THE 1975 ECONOMIC REPORT OF THE PRESIDENT

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BEFORE THE

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THE 1975 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 19, 1975

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

The committee met, pursuant to notice, at 9:45 a.m., in room 1224, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, Javits, and Percy; and Representatives Hamilton, Long, Brown of Ohio, Brown of Michigan, and Heckler.

Also present: John R. Stark, executive director; John R. Karlik, Loughlin F. McHugh, and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; L. Douglas Lee, professional staff member; 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 convene the meeting of the Joint Economic Committee. This morning we will have as our two witnesses, Mr. Henry Ford and Mr. Leonard Woodcock. We are very honored to have these gentlemen take the time to come and share their thoughts with us, and I will be brief in my opening remarks today, because we are, as I said, very fortunate to have two extremely able witnesses who will have, I am sure, a great deal to tell this committee.

They come from a sector of our economy, the automobile industry, that has been in the front lines in the battle with recession. As a result, both men understand the dimensions of the problems we face, and what is at stake if the Government and the private sector do not act promptly and wisely.

In view of the need for prompt action, I believe partisan political bickering about what to do is not only a waste of time, but dangerous. For that reason, I and 13 other members of this committee, went to the President on January 29, 1975, 21 days ago, expressing our concern about the growing confrontation between Congress and the President over energy and the basic problems.

We called upon the President for cooperative action, and he called upon Congress for the same cooperative action in tax reduction and

an energy program to restore economic growth. Let me read just a few excerpts from that letter:

Our first priority must be putting America's capital and human resources back to work. Congressional leaders of both parties recognize this fact and are committed to passing a mutually acceptable tax relief bill. We regret that similar agreement does not exist in regard to your energy proposals. There is agreement that your energy proposals will be inflationary, but little agreement as to how inflationary.

Your own advisers have estimated 2 percent. Others have suggested up to 4 percent. The Congress is naturally reluctant to enter on such a course until alternative proposals have been fully explored.

We therefore urge that the next 60 days be used to bring together a task force on energy policy, made up of representatives in that field from your Administration, and a bipartisan group of members of the House and Senate selected by the Majority and Minority Leadership of both bodies, which would be charged with developing a mutually agreeable energy policy upon which prompt Congressional action might be taken.

Regrettably, the President has not chosen this path of cooperation and conciliation as of yet. Instead, by acknowledging the weaknesses of his energy proposals by imposing energy actions unilaterally, and by barnstorming around the country making speeches on energy, the President, I regret to say, is provoking confrontation with the Congress.

I believe such actions will border upon the irresponsible unless reversed. And we urge the President to publicly seek cooperation and compromise outlined in the January 29 letter from this committee. In view of the actions taken thus far, it is difficult to see what additional steps the Congress can take to reduce the partisan debate about economic and energy policy.

We are honored to have as our first witness this morning Mr. Henry Ford.

Mr. FORD. I have a prepared statement I would like to read at this time.

Chairman HUMPHREY. Yes, certainly, go ahead.

STATEMENT OF HENRY FORD II, CHAIRMAN OF THE BOARD, FORD MOTOR CO., DEARBORN, MICH.

Mr. FORD. I appreciate this opportunity to give you some of my views on the state of the economy and how I think it can be improved.

I know you have already heard and studied a bewildering variety of proposals for solving the Nation's economic problems, and I am not going to add to your burden. I have neither the competence nor the confidence to offer specific advice on such matters as taxes and the Federal budget. and I am not going to try.

My role here today, as I see it, is to speak as a concerned businessman who has some familiarity with the mood of some of your constituents. and with the problems of one major industry. If my remarks are found lacking in specific recommendations, perhaps I can make up for the deficiency by calling attention to basics that are in some danger of being neglected.

There seems to be general agreement that the United States is facing three critical economic problems—unemployment, inflation,

and energy. I would add to this list a fourth problem which is more than an economic problem, but makes the economic problems harder to solve.

The fourth problem is the growing lack of public confidence. People who can still afford to spend have stopped spending because they are afraid they will not be able to keep up the payments. Businesses are cutting capital spending because profits have fallen so low and the outlook for a reasonable return is so uncertain. People who would rally behind governmental programs to solve the Nation's economic problems cannot find a rallying point because no programs have been adopted.

Day by day, the public is exposed by television and the press to administration spokesmen denouncing Congress for doing nothing, and congressional spokesmen denouncing the administration for trying to do the wrong things.

And day by day the problems mount and nothing is decided. People are rapidly coming to the conclusion that nobody knows what to do, nobody is steering, the problems are running away with us, and the country is headed straight for disaster.

Of course, there are bound to be honest differences of opinion on the appropriate course of action, especially when we have a Republican administration and a large Democratic majority in the Congress. But I know I speak for many of your constituents when I say that I believe the time has come for Republicans and Democrats, conservatives and liberals, the administration and the Congress, to stop focusing on the other side's errors and to start searching for common ground.

The place to start, I believe, is to agree that unemployment is now the most critical and the most immediate national problem. Reducing unemployment must take precedence, because the unemployment rate we are now suffering can be reduced, and because the human effects of unemployment are so devastating.

In my judgment, the American people will not, and should not, accept policies that would lead to nearly 7 percent unemployment as late as 1978 as the administration has projected. We must not be so frightened by the perils of inflation that we do too little too late to restore economic growth.

In fact, if timely action is not taken to stop the recession, it may gather so much momentum that there will be no way to stop it except through actions that are so strong and so long lasting that they will guarantee more inflation down the road.

The second point on which it would be possible to reach agreement is that a tax cut is necessary to stop the recession and put people back to work. In my opinion, there are five criteria that such a tax cut must meet.

It should be quick; it should be large; it should be simple; it should reduce taxes for both individuals and corporations; and it should be temporary. Everything else, in my opinion, is secondary.

It should be quick because every American has more to lose from any delay in tax reduction than any American stands to gain from one tax reduction formula or another. It should be large because we need a large tax cut to halt the momentum of this recession. It should be simple so that people understand what it will do for them.

It should provide relief for both individuals and corporations because we need to stimulate both consumer spending and business investment. And it should be temporary because it is obvious that Congress will not enact a large permanent tax cut without lengthy debate over tax reform, and because a large permanent cut would be inflationary unless expenditures are brought under control.

There is a third essential step on which nearly unanimous agreement has long since been reached. And yet, for reasons which escape my understanding, nothing has happened. Everyone seems to agree that easier monetary policy is necessary to halt the recession. The Federal Reserve has announced its intention to provide moderate growth. There is a widespread impression that monetary policy has already been eased. But this is simply not so.

During December and January, the money supply decreased sharply, and during the whole period since last June, the annual growth rate has averaged only about 1 percent. This means, of course, that the real money supply, adjusted for inflation, is much smaller than it was 7 months ago.

I believe that the monetary growth rate should be raised to the range of 6 to 8 percent for a short period in order to make up for the lack of appropriate growth over the past 7 months.

As the rate of inflation subsides, real money balances increase and recovery begins, the monetary growth rate can, and should, be reduced to prevent a new burst of inflation. But I do not understand how the Federal Reserve can permit a sharp contraction in the money supply at a time of sharply rising prices and sharply declining economic activity. This, it seems to me, is a sure formula for a longer and deeper recession.

I believe the American people have every right to expect the members of their government to set aside partisan differences, to agree that unemployment must be reduced quickly, and to provide the tax cut and the money growth that are necessary to stop the recession and put people back to work.

Prompt accomplishment of this three-point agenda is absolutely essential. Every day of delay creates unnecessary hardship, erodes public confidence in both government and business, and weakens the foundations of our free society. Until this simple agenda is accomplished, we cannot afford the luxury of disagreeing over matters that are less basic or less urgent.

Gaining control of inflation is no less basic, but is certainly less urgent at this time. As long as our economy has so much unemployment and so much unused capacity, there is little risk that lower taxes and a bigger money supply will lead to still higher prices rather than more real growth.

Timing, in my opinion, is crucial. The way to get recovery without sowing the seeds of future inflation is not to take weak action to stimulate the economy, but to take vigorous action quickly, and to end it just as quickly when the need has passed.

In the energy area we tend to think that the main problem is the high price of imported oil. It seems to me, however, that two other problems are even more important.

One is that we are still trying, by one expedient or another, to avoid the painful but necessary adjustment to the end of cheap ener-

gy. We are not really running out of energy at the present time, but we are running out of low-cost petroleum and natural gas. And this would be true even if the OPEC nations had not imposed a huge price increase.

We must adjust to the impending depletion of cheap energy sources by developing new, but more expensive, energy sources, and by using all our energy supplies less wastefully and more efficiently.

The need to adjust is not a temporary requirement, but a lasting one, involving every aspect of our complex economy and our whole way of life. Fortunately, there is a simple and effective way of assuring the necessary adjustment without getting the Government permanently involved in planning and controlling every aspect of our economy. That way, as the President has recommended, is to let the price of energy reflect its rising value.

Rationing is not really a viable alternative. It would involve greater hardships, greater inequities, major inefficiencies, and would do nothing to expand energy supplies. Since the problem is not to achieve a temporary reduction in petroleum consumption, but a total and permanent revision of our whole system of energy production and use, rationing cannot possibly do the job.

I am pleased to see that congressional support for gasoline rationing as a key to national energy policy seems to be waning. But I am disappointed by the continuing reluctance to let the marketplace perform its classic function.

As long as we keep the prices of old oil and of natural gas below their market level, we will encourage people to waste these valuable resources and discourage both the expansion of oil and natural gas supplies and the development of other energy sources.

The other basic problem in the energy area is the growing dependence of the United States on interruptible foreign oil supplies. Petroleum consumption already has been reduced by higher prices and by recession, and will fall again if the price of old oil is deregulated.

I believe that it will also be necessary to go even farther by imposing oil taxes such as the President has recommended. I am not sure, however, that the public can be persuaded to accept this additional shock right now, or that it is really essential to do so right now.

I conclude, therefore, that price increases and consumption decreases might be stretched out over a longer period than the President has recommended. Such a stretchout would permit families, industries, and the economy as a whole to make the necessary adjustments at lower cost and with less hardship and disruption.

Mr. Chairman, let me turn now to the situation in our industry. As you know, declining automotive sales have contributed substantially to the severity of the recession. Our industry has had the dubious distinction of leading the downturn—along with housing—partly because of the oil embargo and public uncertainty over gasoline prices and supplies, and partly because of the large price increases might be stretched out over a longer period than the President of the huge cost increases experienced during and after the preceding period of price control.

Industry car sales, including imports, have fallen from an annual rate of 12.3 million in the first quarter of 1973, to 7.3 million in the fourth quarter of last year. Unemployment in the auto industry, as

reported by the Bureau of Labor Statistics, was 20 percent in December and 24 percent in January.

Sales improved substantially toward the end of January because of price rebates offered by all four domestic manufacturers, and the sales rate for the 30 days ending February 10 rose to about 8½ million units. This is, of course, encouraging.

Because of the worsening cost-price squeeze, however, price rebates on today's scale cannot continue. And what will happen to car sales when the present rebates end is anybody's guess. Personally, I see no chance for a sustained improvement in car sales until consumer confidence begins to improve and the economy as a whole begins to recover.

The automobile manufacturers have been criticized because we have been urging the Government to stimulate the economy and have not tried to rescue ourselves and lead the economy out of recession by slashing prices across the board. Speaking only for Ford Motor Co., we have not adopted a general price cut because we cannot.

The current temporary price rebates on selected products were adopted as an experimental effort to rekindle consumer interest and reduce excessive inventories of certain car lines. It would be an entirely different matter for us to reduce all our prices and keep them down.

In spite of retail price increases averaging about $1,000 per car since the end of the 1973 model year, our profit margin has reached the vanishing point. A price reduction would cost us far more than we could possibly save as a result of higher volume and lower fixed costs per unit. We cannot reduce prices at this time, because we could not survive by selling more cars and losing money on every car we sell.

We recognize, of course, that our future sales growth will be severely limited if car prices continue to increase as much as they have in the recent past. But the rise in car prices cannot be slowed until cost increases are slowed. And this, in turn, depends primarily on the Government's success in stimulating economic recovery without bringing on a new round of inflation, and on the Government's willingness to restrain the sharply rising costs of government-mandated standards controlling our products and our plants.

Mr. Chairman, in my 30 years as a businessman, I have never before felt so uncertain and so troubled about the future of both my country and my company. It is not too much to say that the very survival of our free society may depend on finding good solutions to the three basic economic problems I have mentioned this morning.

We must restore economic growth and reduce unemployment. We must gain control of inflation. And we must learn to use petroleum and other energy sources more efficiently.

Whatever progress may be made in the near future, the United States will be striving toward each of those goals at least for the rest of the 1970's. Ford Motor Co. is compelled by its own business interests to work toward each of those same three goals.

To restore our profits, we must increase our sales and our production and put our employees back to work. To restore and maintain the growth of our sales, we must hold down both the price of cars

and the cost of driving them. To hold down driving costs, in spite of high and rising gasoline prices, we must make large improvements in the fuel economy of our products.

Because of the enormous economic role of our industry and its products, our success in working toward these goals will have a significant influence on the Nation's success. That is why I believe that Congress should be concerned over the major obstacles placed in our way by safety, damageability and pollution control legislation, and by standards established pursuant to that legislation.

We estimate that statutory and proposed standards for the 1976 through 1980 model years, could add more than $800 to the retail price of the average Ford-built car. Our present projections indicate that if the statutory emission standards and proposed new safety and damageability standards become effective, the average fuel economy of our 1980 cars might be 6 to 8 miles per gallon less than it could be if 1975 standards were continued.

During the past 3 years, we have invested an average of about $200 million a year to meet car, truck, and plant standards, and the rate of investment will have to go up sharply during the next few years if we have to meet presently scheduled standards.

As you may know, we have pledged that Ford will do its part to reach the President's goal of 40 percent improvement in the average fuel economy of new cars by 1980, if emission standards are no more stringent that the President has proposed. This will require reductions in the sizes of cars, further expansion of small car production and sales, and major technological changes that, together, will take investments of hundreds of millions of dollars. It is difficult to see where the money is going to come from if our sales are depressed by the need to pass on the cost of other government standards and our capital is depleted by the investments required to meet those standards.

Whatever margin of error there may be in the numbers I have cited, the fact remains that government standards for the next 5 years represent a major obstacle to our efforts, and the Nation's efforts, to keep prices down, restore economic growth, reduce unemployment, and conserve petroleum.

This obstacle can be removed without abandoning the health, safety, and environmental goals established by Congress, by deferring any further tightening of standards for 5 years.

Not one of the future vehicle standards now on the books would lead to any large short-run improvement in environmental quality or public health and safety. Every one of them could be deferred for 5 years with no significant slackening in health and safety progress.

The air will get cleaner over the next 5 years, for example, even if emission standards are left at their present level, because older, dirtier cars will be replaced by new cars that meet today's stringent standards.

When the legislation underlying vehicle standards was enacted, Congress could not have foreseen that the major costs would come at precisely the time when the Nation could least afford them. That time has arrived, however, and the choice seems clear to me.

Because the major benefits of this legislation already have been achieved, no great harm will be done if the major costs that lie ahead are deferred until a better time. Meanwhile, Congress would have an opportunity to consider carefully whether the remaining benefits really are worth their cost to the American people, and our industry would have the time it needs to achieve such benefits at lower cost.

Thank you very much, Mr. Chairman. I would be happy to try to answer any questions.

Chairman HUMPHREY. Thank you, Mr. Ford, for your comprehensive statement. I am sure that you will recognize, particularly in the latter portion of your statement on the pollution and environmental standards, there is considerable controversy.

This committee, as such, does not specialize in that kind of legislative study or activity. However, it is, of course, related to the whole economic problem today. I appreciate particularly the candor and frankness of your statement.

Mr. FORD. Thank you.

Chairman HUMPHREY. As we would say, it was on target. It was surely plain, and as you have indicated about what a tax bill ought to be, it was direct, and I think, easy to understand.

I must say insofar as the economic aspects of your statement are concerned, I wish that you were the economic adviser to the Government right now, insofar as my views are concerned. Because I sense that you understand better than most who we have heard from here, the urgency of the situation.

You have emphasized the time factor, is that correct?

Mr. FORD. Yes, sir. I think it should be prompt, done very quickly.

Chairman HUMPHREY. And the legislation on the tax matter, I want to just inquire into it in a little more detail.

You were the first, as I recall, in the business community to call for a very sizable tax reduction. I believe that was last fall sometime, was it not? In November or October?

Mr. FORD. Yes, in November, Mr. Chairman.

Chairman HUMPHREY. In November. A tax reduction designed to stimulate the economy. Now given the worsening of the recession since that time, what size tax cut in round numbers do you recommend at this present time? I believe in November you were suggesting $15 billion. What do you think is necessary now, Mr. Ford?

Mr. FORD. Mr. Chairman, this is not exactly my field. I do not know whether it should be $20 billion or $30 billion. I noticed the other day in the newspapers that George Meany recommended $30 billion. I think it should be very substantial.

Chairman HUMPHREY. Higher than your original estimate?

Mr. FORD. I would think so. Much higher than the $15 billion; yes sir.

Chairman HUMPHREY. What corporate tax reduction do you recommend? As you know, there seems to be general agreement here amongst the bipartisan groups here in the Congress, that there ought to be an investment tax credit.

Would you like to give us your thoughts on any other kind of credit, or your view on investment tax credit, as to whether that should be for 1-year, or whether it should have some continuity?

Mr. FORD. Well, I think on the investment tax credit side, if it is going to continue in effect over a period of time, and I hope it would be written that way, I think going from 7 to 10 percent for industry, generally, and going from the 4 percent to 10 percent for the public utilities would be fine.

But I think you have to know how long it is going to be in effect. As I understand it, the Ways and Means Committee has said that they will talk about it temporarily now, but when they get to the overall tax bill later on this year, they will then talk about a continuing tax credit.

With respect to an overall corporate tax reduction, my personal feeling is that capital formation today is so difficult that it is hard for industry and business in general to find the money to invest. You certainly cannot go to the equity market. Borrowing costs have come down some, but they are still very expensive.

One way to solve that problem would be to reduce corporate taxes. I know that this is not a popular subject. On the other hand, however, I do not know what businesses are going to do when they have to pay higher energy costs. And with the increase in energy costs, individual consumers as well as business are going to be hit by this.

And one of the ways, I suppose, to take care of this would be to reduce corporate taxes. Now the individual has to be considered as well, and I am not sure how that should be done. But I think that that has to be considered at the same time.

But I do worry about capital formation. I think about our own situation, and it is a difficult proposition. And I think we have to produce—business and industry have to produce productive jobs in this country. We do not have the capital at the moment to do that effectively.

Chairman HUMPHREY. I want you to know, Mr. Ford, speaking only for myself as one member of the committee, I do feel that the problem of capital formation is an important one and a perplexing one at this time, and therefore, any tax bill, any writing of a tax bill, ought to take this into consideration.

As for the investment tax credit, I understand that you feel that it ought to be more than a year; is that correct?

Mr. FORD. Hopefully.

Chairman HUMPHREY. To give any sense of confidence in the investment market.

Mr. FORD. I really do not know enough about it, Mr. Chairman.

Chairman HUMPHREY. But let me be more specific, because this is important for us. Investment tax credit, 1 year or more than 1 year in the initial tax bill.

Mr. FORD. The initial tax bill, I understood, for one reason or another it was not possible to go for more than 1 year. I think it should be a continuing thing with no end, and should be raised to 10 percent. Now if it is 1 year, and no more, I think it has to be much higher than 10 percent.

Chairman HUMPHREY. I do not happen to be for just 1 year. Again, I think that you do not get enough results out of that, speaking for myself. You called for a temporary tax cut. Do you mean just for 1975?

Mr. FORD. In my opinion, we have to see what happens. I think that one of the things that we are worrying about, I suppose, is whether the consumer with the tax cut will spend this money, or whether he will pay off his debts and put the money in the bank. Until we find out exactly how it is going to go, I think that 1 year is going to be a stimulant.

And then in the discussions of the total tax reform, an additional look can be taken at it, and taken later on this year.

Chairman HUMPHREY. There is that very serious, unanswered question as to just what the consumer is going to do, particularly with the rebate or tax cut. I think that a reduction in the withholding rate on weekly earnings, I happen to believe, would most likely be spent, because it would be what we would call consumer income available for spending.

I was very pleased with what you had to say on the money supply, and your comments on the Federal Reserve. You would be interested to know that we just have a report published by the St. Louis Federal Reserve Bank on the latest data on M_1. That is, currency and coins, plus checking accounts, what we call money supplies. M_2, currency, coin, checking accounts, plus savings accounts at banks.

And we find out that from early July to early February, the traditional money supply, M_1, has grown only nine-tenths of 1 percent, and since November it has actually declined six-tenths of 1 percent, which is about what you have said in your testimony.

So all of this talk about the increase in the growth of effective money supply—and I repeat the word "effective" money supply—just does not hang together. It is significant to note that both M_1 and M_2 money supply, the traditional measures of money supply, again have declined sharply in the past 2 months.

More importantly, long-term interest rates remain very high, and it appears that the banks are rebuilding their liquidity in reserves, rather than loaning out the funds. Now this is the analysis that comes from the St. Louis Federal Reserve Bank.

Do you have any further comment on this? Do you believe that money supply is at the heart of our economic policy here?

Mr. FORD. I do not see how we can progress unless we get an increase in the money supply at this time. I do not think I have anything to add to what I had in my statement, but I think it is most important that the money supply be increased.

Chairman HUMPHREY. We have a resolution, Mr. Ford, before the Senate Committee on Banking, and it was introduced by Senator Proxmire and myself, calling on the Federal Reserve to increase the money supply substantially, at a rate substantially higher than has been recently experienced.

We asked them to look at the money supply as it relates to our economic potential, not to set any fixed rate. Because I personally think that a fixed rate on the part of Congress would not be as effective as some flexibility. But at the rates that you have suggested, I believe 6 to 8 percent was your suggestion, we have had others which go a little higher.

Some Members of Congress still believe that the Fed should be completely independent from any congressional economic policymak-

ing. What do you think about this kind of a resolution? Do you think the Congress should move ahead on this, or do you think we should keep hands off?

Mr. FORD. Could you repeat the question for me?

Chairman HUMPHREY. Do you think the Congress should, through resolution, direct the Federal Reserve Board to substantially increase the money supply related to the economic potential of this country in order to get us out of this recession?

Mr. FORD. No, I do not, sir.

Chairman HUMPHREY. You do not? How would you get the Federal Reserve to act? I would be glad to hear you on that.

Mr. FORD. I would hope that the chairman would be knowledgeable enough about the economic problems of the country to realize that he has to get this country moving again, rather than worrying about the rate of inflation, which, it seems to me, is the thing he is worrying about.

Chairman HUMPHREY. Would you like to speak to him about that?

Mr. FORD. I will if you want me to.

Chairman HUMPHREY. I would love to have you do so. You are a highly respected man in the business community. I think that Mr. Burns is an extremely able and intelligent man.

Mr. FORD. So do I.

Chairman HUMPHREY. But having said that, I repeat what I have said on other occasions. The fact of the matter is, that the money supply is still tight.

Mr. Ford, do you think there is any chance for economic recovery of your industry with the tight money supply?

Mr. FORD. I would think, Mr. Chairman, that it would be most difficult to do it unless we had an increase in the money supply. But I am more worried about public confidence in this country. And somehow, public confidence has to be restored, and public confidence is going to be restored when jobs start coming back.

Chairman HUMPHREY. How do you get jobs?

Mr. FORD. We have to have money to do that, to produce productive capacity.

Chairman HUMPHREY. Right. My judgment is that we can increase this budget, increase the deficit which some people are perfectly willing to do, and still have very little effect on the overall job market, unless that money supply is relaxed.

My study indicates that a relaxation of the money supply will do more to promote private investment, and restore both investment and consumer confidence, than anything that we do in terms of budgetary policy.

