for all firms and will not rise to 75% for utilities.

(4) The first $50,000 of corporate income will be taxed at 22%, up from the first $25,000.

(5) No windfall tax will be placed on profits, because oil and gas prices will not be deregulated. The depletion allowance, however, will be phased out.

(6) The tax credit for home insulation will be included, but will amount to only $0.5 billion.

(7) No change will be made in the marginal statutory Federal corporate income tax rate for corporate income above $50,000.

(8) Grants-in-aid will rise by $2 billion to cover the cost of higher-priced oil for state and local government.

(9) Social security and other transfer payments will continue to rise as previously projected; the 5% ceiling will not even be considered.

(10) President Ford will use his powers to raise imported crude oil prices by $1, 2, and $3/bbl. on February, March, and April 1st respectively. These will result in an increase in excise taxes of $4.2 billion by midyear, with this figure remaining in force throughout the remainder of the forecast period. Imports of petroleum will be reduced by $0.7 billion; this figure represents a decrease of only 0.18 MMBD of imported oil. These increases will stick because Congress will be unable to override President Ford's veto. However, no further exogenous increases will be forthcoming for either oil or gas prices during the remainder of the forecast period.

In addition to the partial and complete Ford packages, we also consider the Joint Economic Committee proposal, which includes the following stimulative policies:

(1) A $10 billion rebate on 1974 tax liabilities to be paid out in the second quarter of 1975.

(2) A reduction of $20 billion in personal income taxes through 1976.

(3) A $3 billion increase in the investment tax credit for 1975 and 1976.

(4) Growth in M–1 of about 10%

(5) An $8 billion increase in FY 1976 Federal outlays, including a removal of the proposed 5% ceiling on transfers and some reduction in defense spending.

We have also analyzed the effect of this plan. All plans provide a substantial amount of fiscal stimulus during the latter half of 1975. The complete Ford program has a larger ex ante deficit, but because of the higher rate of inflation, more funds are recaptured in tax revenues. Even on an ex post basis, both plans are definitely stimulative: a deficit of $36 billion, even if only for half a year, clearly does result in an upturn in economic activity.

The pattern is completely reversed in 1976, when it becomes clear that the Ford package restrains the economy. It is extremely difficult to make a case for such a package, given that the unemployment rate is still expected to be over 7½% at the end of this year for all three scenarios. The windfall profits tax of $12 billion plus the excise tax of $20 billion far overshadow the $19 billion decline in personal income taxes. In addition, the extra $15 billion—the difference between the ex ante and ex post deficits—represents the additional amount which consumers will have to pay because of higher prices.

Yet even these figures do not fully measure the cost to the consumer of the Ford package for oil and gas. According to this program, the following changes will occur:

(1) A tax of $2/bbl. on all crude oil and imported petroleum products. At present the usage is about 17.2 MMBD, with a drop expected to 16.7 MMBD at the higher prices. This is equal to $12.2 billion.

(2) Deregulation of old oil, which would raise the price from $5.25 to $11.00/bbl. before the excise tax. This affects approximately 7 MMBD, for a total of $14.7 billion.

(3) An excise tax of 37¢/mcf on natural gas. At present usage rates are about 25 billion mcf, with a drop expected to about 24 billion mcf at the higher prices. This is equal to $8.9 billion.

(4) Deregulation of new natural gas, which might raise the price as high as $1.50/mcf. We have assumed a current average price of 42¢/mcf, which implies an increase of as much as 70¢/mcf over and above the excise tax. While this change would occur slowly, it would have a substantial effect by 1980.

As a result of these increases, consumers would be faced with a bill which would be as much as $40 billion higher. In addition to this they would have to pay an additional $15 billion in taxes because their nominal incomes would have been increased by inflation. This is hardly offset by a $19 billion decline in personal income taxes. Thus the Ford program turns from mildly stimulative in late 1975 to definitely restrictive in 1976. In comparison, the partial Ford program, which includes the same tax rebate and a smaller tax cut but no energy program, remains stimulative throughout the forecast period. The JEC proposal is the most stimulative of any alternative considered here. This can be seen by comparing percentage changes in real GNP and industrial production and the unemployment rate for our three alternative scenarios, as given in Table 1.

TABLE 1

	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	Calendar 1975	Calendar 1976	Fiscal 1976	Fiscal 1977
Real GNP:												
No Ford program	—5.1	—1.6	1.3	2.8	5.1	6.2	6.8	6.7	—3.3	4.3	3.9	6.2
Partial Ford program	—5.0	—2.3	2.2	3.9	5.0	5.6	6.2	6.1	—3.3	4.4	4.2	5.6
Complete Ford program	—5.0	—2.7	1.3	4.2	5.0	3.6	3.5	4.4	—3.4	3.5	3.5	3.8
JEC	—4.7	2.1	4.8	4.6	6.3	6.6	6.3	5.7	—2.0	5.7	5.6	4.5
XIP:												
No Ford program	—11.5	—4.6	—2.9	.9	6.0	8.3	7.6	8.0	—6.1	4.1	3.1	7.4
Partial Ford program	—11.5	—4.7	.1	2.2	6.4	7.9	7.0	7.2	—5.7	4.6	4.2	6.7
Complete Ford program	—11.5	—4.6	1.8	4.2	5.9	5.9	4.5	4.3	—5.4	4.2	4.5	4.1
JEC	—11.5	—.3	2.8	5.6	9.3	9.9	7.7	6.7	—4.4	7.2	7.0	5.1
Unemployment:												
No Ford program	8.4	8.8	9.1	9.2	9.1	8.8	8.5	8.2	8.9	8.7	9.0	8.1
Partial Ford program	8.4	8.8	9.0	9.1	8.9	8.7	8.4	8.2	8.8	8.5	8.9	8.1
Complete Ford program	8.4	8.8	9.0	9.1	8.9	8.6	8.5	8.4	8.8	8.6	8.9	8.3
JEC	8.4	8.7	8.8	8.7	8.4	8.1	7.8	7.5	8.6	7.9	8.5	7.5

As can be seen from Table 1, we expect a modest recovery in the latter half of 1975 with or without any tax cuts or rebates. However, the magnitudes are considerably different. Under the baseline case, real GNP rises only 2.0% in the second half of the year, while it rises 3.0% with the partial Ford program and 2.7% with the complete program. The JEC program is clearly the most stimulative, as it raises real GNP growth to 4.7% during the latter half of 1975. During 1976, the economy returns to a period of rapid growth under all programs except the complete Ford program, but the JEC program remains the most stimulative until late in 1976.

The pattern of unemployment is not particularly encouraging under any scenario, as all estimates start off from the 8.2% January figure. The unemployment rate reaches 9% for all cases examined here except the JEC proposal, which holds it at 8.8% in the third quarter. The partial Ford program reduces unemployment by about 0.2% in early 1976, but by the end of the year the advantage has disappeared. The complete Ford program provides an equal amount of stimulus in latter 1975 but, because it turns restrictive in 1976, ends up with a higher rate of unemployment. Only the JEC alternative reduces the unemployment rate to 7½% by the end of 1976, a level which is still unacceptably high. Thus we have ample time to increase capacity if business incentives are not stifled. Table 1 should make clear, however, that the complete Ford program, because of its much more restrictive overall constraints, is clearly the worst alternative in terms of real growth, and in fact is inferior to doing nothing at all. The partial Ford program, which we think is the most likely one to be passed, at least has definite stimulative action. The JEC program is clearly the most stimulative, but as we shall see below, could eventually lead to a resumption of inflationary pressures.

EFFECT ON PRICE AND MONETARY VARIABLES

We now turn to an examination of the effect which the Ford program has on inflation and on financial markets. The deregulation of old oil and a $2/bbl. tax on all crude and imported products would raise the wholesale price index for petroleum products by 47% and the industrial WPI by 3.0%. A 37¢/mcf excise tax would raise the WPI for natural gas by 90% and the industrial WPI by 3.8%. These are the changes which would occur with normal markups; wholesale prices actually rise somewhat less than that because price increases are not fully passed along, at least in the first year. We estimate that on an ex post basis, the industrial WPI rises 5.0% more because of these increases. The CPI rises 2.0% because of these higher gas and oil prices, with an additional 0.8% due to the secondary effects of cost-push inflation. All these results are shown in Table 2.

TABLE 2

	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	Calendar 1975	Calendar 1976	Fiscal 1976	Fiscal 1977
CPI:												
No Ford program	8.8	6.7	5.7	6.9	6.8	6.3	6.2	6.8	9.3	6.7	6.4	6.5
Partial Ford program	8.8	7.9	6.9	7.3	6.8	6.4	6.5	7.1	9.7	7.0	6.8	6.7
Complete Ford program	8.8	9.1	15.3	5.6	8.1	7.5	6.8	7.3	11.0	8.5	9.2	7.1
JEC	8.8	6.5	5.6	6.8	6.9	6.6	6.6	7.2	9.2	6.8	6.5	6.9
WPI, industrial:												
No Ford program	7.0	8.1	9.7	7.3	7.8	5.4	6.6	5.9	13.1	7.4	7.5	6.1
Partial Ford program	7.0	9.9	11.8	7.4	7.7	5.4	6.6	5.9	13.7	7.8	8.1	6.0
Complete Ford program	7.0	11.5	29.0	7.4	8.1	5.5	6.1	6.0	16.5	10.1	12.5	6.2
JEC	7.0	8.2	10.0	7.4	7.9	5.4	6.5	5.8	13.1	7.5	7.7	6.0
GNP deflator:												
No Ford program	7.3	7.5	6.3	7.3	6.3	5.9	6.0	6.4	9.2	6.6	6.5	6.1
Partial Ford program	7.4	8.7	7.4	7.9	6.6	6.2	6.2	6.6	9.7	7.1	7.0	6.3
Complete Ford program	7.3	9.9	15.5	8.1	9.3	7.7	7.2	7.1	11.0	9.5	10.2	7.0
JEC	7.4	7.1	6.1	7.0	6.2	6.1	6.2	6.8	9.1	6.6	6.4	6.5

The 2.8% figure for the CPI increase reflects both the higher cost of oil and gas and the fact that higher prices would lead to higher wages, higher unit labor costs and still higher prices. It also takes into account the inflationary effect of higher interest rates. In contrast we have negligible price effects from the partial Ford program; the WPI for petroleum products is raised only 6% and natural gas prices do not rise at all. As far as the relative effects on inflation are concerned, it is strictly no contest between two alternatives; the complete Ford program clearly has the greatest inflationary effect.

The JEC program has no measurable effect on prices in 1975 as compared to the no change alternative; it results in less inflation than either the partial or complete Ford program because it contains no increase in petroleum or natural gas prices. The main reason why prices do not show any additional increase under the JEC program is the great amount of excess capacity which will exist all year. In addition, however, it should be noted that the larger tax cut increases real disposable income by a larger amount, hence mitigating the upward pressure on wage demands.

The picture is changed somewhat in 1976, when the increase in the CPI under the JEC program begins to rise about ½% faster than the no change alternative. This may not seem like a large amount, but inflationary pressures intensify over time and the effect in 1977 is likely to result in an increase in the rate of inflation rather than the decrease which would otherwise occur. Thus this stimulus should not be continued indefinitely.

The effects on the Federal deficit, the commercial paper rate, and the Aa corporate bond yield are shown in Table 3.

TABLE 3

	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	Calendar 1975	Calendar 1976	Fiscal 1976	Fiscal 1977
Federal deficit:												
No Ford program	40.2	44.7	38.1	38.3	42.5	38.5	34.7	32.9	40.3	37.2	39.4	27.0
Partial Ford program	40.2	41.6	78.4	47.4	50.0	46.2	42.6	41.2	51.9	45.0	55.5	35.4
Complete Ford program	44.2	44.6	77.1	69.1	23.1	19.1	17.0	16.4	58.8	18.9	47.1	10.2
JEC	43.1	85.2	60.2	58.4	61.3	56.6	52.9	51.4	61.7	55.6	59.2	37.2
Commercial paper rate:												
No Ford program	6.71	5.14	5.61	6.24	6.76	6.92	7.08	7.29	5.93	7.01	6.38	7.48
Partial Ford program	6.71	5.17	6.05	6.23	6.71	7.05	7.20	7.41	6.04	7.09	6.51	7.59
Complete Ford program	6.71	5.21	6.31	6.40	6.96	7.32	7.47	7.62	6.16	7.34	6.75	7.79
JEC	6.71	5.22	5.59	6.35	6.94	7.15	7.34	7.56	5.96	7.24	6.51	7.73
Aa corporate bond yield:												
No Ford program	8.89	8.26	8.46	8.85	9.09	9.15	9.25	9.37	8.62	9.22	8.89	9.42
Partial Ford program	8.89	8.31	8.71	9.01	9.17	9.30	9.44	9.56	8.73	9.37	9.05	9.60
Complete Ford program	8.89	8.36	9.11	9.32	9.62	9.79	9.93	10.02	8.92	9.84	9.46	10.05
JEC	8.89	8.21	8.36	8.81	9.12	9.26	9.41	9.56	8.55	9.34	8.89	9.60

It is clear that the Federal government deficit will be quite large even if no program is implemented. This is a direct result of the decline in personal and corporate income and not a result of an increase in the rate of government spending. The very large deficit given under the JEC alternative for 1975.2 stems from the assumption that a tax rebate would be granted during the second quarter; in the other simulations we have assumed that it would be implemented in the third quarter. The deficit for fiscal 1976 ranges from $40 to $60 billion, depending on which alternative is chosen, which represents between 2.7% and 4% of current dollar GNP. This compares with the previous peak values of 3.2% in 1953.4 and 2.8% in 1958.2.

Because the demand for credit in the private sector has dropped so radically during the past six months, we estimate that this deficit can be absorbed by the financial markets without undue dislocation. Our forecasts for both short-term and long-term interest rates show only a modest rise in rates due to the higher deficit levels. The highest interest rates occur under the complete Ford package, which has the lowest deficit but the highest rate of inflation. The decline of some $50 billion in borrowing for inventory investment from mid-1974 to mid-1975 provides sufficient funds for government deficits of this magnitude.

MAXIMUM STIMULUS TO THE ECONOMY

We have also been asked to comment on the policies which might produce a 9% growth rate from the fourth quarter of 1975 to the fourth quarter of 1976. This compares with the maximum rate of 6.2% for the JEC program as indicated in Table 1.

According to Okun's Law, an additional 3% real growth would reduce the rate of unemployment by about another 1%, hence returning this rate to 6½% by the end of 1976. Since 6½% is still well above the level of unemployment previously characterized as satisfactory, it might be thought that such rapid growth would cause no particular problems. Furthermore, since the effect on inflation of the JEC program is only to add ½% to the rate of inflation next year, it might be argued that the risk is worth it. However, this is not my opinion.

The last two years of economic activity have pointed up the vulnerability of the American economy in several areas. It was less than a year ago that we appeared to have shortages of almost every major commodity. We have added virtually no productive capacity to the economy in 1974, and according to current investment plans will add virtually none in 1975. Thus once we reach the level of demand which occurred at the end of 1973, we will once again find ourselves in a picture of serious shortages unless something is done to increase capacity in the meantime. This can be done successfully, but not immediately. We need incentives to business to increase capacity, and we need time to order and deliver this capital plant and equipment. In addition, many firms find themselves unable to raise capital either from internal or external sources, hence precluding their decision to expand or modernize.

Several economic commentators have noted that the unemployment rate which occurs at peak capacity has been drifting upward. Some have suggested that this is due to a change in the labor force characteristics, and that the unemployment rate for married men at business cycle peaks has remained relatively constant. That is part of the story, but not the entire reason. At the last business cycle peak the economy had clearly run out of capacity. While the ratio of fixed business investment to GNP at this cyclical peak was similar to previous peaks, the growth in productivity and capacity over the past five years has fallen far short of the average postwar performance, particularly in the area of raw materials and fabricated metal products. While many forces have combined to cause this to happen, they can be lumped together under the area of lack of incentive to cause these companies to expand. The wage-price controls, an overly tight monetary policy and high interest rates, and diversion of capital spending to meet environmental and safety requirements are all part of the picture. Thus if we are going to employ more labor, we are going to need a larger capital stock to do it—unless we are going to revert to make-work projects and a decline in national productivity, a suggestion which I do not believe is endorsed by any economist.

Thus stimulus must be in the direction of expanding plant and equipment spending as well as restoring real disposable income to its previous level. The latter can be done over a relatively short time frame through tax cuts and increased transfer payments, but the former takes at least two years to have a

significant effect. Thus stimulating the economy too fast would simply result in a return to shortages without reaching what used to be considered the range of full employment.

In my opinion, therefore, a 9% growth rate during 1976 is too fast. There have been only two times in the postwar period when real GNP has increased by 9% or more for four quarters or more in a row. The first time was at the beginning of the Korean War, which clearly put excessive strains on the economy. The second time was immediately following the recession of 1958. However, the fourth quarter of that spurt was the pre-steel strike inventory buildup; if we take the five-quarter average, it was only 8.2%. Furthermore, and probably more important, the economy had significant excess capacity in 1959, the financial markets were in decent shape, and the rate of inflation was already close to zero; obviously none of these apply today.

In my opinion, the $30 billion tax cut which the JEC has proposed can be implemented in 1975 with virtually no ill effects on the economy. If this were to be continued into 1976, however, we would begin to reenter the area of inflationary pressures, and by 1977 problems of double-digit inflation would reappear—unless concomitant action is taken to increase the supply of productive capital to the American economy. Even if this were to occur, I believe that a 9% rate of growth during 1976 is faster than the economy, in its current depleted condition, can safely handle.

Chairman HUMPHREY. Now, our next witness is Mr. David Rowe, an economist with the Wharton Econometric Forecasting Associates. Please proceed, Mr. Rowe.

STATEMENT OF DAVID M. ROWE, WHARTON EFA, INC., PHILADELPHIA, PA.

Mr. ROWE. I suppose I should begin by expressing a certain amount of surprise at a Minnesota native catching the flu in the Washington weather. I really cannot be too surprised though, because my wife is also a Minnesota native, and her flu turned into pneumonia so I guess it can happen.

Let me begin by pointing out that the text of my statement does have summary results for three different solutions that will be the subject of discussion. Let me first of all begin by briefly outlining the varying assumptions of these three solutions.

The first is a slightly modified version of Wharton EFA's latest control forecast in light of the recent unemployment statistics.[1] This forecast makes the following basic public policy assumptions.

First, a significant increase in defense purchases to levels somewhat below those in the official administration budget. Both defense and nondefense purchase assumptions assume pay increases of more than the proposed 5 percent ceiling.

Second, Federal transfer payments to persons growing at rates faster than those in the proposed budget. These transfers include an assumed 8.5 percent social security increase above the proposed 5 percent ceiling in 1975 third quarter, and a 5.5 percent increase effective in 1976 third quarter.

Third, grants-in-aid to State and local governments include a $3 billion per year jobs program which is phased in slowly beginning in the second half of 1975. It is assumed that this jobs program results in an increase of 350,000 employees on State and local government payrolls.

[1] See tables 1, 2, and 3, respectively, pp 527 529.

Fourth, a rebate on 1974 personal income taxes of 10 percent up to $300 per return. In addition, we have reduced the four lowest income tax bracket rates by 2 percent, and increased the personal exemption to $850 per person. We estimate these changes result in permanent tax reductions of $8 billion. We have also assumed a reduction in current overwithholding by $5 billion per year.

Fifth, a permanent increase in the investment tax credit to 10 percent effective in 1975 third quarter. And finally, some deregulation of the price of old oil. Accompanying this we have assumed a modest oil excise tax producing revenues of $5.5 billion.

This control forecast shows a further significant decline in real activity in the first quarter of 1975. This is largely the result of slower inventory accumulation and, in the case of automobiles, actual inventory reductions.

I might add a personal note. Mr. Evans has an advantage on me, being in some sense the top man, his organization's forecast reflects what he thinks. To the extent I have a personal bias different from the organization's, I think we may, in fact, be too optimistic. Not that this forecast could be called optimistic, but I do tend to think that the declines are going to be rather more serious than even the significant declines that the official forecast shows, largely I think, because of additional inventory liquidation on the part of nonauto manufacturing and other businesses.

In addition, the forecast shows further declines in real consumption spending, especially for consumer durables. Price adjusted nonresidential fixed investment also shows a continued decline through 1975, and only recovers late in 1976.

I would emphasize that I agree wholeheartedly with Mr. Evans' comment that we must be careful not to forget that as little as 6 months ago, the dominant discussion centered on the long-term need for expansion and modernization of the American capital stock, and if we are going to have healthy long-run growth, this is not a situation that we can afford to ignore or that we can afford to permit to become fogged, if you will, in the light of short-run circumstances.

The second attached solution, the revised Ford solution,[1] reflects the policy proposals made in President Ford's recent state of the Union message and further detailed in the official budget documents released in early February. These policies have been introduced in as much detail as the model structure permits. Since various aspects of the budget depend on economic activity, the exact budget results are not duplicated in this forecast. Specific assumptions in this forecast include the following:

First, defense and nondefense spending as estimated in the preliminary translation of the budget to a national income basis as released by the Office of Management and Budget.

Second, a $12 billion personal tax rebate on 1974 taxes, 40 percent to be paid in the second quarter of 1975, and 60 percent to be paid in the third.

Third, a temporary 1-year increase in the investment tax credit rate to 12 percent.

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[1] See tables 4, 5, and 6, respectively, pp. 530–531.

Fourth, a permanent personal tax reduction of $16.5 billion, effective June 1, 1975, and retroactive to January 1, 1975.

Fifth, a permanent reduction in the corporate profits tax rate from 48 percent to 42 percent.

Sixth, deregulation of the price of old oil, and imposition of a $2 per barrel equivalent excise tax on oil and natural gas. In addition, we assume a windfall profits tax in the form of a sliding excise tax on old oil as the price rises. The total revenue from these oil excise taxes is assumed to be in excess of $30 billion per year.

I think it is important to note that the well publicized $30 billion figure is, in fact, a minimum impact of the proposed excise which assumed what I consider to be an unrealistic amount of conservation as a result of an increase in the prices.

Seventh, an increase of $2 billion per year in State and local government expenditures to cover the higher cost of fuel.

I would agree, and this may give lie to the comment that if all the economists in the world were laid end-to-end, they could not reach a conclusion, I agree basically with Mr. Evans' comment that the Ford program, while being essentially stimulative in 1975, does turn restrictive in 1976 as the higher prices begin to have a significant impact. The official price impact, official, that is organizational official price impact, that we are saying is about 2 percent on the level of the GNP deflator.

Again, my personal bias tends to be more in the direction of the 2.8 percent impact that Mr. Evans was speaking of earlier.

The third solution is the alternative proposed to us by the JEC involving a $30 billion tax cut and $8 billion jobs program.[1] Let me just outline briefly the assumptions, to be sure that I have them as requested.

One, a $10 billion rebate on 1974 personal income taxes, payable completely in the second quarter of 1975. We have further assumed a $20 billion permanent tax cut effective June 1, 1975, and retroactive to January 1, the withholding schedules to be adjusted through the remainder of 1975 to return the full-year reduction by the end of the calendar year.

Two, we have assumed an increase in the investment tax credit rate to 10 percent from 1975, third quarter, through 1976, fourth quarter.

Three, an $8 billion jobs program which employs 1 million men. This program becomes one-third effective in 1975, third quarter, two-thirds in 1975, fourth quarter, and is fully implemented by 1976, first quarter.

Four, a change in the mix of Government spending which shifts $4.5 billion from defense to personal transfers in fiscal 1976.

Five, we have assumed no freeing of the price of old oil, and no associated excise tax. In light of this we have reduced Federal spending by $3 billion, compared with the official budget estimates which include additional spending for more expensive fuel.

And as I read this, I note there is a slight contradiction between five and one. What I in fact did do is assume the spending in the

[1] See tables 7, 8, and 9, respectively, pp. 532–533.

budget and then went back and made an offsetting reduction of $3 million for the assumption that there would be no increase in the price of energy without the taxes.

And six, I have assumed somewhat higher nonborrowed reserves in the banking system to accommodate the required higher borrowing along with the larger tax cut. The details of these solutions are attached, and may be a subject of later discussion. I would also comment, however, that I do not see a significant problem in terms of financing these larger deficits partly because of monetary accommodation on the part of the Federal Reserve, but in addition because of the decline in private borrowing demands in particular, as Mr. Evans indicated, the declines in the needs for inventory borrowing.

In brief review, these solutions clearly show the serious nature of the current economic slowdown.

We are in the midst of what will certainly become the longest and most severe of the postwar recessions. The need for significant Government action to halt the continuing decline in private spending should be obvious.

On the issue of prices, it is important to realize that we have developed, and are continuing to develop, significant excess capacity in the U.S. economy. In this context, stimulative Government policy has a much smaller impact on prices than is the case when we are operating at near maximum capacity.

In fact, improving real output levels can have a favorable impact on productivity and remove some pressure on prices from unit labor cost.

Chairman HUMPHREY. Do you have any idea at what percentage of capacity we are now operating?

Mr. ROWE. Again, this becomes a problem because there are a variety of measures of capacity. Now the kind of measures we use is one which attempts to measure capacity based on previous peak industry-by-industry, and we then aggregate that to the total. So you can never have a full economy at 100-percent capacity. That would mean all industries at full capacity. But in essence, at the peak of this last cycle, we were operating at about 96 or 97 percent capacity utilization. By our index we estimate we are now operating in the area of 87 to 85 percent capacity utilization at this time.

Continuing in the issue of prices, while the gains from such short-run productivity improvements may be modest, they can be important when capacity utilization pressures are at a minimum, as is true now, and will continue to be true for some time to come.

The needed policy shifts call for a significant stimulus from Government taxation and spending policies in the near future. Lacking such governmental action, the current decline in economic activity will surely continue well beyond the middle of 1975.

It is important to recognize, however, that the return to full employment should be an orderly one. We cannot expect a dramatic upsurge in activity to near full employment and capacity without a serious risk of an additional inflationary outbreak.

It would be tragic indeed if the very legitimate concern for those suffering the most from the current slowdown were to lead to policies

which create inflationary pressure which once again could only be broken by periods of high unemployment and declining real activity.

If we are to avoid major future swings in real activity, it is important that both political parties stop creating public expectations which cannot be fulfilled. Our understanding of economic processes has improved dramatically in the last 30 years. Recent experience should show us, however, that minute fine tuning is not a practical possibility given the current state of our understanding, and the necessarily slow moving nature of the political processes needed to implement public policies. If we are not satisfied with occasionally operating at output levels moderately below full capacity, more serious cyclical swings are inevitable.

May I have just a couple of additional minutes for further comments in addition to what I have in my oral statement?

Chairman HUMPHREY. Go right ahead.

Mr. ROWE. I have already made the comment that in some sense I personally tend to be somewhat more pessimistic than the official forecast that we had presented. I would make some other important comments.

I think one relates to the whole question of the price statistics as we have seen them of late, especially the very rapid wholesale price index increases that we saw at the end of 1974.

My feeling, and I feel quite certain in this, is that some of this increase was in fact spurious. I think what happened was that a number of businesses posted list price increases, but they were never implemented. There were a great many concessions and discounts which offset the posted price increase, and I think the reason for this is clear.

I think there is widespread fear on the part of business that we will return to wage and price controls. And I think it is this fear of a return to wage and price controls which in some measure has slowed the decline in prices. That is, businesses do not want to get caught, if you will, with their prices down at the wrong time.

I would conclude by making one final comment, and again I would emphasize that this is a personal view which should not necessarily be interpreted as the views of my associates in my organization. I have pointed to a number of problems that I think are important relative to what I feel might be a possibility of fine tuning the economy within 1 percent of capacity on a permanent basis.

I would not say, however, that these views should be interpreted as justification for wage and price controls. I think it is extremely important in these discussions to distinguish the difference between absolute and relative price levels.

We often hear discussion about inflation or about changes in the absolute overall level of prices. Unfortunately, we seldom hear discussion of shifting relative prices and yet it is these changes in relative prices which tend to reallocate resources away from areas of declining demand and in the direction of areas of increasing demand.

Now in an economy where we have large concentrations of economic powers, such as the economy of the United States, I think it is quite clear that this price mechanism does not operate with the

sort of pristine efficiency of theoretical economic models. I think the current events in the auto industry, however, should demonstrate that the price mechanism does still work in the American economy.

And I think it is very important, when one considers as a policy option, the possibility of wage and price controls, that we should keep in mind this issue of relative prices. Because if we are talking about imposing across the board wage and price controls, the very real and I think all too often overlooked sacrifice that is involved is that we give up the dynamic reallocation impact of shifting relative prices.

And it is for this reason that I personally would caution seriously against long-range wage and price controls as a viable economic policy.

Thank you.

Chairman HUMPHREY. Very good, thank you very much, Mr. Rowe.

[The attached solutions referred to in Mr. Rowe's statement follow:]

Wharton Mark IV Quarterly Model, February 14, 1975: Revised Control Solution

TABLE 1.—SELECTED MAJOR ECONOMIC INDICATORS

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1974	1976
Gross national product	1,428.0	1,433.2	1,455.7	1,494.3	1,535.3	1,565.9	1,603.8	1,644.3	1,687.0	1,396.7	1,479.6	1,625.3
Percent change, gross national product	3.35	1.47	6.43	11.02	11.45	8.21	10.04	10.47	10.80	7.86	5.94	9.84
Real gross national product	803.7	789.4	788.7	799.7	808.3	810.9	818.3	827.9	838.0	821.1	796.5	823.8
Percent change, real gross national product	—9.10	—6.93	—0.36	5.70	4.36	1.28	3.70	4.80	4.99	—2.15	—2.99	3.42
National income	1,164.3	1,164.8	1,183.6	1,212.3	1,248.4	1,274.0	1,305.9	1,339.6	1,375.5	1,142.2	1,202.3	1,323.8
Personal income	1,186.4	1,199.8	1,219.3	1,249.4	1,280.4	1,303.5	1,332.5	1,368.0	1,402.7	1,150.4	1,237.2	1,351.7
Implicit price deflator—GNP	177.7	181.6	184.6	186.9	190.0	193.1	196.0	198.6	201.3	170.2	185.7	197.3
Percent change, implicit GNP deflator	13.69	9.01	6.81	5.03	6.80	6.84	6.12	5.41	5.54	10.29	9.15	6.21
Implicit price deflator—private GNP	170.7	174.5	177.5	179.7	182.3	185.5	188.4	191.0	193.3	163.3	178.5	189.6
Percent change, private GNP deflator	13.71	9.12	7.04	5.20	5.90	7.07	6.45	5.66	4.95	10.70	9.29	6.19
Percent change, consumer price index	12.17	9.35	7.27	5.66	5.92	7.07	6.47	5.60	4.64	11.04	9.32	6.24
Percent change, wholesale price index	14.69	11.90	7.73	4.80	2.64	2.88	1.31	1.86	1.61	18.81	12.40	2.85
Private output per man-hour	5.71	5.68	5.72	5.82	5.89	5.90	5.95	6.01	6.07	5.80	5.78	5.98
Percent change, private output per man-hour	—2.10	—2.40	2.96	7.47	4.42	0.99	3.33	3.98	3.77	—3.73	—.46	3.54
Private compensation per man-hour	5.64	5.76	5.86	5.96	6.06	6.17	6.28	6.40	6.50	5.46	5.91	6.34
Percent change, private compensation per man-hour	8.58	8.32	7.22	6.82	6.92	7.54	7.70	7.37	6.76	8.54	8.14	7.28
Unemployment rate (percent)	6.54	8.30	9.11	9.44	9.33	8.94	8.44	7.68	7.27	5.59	9.04	8.12
Net exports, current (dollars)	1.1	2.5	5.5	4.9	4.7	4.8	2.1	—2.3	—5.0	1.9	4.4	—.1
Money supply—M1	282.8	286.3	291.2	297.8	303.8	309.6	315.7	323.1	330.1	278.6	294.8	319.6
Percent change, money supply—M1	3.37	4.97	7.11	9.36	8.29	7.82	8.14	9.75	8.95	5.62	5.82	8.43
Money supply—M2	611.4	622.7	637.0	653.3	667.8	681.9	696.1	711.9	726.8	596.5	645.2	704.2
Percent change, money supply—M2	6.61	7.65	9.48	10.63	9.18	8.71	8.58	9.43	8.62	8.54	8.16	9.14
3-month Treasury bill rate	7.36	6.08	5.48	5.39	6.32	6.26	6.54	6.25	6.81	7.83	5.82	6.46
Corporate AAA utility bond rate	9.63	9.49	9.24	9.31	9.42	9.49	9.52	9.32	9.31	9.33	9.36	9.37
4–6-month commercial paper rate	9.05	7.06	6.29	6.08	6.78	6.96	7.16	7.00	7.37	9.83	6.56	7.12
Moody's total corporate bond rate	9.65	9.69	9.61	9.59	9.63	9.67	9.72	9.66	9.55	8.98	9.63	9.65
Personal savings rate (percent)	8.47	8.46	8.59	10.48	10.62	9.47	9.36	9.81	9.81	7.83	9.54	9.61
Corporate profits before tax	132.4	117.9	116.9	121.7	131.9	138.6	145.9	153.7	159.8	140.9	122.1	149.5
Federal surplus, NIA basis	—22.7	—32.2	—38.4	—69.7	—73.2	—53.4	—53.3	—62.9	—65.9	—7.6	—53.4	—58.9