Now I am pleased with what you have had to say about tax relief, and I am hopeful that we can use this occasion and this committee to encourage the Congress to proceed promptly on a tax relief bill of substantial proportions. I personally think it ought to be within the range of $25 to $30 billions. But whatever the range is, it has to be big enough.

I have one other question. I would like to put it to you, but I yield to Senator Javits. Senator Javits has another meeting to attend, and my 10 minutes are up.

Senator JAVITS. Thank you, Mr. Ford, for showing yourself to be what we all know you to be—an enlightened businessman. I thoroughly agree with most of what you have said. Will you agree to some degree with me, also, on this; that the Federal Government should, during this terrible period that we are passing through, attain a level of unemployment compensation, and a quotient of public service jobs, to relieve, as far as we can, the distress to the individual worker?

Mr. FORD. I fully agree with that.

Senator JAVITS. And even if we have to add to our deficit in order to attain that humane atmosphere for Government, we must do so.

Mr. FORD. I fully agree with that, Senator Javits. I would like to make one comment. I hope the public service jobs can be in the big cities, because that is where the big problems are, in the center parts of the big cities. Public service jobs there will do more than they would if they are spread all around the countryside.

Senator JAVITS. I thoroughly agree, and I am the author of the public service job bill with Senator Williams of New Jersey. We will do our best in that regard. We have learned a lot about public service jobs. They can no longer be accused of being leaf-raking jobs.

I am interested in another aspect of your own attitude as an enlightened businessman, and that is what you see in your own business. I listened with great interest to your statement:

> This will require reductions in the sizes of cars, further expansion of small car production and sales and major technological changes that, together, will take investments of hundreds of millions of dollars.

Now, (1) I thoroughly agree with that; (2) I think that if the industry committed itself to that task, it would be an important trade-off for your desire to have us suspend temporarily, for whatever number of years it may be agreed upon, these new environmental standards. Do you see—I would like to divide the question into two parts—(1), how the industry can raise the capital; and (2), whether it also requires a retooling of the industry to make tanks and other weapons during the war? Do we now need also to look to them for guidelines to improve coal production, or mass transit vehicles, to emphasize the mass transit business and other items of that character, dealing with transportation?

Mr. FORD. On the first one, we need large amounts of capital, hundreds of millions of dollars. We need that. In the first place, our profits are very low, if indeed they are there at all. We have to get capital somewhere. We are not getting it out of profits. To come to a 40 percent reduction in fuel economy, there are many things required, but it also takes a lot of money. One of the things required is to take a lot of weight out. When you take a lot of weight out of the car, you cannot just do it with transmissions and rear axles. To take some weight out of the car requires hundreds of millions of dollars to retool the product. It has to be done if we are going to get this fuel economy that will be required of us in order to conserve energy; and we cannot conserve energy, we cannot get better fuel economy, unless we make cars, as I say, lighter and smaller.

Now, in retooling for different kinds of things than we are used to building, I do not know. That is a big problem. What we would be

allowed to do, I do not know. Under mass transit, there are some people who say that we should not be in it, and others who say that we should be in it. But I am not sure where the dividing line is.

Senator JAVITS. You as a company?

Mr. FORD. I mean our industry.

Senator JAVITS. The point that I am driving toward is the fact that the way to restore consumer confidence is to stimulate the consumer's imagination and faith in the ability of American business to be enterprising and full of initiative, et cetera. That is why I am asking these questions. Looking at it from the point of view of the industry, with you as an industry leader, do you believe that it would be desirable for the industry to be far more flexible and mobile in its outlook than simply confined to the making of motorcars?

Mr. FORD. You are asking me, I guess specifically: Should we get into other businesses?

Senator JAVITS. Exactly.

Mr. FORD. I do not know. We are not doing so well in our own business right now, so I wonder whether we should do that. Doing this would require additional capital, getting back to the first part of your question; so I do not know whether we are capable of doing it. If business were good, maybe we would be. But at the present time, I am not so sure.

Senator JAVITS. I come to the capital demand question; do you see the need, in order to restore the momentum of your business, for a major government financing entity to make available the capital in the hundreds of millions, perhaps billions, it will take to enable your industry to do its job, provided—and there you would have to look to us—it does not mean nationalization in the guise of a loan? But do you see capital available in markets, or do you feel that in order to mount the kind of effort you have just described, it is the Government which has to stand ready to make available the necessary capital at a reasonable rate?

Mr. FORD. I would hope it would not be the Government, Senator. I would hope we could do it on our own. But I think it depends upon the larger question of what the standards are that the Government is going to force upon us, and that is a great part of our expenditure program. We take fuel economy and damageability and emissions out; it all adds up as a part of the total of our capital expenditure on a year-by-year basis. The Government mandate is a big part, and it varies year by year, but it gets up into the very large figures.

Senator JAVITS. If we should suspend the standards which you have described for a period of years, say 3 to 5 years, do you believe the industry could then finance itself with retooling of its whole enterprise for lighter, smaller cars using less energy, et cetera, and meet those objectives without government financial help? [1]

Mr. FORD. I really do not know how to answer the question, because I do not know what kind of money we can earn. It depends on the whole economy of the country. But I would suspect—I know we can do it more easily if we were not also burdened with the expenditures

[1] See Mr. Ford's letter to Senator Javits, dated Mar. 26, 1975, p. 657.

required to meet additional government standards. My personal opinion is, it is more important to get this economy moving; and if you burden the public, all of these costs get passed on to the consumer, and why should the consumer be burdened with these extra costs at a time when, basically, he really cannot afford it? Everyone says, you are against clean air, you are against all of these wonderful things ecologists tell me. Well, OK. I think the economy is more important in the short run than clean air. I would not say in the long run, but in the short run, because unless we can produce jobs and keep people employed, I do not know where we are going.

Senator JAVITS. I thoroughly agree with that. I do not know that I would agree with you 100 percent on the question of deferment. I think it is a critically important question as to whether this industry, with that deferment, can undertake to see to its own financing. That is really the question that I am asking you. I gather that you are in no position to reply on that.

Mr. FORD. I just do not know how to answer that question, Senator, quite honestly. I just do not know. I hope we can do it ourselves, but I do not know.

Senator JAVITS. If you cannot do it yourself, in the same vain that you say we have to set aside environment and other objectives in order to deal with unemployment first, would you say, that if it needs government financing, then should there be government financing?

Mr. FORD. Well, I hate to see the Government get into the financing of private enterprise in this country. I think it is leading us down the wrong road. I think we have always felt that the free market economy was the basis upon which we have been able to progress and grow as a country over the long pull; and I think when you get into a situation where, you know, you have the eastern railroads, or Pan American, or something like that, that gets into a particular kind of a situation—I get very nervous when you start to look at this thing on the basis which you are talking about, and frankly, I would be very frightened, and I do not think I would be in favor of it in any way. But who knows what you have to do to get the economy moving? I am not quite sure that I have a feel for it.

Senator JAVITS. I think I have your view, and I think it is a very valuable one. I have one last question. The central bank of the Federal Republic of Germany has recently announced a target for a money supply of 8 percent. Do you think it would be helpful to the business of America—workers, management, and industrialists alike—if a target would be announced, without disclosing its day-to-day operations, by the Federal Reserve Board?

Mr. FORD. I do not think it would be necessary, Senator. I think the Federal Reserve Board is sensitive enough to the economy of the country as it moves along. I do not think it means enough to the people, generally, and the people who need to know, know anyway. Now, they do not know the target way out, but they can find the figures.

Senator JAVITS. My time is up, but this one last point. You feel it is just necessary for the Board to commit itself to expanding the money supply, rather than to name any specific order?

Mr. FORD. I do at the present time. I realize that the Federal Reserve is worried about the inflationary aspect of it, but I think that, if they move with the times, they can take care of that.

Senator JAVITS. Thank you very much.

Chairman HUMPHREY. Might I state, for the information of all those present, that Mr. Woodcock is now with us; and following the interrogation of Mr. Ford, we will have Mr. Woodcock. I believe that is agreeable with you, is it not, Mr. Woodcock?

[Mr. Woodcock nods in the affirmative.]

Chairman HUMPHREY. So we will proceed now with the interrogation of Mr. Ford.

Congressman Hamilton.

Representative HAMILTON. Mr. Ford, let me say that I found your statement exceedingly helpful, and I appreciate it. I want to ask you a short-term question, and then a long-term question. I was impressed by the figure 24 percent unemployment in the automobile industry. I come from a State which has a good many of these unemployed autoworkers—Indiana. What do you envision for the next several months with regard to the unemployment of automobile workers; and in your answer, what has been the impact of the rebates, insofar as the prospect of bringing these workers back is concerned?

Mr. FORD. On your first question, Congressman Hamilton, I do not see a great change in automotive sales in the coming months. I think we hope that there is going to be a spring upturn. So much depends upon the general economy of the country, but I am not sure that a spring upturn has not been sort of pushed off until a much later time this year. I would not be looking for a great big upturn in the springtime.

Representative HAMILTON. Do you see the 24-percent figure running well into the summer, and perhaps the fall?

Mr. FORD. If I could first comment on the rebate a little bit—the rebates got the inventory of cars in dealers' hands down, although not as much as we would have liked. So actually, a lot of the unemployment in the early part of this year was caused by very high stocks, and we had to get those stocks down because the dealers could not afford to carry them. The carrying of those cars was too much for them, so we wanted to get the inventory down. Actually, the production rate was lower than the sales rate in December and January, at least in our company; maybe not so in all of the others, but at least in our company. So that I would say the unemployment rate will not be as high as 24 percent in the automotive industry during the next 2 months. I think it will be lower, because we will be rebuilding inventories in the dealers' hands which have been reduced because of the rebates.

Representative HAMILTON. I would like to shift your focus if I may. I was interested in an article I read this week about the necessity for long-range planning. In the article you seem to think that there would be very great competition for the raw materials and natural resources as far into the future as we can see. You recommended some kind of Government plan with regard to the allocation of resources; and I am very interested in your views on that. What kind of a mechanism do you envision?

Mr. FORD. Well, I have done no deep research into this thing. But I just have a feeling that there is no coordination. There may be a lot of planning done by the Government, but it is not coordinated, and I am not sure that there is really enough being done. And my feeling was to try to get a group together on a high level within the Government, so that it would be listened to by the Congress, by the executive branch, by the consumer, by the labor unions, by business, by whomever. It would be planning on a long-term basis, but without any authority to allocate materials, or anything like that. It would be a planning agency which could speak up and say, look, we are going to run short of bauxite for aluminum, the way we have made our assumptions, in the year 2001, and we must start thinking about what we are going to do. What material can we find to replace aluminum? I am just picking this out of the hat. Or, what are we going to do?

My theory is that you start to look at population growth, the growth in GNP, requirements to support that, where the materials are going to come from to support it. what kind of food supply you will need to support it. It is a big job, and it is going to take years to get this thing moving. You would have to get the organization together, and get it all on computers. I have not thought this thing through. A lot of business people think this is a nutty idea, because once you give Government the planning capabilities, they might push the button and take over the allocation, and then you have a socialized type of government. Well, I think maybe the planning is worth even that risk.

Representative HAMILTON. You would have it strictly as a planning board making recommendations, doing research, distributing information; but not with actual authority to allocate resources?

Mr. FORD. Yes, sir.

Representative HAMILTON. Just setting goals, national targets over a several year period?

Mr. FORD. Well, you could do that, if that was what the Government wanted to do with it. I see nothing wrong with that.

Representative HAMILTON. Would business pay any attention to such planning?

Mr. FORD. I could not answer that question. I do not know. I would suppose they would have to.

Representative HAMILTON. If the competition for resources is going to be as great as you suggest, at some point would it be necessary for mandatory allocation?

Mr. FORD. I hope not. I really do not know. There are always substitute materials that can be found, at least to this point; and I hope that this will be the case. But I cannot speak to it, because I just do not know.

Representative HAMILTON. Thank you, Mr. Chairman.

Chairman HUMPHREY. Before I yield to Congressman Brown, may I just say how much I appreciate the forthrightness of your responses to questions, Mr. Ford. Your are very helpful.

Congressman Brown of Ohio.

Representative BROWN of Ohio. Mr. Ford, the first Henry Ford made a fairly significant contribution to American business by each

year creating a better product, which in many years cost less money in successive years. I assume, in order to do this, he had to get some financing to put together the resources that made those economies possible. What do you anticipate it is going to cost you in the Ford Motor Co. to make the tooling changeovers that will be required to go to more fuel-efficient cars, less polluting automobiles, and other things that have been mandated by the Federal Government?

Mr. FORD. It all depends on the extent of the mandate, and the kinds of retooling we have to do; because General Motors has told EPA that over the next 3 years, they are going to have to spend $3 billion. This is public information.

Representative BROWN of Ohio. How does that relate to profits?

Mr. FORD. I have no idea, sir, what the profits will be. Their profits for last year were down considerably—substantially, I should say. They think they can do this, obviously, or they would not say it. So they have released their profits for 1974. Their profits were $3.27 per share.

Representative BROWN of Ohio. Is that before or after dividends?

Mr. FORD. That is their total profits per share, after all of the expenses—dividend payments would come out of the $3.27.

Representative BROWN of Ohio. As I understand it, profit in total was something less than $1 billion.

Mr. FORD. Less than $1 billion? My figures show only our estimates for the totals. I know the $3.27 figure is accurate, but I really shouldn't comment on any other GM figures, because it is none of my business——

Representative BROWN of Ohio. Can we talk about Ford?

Mr. FORD. I do not think so, sir, because the figures are coming out tomorrow, and I am told by our people that the SEC and the stock exchange would be very upset if I said something today about something coming out tomorrow. Now, I could talk to you privately about it, in the backroom. [Laughter.]

Chairman HUMPHREY. We cannot let you do that any more, either, Mr. Ford. Things have all changed. [Laughter.]

Representative BROWN of Ohio. Can we talk about what they were last year?

Mr. FORD. Yes, we can. Our profits last year, in 1973, were $9.13 per share.

Representative BROWN of Ohio. What I am trying to do, Mr. Ford, is to relate your profit situation to the need for future investment, to get to the point that you made about profits being inadequate for the necessity of future investment; and to try to get some picture of whether it is going to be possible to do that out of profit, or whether it is going to be necessary for the automobile industry to go out and borrow money in the capital market. Then I want to try to make a couple of points about where the capital market is going.

Mr. FORD. It would all depend upon what we will be required to do. I do not know what all we will be required to do.

Representative BROWN of Ohio. Given current requirements.

Mr. FORD. The current requirements would be a lot of trouble. Current requirements require this extra emission expenditure. We would be in deep trouble. We could do nothing about lightening our

cars. We could do nothing about retooling. We would have to be spending everything we have on Government-mandated standards.

Representative BROWN of Ohio. What about increasing fuel efficiency?

Mr. FORD. I am including fuel economy as one of the things they are working on, along with emissions, safety, damageability and noise. I am including that in there, but we could not do anything to retool our cars to make them lighter or smaller or anything else. We would not have the money. We would not even have the money to meet the Government requirements as they are today. It all depends on how the economy goes, and what our profits might be next year.

Representative BROWN of Ohio. All right.

Let us assume that you have to go out on the private money market, then, and borrow. I assume that the problem you will run into is that the Federal Government will be on the private money market, borrowing somewhere between $53 billion and maybe $83 billion on the private capital markets during the next 12 months. How will Ford fare in that comparison?

Mr. FORD. Well, up to this time, we have not had trouble in the money markets in selling debentures. But we have had no recent experience. We will not, hopefully, have to go to the money market this year. We will go to the money market in our credit company, but not the parent, and we could get through the year by short-term borrowings and by temporary borrowings from our credit company to the parent company.

Representative BROWN of Ohio. As I understand it, the interest rates on short-term borrowings are down. Do you know what has happened to the interest rate on long-term borrowings?

Mr. FORD. Not really. No, I do not sir.

Chairman HUMPHREY. Feel free to bring any of your counselors or advisers, Mr. Ford, up to the table with you. Get a chair, and come right on up here and join the party.

Mr. FORD. I really do not have any figures on the long-term borrowing. The short term, as you say, has come down. One bank, I think, went down to 8½ percent this morning on their prime rate.

Representative BROWN of Ohio. That would indicate some increase, if not the money supply, at least credit availability on a short-term basis.

Mr. FORD. Yes, sir.

Representative BROWN of Ohio. On the long-term basis, figures are not quite so optimistic, are they?

Mr. FORD. I would not think so.

Representative BROWN of Ohio. It seems to me that a sharp increase in the money supply might create some problems in the interest rate on a long-term basis, although it might lower the interest rate on a short-term basis.

Mr. FORD. Yes, sir.

Representative BROWN of Ohio. Is that fair?

Mr. FORD. That is fair.

Representative BROWN of Ohio. So, really, the policy that we are sort of balancing here is whether or not you create short-term, low-

interest rate funds without scaring the hell out of everybody with reference to long-range inflationary aspects. Is that not about right?

Mr. FORD. I would think so.

Representative BROWN of Ohio. And a fairly tight rope to walk.

Mr. FORD. It is a tight rope to walk.

Representative BROWN of Ohio. With reference to public financing for the Ford Motor Co. or others, we do not say that if, perhaps, we got into public financing of private enterprises, that we are letting the Government take over the decisionmaking process from consumers, labor, and private industry.

Mr. FORD. Yes, sir.

Representative BROWN of Ohio. In effect, what we are doing about public financing is saying that we are either going to take tax dollars with the authority of Government out of the pockets of individual citizens, and invest it in certain industries, or we are not going to take those tax dollars out. We are going to take them away from them in the form of inflation. Is that about right?

Mr. FORD. I would think so, yes, sir.

Representative BROWN of Ohio. And in effect, the other choice, to do it out of prices and profits, would at least leave the choice free to the consumer, the laboring man, and the private industry, as to whether or not they can negotiate between themselves what those prices and profits would be. I would say, frankly, that the automobile industry right now is facing a little bit of a consumer rebellion in terms of the prices that have already been mandated by the Federal Government.

Mr. FORD. I think that that is part of the case. I think the other part of the case is the inflation that we have lived through in the past few years, up until quite recently. The rate has been going up, and we have not been able through our price increases to recoup our costs, even.

Representative BROWN of Ohio. Do you mean you are not getting the cost back on the price of an automobile?

Mr. FORD. Not in the 1975 model year, we are not. We are $350 million short.

Representative BROWN of Ohio. Well, let me ask you a question.

Mr. FORD. $350 per unit short, pardon me.

Representative BROWN of Ohio. $350 per car?

[Mr. Ford nods in the affirmative.]

Representative BROWN of Ohio. In the price of an automobile, I do not know how I would get the average price of a Ford Motor Co. automobile.

Mr. FORD. I do not know, either. They give it to me in the finance department, and I just have to take their word.

Representative BROWN of Ohio. If you believe it, I will believe it. All right?

Mr. FORD. Yes, sir.

Representative BROWN of Ohio. In the average price of that automobile, how much of that is the result of inflation over the last few years, and how much of it is the result of mandated Government requirements over the last few years?

Mr. FORD. I do not know that I could give you a percentage. I could give you the cost of Government-mandated equipment. Fred, would you like to do that?

Chairman HUMPHREY. Excuse me. Give us your name for the record, please.

Mr. SECREST. I am sorry, Mr. Chairman. My name is Fred Secrest. I am executive vice president of the Ford Motor Co. The mandated Government costs passed on at retail since the beginning of controls in the late sixties—that is, for emission control, safety, and damageability—has contributed about $500 already to the retail price of our average passenger car.

Representative BROWN of Ohio. How much has come from inflation; or have you broken the figure down for the same period of time?

Mr. SECREST. Our inflation, in just the last couple of years, has been as you know at double-digit rates. So it would be several hundred dollars—$500 at least—in the last 2 years.

Mr. FORD. If you would like for us to give you more detail on this, we could get the figures for you, Congressman Brown.

Representative BROWN of Ohio. I guess what I am after here is, how much of the cost of an automobile—and that seems to have something to do with what has happened to the automobile market—is the Government currently responsible for?

Mr. SECREST. Well, we have the $500 for the cost of the standards, and of course our position is not that all of the standards that are presently on the cars are bad.

Representative BROWN of Ohio. I am not suggesting whether they are good or bad. I am trying to determine whether or not they have been mandated, and what the total cost, by requirement of law, is.

Mr. SECREST. $500 for the mandates, and $715 is our estimate of the inflation factor in the last 2 years, from January 1, 1973, to January 1975.

Representative BROWN of Ohio. That is $1,215, based upon what kind of an average automobile price?

Mr. FORD. We are talking cost here, Congressman Brown.

Representative BROWN of Ohio. All right, the average automobile cost.

Mr. SECREST. It is approximately a $3,500 base.

Representative BROWN of Ohio. So $1,215 on a $3,500 automobile——

Mr. SECREST. About one-third; yes, sir.

Chairman HUMPHREY. Congressman Long.

Representative LONG. Mr. Ford, I always hear rumors, and the rumors I hear from my one-man poll of perhaps 10 automobile dealers in my district, and I hear that the bigger cars are continuing to sell, and that the small American-made cars are not selling, even under the rebate program.

Mr. FORD. That was true before the rebate program, but since the rebate program, it has turned around, and the small car volume has gone up about 25 percent since the rebate program went in, and the percentage has changed in daily selling rates from December 11 to January 10, and from January 11 to February 10. Comparing those

two figures, one nonrebated date and one rebated period, the rebated cars have gone up 117 percent, and the nonrebated cars have gone down 18 percent. That is on a daily rate, which you know is a computation that we make.

Representative LONG. There has been a marked change in that direction as the result of the rebate program?

Mr. FORD. Oh, yes. Oh, yes, there is no question about that. The total industry rate has gone up about 25 percent in total.

Representative LONG. Having been in the corporate finance business, as I was for a number of years, I am worried about a long-range capital supply being available for long-range expansion. But one thing does disturb me. Most of the people who have been before this committee have felt that investment tax credits ought to be built in as a part of the economic recovery, and that it ought to be basically long range. To me, whether we like to call it that or not this is a loophole. Everyone is against tax loopholes, and I think the definition of a tax loophole often depends upon whether it affects you or not. I really see little difference between an investment tax credit and an accelerated depreciation, or just depreciation per se for, say, an apartment building or an office building.

Mr. FORD. Well, you can go either route, but the way the depreciation regulations are written today, we do not get enough out of that. So this is the reason we are interested in the other. I do think we have to know how long we are going to have it or it does not really mean much.

Representative LONG. Well, I would agree to that. I think that some stability as to how long it is going to be available to you has to be a part of it.

Another question: Some people argue that the program that has been set forth by the administration for economic recovery, overall and as far as the automobile industry is concerned, really only reestablishes the old order, which I think all of us will admit was highly wasteful in the consumption of natural resources and energy. They argue that, particularly with respect to the automobile industry, this ought not to be rejuvenated. And, as you mentioned earlier, more effort should be made to get the higher gas mileage and better performance out of our automobile, and not to encourage it simply to go back to its old ways.

In this regard, in the Congress, there have been two proposals that have been set forth. I would like your view on each of these.

One of them is the creation of tax credits for the purchase of automobiles that are more fuel efficient balanced by higher taxes on automobiles that are inefficient in their use of fuel, or what is commonly called I guess, a gas guzzler. What would be your view on that?

Mr. FORD. I would not like it very much. My personal opinion—the reason is you try to measure fuel economy in a product, and I think this gets you into a very difficult situation. How are you going to do it? You know, everyone drives differently. Cars have different engine sizes, actual ratios, transmissions. The measurements are sales weighted, and you know sales-weighted averages do not mean an awful lot.

So I would frankly be very much opposed to it. I do not think it would be an efficient way to get the job done. That would be my opinion.

Representative LONG. The second proposal under consideration in that regard is to remove some of the limitations and restrictions with respect to emission control and possible injury resulting from accidents, and, at the same time, to impose a more severe limitation upon the automobile industry to produce more efficient fuel usage cars in a shorter period of time rather than waiting until, say, 1980 or 1982. What would be your view on that?