WHARTON MARK IV QUARTERLY MODEL, FEBRUARY 14, 1975: REVISED CONTROL SOLUTION—Continued

TABLE 2.—FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
Federal Government receipts	294.6	294.2	297.3	283.0	293.6	322.4	331.8	336.6	347.0	291.0	292.1	334.4
Personal tax and nontax receipts	136.6	138.4	141.3	119.3	124.9	146.0	151.1	151.2	157.5	131.2	131.0	151.4
Corporate profits tax accrual	45.8	41.7	41.5	42.8	46.7	49.3	52.1	55.0	57.3	49.1	43.2	53.4
Indirect business tax and special oil tariff	22.2	22.3	22.6	28.5	28.9	29.0	29.3	29.6	30.0	22.0	25.6	29.5
Indirect business tax/nontax accrual	22.2	22.3	22.6	23.0	23.4	23.5	23.8	24.1	24.5	22.0	22.8	24.0
Special oil tariff	0	0	0	5.5	5.5	5.5	5.5	5.5	5.5	0	2.8	5.5
Contributions for social insurance	90.0	91.9	91.9	92.4	93.3	98.1	99.4	100.8	102.3	88.7	92.4	100.1
Federal Government expenditures	317.3	326.5	335.7	352.7	366.8	375.8	385.1	399.5	412.9	298.6	345.4	393.3
Purchases of goods and services	122.8	125.8	128.5	131.2	138.2	140.9	143.6	146.3	152.6	116.4	130.9	145.8
National defense	83.5	85.3	87.0	88.7	93.6	95.3	97.0	98.7	103.0	78.6	88.6	98.5
Other	39.3	40.5	41.5	42.5	44.6	45.6	46.6	47.6	49.6	37.9	42.3	47.3
Transfer payments	127.1	133.1	139.1	150.3	154.8	159.3	163.8	173.3	177.8	117.0	144.3	168.5
To foreigners (net)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.6	2.7	2.7
To persons	124.4	130.4	136.4	147.6	152.1	156.6	161.1	170.6	175.1	114.4	141.6	165.8
Grants-in-aid to State and local governments	45.5	46.5	47.5	50.5	52.5	53.5	54.5	55.5	56.5	43.7	49.3	55.0
Net interest paid	19.7	18.8	18.0	17.7	18.3	19.1	20.2	21.4	23.0	18.8	18.2	20.9
Subtotal: Less current surplus government expenditures	2.3	2.3	2.6	3.0	3.0	3.0	3.0	3.0	3.0	2.1	2.7	3.0
Less: Wage accrual less disbursments	0	0	0	0	0	0	0	0	0	−.5	0	0
Federal Government surplus: NIA basis	−22.7	−32.2	−38.4	−69.7	−73.2	−53.4	−53.3	−62.9	−65.9	−7.6	−53.4	−58.9

WHARTON MARK IV QUARTERLY MODEL, FEBRUARY 14, 1975: REVISED CONTROL SOLUTION—Continued

TABLE 3.—STATE AND LOCAL GOVERNMENT RECEIPTS AND EXPENDITURES

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
State and local government receipts	214.0	217.4	221.4	228.7	235.2	239.9	245.4	251.4	257.4	207.7	225.7	248.5
Personal tax/nontax receipts	41.1	41.6	42.3	43.3	44.8	45.9	47.3	48.7	50.3	39.5	43.0	48.1
Corporate profits tax accrual	6.5	6.2	6.3	6.6	7.0	7.3	7.6	8.0	8.3	6.7	6.5	7.8
Indirect business tax and nontax	107.6	109.5	111.4	114.0	116.4	118.3	120.8	123.6	126.3	104.9	112.8	122.2
Liquor and tobacco sales tax	5.3	5.4	5.5	5.6	5.7	5.7	5.8	5.9	6.0	5.3	5.5	5.9
Gasoline taxes	9.0	9.0	9.3	9.4	9.6	9.7	9.9	10.0	10.2	8.8	9.3	10.0
Property tax	49.1	50.0	51.1	52.1	53.3	54.4	55.5	56.7	57.9	48.1	51.6	56.1
Other	44.2	45.0	45.6	46.9	47.9	48.5	49.6	51.0	52.2	42.7	46.4	50.4
Contributions for social insurance	13.3	13.6	13.9	14.2	14.5	14.9	15.2	15.6	16.0	12.8	14.0	15.3
Grants-in-aid from Federal Government	45.5	46.5	47.5	50.5	52.5	53.5	54.5	55.5	56.5	43.7	49.3	55.0
State and local government expenditures	214.4	220.3	226.3	233.3	239.8	245.7	250.6	255.6	260.6	206.0	229.9	253.1
Purchases of goods and services	199.6	204.6	209.6	215.6	221.6	227.6	232.6	237.6	242.6	192.4	212.8	235.1
Transfer payments to persons	21.4	22.2	22.8	23.5	24.2	24.7	25.3	25.9	26.5	20.2	23.2	25.6
Net interest paid	−1.5	−1.5	−1.6	−1.8	−1.9	−2.1	−2.2	−2.4	−2.5	−1.5	−1.7	−2.3
Less: Current surplus government expenditures	5.0	5.0	4.5	4.0	4.0	4.5	5.0	5.5	6.0	5.0	4.4	5.3
Less: Wage accrual less disbursements	0	0	0	0	0	0	0	0	0	0	0	0
State and local surplus: NIA basis	−.5	−2.9	−4.9	−4.6	−4.6	−5.8	−5.2	−4.2	−3.1	1.7	−4.3	−4.6

Wharton Mark IV Quarterly Model, February 14, 1975: Revised Ford Solution

TABLE 4.—SELECTED MAJOR ECONOMIC INDICATORS

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
Gross national product	1,428.0	1,430.0	1,463.8	1,515.8	1,548.9	1,584.9	1,625.0	1,664.1	1,702.2	1,393.7	1,489.6	1,644.0
Percent change, gross national product	3.35	0.56	9.81	14.97	9.02	9.65	10.51	9.97	9.47	7.86	6.65	10.37
Real gross national product	803.7	787.8	790.8	804.8	804.7	807.6	814.3	821.8	829.1	821.1	797.0	818.2
Percent change, real gross national product	−9.10	−7.67	1.52	7.29	−0.09	1.46	3.36	3.76	3.60	−2.15	−2.93	2.66
National income	1,164.3	1,154.6	1,158.7	1,205.6	1,234.7	1,266.0	1,300.3	1,333.4	1,365.3	1,142.2	1,188.4	1,316.3
Personal income	1,185.4	1,200.8	1,219.4	1,247.9	1,272.9	1,291.6	1,316.4	1,349.3	1,377.9	1,150.4	1,235.3	1,333.8
Implicit price deflator—GNP	177.7	181.5	185.1	188.3	192.5	196.3	199.6	202.5	205.3	170.2	186.9	200.9
Percent change, implicit GNP deflator	13.69	8.90	8.17	7.16	9.12	8.07	6.92	5.98	5.67	10.29	9.81	7.52
Implicit price deflator—private GNP	170.7	174.4	178.1	181.4	185.2	189.1	192.4	195.4	197.8	163.3	179.8	193.7
Percent change, private GNP deflator	13.71	8.96	8.66	7.77	8.56	8.56	7.32	6.25	5.16	10.70	10.08	7.72
Percent change, consumer price index	12.17	9.35	9.16	7.88	8.24	8.16	7.11	6.07	4.85	11.04	10.13	7.52
Percent change, wholesale price index	14.69	11.91	7.83	4.95	2.82	3.03	1.42	1.94	1.65	18.81	12.46	2.98
Private output per man-hour	5.71	5.67	5.74	5.86	5.86	5.89	5.93	5.98	6.02	5.80	5.78	5.96
Percent change, private output per man-hour	−2.10	−3.04	4.90	8.77	.12	1.66	3.22	3.31	2.98	−3.73	−1.40	3.02
Private compensation per man-hour	5.64	5.76	5.86	5.97	6.08	6.21	6.34	6.45	6.56	5.46	5.92	6.39
Percent change, private compensation per man-hour	8.58	8.07	7.13	7.99	7.88	8.76	8.22	7.54	6.72	8.54	8.27	8.01
Unemployment rate (percent)	6.54	8.31	9.11	9.44	9.43	9.13	8.66	8.10	7.54	5.59	9.07	8.35
Net exports, current (dollars)	1.1	2.8	4.5	3.8	6.5	7.1	4.5	.5	−2.0	1.9	4.4	2.5
Money supply—M1	282.8	286.1	292.0	300.0	305.9	312.2	318.6	326.0	332.6	278.6	295.0	322.4
Percent change, money supply—M1	3.37	4.73	8.48	11.37	8.16	8.47	8.44	9.64	8.39	5.5	6.25	8.90
Money supply—M2	611.4	622.7	637.8	654.8	669.0	683.4	697.4	712.7	726.8	596.65	646.1	705.1
Percent change, money supply—M2	6.61	7.65	10.04	11.08	8.96	8.87	8.44	9.08	8.18	8.54	8.30	9.13
3-month Treasury bill rate	7.36	5.94	5.63	5.91	6.52	6.59	7.05	6.74	7.22	7.83	6.00	6.90
Corporate AAA utility bond rate	9.63	9.42	9.42	9.65	9.77	9.89	9.98	9.84	9.67	9.33	9.56	9.84
4-6-month commercial paper rate	9.05	6.96	6.38	6.53	7.07	7.27	7.64	7.50	7.81	9.83	6.73	7.55
Moody's total corporate bond rate	9.65	9.66	9.67	9.76	9.87	9.99	10.09	10.10	10.03	8.98	9.74	10.05
Personal savings rate (percent)	8.47	8.59	9.98	11.36	9.57	8.33	8.01	8.26	8.17	7.83	9.88	8.19
Corporate profits before tax	132.4	109.1	96.9	117.8	123.9	133.4	141.3	148.0	151.4	140.9	111.9	143.5
Federal surplus, NIA basis	−22.7	−36.8	−51.6	−78.9	−49.8	−30.9	−30.0	−38.1	−39.9	−7.6	−54.3	−34.7

TABLE 5.—FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
Federal Government receipts	294.6	293.7	286.5	268.3	305.2	330.2	339.1	347.3	355.0	291.0	288.4	342.9
Personal tax and nontax receipts	136.6	138.0	109.6	83.7	117.7	133.9	138.8	143.4	148.8	131.2	112.3	141.2
Corporate profits tax accrual	45.8	33.0	29.2	36.2	38.3	42.7	45.3	47.6	48.8	49.1	34.2	46.1
Indirect business tax and special oil tariff	22.2	30.8	55.8	55.7	55.6	55.2	55.2	55.1	55.0	22.0	49.5	55.1
Indirect business tax/nontax accrual	22.2	22.2	22.5	22.9	23.3	23.4	23.8	24.1	24.4	22.0	22.7	23.9
Special oil tariff	0	8.6	33.3	32.8	32.3	31.8	31.4	31.0	30.6	0	26.8	31.2
Contributions for social insurance	90.0	91.9	91.9	92.7	93.5	98.5	99.8	101.2	102.5	88.7	92.5	100.5
Federal Government expenditures	317.3	330.5	338.1	347.2	355.0	361.1	369.1	385.4	395.0	298.6	342.7	377.6
Purchases of goods and services	122.8	122.9	121.8	127.3	132.9	138.9	145.2	151.7	158.2	116.4	126.2	148.5
National defense	83.5	81.0	78.5	83.1	87.9	93.3	99.3	105.3	111.3	78.6	82.6	102.3
Other	39.3	41.9	43.3	44.2	45.0	45.6	45.9	46.4	46.9	37.9	43.6	46.2
Transfer payments	127.1	137.0	142.3	147.5	147.8	146.8	146.6	154.1	155.1	117.0	143.6	150.6
To foreigners (net)	2.7	4.4	4.5	4.1	4.0	4.0	3.9	3.7	3.7	2.6	4.3	3.8
To persons	124.4	132.6	137.8	143.4	143.8	142.8	142.7	150.4	151.4	114.4	139.4	146.8
Grants-in-aid to State and local government	45.5	47.7	51.4	49.5	50.7	51.0	52.0	53.2	54.2	43.7	49.8	52.6
Net interest paid	19.7	19.0	18.5	18.8	19.5	20.3	21.2	22.2	23.3	18.8	19.0	21.7
Subtotal: Less current surplus government expenditures	2.3	3.9	4.1	4.1	4.1	4.1	4.1	4.2	4.2	2.1	4.0	4.1
Less: Wage accrual less disbursements	0	0	0	0	0	0	0	0	0	—.5	0	0
Federal Government surplus: NIA basis	—22.7	—36.8	—51.6	—78.9	—49.8	—30.9	—30.0	—38.1	—39.9	—7.6	—54.3	—34.7

TABLE 6.—STATE AND LOCAL GOVERNMENT RECEIPTS AND EXPENDITURES

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
State and local government receipts	214.0	218.3	226.0	229.6	234.5	238.7	244.2	249.9	255.5	207.7	227.1	247.1
Personal tax/nontax receipts	41.1	41.5	42.2	43.5	44.8	46.0	47.4	48.8	50.3	39.5	43.0	48.1
Corporate profits tax accrual	6.5	6.0	5.8	6.5	6.7	7.1	7.5	7.8	8.1	6.7	6.2	7.6
Indirect business tax and nontax	107.6	109.5	112.8	115.9	117.7	119.7	122.0	124.5	126.9	104.9	114.0	123.2
Liquor and tobacco sales tax	5.3	5.4	5.5	5.7	5.7	5.8	5.8	5.9	6.0	5.3	5.6	5.9
Gasoline taxes	9.0	9.0	9.7	10.1	10.3	10.4	10.4	10.5	10.5	8.8	9.8	10.5
Property tax	49.1	50.1	51.2	52.2	53.3	54.4	55.5	56.7	57.9	48.1	51.7	56.1
Other	44.2	45.0	46.4	48.0	48.4	49.2	50.2	51.4	52.5	42.7	47.0	50.8
Contributions for social insurance	13.3	13.6	13.9	14.2	14.5	14.9	15.3	15.7	16.0	12.8	14.0	15.5
Grants-in-aid from Federal Government	45.5	47.7	51.4	59.5	50.7	51.0	52.0	53.2	54.2	43.7	49.8	52.6
State and local government expenditures	214.4	220.3	226.3	234.3	239.9	244.8	249.8	254.7	259.7	206.0	230.2	252.2
Purchases of goods and services	199.6	204.6	209.6	216.6	221.6	226.6	231.6	236.6	241.6	192.4	213.1	234.1
Transfer payments to personnel	21.4	22.2	22.8	23.5	24.2	24.8	25.4	26.0	26.6	20.2	23.2	25.7
Net interest paid	—1.5	—1.5	—1.6	—1.8	—1.9	—2.1	—2.2	—2.4	—2.5	—1.5	—1.7	—2.3
Less: Current surplus government expenditures	5.0	5.0	4.5	4.0	4.0	4.5	5.0	5.5	6.0	5.0	4.4	5.3
Less: Wage accrual less disbursements	0	0	0	0	0	0	0	0	0	0	0	0
State and local surplus: NIA basis	—.5	—2.0	—.2	—4.8	—5.4	—6.1	—5.6	—4.7	—4.2	1.7	—3.1	—5.2

WHARTON MARK IV QUARTERLY MODEL, FEBRUARY 14, 1975: $30 BILLION TAX CUT AND $8 BILLION JOBS PROGRAM

TABLE 7.—SELECTED MAJOR ECONOMIC INDICATORS

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
Gross national product	1,428.0	1,430.5	1,468.3	1,495.5	1,537.3	1,572.8	1,616.6	1,660.3	1,702.9	1,396.7	1,483.2	1,638.1
Percent change, gross national product	3.35	.71	10.99	7.88	11.38	9.55	11.61	11.24	10.67	7.86	6.19	10.45
Real gross national product	803.7	787.9	799.3	80.35	812.0	817.2	827.5	838.3	848.3	821.1	800.7	832.8
Percent change, real gross national product	−9.10	−7.66	5.92	2.13	4.32	2.58	5.13	5.33	4.83	−2.15	−2.49	4.02
National income	1,164.3	1,163.7	1,196.2	1,214.8	1,250.5	1,280.6	1,318.1	1,354.9	1,390.4	1,142.2	1,206.3	1,336.0
Personal income	1,186.4	1,201.6	1,226.5	1,250.5	1,280.8	1,303.3	1,333.9	1,372.4	1,406.1	1,150.4	1,239.8	1,353.9
Implicit price deflator—GNP	177.7	181.6	183.7	186.2	189.3	192.5	195.4	198.0	200.7	170.2	185.2	196.7
Percent change, implicit GNP deflator	13.69	9.06	4.79	5.64	6.77	6.80	6.17	5.62	5.57	10.23	8.84	6.18
Implicit price deflator—private GNP	170.7	174.5	176.7	179.1	181.7	184.8	187.7	190.3	192.7	163.3	178.0	188.9
Percent change, private GNP deflator	13.71	9.14	5.03	5.71	5.90	6.96	6.37	5.82	5.11	10.70	8.97	6.12
Percent change, consumer price index	12.17	9.38	5.59	5.99	5.92	6.90	6.32	5.69	4.72	11.04	9.05	6.12
Percent change, wholesale price index	14.69	11.91	7.70	4.78	2.64	2.87	1.30	1.86	1.62	18.81	12.40	2.85
Private output per man-hour	5.71	5.67	5.79	5.84	5.90	5.92	5.98	6.03	6.08	5.80	5.80	6.01
Percent change, private output per man-hour	−2.10	−3.03	8.96	3.17	4.04	1.79	3.87	3.82	3.31	−3.73	−.10	3.56
Private compensation per man-hour	5.64	5.76	5.86	5.95	6.05	6.17	6.29	6.40	6.51	5.46	5.91	6.34
Percent change, private compensation per man-hour	8.58	8.20	7.57	61.6	7.14	7.72	7.89	7.54	7.03	8.54	8.10	7.37
Unemployment rate (percent)	6.54	8.31	9.04	9.33	9.14	8.64	7.97	7.28	6.69	5.59	8.95	7.64
Net exports, current (dollars)	1.1	2.8	3.0	4.2	4.0	3.7	.6	−3.8	−6.4	1.9	3.5	−1.5
Money supply—M1	282.8	286.2	292.3	298.8	305.0	311.5	318.3	326.1	333.5	278.6	295.6	322.4
Percent change, money supply—M1	3.37	4.78	8.94	9.08	8.66	8.74	9.05	10.19	9.32	5.62	6.10	9.06
Money supply—M2	611.4	622.7	637.8	654.0	669.5	685.3	701.0	717.9	734.0	596.5	646.0	709.5
Percent change, money supply—M2	6.61	7.66	10.02	10.56	9.84	9.72	9.49	10.00	9.33	8.54	8.29	9.83
3-month Treasury bill rate	7.36	5.97	5.79	5.22	5.83	5.73	6.03	5.92	6.22	7.83	5.70	5.98
Corporate AAA utility bond rate	9.63	9.44	9.33	9.12	9.31	9.32	9.31	9.16	8.88	9.33	9.30	9.16
4–6-month commercial paper rate	9.05	6.97	6.51	6.02	6.35	6.42	6.68	6.63	6.83	9.83	6.46	6.64
Moody's total corporate bond rate	9.65	9.67	9.64	9.53	9.54	9.55	9.56	9.50	9.34	8.98	9.59	9.49
Personal savings rate (percent)	8.47	8.62	11.44	10.92	10.88	9.67	9.45	9.75	9.64	7.83	10.47	9.63
Corporate profits before tax	132.4	117.5	123.2	122.6	131.3	139.5	148.3	156.9	162.0	140.9	123.7	151.7
Federal surplus: NIA basis	−22.7	−35.6	−85.0	−75.8	−76.8	−59.1	−55.9	−63.2	−63.5	−7.6	−68.8	−60.7

TABLE 8.—FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
Federal Government receipts	294.6	293.9	250.5	268.7	278.6	305.5	316.1	326.4	336.1	291.0	272.9	321.1
Personal tax and nontax receipts	136.6	138.2	91.8	104.5	109.8	128.6	134.0	139.1	145.1	131.2	111.1	136.7
Corporate profits tax accrual	45.8	41.5	43.9	43.1	46.4	49.6	52.9	56.1	58.0	49.1	43.7	54.1
Indirect business tax and special oil tariff	22.2	22.3	22.7	28.5	28.9	29.0	29.4	29.7	30.0	22.0	25.6	29.5
Indirect business tax/nontax accrual	22.2	22.3	22.7	23.0	23.4	23.5	23.9	24.2	24.5	22.0	22.8	20.4
Special oil tariff	0	0	0	5.5	5.5	5.5	5.5	5.5	5.5	0	2.8	5.5
Contributions for social insurance	90.0	91.9	92.2	92.6	93.5	98.4	99.8	101.4	103.0	88.7	92.5	100.7
Federal Government expenditures	317.3	330.5	336.5	344.5	355.4	364.7	3.0	389.6	399.7	298.6	341.7	381.7
Purchases of goods and services	122.8	122.9	120.8	122.3	125.9	129.9	134.2	138.7	143.2	116.4	123.0	136.6
National Defense	83.5	81.0	77.5	79.1	81.9	85.3	89.3	93.3	97.3	78.6	79.9	91.5
Other	39.3	41.9	43.3	43.2	44.0	44.6	44.9	45.4	45.9	37.9	43.1	45.2
Transfer payments	127.1	137.0	143.3	149.5	151.8	152.8	154.6	164.1	167.1	117.0	145.4	159.6
To foreigners (net)	2.7	4.4	4.5	4.1	4.0	4.0	3.9	3.7	3.7	2.6	4.3	3.8
To persons	124.4	132.6	138.8	145.4	147.8	148.8	150.7	160.4	163.4	114.4	141.1	155.8
Grants-in-aid to State and local governments	45.5	47.7	49.4	49.5	53.7	57.0	58.0	59.2	60.2	43.7	50.1	58.6
Net interest paid	19.7	19.0	18.9	19.1	19.9	20.9	22.1	23.4	25.0	18.8	19.2	22.8
Subtotal: Less current surplus government expenditures	2.3	3.9	4.6	4.1	4.1	4.1	4.1	4.2	4.2	2.1	4.0	4.1
Less: Wage accrual less disbursements	0	0	0	0	0	0	0	0	0	-.5	0	0
Federal Government surplus: NIA basis	-22.7	-36.6	-86.0	-75.8	-76.8	-59.1	-56.9	-63.2	-63.5	-7.6	-68.8	-60.7

TABLE 9.—STATE AND LOCAL GOVERNMENT RECEIPTS AND EXPENDITURES

Item	1974.4	1975.1	1975.2	1975.3	1975.4	1976.1	1976.2	1976.3	1976.4	1974	1975	1976
State and local government receipts	214.0	218.6	225.1	228.5	237.3	244.7	250.6	256.9	263.1	207.7	227.4	253.8
Personal tax/nontax receipts	41.1	41.5	42.6	43.5	45.0	46.3	47.9	49.5	51.2	39.5	43.2	48.7
Corporate profits tax accrual	6.5	6.2	6.5	6.6	7.0	7.3	7.7	8.0	8.3	6.7	6.6	7.8
Indirect business tax and nontax	107.6	109.6	112.8	114.7	117.1	119.2	121.8	124.5	127.3	104.9	113.5	123.2
Liquor and tobacco sales tax	5.3	5.4	5.5	5.6	5.7	5.8	5.9	6.0	6.0	5.3	5.6	5.9
Gasoline taxes	9.0	9.0	9.3	9.4	9.6	9.8	9.9	10.1	10.2	8.8	9.3	10.0
Property tax	49.1	50.1	51.1	52.2	53.3	54.4	55.6	56.7	57.9	48.1	51.7	56.2
Other	44.2	45.1	46.8	47.4	48.5	49.2	50.5	51.8	53.1	42.7	46.9	51.2
Contributions for social insurance	13.3	13.6	13.9	14.2	14.5	14.9	15.3	15.7	16.1	12.8	14.0	15.5
Grants-in-aid from Federal Government	45.5	47.7	49.4	49.5	53.7	57.0	58.0	59.2	60.2	43.7	50.1	58.6
State and local government expenditures	214.4	220.3	226.4	233.3	240.9	247.8	254.7	260.7	265.7	206.0	230.2	257.2
Purchases of goods and services	199.6	204.6	209.6	215.6	222.6	229.6	236.6	242.6	247.6	192.4	213.1	239.1
Transfer payments to personnel	21.4	22.2	22.9	23.5	24.2	24.8	25.4	26.0	26.6	20.2	23.2	25.7
Net interest paid	-1.5	-1.5	-1.6	-1.8	-1.9	-2.1	-2.2	-2.4	-2.5	-1.5	-1.7	-2.3
Less: Current surplus government expenditures	5.0	5.0	4.5	4.0	4.0	4.5	5.0	5.5	6.0	5.0	4.4	5.3
Less: Wage accrual less disbursements	0	0	0	0	0	0	0	0	0	0	0	0
State and local surplus: NIA basis	-.5	-1.7	-1.3	-4.8	-3.6	-3.1	-4.1	-3.8	-2.6	1.7	-2.8	-3.4

Chairman HUMPHERY. Now, Mr. Modigliani, we are looking forward to your testimony.

STATEMENT OF FRANCO MODIGLIANI, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. MODIGLIANI. Mr. Chairman, I must make a brief apology as I start out. I was asked to appear on only 2 days notice, after having volunteered my services perhaps a couple of weeks ago when I realized that I was so unhappy that I could not sleep at night unless I felt I did my duty to my country in speaking out at this time.

I had hardly the opportunity to look at the two statements which have just been presented, even though I understood my main task was to comment on the figures before us, in the sense of, are they credible? What do they suggest in terms of what we should be doing? So perhaps my testimony will be a little rambling, and I hope you will put up with me, and that you will raise any questions you feel like raising in the process.

Chairman HUMPHREY. I hope you will feel perfectly free to comment upon the administration's policies, and not only the statements that you have heard today, but also any personal suggestions that you want to make.

Mr. MODIGLIANI. Thank you, Mr. Chairman. Indeed, I am glad you invited me to comment on the administration's program because I think that is an essential starting point. I do feel that the administration's program is unacceptable in terms of its targets, and besides beyond that, it is even grossly inconsistent in terms of the targets that have been set.

As a matter of fact, let me put the following question before you. Suppose that you had asked a competent economist to set up a program for the American economy which would accomplish the following set of goals: Be sure that the rate of inflation increases; be sure that the contraction is extended and made deeper; insure that the budget deficit of the Government is increased; and make sure that the burden of inflation falls on those that can least afford it.

I think such a person, if he were competent, would come up with the following program. He would first of all suggest that you put a heavy tax on some major component of expenditure which has a very inelastic demand, for instance, oil.

Next, he would suggest that you have a deflationary fiscal policy that would return to the public less than you are taking away from taxes. Mind you, the indirect tax is designed to increase prices, but if you want a neutral policy, you return the tax revenue so that you just get the price increase, but you have no further effect on real demand. But to make sure that you get a further contraction, you return only a fraction of what you are collecting.

Next, in order to insure that the role of the Government will rise, you would try to devise a system which would reduce aggregate demand, and then you would try to stimulate it again by various kinds of interventions like subsidies and things of this kind, which would increase the role of Government.

Also, you would try to increase the size of Government by first putting people out of private employment, and then reemploying them in the public sector through a public employment program.

Finally, you would ask yourself who are the people that are most hit by inflation, who are the poorest people in society? And you come up with two groups, the unemployed and the old, and so you would decide that you would raise the price of food stamps or something like that, and you would make sure that social security benefits would not rise enough to catch up with the increased cost of living.

Now, you might tell me that this program that our economist would provide you with has something "deja vu." Yes, indeed, it does sound ominously like the administration's program. Now, I suggest that if you look at this program as I indicated before, there are two things wrong with it. In some cases, the targets are not acceptable, and in some cases it is just sheer incompetent.

I believe that the only one of the targets I have given to the imaginary economist, is intended by the administration—though they would not come out and say it—and that is the target of keeping unemployment high and keeping output low, and this target they would justify on the grounds that that is the only way to fight inflation.

Now, our understanding of the connections between unemployment and inflation, I admit, is by no means a wholly satisfactory one. No one, I think, can claim that we have this completely under control, but all the evidence I am aware of suggests that once unemployment is at 8 percent, if you increase it from 8 percent to 9 percent, you will gain very little in terms of reduced wage increases, and you will gain even less in terms of reduced price inflation because by pushing unemployment down you do tend to decrease productivity. This increases unit-labor cost, and that does tend to increase the gap between wages and prices, so you get little mileage on wage inflation at that level of unemployment, and you get even less mileage, if any, on the behavior of prices.

You will find that the two analyses which have been brought to us from the University of Pennsylvania and by Mr. Evans, by and large confirm this. In the first place, they do confirm the fact that the administration's program is designed—at least so I must interpret it —to decrease output, not increase it. Both Mr. Evans and Mr. Rowe show that if you did nothing at all, you would end up with less unemployment and higher production than if you accepted the administration's program in toto and Mr. Evans explained to us that the reason for this is, precisely, that you give back less than you take—not perhaps in the first year where you have a small net stimulus, but by 1976, that is exactly what you do, so you end up with a negative effect.

They also show that the differential effect on the price index of alternative policies is negligible—except for the administration's oil taxes. In the case of Mr. Rowe's tables, you will find that under the Joint Economic Committee program, which is more stimulating, significantly more stimulating, than doing nothing, the price level ends up slightly lower, and the reason for that is precisely the productivity affect. It also ends a lot lower than under the administration's

program because in the administration's program, you have the huge indirect tax effect which increases prices.

Again, take the size of the deficit. The administration has come out with a $52 billion deficit. I do not think that they are proud of this budget. I am sure that they regard it as an indecent figure, and that they could think of nothing better than to come out before the world with a balanced budget. But here you have an example where it is not a matter of targets, but a matter of incapacity. They would like to have a low deficit, and they end up with a huge deficit. Why?

That is the result of the policies pursued in 1974 and those which are foreseen for 1975. If, in 1974, we had not pursued a crazy monetary policy, if we had avoided the terrific midyear squeeze by not having the fetish of that 6 percent money supply, for which to some extent this committee is responsible—I want to make clear that you yourself have at times encouraged this foolish notion that there is such a thing as a correct rate of change in money supply which is good for all seasons.

Chairman HUMPHREY. Not this Member.

Mr. MODIGLIANI. You are absolutely right. I think Senator Proxmire has some responsibility and Congressman Reuss, although now Congressman Reuss says at least 6 percent. At least 6 percent is a different speech. I am not sure that I would be willing to have any precise target, but at this moment one less than 6 percent might not be so bad.

Now, that tight policy is largely responsible for where we are today, and let me quote, if I may, from a document of the administration, the Economic Report of the President. I am quoting from page 41, where it says:

> In the spring of 1974 there were signs that the housing downturn might be coming to a halt.

And indeed, there were.

> The recovery was aborted, however, when market interest rates turned up again, reaching historical highs in July and August. Outflows from thrift institutions were heavier and lasted longer than they had in 1973, * * *, and starts fell to an average of 989,000 units in the fourth quarter. The large overhang of unsold units contributed to this.
>
> Housing accounted for fully half of the decline in real output from 1973 to 1974 and was the only major sector to decline throughout the year.

And now, if you allow for multiplier's effect which you have heard before, that is if you reduce one expenditure that reduces income, which reduces consumption, reduces investment, you get easily to the whole of most of the actual decline.

There was some weakness in consumers' spending, that was induced by the monetary policy because I believe—and many by now believe with me—that consumer spending, particularly in durables, is significantly affected by the stock market, and the stock market was sent into a spin by the fiercely tight policy.

Thank God I am on record as having warned the Fed before this happened: "If you will stick to 6 percent, you will not be able to achieve the goals of the administration. You will end up with heavy unemployment."

They did not listen to me. That is exactly what happened.

Chairman HUMPHREY. Did they not go below 6 percent?

Mr. MODIGLIANI. You see more recently—this is an interesting issue —of course, the money supply has increased a lot less. In fact, right now it is declining.

But, I want to make it clear though that there is a real difference. The present decline in money supply is accompanied by sharply falling interest rates, and while it may be desirable to have interest rates fall even faster, I am not feeling that the present policy is one —I would not call it a tight policy. Perhaps it is not loose enough, but it is not a tight policy.

The real tight policy was when the money supply was rising at 6 or 7 percent. That was not enough for an economy in which prices were rising at a faster rate and in which you had to have interest rates come down, not up. In that situation 6 percent was wrong and 6 percent in one quarter is absolute madness. To insist that in any one quarter it should be that, and you do not let interest rates go through the ceiling on that ground, is absolute, sheer madness, especially if you happen to know something about the reliability of those data.

I happen to be on a committee of the Federal Reserve to advise them on statistics, and I am telling you that the inaccuracy of that measuring rod is substantial. Now you know what that means in terms of one quarter change at annual rate? An error of but 1 percent in two successive quarters, if in opposite direction will mean an error of 8 percent in the quarterly growth of the money supply.

Once the monetary squeeze got the economy down, taxes declined, and even if you have the same expenditure, unavoidably you get large deficits. Now, I maintain that to some extent the program that is being suggested for 1975 and 1976—but mostly 1975—also leads to more tax deficit than you need to have.

Why? In the first place, the program involves continuing a tight policy. I will come back to this because that is an open question, but I believe it does. This will keep discouraging investment and housing, and then you subsidize them to prevent them from falling too much. Well, that is costly. You increase government expenditure if you subsidize housing. And you decrease the receipts if you are reducing taxes to encourage investment.

Similarly, take the tax cut. We have a fair amount of evidence suggesting that if you give a tax cut, the stimulus you get per dollar of tax cut is greatest if the tax cut is permanent and it is smaller if it is transitory. A transitory tax cut will eventually lead to higher expenditure, but it will be slow to come in so the initial impact is small. But that is exactly what the administration does.

Most of its net tax relief would be in the form of a cut which is stated to be transient, just once, and therefore per dollar of deficit, it will give you the smallest stimulus you could have.

Now, I could go on with quite a list of places where there is an absolute inconsistency between the administration's targets, as I understand them to be, and the policy which has been chosen. For instance, the shift of employment toward public employment, of course, is not intended. What they really intended to do initially was to have a policy which would defeat inflation. What they got was a lot of unemployment, and then they turned around and absorbed

those people in public employment. Again, that is costly, and that makes the Government sector larger instead of smaller, which is just the opposite of what they want to do.

To summarize, then, what is wrong with the administration's program is in the first place its targets—especially the unemployment target. I believe the targets are unacceptable to the American people and that therefore they should be unacceptable to Congress, and I believe you have to do something to change them—mind you, when I speak of targets, I am not speaking as an economist. I am speaking as a human being. The second thing wrong is the inconsistency between their own targets and their policy. Here I am speaking as an economist and as I have tried to show by a few examples, that program is full of inconsistencies.

That leads us to the question of where we should go from here. Let me perhaps say first a word about the energy, because these two gentlemen have said little about it except to say that the present program of the administration is unacceptable insofar as it has the effect of producing a large increase in the rate of inflation. They have then moved on to your program, which program does not include anything for energy. Now I would like to say that I am not quite in favor of ignoring the energy problem. I do believe that something has to be done about energy. I do believe that——

Chairman HUMPHREY. Might I just interrupt to say that the reason it did not include anything on energy, we just have not gotten that far yet. I agree with you that it has to have an energy factor.

Mr. MODIGLIANI. Let me make a couple of suggestions on that.

Mr. EVANS. Let me say one thing. My remarks have a fair amount about the energy policy, which I think would be appropriate, which I did not mention.

Mr. MODIGLIANI. I am sorry. I did not get your statement, Mr. Evans, until now, so I have not had a chance to study it. Now, let me say about energy, I can see no sound foundation for an import duty of $1, $2, or $3, and I am glad that the Congress has for the moment scotched that attempt. It is, of course, sensible for us to try to reduce dependence on foreign oil, and I believe under present circumstances that is an acceptable goal, but the way you do that is essentially by encouraging domestic production in a variety of ways, and eventually, you might want to discourage consumption more, but I believe that nobody can suggest that at current world prices, we might not get close, fairly close to independence in some time.

Hence, there is no point of depriving ourselves of this imported oil until we have expanded production. Now, it may be sensible if you want to raise prices, if you want to guarantee a return, it may be sensible to announce a schedule of future rises, which would induce people to take steps and fast. But to slam this high tax on them now seems to be quite unnecessary and without sense. I believe Senator Humphrey has a ccpy of a little piece I wrote for my neighbor who kept asking me questions about the administration's program.

In this document I explained to him that the purpose of this tax is to cut off oil imports now by 1 million barrels because if an embargo comes, we will have to do it later. That I think is the logic, and I explained to him, it is just like a doctor who would tell a heavy smoking patient: "Have one of your lungs taken out now because it might get cancerous, and you might have to take it out later."

On the other hand, I do believe that our current posture does subsidize consumption of oil; that is, it does lead us to a consumption of oil which is inconsistent even with the present world prices. How does it do that? The control we now have on the oil industry means that a certain amount of oil goes into the distribution channels at the price lower than the world price.

I would be in favor of decontrolling the oil industry. I want to make clear that I am really a great conservative. You should not think I am any kind of radical. I think of myself as quite conservative, and it is just the point that even a conservative has a stopping point when it comes to the administration's program.

So I believe in decontrolling energy, and I think that the way it should be done is, in effect, by a combination of decontrol and a tax on excess profits, much like the President has suggested. That portion of the program is good. But I am recommending that you take the receipts from that tax, and use it to reduce other indirect taxes. If you do that—and we still have a fair amount of indirect tax collection enough to offset the excess profit tax revenue. If you reduce other direct taxes these two effects on the inflation would cancel out; you have something which raises prices, something else which reduces prices. You are moving demand away from things which are scarce, and we do not want to import, to things we can produce in abundance, like telephone services and the like, and that would have nothing but a healthy effect on the economy.

This then is the essence of my energy suggestion. Of course, there is a longer run problem, which I do not have time to get into, the question of whether you guarantee prices or whether you subsidize producers. I am just talking about the short-run program.

Let us now look at the stabilization program. It seems to me that we need now quite a hefty cut in taxes, and I am going to suggest a somewhat variant program of tax cuts other than the usual monotonous suggestions, I shall make a variety of suggestions. All of the numbers I am going to mention are really big. I am going to tell you that your $20 billion tax cut is insufficient, and that your combination of 20 and 10 is insufficient at the present time.

Chairman HUMPHREY. Insufficient?

Mr. MODIGLIANI. Insufficient.

Chairman HUMPHREY. Even though it is substantially larger than others?

Mr. MODIGLIANI. You need something substantially larger, absolutely.

Now, in order to justify this, let me for a moment explore with you the magnitude of the stabilization task that confronts us. We have now something like between 8 percent and 8½-percent unemployment. We do not know exactly. Last month, it was 8.2 percent. It is rising rapidly. It is probably somewhere not far from 8½ percent. It will certainly get there by the end of this quarter.

Suppose now that we ask what is a prudent unemployment target at which we can aim? Well, there can be some argument about this, but I am going to suggest a very conservative one. I am going to suggest that you are absolutely safe if you aim for a target which is on the low side of 6 percent. That is not my final target. It is an interim target which is chosen to be absolutely on the safe side in terms of inflation. How do I choose that number?

Well, I will tell you how I choose it. It basically comes from a certain picture in the Economic Report of the President, on page 95, lower panel which shows the relation between price changes and the rate of unemployment, adjusted for composition. Because the composition of the labor force changes over time, the full employment-unemployment changes too. To avoid this problem, the lower panel uses the well established technique of relying on an unemployment adjusted for labor force composition. Now the lower panel shows that in every year in which unemployment adjusted was above 4.8, inflation declined; that is, the rate of change of prices was less than the year before—unless inflation was negligible to begin with, in which case it did not change appreciably. There were 11 such years—omitting the Korean war period—and this conclusion holds for every one of them. Note that in 1974 inflation rose sharply, even though unemployment was on the borderline, 4.8 percent; but is well known, this result was due primarily to oil, imports, et cetera, and not to excess demand pressure.

Since an adjusted rate of 4.8 percent corresponds currently to an unadjusted rate of roughly 5.6 percent, I conclude that if you set your interim unemployment target at 6 percent or even a shade below, you are absolutely safe, for you can count on inflation to keep falling all along on your way to the target, and still be falling when you reach the target.

Now, suppose then we take aim at the low side of 6 percent. That means that with unemployment currently at 8½ percent, we have a gap which is at least 2½ percent. That gap, by a well-known empirical law known to economists as Okun's law, implies that the GNP gap is near 7 percent. But that figure is too low at this time because in the last year we have had declines in productivity instead of growth, because output was declining, and perhaps for other reasons. It is to be presumed that some of that loss of productivity would be made up. So I think that you can count on having a gap which is at least 8 to 9 percent. I am proposing a program which would get us back to the short side of 6 percent in 2 years. By that time there will be another 7 percent growth of potential output because potential output should grow at least at something like 3½ percent per year. Now, if you take 8 and 7 percent, you get at least 15 percent as the gap to be made up in 2 years.

For the first year, 1975 in particular, the gap is at least 10 percent and that, gentlemen, at today's prices means $150 billion. This just gives you an order of magnitude.

Now, we know that a tax cut, even of the permanent kind, not the transient kind, will give you an intermediate effect, that is, a 2- to 3-year effect, which is on the order of $2. That is, per dollar of tax cut, you get something on the order of a $2 increase in income. It may be a little more or a little less. That depends in part on what monetary policy you are pursuing. But if you pursue a policy that is not particularly helping the tax cut, all you get is something on the order of $2.

By this token, I would conclude that the tax cut you need is $75 billion, not $30 billion. And mind you, I could argue that even this figure is conservative because it would not have an immediate effect,

so that even the target of recouping gradually would still be satisfied. The response reaches a peak of about 2 in about 3 years, and the first year impact is not much over half as much as the final, so you would get there slowly.

Still, I am not going to suggest this figure because I also would like to be on the safe side, and I would like to move with deliberate speed, but not too fast. Also if you made this tax cut permanent, it would probably be too large in the long run. It would be justified now, but not later, and I do not think there is much point in having ups and downs in the tax rates. And we do not want to fine-tune—as Mr. Evans or Mr. Rowe also suggested—so we want to keep a certain margin of safety.

Now, what do I then suggest? Well, just for an order of magnitude and for your thinking—and remembering that I did not have sufficient notice to study the matter and speak with finality—my order of magnitude would be a tax cut of about $40 billion.

Now, in what form? Well, I would recommend that perhaps half of it may be more or less in the form that it is now proposed by you, a $20 billion permanent tax cut, and I would suggest that you give serious consideration to a different kind of tax cut, which I know has been discussed and I know creates problems for you, but let me put it forward again; that is, a reduction in social security taxes.

Why? What are the advantages? Let me elaborate. If you reduce social security taxes to 7 percent from the present, I think, 11.3 percent to 7 percent, that would give you a little over $20 billion reduction in tax take. But, why social security? Well, there are really a number of reasons why this is a very attractive approach.

No. 1, it does go to people in the lower income brackets, because it is only levied up to a certain level of income, so the tax cut goes the way you want.

No. 2, it has the feature that you are giving something to workers and something to business—in fact you are giving half to business, which then shows up in a lower unit labor cost and therefore in lower prices. So with that tax you have an advantage, that half of it stimulates demand, and the other half reduces the rate of inflation. One other advantage of this tax is that you could make it temporary, and this would not be a disadvantage, and might even be an advantage. Let me explain what I have in mind a little more precisely. In fact, let me connect it with another suggestion.

I do know that you gentlemen have had difficulty with any such kind of tax cut reduction in any social security contributions—on the ground that social security is a contributory system. People contribute to it, and the people of this country do not want to feel that they are retiring on the subsidy of the Government. I understand that quite well.

But when there is a will, there is a way, and let me suggest a couple of alternatives. You could very well reduce the employees' taxes through the form of the income tax, but precisely matching what social security would do so you do not have to say, you reduce social security. You say reduce your income tax, but in exactly a matching way. And you could rebate the tax to employers but not calling it a reduction of social security taxes, but inventing a new name. Call it a

special employment subsidy, employment encouragement, I am missing the word now. Let us see if I have the word here.

Chairman HUMPHREY. Incentive?

Mr. MODIGLIANI. Incentive, exactly. employment incentive tax. You could reduce those taxes, calling it an employment incentive tax, and you could have exactly the same amount. Now, if you make that temporary, that does not make it less effective. It makes it more effective because employers know that if they employ people now, while the tax cut is temporarily in force they can have them cheaper than later, so it will pay to produce things now rather than postpone hiring. So, for this tax cut—its temporary nature increases the power rather than reducing it.

Finally, I support the investment tax incentive program, because I am just uncertain that the Federal Reserve can ever pursue a monetary policy sufficiently encouraging to investment. So to be sure, let us have that program. I would rather have it in monetary policy, but let us not take a chance, so I would go along with that.

I would further keep aside a little money for the housing sector, where I would like you to think in quite different ways than in the past. But, since that is connected with monetary policy, let me try to look first at what should be done with monetary policy.

It is my view that at the present time, we need to pay attention to interest rates. I am not going to say whether I always think that. I frequently do, but not always. Right now, that is what we need to concentrate on. I think the mistakes of last year came from the fact that the Fed was looking at the money supply instead of looking at what really bites the economy. No one, no one except a few fools perhaps on Wall Street are directly affected by the money supply, but people do pay higher interest rates, people do have to pay higher mortgage rates, and that is where monetary policy bites, not through the change of the money supply.

So now I suggest that the Federal Reserve should be, in any possible way persuaded that interest rates should be pushed down to something lower now, as they are in Mr. Evans' simulation. They should be something below 6 percent, and then be kept to a level in the order of 6 percent for a while, not forever, please, but for at least the next three or four quarters. I would say at least the next two or three quarters, but why do I have to commit myself to the fourth quarter? We get there when we can think about it.

In the meantime, that is what we need. Now, where do we get 6 percent? Well, that number comes out of a very simple calculation. In the situation where we have ceilings or thrift institutions, and nobody is dreaming of moving them, it is extremely important to look at the relation of those ceilings and short-term market interest rates, because those control the inflows into the thrift institutions and control the fortune of the housing market.

I do want to make sure that most people have no significant incentive to invest in things other than deposits at savings and loans and thrift institutions. At 6 percent, there will still be some disadvantage, but it will be negligible, and I am willing to pay that much price.

Both simulations you heard before us have an interest rate which having hit something like 6 percent in the second quarter rise gradu-

ally as time goes by to 7½ percent. Now, I think there is no great reason to allow that rise—at least, I do not see any reason at this time.

At the same time, I believe that these gentlemen are much too optimistic in believing that those rates would ever materialize, because both people are assuming a growth in the money supply which is on the order of 8 or 9 percent. Now, in the first place, I doubt that that rate of growth is sufficient to give you those rates—but there I may be wrong.

But second and more important, I am quite convinced that, as the Board of Governors of the Federal Reserve System is now composed and now operating, we will not get 8 or 9 percent money supply growth, that as we make some efforts to push the economy up and as income is expended, we will find that they will sit on their 6 or 7 percent, and they will create a new credit squeeze, which would turn the economy around. And let me say I hope this time, my pessimistic forecast proves wrong because I made some before this committee which proved right. If that happens, we will have exactly the repetition of the 1958–60 episode, where the economy begins to recover, the Federal Reserve slaps on the brakes and we get right back into recession as in 1960.

Chairman HUMPHREY. Why does not the Federal Reserve learn something? Excuse me, I did not mean to interrupt your chain of thought.

Mr. MODIGLIANI. This is a very good point. Let me try to dwell a moment on this situation. Let me first point out that if we in fact follow the fiscal policy I have suggested, and if we in fact maintain an interest rate of 6 percent, which is the condition for those policies to be fully effective—because if the Federal Reserve lets interest rates go way above the ceiling, then that policy will fail—we may need hefty increases in the money supply. I think they may well have to be above 10 percent in some quarters.

Now, is that a crazy figure? I maintain it is not. I told you before that you have a GNP gap on the order of 16 percent. In 2 years—supposing we want to smooth it out evenly—that would call for a rate of growth of 8 percent this year, which I believe is not excessive, if you start it from the second quarter—8 percent rate of growth. Prices are going to continue to rise. You take the simulations; no one dreams that in the course of this year, the rate of inflation will be appreciably less than 8 percent. No matter what you do with unemployment, even under the Ford program that is designed to maximize unemployment, it is the same thing.

Now, 8 percent for real growth and 8 percent for price increases makes 16 percent. That means the money supply will have to grow on the order of 16 percent—a little less because income rises a little faster than money supply—but it has to rise on that order of magnitude. What I am really saying is not that the Federal Reserve should be told make money rise at 16 percent, but should be told look at interest rates, and if it rises at 16 percent for a quarter or two, just keep cool, just let it go. That I wish could be said.

Now, to come to your question; unfortunately, as I explained to my neighbor, the reason for that is that we are in the hands of a sect called the monetarists, whose Mecca is the Windy City. As I put it, these people have some simple axioms. Money income is proportional

to money. Real income and employment are independent of money. They just depend on the physical and technological nature of the economy, and you always have full employment, except for a few lapses, which, of course, are due to the Government messing with the economy. If the Government just stayed out of it, there may be a little deviation, but fundamentally you will always have full employment, and the Government of course should be taken out of the business anyway.

Therefore, since real income is always rising on its full employment path it rises at 4 percent a year, and if you have prices constant, money income must rise 4 percent a year. But if you want monetary income to rise at 4 percent per year, then the money supply should rise at 4 percent per year, and that is what I call their first and only commandment, Thou shall never countenance M1 to rise at more than 4 percent per year.

Now, that is, I think, the essence of what is happening, and if you try to reason with them, that right now output should not rise at 4 percent because, due to the Government's meddling or due to your own meddling, the Federal Reserve meddling, or for any reason, we have a tremendous gap, and we must grow a lot faster, and that you should let money grow faster, what they would answer, as I told my neighbor is this: Never let the devil tempt you into using your commonsense, for if you let the money supply rise more than 4 percent—say 15 percent—for a quarter, you may forget to turn the faucet down later on, and the money supply may keep growing unnoticed at 15 percent forever, and then prices would grow at 11 percent, and how would you like that?

Now, that, Mr. Chairman, is the only way I could really rationalize that position, and I do believe that the position of their leader, Mr. Friedman, is fundamentally this: It is fundamentally that we get the money supply on the target of 6 percent and let the economy adjust it, and if you are patient enough, after the unemployment has gone maybe to 15 percent and after 20 years, the economy will adjust to it. It may also wiggle around a bit—that is also possible—but all you do is you just sit tight and wait.

That seems to me to explain their policies—the fear that anything else you do, you might not do perfectly, and therefore it should not be done. Now, I do believe that it is essential that we get monetary policy to behave sensibly or we shall have another real debacle soon. I believe that right now the money supply is declining for reasons that are complex. In part, money is declining for reasons we do not fully understand. There seems to be a decline in demand for money which makes it possible for money supply to decline and interest rates to decline too, which is somewhat surprising. But I do believe that in the coming two or three quarters, it will be impossible to keep interest rates where they are without a large expansion of growth of money, and that is where the Federal Reserve must be told that we shall not tolerate a repitition of 1974.

Chairman HUMPHREY. When you talk money supply, how do you define that?

Mr. MODIGLIANI. Well, for the purpose of this discussion, I had in mind currency plus demand deposits—so-called M1. But what I told my neighbor when he asked that same question was: Don't bother me

with what they mean by money supply, because the sect has many different designations which they commonly call M1, M2, M3. That is very useful because you can always find one of them that will fit whatever argument you want.

Chairman HUMPHREY. Yes, we had that argument here the other day.

Mr. MODIGLIANI. I am sure you did. I am sure you will find that right now, Mr. Chairman, the monetarists are using M2, because right now M2 has been rather stable in relation to income, and at other times their chief representative, in terms of publications, the St. Louis Federal Reserve has many times said that M1 is the most stable. But right now M2 is in fashion because it fits the argument. It might become M3, it might become M4. It just depends on how things turn out.

Chairman HUMPHREY. Well, what does it mean for the average guy. I mean, when I hear money supply, what are you talking about?

Mr. MODIGLIANI. What do you mean when you say the average guy?

Chairman HUMPHREY. The fellow that wants to buy a house. The man out there that is a small businessman, and somebody tells him the money supply is tight, what is he supposed to know that means?

Mr. MODIGLIANI. It means he has to pay 10 percent for a mortgage if he can get the money. So that is what tight policy means to me——

Chairman HUMPHREY. You know I was originally a pharmacist and if somebody asked me what it was that was in an aspirin tablet, I could tell them that it was acetylsalicylic acid. Now, what is in the money supply?

Mr. MODIGLIANI. You mean why do they care about the money supply?

Chairman HUMPHREY. I mean what ingredients are in the money supply?

Mr. MODIGLIANI. Well, M1 consists of the set of instruments that we use to make payments: Currency demand deposits.

Chairman HUMPHREY. Is that the commonplace definition?

Mr. MODIGLIANI. That is the commonplace definition. That is indeed the definition. Now if you want to go to the details, it will take about five pages to tell you how that is computed.

Now, if monetarists in the street think that the money supply is a straightforward number that you get, that just comes out, I wish they went through the tabulations that the poor guys at the Fed have to do to come up with the number. There are literally dozens—I do not know, 20 or 30 adjustments—you have to subtract this and add this and wonder about whether this number is correct, and so back and forth.

There are besides peculiarities like the fact that the money supply now includes the amount of money held by foreign central banks. You know, foreign central banks hold money which has nothing to do with transactions in this country so you have all kinds of strange definitions. But the notion itself, the notion is clear. The reason why M1 affects the economy is fundamentally, mind you, because it controls interest rates which in turn controls spending.

I do not believe that money has any direct effect upon spending, and of course the monetarists themselves, you will find, have two

answers for that. To the laymen they will tell, look you got more money, you spend more. It is as simple as that. You spend more, prices go up, that is very simple.

When, of course, they are in the academic world they have a complicated story. But I had the opportunity of seeing Professor Friedman at work as a consultant to the Federal Reserve and going through complex contortions on several occasions.

He would say the circumstances today are very special, you have this, and that and therefore, this quarter the money supply should rise 4 percent. The answer is always the same; the story is always different.

Chairman HUMPHREY. All right. Can we——

Mr. MODIGLIANI. Let me just have a moment to finish. I have essentially two more points. One point is that the other aspect of monetary policy that is important is to remove ceilings or at least raise ceilings on savings and loans and mutual saving on various kinds of deposits. That would be extremely helpful right now when interest rates are low. Extremely helpful in order to enable these institutions to compete for funds and help channel the funds into housing.

Now I believe, however, that you will have to pay attention to a longer run reform of that sector which, in my view, would consist in reforming the mortgage instrument. It would consist essentially in enabling these institutions to meet market competition while somehow compensating them for the fact that in the past we had forced them to invest in low interest rate assets such as mortgages when they were, say, 5 percent.

And if you like at some other time, we can discuss this aspect. But I think a little bit of the money you have available to stimulate the economy—of the money we want to return to the economy—ought to be used in this market intelligently.

Finally, let me just say that I would also be quite opposed to a resumption of price controls. I happen to have testified before this committee with this position just before the wage-price controls were imposed. I was appearing with Galbraith who advocated them. I explained my reasons for being against them. I think that the experience we have had with them shows that price controls are impractical except under extreme emergencies where you have patriotic reasons to make them work. Otherwise, they would not work. Particularly in an open economy as we now have in the United States. It just would not work.

I wish we could in some way have wage restraint, we could persuade everybody that higher wages will not give people higher purchasing power, they will just get higher prices. So, wage restraint is, in effect, not punishing labor; it is just preventing the wages from rising and prices from following at the same time.

It is very hard to have such a program, I think, if you want to have any kind of restraint or direct action of the kind, it ought to come through tax incentive programs. It ought to come through a tax that punishes too high settlements of wages or which punishes too high increase in markups.

That possibility exists and I wish, if you ever have a temptation to have wage and price controls, you will ask me again to tell you more about that.

Chairman HUMPHREY. Thank you, Mr. Modigliani, for a very enlightening discussion.

[The prepared statement of Mr. Modigliani follows:]

PREPARED STATEMENT OF FRANCO MODIGLIANI

The life of an economist is a difficult one these days since friends and acquaintances hail you with digs about economics and with demands for explanation, as if you were responsible for the whole mess. Last night I saw Jim, my next door neighbor, while we were shoveling snow. He had read about the President's program and wanted me to explain what it was aiming at and why. I am recording here our conversation so that I can use it again.

"To comprehend the administration's program," I started, "you must appreciate its priorities. Judging from official statements, I would say that the administration's top three targets are: To achieve a reduction in inflation not only in 1975, but also in 1976 and beyond; to bring the recession to an end so that the growth of output can resume and unemployment can be reduced; and to adjust the economy to the higher cost of fuel and reduce oil imports as energy security requires. Other goals include reviving residential construction activity, encouraging investments to relieve capacity shortages and to increase productivity, stopping the erosion of the private sector by the public sector, instituting sound government finances and strengthening international ties, recognizing that what economic policies we pursue affect the economies of other nations."

"Well," said Jim, "this sounds like an excellent set of goals. But I am interested in some concrete targets. Take inflation, for instance. How much are they aiming to reduce it next year?"

"You must remember that inflation was quite high this past year, about 10 percent. If they succeed in hitting their target, inflation will be 11 percent in the coming year."

"But that is an increase, not a decrease. How is that possible with all the unemployment and idle capacity we have?"

"You are right that the unemployment would tend to reduce the inflation, but the administration is expecting to achieve its 11 percent by levying $30 billion of new taxes on oil and other sources of energy; that is a hefty amount, about one and a half times as much as all the excise taxes we are presently collecting. The administration figures that this will add some 2 percent to the rate of inflation, and most other economists think it will add even more. So, with that kind of tax, they should have no trouble meeting their 11 percent target."

"But why do they want to put all those taxes on oil?"

"Oh, it is quite simple—in order to reduce imports by 1 million barrels per day right now. And that is very important because one cannot exclude altogether the possibility of an oil embargo—and in that case we might have to reduce oil imports later on."

"I don't quite get your explanation."

"Oh, that's because it is a very sophisticated policy. Can't you see how a prudent doctor might prescribe to a heavy smoking patient to have a lung removed right now because, should it ever get cancerous, it would have to be removed later on anyway."

"While I think this out," said Jim, "would you tell me by how much they are aiming to reduce unemployment next year?"

"Again, you must remember that unemployment was quite high at the end of 1974, about 6.6 percent on average in the last quarter, and that one cannot change unemployment very fast. But the administration counts on getting it to 8½ percent by midyear, and to an average of over 8 percent for the year; they are well on their way to achieving this target as unemployment has already reached 8.2 percent."

"But that seems to be going in the wrong direction. How did they ever arrive at that target?"

"Well, that is related to the goal of resuming the growth in output. In 1974, output had the worst decline of the postwar period, somewhat over 2 percent. But for 1975, the administration is planning to beat that record by targeting a 3–4 percent decline."

"But how did they reach that target? It sounds terrible, and surely there must be a very good reason for the choice."

"Indeed there is. But if you really want to understand it, you must follow me for a moment into the intricacies of economic theory. You see, the administration now is under the spell of a sect of economists known as The Monetarists, whose Mecca is the Windy City. The Monetarists have a rather simple creed which can be summarized to a good approximation with the following four axioms: (1) Money income is proportional to the quantity of available money (don't bother to ask me what they mean by money, because they have different definitions which they colorfully call M_1, M_2, M_3 and M_4; and this is helpful, for having some choice, they find it easier at every occasion to pull out the one definition that fits their axiom). (2) The economy is always at full employment except for negligible lapses to which no attention should be paid, especially since they are invariably caused by the meddling of government. And one of these days, they hope they will get rid of that. (3) At full employment, U.S. output rises around 4 percent per year; therefore, if the price level is to stay constant, money income must also rise 4 percent per year. (4) The stability of the price level is the most important objective and the one to which all others must unconditionally yield. Combining axiom (4) with (1), one reaches the sect's first and only commandment: 'Thou shalt not countenance M_1 to rise more than 4 percent per year.' More recently, however, the sect has been infiltrated by some heretics who have maintained that because of the increase in the prices of imported goods, like oil, it may be appropriate to make a brief exception and let money rise by 6 percent, and in fact even a trifle more, to allow for the administration's $30 billion tax on oil. Now, if the money supply growth target is 6–7 percent, it follows from axiom (1) that the administration's target for money income growth must be set at about 7 percent. But, since the target increase in prices is 11 percent, the target change in output works out to a decrease of 3–4 percent. Are you with me?"

"Well, frankly I am somewhat baffled. I should have thought that one would arrive at a reasonable target for income, and then derive from that the appropriate target for money growth."

"You have a point there, and some arch heretics like myself and many others have worked out alternative monetary and fiscal policies which might get us back at least to the same unemployment rate we had last quarter—say 6½ percent—by year end, and reduce the rate of inflation by a couple of points, and by somewhat more in later years. But that would likely require an increase of the money supply well over 10 percent and maybe as high as 15 percent in some quarters. Now, the Monetarists will explain to you that you should *never* let the devil tempt you into using your *commonsense*. For, if you once let the money supply rise faster than 4 percent, let alone 6 percent, you may forget later on to turn down the faucet when you get close to full employment. And money may keep rising, of course unnoticed, forever at 15 percent, and you will soon have prices rise at 11 percent per year. Would you like that? There is only one way to avoid that danger, and that is to resist any temptation and stick closely to the 4 percent rule."

"Is the administration doing at least something to encourage investment?"

"They are counting on the high interest rates that will be brought about later this year by the 6 percent money supply commandment to reduce them by some 10 percent and to reduce residential construction by another 15 percent—which, however, is but a small decline seeing that there is hardly any residential construction activity left by now. Actually their monetary policy would bring about a substantially greater reduction in investment and construction, but they feel that the above reductions are adequate for the moment, and in order to counteract the effect of monetary policy, they are going to give some subsidies both to investment and to housing."

"I don't understand you. If they don't want investment and housing to fall, why don't they pursue an easier monetary policy instead of subsidizing them?"

"The answer is simple—by pursuing their game plan, the target level of investment will be achieved at a substantial cost to the Government. Now, as I have told you before, one of the important goals of the administration is sound finances, and that means doing away with large government deficits. In line with this goal, they have targeted a deficit of $52 billion for 1975, the largest in any peace time year. It would be hard to reach that goal unless they can budget a few subsidies here and there. Another device they are planning to use is to stimulate consumption through a temporary reduction in taxes, the method which is known to yield the largest deficit per dollar of stimulus."

"What about the target of putting an end to the growth of the public sector at the expense of the private one?"

"Oh, that is being accomplished by a complex program of first creating a serious depression so that people get thrown out of *private* employment and then re-employing them in the *public sector* through a Public Employment Program."

"What about international cooperation? Are our policies going to help the rest of the world?"

"Most assuredly. Our unemployment will hopefully spread to the other countries and make a prime contribution to their fight against inflation."

"All this seems dreadful. Is there any chance that things will work out differently from what they say?"

"Well, there are those who suspect that the administration has put out this gloomy forecast in order to take credit if things should work out better. But I believe in their sincerity, and I am confident that provided they can keep Congress from disrupting their carefully worked out program, they may well succeed in hitting their targets right on the head."

"I have a feeling that you are laughing about the whole thing."

"No, Jim. But I am *trying* to laugh. I am too old to cry."

Chairman HUMPHREY. Now Mr. Evans, rather than me asking you any questions at this time, I would like to know if you have any rebuttal that you would like to give in my 10-minute questioning period, and then if there is some time left over I will have Mr. Rowe take over for rebuttal here or comments. Go ahead.

Mr. EVANS. Thank you. I just want everyone to know that we have heard from the great conservative, the self-described conservative here. I did not know we were going to get into all these points that Mr. Modigliani has brought up. I would have had some comments of my own.

Let me cover them very briefly. I would say that I did not agree with a lot of what he said, but there is one point which I am in agreement with and I would like to reinforce it. And that is this problem of high interest rates and the low credit crunch coming back.

I believe very strongly about this. That if the Federal Reserve Board, the Federal Reserve System, is not changed in some way that this is what we are going to have. I think, by the way, that the money supply will grow very rapidly in one quarter or a couple of months somewhere in the latter half of the year.

Just because of technical reasons right now, we have declined the money supply for a lot of technical reasons. One reason is people are shifting from demand deposits to time deposits. This is why M2, which includes time deposits, is still growing. There will be a switch back to demand deposits when the economy begins to pick up later in the year.

So for 2 or 3 months, something like that, M2 will grow very rapidly. I would not be surprised to see it at 12 percent or something like that. And the Fed will recoil in horror and say all the work we did was for naught. And they will say we recanted too soon. This is what we heard after 1970 and 1971 if we only held in there for a few more months we would not have had the problems. So we are going to get the same kind of recantation.

Arthur Burns will whip out a speech about how inflation is a menace to society, and will pass around copies of a book which is entitled "Prosperity and Inflation," which was written some 20 years ago, and so forth and so on. And he will go on and he will put the squeeze on the money supply and we will have interest rates which I am abso-

lutely convinced will be higher than the interest rates which were reached in the peak of 1974 unless somebody steps in and does something about it.

I think this is extremely serious and we have to worry, not only about how to get the economy moving, but how to keep it moving, because we can have a $20-billion, $30-billion, even a $40-billion tax cut, I would not go quite that high, but a sizable tax cut this year is what we need. But if we are going to choke it off next year with restrictive monetary policy, then what is the point of it all?

Chairman HUMPHREY. Is that not the weakness in the administration's program? It is a one-shot deal on tax reduction. Plus, it is a restrictive tax program in the second feature, I mean in terms of the energy part where you actually pay out less than you take in?

Mr. EVANS. That is right. Well, we have a number of people associated with the administration who say we do not want to grow too fast. We would like to see unemployment hang up there. And if you have unemployment hang up there for 5 years, you will get rid of inflation.

I mean, I agree with that. We tried it once; we tried it from 1958 to 1964. The 1964 tax cuts came 6 years too late. There was testimony in 1958 from Congress that we should have a tax cut in April, but President Eisenhower sat there and he said, but wait a minute and let's see what happens for a couple of months.

And sure enough, in a couple of months the economy turned around, and then the administration said, well all right there is your signal, we don't need a tax cut. So for 6 years we had a rate of unemployment which was unacceptably high and sure enough, it wound down inflation. And we went into 1964 with virtually no rate of inflation at all. We had the wholesale price index actually decline; we had the consumer price index grow at a very slow rate, about 1½ percent per year.

So it could be done if we are willing to wait 5 years. I know some members of the current administration who identify with that school of thought and I am obviously not one of them from my comments, but I believe that this is more or less behind some of their thinking, and therefore they are willing to get to a restrictive policy.

Chairman HUMPHREY. Back in the 18th century, they used to have doctors that bled the patient whenever the patient had a fever. And that is the way the barber pole became identified with the doctor. That was at the time when the ethics of the profession permitted you to advertise somewhat, so you had that barber pole out there with the red and the blue and the white.

The red was that you were healthy, the blue that you were practically dead, and the white meant you had expired. I have said facetiously, but also with some degree of conviction, that we ought to put a barber pole out in front of the administration because, while they do not want massive hemorrhage, they would sure like you to drip to death. You know it is kind of a long-term anemia, and I really feel that way.

I feel that this is what is at the heart of much of this problem.

Mr. Rowe.

Mr. MODIGLIANI. Could I make just one comment?

Chairman HUMPHREY. I want to get Mr. Rowe to get in here.

Mr. Rowe. I would, I think, just address a comment to two topics. One is on the general question of approaches to fuel conservation. I think there are really two issues that are important here.

One is if you want to do it through the price mechanism I think some sort of approach using the price mechanism is needed; in the long run it is the only viable solution. If that is the approach you want to take you have to look at where price elasticity is the highest. Where can we really conserve and expect response to price increases.

Second, I think you have to look at the question of where do you get the least secondary and tertiary impact on the industrial process. I think on both of those issues the place where you want to try to conserve fuel consumption is at the gas pump.

Now in terms of trying to do this by the price adjustment mechanism, I think Mr. Modigliani's suggestion is a good one; that is, to have an excise tax on gas offset by reductions in other excise taxes.

Now the fact is that we do not really have extensive general Federal excise taxes. There is a great deal of excises at State and local levels, but there are administrative problems in coordinating that sort of an effort. At least one possibility that has occurred to me and that I have been mulling for 6 to 9 months is the possibility of introducing a sliding increase in the excise on gasoline, one which will encourage people to move to more efficient cars and so on, and have this excise set up in such a way that there is a direct corresponding rebate of, let us say, a fixed dollar payment per exemption.

We need a way that returns proportionately more to the poor than to the rich, because after all it is the poor who will be hit the hardest by an increase in the price of gasoline. But in essence, make the package not just one where you have parallel proposals that are passed separately which in some sense we say are offsetting.