Mr. FORD. Well, we have got to build better fuel economy into our cars over a period. And how fast we do it depends on how much money we spend. We can do a certain amount—but to get the weight out, to get the car smaller, as I remarked on before, is a cost problem to us, and we have got to have the capital to get the job done.

Representative LONG. You do think that the tax incentive would assist in making this capital more available, and, as Senator Humphrey pointed out, making more money available in the money market in general by action of the Federal Reserve, would tend to lessen this problem?

Mr. FORD. I am not quite sure what the tax incentive is that you are talking about, Congressman Long.

Representative LONG. I am speaking of the tax credit for the investment tax credit.

Mr. FORD. Oh, yes, certainly, absolutely, no question about it.

Representative LONG. I look upon it, really, as a tax incentive. Perhaps it is not completely that. That is all, Mr. Chairman. Thank you.

Chairman HUMPHREY. Congressman Brown of Michigan.

Representative BROWN of Michigan. Mr. Ford, we have talked about the many standards now. To what extent does your industry have input into the development of safety, emission control, damageability. fuel economy standards?

Mr. FORD. At the present time, I suppose you could say that we have a fair amount on the safety and damageability. We get a chance to get our views listened to. They are not always then accepted, and we would not expect them to always be accepted, but at least we have a chance to make our position clear.

Representative BROWN of Michigan. To what extent have you had that input in the past?

Mr. FORD. On safety and damageability, we have had an opportunity to have our views heard.

Representative BROWN of Michigan. Well, it has been alleged to me that, especially in the safety and damageability area, that really there are ways that if industry was given an opportunity that you could accomplish say 99 percent or a substantial accomplishment of a goal with a much lower weight factor which would then contribute to fuel economy, rather than having the safety standards be counterproductive with respect to fuel economy.

Mr. FORD. That is perfectly true, Congressman Brown.

Representative BROWN of Michigan. Well, why has it not?

Mr. FORD. Well, they have listened with their ears, but they have not acted the way we have suggested many times because they did

not want to for one reason or another. I do not know what the reasons are always, but for one reason or another, they have felt that they did not want to go the way that the automotive companies or an automotive company, an individual company might suggest, they decided to go a different route on whatever the problem is.

Representative BROWN of Michigan. Has there been substantial unanimity in the industry with respect to the better route, as you have suggested it?

Mr. FORD. Well, it depends upon the question, but we do not have unanimity very often.

Representative BROWN of Michigan. Well, we are talking about safety.

Mr. FORD. I cannot speak to specifics. Do you have any specifics, Fred?

Mr. SECREST. Well, there are so many standards, Congressman Brown, that it is difficult to generalize. I think what we are all learning now is because many of the standards, such as bumper standards, have been in effect for such a long time there is beginning to be a body of available evidence—available to all of the companies, to Government and everyone else from which, in our view, judgments can be made as to whether what has been done is cost effective or not, and I hope that we are coming closer to agreement, as far as the record is concerned. There remain a wide variety of opinions and judgments about the possible effect of standards that are still in the future and that therefore can only be tested, if you will, in the laboratory, and as Mr. Ford said, we are listened to on these points.

We sometimes think there is a tendency on the part of some to discount what we say on the grounds that we are speaking too much from self-interest, but we think by and large the engineering judgments are beginning to be listened to, particularly as the need to improve the fuel efficiency of the automobile takes a higher priority.

Representative BROWN of Michigan. Let us move from there on to the question of emission controls.

Where do we stand at the present time on the accomplishment of the emission control goal of the Environmental Protection Act?

Mr. FORD. We now have—if I could answer it a little bit differently than the way you stated it——

Representative BROWN of Michigan. So long as I get an answer.

Mr. FORD. What we now have before the EPA is a request for a 1-year extension of the present standard. Whether they will give us that or not, we do not know. We will not know, I think, until the 6th of March.

Now, the rest of it after that 1-year extension——

Representative BROWN of Michigan. Where does that put you then?

Mr. FORD. What do you mean, where would it put me?

Representative BROWN of Michigan. At the present time, you are complying with the 1975 standards, is that right?

Mr. FORD. Yes, sir.

The 1-year extension that we have applied for—we have applied for a 1-year extension from the EPA for the year 1977, model year 1977. The President's program for the future is slightly different from the 1975 standards. He has suggested a 0.9, 9.0 and 3.10 set of

standards; he has a 0.99 and 31 naughts, and it is now 1.5, 15.0 and 3.10.

As to an extension, we do not know what they are going to do. By March 6 we are supposed to know. The 5-year pause, moratorium, or whatever you wish to call it, has to have an act of Congress. That is the only way it can be accomplished.

Representative BROWN of Michigan. But would you put that 5-year moratorium in a time frame for me? It is 5 years, but to what standards would those 5 years relate?

Mr. FORD. They would relate to the standards beginning in model year 1977 and going through 1978, 1979, 1980, and 1981. The actual standards have got to be decided upon by Congress. We have suggested that they be the same as the 1975 standards.

Representative BROWN of Michigan. You have also said, have you not in the course of advocating that they be the same as the 1975 standards, that you will be able to improve upon the emission control quality, if I may call it such, of the 1975 standards?

Mr. FORD. Yes.

Representative BROWN of Michigan. In other words, by using the same standards, you could do better than was anticipated you would be able to do by the 1975 standards?

Mr. FORD. Well, the 1975 standards, as far as gas consumption, yes; that is true. But the 1975 standards, if you leave them on, only get the air cleaner as more old cars are done away with and junked and new cars are put into usage.

Representative BROWN of Michigan. Is there not some discussion with respect to improvements in the engine that there can be even some improvement on emission controls in 1975 standards?

Mr. FORD. I know of nothing like that. I just do not know about it, Congressman Brown.

Representative BROWN of Michigan. Speaking generally, where are we in this scale of accomplishing the goal of the Environmental Protection Act—8 percent, 85 percent?

Mr. FORD. Well, you have three different things: The hydrocarbons, carbon monoxides, and oxides of nitrogen. On the first two, we are in the 80-percent area; on the oxides of nitrogen, we are in the 50-percent area on the 1975 standards.

Representative BROWN of Michigan. And the ultimate goal in each is what?

Mr. FORD. Well, 97–98, something like that.

Representative BROWN of Michigan. For each?

Mr. FORD. Approximately.

Representative BROWN of Michigan. Let me move to a different subject.

You have talked about the investment tax credit. I noticed in your statement, Mr. Ford, that you say, "gaining control of inflation is no less basic, but certainly less urgent at this time," and then you say, "as long as our economy has so much unemployment and so much unused capacity, there is little risk that lower taxes and bigger money supply will lead to still higher prices rather than more real growth."

The part I want to direct your attention is where you talk about so much unused capacity. How can you talk about increasing the in-

vestment tax credit now, which basically is contemplated philosophically, I think, to provide the wherewithal for the extension of productive capacity and all? How can you advocate increasing the investment tax credit when you say there is so much unused capacity at the present time?

Mr. FORD. Well, because the money that we need is not all needed for capacity. As a matter of fact, we will not put any new capacity in place for probably several years, but that does not mean that we do not need a lot of capital for tooling up, for tooling in the plants, for reequipping everything to change all the products for fuel efficiency. All kinds of tooling for new models costs an awful lot of money.

Plus, if we need new engines—this does not add to the total number of units you can make, but it changes the kind of units within that total capacity, and the amount of money that we need there is tremendous.

That $3 billion that General Motors talked to the Environmental Protection Agency about, very little, if any, of that seems to be for capacity. That is all reworking what they presently have for new models, to get them lighter and smaller and so forth, according to the way it reads to me.

Representative BROWN of Michigan. I think you are saying that the investment tax credit is needed for, in effect, modernization and update, and it is not related to expansion of productive capacity.

Mr. FORD. It does not necessarily have to have anything to do with that.

Representative BROWN of Michigan. Is not the situation of the automobile industry substantially different from that of the utility companies, where there is a need in actual productive capacity?

Mr. FORD. Very much different.

Representative BROWN of Michigan. It has been advocated off and on that the investment tax credit be a variable tax credit with possibly a maximum, that would be within the discretion of the executive to be able to adjust it according to its need. What is your comment on that?

Mr. FORD. Who?

Representative BROWN of Michigan. Well, Arthur Burns has advocated it on occasion.

Mr. FORD. Who would make the adjustment?

Representative BROWN of Michigan. I suppose the President would under a similar authority that the Treasury has with depreciation schedules. In other words the investment tax credit could be increased or decreased, depending upon what appeared to be in the best interest of the economy at a particular point in time, rather than have it fixed by the Congress and go through all of the agonizing that we go through in the legislative process.

Mr. FORD. I just do not know if you would want to pick that one item out of a total of a lot of others, and say that is the one thing that the President can do.

I have always felt, the way I understood it, that the Congress did not want to give to the executive branch any kinds of taxing authority. Those were in the House Ways and Means Committee to start with and then passed through the whole congressional area, and they

did not want to give that authority up, and that is something I really do not know anything about.

Representative BROWN of Michigan. I would suggest that that which the Congress giveth, the Congress can taketh away also.

Mr. FORD. I am sure that that is true.

Representative BROWN of Michigan. I think, Mr. Chairman, my time has now expired. It should have. Thank you very much.

Chairman HUMPHREY. You are very generous, Congressman Brown.

Senator Proxmire.

Senator PROXMIRE. Mr. Ford, I am delighted to read your prepared statement, all except the last two, I think we have the wrong Ford in the White House. [Laughter.]

I am especially happy to hear you stress, as you do, the importance of getting on top of unemployment. That should be the No. 1 issue for us, not inflation now, but unemployment. No. 2—a tax cut, a big one, and a swift one, enacted quickly.

No. 3, easier monetary policy, which we agree on getting interest rates down.

And number 4, a longer period for the energy adjustment that the President proposes.

We believe he is right fundamentally in priciple, but if we are going to put this into effect, it should not be done on a crash basis, as I understand it, otherwise we will aggravate our unemployment problem.

Now, we come to the part of your statement, however, with which I have some problems. A study by the National Research Council's Committee on natural resources requested by the National Academy of Sciences says that they do not see any substantial basis for change in clean air standards.

I would be very grateful to you if you would supply for the record a reasoned rebuttal to that along the lines that you have in your statement. You have a very brief statement, and we appreciate the fact that it is brief, but I think you would agree that this does not constitute any kind of a rebuttal to their formal declaration that we need clean air standards on schedule.

Mr. FORD. I would be very happy to supply it to you, Senator.[1]

Senator PROXMIRE. Then in the second place, I am going to come to a bill that is in the future, another standard that the Federal Government may impose on you and your industry. My colleague, Gaylord Nelson, has a knack of being way ahead of everyone else and being right. He has done this so often that it embarrasses me.

In this case he is calling for mandating fuel economy standards. He points out that the Department of Transportation and the Environmental Protection Agency agree that the technology exists to permit fuel economy that would permit 23.6 miles per gallon average for our cars by 1980, a 57 percent savings, and a 75 percent savings by 1985.

Now, it seems to me that if this is the case and this can be done, there are all kinds of advantages. We could save, according to Sena-

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[1] See Mr. Ford's letters to Chairman Humphrey, dated Mar. 7 and 20, 1975, beginning on p. 647 and p. 653, respectively.

for Nelson's estimates, 2½ million barrels per day, here alone, just by economy measures. We can do so without increasing unemployment, without overall inflation, without gas price increases, without gas rationing. We could save your industry.

It seems to me that this would provide reason for consumers to buy automobiles, plus the fact that the cost, the increased cost of the automobile would be conserved within 1 year or less because of the fuel economy involved. They would pay less for their gasoline because they would use less gasoline.

What is your general reaction to that kind of a new standard?

Mr. FORD. It is a very complicated situation, Senator. It depends upon the base upon which you are measuring your increased fuel economy, and that is very important. It also depends upon what Congress is going to do with the new Clean Air Act amendments that they are going to have to pass.

Again, it is going to depend, as we have discussed here this morning, upon how much money the companies are going to have available to them to reduce the size of their cars so they will use less gasoline. It involves an intricate kind of systems development here. You can generalize and say you can do, and I will not argue that, but it is not easy. It involves an awful lot of outside factors that are impossible to measure at the present time.

I cannot be sure what the Department of Transportation is going to do to use on bumpers. If we could get the bumper weights reduced, we could get more miles per gallon, but I do not know whether that will happen or not. I do not know, as I say, what the emissions law is going to be—the Clean Air Act amendments are going to be.

All of these things enter into it. How much money is going to be available for us to spend on the various kinds of things, We have to give top priority to meeting the emissions standards, improving fuel economy, and meeting the other Government mandated standards. Those have to be first priorities in our spending allocations.

Beyond that, we have some discretionary money, if there is anything left. It varies by year, depending upon what is involved. I am not saying it cannot be done, but I am saying it is very difficult.

Senator PROXMIRE. From what you said earlier in response to the Chairman and others, I take it that to build a lighter car and a car that gets more fuel economy would take a big capital investment?

Mr. FORD. Yes, sir.

Senator PROXMIRE. And you have no way of knowing whether your profits would permit that kind of capital investment, is that correct?

Mr. FORD. Yes, that is correct. We might do a part of it, and not be able to do the rest of it. In other words, you cannot push a button and say, well, this is going to be this way. You have to do it by car lines. You have to decide whether you are going to take your present small cars and make them more efficient. We can go up to 60 percent of our total volume in compact and below.

Senator PROXMIRE. Again, I do not want to——

Mr. FORD. It is a big and complicated problem.

Senator PROXMIRE. Yes. It is probably unfair to ask you this kind of complicated question right off the bat. I wish you would take the

Nelson bill, however, and look it over and give us your reaction to it within the next week or two if you could.[1] Give us the problems this would involve in terms of capital investment, in terms of the technological practicality, as you see it, any other problems involved with it because it seems to me this is something, when I talk about this out in the State, people are very enthusiastic about it, because of course the other options are so very bad.

None of us wants rationing or a big increase in gasoline tax. It is very cruel and devastating to the economy. Now, this seems to be such a logical, sensible way in the long run, but we would like to know what the problems are, and I think you are probably one of the best equipped men in the country to tell us.

Mr. FORD. We fully agree with the objectives, that is not the problem. The problem is, how do you get there, and should the Congress, by law, say you have got to meet a certain figure? That is the real problem to us.

Senator PROXMIRE. I have one other question before Mr. Woodcock comes up. This is a question raised by the chairman, and I would like to follow up on it. He and I are sponsoring a resolution telling the Federal Reserve to get interest rates down by increasing the money supply. You reacted adversely to it.

You know the Federal Reserve is our creature. Under the Constitution, we are given the money power. We created the Federal Reserve. We can abolish it. Every Chairman of the Federal Reserve has told us we have that power. Martin told us that. Burns tells us that. So that if we simply talk about monetary policy but refuse to act, that is a copout. How can the Federal Reserve know how the Congress stands? Chairman Humphrey and Chairman Reuss in the House and I may agree, but that does not speak for 535 Members of Congress.

We pass a resolution—we want to pass a resolution that is practical, reasonable, which does not mandate a particular figure, but simply tells the Federal Reserve Board where its boss stands. Now, why is that not a sensible way for us to indicate our responsibility with respect to monetary policy and get them moving?

Mr. FORD. I cannot argue with that, Senator. You are their boss for sure, and they have got to comply with your wishes. It just depends on how you want to spell it out, I assume.

Senator PROXMIRE. That is the question I ask. Our resolution would do that. It would give us an opportunity to get a vote. Maybe we would be defeated on it, but at least we would have an opportunity for the Congress to tell the Federal Reserve what we want to do. They have indicated they will do whatever we want them to do, if we tell them.

Mr. FORD. I just do not know. I do not know how separate you want to keep the Federal Reserve, in a general way, or how close you want to get it into the political atmosphere.

Senator PROXMIRE. It is a congressional determination as you would agree?

Mr. FORD. Of course.

Senator PROXMIRE. And what we are trying to do is not mandate a particular figure—6 percent, 8 percent, 10 percent—not to tell them

[1] See Mr. Ford's letter to Senator Proxmire, dated Mar. 14, 1975, beginning on p. 648.

when to do it precisely, but to indicate that we want them to cooperate with this, to get interest rates down, and particularly we want to let them know that we do not expect them to abort a recovery, but to start moving ahead.

Mr. FORD. I cannot quarrel with that.

Representative BROWN of Michigan. Will the gentleman yield?

Senator PROXMIRE. Yes, indeed.

Representative BROWN of Michigan. I think you are talking about setting a range, are you not?

Senator PROXMIRE. No, we set a range in which they reported to the Joint Economic Committee, about 5 years ago, saying it should be between 2 and 6 percent, but there are various reasons why that is outdated, and the report is that it is hardly adequate.

I am saying that Congress as a whole, not the Joint Economic Committee, Congress as a whole should go on record one way or the other, telling them what we want them to do with respect to economic policy. It is a copout if we do not, in my view.

Representative BROWN of Michigan. The whole question is, To what extent can you particularize it, what you want them to do?

Senator PROXMIRE. That is correct. I am not asking for a range.

Representative BROWN of Michigan. I think Mr. Burns and others have said that he would be glad to come up here on a monthly basis, whatever kind of a basis you want, so that you can exercise the oversight function, and I think we should do more of that.

Senator PROXMIRE. Nobody can come up better on a month-to-month basis than Arthur Burns and really give us a snow job. [Laughter.]

He is a master at this. What we want to do is tell them that we want the money supply to expand in order to get interest rates down and keep them down, so that we can recover, and we will do this every 6 months or so, we want to take a fresh look at it and tell them what we want to do.

But just to have him come up and confuse us with his great understanding of economics and not come to a resolution, it seems to me is not responsible on our part.

Chairman HUMPHREY. If Mr. Burns had been the commentator on the superbowl, I would have thought, according to the way that he had interpreted it, the Vikings had won. He can make you feel so good when you are really so miserable. [Laughter.]

All right, Senator Percy.

Senator PERCY. Mr. Chairman, I would like to first welcome both Mr. Ford and Mr. Woodcock. Mr. Ford has described himself in his testimony as a concerned businessman. I would like to add that from 25 years of watching him from both the industry and public sector, I think that he is probably one of the most enlightened businessmen that America has ever had. We have a very unique combination with one of the most enlightened labor leaders I think this country has ever had in Leonard Woodcock.

We are particularly grieved at having the automobile industry in such difficult circumstances and yet having both of you take such a broad-gaged view. Both of you are very tough minded, very hard bargainers, and I think the country is better off for having your leadership.

55-821—75——3

I would like to ask you about your comments on gas rationing. I think very rightly you oppose this. However, as it is necessary to cut down gasoline consumption, are there alternate ways we could do this that would be somewhat more acceptable and easy to administer?

For instance, Switzerland decided a few months ago, no driving on certain Sundays. As I got the reports, the people reacted favorably. It made them conscious of the energy crunch and it was not really a hardship.

It has been proposed that we might, rather than gas rationing, resort to 1 day a week, the particular day being the option of each automobile owner, on which the car just is not driven. You can drive it 6 days but not 7.

Would you respond more favorably to something like that than to gasoline rationing?

Mr. FORD. Well, Senator, I think that gasoline rationing has a lot of built in problems that are very difficult to solve. On the other hand, I think it is very difficult also to figure out a way that will be acceptable to everybody to cut down the usage of gasoline.

I think that the price method is probably the best over the long pull. But, you know, today I would not advocate putting a great big price increase on gasoline because I think it would be wrong to do it. I am not sure how important it is to do this, therefore I woud like to see the economy start to come back before you increase the cost to the consumer of energy, no matter whether it is to heat his house, run his car, or whatever it may be.

Senator PERCY. Take into account that we are probably not going to work our way out of this recession very quickly. And yet, the energy problem is going to be with us, as it is today.

For instance, I am going to vote to sustain the administration on the $1, $2, or $3 tariff. I do not like that particular way of doing it, but something is better than nothing. At least it puts our feet, at the congressional level, to the fire, and it says if you do not like this system, do it in another way. But that is at least the power that the President has.

I would much sooner see an increased price on gasoline than on heating oil. I would much sooner see an increased price on gasoline than on petrochemicals, fertilizers, and so forth.

Would your preference be to tilt toward gasoline then, rather than these other costs which add to the cost of living for the average family farmer, such as food prices and so forth; because we are going to put a Javits amendment in today to direct and give authority to the President to tell the oil company to put it on gasoline and not on certain of these other costs, because we look on gasoline as a more flexible item.

Mr. FORD. Yes, I know; easier to get at. I suggested a gasoline tax last November, and I got jumped on pretty thoroughly for it. A lot of people did not like it.

On the other hand, I agree, it is the simplest way to do it. I think there are some problems connected with it on people who are unemployed. But if you can figure out a way to get the fuel to the farmer to run his farm equipment such as has been suggested by the executive branch, you can find a way to give fuel stamps, or something,

to the unemployed, underemployed, or people who can not pay for the extra tax on gasoline.

Senator PERCY. I would like to ask about your comments on confidence, because I happen to agree totally with you that we are not going to have a recovery until we have a restoration of confidence. We contribute to that because there is a low level of confidence in Congress and the executive branch, simultaneously now, which is a new phenomenon, in addition to these twin economic phenomena.

You have advocated a quick tax reduction. Is it your feeling—knowing people as well as you do—that they are going to rush out and buy a car if they get a tax rebate of a couple of hundred dollars and yet see the Federal deficit mount to $35 billion or more this next year. Is that going to cause them to have enough confidence to go out and spend those dollars, or will they put them under a mattress or into savings, which would at least get them into housing?

Mr. FORD. I just do not know the answer to your question. I suspect there will be a certain amount of what you are talking about, that they will save it, they will not spend it.

Senator PERCY. Secretary Kissinger returns this afternoon from the Middle East. I would like to find a resolution of that problem, to find a basis for a peace in the Middle East, which among other things would insure that there would be no oil embargo, no second oil embargo.

Do you think it is things of that kind that might restore confidence in leadership, give us a sense of stability and cause people to have confidence in their future income and therefore to spend present income?

Mr. FORD. I am sure if people knew that there was going to be a sustained peace in the Middle East that would have a lot to do with our confidence. But I still think the confidence chain has got to come from within the United States. It has got to come with jobs, with people who know they are going to keep their jobs at which they are presently working. It has got to come with a complete change, with a reversal of this recession which we are in.

It may be that peace in the Middle East may be a factor, but the problem is right here at home. We can not blame other people for our own problems. We have just not stepped up, in my opinion, to many of the problems we have. I get very nervous when I see, I do not know anything about Vietnam or that business, but $300 million or $500 million going to Vietnam worries me when I know people are starving in Detroit, they are looking in the trash cans trying to find food. We have our priorities all mixed up. That is what worries me.

Senator PERCY. Over a period of years, Mr. Ford, I have had conversations with industrialists in the automotive field about what can be done to move our Nation toward automobiles that get greater mileage and that are more gasoline efficient.

The answer that has come back frequently—in this case not from representatives of your own company—is that it is very hard for us to change the buying habits of people. Yet, I pointed out that by the very names of these automobiles and the fact that their speedometers go up to 120, 140, 160 miles an hour when the speed law is 55, the

industry is helping to create power consciousness and drive, and so forth, which create high energy consumption.

The President has asked the industry to convert to more efficient automobiles. Would it help if a bill such as I have put in to provide an increasing penalty for people who purchase cars that are low-mileage efficient cars, and out of the fund created, pay a bonus to companies and individuals who buy a car that is highly gas efficient? Would that help to change customer buying habits much more rapidly and possibly begin a whole new buying pattern and habit?

The automobile industry has about 100 million cars that could be replaced. This is planned obsolescence for the big gas-guzzling cars that we now have; to move people toward the purchase of cars that the industry could more rapidly convert to. We are trying to say what we can do to provide incentives and be a catalyst in this, or is it unnecessary? Will the industry do this all on its own?