Make, in fact, the single piece of legislation set up so that by law any collection from the gas tax will be directly and almost immediately, or as immediately as is administratively possible, returned to the public in the form of lump-sum returns of x dollars per person in such a way that the revenue impact is zero.

So that is a comment on that.

The comment on housing, to my mind what we have done in this country on housing is a very classic example of good intentions leading to bad results. In essence, we have passed legislation that has, in effect, given tax advantages to savings and loans in exchange for restrictions on their investment portfolio.

In essence, constraining them to invest a larger portion of their assets in mortgages. Now I think in some sense the goal of promoting a nation of home ownership is a very valuable goal. But one of the things we have seen is that in particular with fixed-rate mortgages where we have savings and loans that have large portfolios of 4 and 5 percent mortgages, when you have cyclical activity and cyclical movements in interest rates, you find that you have actually quantitative restraints on money availability.

The effect of that is to create not just periodic recessions in the construction industry, but wholesale depressions. I mean, we are talking about a fall in housing construction of 2.4 million to 900,000 starts. By any yardstick for that industry, that is a depression. The notion that a set of institutional arrangements that leads to those

kinds of fluctuations in the homebuilding industry is in some sense encouraging to the construction of housing in this country is ludicrous.

I think an important proposal and one that I am always puzzled seems to have difficulty in being supported in Congress, is the notion of allowing savings and loans to have sliding-rate mortgages. The problem which the mortgage institutions face is that they are competing against 10- or 12-percent securities for housing money by trying to offer 5 and 6 percent.

The point is, even if you did not have deposit ceilings, even if you lifted the deposit ceilings, it is by no means clear that would allow the mortgage institutions to compete because with large portions of their assets tied up in 5, 6, and 4 percent interest-earning assets, it is virtually unthinkable that they could make a wholesale increase to 8 or 9 percent in deposit payments. I mean, it is just untenable.

Now it seems to me in some sense that if this kind of legislation is ever going to be accepted there are probably two things that are required. One is that the arrangement be not that the mortgage payment fluctuates, but that the interest versus the principal component of the payment be allowed to vary. I tend to think that is probably a more palatable kind of arrangement for sliding-rate mortgages.

And second, I think the only way it is going to be publicly accepted is if it is introduced when the mortgage rates are high, like right now, so that you do see the fact that it works on the down side as well as the up side.

Chairman HUMPHREY. Why have the mortgage rates not come down appreciably in light of the reduction in the overall interest rate? I mean, for example, the prime rate.

Mr. ROWE. Well, one consideration is the fact that the mortgage rate is analagous to a long-term interest rate instead of a short-term interest rate, and the fact is that long-term bond rates have not come down.

I think the other aspect is that many savings institutions are being very cautious. We are starting to see flows back to the savings institutions, but they have been squeezed repeatedly, and this last time they have been squeezed just about as hard as they have ever been squeezed. It is not realistic to expect the organizations to move quickly back into aggressive mortgage lending when there is at least the prospect we mentioned here that we are going to see another tightening up of money supply and another rise in interest rates. So, I think it is quite rational behavior on the part of mortgage lenders to want to build up their liquidity to create a certain cushion as a contingency against this kind of tight money possibility.

Chairman HUMPHREY. Mr. Modigliani, you wanted to make another comment?

Mr. MODIGLIANI. Yes. Mr. Evans has sort of indicated he has agreed with me and then proceeded to discuss the point on which he agreed. I wish he would discuss the others so I would have had a chance to know. But let me just point out one thing: My recommendation, that there should be a heavier tax cut—on which we had no comment from the two other members—is based on their own results.

If you take a look at Mr. Evans' table 3 of his prepared statement and at the tables attached to Mr. Rowe's statement you will

find that under the Joint Economic Committee program the average rate of unemployment for the year 1976. Unemployment for the year 1976 is 7.9 percent under Evans' simulation of the Joint Economic Committee. Mr. Rowe has been greatly more optimistic. It is as low as 7.6 percent.

The last unemployment figures at the end of the periods are 7.5 and 6.7 percent.

Now I suggest that these are inadequate targets and if you want to get more than that, and I think we should in 2 years get back to at least 6 percent, you will need more stimulus. So that is the basis for my recommendation—it is quite consistent with these two results. I probably would fall in between the two simulations in terms of the implication of your program, which would leave me somewhere in the very high 7 percent with the current program. So that justifies my thinking.

Second, I just want to make a brief comment on Mr. Rowe's reference to the thrift institutions and the housing problem. I happen to think that this is, indeed, one of the longer run, most pressing problems of the country, and on this basis I have directed a preliminary study which has just been completed, financed by HUD, on alternative ways of handling the problem, in particular, how to reform the mortgage instrument and how to take care of the problem of the savings and loans themselves.

And briefly, our conclusions are that the kind of solution that Mr. Rowe suggests; namely, variable interest rates, while better than nothing from the point of view of the savings and loans is worse than nothing from the point of view of the consumers and that there are far better solutions which essentially rely on a new principle we have developed that you can separate the interest rates you charge on the outstanding balance from the interest rate which you use for computing the monthly payment.

And we have come up, for instance, with schemes that the monthly payment grows only if the cost of living rises and yet, the interest rate charge could be the current market rate which would keep the savings and loan and the thrift institutions quite competitive in the market.

It is true, however, that if you do that you will have to do something about the whole portfolio of low-yielding assets that they have and that is why my suggestion came that some of the money which we want to give back to the economy might well be used for this program. But again, if there is a chance we will discuss that further at some other time.

Chairman HUMPHREY. Congressman Bolling.

Representative BOLLING. Thank you, Mr. Chairman.

First, I have a question that I would like each member to answer briefly. If I understand correctly, every member of the panel feels with considerable strength that there should be a substantial tax cut very promptly, quickly, immediately.

Mr. ROWE. I think that is accurate.

Representative BOLLING. There is no argument with that. Everybody agrees.

Mr. MODIGLIANI. Everybody agrees.

Representative BOLLING. That even the emphasis there should be on the hot money kind of tax cut that would get money back. The money would go back into the economy quickly.

Well, this being obviously a key element of what the Congress does, I wanted to establish that everybody agrees on that.

Now, I would like to go off in an entirely different direction. I think each one of these statements has been very valuable. I think it is fine that the chairman decided to have this particular hearing with these particular people and I think it makes a real contribution to what the Congress does. I think that real contribution will be that these eminent gentlemen agree that the Congress ought to move very quickly on a rather simple first step.

The second step becomes somewhat more complicated and I think we can probably face that when we get to it. So I am going to start anticipating beyond that. I have not been active on this committee for a dozen years; however, I was very active until a dozen years ago. Now, I would like to know, as I refresh myself on the work of this committee—what does Professor Modigliani think we can do about the Fed? That is the second thing that keeps coming up. We have got to do something about the way in which the money supply grows, and we have an institution that I have supported in the past because I surely did not want the Congress acting directly on interest rates even on a yearly basis. And in the old days I used to say, if we improved the Board, if it is more representative, if its members do not just consist of bankers, it will be better.

How do we make the Fed more responsive to the realities of the economic situation in a constantly changing economy?

Mr. MODIGLIANI. Congressman Bolling, I have thought about that to a very limited extent, but it seems to me that probably one way you could try to handle that would be by some sense of Congress resolution which would call specific attention to the serious damages, which have been done last year in a slavish pursuit of a monetary rate of growth rule, and which would call on them to at least consider the importance of maintaining interest rates stable in the period in which the stimulating program you are enacting is taking place, say, over the next two or three quarters, say, on the ground that if they do not do that, they are acting against you.

In other words, you simply are saying, "Let our program go through and do not stop it."

What we are risking now is just like a person that gets in his car in a hurry to go home, starts the motor and gets going with the brakes on.

Representative BOLLING. The answer is helpful and I think that may be something that we can do but it is very significant in that you do not suggest we do anything radical about the Fed.

Mr. MODIGLIANI. No.

Representative BOLLING. In other words, you feel that the structure, if it behaved a little better, is about the right kind of central banking structure for us to have.

Mr. MODIGLIANI. Well, Congressman Bolling, I would perhaps make one additional remark on this which I have thought deeply about, and that is my feeling that perhaps at some point it should be said

that the central bank has the duty to enforce the program of the administration. In other words, it should be free to do that as it sees best. But it should not set up a target of its own which is inconsistent with the administration's program.

Representative BOLLING. You do not really mean the administration, do you?

Mr. MODIGLIANI. I mean the administration.

Mr. EVANS. This administration and this program.

Mr. MODIGLIANI. I mean I believe——

Representative BOLLING. Do you not mean the Federal Government, the interaction between the two?

Mr. MODIGLIANI. The economic program of the country however established, and I do believe that at present they are not even in tune with the administration's program and certainly in the past they have done it.

Representative BOLLING. That is what I was curious about; because, a long time ago—I do not intend to reminisce—I had a key role in the ratification of the accord between the Fed and the Treasury. I have always had it a little bit on my conscience and I wanted to be sure that there was a method that we could use currently that might be helpful; and also, that I have not made a profound mistake in that long ago.

Mr. MODIGLIANI. You did not.

Representative BOLLING. Would either of you like to add any comment to that, Mr. Evans?

Mr. EVANS. Yes. Well, I believe William McChesney Martin, when he was chairman of the Fed, was quoted as saying he had never done anything that was against the wishes of the President. I think that the cherished independence of the Fed, which is often referred to probably is not quite as emphatic as he said in the popular press. I believe that in some sense the chairman of the Fed does do what he thinks the President wants him to do.

I think that in this case—well, last year was a little unusual in the sense that there was a change of Executive powers, of course. But in general, Arthur Burns is probably in step with the President and his top economic advisers in the view that we should have a long, painful winddown and that inflation receives a higher rate relative to unemployment than the views of the Congress.

So I think we need not to change the system but to change some of the people.

Chairman HUMPHREY. Change the players.

Mr. EVANS. We had a change in Presidential power once in midterm. I am by no means suggesting another such change, but I do not think the system is rotten, I do not think the system is at fault. I am 102 percent against having Congress pass a resolution that the money supply or interest rates or any prices, for that matter, shall be thus and so. It never worked in the past; it is not going to work in the future.

So I do not ever want to be associated with that point of view. On the other hand, I think that the Fed is still the creature of the executive branch to some degree. And if you have an executive branch that is committed to this painful slowdown, then I do not

know that there is a great deal you can do except to educate the executive branch into believing that we should have a more protracted acceleration of the economy.

Mr. ROWE. It might be just valuable to comment that I think the Congress has already taken steps to undercut what had been one of the strongest traditional arguments for an independent Federal Reserve, and that is to try to get a handle on the whole budgetary process. One of the longstanding arguments is that the Congress really cannot get a handle on fiscal policy by handling it piecemeal, that there is never anybody to look at the total.

One of the most encouraging things I have seen in the last few years is the development of the congressional budget committees, and I hope sincerely that these committees become a genuine instrument for augmenting the congressional impact on overall economic policy. I realize the political problems involved in that and the problems of having to sacrifice individual special interests. Hopefully, however, it will succeed.

Representative BOLLING. Well, as a floor manager of that bill in the House in the last Congress, I agree with you very much and I hope, and I think it is certainly possible, that this attempt to have an overall budget process will succeed. But if it were to fail this time and the country to survive that kind of thing, I am pretty sure that the Congress would either try again or it would not survive.

I think it is fairly clear that if the Congress cannot deal with the Federal budget somewhat in the fashion that the Executive has been dealing with it, that the people are going to discard the Congress as not worth having.

That is an extreme statement but I think it is reasonably accurate. If we cannot deal with our overall priorities in a rational way, and then deal in detail with the macroeconomics and microeconomics implicit in the budget, then I just do not think they are going to put up with us.

I will end on that more cataclysmic note than I intended.

Chairman HUMPHREY. You have raised the threshold of my concern.

Congressman Long.

Representative LONG. Mr. Evans, your description of the philosophical approach toward the economic theories of Professor Modigliani further convinces me that the definition of the word "conservative" or the definition of the words "conservative" and "liberal" are perhaps as widely used, erroneously used, as that of "money supply." Perhaps there are more than four bags when you come to these descriptions because as these things change, we structure ourselves into a particular approach to them. In my opinion, we restrict our ability to come out with workable solutions to them.

A brief comment from each of you three gentlemen. As you know, the Congress has been under a considerable amount of pressure by the President with respect to not immediately adopting his energy policy or not immediately coming up with its own comprehensive economic policy, saying that he has come up with his and he has consequently set certain priorities in the approach that he is using to his.

I feel strongly that what we have done insofar as the congressional approach to it is correct, that this was putting the cart before the horse, adding something on to an already overly imbalanced situation that needed some leveling out rather than going to peaks and valleys, but that in the long range this does lead to the needed approach but that other things are needed to be approached before that was, again, tackled.

I would like the views of each of you. Perhaps, if you would, with Mr. Rowe in that regard as to the setting of the priorities of economic policy by both the Congress and the executive branch, and particularly, your views with respect to the approach used by the executive branch in setting such priority.

Mr. ROWE. That is a very broad question. I am not sure I can address it in totality. I think in my earlier comments I, in essence, agreed with your concern about the problem of peaks and valleys and finding ourselves in a constant up and down.

I think the reason that all three of us agree on the need for a sizable tax cut is what to us is the very obvious and very severe kind of downturn in which we find ourselves. I think, however, at a later time when one begins to discuss the details we might find ourselves in disagreement. But on the broad issue of the fact that we should at this point look for an immediate and significant stimulus has been conbined with the view that we must be somewhat cautious. Once we return to positive growth, then we must realize that we really do not have, I think, either the understanding or, in some sense, the public policy institutions to effectively fine tune this kind of unemployment picture.

Representative LONG. Just going back to the definition of the words "conservative" and "liberals," liberals are often described as being knee jerk. It seems, though, in this instance, we have perhaps a knee jerk conservative approach toward policy with respect to the overreaction in this particular end of the field with the energy remarks.

Excuse me, Mr. Evans. Go ahead.

Mr. EVANS. Well, I think after we get the problem of the short-term tax cut, the rebate plus the permanent tax reduction, out of the way, then we need to consider, as I mentioned earlier very strongly, the problem of restimulating investment through a number of methods such as changes in investment tax credit and the corporate tax rate, and I think we need to map out, at least, a 5-year energy program which has some rationality to it and looks at the totality.

I think that most people are agreed—well, not all, there are some holdouts in the administration—in principle that the best place to reduce our uses of energy is in the area of the automobile. In this sense we need a combination of gasoline tax and horse-power tax subsidy, which, as I mentioned, helps small cars and discourages the sale of large cars.

Representative LONG. By the way, I thought in that regard that your suggestion with respect to setting that out over a long period of time, because it was an excellent one merely because of the fact that you find many of the poorest people today end up with the biggest automobiles and the biggest gas guzzlers. It really would work a very undue hardship upon, for example, the area that I represent and a

half million or so people that I represent in a very poor area of Louisiana.

Go ahead, sir. I am sorry to interrupt.

Mr. EVANS. Then I would also encourage domestic exploration, production of fuels, and I believe this should be done through deregulation. I do not think it should come off all at once, but some reasonable schedule within the framework needs to be worked out, and I do not know exactly what that would mean, whether it would be a dollar a barrel a year or perhaps somewhat more. But steps should be taken in this direction.

The natural gas program has been a complete fiasco, where we have gas prices ranging anywhere from 6 cents an Mcf to $1.50 an Mcf, depending on whether it is interstate, intrastate, old gas, new gas, old contracts, new contracts. It is hard to imagine a bigger mess.

So we need to sit down. That will take a lot of study, a lot of work, and it is not something that comes out in 3 weeks. We do need the tax cut program in 3 weeks, but an energy program needs to take time, and it might take a year or two. But the point is the Arabs, if the Arabs pull another embargo—it happens. You cannot plan in advance for a total embargo. We can plan in advance for a rational energy program which, as I said, would take us at least 5 years and that seems to me to be the very important work of the Congress over, certainly, the rest of this year and possibly extending into next year as well.

Representative LONG. That would be the order on which you would set your priorities for the overall economy.

Mr. EVANS. Yes. First I would get the economy going, and then I would make sure we have enough capacity so we do not get it choked off, and then I would set out to reordering our longer term needs for the energy area.

Representative LONG. Thank you.

Professor Modigliani.

Mr. MODIGLIANI. Well, I would say that I largely agree with Mr. Evans. Certainly in the priorities I would like to add to my justification for the permanent portion of my large tax cut; you see, I have suggested fundamentally a permanent portion to come from the income tax, and a transient portion to come through essentially the social security system or an equivalent method. The reason for my sizable permanent one, of course, is that by 2 years from now there will be a very large full-employment surplus in the economy, and we should not have it. There is no reason we should have it. Therefore we should make a tax cut, which would essentially bring that to a reasonable figure by that time.

I think that even a transient tax cut in some form which might be less effective than other ways, might be justified if it is speedier to enforce, although I would say that your particular figure of $10 billion all at once does strike me as a little questionable. I agree that energy is fundamentally a long-run problem. Sure, if we have en embargo, it is a short-run problem, but there is nothing we can do about it.

And it is not true that by importing less oil now we are better prepared for an embargo if it comes next month or 5 months from now.

We should take all the steps we can to be better prepared, like prepare ourselves for rationing, if it is needed, and whatnot, but not cut imports.

I do not feel that in the longer run we have to consider various alternatives in terms of domestic production and in terms of how to encourage substitutes and how you can guarantee those who invest in substitutes in case the price should come down again. Those are indeed issues that have to be studied carefully. But at the moment I certainly do not see any urgent need for reducing imports, although I think decontrolling is a fairly urgent need, because I think we are misallocating both gas and oil at the present time.

Representative LONG. Thank you, gentlemen.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Well, thank you.

Let me just comment on the matter of the rapidity with which we move on the energy questions.

It has almost become an article of faith here and religion that you have to move in at once otherwise you are not really a concerned American and the Congress is not doing its job. I gather that what the witnesses here today have said is we must move on it. However, we must move in such a way that it does not have an adverse impact on our economy. It is a long-range problem and we have to gear our sights accordingly. We have had this million barrel figure that has been pulled right out of thin air, I am sure, because it sounds good. There is so much public relations in all of this business, gimmickry, that gets a hold of the public's mind but does not have any real economic or social sense.

I have a few questions I would like to run through quickly and get through our record here without any major discussion; just a very brief answer—some of it I am sure is a yes or no.

I have asked every witness so far during this series of the hearings this question. Viewed as an antirecession program, is the set of policies recommended by the President adequate?

Mr. Rowe.

Mr. ROWE. Certainly not the level they are considering.

Mr. EVANS. No.

Mr. MODIGLIANI. Unquestionably no.

Chairman HUMPHREY. In other words, you are of the mind that it will not do the job of halting the recession and restoring a healthy rate of economic growth and reducing unemployment.

Is that the general view?

Mr. MODIGLIANI. Absolutely. It would increase the recession.

Mr. EVANS. It would make it worse next year. Well, again I think in the short term we would see some stimulus, but in the long term it would increase unemployment.

Chairman HUMPHREY. Let me tell you what I am concerned about here because I am essentially a political man and have had some modest amount of theoretical background in economics and a good deal of practical experience, having been in business with my father during the Depression and afterwards. That taught me more than I learned at the university, but both were helpful.

What I am worried about is that I feel that the administration is setting up a strawman, saying, that we will give this immediate tem-

porary tax relief, the rebate and one other year, or one other year tied in with their energy program. Then they have spokesmen to come along and say, well if we move too fast on the money supply, and they are talking very low figures, that everything will get out of hand again.

It is my judgment, and I would appreciate your comment, that the program of the administration, as was indicated by Mr. Rowe, would maybe have some temporary affect; but its side effects, as we say, on the long term, not even long term but after 1976, could very well result in a replay of everything that has happened now, and even more so.

Run down the line. What is your view?

Mr. ROWE. I think they are real possibilities of that scenario of developing.

Chairman HUMPHREY. Mr. Evans, is that scenario within the ballpark?

Mr. EVANS. Yes, I would agree with that. We are even now predicting another recession in a few years, so I would agree with that.

Chairman HUMPHREY. Is your prediction that the administration's program would result in another recession in the next 2 years?

Mr. EVANS. The combination of the administration's program and what I am afraid the Fed will do. Yes. That is right.

Chairman HUMPHREY. Mr. Modigliani.

Mr. MODIGLIANI. The administration's program as written down is such to produce deterioration, after an initial stimulus a deterioration, certainly by 1976. I would not want to comment much beyond 1976 except to say that their own program beyond 1976——

Chairman HUMPHREY. They do not have any.

Mr. MODIGLIANI. Well, they do have a projection that says unemployment is going to come down. But even if that succeeded, I think it would be totally unacceptable and I really find it hard to know whether it would succeed.

I agree with Mr. Evans' concern that the Federal Reserve might create a depression even earlier if they stick to their policies, to past policies.

Mr. EVANS. I would just like to add one thing very briefly. It was mentioned, but I just want to stress it again, the analogy between 1958 and 1961, when we had two recessions in a little over 2 years, is very apt here. It can happen. We do not have to wait a long time for another recession, just because we have a high rate of unemployment.

Chairman HUMPHREY. The point there was made that just at the time the economy looked like it was on an upturn, then the Fed clamped down on the money again.

Mr. EVANS. That is right.

Chairman HUMPHREY. Is it your feeling that this could happen all over again?

Mr. EVANS. I am afraid it will, yes.

Chairman HUMPHREY. Let me go over a few quick notes. The investment tax credit. Do I understand you think that ought to be permanent? The administration, I think, has a 1-year investment tax credit rebate, and then another 1-year proposal.

Mr. Rowe.

Mr. ROWE. Well, I think the difference in the proposals is very much a function of the different intent. I think one can argue that the temporary 1-year proposal the administration is talking about they want as a temporary stimulus for the short run, and in that context, given that it is to be paid on orders put in place by the end of 1976, I think that is a viable policy option.

My own feeling, however, is that the big concern, and the one that Mr. Evans has expressed is for the long-run capital adequacy of the economy. If that is your concern, then I think that a smaller, but permanent change in the investment tax credit is probably a more appropriate policy.

Mr. EVANS. I think it should be permanent. I do not think a temporary 1-year change would make that much difference. I do not think businessmen will respond to it in the way it is intended that they will.

Mr. MODIGLIANI. Well, here I disagree with Mr. Evans.

I personally favor only a temporary investment credit. First, because I believe it is more effective in the short run. The fact of termination tends to give a stimulus to do things right now, and therefore it does increase, it has a larger effect on aggregate demand right now.

Second, in the longer run, I do agree that we do need to have more investment. But this, I remind you, has to be accomplished by essentially easier monetary policy. I see no reason for an investment credit whose only effect in the final analysis is that of raising interest rates. That is fundamentally what the thing does.

Now if we do need investment, what we need to do is encourage saving and not give an incentive to investment.

Mr. EVANS. I would like to make just one very brief comment here.

Chairman HUMPHREY. Mr. Evans.

Mr. EVANS. I talked to most of our clients who are basically large businessmen, and I believe what they tell me which is that they would react very positively to a permanent increase, but they simply will not react to a temporary 1-year increase. This is the year of the recession, and time after time we hear the same story. We are not going to expand this year until we see some sign that the economy is turning around. It does not matter what you do; if it is only 1 year we will not react to it. Maybe some other year they would, but they are not going to this year. We are just deluding ourselves, in my opinion, if we think they are going to react to a temporary credit. It is not there this year.

Chairman HUMPHREY. This gets to a psychological question that I want to bring to your attention.

The University of Michigan survey said that consumer confidence was at an all time low.

Mr. MODIGLIANI. Correct.

Chairman HUMPHREY. Now the other day I had a group of business people, some in industry and in finance, come in to see me, and one of the gentlemen that was a spokesman said that what is happening in the last few months is a crisis in investment confidence. Just as you have a low rate of confidence of the consumer, there is a crisis

today in investment confidence. One of the gentlemen was an investment banker and he said that things have fallen precipitously in terms of confidence on the part of the investing community. How do we restore that sense of confidence, because obviously it is an important factor.

Mr. Modigliani.

Mr. MODIGLIANI. You will let me comment. I think Mr. Evans' argument might be valid or not. I sometimes mistrust the responses of businessmen, but all this really implies is that an investment tax credit, permanent or temporary, will have no effect until the economy starts going; which would be a case against investment tax credit because when the economy gets going we do not need it particularly. So I do not know. I believe that at least some people would respond, but perhaps that is not the case.

Now the question of how to restore confidence. I am afraid that there is no way except to help through a tax cut or through some temporary or permanent measure, to get rid of those inventories. Then give them the sense that the economy is recovering, and then I think confidence will be restored quite quickly. If again we also manage to keep the Federal Reserve from jacking up interest rates, if we can get the stock market up, those are the kinds of things that will restore confidence. I think it is essentially your legislation that will do it. No words of any kind will do it. It is up to you to do it.

Chairman HUMPHREY. Mr. Evans.

Mr. EVANS. I basically take the same point of view. I would phrase it as such, business confidence is a lagging indicator. It always turns up after everything else has turned up. Businessmen do not want words. They want action. When their sales start picking up and the unemployment rates starts going back down, they see more business, then they will start investing. It really does not matter what you tell them.

Chairman HUMPHREY. Then they get to smile, they get to smile after they have been tickled.

Mr. EVANS. That is right. They see their profits go up and their sales go up and then they are interested. Before that they do not want to hear about it.

Chairman HUMPHREY. Mr. Rowe.

Mr. ROWE. Well, I think in connection with the whole issue of inventory liquidation, it is important to realize that inventories are in some sense relative to sales, and once you get a turnaround in activity, you get a turnaround in sales, you reduce the incentive to liquidate these inventories, and probably will reduce what inventory liquidation will take place.

Chairman HUMPHREY. I hear, gentlemen, from my outside contacts—by the way, I want you to know I spend a lot of time on the telephone and visiting with people. I just pick up the phone and call people that I know in the business community, and I ask a question like this. What do you think is happening to inventory liquidation out our way?

I talked to a gentleman the other day in Denver. I have talked to them at home, repeatedly, and other people that I know, and I am getting the word back that the inventory liquidation is not nearly as

rapid or as fast as the administration's witnesses have testified here. Now this is just, you know, a very primitive sampling, but from people that are very prominent in the business world.

What do you hear about it?

Mr. MODIGLIANI. Mr. Chairman, may I ask you a question?

Are they happy or unhappy about the fact that they are not liquidating?

Chairman HUMPHREY. They are unhappy. They feel that what they are really saying, in substance when you talk to them, is that their sales, of course, are not what they would like, sales are down; and that orders are down; and that capital investment is down; and that all the inventories that people have that they accumulated are not moving out as rapidly as they would like, so that they could place new orders or feel that their cash flow was better.

What is your feeling about that?

Do you get any noise on it, any feel about it?

Mr. EVANS. Yes, I think people are unhappy. I think the big companies, industrial production in January was a reflection of this. We expect the inventory liquidation will continue, negative inventory investment all four quarters of 1975. In other words, it would take until the end of the year to run its course.

Also there was sort of a hidden element in here, that a lot of people were kind of piggy last year, not in the pejorative sense, but they were worried about shortages, and so they did not tell anybody but they were buying all this stuff that they really had no use for just in case it was still in shortage. So actually, inventory numbers are terrible. I do not want to spend a whole hour on it, but in my opinion, inventory buildup was understated last year, and so we have all these inventories. Now what really happens in a recession with all this stuff that is hoarded in an economic sense last year, and now they are very happy about it.

Mr. ROWE. I would say that the reaction we have been getting reflects at least that broad an idea. It's not for lack of trying that businesses have failed to liquidate inventories, but sales are declining too fast.

Chairman HUMPHREY. I just want to conclude my part and then we will go to Congressman Long.

On the Federal Reserve, I am not one that happens to believe that the Congress ought to say to the Federal Reserve your money supply rate for the following year will be 14 percent or 10 percent. I do not believe that. I believe that the Federal Reserve has been established to be like a doctor, so to speak, in a medical situation where you are keeping constant watch over a very uncertain question. It is just about what it boils down to. When you have somebody that has had a serious illness, you put them in a ward, and you have got the monitoring apparatuses looking at them all the time, and you do not just simply say well, now, I will tell you what we are going to do. We are going to give you two of these pills, every 4 hours, 24 hours a day, and regardless of what happens to you, you get two pills. I mean, this is ridiculous. There ought to be at least some commonsense in here.

But the Federal Reserve Board is not a creature of the executive. I want to state that for the record here, the Federal Reserve Board,

like other agencies of the Government, is an extension of the arm of the Congress. The Congress came to that judgment in 1913 or 1914 whenever the Federal Reserve was set up, that they were not able to really handle the money supply and the whole monetary situation out of the committees of the Congress, so they established the Federal Reserve System. Carter Glass, I believe, was one of the major architects of this system.

I remember what Paul Douglas told McChesney Martin. He said, Mr. Chairman, I want you to write on your mirror so that you can see it every morning when you shave, that "I am a creature of the Congress." I think that is exactly what needs to be written on that mirror, because Congress is much more sensitive to what is happening in the economy. I have been over on that other side, and I want to tell you, when I was Vice President listening over there, you got four layers of walls to go through before anything gets to you.

But when you are up here in Congress, they are in on you every day. They catch you. They tackle you outside this door and they walk alongside of you. The minute I go home to Minnesota they meet me at the airport. I do not need a lot of surveys. Good God, I have that pounded into my head every day, and the very people who will say they do not want the Government to interfere are out there saying what are you going to do. They are right out there now.

How do we bring pressure to bear on Federal Reserve, not to tell them that you have got to have a particular rate, but to get them to understand that fiscal and budgetary policy are but two legs of a three-legged stool? As a boy from the Midwest, I learned a long time ago what happens when you sit on a three-legged stool with just two legs there, or one shorter than the other.

Now, what do we do? You men are people trained in this field. What do you do? How do you get to them without taking the club out, because you know, after all, if it keeps up, 535 Members of Congress, a majority of them are going to say, we have had enough of this.

Mr. EVANS. That is right.

Chairman HUMPHREY. And then you make bad judgment. How do we do it?

Mr. MODIGLIANI. Well, let me say yes, I do not think you should at the moment impeach Mr. Burns.

Chairman HUMPHREY. May I say, by the way, you said the last time you were here that Mr. Nixon should be impeached, and he is gone. We have a replacement that did not cure the problem.

Mr. MODIGLIANI. You are absolutely right. You see, I believe that sort of my hunch was right, that the departure of Mr. Nixon was one element of the situation. What I did not figure is that the Federal Reserve would act the way they did. When I was here it was before the great crunch of midyear, and I had assumed that they would show sense, which they did not.

Now, let me just, since you are really addressing another fundamental question, let me again sort of give you my thoughts on this issue.

My idea is that as a scheme, if you like, to be implemented out of the administration and the Congress, there should come out a pro-

gram for the year in terms of output, employment, unemployment, expected inflation, and therefore money income, and once this is set up, then it should be a function of the administration and the Federal Reserve jointly to see that that program materializes. And you tell the Federal Reserve not how to do it but you say: With your technical knowledge be sure that those numbers come about.

Now, it seems to me that what happened last year is that the Federal Reserve was shooting at an unemployment number which was not consistent with the administration's program. The administration had said that by yearend unemployment should be not much above 5.5 percent. They were off quite a bit, and I believe it was the Fed's doing.

So it seems to me that the way we want to handle this problem is to tell them that your function as a doctor is to achieve this goal. You do that to the best of your knowledge, and you will be judged by how close you come to the goal. Do it any way you see fit, and perhaps every now and then we can ask you, are you coming close to that? Why are you failing?

But in other words, it should be a monitoring. That is the way I would see the relation between the Federal Reserve, the administration, and Congress.

Mr. EVANS. Continuing this doctor analogy which has been mentioned several times, it seems to me if you go to the doctor and you are very sick and you have appendicitis but instead he takes out your gallbladder, you probably get another doctor next time. And I think I have perhaps an extreme position, but it is my considered viewpoint, and I have thought a lot about this, we have to change the players because if we do not change the players, I agree with you, and we have said this to our clients and so forth, that the majority of Congress, if we have one more credit crunch, the majority of Congress will rise up and destroy the independence of the Federal Reserve System. In my opinion, that would be a mistake.

And so therefore I believe we have to remove some of the players in there, including the chief player.

Chairman HUMPHREY. May I just say that one of the problems even with changing the players, there has been an awful lot of indoctrination in the same set of plays so that even though you change the names—let's say that the elections change the players. The question is, What plays do the players know? In other words, have they been sold on the idea of the monetarists, as was indicated here.

For example, many of my fellow Democrats are scared to death of going into a tax reduction that is over $15 or $16 billion. When you are out home with the folks and they hear about a tax reduction like that and a budget deficit of $52 billion, they start to turn green. They really do. And let me tell you what is the trouble. Since we are kind of freewheeling here today, I want you to take a look over here.

Now, if Mr. Burns was here or Mr. Simon was here, or Mr. Greenspan was here, television cameras over there, the reporters cannot find enough space over here, and they get that doctrine out across the country, and I notice that, and I am just being as blunt as I can about it, and as frank as I can because I am in a happy period in my life where I have that freedom. I do not have to worry about those

next year's votes because I am not running for anything. I am not resigning from the Senate, do not misunderstand me.

But what happens? The reports are very good on the meetings of the Joint Economic Committee. We are fortunate to have good copy, but 98 percent of the copy is what the administration's witnesses say.

Now, today here are three of the best witnesses we have had. I think it is a shame, and I am going to put it on the record, and I do not care if the press association knows about it, but when men of your caliber are here, the public has a right to know more than what few little stories are going to come out of here. This is education; this is education for us. It is education for the public.

In my job as a Senator, or a Member of Congress, it is not only that I get educated, but let me tell you, if you get too far ahead in your education of the folks back home that send you here, you get a chance to go home and get reeducated. Believe me. That is what the problem is here. And this is a very serious matter.

The whole business of the monetary system in this country, the Federal Reserve, well, I want to tell you that there is more mystery about the Federal Reserve than there is about UFO's, there really is. It is a mystical thing.

When you talk about this out there, unless you overly simplify it, they will just say well, that is something we ought not talk about. It is something like with the CIA here for a while. We used to say, well, we just do not want to know what they are doing. Then we had folks say, we do not want to know how many atom bombs we have got. We do not want to know anything about the money situation because if we know about it we might do something about it, you know.

Now I have taken too much time.

Congressman Long.

Representative LONG. Not at all.

Let me say, Mr. Chairman, that I certainly agree with you, and I agree with you with respect to the press coverage of this thing. It seems as though what they are looking for are simple answers to very complex problems that they can present within 45 seconds, and 45.2 seconds rather than getting an explanation of what the problem is. And the problem is—problems are no longer simple. They are complex problems.

One thing in this regard, one of the things that we have been talking about all the way through, and one facet of this whole program and approach is doing away and closing a lot of the loopholes in the law. Does the definition of loophole include, for example, Mr. Evans, investment tax credit?

Mr. EVANS. I was in favor of having an investment tax credit that would vary by the type of investments, and I agree that the word "loophole" is like liberal and conservative. It can mean anything that the user wants it to mean. In my own personal lexicon, the investment tax credit is not a loophole.

Representative LONG. I have found from the years of experience I have had as a corporation lawyer and also as a Member of Congress, that, as you say, people define the term "loophole" the way they want to define it. In oil industry, depletion is not a loophole. To the real estate people, long-term capital gain is not a loophole. To the investment banker, long-term capital gain is not a loophole. Yet to the in-

dustrialist who wants to put in a particular type of equipment, and he wants an investment tax credit for it, investment tax credit is not a loophole.

So, as I say, they basically tend to define it the way they want it defined, and it seems to me that while taking loopholes away and closing some that perhaps our whole program here is based on opening others.

Do you have a view on that, Mr. Modigliani?

Mr. MODIGLIANI. Well, I would agree that it is hard to define loopholes. I would agree that the specific case of investment credit is not a loophole in the sense that its main purpose is not to enable high income tax people to avoid income taxes, for instance, as is true of tax exempt things. However, as I indicated, I have some reservations about investment tax credit because I believe in the long run the only effect it has is, in fact, that of increasing interest rates.

Representative LONG. Mr. Modigliani, if I may argue with you a moment, what you are going to find is that in speaking as Senator Humphrey was, as a political man, it is going to find that if we write in investment tax credits here, and say we write them up to the percentage that has been recommended here, you are going to find that when times get better, you are going to find people building plants that they do not need, making investments that really are not economically sound, and they are going to abuse investment tax credit just to the extent that some people in the oil industry have abused depletion, and some in the real estate business. What they do is that they build a big apartment building or an office building and let it stay there for about 8 or 10 years, and then they sell it to somebody else at an inflated price so that they never have to pay any tax on the income about the time that they depreciate it off the books. So then they pay it off as a long-term capital gain rather than paying on it as they earn the money over the years. And the same thing will happen probably if we allow an investment tax credit to go for an extended period of time.

Mr. MODIGLIANI. See, I think Mr. Evans and I and Mr. Rowe all agree that it is very unlikely that the investment tax credit could be abused in the way in which the special benefits for housing and for construction. I do not think anybody would build a plant which he could not use just because of a tax credit, and the one I favor, the temporary tax credit, is precisely because right now it would lead people to anticipate things that they did need anyway, and God knows, we do need additional investments So, they would just get it right now, and later on it should pay for itself.

Now, may I make just a brief comment about what you said, Senator Humphrey?

You are absolutely right that one of the problems is that the monetarists have been extremely vocal and able in presenting their case. You see, when I talk these matters over with Professor Friedman, as I do quite frequently, we understand each other, and our technical analysis is the same. The differences are a difference of values. I do agree with him that if you keep money supply at 4 percent, in the long run, eventually the economy would adjust to it. The difference between us turns out to be that I am impatient and I do mind people not having enough to eat right now, losing their jobs, losing their dignity, and he does not care very much. He says well,

they have got to adjust to it. But then when they go before the public the talk is different. If the money supply was more than 4 percent, inflation is rampant. That is the kind of talk they sell.

But perhaps it is time for the people who think otherwise, to sort of try to get together in some kind of formulation, that is easily explainable. Perhaps you gentlemen ought to consider setting up a counter-Council of Economic Advisers, in an emergency situation—we do have an emergency—to help you formulate a program and a clear explanation of what is involved in that program.

Chairman HUMPHREY. I want you to know that this is exactly what I have been thinking about in terms of this Joint Economic Committee, and I have not discussed it with our membership yet except individually, of setting up a group of economists, setting up a panel of economic advisers to this Joint Economic Committee.

Now, do not misunderstand that. We get all kinds from you men. But also, a panel that can in a sense be working continuously to pull in the information from other economists.

Mr. MODIGLIANI. Perhaps I should make one other point. You see, in terms of the profession, the fact that we have a great deal of common understanding is perhaps testified by the following consideration. Professor Friedman has been president of the American Economic Association a few years back. I am the president-elect. So the profession recognizes that both of us in terms of technical analysis are competent, and yet we come to different conclusions, and those different conclusions are not really a matter for analysis. They are mostly a matter of underlying values and the extent to which we are willing to sacrifice something versus something else.

Chairman HUMPHREY. I am sure that this is exactly the situation in the administration itself with respect to certain Members of Congress. I think we are all dealing pretty much with the same statistics. We are dealing pretty much with the same system of analysis.

In fact, I have a question here about that. It is a question of the values, and when you can talk yourself into believing that an acceptable rate of unemployment is 5 or 6 percent in an economy like ours, where you used to talk about it being 4 percent, and even lower than that, then that means that you have changed your values.

Now, there may be tradeoffs on that, but I think it at least is worthy of our argument.

Congressman Long.

Representative LONG. I have nothing further unless Mr. Rowe would like to comment on my remark about investment tax credit and perhaps we are taking away—you know, the Lord giveth and the Lord taketh away, and we are taking away from some and giving it to others.

Mr. ROWE. I was just going to disagree with Mr. Modigliani. I think loopholes are easy to define. They are tax breaks available to other people and not to me.

Representative LONG. That is right, and that is sort of the same thing. That is my point.

That is all I have, Mr. Chairman.

Chairman HUMPHREY. I think the point we need to know about our tax structure is that it is a very powerful instrument for either acceleration of the economy or to give it a distortion or to give it an adjustment, depending on how you want it to be used.

There is no greater incentive than the profit incentive when it comes to the business world, and I think a tax structure can be used to do what you want to have done.

Mr. Modigliani, you have said something about the 6-percent rate of unemployment by the end of 1976.

Mr. MODIGLIANI. As an interim target.

Chairman HUMPHREY. Is that realistic?

Mr. MODIGLIANI. Yes, I think it is realistic.

Chairman HUMPHREY. But it will require the kind of tax reduction that you are talking about.

Mr. MODIGLIANI. That is correct, and the appropriate monetary policy. I think that is realistic. It will take, and I might change my mind on my way, but as a target to shoot at, I believe it is a reasonable target.

Chairman HUMPHREY. Can you do that without, as the present jargon is, reigniting the fires of inflation?

Mr. MODIGLIANI. I certainly believe that. Let me put it this way, during the first leg of the program, the first year will be perfectly safe, and I would be willing when we get there at the end of the first year to take a second look and see whether we should still aim at the same target.

Chairman HUMPHREY. Mr. Evans, I saw you shaking your head.

Mr. EVANS. I disagree. I think the unemployment rate is much too high. That is not the problem, but the economy cannot be turned around that fast, unfortunately.

Tax cuts or increases or whatever take time to work through the economy, and there is almost nothing that we can do. The economy was ruined last year by the tight monetary policy. Mr. Modigliani called it crazy. I have really no argument with that. I think that it was also ruined in part by the wage and price controls which led to the shortages, and before that it was the Vietnam war. So basically the way I figure it, in the last 10 years we have had no increase in productivity in this economy. That is a terrible record.

If you go back to the previous 20 years, it was 2½ to 3 percent a year.

Chairman HUMPHREY. Is that a factual statement?

Mr. EVANS. I believe it is.

I have prepared a long paper basically on what is wrong with the productivity measures published by the Government, and I come to the same conclusion in 1965, and after that, there are a number of adjustments which I feel are deficient in the statistics, but I am willing to back this statement up.

Chairman HUMPHREY. At least you would say very little increase.

Mr. EVANS. Very little, certainly not more than 1 percent. No one can argue more than 1 percent, even if you take the statistics as given. But I think they overstate it by about 1 percent, and this is a terrible record. Basically we have suffered from a combination of circumstances, all of which were unfortunate, and that led us to an economy which is not in very good shape and is not poised, cannot handle an overly rapid expansion. We need to get there but we cannot go at such a rapid rate as that would imply. That would imply a growth rate of 9 or 10 percent, something of this sort, for six quarters

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in a row. The economy has never done that. The economy has never done that before, and I do not think in its present depleted condition it could do that. We cannot recover all of the past 10 years of sins in 1 or 2 years.

Chairman HUMPHREY. What is a reasonable growth rate that you could anticipate?

Mr. EVANS. Eight percent is fine with me. Above that I believe we get into distortions because of the lack of capital and lack of liquidity.

Chairman HUMPHREY. Do you think we could get an increase in the growth rate of this economy in the next year with the stimulus that we are talking about of 8 percent?

Mr. EVANS. For 1976, yes. It will take the rest of this year to turn around. It is a huge ship that we have to turn around. We are still suffering the consequences of tight money. So we are going to have a negative growth rate this quarter no matter who does what and who says what. We are going to have a negative growth rate next quarter for the same reason. The second half of the year, with the proper policies, we could begin to see a vigorous upturn, but it will not be until 1976 that you get up to the 8 percent because we have to wait until the inventory liquidation is over. We have to wait until the tax cut enters and all of the usual things.

Chairman HUMPHREY. Let's say you get that nice vigorous upturn of 8 percent and then all at once the Federal Reserve Board says whoops?

Mr. EVANS. That is right, you have had it.

Chairman HUMPHREY. Do you worry about that?

Mr. EVANS. Every day.

Chairman HUMPHREY. Mr. Rowe, how about you? How do you feel?

Mr. ROWE. In some sense, I find myself in the middle in terms of maximum growth, 6 percent unemployment at the end of 1976 I think is a reasonable target. It may be an ambitious target, but I think even that, let's face it, 6 percent unemployment is not a highly attractive number. I think that is clear; 12 months ago 6 percent unemployment was disastrous, and now we are talking about that as an optimistic target, and I think that is an extremely unfortunate situation.

An additional comment I would make about prices is I think worthwhile. There are at least two very special circumstances in the dramatic kind of price rise that we saw in the middle of 1973 through 1974. For the first time in the postwar period the Arabs began to fight us and not each other. The fact that there was a political cohesion developed in the Arab world that permitted them to form this cartel and to make it stick clearly had a dramatic impact on prices in all the developed countries. Second, we saw for, I think, the first time in at least 15 to 17 years a simultaneous peaking in the business cycles of all the developed Western countries. Up to that time we had seen somewhat counterbalancing movements in the cycles, and one of the impacts of this was to put extreme pressure on raw material markets, and to produce very significant and dramatic increases in commodity prices.

Now wages do not go down. Wages only go up in this economy. But commodity prices do go down, as anyone from an agricultural State well knows. In fact I think we are seeing the beginnings of this trend,

and I think this is a trend which is indeed going to continue, and I think in some sense we are starting to see a turnaround on the price picture.

Now, for another 2 or 3 years, we are going to have to live with the kind of wage escalation that is built into the labor contracts that have been negotiated in the last 12 to 18 months, and there is no way that that is going to be avoided, but I do think the extreme pressure from the commodity inflation has begun to ease already and will continue to ease.

Chairman HUMPHREY. Let me just say a word about those wage contracts. Everybody has his prejudices. I always looked at these 3-year contracts on this, along this line, that the first year you catch up for what you have lost the last couple of years, and the second year you just stay in there, and you are hanging in good, and the third year you start to lose it again, and that is why you have 3-year labor contracts. It is sort of a catchup business. Year one is generally a pretty good bump, and the second year, why your inflation and your wages kind of even off. The third year you are in trouble again, in recent past. I think that can be somewhat documented.

Mr. EVANS. Can I just get one point in here?

I talked about what we need to get back to an unemployment rate of 6 percent lower and so forth, and I would like to just make this one observation. It is a matter of simple arithmetic, not just forecasting what is happening. If we were to turn real disposable income to the level that it was at the end of 1973, we would in fact need a $60 billion tax cut. That is how much purchasing power has eroded. Now, no one has come out——

Chairman HUMPHREY. Let's get that again. You say if in order to return to the disposable income at the end of 1973, we would need a tax cut of at least $60 billion.

Mr. EVANS. That is right. That is just doing the arithmetic.

Now, no one here or other places I do not think has suggested that be the tax cut. Why? Because, of course, we had shortages in 1973 at the end of the year, and we have not had added productive capacity to the economy. So the question is how much less do we need before we start reaching bottlenecks. My view of the world is pessimistic in the sense that unfortunately I think the bottlenecks are still there, and we need enough time to invest to get rid of those before we go ahead at a very fast speed. That is why I put my upper limit of 8 percent, because I wanted to give the economy time to reinvest so that we can have continued growth instead of these bottlenecks in 2 or 3 years.

Chairman HUMPHREY. Did I hear someone here say that the actual take-home pay has been reduced by 7 percent—that is, the purchasing power?

Mr. EVANS. Yes.

Chairman HUMPHREY. 7 percent?

Mr. EVANS. Yes.

Chairman HUMPHREY. Over what period of time?

Mr. EVANS. Over roughly the last 18 months.

Chairman HUMPHREY. 18 months.

Mr. MODIGLIANI. Could I make a comment on this?

Chairman HUMPHREY. Yes.

Mr. MODIGLIANI. First, I want to say that I beg to differ again with Mr. Evans who worries about the Federal Reserve's new crunch every day. I worry every day and every night. Second, on a more serious matter, I would like to say that the reason why I feel that an 8 or 9-percent rate of growth is not realistic is that past experience of the postwar period is not relevant.

Chairman HUMPHREY. What was that growth rate again?

Mr. MODIGLIANI. 8 or 9-percent growth is not unrealistic.

Mr. EVANS. 8 percent is all right, just not 9 percent.

Mr. MODIGLIANI. 8 or 9 percent to me is not a distinguishable difference. The reason I feel the postwar period experience is not relevant, is that we have got ourselves in a hole so deep as we have never had in the postwar period, and we have been moving awfully fast. Remember, unemployment has gone from 6½ to some 8½ percent in one quarter, or roughly so; if it can go up that fast, it can also go down pretty fast.

I do not mean just as fast, perhaps because on the way down you have certain special phenomena such as initial hoarding of labor, which is then fired when hanging on appears hopeless. But I do believe the turnaround, particularly the inventory dynamics, is frequently quite fast. You stop the liquidation. Just that alone gives quite a lift to the economy, because during the liquidation you were selling and not producing. Now you have to produce as much as you sell, and that alone can make quite a difference.

And if you go back to the big Depression, you will find that between 1934 and 1937, income grew awfully fast, year after year at an average rate of nearly 10 percent. Why? The economy was so low, so far down, that there was a lot of room for recovery; and, you see, you are really growing into old grooves, which is much easier than to cut into new ground. So, 9 percent growth for a while is, I believe, a target which is feasible.

Let me also add that while I agree with Mr. Evans that we do need additional capacity, you do have the problem that capacity is not going to be built if we have a lot of unemployment, a lot of excess capacity. That means we have first to get moving with the recovery before you get additional capacity.

Chairman HUMPHREY. Now, gentlemen, I know I am keeping you a long time but this is highly informative to me, and since I have got you here I want to exploit you as much as I can. First of all, it is so pleasant to know we can do this and not cost us anything.

Mr. MODIGLIANI. Well, we get $18 a day.

Chairman HUMPHREY. I sat in a meeting yesterday with some of my colleagues in the Senate. You may know that we are trying to put together an overall economic recovery program and also an energy program which is vital to that recovery program, and sometime within the next 10 days, hopefully, we will be able to announce at least the outlines of that program, and then direct the appropriate legislative committees to get at it. We are not going to fill in all the details because once you start to do that, you have got nothing but an argument on every little item. The place to argue it out is in the legislative committees.

Now, my point—and I by the way am a sponsor of the bill with Senator Javits, Senator Williams, and others for a million public

service jobs. I know we need some way to pick up unemployed people and get them to work. I am not a great enthusiast for unemployment compensation if there is an alternative; namely, some work. The best work is in the private sector. The public service jobs are what they say they are, in public areas, courthouses and city halls and parks and libraries and what have you. But it is an $8 billion program. There are many of us that feel that the impounded funds for housing, for highways, for water and sewer, for airports, for a host of construction projects would actually do a better job if they were released than even an extended public service employment program.

I happen to be one that believes that you need public service as a sort of transitional job, that you need some of those jobs to, over and beyond unemployment compensation, get people over the hump, if you have something else to offer at the end of the line. Otherwise public service jobs become nothing more or less than just public employment.

What is your view on the matter of the release of the budget funds, the funds that have already been budgeted and appropriated, plus the fact that the President in his new budget is contemplating deferrals in terms of around $17 billion. Some of those are transfer payments to which you have alluded in your testimony.

I would just be interested in what you feel about the budget, its spending. We are talking about spending in a very real sense. Our budget ought to be a capital budget. We ought to have the difference between spending on the one hand and construction on the other. The Federal Government budget policy, if it were applied to any other institution of human creation would be denounced. No business firm would ever have such a policy because we put it all in just as if somehow or another you put it all in and just shoot Roman candles or firecrackers, when in fact a lot of that budget is for equipment, it is for public works, it is for highways, airports and hospitals, schools, et cetera.

What is your view about it? Do you think that money ought to be released?

If you do, what do you think its impact would be? How would you judge it in terms of desirability as compared to public service employment?

Mr. MODIGLIANI. Mr. Chairman, you will find me supportive of both things you have just said. First about the kind of budget. I have been advocating this in this country for a long time. And I want you to know that the United States is the only member of the United Nations that does not make a distinction between current expenditure and capital expenditure in the Government account.

Chairman HUMPHREY. I have introduced a bill on this matter ever since 1949, and you can see how persuasive I am.

Mr. MODIGLIANI. Well, I will be glad to cosponsor it.

Chairman HUMPHREY. Well, I have not got one in this year, but I just want staff to listen loud and clear to me because I want to put another one in.

Mr. MODIGLIANI. I do not know who opposes this. It seems to me such an obvious thing to do, at least it should be done for accounting purposes in the national income accounts if not anywhere else, but I think it would be an extremely useful thing to have.

Now, second, I would be enthusiastically in favor of using more expenditure on projects than on public employment programs.

I am quite cool on public employment programs. It is only a last resort. That is really my lowest preference, I think it should have money included in my program, some increase in current expenditure of that kind, if the projects exist where it is possible to act fast, and to make room I would shake down perhaps some of my income tax proposal. Again, expenditures can be cut back more easily than a permanent tax cut.

They are not the easiest to curb, but they can be. So I would be completely in favor of such an approach.

Chairman HUMPHREY. Mr. Evans.

Mr. EVANS. That is about what I was going to say. I was also going to point out that we are the only country that does not have capital and current budgets separated, and as far as the other point, I also agree. I really am not very much in favor of public service jobs because I believe they turn out to be dead ends. I think we need to go with the construction. After all, which sector of the economy has been hit the hardest, which sector of the economy has the most unused resources?

The unemployment rate in the construction industry is reported to be 15 percent, and we could certainly add several billion dollars there without having any shortages, any problems at all. So I think that is a very good idea.

Representative LONG. Also long range it lends itself to a minor degree, or not minor, but not full, 100 percent, towards productive capacity.

Mr. EVANS. That is right.

So I would really be in favor of this, and I would try to stay away from the public service jobs except as possibly a very last resort.

Mr. ROWE. I think on the issue of a capital budget, I find I agree with Mr. Modigliani that, you know, who is against it. The Federal Government would never get a statement certified by a public accountant. That is pretty clear.

On the issue of construction versus public employment, my attitude is that in the short run construction and release of funds is probably the best alternative, in part because it can be short run. You know, it is a temporary project that reaches completion and in fact is a temporary stimulus. It does not have further problems of how do you eliminate this sort of project. I think I would even go farther and say it would be desirable if it were possible to add some sort of provisions that would provide matching funds, and in addition would set a time limit on the expenditure of these funds, that these funds are available if expended by the end of 1975, let's say, although I know there are problems here. This would represent the kind of short-run stimulus to the economy that we need. I would make another comment about public service jobs: namely, that I view that as an approach to a longer term problem and not as a cyclical problem. I do think one difficulty we have as a structural problem in the U.S. economy is a tendency for the spread to grow between requirements required in private industry versus the skills of the population, and I think the notion of public service employment is one that should be directed toward that longer term problem. I think this is one reason why we find it increasingly difficult to get the unemployment rate down without unacceptable high inflation.

In a sense there is a structural shift here.

Chairman HUMPHREY. I agree. I think it is far too little discussed. My final observation is, I listened to Alan Greenspan, Chairman of the Council of Economic Advisers, speak to us, and I have a great respect for Mr. Greenspan. I do not agree with some of his economic philosophy, and some of his policy declarations. I think he comes to us with great integrity. But I noted in one place he pointed out that one of the more encouraging developments was the drop in agricultural prices, and how I let that get by that day was beyond me.

Mr. ROWE. It is beyond me, too, Senator.

Chairman HUMPHREY. Well, I tell you, the reason is we just do not have enough time because I would not have even got wound up for the question in less than 20 minutes. I just came back from a meeting in my State with 200 farm people who were selected from around the State by the different farm organizations, the dairy industry, the beef industry, poultry, the drop in feed grain prices, and you ought to hear what—and by the way, one-third of all the people present at that were bankers, from rural Minnesota and northern Iowa.

Now, if you cannot make it go in agriculture in northern Iowa and rural southern Minnesota, you are in trouble because they are good farmers and they have good land, highly productive land, and they are very skilled, with good equipment. The cost of equipment is unbelievable. You cannot imagine. A tractor that used to sell for $8,000 sells for $17,000. A tractor that used to sell 3 years ago for $15,000 sells for $30,000. And then you start to get the repair parts, and apparently the repairs come from Mars, and they are delivered by some kind of superjet, because it has to come in air express to have it that expensive. It is unbelievable.

Now, when the Chairman of the Council of Economic Advisers would come here and say that one of the encouraging developments is the drop in farm prices, I wonder if he realizes that that is a drop in income, and that one of the largest consuming sectors of this economy is agriculture. They consume more steel in agriculture than the automobile industry does. They consume more oil and petroleum than any other segment of American industry, and it represented last year $440 billion out of our GNP. I think the automobile industry represented $77 billion according to the figures I have read.

We get a little trouble in the automobile industry, and the whole country is in. You know, it is like they dropped the third atom bomb, and do not misunderstand me, I think there are very serious concerns about what is happening in the automobile industry, but I have to repeat to a number of my young friends and to my city friends that when you put together agriculture, that includes its processing agribusiness, you have almost two-fifths of the total GNP, and yet the Chairman of the Council of Economic Advisers said one of the encouraging signs is the drop in farm prices.

I can assure you that out my way, and I think out my way includes an awful lot of way because it goes clear across this country, that that is not an encouraging sign, cotton today selling at 28 cents a pound and some places lower, is not a good sign. My milk producers out there are getting $6.54 per hundredweight, and the University of Minnesota School of Agricultural Economics and the University of Wisconsin says it costs them between $8.95 and $9.25, take your choice,

to produce it. You lose every time you produce 100 pounds. When the cattle prices are going down, everybody knows that anybody that feeds cattle on anything but grassland today is losing from $100 to $200 a head.

You take a calf, which they call a calf in some places that weighs 300 and 400 pounds, on into the stockyard, and by the time you have sold it and paid for the transportation you owe somebody something to take it off your hands. Now, that kind of thing in this country is not affected particularly right now by public service jobs. It is not affected. It can be helped by tax reduction. It can definitely be helped, particularly on tax rebates, because a year ago our farm people had a good year.

I just toss this in because I do not think that it is really given enough consideration. What happened to all the money that was made available and when the money supply was increased, what happened to it if it did not go into productive capacity?

Do you get what I mean? I know there was a period of time in which the money supply was much larger than it has been in recent months. What happened to it?

Mr. MODIGLIANI. Since last year the money supply has never been growing very fast. There was a very short time money grew, perhaps at 7 percent, from my recollection. Most of the time it has been less. In the last say 7 or 8 months, the money supply has actually declined. It has been first flat and now declining, according to the statistics, whatever their reliability.

So there is no problem of where it went. It was not created, so it did not go anywhere. But insofar as you asked the general question what happens if the money supply increases, where does it go, well, it goes in the pockets of people who presumably have to transact a large amount of business. If the economy grows you have more things sold, more people to be employed, and more needs for the transaction in the economy, and thus the money supply ends up in transit, in the pockets of people between one transaction and the other, and the more the transactions, the more the money.

Chairman HUMPHREY. The reason I asked the question is there is a good deal of talk, about when the money supply was increased, it was used for speculation on the money markets, not for productive capacity, not for consumption.

Now, is there any truth to that? I am just tossing out what is the conventional wisdom in the countryside.

Mr. MODIGLIANI. Well, let me try to reply to this. I do not believe there is much foundation to the view that money was misused in the financial markets. But there is a proposition which may have some truth—although I have not investigated it—that in 1973 and perhaps early 1974 when there was fear of shortages and an expectation of rising prices, people may have been accumulating unduly large inventories, as he was pointing out, and they used loans for that purpose. So to that extent there is some foundation.

Chairman HUMPHREY. Mr. Burns said here the other day that the recent increase in money supply had been used primarily by banks to repay the Federal Reserve. Tell me a little bit about that. What is that all about?

Mr. MODIGLIANI. Well, that gets into a fairly complicated, technical problem. That statement is correct. They now have repaid their debt, so there is nothing more to pay. But it is correct that the way in which the central bank runs its policy is when it does not want the money supply to grow—it wants to hold down the economy—it does not supply reserves to the banks. If the banks, nonetheless, expand, as they do because of commercial loans or because of high interest rates and so on, then the banks have to borrow from the Federal Reserve in order to make up the reserve requirements.

So essentially, their borrowing is really a reflection of what the central bank is trying to do to the money supply.

Now, in recent periods the demand for money has been growing very slowly and the reserves have grown, as the central bank was trying to help ease things. You see, that is why I do not complain much about recent behavior. They were supplying reserves, but the need for them was not growing, so the banks were repaying the debts which they had accumulated. This contributed to the tremendous easing in the short-run market rates from 13 percent down to 6 percent.

Chairman HUMPHREY. But how does that make any money available to John Smith out here that wants to build himself a cement plant?

Mr. MODIGLIANI. Well, that has little to do with it. You see what happens——

Chairman HUMPHREY. It seems to me like the bankers were just taking care of each other. Who is taking care of farmer Jones?

Mr. EVANS. Farmer Jones could have got a loan last month if he wanted it. He could not have gotten one 6 months ago.

Mr. ROWE. He could have gotten one easier last month, or even more easily today. The bankers will tell you, and on this score I think they are on the level, the problem is that farmer Jones is so concerned about economic activity and other businessmen are so concerned that they are not coming in to borrow because they do not want to place themselves in a debt position in these uncertain times.

Chairman HUMPHREY. So what you are saying is that when the banks repay their loans to the Federal Reserve, that, of course, frees up credit from the bank.

Mr. MODIGLIANI. That is right.

Chairman HUMPHREY. So, in a sense, that is the way that the money supply increases?

Mr. MODIGLIANI. That helps.

Chairman HUMPHREY. Was that enough?

Mr. MODIGLIANI. Well, that is a point in which I feel a little more certain. I think it would be preferable if it had been more aggressive, but I do not feel that it was an error of an order of magnitude as it was at midyear during the crunch.

In other words, after banks repay and you still increase reserves, then they turn out to have excess reserves, and that is a stimulus. It makes it even easier for them. So, essentially they could continue to expand, and even though some of the reserves may end up not immediately used, it does help to increase the availability of credit.

Chairman HUMPHREY. Mr. Burns said before this committee that the money supply, however you wish to define it, M1, M2, whatever,

and all the different M's, that it was very much expanded now, and I think he indicated that he thought it was adequate as of now.

Is that your judgment?

Mr. MODIGLIANI. Certainly not.

Chairman HUMPHREY. He said there had been so many measures taken that he could name off several measures that would free up the money supply so to speak, and I gathered—I do not want to put words in his mouth, but at least in trying to pin him down as to what they were going to do, he indicated that what they are doing is what they ought to do.

Mr. MODIGLIANI. Well, again, as I said before, they have been easing a great deal and they have been taking a number of measures which help in this direction. Whether it is enough is another matter, but there is no question that right now they have done a great deal of easing. Nonetheless the money supply is declining.

Chairman HUMPHREY. Well, all right, now, nonetheless the money supply is declining.

Now, may I say as a simple man, what do you mean?

Mr. MODIGLIANI. Well, what I mean is you see the money supply is demand deposits and currency. The banks need reserves to expand the money supply, but if they had more reserves they need not expand. So it is quite possible that they will not use, shall we say, the fact of having less debt to expand rapidly, making new loans, buying things. So the money supply reflects what the banks do, whether they go out and buy things, like make loans and buy things. To do that they need to have behind them the reserves. But availability of reserves does not assure that they will expand the money supply.

Chairman HUMPHREY. It does not assure it?

Mr. MODIGLIANI. It does not assure it. If you persist enough, you will get there, but there is slack. It is sort of as if you were driving uphill. You might give more gas and you will not immediately have a response. Given some time you will. But you can see two things going on at the same time, you are giving more gas and the car is going slower. That is how the situation is right now.

Chairman HUMPHREY. All right, now, I am going to be on a TV panel, and I know that some smart, intelligent, able economic commentator is going to say well, Senator Humphrey, you have been complaining about the money supply. Do you think it is adequate now, or is it not adequate.

What would you say if you were in my position?

Mr. MODIGLIANI. I would say that I would rather tell you that it was thoroughly inadequate in the past months until fall, and it is probably in great danger of its being thoroughly inadequate a few months from now, and that right now it is not important. The important thing is that we should make sure that it is not inadequate as the economy picks up. Right now I would say that probably it is perhaps somewhat low, but I would not say this is a large factor.

Chairman HUMPHREY. Well, how can you predict that it will be inadequate some months from now then?

Mr. MODIGLIANI. Oh, the prediction relies on the fact that as the economy picks up, the bankers will find people wanting more loans.

Chairman HUMPHREY. Right.

Mr. MODIGLIANI. And they will find that there is an incentive to buy certain assets, but particularly they will find that there is need for loans. If they are not given reserves, they will have difficulty in making those loans.

Chairman HUMPHREY. So what you are really saying to me is that while it is better now, the real issue is whether or not the Federal Reserve is going to provide the reserves for the banking structure, for expansion——

Mr. ROWE. After the recovery gets underway?

Mr. EVANS. As it begins.

Chairman HUMPHREY. And you are worried that the history of the past indicates that the minute it looks like the patient is going to feel better, they take off the vitamins.

Mr. EVANS. They send him home.

Mr. MODIGLIANI. Exactly. If you say that on your program you will be all right.

Mr. EVANS. There is some excess slack now, so you can say the money supply is all right, and this excess slack will be used up fairly quickly once we get going, and then the question is, Do they supply any more or not?

Chairman HUMPHREY. And the history is they choke.

Well, I hope that will go over. I may have to simplify that a bit, and I hope you will not be shocked if I do.

Mr. MODIGLIANI. Which program is this, Senator?

Chairman HUMPHREY. It is "Meet the Press," and I want to be somewhat educational. That is why I have been quizzing you here.

When I went to the university, gentlemen, I used to get what we call instant education. I had to work on so many jobs I did not have time to do my daily course work, so I would knock off the last 4 or 5 days and stay up day and night, and they used to call it cramming. I heard many people say that it did not work, but it worked very well for me. I do not know whether it had any long-term effect, but temporarily, let's put it this way, temporarily it was a good intellectual stimulus.

Thank you very, very much. You have been so considerate and patient here, we are most grateful to you. And by the way, we are going to be asking you to give us more of your counsel and advice, and I want you to take a look at some of the things you have said today, and if you think that we need to have a further documentation, I hope that you will not only feel free to present it, but feel some obligation to present it because it would be very, very helpful to us. Thank you so much.

The committee is adjourned.

[Whereupon, at 1:20 p.m., the committee adjourned, subject to the call of the Chair.]

APPENDIX

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., February 11, 1975.

Hon. ARTHUR F. BURNS,
Chairman, Board of Governors, The Federal Reserve System, Washington, D.C.

DEAR CHAIRMAN BURNS: In your testimony before the Joint Economic Committee last week, you agreed to supply the committee with your evaluation of some alternatives to the policy recommendation contained in the President's Budget and Economic Report. The following is one such alternative package.

A $30 billion cut in personal income taxes, $10 billion to be a rebate on 1974 tax liabilities paid out in the second quarter of 1975 and $20 billion to be a reduction from 1975 liabilities effective through a change in the withholding schedule. The $20 billion tax cut would be constant throughout 1976. A $3 billion increase in the investment tax credit, to be effective from January 1, 1975 through 1976. An $8 billion increase in fiscal year 1976 Federal outlays primarily to finance public service jobs. An increase in the money supply (M–1) of about 10 percent. The mix of Federal spending would be altered by removing the President's proposed 5 percent ceiling on transfers offset by reductions in other spending, primarily in defense. Total outlays in fiscal year 1976 would be approximately $3 billion more than the President's budget request.

Secondly, we would like your evaluation of the policies which would be necessary to achieve a real rate of growth of 9 percent over the period 1975:4 to 1976:4.

Thirdly, we would like your opinion about the maximum rate of growth which can realistically be achieved over the next 2 years.

In order for us to make the best use of your evaluations, we would like to have this information by February 18. This will allow us to give full consideration to your work in drafting our annual report to the Congress.

On behalf of the Committee, I want to express our appreciation to you for cooperating so fully with us as we examine the various policies which the government might pursue over the next 2 years. If you have any further questions regarding these alternative proposals, please contact Mr. Douglas Lee of the Committee staff.