Mr. FORD. I think the industry will do it on its own, but maybe not at the pace you would like to see it accomplished.

I do not particularly care for the method you talk about in your bill, Senator, simply because I think when you start to, by law, measure gas mileage in a vehicle, you are treading on some very difficult grounds. It is hard to measure.

You know, there are so many variables in it. I would rather see—if you want to go this way—I would rather see you put the tax on the weight or engine size, or something like that rather than on the specific of gas mileage in a vehicle.

The industry is going to get there, but I suppose it will not get there soon enough to satisfy the Congress.

Senator PERCY. I think from the tone of your testimony, there is an indication that there is a sense of urgency that you feel that the country must do. What we want to do is develop a cooperative program that will help create the incentive to move us there much more rapidly than we would get there under our normal steam. I certainly would welcome comments and suggestions from any of your colleagues in your industry as to how we can do that.

We are looking for the best way which will interfere with the private process as little as possible. But we know, through tax incentive, we cause a great many contributions to be made to charity that would not be made otherwise. The tax system is used as an incentive. We are just trying to say does it now, would it help the industry?

Thank you very much indeed.

Mr. FORD. Thank you.

Chairman HUMPHREY. We are running a little late. I have asked Congresswoman Heckler if she has questions, and she does. Following that, if it is agreeable with my colleagues, we will proceed to hear from Mr. Woodcock.

Mr. Ford, I note that you did have another appointment, and we do not want to keep you unduly. Could you tell us what your time-frame is?

Mr. FORD. I would hope, Senator, that I could get out by about 12.

Chairman HUMPHREY. Yes. Fine.

We will proceed then with Congresswoman Heckler. We will call Mr. Woodcock, and feel free to leave whenever you need to, Mr. Ford.

Mr. Ford. Thank you. Thank you very much.

Representative Heckler. Thank you, Mr. Chairman.

Mr. Ford, I will be very brief.

One of the comments frequently stated in my district, and I think throughout the country, is why is it that you and Congress did not anticipate the energy crisis.

Certainly we did. We knew the shortage was coming. We had read a great deal about it. But we seem to have government by crisis, and while we were becoming informed we did not have the will to deal with the problem.

What I question is whether or not you and the automotive industry were seeing the same things we were seeing, and what were you doing in your boardrooms? Did you anticipate the energy crisis, and what modifications did you start to take, and when, in terms of dealing with it in your particular industry?

Mr. Ford. I do not think we foresaw it, Mrs. Heckler, as soon as we should have. I do not think we foresaw it in the sense that we made our forward product plans on the small cars as rapidly as we should have. It so happened in our company we brought out a couple of small cars by the 1973 model years, and then we converted three plants in 1973 and 1974 to also small cars, but I do not think—we perhaps did not go fast enough—but the marketplace did not want to go that way either.

If we are living in a market economy, such as we are, we have a problem. Last year with the embargo you could not sell a big car. Now the embargo is gone, the lineup in the gas station is gone, and everything, and even though the price is higher, you cannot sell a small car. So you have to have a rebate on all the small cars trying to get rid of our excessive stock of small cars. The big cars people want to buy.

So you have a marketplace economy that says to itself, because it is not educated fully, or for one reason or another, I do not know why exactly, that we are really not interested in having a small car that uses less gasoline. We want a bigger car.

Representative Heckler. Of course, sir, your company invests a substantial sum in advertising which does motivate the consumer, so that you have an opportunity to lead the marketplace as well as to be the victim of it.

Mr. Ford. Well, that is true. But I think you have to realize, and I am sure Mr. Woodcock will speak to this point, that we have plants now that are dedicated to the assembly and manufacture of components of big cars. It is only about 40 percent of our total output, but you cannot change that all overnight if you do not want to create a situation which by some edict of Congress or a law or whatever it might be, you automatically throw those people out on the street.

It does not seem to me that that is the right way to go, so I think that it has to be a gradual thing. It cannot be rushed. I think if you take more time to do it, you can do it without the loss of the kinds of things that are important.

Representative Heckler. It seems to me that while we want one man, one vote in the Congress, one thing we cannot afford is one car, one driver. I think your industry will have to come to grips with that reality.

I want to know, have you considered what the employment base will be in terms of the automotive industry in the future, based upon what has to be the changing American lifestyle.

Do you see this as a reality, that we will give up the great luxury of our individual transportation on a daily basis?

Mr. FORD. I find it hard to believe. The cars will be smaller, they will use less gas, but I still think there will be a lot of them around. On the theory that this country has been built up because it had automobiles, it was built up basically in this century. European cities were built in prior centuries, and this whole arrangement of the United States is built on the automobile.

That is none of our fault there. But there it is, and we cannot push a button and change it. Therefore I think that the automobile causes problems to a lot of people, but it is, as Walter Reuther said, a fifth freedom.

I like them because it is my business. But I think a lot of other people like them for a lot of other reasons.

Representative HECKLER. Do you not feel that in part it is necessary, as a matter of policy, to remove this total dependence upon the private car?

Mr. FORD. If it is possible to do it. I do not really know how it is going to be done. There have been a lot of efforts made in this direction, and I do not know that any of them have been very successful. Morgantown has not been very successful. I do not believe that BART has been either economically viable or successful in total. So I think you have a problem.

A lot of money can be voted for different kinds of systems and they can be tried; but if the public does not want to use them and it does not fit their way of moving about, they will not work.

I do not really know what the system should be here. I just do not know myself.

Representative HECKLER. Mr. Chairman, in the interest of time I will not go on.

Chairman HUMPHREY. Thank you Congresswoman Heckler.

Mr. Ford, on behalf of this committee I want to thank you for some of the most frank and thoughtful testimony that we have had. It is not a question of whether every member of this committee agrees with all of your statements. It is the fact that you have been willing to come here as a leader in the business community to share with us your thoughts and observations. I appreciate this very much.

This testimony will be studied by a number of Members of Congress. I think that I should call to your attention that we are presently putting out a little bulletin each week that we call The Notes of the Joint Economic Committee.

This little bulletin goes to every Member of Congress and also to other Federal executives and officials. I am suggesting that it also go to the Governors and members of State legislatures.

This is not an opinionated bulletin. It is merely a report of what witnesses tell us. We try to extract what we believe is the essence of testimony. We will take the liberty of extracting and excerpting from your testimony those points which you have made on the economic program, on the energy program, on the pollution control program, and share your thoughts, on a very wide basis.

It is fortunate you are here to testify, and we have a very fine representation of the medium. We think this committee can do a great job, or, let me put it this way, we think this committee can do a helpful job in economic education.

We are going through a very difficult time. It is unusual, with both inflation and recession, which we have never experienced before. On other occasions, when we have had recession, we have had deflation. In other periods when we have had inflation, we have generally had full employment. We are dealing with a set of circumstances which are unique, and which this Government has never had to wrestle with or to confront in any other time.

This is why I believe there is some confusion. There appears to be some confrontation. But I believe that your testimony has told us what we know is necessary—action, prompt action, particularly in the tax field—restoration of confidence, to which Senator Percy addressed his questions.

I hope that we can get that. I am one who happens to believe that our illness is not terminal; that is, that it is something that we can master, and it is men such as yourself who will help us do it.

I want to express our appreciation to you.

Now we have Mr. Woodcock here. We do not expect that you should remain. Mr. Ford. It is up to you as to how long you wish to be here. We appreciate the attendance of your executive vice president and the questions which you have answered which we have asked you to delineate in more detail. That material would be very much appreciated, if it be directed to the committee, and also to the particular Congressman or Senator who asked. For example, Senator Proxmire asked for certain information, so if you would direct your answers to both places.

Mr. SECREST. Yes, Mr. Chairman. We will do that.

Chairman HUMPHREY. I thank you very much.

Mr. FORD. Thank you very much, Mr. Chairman, gentlemen.

[The following letters were subsequently supplied for the record in the context of Mr. Ford's testimony:]

FORD MOTOR CO.,
THE AMERICAN ROAD,
Dearborn, Mich., March 7, 1975.

Hon. HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR SENATOR HUMPHREY: Thank you again for the opportunity to testify before the Joint Economic Committee on February 19. I was encouraged to find enthusiastic support among the members of the Committee for substantial tax reduction and faster growth in the money supply. In my opinion, the need for immediate action to achieve these two goals cannot be exaggerated.

I have asked Mr. Fred G. Secrest, our Executive Vice President for Operations Staffs, to pull together the detailed additional information on emission standards and fuel economy requested by members of the Committee, as summarized in your letter of February 20. Mr. Secrest will send you this material within the next week or so.

Meanwhile, I should like to respond to your request by summarizing very briefly the basic reasons for our belief that Congress should keep the present emission standards in effect for five more years.

If the present standards are continued (1.5 HC/15 CO/3. 1 NOx), we can and will achieve the target assigned to us under the President's program to raise average sales-weighted fuel economy 40 percent by the 1980 model year. The President has proposed, however, that the national standards for hydrocarbons and carbon monoxide be tightened to the level of the California

requirements for 1975 models (.9 HC/9 CO). We believe we could reach our fuel company target even with this tightening of the standards, but we know that more and faster fuel economy improvement could be achieved at lower cost to consumers in the 1975 national standards were unchanged.

Continuation of the present standards also would permit the industry to move toward reduced reliance on catalyst technology—thereby minimizing any health hazard associated with sulfate emissions produced by catalysts—without excessive costs or fuel economy penalties. On the other hand, if all cars have to meet the present California requirements for HC and CO, more reliance will have to be placed on catalysts, and sulfate emissions will increase. As you know, this was the reason for Mr. Train's recommendation that the Federal HC and CO standards for 1975 be kept through the 1979 model year.

In either case, fuel economy improvement will require reductions in the size and weight of our cars and major technological changes. In spite of all such efforts, 1980 fuel economy will be substantially lower than 1975 fuel economy if we are required to meet the statutory emission standards for 1978 (.41 HC/3.4 CO/.4 NOx). I cannot be more specific because we have not yet been able to develop technology that will enable us to meet the 1978 standards. It will be impossible to achieve anything like the President's fuel economy target if we are required to meet the standards that had been scheduled for 1977 until they were suspended by Mr. Train earlier this week (.41 HC/3.4 CO/2 NOx).

Your letter asked for information on the costs associated with relaxing vs. not relaxing the standards. As you know, we are not asking for relaxation but for continuation of the present stringent standards, which already call for an overall reduction in vehicle emissions of approximately 75 percent from uncontrolled levels.

These standards cost the customer about $180 per average Ford-built car. This amount includes no profit to Ford. If these standards are retained, I would expect some minor cost savings resulting from engineering improvements and production efficiencies over the next five years. On the other hand, the recently suspended standards for 1977 would add about $150 more to the retail price of the average car, and the statutory standards for 1978 would be even more expensive.

There is no doubt in our minds that the costs of the statutory standards for 1978 would far exceed any public benefits that might be produced. Senator Proxmire requested our analysis of the report issued last fall by the National Academy of Sciences which, he said, found no substantive reasons for relaxing the statutory standards. It would be equally correct to say that the report found no substantive reasons for keeping the statutory standards. In our judgment, the principal conclusion which emerges from the report is that very little is known about the potential benefits of vehicle emission control.

I might add that the report does not even address the questions raised by our suggestion that the 1975 standards be kept in effect. The benefit estimates in the report include benefits of past and present emission control standards and benefits that can be achieved only through control of pollutants from stationary sources. The report does not isolate the additional benefits that would be produced solely as a result of moving from the vehicle emission standards for 1975 to the statutory standards. Whether the additional benefits would be worth the additional costs is the question raised by our proposal, and the National Academy of Sciences report provides no answer.

Best Regards,

HENRY FORD II,
Chairman of the Board.

FORD MOTOR CO.,
THE AMERICAN ROAD,
Dearborn, Mich., March 14, 1975.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: At the Joint Economic Committee hearing on February 19, you asked that I review and offer my comments on S. 654, Senator Nelson's bill that would establish mandatory fuel economy standards for the automotive industry.

As you know, the Senate Commerce Committee requested the auto producers to appear at its March 12 hearing on Senator Nelson's bill and two similar proposals introduced by Senators Hollings and Domenici. Mr. Fred Secrest, our Executive Vice President—Operations Staffs, testified at this hearing in

opposition to these bills. I have taken the liberty of attaching a copy of his remarks as my response to your inquiry.

I wish to emphasize that our objections to mandatory fuel economy standards relate to practicability. I could not agree more with Senator Nelson's views that it is essential to increase the fuel efficiency of automobiles. This means many car lines must be totally redesigned, primarily to become smaller and lighter, and that technological advances must be incorporated in all cars.

To do this is going to take enormous investment—our present forecast, as set forth in Mr. Secrest's statement, is over $2 billion for 1976–1980. We are dedicated to doing this but, quite frankly, I am very concerned at this time about the capability of Ford Motor Company to generate or raise the capital necessary to accomplish this task, even with the degree of flexibility inherent in a voluntary commitment.

We surely can't achieve this on a forced draft basis, if we face overly stringent regulations that mandate X performance by Y date without regard to our product investment cycle planning and the effect on car prices. The multi-million dollar punitive penalties for the inadvertent failure to meet a target, as outlined in the draft legislation, are especially repugnant to me.

The current situation with respect to catalytic converters illustrates why I am so concerned about forced draft technology. A law with a rigid effective date led to the widespread, expensive and probably premature introduction of devices that may well be judged to produce unacceptable side effects. Because emissions control clearly can't be achieved only through market forces, however, the nation must be prepared to pay huge penalties for false starts. The most dedicated efforts to avoid such penalties will nevertheless fall short on occasion, because of the complexities of engineering and technology.

For these reasons I have always viewed a public law mandating technological change as an action of last resort, to be invoked only when it is clear that free market forces or ethical processes will fail to function. In the case of improved fuel economy, to which we have already committed ourselves to the President, I think it would be highly regrettable for the Congress to conclude that it must impose this burden of another mandatory control system to cause us to do what we are committed to do anyway, and what I think we must do in order to prosper and, indeed, to survive.

Finally, until and unless Congress acts to modify the statutory emission standards for 1978 and beyond, it seems futile to consider mandatory fuel economy standards for those years. Every responsible study indicates a major adverse effect of some magnitude on fuel economy from the statutory NOx level of 0.4 gpm. Especially if catalysts should be ruled out because of sulfate problems, there is general agreement that the statutory HC and CO standards, as well, probably can't be achieved in the 1978-1981 period with acceptable fuel economy. Surely Congress should complete the vital task of reappraising these legislated standards before it seriously considers mandating fuel economy standards.

Best regards,

HENRY FORD II,
Chairman of the Board.

Attachment.

REMARKS BY F. G. SECREST, EXECUTIVE VICE PRESIDENT—OPERATIONS STAFFS, FORD MOTOR CO., BEFORE HEARINGS OF THE SENATE COMMERCE COMMITTEE IN WASHINGTON, D.C., MARCH 12, 1975

Mr. Chairman and members of the Senate Commerce Committee, I am Fred G. Secrest, Executive Vice President—Operations Staffs, Ford Motor Company.

When I testified before you in December on a draft fuel economy standards bill somewhat similar to those under consideration today, I voiced Ford's conviction that the marketplace was moving toward the goals of that bill * * * and that the market would be the most effective and least disruptive stimulus to future fuel conservation if it were allowed to work. Today I am even more convinced that this is the case.

Consumers have demonstrated how strongly they can react to higher gasoline prices—even though continued price control on "old" oil has not allowed the full impact of OPEC actions to be felt by the consumer. Gasoline usage in automobiles *decreased* 4 percent in 1974, in sharp contrast to an average annual *increase* of about 5 percent in the preceding five years. In part, the 1974 decrease was due to declining real incomes, but it was largely caused by the increase of the oil embargo. The reduction in gasoline consumption came mainly from a reduction of nearly 3 percent in vehicle miles traveled. People

cut out marginal auto travel; they increased their usage of public transit; they made greater use of car-pooling. Even when vehicle miles traveled could not be easily reduced, consumers saver gasoline by reducing average speeds and, probably, by following guidelines for more efficient driving techniques.

Those people who bought new cars during and after the OPEC embargo reacted by sharply increasing their relative purchase of smaller, fuel-efficient vehicles. Small cars accounted for 38 percent of total industry sales in 1972, 42 percent in 1973, and then 48 percent in 1974. In the first quarter of 1974, small cars were 51 percent of total industry sales, and the share would have been even higher if manufacturers had had sufficient capacity at that time to produce more.

Nearly all of the increase in small-car market share from 1973 to 1974 was in U.S.-made cars; the foreign share increased only from 15 percent to 15.7 percent. This response to consumer demand was made possible by the introduction of new small cars by the U.S. producers and by all-out utilization of existing small-car capacity and addition of new capacity. For example, Ford introduced the Mustang II in the 1974 model year and the Granada and Monarch as 1975 models. Concurrently, Ford converted two assembly plants from large to small cars, increased the capacity of three other small-car assembly plants, and added to its capacity for smaller engines and transmissions. The total cost of these product and capacity actions was about $1 billion. Similar moves throughout the industry, coupled with vigorously-competitive price rebate programs, led to the 60 percent small-car market share we saw in January and February of this year.

In short, a substantial amount of automotive fuel conservation has already occurred in response to actual and anticipated increases in gasoline prices. Our future product plans reflect our belief that gasoline prices will continue at high levels and that fuel economy will become even more important to the consumer. Currently, we plan to spend more than $2 billion between now and 1980 on fuel economy related actions. Based on these plans, we were able to commit to the President's goal of a 40 percent improvement in fuel economy by 1980 at emission standards no tighter than .9/9.0/3.1.

We share the Committee's view that actions must be taken to reduce the nation's dependence on insecure petroleum sources. We further agree that efficiency in motor vehicle fuel use—as well as in the use of all petroleum—is a major national priority. In our view, there is every reason to believe that market forces will continue to generate the very substantial improvements in automotive fuel efficiency that will be required if our industry is to remain strong and vigorous.

In view of today's complex economy/energy situation, we believe that an automotive fuel conservation program should meet the following criteria:

It should have both a short and long-term impact.

It should be accomplished at minimum cost to consumers.

It should impose minimum restrictions on the freedom of individual consumers to choose the best way for each of them to adjust to the national need to conserve petroleum.

It should disrupt the involved product development and manufacturing processes as little as possible, in order not to cause unnecessary unemployment and not to impede the nation's economic recovery.

It should not impose rigid constraints on new vehicles that would discourage their purchase—especially as the cars planned for production during the next few years will clearly be more fuel-efficient, and cleaner in terms of emissions, than most of the vehicles on the road today.

It should take into account the interaction of new-car fuel economy improvement with the other national priorities of emissions control, safety and price stability.

In our opinion, fuel economy standards such as proposed in the bills under consideration would fall far short of most of these criteria.

SHORT- AND LONG-TERM IMPACT

As the recent Rand Corporation study forcefully concludes, significant short-term improvements in automotive fuel usage must come from reduced gasoline consumption by the vehicles now in use in the country. Because new cars compose only 1/10th to 1/12th of the total vehicle fleet, even substantial improvements in new-car efficiency, and further mix shifts toward smaller cars would take years to yield major overall reductions in gasoline consumption. To achieve short-term conservation, then, we need policies aimed at continuing the 1974 trend toward reduced vehicle miles of travel, fuller utilization of

vehicle capacity—i.e., more passenger-miles per vehicle mile—and more fuel-efficient driving patterns.

MINIMUM CONSUMER COST

Some proponents of vehicle standards seem to believe that while gasoline price increases come out of the consumer's pocketbook, improved fuel economy comes free. This is not the case. The 40 percent improvement to which Ford has committed will require expensive engineering efforts and large investments in new tools and facility conversions. These enormous capital costs can be sustained, without prohibitive price increases, only if producers can plan their product and component changes over a period of years, with the flexibility to divert resources toward those particular changes that show the greatest cost-benefit promise as the engineering programs proceed. If mandated standards should remove this flexibility, the result seems certain to be higher cost to the consumer. Added to this burden would be substantial administrative costs on the part of government. Finally, mandated standards, with unbending effective dates, may well prove beyond the financial and technical capacity of at least some of the producers on some of the dates.

MINIMUM RESTRICTIONS ON CONSUMER CHOICE

It seems that most people equate the term "gas guzzler" with large "luxury" cars driven by rich people for largely-frivolous reasons. The facts are that there are strong fundamental economic rquirements for cars of large package dimensions—for larger families, for load carrying capacity, for use in car pools to school or work, for combined small-business and personal use, and for ease of entrance and exit for the elderly or the infirm. Sonme 20 percent of our Ford and Mercury car line production consists of station wagons, almost all of which we think are bought for these "hard" reasons. Of course we are planning to improve the fuel economy of these larger vehicles, so people who need them will still be able to afford to operate them at high gasoline prices. The technical realities, however, dictate that these vehicles will not approximate the fuel economy standards set forth in some of the pending bills; so that such overly-stringent standards might well eliminate these kinds of cars. It's important to note that by car-pooling, for example, a "family car" owner can obtain 90 passenger miles per gallon from his 15-mpg vehicle—about double the average passenger miles per gallon achieved by bus transit systems.

ECONOMIC DISRUPTION

Converting facilities from large to small car production is very costly, and it always requires substantial lead-time. Mandated fuel-economy standards, especially if based on "sales-weighted" averages, may prove unachievable for specific producers in specific years, even if the general parameters are reasonable. No matter what the price of gasoline, or the prices of various sizes of cars, the market can't be expected to conform in every year for every company to the terms of a law. In such conditions of unpredictable shortfall, manufacturers would have to cease production of some kinds of vehicles— with potentially severe effects on employment and financial stability.

SHOULD NOT DISCOURAGE NEW CAR SALES

The Rand Study points out that long-term fuel economy improvement can best be achieved if new cars remain attractively priced and offer features the consumer wants and needs. If a standard should require substantial increases in new car price, or if it should eliminate a type of vehicle or product characteristic that consumers consider inmportant, new car sales are certain to be discouraged.

People will opt to keep their old, less-efficient cars if the sacrifices they must make for improved fuel economy are unreasonable to them. The fewer cleaner, safer, more efficient vehicles entering the car population, the longer the national goals of air quality, safety and fuel economy will take to achieve.

INTERACTION OF FUEL ECONOMY WITH OTHER NATIONAL OBJECTIVES

To mandate fuel economy standards would suggest that all the signficant variables affecting the fuel economy of our future products are controlled by manufacturers. This clearly is not the case. Government requirements for safety, damageability and emissions all affect vehicle fuel economy—both in terms of vehicle weight and engine efficiency, and in terms of the resources

that are available to pursue each of these goals. An especially critical determinant of fuel economy is emissions control. There are two points we need to emphasize with regard to emissions:

First, there is an inherent conflict between fuel economy improvement and emissions control. Both objectives are vital, and fuel economy improvement will be a major priority for Ford at any level of emissions standards. However, the tighter the emissions standard, the more difficult the fuel-economy improvement job will be. Only with a five-year continuation at, or close to, present emission levels do we feel we can meet out 40 percent target, assuming we can still utilize present emission control technology.

Secondly, the level of uncertainty with regard to emission levels and emission control technology makes even predicting, much less attaining, any given fuel economy goal difficult. Although there does not yet appear to be enough evidence to show that sulfate emissions from catalyst- equipped cars are a severe health problem, EPA is planning to propose a sulfate emission standard that may prevent the continued use of catalysts. At the same time, Mr. Train has stated: "There is no reason to believe that the stautory emission levels of .4 gpm of hydrocarbon and 3.4 gpm of carbon monoxide can be met at any time in foreseeable future with good fuel economy unless a catalyst is used." EPA has rcommended to Congress that present hydrocarbon and carbon monoxide standards be carried over until 1979. We think that a plan of this nature would allow the industry to make substantial fuel economy improvements while granting time to define, and then to resolve, the sulfate problem. If, however, we are faced in the short-run with mandatory fuel economy standards, tightened emission levels, and restrictions on the use of catalysts, to the best of our technical knowledge we would have to state that the goals couldn't be achieved.