Best wishes.

Sincerely,

HUBERT H. HUMPHREY,
Chairman.

EDITOR'S NOTE.—Similar letters were sent to Mr. Frank P. Murphy, chief economist and manager, economic forecasting operation, General Electric Co., and Hon. Alan Greenspan, Chairman, Council of Economic Advisers.

GENERAL ELECTRIC CO.,
Fairfield, Conn., February 18, 1975.

Senator HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee
Congress of the United States
Washington, D.C.

DEAR SENATOR HUMPHREY: Thank you very much for the opportunity to participate in the Joint Economic Committee's activities. Of course, my views are my own and do not in any form represent my employers.

53-524—75——18

The Joint Committee's alternatives to the Administration's programs appear well thought out and would provide the sagging economy with a much needed stimulus. Specifically:

"A $30 billion cut in personal income taxes, $10 billion to be a rebate on 1974 tax liabilities paid out in the second quarter of 1975 and $20 billion to be a reduction from 1975 liabilities effective through a change in the withholding schedule. The $20 billion tax cut would be constant throughout 1976."

Comment

The amount of the tax reduction proposed for 1975 appears sufficient at the present time to stimulate consumer spending, recognizing, however, that the economic situation is eroding fast and the amount of expansionary force required is growing. Both the rebate and the reduction of 1975 taxes should focus on the lower income groups, with a cap of about $500 per tax return. The lower income groups have been severely hurt by inflation and the insidious increase in their effective tax rates, especially because of the structure of the social security tax system. These groups also have a high spending propensity so that the tax cut is more likely to quickly enter the spending stream, rather than be saved as would be more probable in the upper income groups. The aforementioned progressive increase in the effective tax rate suggests that the downward change in the withholding schedule be made permanent to offset the fiscal drag.

"A $3 billion increase in the investment tax credit, to be effective from January 1, 1975 through 1976."

Comment

I assume this is similar to the Administration's request to increase the investment tax credit from 7 to 12%, covering utilities. I heartily endorse this proposal. Incentives to invest have to be increased if the economy is going to recover from the recession, as well as provide for its longer-term capital requirements, particularly in the energy area. For that reason I would like to see the investment tax credit raised to 12% permanently. My studies indicate that the investment tax credit has greater significance in changing long-term investment spending trends than as a countercyclical measure in the short-run. Furthermore, incentives to invest should also include a reduction in the corporate tax rate and liberalization of depreciation rules. The replacement costs of plant and equipment have been warped by inflation; and depreciation allowances are clearly inadequate. In addition, after adjusting profits for inflation, phantom inventory gains and higher replacement costs, the real after-tax return on investment of nonfinancial corporations has dropped sharply, well below the return in 1965 and is seriously impairing incentives to expand investment.

"An $8 billion increase in FY 76 Federal outlays primarily to finance public service jobs."

Comment

Alleviation of the burden of unemployment via public service jobs is necessary and I concur in this proposal. However, public employment remedies the symptoms. Perhaps the money might be more effective in correcting unemployment if used to encourage exports or housing or urban renewal via credits or tax relief.

"An increase in the money supply (M-1) of about 10 percent."

Comment

As you know, the money supply has been virtually unchanged for three months now and with inflation still galloping *real* money supply is 7% below a year ago. Obviously, a recovery would be unlikely without monetary expansion and money supply growth in the 10% range will be necessary for some time to come to help pull the economy out of the recession.

"The mix of Federal spending would be altered by removing the President's proposed five percent ceiling on transfers offset by reductions in other spending, primarily in defense."

Comment

The 5% limitation on transfer payments would adversely affect low income groups, hardest hit by inflation. I agree that the ceiling should be removed but I am not certain whether the defense budget is capable of absorbing an equivalent reduction without impairing national security. Changes in defense spending

should be judged in terms of their national security implications alone. Moreover, I question whether an offsetting decrease in other Federal spending is desirable since I suspect that the economy needs all the stimulus it can get from the Federal budget.

"Total outlays in FY 76 would be approximately $8 billion more than the President's budget request."

Comment

As indicated, speeding the recovery may require an increase in government spending as well as the tax reductions discussed earlier. Certainly, the $8 billion override should be balanced against the economy's need for stimulation.

The real GNP is likely to drop over 4% this year and I am expecting a rise of approximately 5½% in 1976. Given the delays in implementing fiscal stimulus and the lag in their effects on economic activity, it is unlikely that growth next year could be much higher than predicted.

A target growth rate of 9% from the fourth quarter of 1975 to the fourth quarter of 1976 seems unrealistic. Much larger tax cuts and higher spending would have to be enacted promptly in order to achieve such an expansion rate. And, I am sure, would be accompanied by a renewal of double digit inflation.

I hope these comments have been helpful. Pardon the delay in responding to your request but I only received your letter on 18 February 1975.

Sincerely,

FRANK P. MURPHY
Chief Economist and Manager,
Economic Forecasting Operation.

THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADIVISERS,
Washington, D.C., February 19, 1975.

Hon. HUBERT H. HUMPHREY,
Congress of the United States,
Joint Economic Committee,
Washington, D.C.

DEAR MR. Chairman:

This is in response to your letter of February 11 in which you requested an evaluation of the economic impact of a number of proposals; including a $10 billion rebate of 1974 taxes, a permanent reduction in the tax rates that will initially reduce taxes by $20 billion at an annual rate, a $3 billion increase in the investment tax credit, an $8 billion expansion in outlays for public service employment starting in fiscal 1976 and maintained thereafter, and the substitution of offsetting reductions in federal outlays for the proposed ceiling on transfers.

We have examined the effect of these proposals within the framework of the DRI and the Chase Econometrics quarterly forecasting models. I believe that the results of the simulations are at best only partial answers to your questions. The models do not contain a well developed and comprehensive framework for the analysis of the financial market implications of your proposed program; nor do the models adequately capture the dynamics of the interactions between the real and the financial sector. My own experience suggests that the models and most analysts usually underestimate movements in the economy during the early stages of both declines and recovery in business activity. The models did not capture the sharpness of the decline in late 1974 and early 1975 and they may also be underestimating the sharpness of the recovery which we expect later this year.

THE FISCAL PROGRAM

Within the constraints of the models, the fiscal program you have asked us to analyze would be expected to raise real GNP by 1-½ to 2 percent above the levels forecast under the program proposed by the President by the end of 1976. The unemployment rate would be 0.5 to 0.8 percentage points lower and the NIA deficit would be approximately $20 billion higher. About one-third of the $33 billion *ex ante* cost of the stimulus program still operative in the fourth quarter of 1976 would be recouped by the income induced growth in revenues.

Since the structure of these models is similar, both the Chase and DRI models are fairly close regarding the output-raising effects of increases in govern-

ment expenditure. Both models show that the $8 billion increase in public service payrolls, which is treated generically like an increase in Government purchases, would raise real GNP by about ½ of one percent by the fourth quarter of 1976. As for the cut in personal taxes in the Chase model, the $20 billion permanent tax cut would raise real GNP by about 2 percent while in the DRI model the $20 billion tax cut has about the same effect as an $8 billion increase in purchases. The CEA would estimate that a $20 billion permanent tax cut would have effects on real GNP that are about twice as large as those of an $8 billion expenditure increase. Since the multipliers for transfer payments are expected to be similar to the tax multipliers, the substitution of roughly $5 billion in transfer payments for $5 billion of defense purchases would be slightly contractive. The $3 billion investment tax credit raises GNP by about ¼ percent. To sum up the particular formulations of the model structures given a growth of M_1 ranging between 7 percent (Chase) and 8 percent (DRI) the combined fiscal changes yield an increase in real GNP by between 1-½ and 2 percent by the end of 1976, and as a result, show a lower unemployment rate would be lowered by between 0.5 and 0.8 percentage points.

MONETARY POLICY PROPOSAL

The econometric models disagree on whether increased monetary growth would raise real output strongly in 1975 and 1976. The Chase model has interest rates stay high in spite of faster growth in M_1. As a result the savings inflow into thrift institutions remains small. Housing starts never get above the 1.8 million level in that model and other interest-sensitive spending recovers much less than in the DRI simulation. Thus, the income velocity of money declines. As this decline will tend to be reversed subsequently, inflation could again flare up even if the money supply increases less rapidly in 1977–78 than in 1975–76.

THE EFFECT UPON INFLATION

We believe that price behavior will not be modified immediately by either monetary or fiscal stimuli if resources are substantially underemployed. Most econometric models agree that the short-run inflation penalties are small if they even exist at all under such conditions. Nevertheless the long-term inflationary potential of 10 percent growth in M_1 is serious. For instance, in the DRI model maintaining 10 percent growth in M_1 through 1976 feeds a much higher rate of growth in M_2 12–14 percent), drives interest rates down to very low levels, and thus creates an explosion in private housing starts up to the 2.6 million annual level by the fourth quarter of 1976. A level of 2.6 million conventional starts (excluding mobile homes) is clearly unsustainable as is the low level of interest rates.

The large growth in liquidity and real balance that a prolonged period of rapid monetary growth would induce would, however, surely lead to an increase in the rate of inflation as the recovery progresses. If the rate of growth of the money supply is then slowed, interest rates will rise immediately as increased business and consumer demand for loans is satisfied by a reduction in bank liquidity. For example, attempts to unload government securities will drive up interest rates. On the other hand, if the rate of growth of the money supply is not slowed, inflation will accelerate even more in the course of the later stages of recovery and beyond as inflation premiums raise the level of nominal interest rates. In this way 10 percent growth in M_1, if maintained for two years, will inevitably lead to a recurrence of high rates of inflation in 1977 if not in 1975. In fact, great instability in the rate of growth of the money supply would eventually turn out to be a cause rather than a cure for recessions. After 1976 this high rate of monetary expansion would increasingly be reflected in higher prices. Accelerating inflation would then threaten to destabilize the economy anew in 1977–78.

There are several additional points that must be considered in assessing these or any forecasts for 1975 and beyond. The forecasts are surrounded by a wide band of uncertainty and the probable range of error even approaches the differences between our forecasts based upon the President's program and the alternative solutions under the assumptions that you have provided. In addition, the forecasts neither reflect nor adequately evaluate the risks of a finan-

cial backwash from the very large federal deficits. These difficulties may not be serious during 1975 but the risk of choking off some of the recovery during 1976 and beyond cannot safely be ignored. These are problems which we cannot examine adequately within the currently available models but the probability of serious adverse effects in 1976 and thereafter obviously rises with both the size of the deficit and the strength of the recovery.

I sincerely hope that this response is useful to you and your committee in your policy deliberations.

Sincerely yours,

ALAN GREENSPAN,
Chairman.

CHAIRMAN OF THE BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., February 21, 1975.

Hon. HUBERT H. HUMPHREY,
Chairman,
Joint Economic Committee,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: I am glad to have this opportunity to respond to your letter of February 11, asking for my evaluation of public policy alternatives designed to promote a prompt and vigorous economic recovery. We at the Federal Reserve fully recognize the human misery and heavy economic loss that has been caused by the current economic recession, and we—as much as you and your colleagues in the Congress—want to be sure that every responsible action to help restore our nation's prosperity is fully considered, and adopted.

I am doubtful, however, that even larger Federal deficits will have the hoped-for results. The size of the deficit that could eventuate, even from the Administration's program, is not widely understood. Leaving aside the measures embodied in the President's energy program, the Administration's proposals call for temporary tax reductions amounting to $16.3 billion, as you know. But in addition, the substantial increases in Federal expenditures called for in the budget document still contemplate savings in outlays aggregating $17 billion in fiscal 1976. Nearly all of these savings require Congressional assent, which may well not be forthcoming. Moreover, the unified budget expenditure totals do not include off-budget outlays, which are expected to expand to over $10 billion in both this and the 1976 fiscal year. Finally, we need to keep in mind the larger tax reductions that appear to be taking shape in the Congress.

Making allowance for these understatements in the budget, and still overlooking the outlays of government-sponsored corporations, it appears to me that the true budget deficit (given the Administration's economic assumptions) will be substantially higher than the official figure for fiscal 1975 and that it would exceed $80 billion in fiscal 1976, rather than the $52 billion figure of the budget document. You now propose tax relief of an amount that even exceeds the figure that has emerged from the House Ways and Means Committee, besides an additional $8 billion in expenditures primarily to finance expanded public service employment. These proposals may bring the deficit for fiscal 1976 to nearly $100 billion, after allowing for the revenue-producing effects of the additional income created and for reduced outlays on account of unemployment compensation.

A budget deficit of this size, taken by itself, would surely add to private sector income. But often overlooked is the effect that the financing of such a deficit would be likely to have on our capital markets. Once economic recovery has set in, and perhaps sooner in view of the anticipatory concerns of market participants, the combination of swollen Federal credit demands and expanding private credit requirements would put an overall debt-raising burden of extraordinary proportions on our financial system. The result could well be sharply higher interest rates and tight credit conditions that would tend to choke off private credit demands and the increases in spending that such credit would have financed.

This problem is apparently anticipated in the package of policy alternatives that you propose, since it includes the stipulation that the rate of growth in the

narrow money supply (M_1) be increased to about 10 per cent. As I have often stated, I firmly believe that a prescription for rapid monetary growth, however defined, will in the end prove highly inflationary and defeat the objective of lower interest rates that it seeks to achieve.

A 10 per cent growth in the narrowly defined money stock is well beyond the rates of expansion we have before seen for any extended period. The increased supply of money and credit associated with it might for a time hold down short-term interest rates. But the inflationary fears of long-term investors would be aggravated by this explosion in the money supply, and they would demand higher interest rates in an effort to protect the future purchasing power of their capital. Higher long-term interest rates, in turn, would tend to choke off any recovery in housing, exacerbate the financial problems of our State and local governments, and deter many business firms from going ahead with their capital spending plans. Moreover, once the swollen money supply did in fact begin to generate a higher rate of inflation, even short-term interest rates would rise—perhaps to levels far higher than would otherwise have prevailed. The notion that a large Federal deficit should or could be readily financed, if only we would create enough new money to finance it, is dangerously naive. This is the road to ruin.

Turning next to your third question, I find it very difficult to say what maximum rate of economic growth represents a realistic expectation over the next two years. We are currently experiencing a serious decline in economic activity. Once such a movement is underway, it is practically impossible to know how deep or how prolonged it may prove to be. I can say, however, that my long experience in business cycle analysis has taught me not to underestimate the strength of a cyclical recovery.

Once the base for recovery has been laid—that is, as excess inventories are liquidated, more efficient business practices introduced, financial liqudity restored, and other imbalances that had developed in the course of the preceding boom eliminated—the subsequent recovery has usually been much faster than seemed possible at the time. I would not be surprised to see a robust recovery in economic activity, once it begins later on this year, as I am inclined to think it will. Given the economic adjustments that are now taking place, an increase in real GNP averaging 8–10 per cent in the first year or perhaps year and a half of recovery would not be extraordinary.

This brings me, finally, to your second question as to the public policies that might foster real growth at a 9 per cent rate from the fourth quarter of 1975 on through 1976. I do not think that this is an unreasonable objective. The human and other resources to support such a rate of growth should be readily available, with the possible exception of energy. To bring about that growth, however, a strengthening in public confidence will be required—on the part of the nation's families, businesses and investors alike. Massive Federal deficit spending and an explosive expansion in money and credit will not contribute to this objective, and it could well destroy the emerging base on which a resurgence of public confidence can be built.

The recent advances in the stock market are an encouraging development. In part, higher stock prices reflect the easing in credit market tension and the declining trend of interest rates. More importantly, however, I believe that the improvements in the stock market and long-term credit markets are telling us that progress is being made in dampening what have been widespread and strongly held fears that inflation will intensify in our country over the years ahead. We have made real progress in combatting our inflationary problem in recent months. And as the new sense of movement towards price stability spreads to businessmen and the consuming public, new confidence can be generated in the future and expanded spending plans can be set in place.

Government policy has an important role to play in this process. Of course, fiscal action is desirable and necessary in order to deal with the recession. Those who lose their jobs must be assisted by unemployment compensation, by public relief when necessary, and by opportunities for productive temporary employment in public service jobs; those whose real incomes have suffered from the inflation, even though they are employed, are entitled to reasonable tax relief. Of course, monetary policy should provide for an adequate and reasonable ex-

pansion in the nation's supply of money and credit, so that those who wish to borrow and are creditworthy can finance their needs on reasonably liberal terms. And the enduring need of policy is to do everything within the capacity of government to encourage improvements in productivity and to establish conditions under which prices and wage rates are set in more competitive markets. Meaningful progress in this direction would go far to set us again on the path of lasting, noninflationary prosperity.

Sincerely yours,

ARTHUR F. BURNS.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., February 25, 1975.

Dr. ALVIN J. KARCHERE,
Director of Economic Research,
IBM Corporate Headquarters,
Armock, N.Y.

DEAR DR. KARCHERE: The Joint Economic Committee is currently in the process of drafting its annual report to the Congress. We have had a great deal of testimony to the effect that the programs proposed by President Ford in his economic message and the budget will not be adequate to restore economic growth to our economy in the near future and reduce the unemployment rate. We are therefore considering several alternative policies in formulating our recommendations to the Congress.

The opinion of an outside expert like yourself would be most useful in helping us arrive at a policy package best suited to return the economy to economic growth in a reasonable period of time. It would be of great assistance to the Committee if you would provide us with your analysis of the following package of policy changes:

(1) Accept the bill which has been reported out of the House Ways and Means Committee as it stands.

(2) Reduce personal income taxes by an additional $12 to $15 billion dollars (annual rate) during 1975 and 1976.

(3) Remove the ceiling on social security and pay raises proposed by the President to increase spending by about $6.1 billion in fiscal 1976.

(4) Give States and local governments an anti-recession grant equal to $1 billion for each percentage pont of which the national unemployment rate exceeds four percent.

(5) Provide 500,000 public service jobs for each percentage point by which the unemployment rate exceeds five percent. At eight percent unemployment, the program would provide 1½ million jobs at an approximate annual cost of $12 billion.

(6) Increase maximum weekly unemployment benefit to two-thirds the average rate in each State, with individuals to receive at least 50 percent of their previous weekly wage up to the maximum. At eight percent unemployment this program would cost approximately $2.3 billion per year; at eight and a half percent, it would cost approximately $2.5 billion.

(7) Increase the rate of growth of the money supply sufficiently to accommodate Federal borrowing requirements and reduce short-term interest rates below six percent throughout 1975 and 1976.

If you could provide us with your evaluation by March 10, 1975 we would be able to fully consider it in drafting our report. We will be very pleased to make your evaluation a part of the record of the hearings we are currently holding on the President's budget and economic report. If you have any problems or questions regarding these policy alternatives please contact Mr. Douglas Lee of the Committee staff.

On behalf of myself and the full Committee I want to express our deep appreciation for your assistance.

Best wishes.

Sincerely yours,

HUBERT H. HUMPHREY,
Chairman.

INTERNATIONAL BUSINESS MACHINES CORP.
Armonk, N.Y., March 7, 1975.

Hon. HUBERT H. HUMPHREY,
Chairman,
Joint Economic Committee,
Dirksen Senate Office Building,
Washington, D.C.

Attention: Mr. Douglas Lee

DEAR SENATOR HUMPHREY: As you requested, we have generated forecasts of U.S. economic activity using our econometric model for three sets of assumptions—an Administration budget (excluding energy) case, a case which superimposes on the Administration budget the package of policy changes indicated in your letter of February 25, 1975, and the IBM forecast which lies between the two other cases in terms of the degree of stimulus imposed. The assumptions underlying these three simulations are given in the Appendix.

Details of the three cases, including quarterly numbers, are attached. Some of the major indicators on an annual basis are as follows:

	1974	1975	1976
Case I—Administration nonenergy budget:			
GNP (billions of 1958 dollars)	$821.1	$779.1	$824.2
Consumer price index (1967=100)	147.8	162.0	171.9
Unemployment rate (percent)	5.6	9.4	9.2
Case II—Senator Humphrey program:			
GNP (billions of 1958 dollars)		$799.0	$845.8
Consumer price index (1967=100)		161.6	171.8
Unemployment rate (percent)		8.3	7.1
Case III—IBM forecast:			
GNP (billions of 1958 dollars)		$786.5	$831.9
Consumer price index (1967=100)		161.9	172.0
Unemployment rate (percent)		9.2	8.7

The simulations show that real output will begin to improve in the second half of 1975 even with the Administration budget; this improvement will extend through 1976. The turnaround will occur because real disposable personal income will begin rising in the spring of 1975, reflecting the Administration tax cut, higher unemployment benefits, and a sharp deceleration in the rate of inflation. This will end the steady decline in real consumer spending which has occurred since late 1973. Furthermore, the major portion of the elimination of excessive inventories will occur early in 1975, so inventory decumulation will not continue to hold down production later in 1975 and in 1976. Both of the other two cases, however, would produce a faster recovery than the Administration case. For 1976 as a whole, real output would be 2.6% higher if the policies listed in your letter were implemented than under the Administration budget, and the unemployment rate would average 7.1% as compared with 9.2% in the Administration budget case. In addition, the extra stimulus will not add significantly to inflation in 1976 (and slightly reduces it in 1975) because productivity growth will be more rapid, resulting in a smaller increase in unit labor costs. The utilization of capacity remains very low, so little extra inflation from the demand side would result as well.

Policy stimulus of the dimensions embodied in the Case II assumptions clearly offers the strongest real growth and the sharpest reduction in the unemployment rate of the three cases studied. However, in this case after the tax cuts, expenditure increases and relatively expansive monetary policy drive the unemployment rate down substantially in late 1975 and early 1976, it becomes very difficult to reduce the jobless rate below the 7% area later in 1976. This occurs when, as the economy improves, the stimulus provided by the public jobs and other unemployment-related programs is reduced in accordance with the terms of these programs. If these programs were not reduced in size, growth in the later stages in 1976 would be more rapid and the unemployment rate would fall even further.

An examination of the quarterly projections shows that most of the effect of the added stimulus embodied in the Senator Humphrey policies shows up in the last three quarters of 1975; growth in real GNP is over 11% (at annual rate) during the second half of 1975 but the growth rate declines during the course

of 1976. This results in great part from the way these policy changes were incorporated into the model and the timing of their effects. The added tax reduction was assumed to occur in the second quarter. We assumed that the public service jobs program will add one million jobs by the third quarter of 1975; its effect shows up immediately in GNP as part of State and local government spending. Additional grants-in-aid to State and local governments were assumed to take effect in the second quarter of 1975, with increases in spending by these governments (and GNP) starting at that time. Furthermore, the size of these programs is reduced during the course of 1976 as the economy improves, in accordance with the conditions given to us. Therefore, the stimulative effect tends to become smaller, causing slower growth (from the higher level achieved in 1975). Any delays in the timing of these programs, either in the date of enactment or in the speed with which they are implemented, from what we have assumed would shift more of the stimulus into 1976. However, the difference in GNP and unemployment between the Administration case and the Senator Humphrey case *as of the end of 1976* would be fairly similar to what are shown in the attached simluations.

If you would like us to make calculations based on the Senator Humphrey assumptions but with different timing, we would be glad to do so.

Sincerely yours,

ALVIN J. KARCHERE,
Director.

Attachments.

Appendix.—Underlying Assumptions

CASE I—ADMINISTRATION BUDGET EXCLUDING ENERGY TAXES AND OFFSETTING TAX CUTS AND EXPENDITURES

1. Quarterly expenditure pattern as on p. 18 of Special Analysis volume of the Fiscal 1976 Budget, reduced by $3 billion for purchases of goods and services, $2 billion for domestic transfers, and $2 billion in grants-in-aid to State and local governments (all energy related), effective July 1975.
2. Personal tax rebates of $12 billion concentrated into reductions of $4.9 billion in the second quarter and $7.1 billion in the third quarter of 1975.
3. An increase in the investment tax credit, reducing corporate tax liabilities by $3¼ billion in 1975 and phasing down to a $2.6 billion reduction by 1976-III. The ITC increase also cuts personal taxes by about $1 billion.

CASE II—ABOVE CASE MODIFIED BY SEVEN CHANGES INDICATED IN THE LETTER OF FEBRUARY 25, 1975

1. Personal and corporate taxes adjusted to conform to House Ways and Means Committee Bill.
2. Personal taxes were reduced by an additional $13½ billion for 1975 and 1976. It was assumed that the new law, retroactive to January 1, would take effect in time for withholding rates to be adjusted starting in mid-May. Thus, the cut is concentrated into 2½ quarters in 1975 and spread over four quarters in 1976.
3. The Administration's 5% ceiling on CPI-related expenditure increases was dropped, raising expenditures by $6.1 billion in FY 76.
4. State and local governments were given an anti-recession grant of $1 billion for each percentage point which the national unemployment rate exceeds 4%. Five billion dollars was added to grants-in-aid and State and local government purchases, starting in 1975-II; this was reduced in stages to $3 billion by 1976-II.
5. Provide 500,000 public service jobs for each percentage point by which the unemployment rate exceeds 5%. Incremental State and local government employment was raised by one million in 1975-III, an additional one-half million in 1975-IV, and then reduced by one-half million in 1976-I. Because these new employees receive relatively lower salaries, the average salary per State and local government employee was adjusted a bit downward. For FY 1976 this program increased grants-in-aid (and State and local government purchases) by over $8 billion.

6. Unemployment benefits were increased by $2.2 billion in FY 75 and by a $1.6 billion annual rate in the second half of 1976.

7. Short-term interest rates were kept below 6% in 1975 and 1976. This involved greater monetary ease than in Case I or Case II throughout 1976. Money supply is not explictly included in our econometric model.

CASE III—IBM FORECAST (PREPARED ON FEBRUARY 13, 1975)

1. Tax cuts approved by the House Ways and Means Committee.

2. No energy tax or tax offsets. (A much more gradual program than the Administration's had been anticipated—with less adverse effect on output, employment and prices in 1975-76. However, since the dimensions of such a program were then so uncertain, no specific assumptions were incorporated into the forecast).

3. The rise in Federal expenditures from FY 75 to FY 76 was $13 billion more than projected in the Budget, if the $7 billion in energy-tax-offset expenditures are excluded from the Administration's figures.

4. The rise in defense purchases is less than in the Budget, especially during CY 1976. Much larger increases are assumed in the form of transfer payments and grants-in-aid to State and local governments.

5. There will be no 5% lid on Federal pay rises and program tied to the Consumer Price Index.

6. Monetary policy would continue to ease through mid-1975 and in a situation of weakened private demands for funds would essentially accommodate the huge Federal deficit. This posture is consistent with the 3-month Treasury bill rate dropping to 5.2% in 75-II and then gradually rising to 6% by 75-IV and 7.45% by 76-IV.

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product, current dollars	1,358.8	1,383.8	1,416.3	1,428.0	1,415.6	1,422.3	1,464.6	1,502.1	1,552.9	1,602.5	1,646.1	1,681.9
Personal consumption expenditures	840.6	869.1	901.3	896.8	911.3	920.2	954.7	969.4	990.8	1,013.8	1,036.6	1,059.9
Durable goods	123.9	129.5	136.1	121.5	122.4	116.9	125.6	123.8	127.4	132.0	135.9	140.5
Nondurable goods	364.4	375.8	389.0	391.5	398.3	406.7	421.5	430.2	438.4	446.5	454.5	462.2
Services	352.4	363.8	376.2	383.8	390.6	396.6	407.6	415.3	425.1	435.3	446.2	457.2
Gross private domestic investment	210.6	211.8	205.8	207.7	176.2	167.4	169.0	180.9	199.4	216.1	225.9	229.6
Fixed investment	193.7	198.1	197.0	193.3	186.5	179.4	180.1	187.4	199.0	209.3	216.6	219.6
Nonresidential	145.2	149.4	150.9	152.7	149.5	143.9	143.2	146.8	153.2	158.6	163.0	164.5
Structures	51.3	52.2	51.0	54.3	51.4	50.7	52.8	55.0	57.5	58.4	58.1	55.4
Producers durable equipment	93.9	97.2	99.9	98.4	98.1	93.2	90.4	91.8	95.8	100.2	104.9	109.1
Residential structures	48.5	48.7	46.1	40.6	36.9	35.6	36.9	40.5	45.8	50.6	53.6	55.1
Nonfarm	47.8	48.0	45.4	39.8	36.2	34.8	36.0	39.7	44.9	49.8	52.8	54.2
Change in business inventories	16.9	13.7	8.8	14.4	−10.3	−12.1	−11.1	−6.5	.4	6.9	9.2	10.0
Net exports of goods and services	11.3	−1.5	−3.1	1.1	1.4	3.8	5.0	6.9	7.5	7.3	6.9	6.2
Exports	131.2	138.5	143.6	144.3	147.6	151.4	154.4	158.2	161.2	164.0	166.8	169.6
Imports	119.9	140.0	146.7	143.2	146.2	147.6	149.4	151.3	153.7	156.7	159.9	163.4
Government purchases of goods and services	296.3	304.4	312.3	322.4	326.7	330.9	336.0	344.9	355.1	365.3	376.7	386.3
Federal	111.5	114.3	117.2	122.8	122.9	121.8	124.3	129.5	135.4	141.8	148.3	152.5
National defense	75.8	76.6	78.4	83.5	81.0	78.5	81.1	85.9	91.3	97.3	103.3	106.4
Other	35.7	37.7	38.8	39.3	41.9	43.3	43.2	43.6	44.2	44.5	45.0	46.1
State and local	184.8	190.1	195.1	199.6	203.8	209.1	211.6	215.4	219.7	223.4	228.5	233.8

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product, 1958 prices	830.5	827.1	823.1	803.7	780.5	768.5	780.1	787.2	803.4	819.5	832.3	841.4
Personal consumption expenditures	539.7	542.7	547.2	530.1	528.9	522.9	534.5	534.0	538.9	545.3	551.7	558.5
Durable goods	105.2	106.8	107.8	93.7	94.6	89.6	95.4	93.2	94.9	97.5	99.5	101.9
Nondurable goods	223.9	223.6	225.8	221.7	219.4	218.6	222.1	223.1	224.5	226.2	228.2	230.2
Services	210.6	212.2	213.7	214.7	214.9	214.6	217.0	217.7	219.5	221.6	224.0	226.4
Gross private domestic investment	133.3	130.3	122.7	118.9	97.7	91.3	90.8	96.0	104.9	112.7	116.9	118.1
Fixed investment	122.7	122.2	117.6	109.8	103.9	98.5	97.3	99.7	104.6	108.9	111.8	112.7
Nonresidential	96.3	96.5	94.1	89.3	85.6	81.1	79.4	80.3	83.0	85.2	87.0	87.5
Structures	26.7	26.6	25.4	26.2	24.3	23.6	24.3	25.0	25.8	25.9	25.4	24.0
Producer's durable equipment	69.7	69.9	68.7	63.1	61.2	57.5	55.1	55.3	57.1	59.3	61.6	63.6
Residential structures	26.4	25.7	23.5	20.5	18.4	17.5	17.9	19.4	21.6	23.7	24.8	25.2
Nonfarm	26.0	25.3	23.1	20.1	18.0	17.1	17.5	19.0	21.2	23.3	24.4	24.8
Change in business inventories	10.6	8.2	5.0	9.1	−6.2	−7.2	−6.5	−3.7	.2	3.8	5.1	5.4
Net exports of goods and services	11.5	8.3	7.3	8.9	8.9	9.8	10.2	11.2	11.5	11.4	11.2	11.0
Exports	73.3	73.4	70.9	68.9	69.2	70.1	70.7	72.0	72.8	73.3	73.9	74.5
Imports	61.8	65.1	63.6	60.0	60.3	60.3	60.5	60.8	61.2	61.9	62.7	63.5
Government purchases of goods and services	146.0	145.8	145.9	145.8	145.0	144.4	144.6	146.0	148.2	150.1	152.6	153.8
Federal	56.3	56.3	56.5	56.3	55.5	54.3	54.9	56.4	58.5	60.6	62.9	63.7
State and local	89.7	89.5	89.4	89.5	89.5	90.1	89.7	89.6	89.7	89.5	89.7	90.1
GNP price deflator (1958=100)	163.6	167.3	172.1	177.7	181.4	185.1	187.7	190.8	193.3	195.5	197.8	199.9
Industrial wholesale prices (1967=100)	138.6	150.2	160.8	165.6	167.0	168.5	169.7	170.9	172.0	172.9	173.7	174.6
Consumer price index (1967=100)	141.4	145.6	150.1	154.2	157.5	160.9	163.4	166.2	168.6	170.9	173.0	175.0

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product	1,358.8	1,383.8	1,416.3	1,428.0	1,415.6	1,422.3	1,464.6	1,502.1	1,552.9	1,602.5	1,646.1	1,681.9
Less:												
Depreciation (CCA)	115.8	118.6	120.7	123.0	124.8	127.0	128.9	130.8	132.8	135.1	137.6	140.2
Indirect business taxes	122.6	125.9	129.5	129.8	133.1	134.4	142.2	144.4	148.6	153.1	157.6	151.1
Business transfers	5.1	5.2	5.3	5.3	5.4	5.5	5.5	5.6	5.7	5.8	5.8	5.9
Statistical discrepancy	−6.3	.3	3.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Plus: Subsidies less surplus	−2.7	−3.7	−2.4	−2.7	−1.3	−1.2	−1.2	−1.3	−1.4	−1.4	1—.4	−1.4
Equals national income	1,118.8	1,130.2	1,155.5	1,162.2	1,146.0	1,149.3	1,181.8	1,215.0	1,259.4	1,302.2	1,338.7	1,368.3
Less:												
Corporate Profits and IVA	107.7	105.6	105.8	100.6	87.5	81.8	92.9	102.8	119.3	132.4	140.0	140.4
Contribution for Social Security	99.1	100.8	103.0	103.2	104.6	104.9	106.2	107.8	111.6	113.7	115.6	117.7
Wage Accruals	0	−.6	−1.5	0	0	0	0	0	0	0	0	0
Plus:												
Government Transfers	123.1	130.6	138.7	145.8	152.7	159.1	165.0	169.1	171.6	174.1	183.0	184.1
Interest Paid	40.8	41.9	42.7	43.6	44.3	44.9	46.2	47.6	48.7	49.9	50.6	51.5
Dividends	31.6	32.5	33.2	33.3	33.2	33.1	33.1	33.3	33.8	34.4	35.1	35.7
Business Transfers	5.1	5.2	5.3	5.4	5.5	5.5	5.5	5.6	5.7	5.8	5.8	5.9
Equals personal income	1,112.5	1,134.6	1,168.2	1,186.4	1,189.6	1,205.2	1,232.4	1,260.0	1,288.2	1,320.2	1,357.6	1,387.4
Less personal income taxes	161.9	168.2	175.1	177.8	175.2	155.9	153.7	188.7	194.3	200.6	210.2	215.4
Equals disposable personal income	950.6	966.6	993.1	1,008.7	1,014.4	1,049.3	1,078.7	1,071.3	1,093.9	1,119.6	1,147.3	1,172.0
Savings ratio (percent of discrepancy income)	9.0	7.5	6.7	8.5	7.6	9.8	9.1	7.1	7.0	7.1	7.3	7.2
Consumption ratio (percent)	88.4	89.9	90.8	88.9	89.8	87.7	88.5	90.5	90.6	90.5	90.3	90.4
Private annual earnings (thousands of dollars)	8.68	8.92	9.10	9.24	9.40	9.59	9.76	9.95	10.12	10.30	10.46	10.63
Private Hourly earnings (dollars)	4.56	4.69	4.81	4.90	5.00	5.11	5.18	5.28	5.43	5.34	5.53	5.63
Private output per manhour (1958=100)	153.5	153.6	152.8	150.9	150.1	149.3	150.6	151.6	153.1	154.8	156.2	156.9
Unit labor cost (1958=100)	158.8	162.1	167.1	172.5	177.2	181.8	184.6	184.6	185.0	185.9	187.5	190.0
Civilian labor force (millions)	90.5	90.6	91.4	91.8	92.1	92.3	92.3	92.4	92.6	92.9	93.3	93.6
Civilian employment (millions)	85.8	86.0	86.3	85.8	84.2	83.4	83.4	83.5	83.8	84.8	84.8	85.3
Unemployment rate (percent of labor force)	5.2	5.1	5.5	6.5	8.6	9.6	9.7	9.6	9.5	9.3	9.1	8.9

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
National income	1,118.8	1,130.2	1,155.5	1,162.2	1,146.0	1,149.3	1,181.8	1,215.0	1,259.4	1,302.2	1,338.7	1,368.3
Compensation of employees	828.8	848.3	868.2	877.3	876.5	884.9	902.6	922.8	945.6	970.3	994.5	1,019.8
Wages and salaries	727.6	744.6	761.5	768.7	766.1	772.7	787.8	805.2	823.9	845.4	866.3	888.4
Private	573.8	588.3	602.5	604.7	599.5	603.5	615.7	629.1	644.3	662.1	679.9	697.6
Military	21.0	20.9	20.8	22.0	22.1	22.2	22.3	22.9	23.1	23.2	23.4	24.0
Civilian government	132.8	135.4	138.2	142.0	144.4	146.9	149.8	153.2	156.6	160.1	163.1	166.8
Supplements	101.2	103.7	106.7	108.5	110.4	112.2	114.8	117.6	121.7	124.9	128.2	131.4
Rent, interest, proprietors income	182.2	176.3	181.5	184.3	182.1	182.6	186.2	189.4	194.5	199.4	204.2	208.1
Corporate profits plus IVA	107.7	105.6	105.8	100.6	87.5	81.8	92.9	102.8	119.3	132.4	140.0	140.4
Profits before tax[1]	135.4	139.0	157.0	130.4	101.8	95.9	104.5	112.3	129.0	141.6	149.4	150.6
Profits tax liability	52.2	55.9	62.7	51.1	37.9	35.8	39.0	41.9	48.5	53.4	56.6	57.5
Profits after tax	83.2	83.1	94.3	79.3	63.9	60.1	65.5	70.4	80.5	88.2	92.8	93.0
Dividends	31.6	32.5	33.2	33.3	33.2	33.1	33.1	33.3	33.8	34.4	35.1	35.7
Undistributed profits	51.6	50.6	61.1	46.0	30.7	27.0	32.4	37.1	46.7	53.8	57.7	57.3
Inventory valuation adjustment	−27.7	−33.4	−51.2	−29.8	−14.3	−14.1	−11.6	−9.5	−9.7	−9.2	−9.4	−10.1
Memo: new orders, machinery and equipment	134.9	143.0	145.7	129.0	125.0	122.1	124.8	129.2	137.3	142.9	148.2	152.0
Federal Government receipts	278.1	288.6	302.8	293.9	280.3	258.9	258.3	295.3	308.0	319.4	330.5	337.4
Federal Government expenditures	281.0	291.6	304.7	317.3	329.4	338.4	342.2	352.4	360.8	370.4	386.6	392.9
Surplus or deficit	−2.8	−3.0	−1.9	−23.4	−49.0	−79.5	−83.9	−57.2	−52.8	−51.0	−56.1	−55.6
State and local government receipts	200.6	205.3	210.9	213.8	218.0	223.4	230.4	236.2	244.0	251.3	260.8	266.7
State and local government expenditures	197.4	203.3	208.8	214.4	219.5	225.9	229.8	234.9	240.2	244.9	250.5	256.4
Surplus or deficit	3.2	2.0	2.1	−.6	−1.5	−2.5	.5	1.4	3.8	6.4	10.3	10.2

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross national product, current dollars	930.3	977.1	1,054.9	1,158.0	1,294.9	1,396.7	1,451.1	1,620.8
Personal consumption expenditures	579.5	617.6	667.1	729.0	805.2	876.9	938.9	1,025.3
Durable goods	90.8	91.3	103.9	118.4	130.3	127.7	122.2	133.9
Nondurable goods	245.9	263.8	278.4	299.7	338.0	380.2	414.2	450.4
Services	242.7	262.5	284.8	310.9	336.9	369.0	402.5	441.0
Gross private domestic investment	139.0	136.3	153.7	179.3	209.4	209.0	173.3	217.7
Fixed investment	131.2	131.7	147.4	170.8	194.0	195.5	183.3	211.1
Nonresidential	98.5	100.6	104.6	116.8	136.7	149.5	145.9	159.8
Structures	34.2	36.1	37.9	41.1	47.0	52.2	52.5	57.3
Producers durable equipment	64.3	64.4	66.6	75.7	89.7	97.3	93.4	102.5
Residential structures	32.6	31.1	42.8	53.9	57.3	46.0	37.5	51.3
Nonfarm	32.0	30.7	42.3	53.4	56.7	45.2	36.7	50.4
Change in business inventories	7.8	4.5	6.3	8.6	15.3	13.4	−10.0	6.7
Net exports of goods and services	1.9	3.6	−.1	−6.0	4.0	2.0	4.3	6.9
Exports	55.5	62.9	65.5	72.4	100.4	139.4	152.9	165.4
Imports	53.6	59.3	65.6	78.4	96.4	137.4	148.6	158.5
Government purchases of goods and services	209.9	219.5	234.2	255.6	276.4	308.8	334.6	370.9
Federal	98.8	96.2	97.6	104.8	106.6	116.4	124.6	144.5
National defense	78.4	74.6	71.2	74.8	74.4	78.6	81.6	99.6
Other	20.4	21.6	26.4	30.1	32.2	37.9	43.0	45.0
State and local	111.2	123.3	136.6	150.8	169.8	192.4	210.0	226.4

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross national product, 1958 prices	725.6	722.4	746.3	792.4	839.2	821.1	779.1	824.2
Personal consumption expenditures	469.1	477.5	496.4	527.3	552.1	539.9	530.1	548.6
Durable goods	85.6	83.8	92.5	104.9	113.6	103.4	93.2	98.4
Nondurable goods	201.3	206.5	211.3	220.2	228.6	223.7	220.8	227.3
Services	182.2	187.2	192.6	202.1	209.9	212.8	216.1	222.9
Gross private domestic investment	110.5	103.4	111.1	125.0	138.1	126.3	94.0	113.1
Fixed investment	103.8	99.4	105.7	117.9	127.3	118.1	99.9	109.5
Nonresidential	80.1	77.2	76.7	83.7	94.4	94.0	81.6	85.7
Structures	24.3	23.7	23.2	23.8	25.3	26.2	24.3	25.3
Produces durable equipment	55.8	53.5	53.5	59.8	69.0	67.8	57.3	60.4
Residential structures	23.7	22.2	29.0	34.2	32.9	24.0	18.3	23.8
Nonfarm	23.2	21.9	28.6	33.9	32.6	23.6	17.9	23.4
Change in business inventories	6.7	3.9	5.3	7.0	10.8	8.2	−5.9	3.6
Net exports of goods and services	.2	2.2	−.5	−2.9	4.6	9.0	10.0	11.3
Exports	48.4	52.2	52.1	55.7	66.6	71.6	70.5	73.6
Imports	48.2	50.0	52.6	58.6	62.0	62.6	60.5	62.4
Government purchases of goods and services	145.8	139.3	139.3	143.1	144.3	145.9	145.0	151.1
Federal	73.4	64.4	60.9	61.0	57.3	56.3	55.3	61.4
State and local	72.4	74.9	78.4	82.1	87.0	89.5	89.7	89.7
GNP price deflator (1958=100)	128.2	135.2	141.3	146.2	154.3	170.2	186.2	196.6
Industrial wholesale prices (1967=100)	106.0	109.9	114.0	117.9	125.9	153.8	169.0	173.3
Consumer price index (1967=100)	109.8	116.3	121.3	125.3	133.1	147.8	1,162.0	71.9

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross National Product	930.3	977.1	1,054.9	1,158.0	1,294.9	1,396.7	1,451.1	1,620.8
Less:								
Depreciation (CCA)	81.6	87.3	93.7	102.9	110.8	119.5	127.9	136.4
Indirect business taxes	85.9	93.4	102.7	110.0	119.2	126.9	138.5	155.1
Business transfers	3.8	4.0	4.3	4.5	4.8	5.2	5.5	5.8
Statistical discrepancy	−6.1	−6.4	−2.3	−3.8	−5.0	.5	5.0	5.0
Plus: subsidies less surplus	1.0	1.7	1.1	2.3	.6	−2.9	−1.2	−1.4
Equals national income	766.0	800.4	857.7	946.5	1,065.6	1,141.7	1,173.0	1,317.1
Less:								
Corporate profits and IVA	79.8	69.3	78.7	92.2	105.1	104.9	91.2	133.0
Contribution for social security	54.2	57.7	63.8	73.0	91.2	101.5	105.8	114.7
Wage accruals	0	−0	.6	0	−.1	−.5	0	0
Plus:								
Government transfers	61.9	75.1	89.0	98.6	112.9	134.5	161.5	178.2
Interest paid	28.7	31.0	31.2	33.0	38.3	42.3	45.7	50.2
Dividends	24.3	24.7	25.0	27.4	29.6	32.6	33.2	34.7
Business transfers	3.8	4.0	4.3	4.5	4.8	5.2	5.5	5.8
Equals personal income	750.9	808.3	864.1	944.9	1,055.0	1,150.4	1,221.8	1,338.4
Less personal income taxes	116.5	116.6	117.6	142.4	151.3	170.7	168.4	205.1
Equals disposable personal income	634.4	691.7	746.4	802.5	903.7	979.7	1053.4	1133.2
Savings ratio (percent of disposable income)	6.1	8.2	8.2	6.6	8.3	7.9	8.4	7.1
Consumption ratio (percent)	91.4	89.3	89.4	90.8	89.1	89.5	89.1	90.5
Private annual earnings (thousands of dollar)	6.60	6.96	7.36	7.83	8.37	8.99	9.68	10.38
Private hourly earnings (dollars)	3.41	3.64	3.87	4.10	4.38	4.74	5.14	5.48
Private output per man-hour (1958=100)	139.2	140.6	146.6	152.4	156.5	152.7	150.4	155.2
Unit labor cost (1958=100)	125.8	133.2	135.8	140.0	148.9	165.1	181.5	187.1
Civilian labor force (millions)	80.7	82.8	84.1	86.5	88.7	91.1	92.3	93.1
Civilian employment (millions)	77.9	78.6	79.1	81.7	84.4	86.0	83.6	84.5
Unemployment rate (percent of labor force)	3.5	5.0	5.9	5.6	4.8	5.6	9.4	9.2

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
National income	766.0	800.4	857.7	946.5	1,056.6	1,141.7	1,173.0	1,317.0
Compensation of employees	566.0	603.9	643.0	707.1	786.0	855.6	836.7	982.6
Wages and salaries	509.6	541.9	573.6	626.8	691.6	750.6	782.9	856.0
Private	405.5	426.9	449.5	491.4	545.1	592.3	612.0	671.0
Military	19.0	19.5	19.4	20.5	20.6	21.2	22.4	23.4
Civilian government	85.1	95.5	104.7	114.8	125.9	137.1	148.6	161.7
Supplements	56.3	61.9	69.4	80.3	94.3	105.0	113.8	126.5
Rent, interest, proprietors income	120.3	127.3	135.9	147.2	147.5	181.1	135.1	201.6
Corporate profits plus IVA	79.8	69.3	78.7	92.2	105.1	104.9	91.2	133.0
Profits before tax	84.9	74.1	83.6	99.2	122.7	140.4	103.6	142.6
Profits tax liability	40.1	34.8	37.5	41.5	49.8	55.5	38.6	54.0
Profits after tax	44.8	39.3	46.1	57.6	72.9	85.0	65.0	88.6
Dividends	24.3	24.7	25.0	27.4	29.6	32.6	33.2	34.7
Undistributed profits	20.5	14.6	21.1	30.3	43.3	52.3	31.8	53.9
Inventory valuation adjustment	−5.1	−4.8	−4.9	−7.0	−17.6	−35.5	−12.4	−9.6
Memo: New orders, machinery and equipment	92.3	84.5	87.8	101.9	123.9	138.2	125.3	145.1
Federal Government Receipts	197.3	192.0	198.5	227.2	258.5	290.8	273.2	323.8
Federal Government expenditures	189.2	203.9	220.3	244.7	264.1	298.6	340.6	377.7
Surplus or deficit	8.1	−11.9	−21.9	−17.5	−5.6	−7.8	−67.4	−53.9
State and local government receipts	119.7	135.0	152.2	177.2	193.5	207.6	227.0	255.7
State and local government expenditures	119.0	133.2	143.8	164.8	184.4	206.0	227.5	248.0
Surplus or deficit	.7	1.8	3.3	12.3	9.1	1.7	−.5	7.7

CASE I.—ADMINISTRATION'S BUDGET (NONENERGY)—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Percent growth (annual rates)								
GNP, current dollars	7.6	5.0	8.0	9.8	11.8	7.9	3.9	11.7
GNP, 1958 prices	2.7	−.4	3.3	6.2	5.9	−2.2	−5.1	5.8
GNP price deflator	4.8	5.5	4.5	3.4	5.6	10.3	9.4	5.6
Industrial wholesale prices	3.3	3.7	3.7	3.4	6.8	22.2	9.9	2.5
Consumer price index	5.4	5.9	4.3	3.3	6.2	11.1	9.6	6.1
Private hourly earnings	6.6	6.9	6.2	5.9	6.8	8.4	8.5	6.6
Private annual earnings	6.6	5.5	5.8	6.4	6.9	7.4	7.7	7.2
Private workweek	.0	−1.3	−.4	.4	.1	−.9	−.7	.6
Productivity	.5	1.1	4.2	4.0	2.7	−2.5	−1.5	3.2
Unit labor cost	6.9	5.9	1.9	3.1	6.3	10.9	9.9	3.1
Civilian labor force	2.5	2.6	1.6	2.9	2.5	2.6	1.3	.9
Civilain employment	2.6	1.0	.6	3.3	3.3	1.8	−2.7	1.1
Unemployment (percent of labor force)	3.5	5.0	5.9	5.6	4.8	5.6	9.4	9.2
New orders, machinery, and equipment	10.9	−8.4	3.9	16.0	21.6	11.5	−9.3	15.8
Corporate profits before taxes	−3.1	−12.8	12.9	18.6	23.7	14.5	−26.2	37.7
Business fixed investment	10.9	2.1	4.0	11.7	17.1	9.4	−2.5	9.6
Nonresidential structures	12.9	5.5	4.9	8.4	14.3	11.1	.5	9.2
Producers durable equipment	9.8	.2	3.5	13.6	18.6	8.5	−4.1	9.8
Inventory investment (billions of dollars)	7.8	4.5	6.3	8.6	15.3	13.4	−10.0	6.7
Residential construction	8.6	−4.5	37.4	26.0	6.2	−19.7	−18.5	36.8
Disposable personal income	7.3	9.0	7.9	7.5	12.6	8.4	7.5	7.6
Consumption	8.1	6.6	8.0	9.3	10.5	8.9	7.1	9.2
Durable goods	8.1	.6	13.8	14.0	10.0	−2.0	−4.4	9.6
Nondurable goods	6.5	7.3	5.6	7.3	12.8	12.5	8.9	8.7
Services	9.7	8.2	8.5	9.2	8.4	9.5	9.1	9.5
Savings ratio (percent of disposable income)	6.1	8.2	8.2	6.6	8.3	7.9	8.4	7.1
Net exports (billions of dollars)	1.9	3.6	−.1	−6.0	4.0	2.0	4.3	6.9
Federal Government	.0	−2.6	1.5	7.4	1.6	9.3	7.0	15.9
Defense spending	.1	−4.9	−4.6	5.1	−.5	5.6	3.9	21.9
State and local government	10.3	11.0	10.8	10.4	12.6	13.3	9.1	7.8

CASE II.—SENATOR HUMPHREY'S PACKAGE

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product, current dollars	1,358.8	1,383.8	1,416.3	1,428.0	1,417.4	1,445.2	1,509.7	1,571.1	1,606.5	1,646.0	1,684.5	1,720.8
Personal consumption expenditures	840.6	869.1	901.3	896.8	911.4	930.2	975.0	1,006.4	1,020.3	1,043.4	1,067.5	1,091.7
Durable goods	123.9	129.5	136.1	121.5	122.5	121.7	134.9	140.0	138.3	142.9	147.1	151.6
Nondurable goods	364.4	375.8	389.0	391.5	398.3	409.6	429.4	444.3	450.8	459.0	467.4	475.5
Services	352.4	363.8	376.2	383.8	390.6	398.9	410.8	422.1	431.2	441.5	453.0	464.6
Gross private domestic investment	210.6	211.8	205.8	207.7	176.3	171.4	178.6	196.9	216.8	227.8	235.0	237.5
Fixed investment	193.7	198.1	197.0	193.3	186.5	180.6	183.3	193.7	207.4	218.6	226.4	229.8
Nonresidential	145.2	149.4	150.9	152.7	149.5	144.6	145.4	151.2	159.5	165.4	169.5	170.4
Structures	51.3	52.2	51.0	54.3	51.4	50.6	52.9	55.5	58.7	60.1	60.1	57.5
Producers durable equipment	93.9	97.2	99.9	98.4	98.1	94.0	92.5	95.8	100.8	105.3	109.4	113.0
Residential structures	48.5	48.7	46.1	40.6	36.9	36.0	37.8	42.4	47.9	53.2	56.9	59.4
Nonfarm	47.8	48.0	45.4	39.8	36.2	35.2	37.0	41.6	47.1	52.3	56.0	58.5
Change in business inventories	16.9	13.7	8.8	14.4	—10.2	—9.1	—4.6	3.3	9.4	9.2	8.6	7.6
Net exports of goods and services	11.3	—1.5	—3.1	1.1	1.3	3.0	3.0	3.3	3.0	2.4	2.0	1.4
Exports	131.2	138.5	143.6	144.3	147.6	151.4	154.4	158.2	161.2	164.0	166.8	169.6
Imports	119.9	140.0	146.7	143.2	146.3	148.4	151.4	154.9	158.2	161.6	164.8	168.2
Government purchases of goods and services	296.3	304.4	312.3	322.4	328.3	340.5	352.9	364.5	366.4	372.5	380.9	390.2
Federal	111.5	114.3	117.2	122.8	124.5	126.4	128.2	132.8	136.8	138.5	141.0	146.2
National Defense	75.8	76.6	78.4	83.5	84.2	84.8	85.6	88.5	90.2	91.7	93.0	96.2
Other	35.7	37.7	38.8	39.3	40.3	41.6	42.6	44.3	45.6	46.7	48.0	50.0
State and local	184.8	190.1	195.1	199.6	203.8	214.1	224.7	231.7	230.7	234.0	239.0	244.0

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product, 1958 prices	830.5	727.1	823.1	803.7	781.5	781.8	806.1	826.6	833.2	842.6	850.6	856.8
Personal consumption expenditures	539.7	542.7	547.2	530.1	529.0	529.5	547.8	557.5	556.7	562.2	568.1	574.1
Durable goods	105.2	106.8	107.8	93.7	94.6	93.3	102.6	105.4	103.0	105.2	107.0	108.9
Nondurable goods	223.9	223.0	225.8	221.7	219.4	220.3	226.4	230.6	231.0	232.5	234.3	236.1
Services	210.6	212.2	213.7	214.7	214.9	215.9	218.9	221.5	222.7	224.5	226.8	229.1
Gross private domestic investment	133.3	130.3	122.7	118.9	97.8	93.9	96.5	105.2	114.4	118.6	120.8	120.9
Fixed investment	122.7	122.2	117.6	109.8	104.0	99.3	99.2	103.3	109.1	113.5	116.1	116.7
Nonresidential	96.3	96.5	94.1	89.3	85.6	81.6	80.8	83.0	86.4	88.7	89.9	89.6
Structures	26.7	26.6	25.4	26.2	24.3	23.6	24.4	25.3	26.3	26.6	26.1	24.6
Producers durable equipment	69.7	69.9	68.7	63.1	61.2	58.0	56.4	57.8	60.1	62.1	63.7	65.0
Residential structures	26.4	25.7	23.5	20.5	18.4	17.7	18.4	20.3	22.7	24.8	26.2	27.1
Nonfarm	26.0	25.3	23.1	20.1	18.0	17.3	18.0	19.9	22.3	24.4	25.8	26.7
Change in business inventories	10.6	8.2	5.0	9.1	—6.2	—5.4	—2.7	1.9	5.3	5.1	4.7	4.1
Net exports of goods and services	11.5	8.3	7.3	8.9	8.9	9.5	9.4	9.6	9.6	9.3	9.0	8.6
Exports	73.3	73.4	70.9	68.9	69.2	70.0	70.7	71.9	72.6	73.2	73.6	74.0
Imports	61.8	65.1	63.6	60.0	60.3	60.6	61.3	62.3	63.0	63.8	64.6	65.4
Government purchases of goods and services	146.0	145.8	145.9	145.8	145.8	148.9	152.4	154.2	152.5	152.4	152.7	153.4
Federal	56.3	56.3	56.5	56.3	56.3	56.6	56.9	57.3	57.9	58.2	58.5	59.0
State and local	89.7	89.5	89.4	89.5	89.5	92.3	95.5	96.9	94.6	94.3	94.2	94.3
GNP price deflator (1958=100)	163.6	167.3	172.1	177.7	181.4	184.9	187.3	190.1	192.8	195.4	198.0	200.8
Industry wholesale prices (1967=100)	138.6	150.2	160.8	165.6	167.0	168.2	169.4	170.8	172.5	174.1	175.8	177.3
Consumer Price Index (1967=100)	141.4	145.6	150.1	154.2	157.5	160.6	162.9	165.4	168.2	170.6	173.0	175.3

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product	1,353.8	1,383.8	1,416.3	1,428.0	1,417.4	1,445.2	1,509.7	1,571.1	1,606.5	1,646.0	1,684.5	1,720.8
Less:												
Depreciation (CCA)	115.8	118.6	120.7	123.0	124.8	127.0	128.9	130.9	133.1	135.6	138.3	141.2
Indirect Business taxes	122.6	125.9	129.5	129.8	133.1	135.8	145.3	149.9	153.0	157.5	162.3	165.9
Business transfers	5.1	5.2	5.3	5.3	5.4	5.5	5.5	5.6	5.7	5.8	5.8	5.9
Statistical Discrepancy	−6.3	.3	3.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Plus: Subsidies less surplus	−2.7	−3.7	−2.4	−2.7	−2.4	−2.1	−2.3	−2.1	−1.5	−1.5	−1.3	−1.1
Equals National income	1,118.8	1,130.2	1,155.5	1,162.2	1,146.7	1,169.8	1,222.7	1,277.6	1,307.9	1,340.5	1,371.8	1,401.6
Less:												
Corporate profits and IVA	107.7	105.6	105.8	100.6	87.8	96.6	112.7	129.3	134.7	140.1	141.3	142.7
Contributions for social security	99.1	100.8	103.0	103.2	104.5	105.1	108.0	110.6	114.3	116.2	118.4	120.3
Wage accruals	0	−.6	−1.5	0	0	0	0	0	0	0	0	0
Plus:												
Government transfers	123.1	130.6	138.7	145.8	152.7	158.9	170.2	172.1	175.1	177.0	189.8	191.8
Interest paid	40.8	41.9	42.7	43.6	44.3	44.9	46.4	48.1	49.5	50.6	51.1	51.9
Dividends	31.6	32.5	33.2	33.3	33.2	33.3	33.6	34.2	34.8	35.5	36.1	36.7
Business transfers	5.1	5.2	5.3	5.3	5.4	5.5	5.5	5.6	5.7	5.8	5.8	5.9
Equals personal income	1,112.5	1,134.6	1,168.2	1,183.4	1,189.9	1,210.7	1,257.7	1,297.6	1,324.0	1,353.0	1,394.9	1,425.0
Less personal income taxes	161.9	108.2	175.1	177.8	175.3	132.5	133.8	148.6	180.4	185.8	194.0	198.5
Equals disposable personal income	950.6	966.5	993.1	1,008.7	1,014.6	1,078.2	1,123.9	1,149.1	1,143.7	1,167.2	1,200.9	1,226.5
Savings ratio (percent of disposable income)	9.0	7.5	6.7	8.5	7.6	11.3	10.9	10.1	8.5	8.3	8.9	8.7
Consumption ratio (percent)	88.4	89.9	90.8	88.9	89.8	86.3	86.8	87.6	89.2	89.4	88.9	89.0
Private annual earnings (thousands of dollars)	8.68	8.92	9.10	9.24	9.41	9.59	9.76	9.96	10.14	10.31	10.49	10.66
Private hourly earnings (dollars)	4.56	4.69	4.81	4.90	5.00	5.09	5.16	5.26	5.37	5.45	5.55	5.65
Private output per man-hour (1958=100)	153.5	153.6	152.8	150.9	150.2	150.9	153.4	155.4	155.7	155.9	156.4	156.7
Unit labor cost (1958=100)	158.8	162.1	167.1	172.5	177.1	179.1	178.5	179.6	183.0	185.4	188.3	191.2
Civilian labor force (millions)	90.5	90.6	91.4	91.8	92.1	92.3	92.3	92.4	92.6	92.9	93.3	93.6
Civilian employment (millions)	85.8	86.0	86.3	85.8	84.3	83.6	84.8	85.8	85.8	86.3	86.8	87.2
Unemployment rate (percent of labor force)	5.2	5.1	5.5	6.5	8.6	9.4	8.1	7.2	7.3	7.1	7.0	6.9

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
National income	1,118.8	1,130.2	1,155.5	1,162.2	1,146.7	1,169.8	1,222.7	1,277.6	1,307.9	1,340.5	1,371.8	1,401.6
Compensation of employees	828.8	848.3	888.2	877.3	876.7	888.0	918.8	951.6	973.6	997.4	1,023.5	1,048.5
Wages and salaries	727.6	744.6	761.5	768.7	766.3	775.6	802.8	831.9	849.8	870.4	893.2	915.0
Private	573.8	588.3	602.5	604.7	599.7	606.4	622.5	643.0	661.7	679.1	697.7	714.4
Military	21.0	20.9	20.8	22.0	22.1	22.2	22.3	23.5	23.7	23.8	24.0	25.2
Civilian government	132.8	135.4	138.2	142.0	144.4	146.9	157.9	165.3	164.4	167.5	171.5	175.3
Supplements	101.2	103.7	106.7	108.5	110.5	112.5	116.0	119.7	123.8	127.0	130.4	133.5
Rent, interest, proprietors income	182.2	176.3	181.5	184.3	182.1	185.2	191.2	196.7	199.5	203.0	207.0	210.5
Corporate profits plus IVA	107.7	105.6	105.8	100.6	87.8	96.6	112.7	129.3	134.7	140.1	141.3	142.7
Profits before tax	135.4	139.0	157.0	130.4	102.1	109.9	124.3	139.4	146.1	151.3	153.2	154.8
Profits tax liability	62.2	55.9	62.7	51.1	38.1	41.1	46.5	52.1	55.1	57.0	57.8	58.4
Profits after tax	83.2	83.1	94.3	79.3	64.0	68.8	77.8	87.3	91.0	94.2	95.4	96.5
Dividends	31.6	32.5	33.2	33.3	33.2	33.3	33.6	34.2	34.8	35.5	36.1	36.7
Undistributed profits	51.6	50.6	61.1	46.0	30.8	35.5	44.2	53.1	56.2	58.8	59.4	59.8
Inventory valuation adjustment	—27.7	—33.4	—51.2	—29.8	—14.3	—13.3	—11.6	—10.1	—11.4	—11.1	—11.9	—12.2
Memo: New orders, machinery and equipment	134.9	143.0	145.7	129.0	125.0	125.7	130.4	137.3	143.8	148.3	152.5	156.7
Federal Government Receipts	278.1	288.6	302.8	293.9	280.6	240.5	245.2	264.8	300.8	308.8	316.3	322.2
Federal Government expenditures	281.0	291.6	304.7	317.3	328.3	345.3	362.5	373.9	375.4	379.2	397.1	405.2
Surplus or deficit	—2.8	—3.0	—1.9	—23.4	—47.7	—104.8	—117.3	—109.2	—74.6	—70.4	—80.8	—83.0
State and local government receipts	200.6	205.3	210.9	213.8	218.1	230.5	248.9	261.5	262.0	266.9	277.8	283.5
State and local government expenditures	197.4	203.3	208.8	214.4	219.5	230.9	242.9	251.2	251.2	255.5	261.0	266.6
Surplus or deficit	3.2	2.0	2.1	—.6	—1.5	—.4	6.0	10.3	10.8	11.4	16.8	16.9

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross National Product, current dollars	930.3	977.1	1,054.9	1,158.0	1,294.9	1,396.7	1,485.8	1,664.4
Personal consumption expenditures	579.5	617.6	667.1	729.0	805.2	876.9	955.8	1,055.7
Durable goods	90.8	91.3	103.9	118.4	130.3	127.7	129.8	145.0
Nondurable goods	245.9	263.8	278.4	299.7	338.0	380.2	420.4	463.1
Services	242.7	262.5	284.8	310.9	336.9	369.0	405.6	447.6
Gross private domestic investment	139.0	136.3	153.7	179.3	209.4	209.0	180.8	229.3
Fixed investment	131.2	131.7	147.4	170.8	194.0	195.5	186.0	220.6
Nonresidential	98.9	100.6	104.6	116.8	136.7	149.5	147.7	166.2
Structures	34.2	36.1	37.9	41.1	47.0	52.2	52.6	59.1
Producers durable equipment	64.3	64.4	66.6	75.7	89.7	97.3	95.1	107.1
Residential structures	32.6	31.1	42.8	53.9	57.3	46.0	38.3	54.4
Nonfarm	32.0	30.7	42.3	53.4	56.7	45.2	37.5	53.5
Change in business inventories	7.8	4.5	6.3	8.6	15.3	13.4	−5.2	8.7
Net exports of goods and services	1.9	3.6	−.1	−6.0	4.0	2.0	2.7	2.2
Exports	55.5	62.9	65.5	72.4	100.4	139.4	152.9	165.4
Imports	53.6	59.3	65.6	78.4	96.4	137.4	150.2	163.2
Government purchases of goods and services	209.9	219.5	234.2	255.6	276.4	308.8	346.6	377.3
Federal	98.8	96.2	97.6	104.8	106.6	116.4	128.0	140.4
National defense	78.4	74.6	71.2	74.8	74.4	78.6	85.8	92.8
Other	20.4	21.6	26.4	30.1	32.2	37.9	42.2	47.6
State and local	111.2	123.3	136.6	150.8	169.8	192.4	218.6	236.9

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross national product, 1958 prices	725.6	722.4	746.3	792.4	839.2	821.1	799.0	845.8
Personal consumption expenditures	469.1	477.5	496.4	527.3	552.1	539.9	541.0	565.3
Durable goods	85.6	83.8	92.5	104.9	113.6	103.4	99.0	106.0
Nondurable goods	201.3	206.5	211.3	220.2	228.6	223.7	224.2	233.5
Services	182.2	187.2	192.6	202.1	209.9	212.8	217.8	225.8
Gross private domestic investment	110.5	103.4	111.1	125.0	138.1	126.3	98.4	118.7
Fixed investment	103.8	99.4	105.7	117.9	127.3	118.1	101.5	113.9
Nonresidential	80.1	77.2	76.7	83.7	94.4	94.0	82.8	88.7
Structures	24.3	23.7	23.2	23.8	25.3	26.2	24.4	25.9
Producers durable equipment	55.8	53.5	53.5	59.8	69.0	67.8	58.3	62.8
Residential structures	23.7	22.2	29.0	34.2	32.9	24.0	18.7	25.2
Nonfarm	23.2	21.9	28.6	33.9	32.6	23.6	18.3	24.8
Change in business inventories	6.7	3.9	5.3	7.0	10.8	8.2	−3.1	4.8
Net exports of goods and services	.2	2.2	−.5	−2.9	4.6	9.0	9.3	9.1
Exports	48.4	52.2	52.1	55.7	66.6	71.6	70.5	73.3
Imports	48.2	50.0	52.6	58.6	62.0	62.6	61.1	64.2
Government purchases of goods and services	145.8	139.3	139.3	143.1	144.3	145.9	150.3	152.7
Federal	73.4	64.4	60.9	61.0	57.3	56.3	56.8	58.4
State and local	72.4	74.9	78.4	82.1	87.0	89.5	93.6	94.4
GNP price deflator (1958=100)	128.2	135.2	141.3	146.1	154.3	170.2	185.9	196.8
Industrial wholesale prices (1967=100)	106.0	109.9	114.0	117.9	125.9	153.8	168.8	174.9
Consumer price index (1967=100)	109.8	116.3	121.3	125.3	133.1	147.8	161.6	171.8