One final point should be made about emissions control and fuel economy—their difference in appeal to the consumer. Mandatory emission standards were, and are, necessary primarily because the individual consumer would have a hard time perceiving—and putting a dollar value on—the small contribution his or her car is making to clean air. On the other hand, fuel economy is marketable. Increased fuel efficiency in a new car can immediately offset rising operating costs due to higher gasoline prices.

For these reasons, and because we think it is clear that the market has already moved and will continue to move to force fuel economy improvements, we firmly believe that vehicle fuel economy standards are not needed and would, moreover, be costly and disruptive. One has only to look at the latest full page ads for some of the more fuel-efficient vehicles on the market today to realize the importance of fuel economy as a competitive element. Virtually all automotive manufacturers have announced major programs to improve the fuel economy of their vehicles. It is surely beyond credibility to assume that, without a law, many of these producers would deliberately subvert their announced plans and yield to their competitors the market advantage of better economy.

This seems especially obvious if the approximate relative fuel economy of various makes of cars is measured by the Government and posted on every new vehicle offered for sale. Ford has participated in the EPA voluntary fuel economy labeling program since its inception, and we have supported legislation to provide an administrative agency with the authority for mandatory labeling. Labeling will help insure that the market functions effectively.

To increase the assurance that vehicle fuel economy will continue as a high consumer priority, the market must be allowed to operate with respect to fuel price. New petroleum supplies from "secure" sources—whether form Alaska, offshore, shale, coal, tertiary recovery or whatever— will certainly be more costly than OPEC oil was prior to the fall of 1973. As producers of automobiles, we wish this weren't true—but we know it is. To bring these new supplies into use, then, will require higher prices. These price increases will simultaneously insure strong market pressures for improved fuel efficiency, in cars and indeed in all oil-consuming applications. We think both these results—new, secure oil supplies and market pressures for oil conservation—are necessary and desirable in terms of national policy. Accordingly, Ford supports the decontrol of "old" oil prices through the national economic situation probably requires a gradual approach to this. We would also support a degree of "skewing" or "tilting" the rising price of oil toward gasoline, because of the short-term constraints on quick conservation in other forms of petroleum use. There is some discretionary use of gasoline, as shown by the 1974 usage data. We must

emphasize, however, that 82 percent of all workers travel to their jobs by car, and 68 percent of all auto trips relate to earning a living or to essential family business. Mass transit can't change these statistics significantly in the next decade, given America's present home/job geographical dispersion. In a few years, many stationary uses of petroleum can be converted to other fuels, just as coal-burning boilers were converted to oil and gas in the past because of convenience, cleanliness, cost and relative immunity to labor strikes. There are no present substitutes for oil in automotive transportation, however. Accordingly, we believe it would be a mistake to tamper with the price mechanism so greatly as to force all the higher cost of new oil, or all the desired amount of oil conservation, on the users of gasoline.

In summary, Ford Motor Company opposes mandatory standards because we believe that improved fuel economy is so clearly in the interests of our customers that they will demand it. We intend to offer it to them. If we should fail, we would expect to lose sales—and that would be as powerful a stimulant as could be devised to insure that any deficiency would be brief and limited. Mandatory standards, no matter how carefully drawn, would in our judgment simply complicate, and very seriously raise the cost of, getting the job done. If we are wrong—if our industry really will never do anything worthwhile, even when it's clearly in our own bst interests—the Congress could of course legislate standards or other punitive measures when the Government's surveillance program, and its continual testing and publication of results, shows that we've missed the mark. Because our own future is so clearly dependent on success in improving fuel economy, I believe that there is literally no possibility of failure, provided only that the Government doesn't rule out success by placing extreme emphasis on other, conflicting objectives.

FORD MOTOR CO.,
THE AMERICAN ROAD,
Dearborn, Mich., March 20, 1975.

Hon. HUBERT H. HUMPHREY,
Chairman, Congress of the United States, Joint Economic Committee, Washington, D.C.

DEAR SENATOR HUMPHREY: Mr. Henry Ford II has asked me to submit written material for the hearing record of the Joint Economic Committee of Congress.

Specifically, I am addressing the questions on fuel economy and costs in your letter to him dated February 20, 1975.

FUEL ECONOMY

On fuel economy, you asked for a "detailed analysis . . . on the interaction of auto emission standards and the gas mileage efficiency of autos over the coming five years" and for our estimate of "the maximum percentage increase in fuel economy by 1980 if standards were not relaxed or delayed."

Attachment I (from our January, 1975 Application to EPA for Suspension of 1977 Motor Vehicle Exhaust Emission Standards) summarizes our projected fuel economy capabilities in 1977 for several sets of alternative emissions standards. This attachment shows that, given an extension of current emission standards, we project fuel economy improvement from our current average of 14 mpg to 18 mpg by 1977 (a 29 percent improvement). The projected fuel economy figures drop significantly as emission standards are made more stringent for 1977.

While these data were specifically related to model year 1977, we have also considered alternatives through 1980. Before the March 5. 1975 announcement by the EPA Admiinstrator, we were confident of achieving an average fuel economy of 18.7 miles per gallon by 1980 under the EPA city/highway test procedure, provided President Ford's proposed standards were extended through 1981—this was our goal under the President's 40 percent fuel economy improvement program. This commitment, however, was based on systems employing catalysts. and the future sulfate standard revealed in the EPA announcement may rule out catalysts as emission control components. Although we have not yet fully analyzed the fuel economy effects of meeting a sulfate standard with the President's or with Mr. Train's suggested standards for HC, CO, and NOx, it is very unlikely that the 40 percent improvement could be achieved by 1980 without catalysts.

On the other hand, if the present schedule of statutory standards is retained by Congress for 1978 and beyond, we would be faced with two real problems: first, we do not yet know how to meet the 1978 statutory standards, and, second, even if we were able to develop systems to meet the emission standards, the resulting fuel economy would be far below the 18.7 mpg achievable in 1980 at less stringent emissions standards.

Attachments II and III (also from data in our Suspension Application) provide some of the basis for our projections. Attachment II shows how fuel economy has varied over the model years since 1967. The calculations were averaged on a 1967 sales mix for each of the model years, so the trends of the curve are largely due to emission control and safety/damageability changes. We have emphasized in the past that, although fuel economy may drop when a new set of emissions standards is first introduced, several years of refinement at the same emission levels will give us an opportunity to improve fuel economy. This is clear at two locations n the curve of Atachment II. A new tandard for oxides of nitrogen was introduced in 1973, and fuel economy dropped from its 1972 level. At the same emission levels in 1974, fuel economy was improved. The stringent 1975 emissions standards caused fuel economy to drop again, but we have already introduced running changes to improve fuel economy in mid-year 1975, and we shall make a number of further improvements this fall on our 1976 models. It might not have been practical to implement these changes if the 1975 standards had not been extended through 1976.

Beyond 1976, the trend of the curve will be determined in part by the emissions standards required. At present standards, as indicated earlier in this letter, we are confident that fuel economy would continue to improve if present catalyst technology is utilized. To determine the probable effect of various sets of more stringent standards on fuel ecenomy, we tested a small engine and a large engine on an optimized basis. They were calibrated for four alternative standards that might be implemented in 1977. Attachment III summarizes the results of these tests. The degradation of fuel economy with more stringent emission standards is clear, especially if standards are set lower than those currently in effect in California. All these data will now have to be reevaluated based on the EPA decision of March 5, 1975 to propose a standard for sulfate emissions from automobile exhausts. It will take some time, after the EPA proposal is published, to determine the effect of such a standard on alternate emission control systems and fuel economy.

COST

You asked for exact costs associated with relaxing versus not relaxing the standards, both to our company and to the consumer on the purchase of an auto.

Attachment IV summarizes projected retail cost increases for four alternative sets of emission standards. All of these costs are compared with 1975 levels. Although we have not yet developed suitable systems to meet the 1978 statutory standards of 0.41/3.4/0.4, we estimate that they would cost $375–$475 more than 1975 systems. Additional scheduled maintenance will also likely be required, but we cannot estimate the cost of this maintenance until the systems are clearly defined. (If 1977 statutory standards of 0.41/3.4/2.0 were established, we did not anticipate any more scheduled maintenance than needed for 1975 models.)

Attachment V summarizes estimated Company expenditures for three sets of emissions assumptions. Alternative A assumed that all statutory standards would be implemented on schedule—.41/3.4/2 in 1977, and 41/3.4/.4 beginning in 1978. Of the $700 million budgeted for this alternative, approximately half would be spent achieving the 1977 standards, and the other $350 million would be spent in reducing NOx from 2 grams per mile to 0.4 grams per mile. Carrying over the present emissions standards will leave more resources which we can devote to fuel economy improvement. If catalyst control technology is ruled out by future EPA action on sulfuric acid emissions, new technology must be developed by our engineers. Until such development has proceeded further, we cannot estimate the capital expenditures required.

Sincerely,

F. G. SECREST,
Executive Vice President—Operations Staff.

Attachments.

ATTACHMENT I

FIGURE 1.—*Ford Motor Co. projected corporate average fuel economy (EPA city/highway test cycle)*

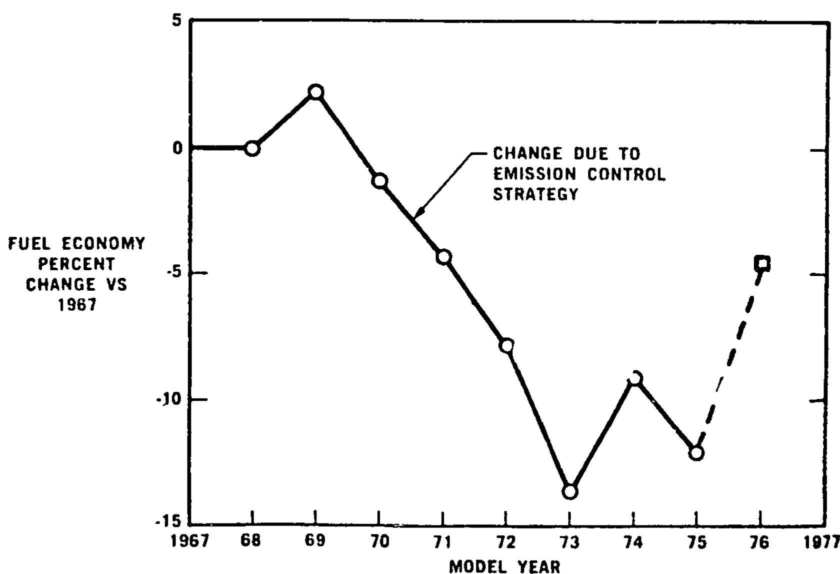
	Miles per gallon
1975 at programed mix	14. 0
1976:	
Catalyst additions, recalibrations, revised octane requirements, lower axle ratios	1. 6
2.3 engine improvement	. 3
Proportional EGR	. 5
200 CID engine	. 1
	16. 5
1977 at 1.5/15.0/3.1:	
Lower axle ratios	. 1
Engine improvements plus octane recalibration 200, 250, 302, 351M, 400 CID engines	1. 4
	18. 0
1977 at 1.5/15.0/2.0	[1] 17. 1
Percent better/(worse) than 1.5/15.0/3.1 (5%).	
1977 at 9/9.0/2.0	[1] 16 0
Percent better/(worse) than 1.5/15.0/3.1 (11%).	
1977 at .41/3.4/2.0	13. 2
Percent better/(worse) than 1.5/15.0/3.1 (27%).	

[1] At an emissions standards level of 2.0 gm/mi NO_x revised octane requirements, lower axle ratios, and proportional EGR have substantially lower fuel economy improvement potential than at 3.1 gm/mi NO_x. This loss in potential is incremental to the basic 3 percent loss at 1.5/15/2.0 and 7 percent loss at 0.9/9.0/2.0 shown in the table on page 5, section IIB and figure 2, section IIB, and has been estimated on a judgment basis.

Memo: 1977 effect of expected safety, damageability standards and mix changes (additive at any emissions standards level). Mix: 0.3 mpg. Safety and damageability standards: (0.3) mpg.

ATTACHMENT II

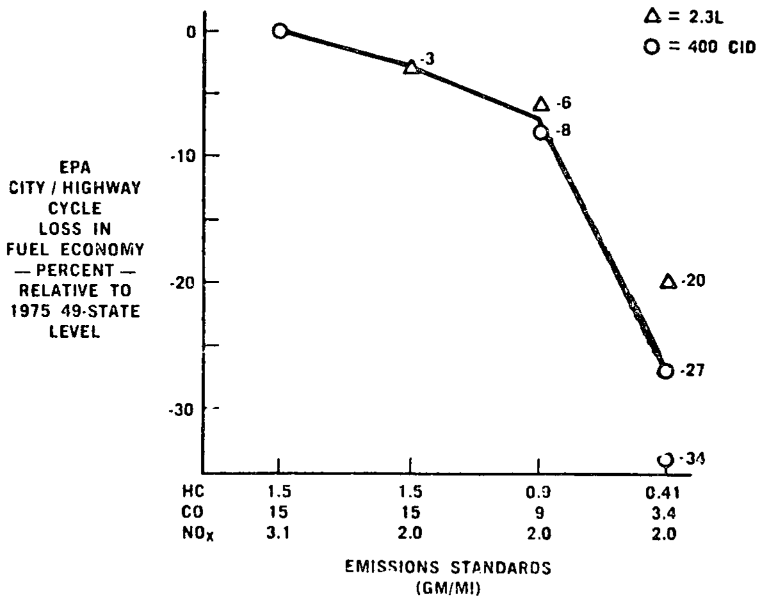
FIGURE 1
FORD CITY / SUBURBAN FUEL ECONOMY
HARMONIC MEAN-CONSTANT 1967 FORD SALES MIX



ATTACHMENT III

FIGURE 2

RELATIVE FUEL ECONOMY VS EMISSIONS STANDARDS FOR SYSTEMS OPTIMIZED FOR 1975 FEDERAL (49-STATE) STANDARDS */



SOURCE: 2.3 LITER, 400 CID DATA

*/ Emission control effect assuming 1977 level hardware.

ATTACHMENT IV

FORD MOTOR CO., PROJECTED RETAIL COST INCREASE AT ALTERNATE EMISSIONS STANDARDS

[In dollars]

	Projected average customer retail cost "prime" system compared with 1975			
	1.5/15/3.1	1.5/15/2.0	0.9/9.0/2.0	0.41/3.4/2.0
Exhaust treatment: Catalytic converters; heat protection; thermactor air pump; other vehicle effects	0	0	50-55	120-145
Induction system: Exhaust gas recirculation; carburetor/fuel injection; feedback control system; ignition modifications; air cleaner modifications	0	5	5	25-50
Engine improvements	0	0	0	5
Total emissions cost	0	5	55-60	150-200
Fuel economy improvements	15-25	15-25	10-25	0
Total initial cost	15-25	20-30	65-85	150-200
Operating cost (savings) [1]	(889)	(725)	(500)	243
Total cost (savings)	(874-864)	(705-695)	(435-415)	393-443

[1] Based on average driving of 10,000 miles per year and an average gasoline price of 56 cents per gallon.

Attachment V

1977–80 FUEL EOCONOMY ALTERNATIVES INCURRED ECONOMICS

[Dollars in millions]

	Alternative A .4/3.4/2[1] statutory	Alternative B .9/9.0/3.1 nationwide	Alternative C 1.5/15/3.1
Emissions	700	50	
Fuel Economy:			
Vehicles—downsized, new, weight reduced	1,000	1,250–1,050	1,300–1,100
Components—Transmissions, axles, engines, etc.		400–600	400–600
Total investments emissions and fuel economy	1,700	1,700	1,700

[1] 1977 NO_x standard. For 1978 this is reduced to 0.4 gpm in accordance with the existing law.

FORD MOTOR CO.,
THE AMERICAN ROAD,
Dearborn, Mich., March 26, 1975.

Hon. JACOB K. JAVITS,
U.S. Senate,
Washington, D.C.

DEAR JACK: Thank you for your letter asking for my considered reply to the question of "whether the vast amount of capital required to re-tool the automobile industry in terms of 'lighter, smaller cars using less energy' can be achieved without government financing."

I really have nothing to add to what I said at the hearing on February 19, but I will try to explain my views on this question more clearly.

The amount of capital our industry can raise depends primarily on the restoration of sound economic conditions—including a reasonable level of consumer confidence, strong economic growth, reasonable price stability, lower interest rates and a healthy equity market. I have seen little sign that Washington is moving effectively to achieve these goals.

The amount of capital our industry can devote to retooling for lighter, smaller cars using less energy depends largely on what portion of our financial resources is preempted by government safety, damageability, emissions and plant pollution control standards. In recent years, these standards have eaten up a large and growing portion of the capital we have been generating, and again I have seen very little sign that the government is restraining its demands. In addition to using up our capital, these standards are also helping to push up our prices and thereby reduce our sales and earnings.

If and when present economic conditions and regulatory trends are reversed, there is no doubt that we will be able to raise the capital required to retool for energy conservation. As long as these conditions and trends persist, our ability to raise the required capital will be in doubt. Hong long these conditions and policies are going to persist is a question that can be answered better in Washington than in Detroit.

If we cannot raise the required capital, the only solution consistent with the preservation of our free economic system is a radical change in the economic and regulatory policies that stand in the way. The Federal government already is deeply involved in managing our industry, and I see no way of maintaining a viable, privately-owned and operated automobile industry in this country if, in addition, the government finances our capital expenditures.

I appreciate your offer to have this reply inserted in the record of the hearings and I would be pleased to have you do so.

Best Regards,

HENRY FORD II,
Chairman of the Board.

Chairman HUMPHREY. Mr. Woodcock, we are sorry we are somewhat delayed in getting to your testimony, but I am sure that you will find that this committee is extremely interested in what you have to say.

Again, on behalf of the committee, we express our thanks to you for coming here today. We have your prepared statement and I want

to say that all of it will be incorporated, of course in its totality, in our record, and if it is possible so that we might get to the questioning with you, if you would abbreviate some of it.

But it is at your discretion, sir. You have come a long way and we are prepared to spend the time that is required and necessary with you, so you do as you see fit, because we know that you have a message to give us.

TESTIMONY OF LEONARD WOODCOCK, PRESIDENT, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

Mr. WOODCOCK. Mr. Chairman, as you have stated, we have submitted an extensive prepared statement, and it had been my intention to excerpt from it, not to read it in its entirety. In view of the lateness of the hour I would like to skip even that and go specifically to the areas of unemployment insurance, public service employment, and the tax cut, which will have to be in bigger numbers than have been talked about up to this point, including myself, separate from ongoing tax reform and the whole energy problem.

So with your permission, sir, I would just as soon go directly to the questions. I assume if one will not read, one will not listen, so I am going on the simple proposition that my prepared statement will be read.

Chairman HUMPHREY. Your entire prepared statement will be placed in the record at this point.

[The prepared statement of Mr. Woodcock follows:]

PREPARED STATEMENT OF LEONARD WOODCOCK

Americans are currently going through the worst economic upheaval since the Great Depression. In all the years since it was created nearly 30 years ago, this Committee has never before had to deal with a rate of unemployment or of inflation as high as we have now, or with real wages and production falling as fast as they presently are. On the other hand, this is the second engineered recession that we have had in the last five years—Nixon's claims the honor of being first—but the current economic nightmare makes the 1969-1970 recession look like the work of an amateur. Currently 7.6 million people are unemployed. This is an incalculable human tragedy and a national disaster. Yet the worst is still to come. Recent findings by the Bureau of Labor Statistics reveal that employment has declined in 86 percent of our industries. Thus, incomes and confidence are tumbling while stocks of unsold goods are still climbing. Last week the chairman of the Council of Economic Advisers conceded that "The unemployment rate may top 8.5%." We think it may very well climb to between 9 and 10 percent. As one economist has put it, this is not our largest recession but our smallest depression.

The result is that well over 20 million Americans will experience some unemployment during 1975—7 or 8 million of those for periods of 3½ months or more. Counting dependents, this means that the lives of 45 to 50 million Americans—or nearly 1 in 4—will be directly scarred by the bitter failure of our society to provide useful work for all who want and need it. And for every person who is actually laid off there are 2 or 3 who fear they will be. This insecurity and fear that one's livelihood as well as one's sense of dignity and social usefulness may be suddenly taken away, can eat away at a marriage, at family hopes and plans, like a vicious acid. It spreads throughout society, setting white against black, men against women, young against old. It corrodes the very basis of a free, just and democratic nation.

The cost of being unemployed cannot be measured either in cold dollars and cents or in terms of some hypothetical tradeoff against percentage price increases—especially not when the jobless rate reaches the current levels and there is no hope whatever that those laid off will find alternative employment. Thus the President's recent remarks to the New York Society of Security Analysts that, while unemployment is the "biggest concern of the 8.2 percent of American workers temporarily out of work," inflation "is the universal concern of 100 percent of our people" were not only cruel and inaccurate; they demonstrated total ignorance of what mass unemployment really means to people and societies affected by it.

What are the immediate prospects? Latest figures on industrial output showed the steepest one-month decline since the depression. The auto industry is in a state of collapse: by the Bureau of Labor Statistics' count, almost 1 worker out of 4 in the industry is out of work; in the Big Three automobile companies, 1 out of 3 workers is laid off in any given week. In January, auto assemblies declined another 10 percent to an annual rate of 4.8 million units. Construction is another calamity area: 15 percent of workers are unemployed while housing starts dropped in December to their lowest level in 31 years. Earlier this year we learned that real Gross National Product plunged at an annual rate of 9.1 percent in the fourth quarter of 1974, which about matched the earlier postwar record of 9.2 percent in the first quarter of 1958. All this confirms that while the President was promoting his gimmicky "WIN" program before Congress and the country, his *real* program—a long and deep recession allegedly to end inflation—was taking hold of our economy, cutting down the average take-home pay of employed workers and pushing millions of others out on the streets.

It is true that recession is having some impact on prices; although the rate of inflation in 1974 was well above earlier records, there are some indications that the pace of price increases may be slowing down. While this may comfort the Council of Economic Advisers, it brings meager consolation to the tens of millions of American workers, who, even when working full time find that the burden of unfair taxes and inflation pushed them below the poverty line.

Even the slight reduction in inflation which may be occurring pales beside the colossal price being paid by ordinary Americans. Indeed, while it is practically certain that 20 to 25 million workers will be unemployed at one time or other in 1975, it is not all clear that the promised slowdown in inflation will actually materialize. Prices of food and petroleum products could provide another jolt to the economy in 1975, if crops are disappointing for the third consecutive year and if the wrong energy policies (such as those proposed by the Administration) are implemented.

The Administration is reluctantly being forced to deal with the fact that the worst recession in the postwar period, and in all likelihood the longest, is upon us. (The government's index of leading economic indicators slipped again in December for the fifth time in a row and for the steepest sustained decline on record.) But its response is too little, too late and rooted in the same old fallacies and shibboleths. We have seen the President tell the nation that on the one hand we need to cut taxes in order to stimulate the economy but on the other hand we must cut spending to prevent inflationary deficits. This is self-contradictory nonsense and raises serious questions about either the President's sincerity (in saying he really wished to end the recession) or his ability to understand the nature of a recession.

The President's new program which he said would lift us out of recession and solve the energy crisis, will do neither. Instead it will put more money in the pockets of those who have plenty and not enough in the pockets of those who need it desperately. Additionally, it is bound to fuel inflation as a result of an across-the-board increase in energy prices.

I will go into detail later on in my presentation as to what the UAM is proposing in the areas of tax relief, energy, public employment and unemployment. Taken as a whole, we regard the entire economic package of the Administration as, at best, tardy and inadequate. Some of the figures underlying the budget projections make it obvious that the President and his top economic advisers are only paying lip service to decisive government intervention to turn the economy around. A budget is fundamentally a statement of

the Administration's intentions. When the President's budget "projects" 7 and 8 percent unemployment, an average of over 7.5 percent for the next 3 years, what is really being said is that the Administration intends to do nothing to prevent such a tragedy. This is totally inexcusable and insupportable.