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross national product	930.3	977.1	1,054.9	1,158.0	1,294.9	1,396.7	1,485.8	1,664.4
Less:								
Depreciation (CCA)	81.6	87.3	93.7	102.9	110.8	119.5	127.9	137.0
Indirect business taxes	8.9	93.4	102.7	110.0	119.2	126.9	141.0	159.7
Business transfers	3.8	4.0	4.3	4.5	4.8	5.2	5.5	5.8
Statistical discrepancy	−6.1	−6.4	−2.3	−3.8	−5.0	.5	5.0	5.0
Plus: Subsidies less surplus	1.0	1.7	1.1	2.3	.6	−2.9	−2.2	−1.4
Equals national income	766.0	800.4	857.7	946.5	1,065.6	1,141.7	1,204.2	1,355.5
Less:								
Corporate profits and IVA	79.8	69.3	78.7	92.2	105.1	104.9	106.6	139.7
Contribution for social security	54.2	57.7	63.8	73.0	91.2	101.5	107.1	117.3
Wage accruals	.0	−.0	.6	.0	−.1	−.5	.0	.0
Plus:								
Government transfers	61.9	75.1	89.0	98.6	112.9	134.5	163.5	183.4
Interest paid	28.7	31.0	31.2	33.0	38.3	42.3	45.9	50.8
Dividends	24.3	24.7	25.0	27.4	29.6	32.6	33.6	35.8
Business transfers	3.8	4.0	4.3	4.5	4.8	5.2	5.5	5.8
Equals personal income	750.9	808.3	864.1	944.9	1,055.0	1,150.4	1,239.0	1,374.2
Less personal income taxes	116.5	116.6	117.6	142.4	151.3	170.7	147.5	189.7
Equals disposable personal income	634.4	691.7	746.4	802.5	903.7	979.7	1,091.4	1,184.6
Savings ratio (percent of disposable income)	6.1	8.2	8.2	6.6	8.3	7.9	10.0	8.6
Consumption ratio (percent)	91.4	89.3	89.4	90.8	89.1	89.5	87.6	89.1
Private annual earnings (thousands of dollars)	6.60	6.96	7.36	7.83	8.37	8.99	9.68	10.40
Private hourly earnings (dollars)	3.41	3.64	3.87	4.10	4.38	4.74	5.13	5.50
Private output per man-hour (1958=100)	139.2	140.6	146.6	152.4	156.5	152.7	152.5	156.2
Unit labor cost (1958=100)	125.8	133.2	135.8	140.0	148.9	165.1	178.6	187.0
Civilian labor force (millions)	80.7	82.8	84.1	86.5	88.7	91.1	92.3	93.1
Civilian employment (millions)	77.9	78.6	79.1	81.7	84.4	86.0	84.6	86.5
Unemployment rate (percent of labor force)	3.5	5.0	5.9	5.6	4.8	5.6	8.3	7.1

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
National Income	766.0	800.4	857.7	946.5	1,065.6	1,141.7	1,204.2	1,355.5
Compensation of employees	566.0	603.9	643.0	707.1	786.0	855.6	908.8	1,010.8
Wages and salaries	509.6	541.9	573.6	626.8	691.6	750.6	794.1	882.1
Private	405.5	426.9	449.5	491.4	545.1	592.3	617.9	688.2
Military	19.0	19.5	19.4	20.5	20.6	21.2	22.5	24.2
Civilian government	85.1	95.5	104.7	114.8	125.9	137.1	153.6	169.7
Supplements	56.3	61.9	69.4	80.3	94.3	105.0	114.7	128.7
Rent, interest, proprietors income	120.3	127.3	135.9	147.2	174.5	181.1	188.8	205.0
Corporate profits plus IVA	79.8	69.3	78.7	92.2	105.1	104.9	106.6	139.7
Profits before tax	84.9	74.1	83.6	99.2	122.7	140.4	118.9	151.4
Profits tax liability	40.1	34.8	37.5	41.5	49.8	55.5	44.5	57.1
Profits after tax	44.8	39.3	46.1	57.6	72.9	85.0	74.5	94.3
Dividends	24.3	24.7	25.0	27.4	29.6	32.6	33.6	35.8
Undistributed profits	20.5	14.6	21.1	30.3	43.3	52.3	40.9	58.5
Inventory valuation adjustment	−5.1	−4.8	−4.9	−7.0	−17.6	−35.5	−12.3	−11.6
Memo: New orders, machinery and equipment	92.3	84.5	87.8	101.9	123.9	138.2	129.6	150.3
Federal government receipts	197.3	192.0	198.5	227.2	258.5	290.8	257.8	312.0
Federal government expenditures	189.2	203.9	220.3	244.7	264.1	298.6	352.5	389.2
Surplus or deficit	8.1	−11.9	−21.9	−17.5	−5.6	−7.8	−94.7	−77.2
State and local government receipts	119.7	135.0	152.2	177.2	193.5	207.6	239.8	272.6
State and local government expenditures	119.0	133.2	148.8	164.8	184.4	206.0	236.1	258.6
Surplus or deficit	.7	1.8	3.3	12.3	9.1	1.7	3.6	14.0

CASE II.—SENATOR HUMPHREY'S PACKAGE—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Percent growth (annual rates)								
GNP, current dollars	7.6	5.0	8.0	9.8	11.8	7.9	6.4	12.0
GNP, 1958 prices	2.7	−.4	3.3	6.2	5.9	−2.2	−2.7	5.9
GNP price deflator	4.8	5.5	4.5	3.4	5.6	10.3	9.2	5.8
Industrial wholesale prices	3.3	3.7	3.7	3.4	6.8	22.2	9.8	3.6
Consumer price index	5.4	5.9	4.3	3.3	6.2	11.1	9.3	6.3
Private hourly earnings	6.6	6.9	6.2	5.9	6.8	8.4	8.2	7.3
Private annual earnings	6.6	5.5	5.8	6.4	6.9	7.4	7.7	7.5
Private workweek	0	−1.3	−.4	.4	.1	−.9	−.5	.2
Productivity	.5	1.1	4.2	4.0	2.7	−2.5	−.2	2.4
Unit labor cost	6.9	5.9	1.9	3.1	6.3	10.9	8.2	4.7
Civilian labor force	2.5	2.6	1.6	2.9	2.5	2.6	1.3	.9
Civilian employment	2.6	1.0	.6	3.3	3.3	1.8	−1.6	2.2
Unemployment percent of labor force	3.5	5.0	5.9	5.6	4.8	5.6	8.3	7.1
New orders, machinery, and equipment	10.9	−8.4	3.9	16.0	21.6	11.5	−6.2	16.0
Corporate profits before taxes	−3.1	−12.8	12.9	18.6	23.7	14.5	−15.3	27.3
Business fixed investment	10.9	2.1	4.0	11.7	17.1	9.4	−1.2	12.5
Nonfesidential structures	12.9	5.5	4.9	8.4	14.3	11.1	.8	12.3
Producers durable equipment	9.8	.2	3.5	13.6	18.6	8.5	−2.3	12.6
Inventory investment (billions of dollars)	7.8	4.5	6.3	8.6	15.3	13.4	−5.2	8.7
Residential construction	8.6	−4.5	37.4	26.0	6.2	−19.7	−16.7	42.0
Disposable personal income	7.3	9.0	7.9	7.5	12.6	8.4	11.4	8.5
Consumption	8.1	6.6	8.0	9.3	10.5	8.9	9.0	10.5
Durable goods	8.1	.6	13.8	14.0	10.0	−2.0	1.6	11.7
Nondurable goods	6.5	7.3	5.6	7.6	12.8	12.5	10.6	10.2
Services	9.7	8.2	8.5	9.2	8.4	9.5	9.9	10.4
Savings ratio (percent of disposable income)	6.1	8.2	8.2	6.6	8.3	7.9	10.0	8.6
Net exports (billions of dollars)	1.9	3.6	−.1	−6.0	4.0	2.0	2.7	2.2
Federal Government	0	−2.6	1.5	7.4	1.6	9.3	9.9	9.7
Defense spending	.1	−4.9	−4.6	5.1	−.5	5.6	9.2	8.1
State and local government	10.3	11.0	10.8	10.4	12.6	13.3	13.6	8.4

CASE III.—IBM'S BASE FORECAST

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product, current dollars	1,358.8	1,383.8	1,416.3	1,428.0	1,418.0	1,434.0	1,477.3	1,527.6	1,574.6	1,621.4	1,661.8	1,700.1
Personal consumption expenditures	840.6	869.1	901.3	896.8	911.9	926.8	959.8	985.6	1,004.5	1,028.7	1,052.4	1,077.6
Durable goods	123.9	129.5	136.1	121.5	122.5	119.6	126.5	129.0	130.2	135.0	139.0	143.8
Nondurable goods	364.4	375.8	389.0	391.5	398.6	408.8	423.9	436.3	444.4	453.0	461.2	469.6
Services	352.4	363.8	376.2	383.8	390.9	398.4	409.4	420.4	429.9	440.8	452.2	464.2
Gross private domestic investment	210.6	211.8	205.8	207.7	176.4	169.6	172.8	186.9	206.6	221.4	230.5	233.0
Fixed investment	193.7	198.1	197.0	193.3	186.5	180.1	181.4	190.0	202.7	213.5	221.1	224.2
Nonresidential	145.2	149.4	150.9	152.7	149.5	144.2	144.2	148.7	156.0	161.9	166.4	167.9
Structures	51.3	52.2	51.0	54.3	51.4	50.7	52.9	55.2	58.0	59.2	59.1	56.6
Producers durable equipment	93.9	97.2	99.9	98.4	98.1	93.6	91.3	93.5	98.0	102.6	107.3	111.3
Residential structures	48.5	48.7	46.1	40.6	37.0	35.9	37.2	41.4	46.7	51.7	54.7	56.3
Nonfarm	47.8	48.0	45.4	39.8	36.2	35.1	36.4	40.5	45.8	50.8	53.9	55.4
Change in business inventories	16.9	13.7	8.8	14.4	−10.1	−10.5	−8.6	−3.2	3.9	7.8	9.3	8.8
Net exports of goods and services	11.3	−1.5	−3.1	1.1	1.3	3.3	4.3	5.6	5.8	5.5	5.1	4.5
Exports	131.2	138.5	143.6	144.3	147.6	151.4	154.4	158.2	161.2	164.0	166.8	169.6
Imports	119.9	140.0	146.7	143.2	146.3	148.1	150.1	152.6	155.4	158.5	161.7	165.1
Government purchases of goods and services	296.3	304.4	312.3	322.4	328.3	334.2	340.5	349.6	357.7	365.9	373.9	385.1
Federal	111.5	114.3	117.2	122.8	124.5	126.4	128.2	132.8	135.8	138.5	141.0	146.2
National defense	75.8	76.6	78.4	83.5	84.2	84.8	85.6	88.5	90.2	91.7	93.0	96.2
Other	35.7	37.7	38.8	39.3	40.3	41.6	42.6	44.3	45.6	46.7	48.0	50.0
State and local	184.8	190.1	195.1	199.6	203.8	207.8	212.2	216.8	221.9	227.4	232.9	238.8

CASE III.—IBM'S BASE FORECAST—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross National Product, 1958 prices	830.5	827.1	823.1	803.7	781.8	775.6	787.3	801.3	814.5	828.2	838.4	846.6
Personal consumption expenditures	539.7	542.7	547.2	530.1	529.3	527.1	537.6	543.8	546.5	553.1	559.4	566.5
Durable goods	105.2	106.8	107.8	93.7	94.7	91.7	96.1	97.0	96.9	99.4	101.2	103.6
Nondurable goods	223.9	223.6	225.8	221.7	219.5	219.8	223.4	226.4	227.6	229.6	231.6	233.7
Services	210.6	212.2	213.7	214.7	215.1	215.6	218.0	220.4	222.0	224.2	226.6	229.2
Gross private domestic investment	133.3	130.3	122.7	118.9	97.9	92.7	93.0	99.4	108.7	115.3	118.8	119.1
Fixed investment	122.7	122.2	117.6	109.8	104.0	99.0	98.0	101.2	106.5	110.9	113.7	114.4
Nonresidential	96.3	96.5	94.1	89.3	85.6	81.3	80.0	81.4	84.4	86.8	88.4	88.7
Structures	26.7	26.6	25.4	26.2	24.3	23.6	24.4	25.1	26.0	26.2	25.8	24.3
Producers durable equipment	69.7	69.9	68.7	63.1	61.3	57.7	55.6	56.3	58.4	60.5	62.6	64.3
Residential structures	26.4	25.7	23.5	20.5	18.4	17.6	18.1	19.8	22.1	24.1	25.3	25.7
Nonfarm	26.0	25.3	23.1	20.1	18.0	17.2	17.7	19.4	21.7	23.7	24.9	25.3
Change in business inventories	10.6	8.2	5.0	9.1	−6.1	−6.3	−5.0	−1.8	2.2	4.4	5.1	4.7
Net exports of goods and services	11.5	8.3	7.3	8.9	8.9	9.6	9.9	10.6	10.8	10.6	10.3	9.9
Exports	73.3	73.4	70.9	68.9	69.2	70.0	70.7	71.9	72.7	73.2	73.7	74.1
Imports	61.8	65.1	63.6	60.0	60.3	60.4	60.8	61.4	61.9	62.6	63.4	64.2
Government purchases of goods and services	146.0	145.8	145.9	145.8	145.8	146.2	146.7	147.5	148.4	149.2	150.0	151.1
Federal	56.3	56.3	56.5	56.3	56.3	56.6	56.8	57.3	57.8	58.2	58.6	59.2
State and local	89.7	89.5	89.4	89.5	89.5	89.6	89.9	90.2	90.6	91.0	91.3	91.9
GNP price deflator (1958=100)	163.6	167.3	172.1	177.7	181.4	184.9	187.7	190.6	193.3	195.8	198.2	200.8
Industrial Wholesale prices (1967=100)	138.6	150.2	160.8	165.6	166.9	168.3	169.7	171.0	172.4	173.8	175.1	176.4
Consumer Price Index (1967=100)	141.4	145.6	150.1	154.2	157.5	160.7	163.4	165.9	168.6	170.9	173.2	175.3

CASE III.—IBM'S BASE FORECAST—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
Gross national product	1,358.8	1,383.8	1,416.3	1,428.0	1,418.0	1,434.0	1,477.3	1,527.6	1,574.6	1,621.4	1,661.8	1,700.1
Less:												
Depreciation (CCA)	115.8	118.6	120.7	123.0	124.8	127.0	128.9	130.8	132.9	135.3	137.9	140.7
Indirect business taxes	122.6	125.9	129.5	129.8	133.1	135.3	143.0	146.9	150.7	155.3	160.0	163.8
Business transfers	5.1	5.2	5.3	5.3	5.4	5.5	5.5	5.6	5.7	5.8	5.8	5.9
Statistical discrepancy	−6.3	.3	3.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Plus: Subsidies less surplus	−2.7	−3.7	−2.4	−2.7	−2.4	−2.1	−2.3	−2.1	−1.8	−1.5	−1.3	−1.1
Equals national income	1,118.8	1,130.2	1,155.5	1,162.2	1,147.2	1,159.1	1,192.6	1,237.3	1,278.5	1,318.5	1,351.9	1,383.6
Less:												
Corporate profits and IVA	107.7	105.6	105.8	100.6	88.2	88.5	99.2	115.2	127.4	137.7	142.3	143.7
Contribution for social security	99.1	100.8	103.0	103.2	104.5	105.0	106.5	108.2	112.3	114.4	116.4	118.4
Wage accruals	.0	−.6	−1.5	.0	.0	.0	.0	.0	.0	.0	.0	.0
Plus:												
Government transfers	123.1	130.6	138.7	145.8	154.6	162.4	172.1	176.1	179.8	183.2	191.1	195.1
Interest paid	40.8	41.9	42.7	43.6	44.3	44.9	46.3	47.8	49.2	50.4	51.2	52.2
Dividends	31.6	32.5	33.2	33.3	33.2	33.2	33.3	33.7	34.2	34.9	35.6	36.2
Business transfers	5.1	5.2	5.3	5.3	5.4	5.5	5.5	5.6	5.7	5.8	5.8	5.9
Equals personal income	1,112.5	1,134.6	1,168.2	1,186.4	1,191.9	1,211.5	1,244.1	1,277.0	1,307.7	1,340.8	1,376.9	1,411.0
Less: Personal income taxes	161.9	168.2	175.1	177.8	175.3	142.7	154.4	168.4	191.7	197.9	206.3	211.6
Equals disposable personal income	950.6	966.5	993.1	1,008.7	1,016.6	1,068.8	1,089.7	1,108.6	1,115.9	1,142.9	1,170.6	1,199.4
Savings ratio (percent of disposable income)	9.0	7.5	6.7	8.5	7.7	10.9	9.5	8.7	7.6	7.6	7.8	7.8
Consumption ratio (percent)	88.4	89.9	90.8	88.9	89.7	86.7	88.1	88.9	90.0	90.0	89.9	89.8
Private annual earnings (thousands of dollars)	8.68	8.92	9.10	9.24	9.41	9.59	+ 9.76	9.95	10.13	10.31	10.48	10.64
Private hourly earnings (dollars)	4.56	4.69	4.81	4.90	5.00	5.10	5.18	5.26	5.35	5.44	5.54	5.64
Private output per man-hour (1958=100)	153.5	153.6	152.8	150.9	150.2	150.1	151.5	153.1	154.2	155.4	156.3	156.8
Unit labor cost (1958=100)	158.8	162.1	167.1	172.5	177.0	180.4	181.4	182.5	184.1	185.7	187.9	190.6
Civilian labor force (millions)	90.5	90.6	91.4	91.8	92.1	92.3	92.3	92.4	92.6	92.9	93.3	93.6
Civilian employment (millions)	85.8	86.0	86.3	85.8	84.3	83.5	83.6	83.8	84.2	84.7	85.2	85.7
Unemployment rate (percent of labor force)	5.2	5.1	5.5	6.5	8.5	9.5	9.5	9.3	9.0	8.8	8.7	8.5

CASE III.—IBM'S BASE FORECAST—Continued

	74.1	74.2	74.3	74.4	75.1	75.2	75.3	75.4	76.1	76.2	76.3	76.4
National income	1,118.8	1,130.2	1,155.5	1,162.2	1,147.2	1,159.1	1,192.6	1,237.3	1,278.5	1,318.5	1,351.9	1,383.6
Compensation of employees	828.8	848.3	868.2	877.3	876.8	886.7	905.9	930.1	954.6	979.9	1,004.2	1,030.5
Wages and salaries	727.6	744.6	761.5	768.7	766.4	774.4	790.8	812.0	832.3	854.2	875.3	898.5
Private	573.8	588.3	602.5	604.7	599.8	605.2	618.6	634.5	651.2	669.5	687.5	704.8
Military	21.0	20.9	20.8	22.0	22.1	22.2	22.3	23.5	23.7	23.8	24.0	25.2
Civilian government	132.8	135.4	138.2	142.0	144.4	146.9	149.8	154.0	157.4	160.9	163.9	168.4
Supplements	101.2	103.7	106.7	108.5	110.5	112.4	115.1	118.1	122.3	125.6	128.9	132.1
Rent, interest, proprietors income	182.2	176.3	181.5	184.3	182.2	183.8	187.5	192.0	196.4	201.0	205.3	209.4
Corporate profits plus IVA	107.7	105.6	105.8	100.6	88.2	88.5	99.2	115.2	127.4	137.7	142.3	143.7
Profits before tax	135.4	139.0	157.0	130.4	102.5	102.2	111.2	125.1	138.1	148.1	153.1	155.0
Profits tax liability	52.2	55.9	62.7	51.1	38.2	38.2	41.6	46.8	52.1	55.8	57.7	58.5
Profits after tax	83.2	83.1	94.3	79.3	64.2	64.0	69.6	78.3	86.0	92.3	95.4	96.6
Dividends	31.6	32.5	33.2	33.3	33.2	33.2	33.3	33.7	34.2	34.9	35.6	36.2
Undistributed profits	51.6	50.6	61.1	46.0	31.0	30.8	36.3	44.6	51.8	57.4	59.8	60.3
Inventory valuation adjustment	−27.7	−33.4	−51.2	−29.8	−14.3	−13.7	−12.0	−9.9	−10.7	−10.5	−10.8	−11.3
Memo: New orders, machinery, and equipment	134.9	143.0	145.7	129.0	125.1	123.7	126.7	132.9	140.5	145.8	150.7	155.1
Federal Government receipts	278.1	288.6	302.8	293.9	280.8	248.0	261.5	279.7	309.1	319.5	328.1	334.8
Federal Government expenditures	281.0	291.6	304.7	317.3	330.1	340.8	352.7	363.1	372.4	380.7	393.0	403.6
Surplus or deficit	−2.8	−3.0	−1.9	−23.4	−49.3	−92.8	−91.2	−83.4	−63.3	−61.2	−64.9	−68.8
State and local government receipts	200.6	205.3	210.9	213.8	218.0	221.7	233.0	241.1	250.4	258.6	268.6	275.0
State and local government expenditures	197.4	203.3	208.8	214.4	219.5	224.6	230.4	236.3	242.4	248.9	254.9	261.4
Surplus or deficit	3.2	2.0	2.1	−.6	−1.5	−2.9	2.6	4.9	8.0	9.7	13.7	13.5

CASE III.—IBM'S BASE FORECAST—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross national product, current dollars	930.3	977.1	1,054.9	1,158.0	1,294.9	1,396.7	1,464.2	1,639.5
rsonal consumption expenditures	579.5	617.6	667.1	729.0	805.2	876.9	946.0	1,040.8
Durable goods	90.8	91.3	103.9	118.4	130.3	127.7	124.4	137.0
Nondurable goods	245.9	263.8	278.4	299.7	338.0	380.2	416.9	457.0
Services	242.7	262.5	284.8	310.9	336.9	369.0	404.8	446.8
Gross private domestic investment	139.0	136.3	153.7	179.3	209.4	209.0	176.4	222.8
Fixed investment	131.2	131.7	147.4	170.8	194.0	195.5	184.5	215.4
Nonresidential	98.5	100.6	104.6	116.8	136.7	149.5	146.6	163.0
Structures	34.2	36.1	37.9	41.1	47.0	52.2	52.5	58.2
Producers durable equipment	64.3	64.4	66.6	75.7	89.7	97.3	94.1	104.8
Residential structures	32.6	31.1	42.8	53.9	57.3	46.0	37.9	52.3
Nonfarm	32.0	30.7	42.3	53.4	56.7	45.2	37.1	51.5
Change in business inventories	7.8	4.5	6.3	8.6	15.3	13.4	−8.1	7.5
Net exports of goods and services	1.9	3.6	−.1	−6.0	4.0	2.0	3.6	5.2
Exports	55.5	62.9	65.5	72.4	100.4	139.4	152.9	165.4
Imports	53.6	59.3	65.6	78.4	96.4	137.4	149.3	160.2
Government purchases of goods and services	209.9	219.5	234.2	255.6	276.4	308.8	338.2	370.6
Federal	98.8	96.2	97.6	104.8	106.6	116.4	128.0	140.4
National defense	78.4	74.6	71.2	74.8	74.4	78.6	85.8	92.8
Other	20.4	21.6	26.4	30.1	32.2	37.9	42.2	47.6
State and local	111.2	123.3	136.6	150.8	169.8	192.4	210.2	230.3

CASE III.—IBM'S BASE FORECAST—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross national product, 1958 prices	725.6	722.4	746.3	792.4	839.2	821.1	786.5	831.9
Personal consumption expenditures	469.1	477.5	496.4	527.3	552.1	539.9	534.5	556.4
Durable goods	85.6	83.8	92.5	104.9	113.6	103.4	94.9	100.3
Nondurable goods	201.3	206.5	211.3	220.2	228.6	223.7	222.3	230.6
Services	182.2	187.2	192.6	202.1	209.9	212.8	217.3	225.5
Gross private domestic investment	110.5	103.4	111.1	125.0	138.1	126.3	95.7	115.5
Fixed investment	103.8	99.4	105.7	117.9	127.3	118.1	100.6	111.4
Nonresidential	80.1	77.2	76.7	83.7	94.4	94.0	82.1	87.1
Structures	24.3	23.7	23.2	23.8	25.3	26.2	24.4	25.6
Producers durable equipment	55.8	53.5	53.5	59.8	69.0	67.8	57.7	61.5
Residential structures	23.7	22.2	29.0	34.2	32.9	24.0	18.5	24.3
Nonfarm	23.2	21.9	28.6	33.9	32.6	23.6	18.1	23.9
Change in business inventories	6.7	3.9	5.3	7.0	10.8	8.2	−4.8	4.1
Net exports of goods and services	.2	2.2	−.5	−2.9	4.6	9.0	9.8	10.4
Exports	48.4	52.2	52.1	55.7	66.6	71.6	70.5	73.4
Imports	48.2	50.0	52.6	58.6	62.0	62.6	60.7	63.0
Government purchases of goods and services	145.8	139.3	139.3	143.1	144.3	145.9	146.6	149.7
Federal	73.4	64.4	60.9	61.0	57.3	56.3	56.7	58.5
State and local	72.4	74.9	78.4	82.1	87.0	89.5	89.8	91.2
GNP price deflator (1958=100)	128.2	135.2	141.3	146.1	154.3	170.2	186.1	197.0
Industrial wholesale prices (1967=100)	106.0	109.9	114.0	117.9	125.9	153.8	169.0	174.4
Consumer price index (1967=100)	109.8	116.3	121.3	125.3	133.1	147.8	161.9	172.0

CASE III.—IBM'S BASE FORECAST—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Gross national product	930.3	977.1	1,054.9	1,158.0	1,294.9	1,396.7	1,464.2	1,639.5
Less:								
Depreciation (CCA)	81.6	87.3	93.7	102.9	110.8	119.5	127.9	136.7
Indirect business taxes	85.9	93.4	102.7	110.0	119.2	126.9	139.6	157.4
Business transfers	3.8	4.0	4.3	4.5	4.8	5.2	5.5	5.8
Statistical discrepancy	−6.1	−6.4	−2.3	−3.8	−5.0	.5	5.0	5.0
Plus: Subsidies less surplus	1.0	1.7	1.1	2.3	.6	−2.9	−2.2	−1.4
Equals national income	766.0	800.4	857.7	946.5	1,065.6	1,141.7	1,184.0	1,333.1
Less:								
Corporate profits and IVA	79.8	69.3	78.7	92.2	105.1	104.9	97.8	137.8
Contribution for social security	54.2	57.7	63.8	73.0	91.2	101.5	106.1	115.3
Wage accruals	.0	−.0	.6	.0	−.1	−.5	.0	.0
Plus:								
Government transfers	61.9	75.1	89.0	98.6	112.9	134.5	166.3	187.3
Interest paid	28.7	31.0	31.2	33.0	38.3	42.3	45.8	50.8
Dividends	24.3	24.7	25.0	27.4	29.6	32.6	33.3	35.2
Business transfers	3.8	4.0	4.3	4.5	4.8	5.2	5.5	5.8
Equals personal income	750.9	808.3	864.1	944.9	1,055.0	1,150.4	1,231.1	1,359.1
Less personal income taxes	116.5	116.6	117.6	142.4	151.3	170.7	160.2	201.9
Equals disposable personal income	634.4	691.7	746.4	802.5	903.7	979.7	1,070.9	1,157.2
Savings ratio (percent of disposable income)	6.1	8.2	8.2	6.6	8.3	7.9	9.2	7.7
Consumption ratio (percent)	91.4	89.3	89.4	90.8	89.1	89.5	88.4	89.9
Private annual earnings (thousands of dollars)	6.60	6.96	7.36	7.83	8.37	8.99	9.68	10.39
Private hourly earnings (dollars)	3.41	3.64	3.87	4.10	4.38	4.74	5.14	5.49
Private output per man-hour (1958=100)	139.2	140.6	146.6	152.4	156.5	152.7	151.2	155.7
Unit labor cost (1958=100)	125.8	133.2	135.8	140.0	148.9	165.1	180.3	187.19
Civilian labor force (millions)	80.7	82.8	84.1	86.5	88.7	91.1	92.3	93.1
Civilian employment (millions)	77.9	78.6	79.1	81.7	84.4	86.0	83.8	84.9
Unemployment rate (percent of labor force)	3.5	5.0	5.9	5.6	4.8	5.6	9.2	8.7

CASE III.—IBM'S BASE FORECAST—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
National income	766.0	800.4	857.7	946.5	1,065.6	1,141.7	1,184.0	1,333.1
Compensation of employees	566.0	603.9	643.0	707.1	786.0	855.6	899.9	992.3
Wages and salaries	509.6	541.9	573.6	626.8	91.6	750.6	785.9	865.1
Private	405.5	426.9	449.5	491.4	545.1	592.3	614.6	678.3
Military	19.0	19.5	19.4	20.5	20.6	21.2	22.5	24.2
Civilian Government	85.1	95.5	104.7	114.8	125.9	137.1	148.8	162.7
Supplements	56.3	61.9	69.4	80.3	94.3	105.0	114.0	127.2
Rent, interest, proprietors income	120.3	127.3	135.9	147.2	174.5	181.1	186.4	203.0
Corporate profits plus inventory valuation adjustment	79.8	69.3	78.7	92.2	105.1	104.9	97.8	137.8
Profits before tax	84.9	74.1	83.6	99.2	122.7	140.4	110.2	148.6
Profits tax liability	40.1	34.8	37.5	41.5	49.8	55.5	41.2	56.0
Profits after tax	44.8	39.3	46.1	57.6	72.9	85.0	69.0	92.6
Dividends	24.3	24.7	25.0	27.4	29.6	32.6	33.3	35.2
Undistributed profits	20.5	14.6	21.1	30.3	43.3	52.3	35.7	57.3
Inventory valuation adjustment	−5.1	−4.8	−4.9	−7.0	−17.6	−35.5	−12.5	−10.8
Memo: New orders, machinery, and equipment	92.3	84.5	87.8	101.9	123.9	138.2	127.1	148.0
Federal Government receipts	197.3	192.0	198.5	227.2	258.5	290.8	267.5	322.9
Federal Government expenditures	189.2	203.9	220.3	244.7	264.1	298.6	346.7	387.4
Surplus or deficit	8.1	−11.9	−21.9	−17.5	−5.6	−7.8	−79.2	−64.5
State and local Government receipts	119.7	135.0	152.2	177.2	193.5	207.6	228.5	263.1
State and local Government expenditures	119.0	133.2	148.8	164.8	184.4	206.0	227.7	251.9
Surplus or deficit	.7	1.8	3.3	12.3	9.1	1.7	.8	11.2

CASE III.—IBM'S BASE FORECAST—Continued

	69.0	70.0	71.0	72.0	73.0	74.0	75.0	76.0
Percent growth (annual rates)								
GNP, current dollars	7.6	5.0	8.0	9.8	11.8	7.9	4.8	12.0
GNP, 1958 prices	2.7	−.4	3.3	6.2	5.9	−2.2	−4.2	5.8
GNP price deflator	4.8	5.5	4.5	3.4	5.6	10.3	9.4	5.9
Industrial wholesale prices	3.3	3.7	3.7	3.4	6.8	22.2	9.9	3.2
Consumer price index	5.4	5.9	4.3	3.3	6.2	11.1	9.5	6.2
Private hourly earnings	6.6	6.9	6.2	5.9	6.8	8.4	8.3	6.9
Private annual earnings	6.6	5.5	5.8	6.4	6.9	7.4	7.7	7.4
Private workweek	.0	−1.3	−.4	.4	.1	−.9	−.6	.4
Productivity	.5	1.1	4.2	4.0	2.7	−2.5	−1.0	2.9
Unit labor cost	6.9	5.9	1.9	3.1	6.3	10.9	9.2	3.7
Civilian labor force	2.5	2.6	1.6	2.9	2.5	2.6	1.3	.9
Civilian employment	2.6	1.0	.6	3.3	3.3	1.8	−2.5	1.4
Unemployment (percent of labor force)	3.5	5.0	5.9	5.6	4.8	5.6	9.2	8.7
New orders, machinery, and equipment	10.9	−8.4	3.9	16.0	21.6	11.5	−8.0	16.5
Corporate profits before taxes	−3.1	−12.8	12.9	18.6	23.7	14.5	−21.5	34.8
Business fixed investment	10.9	2.1	4.0	11.7	17.1	9.4	−1.9	11.2
Nonresidential structures	12.9	5.5	4.9	8.4	14.3	11.1	.6	10.8
Producers durable equipment	9.8	.2	3.5	13.6	18.6	8.5	−3.3	11.4
Inventory investment (billions of dollars)	7.8	4.5	6.3	8.6	15.3	13.4	−8.1	7.5
Residential construction	8.6	−4.5	37.4	26.0	6.2	−19.7	−17.7	38.3
Disposable personal income	7.3	9.0	7.9	7.5	12.6	8.4	9.3	8.1
Consumption	8.1	6.6	8.0	9.3	10.5	8.9	7.9	10.0
Durable goods	8.1	.6	13.8	14.0	10.0	−2.0	−2.6	10.1
Nondurable goods	6.5	7.3	5.6	7.6	12.8	12.5	9.7	9.6
Services	9.7	8.2	8.5	9.2	8.4	9.5	9.7	10.4
Savings ratio (percent of disposable income)	6.1	8.2	8.2	6.6	8.3	7.9	9.2	7.7
Net exports (billions of dollars)	1.9	3.6	−.1	−6.0	4.0	2.0	3.6	5.2
Federal government	.0	−2.6	1.5	7.4	1.6	9.3	9.9	9.7
Defense spending	.1	−4.9	−4.6	5.1	−.5	5.6	9.2	8.1
State and local government	10.3	11.0	10.8	10.4	12.6	13.3	9.2	9.6

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