The Administration's overwhelming concern about inflation results in its clinging to outdated, callous, "laissez-faire" and "let-them-eat-cake" philosophies, best reflected in some of the 1976 budget recommendations. Most social welfare programs are budgeted to be hard hit by cutbacks. More than half of the $17 billion in proposed reductions are in federal programs that serve the poor and elderly—community health and mental health centers, Medicaid, food stamps, welfare, child nutrition programs, Social Security, federal pensions and income plans.

On the other hand, total budget authority requested under the national defense category amounts to an 18 percent increase over the estimated comparable figures for fiscal 1975 (which, at $91.3 billion already represented a 2.3 percent expansion over fiscal 1974), while nondefense budget authority requests represent an 8.4 percent decline from fiscal 1975.

It passes my understanding how in times like these a president of the United States can ask the elected representatives of the American people to approve $300 million more for a corrupt Southeast Asian regime and to pay for it by such measures as cutting Social Security for the elderly below what they would get under existing arrangements and by charging the poor more for food stamps.

Let me start with the most important issue:

FULL EMPLOYMENT

Americans are once again learning the hard bitter lesson which those of us who lived through the Great Depression learned once before: secure and suitable employment at a decent wage is the absolute bedrock of a free and democratic society. Next year our nation will celebrate its bicentennial. Our President tells us that we will be asked to celebrate this triumphant moment during a year in which over 20 million of our fellow citizens will stand in unemployment lines. Without full employment our forefathers' vision of a nation where every individual could enjoy life, liberty and the pursuit of happiness is impossible. Without full employment, fine speeches next year about how our nation is fulfilling the high principles embodied in our Declaration of Independence and our Constitution will be a fraud and a deceit. Full employment—the foundation of every other social goal we wish to achieve—will not happen by accident. There is a powerful minority in America which does not consider it a fundamental goal. Those interests have had their representatives in control of our national economic policy for the last six years—and they have had their way.

In 1946, the 79th Congress passed what many people thought was a landmark bill which would end mass unemployment forever. The Employment Act of 1946 created important parts of the modern machinery of macroeconomic policy. That machinery has not been wholly unsuccessful. Part of the prosperity of the 25 years which followed it can certainly be attributed to its operation. But the 1946 bill did not mandate full employment as the fundamental obligation of national policy upon which all other policies must be built. Instead it hedged the goal of full employment with a forest of caveats and qualifications. The hedges were so thick that those subsequent administrations which did not subscribe to the spirit of the 1946 Employment Act could effectively ignore it.

Now with the specter of depression once again beginning to haunt us the time has come to pick up where we left off in 1946 and finish the job.

The chairman and vice chairman of this Committee together with Congressman Hawkins and scores of other legislators have begun that task with what is potentially one of the most important and far reaching pieces of legislation ever to come before the United States Congress. This legislation sets out to establish the right of every American who is able and willing to work to a suitable job at decent wages. It mandates all agencies of government, including the Federal Reserve Board, to enforce this commitment through appropriate policies. It specifies that the goal of full employment may not be sacrificed in

the interest of any other economic goal. Further, it mandates the president to prepare a Full Employment and National Purposes Budget annually. The goal of this budget is to design programs capable of reducing unemployment to no more than 3 percent within 18 months of the first report and lower at a later time. This is perfectly possible. It has been done before. Unemployment was reduced from over 10 percent in mid-1941 to under 2 percent 18 months later. At that time we had a war to fight against the Axis powers. Today, we have a war to fight against the threat to our energy supply, against poverty, bad housing, inadequate education, poor medical care, a deteriorating mass transportation system and destruction of our environment.

As the chairman of this Committee testified before the House Subcommittee on Equal Opportunities on October 8, 1974 regarding an earlier House version of the proposed legislation, this bill does not solve all problems, rather, it lays the essential foundation, which is an unequivocal political commitment to full employment as the basis for all other economic and social policies.

Meshing our other national goals with the fundamental need for full employment will require a major mobilization on the part of government and the private sector. Some of the mechanics for doing this are spelled out or suggested in the proposed legislation. Some will require complimentary legislation. Plant closings, for instance, is obviously an important area in which parallel action will have to be taken.

I urge this Committee to undertake, as soon as possible, preferably by March or April, detailed hearings in depth on the subject of planning for full employment. It is evident that no reliable automatic mechanism in the modern economy relates human needs to available manpower, productive capacity and materials. In consequence, we have shortages of housing, medical care, municipal services, transportation, energy, and numerous other requirements of pressing importance while at the same time we have massive unemployment and unused productive resources. We, as a society, have not made it our business to foresee these critical problems and to take steps to forestall them.

Unfortunately, our national behavior pattern tends to be like that of many individuals who get sick: short-term curative actions are emphasized, and once the crisis is past little thought is given to the prevention of future ills.

Such prevention requires planning. An essential function of the economic leaders in any organization is planning for the future, yet we permit the planning for our national economy to be uncoordinated and essentially short range.

In fact, many people have an "anti-planning" attitude toward the federal government. They use the concept that an absolute minimum of coordination will somehow produce a desirable result and avoid individual hardship. This is a concept formulated for an agricultural society rather than an industrial one. It may have been appropriate when decisions in one portion of the economy took weeks or months to affect—or even be communicated to—others. It simply does not apply to an age of instant communication, specialized production, sophisticated business forecasting and immense investment in complex technology. Every organization attempts to anticipate future developments in order to best achieve its goals and avoid disruption. Nevertheless, those who usually urge that the Federal government's activities be "responsible and businesslike" are often the first to oppose a rational approach to long-range planning. If such a ngative attitude toward his own planning function were expressed by the leader of any sizable organization, he would be considered irresponsible.

We need mechanisms by which to guide our economy in the direction prescribed by national policy. But at the same time I cannot stress too strongly that such instrumentalities must be robust democratic institutions carefully designed so that the will and needs of the majority of Americans will determine the course of our economy. The nation's experience up to now with quasi-planning and regulatory agencies has been instructive: such agencies have too often been controlled by the very industries they were intended to regulate and have earned reputations for secrecy and unresponsiveness to public opinion. It is essential that we move ahead while at the same time learning from past mistakes.

For some time I have been meeting with a small group of distinguished economists to discuss ways of moving in this direction. These meetings have

been fruitful and I hope that should this Committee undertake hearings of the sort I have suggested, the thoughtful insights which come out of our meetings will be sought. I'm sure many other professional economists would also have valuable contributions to make.

But the issues which are involved go far beyond the scope of any one profession. Indeed they go to the heart of what our society now is and what we hope it will become. Therefore, I hope that this Committee would undertake to seek the views of thoughtful people in many different professions and walks of life.

IMMEDIATE LEGISLATIVE GOALS

While we believe that Congress must address itself seriously to basic issues and fundamental reform, it must also take vigorous immediate action to alleviate the catastrophe which is sweeping our land:

(a) *Unemployment Compensation.*—Although we have urged fundamental reform of the unemployment insurance system on many occasions, its immediate importance to our current crisis is self-evident.

Unemployment insurance is the only area of assistance to the unemployed for which the 1976 budget proposes increased outlays. But the 018.2 billion estimated unemployment compensation expenditure merely reflects continuation of the recent short-run and half-hearted extensions of federal responsibility. Although we welcomed these recent stop-gap emergency measures and the extension of unemployment insurance benefits to groups not previously covered as a minimum first step toward the kind of protection we would like to see, many workers who do not have jobs will still not be getting any unemployment compensation. According to the BLS the number of people who are not now counted as unemployed because they have given up hope of finding a job rose to 845,000 in the fourth quarter of 1974 compared to 687,000 a year earlier. Among those who are counted, many will be exhausting their benefits because they have been out of work so long. In January 1975, according to the BLS, the number of those unemployed for 27 weeks or longer almost doubled to 623,000 compared to 326,000 a year earlier.

At the same time almost half of the work force that is covered under our present system is in states where no individual earning the average wage can receive a weekly benefit equal to even 50 percent of that weekly wage. Waiting period provisions and unjustifiably short benefit duration period in many states deny people in dire need even these meager benefits. Under the experience rating system, states are engaged in competition with each other to offer the lowest contribution rates possible to attract and hold industry. Thus they enable employers to hold the threat of plant relocation over the heads of state legislators contemplating unemployment insurance improvements. Similarly, our experience with many states is that their administration of unemployment insurance laws has placed greater emphasis on finding ways to restrict or deny insurance rather than protecting workers' incomes during periods of unemployment.

Thus, the UAW's strong preference is for federalizing the unemployment compensation system. We favor a federal benefit standard that will replace 66 2/3 percent of a jobless worker's full-time weekly wage up to an amount equal to the statewide average weekly wage. We recommend a qualifying minimum of not more than 10 weeks of employment (covered or uncovered) in the worker's base year, and no waiting period for benefits to begin. We strongly oppose triggering devices for benefit duration based on unemployment rates. (An unemployed worker is just as unemployed when there are 3 million others in the same situation as when there are 5 million.) A 52-week duration of benefits is needed at all times, aside from emergency considerations.

By the standards of other Western industrial countries these benefit standards, if enacted, would still be modest. In France, for instance, a laid-off worker is entitled to full take-home pay for up to a year. In Sweden, a worker gets 90 percent of his wages for 52 weeks or, if he or she is over 50, for 75 weeks. We have fallen so far behind other countries that it may be impossible to catch up at one jump. But there is no excuse for not taking a major step forward in that direction.

Finally, until we achieve adequate health care for all through the enactment of the Kennedy-Corman Health Security Program (S. 3), some interim provi-

sion is needed for making good employment-related health insurance coverage which lapses when a worker is laid off. In this regard, the International Executive Board of the UAW has unanimously endorsed S. 675 to provide federal government payment of premiums to continue the private health insurance coverage which a worker lost when his employment was determined.

Over the past 30 years our unemployment compensation system has done a great deal to cushion some of the hardships forced upon unemployed workers and has functioned as an effective built-in stabilizer to help put a floor under the economy during minor recessions. While the system has long needed a major overhaul, disastrous economic conditions such as we face at the moment bring its long standing inadequacies to the forefront. The need for major reform is now inescapable.

(b) *Job Creation.*—The Administration's overall economic program has been deliberately designed to swell the number of unemployed workers in this country to record levels; we now face the worst crisis of employment since the Great Depression. But confronted with grimmest economic situation in 35 years, President Ford is asking Congress to pour salt into the wounds of the beleaguered labor force by advancing ridiculously low fiscal 1976 budget proposals to create new jobs. With 7.5 million people jobless and unemployment clearly on the rise, it would be totally irresponsible for Congress to allocate only $1.3 billion towards public service employment, the amount specified in the President's budget and the same amount as estimated for fiscal 1975.

Thanks to the Employment Act passed by Congress last December, there may be funding for about 300,000 jobs before the end of fiscal 1975, under Title VI of the Comprehensive Employment Training Act (CETA), but this is hardly enough. At this time of crisis our private economy is clearly incapable of employing millions of people who have the skills and initiative that helped build this nation. Their abilities and spirit are wasting away while so many of our needs go unmet. The government must put these people to work. The country cannot wait any longer.

Congress must immediately appropriate the remaining $1.5 billion in funds for Title VI of CETA which were authorized last December, and must appropriate more with new legislation as quickly as possible. We support the bills introduced in Congress so far to create more public service jobs as a start in the right direction, including such proposals as the $7.8 billion bill introduced by Senators Williams and Javits and the $5 billion bill introduced by Senator Daniels.

But even the largest of these bills, which we endorce, does not fully meet the nation's needs. A permanent federal program of public service jobs is needed, jobs that will help clean up the environment, improve and expand health care and other social services, as well as employ the unemployed. Even in relatively prosperous times there are large and increasing numbers of individuals—mostly, but not all youth and minorities—who are barred from entry level jobs which were much more available a generation ago. Furthermore, experience has shown that we cannot rely on initiatives from state and local governments alone, for when they are depended upon to spend public employment funds they are reluctant to do so, if they feel that funding for all jobs might not be permanent.

Funding of an adequate permanent public employment program should at a bare minimum approximate one-half percent of the federal budget when the national unemployment rate is 4 percent or lower. For every one percentage point increase in the unemployment rate above 4 percent there should be earmarked at least an additional one-half percent of the federal budget. At currently expected unemployment rates in fiscal 1976, this "bare minimum" formula could allocate over $10 billion to create between 1.25 and 1.5 million public service jobs.

TAX REFORM

The UAW along with many others has appeared before Congress year after year to present the case for making our tax system more equitable. While a thorough reform of our tax system has long been needed, the economic trends of the past two years and the current economic outlook are such that tax reform has now become almost a pre-condition for returning our country to economic health.

This is the first recession in history in which the tax burden on families and individuals has increased. Taxes as a proportion of income have traditionally declined with declining output, offsetting to some extent the ravages of a recession on the earnings of working people and pensioners. In 1957-58, for example, the percentage of taxes on personal income went from 14.7 percent to 14.4 percent from peak to trough, while real disposable personal income dropped 1.3 percent. From 1973 to 1974, the percentage decline in real personal disposable income reached 3.2 percent; but the tax bite increased from 19.9 percent to 20.8 percent—and it could go even higher if a tax cut is not enacted promptly.

According to a recent study of this Committee, the cost of the lower budget compiled by the Bureau of Labor Statistics increased 14 percent from 1973 to 1974 (from $8,181 to $9.320) ; during the same period, personal income taxes in the budget increased 31.2 percent.

The same study found that if a family with 1973 income of $13,000 had obtained wage and salary increases of 12 percent (leaving its real pre-tax income unchanged) it would still have experienced a 3 percent decline in real spendable income last year because of its increased tax burden. On the other hand, a family with income of $50,000 in 1973 could experience an income gain of 13 percent or more in 1974 and still remain in the same tax bracket.

The impact of higher taxes has also been most devastating on lower and middle income earners because these groups cannot take advantage of the numerous loopholes built into our tax laws for the benefit of the wealthy. Thus, we can be sure that the after-tax distribution of income has shifted in favor of the upper income brackets in the last two years, by proportionately more than the pre-tax income distribution. It has been truly said that we should measure the prosperity of a nation not by the number of millionaires but by the absence of poverty. By this standard our society has been heading straight downhill for the last six years and our tax system has clearly been a major force dragging us down. Even auto workers, those fortunate enough still to be working under one of the best and strongest collective bargaining contracts in the world, have seen the real purchasing power of their hourly wage decline during the last 13 months under the impact of inflation reenforced by a rising tax burden.

The accelerating fall in real spendable incomes and the specter of rising unemployment have brought about a crisis of confidence in the country. Showing the people that somebody in government is not deaf to their plight can do much to restore needed confidence and we are therefore encouraged to see Congress moving quickly on an emergency tax cut. We are also pleased to see that the Tax Reduction Act of 1975 tentatively approved by the House Committee on Ways & Means has successfully turned around the Administration's rebate plan.

Although we welcome the Administration's belated move away from its October 1974 position supporting a tax increase, we definitely reject its proposed 12 percent rebate on 1974 taxes as insufficient and skewed in the wrong direction. In contrast, the Ways & Means bill concentrates a large proportion of the rebate of 1974 taxes on families and individuals with incomes below $20,000 who have been especially hard hit by inflation and higher taxes and who are much more likely to spend rather than save the difference. Thus, this bill is far superior to the Administration's plan both in its economic impact and its harmony with democratic principles.

The 1974 tax rebate (hopefully to be paid out in May) would give a quick shot in the arm to the economy. It would also grant some equity to those millions who were taxpayers in 1974 and who are now unemployed. However, the $8 billion ceiling placed by the Committee on the total revenue cost of the rebate is too low. The economy needs a stimulus of upwards of $18 billion directed to individuals, which would put the floor for the total rebate at $9–$10 billion. Our suggestion is to provide a 12 percent rebate with a minimum equal to the smaller of $100 or taxes paid and a maximum of $250, with the rebate declining above $20,000 of adjusted gross income until it reaches $100 at and above $30,000.

The reduction in withholding taxes proposed by the Ways & Means bill would carry forward the stimulus. The bulk of middle income earners deter-

mine their purchase of big ticket items by their ability to fit the monthly payments into their monthly budgets. Reduction of withholding goes right to this problem.

However, it cannot be overemphasized that an emergency tax cut should in no way be allowed to hinder the work that Congress must undertake for effective tax reform. In the UAW's view, the provisions of the Ways & Means bill should be limited to the calendar year 1975 so that the Committee can move on quickly to provide equitable and comprehensive tax reform.

Oil tax reform must be an absolute priority in the 94th Congress. Even in a year of "embarrassing" profits, the oil industry pays practically no corporate income taxes. According to a report[1] released last December, the aggregate adjusted gross income of the 12 oil companies for which comparable data are available increased by 61 percent in 1973 over 1972. Yet the effective federal income tax rate measured as a percentage of profit actually paid as tax merely inched up from 7.9 percent to a still ridiculously low 9.6 percent—a far lower rate than the average worker pays. These corporations have probably done nothing illegal in lowering their tax rates. They have simply taken utmost advantage of the multitude of tax subsidies which have been enacted into the tax laws over the years.

The biggest of these tax subsidies is the depletion allowance, which is not really a depletion allowance at all but a direct tax reduction and an extraordinary tax benefit as it permits the tax-free recovery of dollar amounts which are far greater than the corporations original investment in the depletable property. In fiscal 1975, this item accounts for $3 billion of lost federal revenues, which, according to now Treasury Secretary Simon (in a 1973 letter to the Senate Interior Committee), do not translate themselves into substantial stimulus for development and exploration nor into lower consumer prices. The necessary implication is that this subsidy goes to profits, royalties and dividends.[2]

Two other substantial tax breaks which the oil industry shares with the rest of business are deferral of taxes on foreign profit and the foreign tax credit. Together, these giveaways—as well as various others connected with production of U.S.-based multinational corporations in other countries—provide huge financial incentives which in many cases make corporate investment abroad preferable to investment at home. This is especially grievous when there is in our own country both a shortage of capital for investment and mass unemployment.

Under the tax deferral provision, which Professor Peggy Musgrave estimated to cost American taxpayers about $1 billion per year, profits of foreign subsidiaries of U.S. corporations are not taxed unless and until they are remitted to the U.S. parent corporation as dividends. They escape U.S. taxation forever if they are reinvested abroad. Withholding taxes on dividends leview by many countries further encourage such reinvestment. Even if the profits are ultimately repatriated, taxes on such profits amount, during the period of deferral, to an interest-free loan from the U.S. government which gives the corporation involved considerably more to invest abroad than it would have available for domestic investment if the same profits were brought home and thereby made subject to U.S. taxes.

The elimination of tax deferral on foreign profits, of course, would also eliminate the excuse that was used to secure enactment of the DISC legislation that defers taxes on part of the profits of U.S. export sales subsidiaries. The argument was that the DISC deferment would reduce the advantages of foreign over domestic production for U.S.-based corporations. The *Wall Street Journal's* recent succinct comments on the DISC are worth quoting: "Ford's

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[1] Report made by Congressman Charles Vanik on a study of the Joint Committee on Internal Revenue Taxation with the assistance of the General Accounting Office, December 18, 1974.

[2] It has been argued that much of the actual new oil exploration and drilling that gets done is done by relatively small independent firms and these companies genuinely need the oil depletion allowance in order to continue their activities. But it is also true that most of the cost of the depletion allowance loophole goes to the major companies to whom it is a pure tax giveaway with little impact on new exploration. The question of small independent drillers should be examined, however. If it is found to have some merit a special incentive, directly related to exploration could be arranged for them. This would not involve giving away billion of taxpayers' dollars to major oil companies already bloated with excessive profits.

budget is the first to include 'tax expenditures,' or money Uncle Sam gives up in special tax provisions. One startling figure is the cost given for the DISC. or Domestic International Sales Corp., which the Nixon administration devised to spur export sales. The budget says DISC will cost $870 million this [1974] fiscal year, far above the $170 million the Treasury projected back in 1971. The budget shows the cost rising to $1.07 billion in fiscal 1975 and to $1.32 billion the year after. What's more, nobody has been able to demonstrate that DISC actually spurs exports."

In other words, a tax loophole that will cost taxpayers $1.07 billion in fiscal 1975 was opened in 1971 to offset the harmful effects of an existing loophole. Although the obvious solution was to close that loophole the nation has instead been saddled with a costly and ineffective tax giveaway.

There are other tax concessions—for Western Hemisphere trade corporations, less developed country corporations and investment in U.S. possessions—which amount, in effect, to windfalls for corporations disguised as aids to foreign economic development at a cost of about $200 million in fiscal 1975. U.S. subsidies to the affected countries in the form of direct loans, grants, and technical assistance would probably be far more effective in assisting them to achieve well-balanced growth.

Although we have not yet had time to give S. 651, the Tax Neutrality Act of 1975 introduced by Senators Frank Church and Floyd Haskell, a thorough study, my preliminary inclination is to give it my strong support. This bill would eliminate the Western Hemisphere Trade Corporation provision, the "less developed country corporations" provision, the DISC loophole and the deferral of foreign earnings at an aggregate annual savings of $2.1 billion. It would also remove some (though not all) of the most objectionable features of the $4.3 billion per year foreign tax credit which permits corporations to treat foreign income taxes as a direct credit against their U.S. taxes rather than as a reduction of taxable earnings. S. 651 would save $2 billion by eliminating the carryforward and carryback of excess credits and by preventing corporations from using taxes paid in one foreign country to offset profits made in another.

Until thorough tax reform takes place with regard to individuals, the "minimum tax" provision of the 1969 Revenue Act should be strengthened by reducing the current exclusion of $30,000, increasing the tax rate, and adding the interest on state and local bonds to the list of tax preference items. According to Senator Mondale, whose proposal to modify the minimum tax would add about $0.9 billion to Treasury funds, the increase in the minimum tax will fall overwhelmingly on those making more than $100,000 a year, 402 of whom paid no taxes at all in 1972, and many others of whom paid a lower percentage in taxes than the average worker.

We are on record before Congress as favoring a sweeping reform of our tax system to eliminate expensive and inequitable tax expenditures such as the capital gains loophole, the preferential treatment of capital gains on property transferred at death, the exemption for interest income from state and local bonds, the various tax shelters that enable the rich to wash out other taxable income, and the loopholes in estate and gift taxations. Minimum reform along these lines could add $1 billion to tax revenues. A bill, S. 512, proposing comprehensive tax legislation has already been introduced by Senator Haskell. This bill represents a very promising point of departure for thorough tax reform.

Thoroughgoing tax reform could raise at least $20 billion without increasing the burden on low and middle income groups. In the meantime, the elimination of such loopholes as we have discussed above in detail could add $9 billion to general revenues. Such sums could be used to offset the additional cost of extending tax relief to lower and middle income groups beyond 1975. Our preference is for an immediate package which would:

(a) make permanent the changes in the low-income allowance and the standard deduction introduced by the Tax Reduction Act of 1975—cost $5.1 billion a year;

(b) adjust the individual income tax rates in the lowest income bracket as in the Administration's permanent tax cut proposal (the first bracket from 14 percent to 7 percent, etc., until the present rates are reached at $24,000 taxable

income levels for married couples and $8,000 for single persons)—cost $10.6 billion a year;

(c) make payments to families and individuals whose income is less than $4,500. Households outside the federal income tax system should be entitled to relief when tax cuts are being handed out; there is a continuity of ability to pay from the lowest to the highest income level, rather than a continuity starting at the minimum taxable level. This provision would reintroduce the concept of a negative income tax embodied in the defunct Family Assistance Plan of 1972, and would be a first step in the direction of the completed overhaul of our hopelessly entangled welfare system—cost $4 billion.

The cost of this package thus amounts to $19.7 billion—$9 billion of which would be offset by closing the loopholes we have listed above. A tax cut of $10.5 billion would be appropriate in 1976, when the economy will still be struggling to get on its feet again. In 1977 and beyond, further loopholes would probably have to be closed in order to compensate for this differential.

Let me stress that Social Security tax reform is an indispensable part of our proposal. The Tax Reduction Act of 1975 will effectively remove the poor from the tax payrolls in 1975, as it provides for a refundable tax credit equal to 5 percent of earned income up to $200 to families with earnings of $4,000 or less. For 1976 and successive years, tax relief for the poor must be continued to offset the effects of the Social Security tax system.

We see no need to further emasculate the corporate side of the tax structure by enacting the Administration's proposed permanent reduction in the rate from 48 to 42 percent. The 48 percent is more myth than reality. The corporate tax system is beset with loopholes which permit large, knowledgeable corporations to escape taxes amounting to tens of billion a year. Congressman Vanik's previously cited study shows that the effective rate of taxes on corporate profits was only 27.1 percent in 1973, down from 29.3 percent in 1972 and 29.6 percent in 1971. This is largely responsible for the decline in the corporate tax share of federal revenues in recent years, increasing the proportion which individuals have had to bear.

Congressman Vanik's calculations of the corporate tax rates uncover only part of the problem, however. Some of the tax escape devices take the form of redefining taxable profits in a downward direction by creating artificial deductible expenses such as the various forms of accelerated depreciation and LIFO inventory valuation. The latter device deserves some comment because of the alarming increase in its use in the United States (few other countries allow it).

Estimates of the tax loss from the switch to LIFO vary considerably but no one doubts that the loss will be substantial. Various economists, businessmen, Congressmen, Administration spokesmen and others have defended the switch to LIFO on the basis that in periods of high inflation a large portion of business profits is "illusory." In words of the October 1974 issue of *Fortune*, "As goods bought at earlier prices were sold at higher ones, inventory profits in particular ballooned * * *" But these profits, which in many cases have been extracted out of the hides of consumers in the unconscionable price increases we have seen since the end of price controls, are very real indeed. The goods were in fact sold at the inflated prices, the profit markups were in fact achieved. The resulting profits are in fact on hand to be used for dividends, increased working capital or whatever. Not to tax the so-called inventory profits is in many cases to reward rather than to punish price gouging.

There has been a lot of nonsense in the media about inventory profits. Popular thinking seems to be that the use of FIFO involves a reevaluation of inventories to reflect current market prices, thereby inflating asset values, understating costs and overstating taxable profits. This is not the case at all. Inventories are valued at "lower of cost or market" whether valued on a last-in-first-out or a first-in-first-out basis.

Of the two methods, it is FIFO rather than LIFO that comes closest to valuing inventories at what they actually cost, thereby resulting in taxable profits which bear some semblance of reality. It is LIFO which produces illusory results, in the form of "phantom" production costs which were never actually incurred. Congress would do the cause of tax justice a great service by closing the LIFO loophole immediately.

FACT SHEET ON TAX REFORM

1. *Tax Reduction Act of 1975*	*Billions of dollars*
Individuals:	
Rebates	8.0
Increase in low-income allowance and in percentage standard deduction	5.1
Earned income credit	3.3
Total individuals	16.4
Corporations:	
Investment tax credit	2.6
Temporary adjustment in the corporate surtax exemption	1.2
Total Corporations	3.8
Total package	20.2

2. *UAW proposal for extended and expanded tax relief for lower and middle income groups*	*Billions of dollars*
A. 1975:	
Rebates [1] (approximate)	10.0
Increase in low-income allowance and in percentage standard deduction as in Tax Reduction Act of 1975 (approximate)	5.1
Earned income credit as in Tax Reduction Act of 1975 (approximate)	3.3
Total	18.4
B. 1976 and beyond:	
Increase in low-income allowance and in percentage standard deduction as in 1975	5.1
Cut in tax rates as proposed by the administration	10.6
Payments to individuals under $4,500 of income [2] (approximate)	4.0
Total	19.7

3. *Loopholes that the UAW Wants Closed Presently*	*Billions of dollars (approximate)*
Oil depletion allowance	3.0
Elimination of special provisions for Western Hemisphere Trade Corp	.100
DISC	1.070
Less developed country corporations	.080
Deferral of foreign earnings	1.000
Optional "overall limitation" on foreign tax credit	2.000
Strengthening minimum tax [3]	.900
Other loopholes, for example:	
Real estate tax shelters [4]	.400
Maximum tax on earned income [5]	.200
Present exclusion from taxable income of $100 of dividend income	.340
Total	9.090

[1] 12 percent with a maximum of $250, a minimum of $100 or amount of taxes paid, and a phaseout between $20,000 and $30,000 of income, such that rebate is $100 at and above $30,000.

[2] Structure of payments not specified.

[3] Senator Mondale's S. 4187 reducing the current exclusion from $30,000 to $10,000, and eliminating the current deduction for regular taxes paid.

[4] Revenue gain under plan for Limitation on Artificial Accounting Losses (LAL) which would deny accounting losses until such time as they could be deducted from related income. Proposal made by Treasury to the House Committee on Ways and Means in 1974.

[5] Top tax rate on earned income is 50 percent.

ENERGY

The size and nature of our energy problems can only be grasped when we realize that the entire structure of production and consumption in our nation is built on the assumption of cheap and abundant energy. Every factory, every machine, the location and design of every building as well as every item of

consumption has been chosen explicitly or implicitly on this assumption. Now that assumption no longer holds. That fact had been creeping up on the industrial world for some time. It burst open on October 19, 1973. It will never go away again. The back of the energy problem has not been broken, as Richard Nixon once claimed, because it is not that kind of problem. It cannot be defeated in one fell swoop. Instead, millions of adjustments must be made in our systems of production and consumption in order to adapt them to the new realities. These adjustments cannot be made overnight or by accident.

The job ahead requires a long hard slog with determined, coordinated and comprehensive programs. Almost exactly one year ago the UAW International Executive Board issued a National Energy Program outlining the elements of such a program. I will not reiterate all of that program here but will confine myself to the basic principles which we feel are essential. I will then go on to specific measures which can and should be enacted in the near future.

A National Energy Program must be built upon five essential principles. The first is recognition of the need for a planned approach to energy decision-making. Energy is a critical social resource requiring coordinated democratic planning in the public interest; the 18th Century principles of Adam Smith are simply not sufficient for this. It is quite clear that the interests of both equity and efficiency require a much greater degree of public control of the energy sector than exists at the moment.

Effective planning necessarily implies a new role for the public sector. The keystone of an effective reform of national energy supply is a central government body responsible for consistent long-range planning and implementation and for coordination of the activities of its otherwise independent subsidiaries. The staffing of this authority must be subject to congressional approval and staff members must be completely "clean," free of any vestige of association with the private energy industry.

The second basic principle is achieving democratic control. It is of paramount importance that any new public institutions be responsive to the goals and criticisms of the citizens they are meant to serve. They must be subject to the will of Congress and must be open to the scrutiny of the public. The views of all sectors of the community must be heard in the making of policy.

Among other things, access to information is essential. There is an overwhelming sentiment in the nation at large that the first step toward real democratic control of public policy is the independent collection and dissemination of data.

Similarly, democratic control will remain a pipe dream until we limit the antisocial aspects of monopoly. Giant private corporations bent only on profit have been able to exploit the nation's energy difficulties to their own ends. This has multiplied the hardships and severely hindered progress toward a solution. Any serious attempt to solve the energy problem must correct the current antisocial abuses of monopoly power by giant energy corporations. Regulation by public bodies along the lines of public utilities, while sound in principle, has failed to prevent monopoly abuses. Thus, reform and strengthening of the regulatory mechanism together with its possible extension to other critical areas is also important.

Thirdly, an effective program must recognize the need to diversify our sources of energy. We are learning the hard way that our reliance on a few depletable fuels has been too great and our rate of consumption has risen too rapidly. We must plan for a future in which our overall well-being is no longer so dependent on the continuous flow of one major source of energy.

Fourth, a National Energy Program must give due regard to protection of the environment. The development of new sources of energy cannot take precedence over the protection of the environment, or the ultimate aim of enhancing the public welfare will be defeated. The failure to face up to these issues has been a major contributor to the energy problem in the first place. Only by taking full account of the environmental cost in any national policy can we come to grips with the basic question: conservation of scarce and often irreplaceable resources.

Finally, conservation: Until such time as limitless sources of energy (such as solar or fusion) have been made fully and safely available, every B.t.u. consumed depletes a limited terrestial stock of fuels. More to the point—each B.t.u. consumed means the next will be costlier to obtain. Programs to reduce consumption by increasing efficiency thus not only prolong our supply of fuels but reduce the inflationary pressure derived from inefficient use of increasingly costly fuel.

SPECIFIC LEGISLATIVE GOALS FOR 1975

1. What *NOT* to do:

(a) *No forced drastic reduction in imports should be attempted at this time.*—Although strong action is needed to deal with the underlying long-run problem of energy, it must also be recognized that we are not only in the worst recession in 40 years but we are in serious danger of entering a real depression; a depression, moreover, whose misery would be compounded by continually rising prices. Short-term energy policy must recognize this fact and carefully avoid exacerbating an already dangerous situation.

Therefore, we believe that forced drastic reductions of oil imports at this time are undesirable. No matter how accomplished, whether tariffs, prices or quotas, such reduction would cripple further an already badly damaged economy. Nor will it materially contribute to the long-run solutions—in fact, it may well retard them. The real solution lies in new investment—in new energy production, in purchases of alternative consumption goods (e.g., more efficient cars), and in energy-conserving buildings and industrial techniques. All of these will be retarded by measures that force the economy into recession or depression.

(b) *The Administration's program for increasing the price of energy should be rejected.*—In addition to being unjust and recessionary, the President's program is also inflationary—in fact, if enacted it will almost certainly keep us in the double-digit range of price increases. Mass unemployment is bad enough when prices are stable or falling—as they have in past recessions. But when compounded by inflation it becomes desperate.

The energy program recently proposed by the President would have a severely disruptive effect on our already damaged economy without any guarantee that it would alleviate the long-term problem. The quadrupling of oil prices by OPEC last year cost consumers about $30 billion. The President's program would impose a burden on the country of $40 to $50 billion (according to the Library of Congress and other studies available to us) in 1975 in direct costs alone. Although the President's program envisages returning $30 billion to the economy, this is still far less than the total cost. In addition, much of these refunds will go to businesses and upper income groups, thus compounding recession with injustice.

The President asked Congress to authorize and require tariffs, import quotas and/or guaranteed price floors in order to ensure that domestic prices stay at a level which makes domestic production economical.

The argument here is that the long-term price of energy is almost certain to remain where it is or even rise. Enterprises which undertake socially desirable developments on that assumption should be protected from the unlikely but conceivable possibility of a short-term fluctuation below the long-term trend.

Yet, even if the principle were sound, a great deal depends upon the details of its implementation. For instance, what price should be set and why shouldn't it be a ceiling as well as a floor? The current average price of oil in the U.S. is about $8.90 per barrel. The President's program proposes that this be raised to roughly $13 per barrel and that all other forms of energy (gas, coal, etc.) be allowed to rise to an equivalent level. Such price increases are quite unnecessary. Virtually all forms of energy which offer immediately feasible, large-scale development opportunities (offshore oil, coal—including liquefaction and gasifaction, solar, etc.) are more than adequately economical at $8 to $9 per barrel equivalent prices. Why should the price of all energy consumed in the U.S. be set at a level necessary to cut imports by 1 million barrels a day?[3] Instead of being determined by a questionable foreign policy, any U.S. guaranteed price for new energy which may be enacted should be derived from the real costs of developing and producing new domestic energy sources.

Secondly, the President has proposed increasing the price of oil by 46 percent and letting all other energy rise to an equivalent level. He then proposes a windfall profits tax to capture the estimated $12 billion of totally unearned and undeserved profits which would fall into the hands of energy producers and middlemen through this move. We urge Congress to reject this unnecessary and economically disastrous pricing policy, but instead to relate energy prices to real costs of development and production. If Congress does, then the President's windfall profits tax will be unnecessary.

[3] One million barrels of oil is less than approximately 5 percent of total oil consumption and less than 2 percent of total energy consumed.

(c) *Natural gas prices should not be deregulated.*—What is the real nature of the natural gas problem? There are really two parts to our so-called shortages of natural gas. The first is the question of "shrinking reserves and stagnant production," and the second has to do with the allocation of production between the interstate and intrastate markets.

An enormous campaign is currently underway to deregulate interstate sales of natural gas already under the pretext that the three- or four-fold price increases which would result from deregulation are essential to provide an incentive for exploration and development of new supplies. This simple cause and effect hypothesis begs a number of important questions about the structure of the industry and its response to price incentives. These issues have been spelled out in detail in a number of quarters and we need not go into them here. Suffice it to say that the Project Independence Blueprint itself, anticipates that even with deregulation gas production would only increase by a 2 tcf (trillion cubic feet) increment by 1985, a mere 10 percent over current levels. Meanwhile the evidence is mounting, from a series of investigations by the staff of the Federal Power Commission, that natural gas producers and suppliers are in fact holding back supplies in speculative anticipation of the astronomical price increases that would follow deregulation. To cite just two examples, an FPC staff survey of offshore gas leases in 1974 discovered 4.7 tcf of proved reserves that are producible but shut in, which would have added another 70 percent or so to the 6.5 tcf of new additions of proved reserves that were actually reported to the American Gas Association as available for sale. At the present time, the FPC staff is also investigating 13 pipeline companies that have constructed pipelines to gas fields that have 9.7 tcf of reserves which were dedicated to production back in 1973 by major gas producers but from which there has been no production. Not surprisingly, all the major interstate pipeline companies that complain about supply shortages have affiliates or divisions that are gas producers. They also engage in joint lease-bidding ventures with the oil majors (who own intrastate pipelines).

On the second part of our problem, we know that one of the reasons industrial and household consumers in the Northeast and Midwest have been threatened with supply curtailments is that a rapidly increasing proportion of new gas commitments is going to intrastate contracts rather than to the interstate market. In many cases these intrastate contracts are for gas to be used as boiler fuel in industry and power generation. In spite of the 15 percent rate of return currently allowed by the FPC for interstate pipeline companies, profit-maximizing oligopolies naturally prefer to contract to the unregulated intrastate market where new contract prices are at least three times higher.

Evidence currently being gathered by the FPC indicates that the rapid escalation of supply curtailments by interstate companies is being used to create an unnecessary panic atmosphere to force rapid, unthinking moves toward total deregulation.

What positive actions should Congress take.— 1. Natural Gas: The anomalies in the present structure of natural gas supply and consumption can only be eliminated by basic structural reform (a) to break up the cartelization of the industry, (b) to eliminate the dichotomy between the interstate and intrastate markets by putting all of it under federal jurisdiction, and finally (c) by a conservation program to cut down on the consumption of this precious and scarce fuel in such inefficient and inappropriate uses as boiler fuel in industry and utilities. Such a program could be based either on a direct system of regulation and allocation or on a multi-tiered pricing system. (A system of the latter sort would charge the efficient consumer, such as private households, the true cost of production and charge inefficient consumers, such as utilities, a much higher scarcity price.)

2. A National Energy Production Board: Congress should create a National Energy Production Board modeled on the wartime production board. Senators Stevenson, Jackson and Hollings have all indicated serious interest in a measure of this sort. We welcome the spreading interest in this approach and express our hope that Congress can unite behind a strong and effective bill. In our view the purpose of a National Energy Production Board would be to develop and execute a vigorous program to develop our energy resources using the vast reserves of manpower and productive capacity which now lie idle because of the recession. Such a Board should be both authorized and adequately funded to (1) make loans, (2) contract with the private sector, (3) enter into joint ventures, (4) undertake its own activities where necessary to break

bottlenecks and stalemates or undertake new initiatives. It should determine specific targets for the nation in all forms of energy, then develop and undertake action programs to achieve those goals.

While we do not wish to preempt or prejudge the decisions of such a National Energy Production Board we would urge that Congress give consideration to the following priorities:

1. After a year of debate it has become clear to us that a major national effort should be put into the development of coal, including hard coal for conventional use plus liquefication and gasification. Coal is by far our largest energy resource—indeed, U.S. coal constitutes the largest single known fossil fuel reserve in the world. It is readily available and susceptible to known techniques of production and consumption and is economic at prices which now obtain. The vast bulk of our coal is east of the Mississippi and most of that requires deep mining. This is where our attention should be focused.

2. Another extremely promising source of energy is solar. It is unlikely that solar energy will be a feasible source of electricity in the foreseeable future. However, approximately 25 percent of our energy goes to space heating and cooling and here solar energy has enormous potential.

By contrast nuclear energy which has been and remains one of our most promising long-range possibilities has come under a cloud. The bulk of federal energy development funds have gone not simply into nuclear but into one particular nuclear technology—the liquid metal fast breeder reactor (LMFBR). In spite of the vast sums spent on it, the LMFBR is still a long way from being operational. It is very expensive and major questions have been raised by men of unimpeachable integrity and qualifications as to its safety (particularly regarding the disposal of plutonium waste products). Prudence, therefore, dictates that the LMFBR program be deemphasized.

In the previous budget the LMFBR received the largest share of energy research and development funds:

	Fiscal year 1975[1]		Fiscal year 1976[1]	
	Millions of dollars	Percent	Millions of dollars	Percent
Nuclear, LMFBR	540	36.9	470	28.3
Nuclear, other	380	31.1	520	31.3
Fossil and all other	400	32.8	670	40.4
Total	1,220		1,660	

[1] Estimated.

Note.—Totals do not add due to rounding.

Source: U.S. Budget in Brief Fiscal Year 1976.

The President's new budget proposes a relative deemphasis of the LMFBR and relatively greater attention to other forms of energy. We urge Congress to go even further. Still more of our national effort should be channeled into the more certain and reliable energy sources such as (a) coal and solar as mentioned above, (b) refining current nuclear reactor technology to greatly improve safety, safeguards and reliability, (c) search for uranium to fuel conventional reactors.[4]

3. The proposal to create a strategic oil reserve should be given careful examination. The President suggested 1.3 billion barrels—1 billion for civilian and 300 million for military use. We think rather less would probably suffice. One billion barrels would represent nearly 5 months of imports at current rates. This seems adequate given that a complete shutoff of imports is extremely unlikely (the proportion of our pre-embargo imports which the Arab boycott succeeded in shutting off never reached 30 percent). More than 1 billion barrels would cost too much to accumulate and to store.

Establishing a strategic reserve would entail increasing imports rather than reducing them. If, for instance, we decided to build up the reserve at the rate

[4] It is claimed that a shortage of uranium necessitates the breeder reactor. However, 50 years ago the world had little idea of how much oil was really available. A thoroughly prospected data base for terrestial uranium reserves simply does not exist—anymore than it existed for oil 50 years ago.

of 600,000 barrels per day, it would take about 4½ years. If such a program is enacted, a government oil importing agency should be created for this purpose. Imports for the stockpile should be allocated according to competitive sealed bidding.

4. Standby emergency authority to deal with emergency shortages—including rationing—should be authorized but not implemented at this time. The appropriate legislation should require that within 10 days of implementing these measures the President must make available to Congress all the information which led him to take emergency action plus any relevant information Congress should deem necessary. Congress would then have 20 days to approve the emergency measures, otherwise they would lapse.

5. Next, we think there are good arguments for considering the enactment of an import quota system. However, although we urge Congress to consider creating such a mechanism now, it should not be put into effect at this time. Such a mechanism would relate total expected and desired demand to expected and desired domestic production and set import quotas accordingly. The right to import could be distributed between private and public agencies according to various mechanisms. In the past quotas on imported oil have been used to provide windfall profits to high cost domestic monopolistic producers. Steps must be taken therefore to ensure that any new quota system could not be used to protect incompetent or ill-advised investments in energy development. The creation of such a mechanism would provide the U.S. with the means to apply national policy objectives to energy imports instead of having them set largely by international oil companies.

6. Antitrust and other measures to prevent abuse of monopoly power. Although our energy problems are real there is also no doubt that they have been exploited and exacerbated by the giant monopolies who control virtually all our energy resources. To reiterate what is now common knowledge, the 18 largest oil companies control:

70% of domestic crude oil production;
84% of domestic refining capacity;
72% of gasoline market;
72% of gasoline reserves;
72% of natural gas production;
30% of domestic coal reserves;
20% of domestic coal production capacity;
50% of uranium reserves; and
25% of uranium milling capacity.

We cannot continue to permit our most vital resource and hence the welfare of the nation to be manipulated by a few giant corporations. Instead, we need a coordinated program of (1) antitrust prosecutions under existing law together with (2) new legislation forbidding control of one type of energy resource by a corporation with major interest in another, (3) the institution of federal charters for major energy companies. The Senate Interior Committee gave serious consideration to possible legislation of the latter type last year. We urge that the subject be reopened and given serious consideration.

Chairman HUMPHREY. I have a few questions I would like to ask you, and I noticed one thing, just quickly. You came down with Mr. Henry Ford on the necessity of some government planning in your testimony.

Mr. WOODCOCK. Very definitely.

Chairman HUMPHREY. I was very much interested in Mr. Henry Ford's statement of the necessity of at least some kind of structural arrangement in the Federal Government for planning.

Mr. WOODCOCK. In that regard, Mr. Chairman, both at the labor economic summit and the general summit held at the end of October, on both occasions I urged that we begin to take steps to move toward economic planning so that we are not continually overwhelmed by disaster. There was no response to that, so I took the initiative on behalf of the UAW to pull together a group which has been working on a document which we will make public under the auspices of a

broad committee in the business community, the academic community, and labor, and other sections of our society, and that will be made public on the 27th of February, hoping it will lead to a thoroughgoing public debate about the urgent necessity of moving in this direction.

Chairman HUMPHREY. Can you be sure that this committee receives a document with any detailed analysis that you might have, because this committee has a subcommittee that is working on the whole subject of economic growth and planning, headed by Senator Bentsen of Texas.

Mr. WOODCOCK. I am well aware of that.

Chairman HUMPHREY. We would appreciate it very much.

Let me just go over a little bit here of the material on certain matters to which you referred, Mr. Woodcock.

In your splendid prepared statement, you make the interesting statement, a very interesting statement about public service jobs, and I believe that I quote you correctly, "when even the largest of these bills," speaking of the public service jobs bills, "which we endorse, does not fully meet the Nation's needs. A permanent Federal program of public service jobs is needed, jobs that will help clean up the environment, improve and expand health care and other social services, as well as employ the unemployed."

Now, I happen to believe your statement is very significant because it calls for a program of Federal public service jobs.

My question is, one, what do you see as the deficiencies in existing public service job programs to cause you to recommend that we consider a Federal public service jobs program, and, two, could you tell the committee in any greater detail how such a Federal program as compared now to local public service jobs program would work?

Who would, for example, decide what jobs would be done under such a program? And finally, as you know, a major stumbling block to using the public service jobs program to put people to work on major projects such as improving, for example, railroads, the railroad rights-of-way and railroad beds, is that many unions do not support public service jobs for such purposes.

In a time of rising unemployment it may be that we will have to put people to work on such programs if we are to keep unemployment down.

Therefore, how can we develop a public service jobs program that puts people to work on national improvements without running afoul of the standards of labor unions?

The last one relates to organized labor and public service jobs. As to the other two, what do you consider the deficiencies in the existing public service jobs?

Finally, could you give some detail as to how a Federal public service program would work?

Mr. WOODCOCK. The essential point here, Mr. Chairman, is we are talking about a permanent Federal program. It would not necessarily be different in kind. It might be different in degree. Obviously if one has a permanent program, it has to have some relationship to the wage structure paid for that kind of activity. I am not suggesting that we create something in opposition to the normal labor force.

Our society has, in the last several years, developed a lower number of what used to be called entry jobs. We are developing in our society a permanent subclass which is pure social dynamite for a democratic society. Sweden, for example, has an ongoing job program which is tied to a percentage of the budget.

I suggest in my prepared statement that we should have at least one half of 1 percent of the Federal budget up to a level of say 4 percent unemployment, and for every 1 percentage point rise above that, there should be an additional 0.5 percent. But similarly, when unemployment comes down, that would shrink, but it would be a permanent base of entry jobs which if they were truly entry jobs would not necessarily be in conflict on the wage structure.

And I think if that were done on a planned basis, the labor movement, all of the unions involved would thoroughly cooperate. Their instinctive reaction is that this is a planned governmental job force to undercut them. It does not have to be that. I am thinking in terms of a supportive force.

Chairman HUMPHREY. Any further details that you and your organization might supply this committee would be very helpful. We are going to delve into this in considerable detail as a way of improving what we consider the present jobs program, that is, public service jobs program.

I want to get to you on the tax question because I know you have been a leader in this matter.

In your prepared statement you have indicated that your tax package would cost about $20 billion; $9 billion of this cost would be offset by tax reform.

Now, you know of my interest in the subject of tax reform. I question whether even a $20 billion tax cut is large enough at this stage of the game, and I have serious doubts that $10 billion worth of stimulus will do anything significant.

Do you believe that a $20 billion tax cut which decreases to $10 billion when tax reform is added on to it will provide sufficient stimulus to this economy to have any real impact on unemployment?

Mr. WOODCOCK. No, I do not, Mr. Chairman, but the reference in my prepared statement is to the second stage. No. 1 is the emergency tax cut which I think should now be in the range of, I would say, $23 billion to $28 billion, possibly more, and weighted, of course, on the personal income tax and toward middle- and low-income groups.

I might add in that connection, even if that is done in adequate numbers, unless the money supply is loosened we will not be doing the job because that has to be the necessary second step that is accomplished, and I hope that that is done quickly, because when I was before the House Ways and Means Committee as one of a panel of seven, all of us agreed that speed is of the essence, that a dollar that is put out in the public domain now is worth $2 that may be put out in July and August.

Chairman HUMPHREY. I hope you will just repeat that and I wish that every Member of Congress would listen to it.

What did I understand you to say?

Mr. WOODCOCK. That a dollar put out now, quickly, is worth, in our opinion—this is a panel of seven, six economists and me, I was

sort of tailing along—but we all agreed, including the Republican economists, who are a vanishing breed, we all agreed that speed is of the essence and that a dollar now is worth $2 in a few months time the way we are going now toward depression.

Chairman HUMPHREY. In other words, you find yourself in agreement with Mr. Henry Ford, who testified just before you as to the necessity of prompt and quick action.

Mr. WOODCOCK. That is correct, sir.

We assume the stimulus has been applied now and the economy is recovering, but any prediction as to the recovery indicates it is going to be slow moving, so we will still need a stimulus in 1976, and this $10.7 billion stimulus refers to the 1976 period, on the assumption that we have already begun to move the economy up, which would be in part by carrying out tax reform, closing of loopholes, and then after that getting the rest of it by a further closing of loopholes which we detail in the prepared statement.

Chairman HUMPHREY. Very good.

Now, Mr. Woodcock, what kind of a tax stimulus do you think we need in calendar year 1975?

Mr. WOODCOCK. I think in terms of the tax rebate which should be paid certainly not later than May, that should be in the range of $8 billion to $10 billion, the reduction of withholding taxes in July should be in the very least a further $10 billion, and I think now that stimulus should be more.

Let me say that the automobile industry executives, having first said the tax cut should go to middle-and low-income groups, unfortunately have now publicly supported, although Henry Ford II did not this morning, the President's tax program, on the theory that these $1,000 rebates would all be pushed into the automobile market.

That is nonsense. First, we have got to revive the housing industry, because until the housing industry revives, the economy will not revive, and until the economy revives, the automobile industry will not revive.

The average automobile buyer determines his willingness to buy a car by whether he can fit the monthly payments into his monthly budget. That is where the reduction in withholding taxes as of July 1 becomes all important and necessary.

Chairman HUMPHREY. Mr. Woodcock, I have been proposing a tax cut which would supply a $10 billion rebate in 1974 taxes, and approximately $20 billion, including some investment tax credit in the range of $3 billion to $4 billion, for the calendar year 1975 as a stimulus.

Now, this is an upgrading of what I originally proposed, which was considerably less, because in looking at the Economic Indicators that have come before this committee's attention, the drop in industrial production, the drop in the gross national product, the precipitous decline in employment, the consideration that there will be further unemployment, further increase in unemployment and part-time unemployment. I might note here for the record that while the official figures are 8.2 percent unemployment, the Bureau of Labor Statistics also notes that there are 3,800,000 people that are called employed that are working only part time that want and have registered for full-time employment. There is another better than 1¼

million who have disappeared off the employment rolls, according to the Bureau of Labor Statistics, simply because they have given up looking for a job.

So this record ought to indicate that the real unemployment is not 8.2 percent. The real unemployment in this country borders on 11 percent today. It is estimated by the calculations of staff of this committee at 10.9 percent. That was as of February 1.

Now, I therefore have proposed a tax cut along the following lines: Low-income allowance to be increased by $1,300 to $2,000. That is to help those who are really low-income producers. Personal exemption $750 to $900, the standard deduction for the short form from 15 percent up to 17 percent, and the refundable income tax credit of 1½ percent of a worker's wages that are subject to social security taxes, up to $14,100 maximum.

Now, this program would provide along with that a $10 billion tax rebate in 1974. This would put on a weekly basis, effective as of January 1, retroactive to January 1, in every weekly paycheck, an increased amount of take-home pay. That take-home pay today, in the last 18 months, has dropped 7 percent in purchasing power, over 8 percent in the last 24 months, and I find that workers are complaining that the tax that seems most burdensome to them with the high rate of inflation is the social security tax. We have also found out, of course, that workers in this $14,000 bracket, Mr. Woodcock, are penalized by the tax rate schedule, that as your income goes up, even though it does not purchase more. You get into a new tax bracket, and therefore the individual in the income tax bracket between $10,000 and $20,000 a year is having a tough time making ends met and is paying a larger amount of Federal income taxes simply because of the inflation, increased pay to be sure in many instances but buying less.

Could you support a tax program that had such things as low-income allowance increases, personal exemptions up from $750 to $900—that is for child support and so forth—standard deduction increased from 15 to 17 percent, and a refundable tax credit upon worker's wages up to the $14,100 of 1½ percent.

Mr. Woodcock. Let me first say, Mr. Chairman, that I certainly support the gross numbers that you suggest. It comes to a total of $30 billion, and the specifics, yes, I could support them because taxes have to be pushed down, because this is the first recession in our history where the people's real earnings have gone down but their taxes have gone up. In all past recessions at least their taxes also went down. This is the first recession where exactly the opposite is true.

So this is not simply a question of pushing tax money out there to stimulate the economy. This is also remedying the gross inequities which have been perpetrated over these past 12 months or so.

Chairman Humphrey. I thank you. My time is up and I now yield to Senator Percy.

Senator Percy. Mr. Woodcock, we welcome you, and I want to indicate I fully support the program that you have advanced on public service jobs.

I think it is economically right. It is certainly a dehumanizing aspect for a person who has worked all his life to be, for reasons beyond his control, out of work and have nothing to do day after

day. It is just an unbelievable experience. Such persons need to feel that they are getting paid for doing something. I think 99 percent of them would much prefer to do something rather than to just take a welfare check or something comparable. I think it is certainly in the best interest of the country to create a public service jobs program, and we will work together, all of us, on that.

I would like to ask your impression again on the highway trust fund. Have you altered your position? Do you favor abolition of the highway trust fund, and what form do you see of using revenue and getting enough revenue so that we can develop a balanced transportation system in the country?

Mr. WOODCOCK. I would favor the continuance of the highway trust fund, but we continue to favor tapping that highway trust fund in massive amounts to begin to develop a balanced transportation system, of which the automobile will certainly be an integral part for the reasons Henry Ford II stated.

But even if we made a total commitment toward developing a mass transit system today—and we are far from that—it would be years before we could alleviate our dependence upon the private automobile.

Senator PERCY. Would it be a balanced transportation fund rather than a highway trust fund in the sense that now the money can really only be used for highways?

Mr. WOODCOCK. Oh, of course. Money is now being released. With the deplorable state of our railroad system, we should be putting the money into recovering that railroad system instead of more highways.

Senator PERCY. Would you care to state your position on gasoline rationing. Do you feel that that is necessary now?

Would you advocate it now or try to find other ways to conserve gasoline?

Mr. WOODCOCK. First of all, I do not know why at this juncture in our situation we are advocating the reduction of imports. We are opposed to the reduction of imports. We are certainly opposed to the reduction of imports by the tariff and taxing mechanism.

Now, if we have to reduce imports, and at this time I insist we do not have to, the problem is not one of supply, it is one of economics, the balance of payments, trying to develop a permanently high price for energy so that alternative domestic sources can come aboard. But, if we have to—and we do not have to at this juncture—then we would favor allocation and rationing rather than the price mechanism.

Now, rationing could be on a two-tier basis: Basic rationing, when you come to gasoline, and then a high price for discretionary driving.

Senator PERCY. Would you care to comment on your judgment as to whether rationing would actually conserve fuel and move us more toward independence from outside sources if we tried to experiment with the concept of having each car not driven on 1 day of a week, at the option of the car owner as to what day it is.

Do you think it would actually save much fuel?

Mr. WOODCOCK. I come back to the point that at the present time our problem is not supply. In Detroit where I live we have gasoline

price wars going on. So it is not a problem of supply. We are awash in gasoline at this time. I do not mean this to indicate that I do not believe there is an ongoing energy problem. I think it is real. I don't think it is real short term, but Lord knows it is real long term, and we have wasted a whole year coming to grips with this problem, the long-term problem.

Senator PERCY. If you feel that we ought to move in the direction of consuming less, we have got to find practical ways of doing it. My question is, is this a relatively painless method of doing it, giving a great deal of flexibility to the automobile owner but taking the car off the road 1 day a week?

Mr. WOODCOCK. First of all, the American people do not believe there is a problem, short term, long term, or any term. Every survey has shown that. So they first have to be convinced of the problem.

If somebody just said, okay, now everyone is going to get off the road 1 day a week, when they do not know there is a problem, you would get wholesale ignoring of it, and you would have a further disrespect for law, which this country cannot afford. We are not in that state of crisis at the moment.

Now, the fact that the President says it does not make it so. I wish some of the things the President says would become a fact. We were going to turn the corner last October and all sorts of things were going to happen, but we are not in that kind of crisis at the moment.

Senator PERCY. Are we at a stage where it is in the national interest that we move rapidly toward the use of automobiles that will give greater gasoline efficiency and mileage?

Mr. WOODCOCK. Absolutely, and let me say I disagree with Mr. Henry Ford and the industry on this. I think their track record unfortunately shows that unless their feet are put to the fire they have not done the job.

I am supportive of a pause on emissions because first of all we have come a long way, 90 percent on hydrocarbons, 83 percent on carbon monoxide, and 48 percent on oxides and nitrogen which is a very controversial area. But we support a mandated fuel economy using the same sort of certification process that we used on emissions, setting feasible standards that they have to meet, but not to say that they cannot market them if they do not meet them, but to tax them, to tax the producers if they do not meet them, and beyond that, there should also be a mandate for continuing research in the emissions area, because we cannot give them a 5-year pause and come to the end of the 5 years and have them say, "Gee, we still cannot make it." In those 5 years we have to find out not simply through the industry but through the Government, can we or can we not in fact with feasible technology within the necessary economic parameters do the job. It is for these reasons we support the pause.

Senator PERCY. I rather like your term, putting their feet to the fire, because I think that is what people ought to do to us until we start to move.

Do you think it would help provide incentive to the industry to move more rapidly if we did have some sort of a bonus system for people who would buy automobiles with greater mileage capability and a penalty for people who purchase cars which provide very little

gas mileage, and therefore were not as much in the national interest, and have a self-liquidating fund so that those who want to buy the less efficient automobiles help subsidize the people who are willing to put up with some of the less luxurious features, possibly, but greater mileage in the other car; and secondly, would it possibly help provide employment in the industry to have a massive conversion—to have an incentive to convert from our less efficient cars on the road today?

Mr. WOODCOCK. Of course it would, but the reason I say it should be done through mandated requirements rather than the taxing system is that this becomes a necessity, because ongoing we do have a petroleum shortage, petroleum deficiency. So why should people who are rich and can afford to pay a tax be able to drive cars around that only get 8 miles to a gallon. They should not be allowed to. It should be on a sales weighted basis, a mandated requirement. If they are going to continue to build big cars, they can build big cars, big interiors and get 18 to 22 miles per gallon. They should not be able to market them with 9 miles a gallon just because the rich can pay the tax. That is still wasting the basic resources of the Nation.

Senator PERCY. Mr. Chairman, I would like to yield the balance of my time to Senator Javits whom I thought was on the floor handling legislation and would not be returning. But as the ranking Senate minority member on the committee, I think he should have the privilege of finishing up my time.

Chairman HUMPHREY. Go right ahead.

Senator JAVITS. Thank you very much, Senator Percy. That was very gracious of you, and I will just take 2 minutes.

I have read your prepared statement, Mr. Woodcock, and I am deeply, deeply impressed with the need for some planning mechanism by the United States, which you go into in very great detail, and I notice that you say that you have been working with some economists on this subject. I was just trying to find the place, but I remember quite distinctly.

Could you tell us whether you would be willing to make available to us in this committee your thoughts. You note of your meeting with a small group of distinguished economists to discuss ways of moving in this direction.

Could you tell us whether you would be willing to make available to us some of the results of your work?

Mr. WOODCOCK. Yes. May I say, Senator, that we started with a small group, most of whom were economists, and we have developed a larger committee. We have some distinguished business people, people from the financial community, people from the labor and academic communities. We are going to put this document into the public domain on the 27th of February. We have not approached any Members of the Congress because we wanted to have a public debate mechanism before we come to that point. We would be happy to submit it then.

Senator JAVITS. Mr. Chairman, I ask unanimous consent that it might be made part of this record.

Chairman HUMPHREY. Surely.

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

For a National Economic Planning System

(By the Initiative Committee for National Economic Planning)

Few Americans are satisfied with the way in which the economy is now operating. Unemployment is increasing; prices are rising. Inflation in the United States has become a source of instability in the world at large. No reliable mechanism in the modern economy relates needs to available manpower, plant and materials. In consequence we have shortages of housing, medical care, municipal services, transportation, energy, and numerous other requirements of pressing importance.

We have not made it our business to foresee these critical problems and to take steps to forestall them. We do not plan. But in a modern economy planning is not a matter of preference or ideology. It is one of immediate need. In its absence we will all suffer. This suffering is avoidable.

We therefore urge that provision be made for planning at the highest level of the United States government and through regional, state and local units of administration. This effort must be backed by education, by the widest public discussion of the methods and objectives of planning, and by full public participation in the planning process.

NATIONAL ECONOMIC PLANNING

We believe that economic leadership must be exercised in a new way through an Office of National Economic Planning. This Office must be in a position to perceive our country's economic and social needs now and for many years to come and to provide the public, Congress and the executive branch with alternative plans of action, not only to enable us to avert hardship and disaster, but to guide the economy in a direction consistent with our national values and goals.

Planning is neither strange nor unfamiliar. Every individual and business plans for the years ahead. Our space program is a good example of planning in its most sophisticated and successful form. It also illustrates the magnitude of the effort that must go into national economic planning. Nevertheless, the principles are simple. First, from a set of feasible alternatives, a definite and realizable goal was decided upon: to carry a man to the moon and bring him back to earth. This required setting up a long-range program to fulfill the mission. All the necessary information had to be gathered together in a consistent and useful form. Then, step by step, the program had to be carried out in the required sequence, the results monitored, and corrections made whenever necessary.

Just as it would have been impossible for a man to go to the moon and back by accident, it is impossible for us to achieve our economic objectives by accident.

But the most striking fact about the way we organize our economic life is that we leave so much to chance. We give little thought to the direction in which we would like to go. We make no consistent effort to balance different parts of the economy. We do not attempt to ensure that resources are allocated to meet our most urgent national needs. In fact, we know that they are not so allocated.

Instead of systematically trying to foresee the needs of the nation in years ahead, we have dozens of separate, uncoordinated agencies making policy in this area and that, without any thought of how it all fits together. We have over fifty federal offices collecting economic data, in most instances insufficiently detailed, frequently obsolete, often contradictory and incompatible. No single office is responsible for setting appropriate standards and bringing these data together so that they can be used to pursue coherent national objectives. We make economic policy from quarter to quarter or year to year without any perspective on where the economy is going or where we want it to go.

HOW PLANNING COULD WORK

The mere cataloguing of these problems reveals the inadequacy of our present economic techniques. We therefore recommend that an Office of National Economic Planning, described below, be established with:

Plenary power to accumulate, collate, and analyze detailed economic information from all sources;

a mandate to examine major economic trends and work out realistic alternative long-term economic programs for periods of fifteen to twenty-five years, to be submitted to the President and Congress;

a mandate to work out alternative plans of intermediate length, such as five or six years, to be submitted to the President and Congress, designed to carry us toward our long-range objectives;

responsibility to specify the labor, resources, financing, and other economic measures needed to realize these programs and plans.

Needless to say, all programs and plans must be periodically reviewed and revised as changing circumstances require.

Let us examine how the planning Office would go about its work. Its function would be to develop programs in specific areas where there are discernible national needs. Energy, transportation and housing are obvious examples. But it is clear that a planning Office cannot look at energy alone, transportation alone, housing alone, or at any other sector of the economy in isloation. All these sectors interact, draw on scare resources, require definite numbers of workers with specific training, and require financing. Above all, planning is a way of looking at economic problems as a whole, providing the information needed to set explicit priorities in the use of resources, and guiding all sectors of the economy toward the attainment of our chosen goals. A planning system must balance resources with needs, set goals that can be realized, and inform the public what the choices really are.

PLAN AND MARKET

The heart of planning is to go from information to action. Most of the action in the U.S. economy takes place in the private sector. Democratic planning is not a substitute for a decentralized economy nor does it replace the millions of private decisions that are made in the market every day. Rather, to reach democratically chosen objectives, it influences those decisions with a consistent set of economic techniques. The means of influencing those decisions are already familiar to us. Some, such as tax incentives and disincentives, and traditional monetary and fiscal policies, influence individual actions indirectly. Others, such as selective credit controls, guidance of basic capital flows, limits to the use of air, water and land, and mandatory resource allocation, affect individual actions directly. All these measures have been used at one time or another by the federal government, but—save in World War II—in a haphazard fashion, with no view to their overall effect. The purpose of planning is to provide that view.

It should be clear that the planning Office would not set specific goals for General Motors, General Electric, General Foods, or any other individual firm. But it would indicate the number of cars, the number of generators and the quantity of frozen foods we are likely to require in, say, five years, and it would try to induce the relevant industries to act accordingly.

One of the best persuaders available to the planning Office is information. The flow of goods, services, and money from one industry to another can be grasped in great detail through the use of input-output and other programming techniques. The planning Office can provide a continuous stream of detailed information about how various sectors of the economy mesh—and are expected to mesh in the future—enabling individual firms, as well as federal, state, and local governments, to make enlightened and coherent decisions about production and consumption.

ORGANIZATION

In order to be effective and useful, an Office of National Economic Planning must be set up at the center of our economic and political life as one of our most influential institutions. To provide leadership at the highest level, we propose the establishment of such an Office within the Executive Office of the President, provided with sufficient funding and supported by a professional staff large enough to carry out the many functions discussed here. The Director of the Office of National Economic Planning should be designated as the chief adviser to the President for economic affairs. The Office should oversee the implementation of the national economic plan within the executive branch of government. Accordingly, the membership of the Board of this Office should be composed of high administration officials and be supported by an advisory group representing the best talent of business, labor, farmers, consumers, minorities and other sections of society.

We also propose that the Council of Economic Advisers be made a part of the Office and continue to concentrate on short-run problems of full employment and stabilization, usefully supplementing the long-run concerns of the Office.

PLANNING AND DEMOCRACY

It goes without saying that the final choice among all feasible alternative planning objectives and programs belongs to Congress; and the execution of all laws embodying planning policy is the responsibility of the Administration. Congress and the executive branch must be equal partners in planning. We therefore recommend that a Joint Congressional Planning Committee, supported by a Congressional Office of Planning, with the necessary funding and technical assistance, be established to oversee all planning activities of the executive branch, and to initiate and review legislation related to planning.

But to be successful, planning has to be undertaken with the full understanding, acceptance, and support of the public. The participation of representatives of all important economic and social interests in every phase of planning is essential. Regional, state, and local units of government must fully share in the planning process. Every national forum—the press, Congress, and the executive branch—should be used for a continuous airing of opinion on planning goals and methods. A network of committees representing every area of economic life should be available for mutual consultation with members of the planning Office.

No one can possibly argue that planning will solve all our problems. Nor will it reconcile conflicting interests between different sections of our society. These will continue to be contested in the political arena as before. But planning can spare all of us the sense of helplessness we feel as the economy drifts from crisis to crisis and replace frustration with a sense of hope, with the conviction that we can, in fact, exert some control over our affairs.

Nor is planning an easy task. It is one of the most difficult enterprises that any society can undertake. But the technical capability and know-how exist to do the job. We believe that the hard thinking, work and experimentation required by a planning effort will be repaid many times over. We are convinced that the American people will respond to the challenge.

The signers do not necessarily agree with every detail of this statement, but do share the view that national economic planning as generally described here has become an economic and social necessity.

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MEMBERS OF THE INITIATIVE COMMITTEE FOR NATIONAL ECONOMIC PLANNING

Co-chairmen: Leonard Woodcock, President, UAW; Wassily Leontief, Harvard University, Nobel Laureate.

Coordinator: Myron E. Sharpe, Editor and Publisher, *Challenge*: The Magazine of Economic Affairs. Anne Carter, Brandeis University; Abram Chayes, Harvard University; John Kenneth Galbraith, Harvard University; Robert Heilbroner, The New School for Social Research; Robert Lekachman, Lehman College, CUNY; Robert R. Nathan, President,Robert R. Nathan Associates; Robert V. Roosa, Partner, Brown Brothers Harriman & Co.; Nat Weinberg, Economic Consultant.

Senator JAVITS. I know of no other single lesson which we can draw more clearly from this recession-depression than the need for some sort of national planning mechanism in this country.

I know Americans abhor the nasty word, but there is no way out of it. We are absolutely caught so short in this matter that the precipitousness of the economic downturn in just 2 months, November and December of 1974, is absolutely appalling, such that a great nation like our should literally be caught flatfooted in that way without any anticipation of the side effects of the fallout of a highly restrictive policy to deal with inflation.

It is like those medicines that doctors often find have much worse side effects than the illness which the medicine is intended to cure.

I deeply believe that you have emphasized, and I think in the name of your hundreds of thousands of members, very appropriately this single fact, and I would pledge myself to that objective of installing some form of effective planning mechanism for our country which in our country will not be mandatory. We do not mean a Communist system, but it will be a basic blueprint for government, and I emphasize that very strongly, private enterprise policy. And that, I gather, is what you have in mind.

Mr. WOODCOCK. Exactly, with an emphasis on democratic planning.

Senator JAVITS. Exactly. And the only other point I would like to make, sir, is do you feel it is possible to do this and that it deserves the support of enlightened businessmen, business investors and managers like Henry Ford who was here this morning, and that they really have nothing to fear from it. And could you tell us why?

Mr. WOODCOCK. I think they have more to fear from its not coming about because every segment of our economy is run by a plan, but the economy as a whole drifts like a ship without a rudder.

We are learning again that disaster keeps overwhelming us. In the few places I have talked about this concept before business audiences, I am very heartened by the letters I get from very prominent business people: I did not believe this was needed, but I would like to look at what you have when it is available. I think the sentiment of the business community is substantially changing.

Senator JAVITS. I am very pleased to hear that, and it has been my experience as well. It is something we simply cannot do without.

Now, Senator Humphrey and Congressman Hawkins have introduced a very gifted bill, and I am a party to it. A group of Senators and I have also introduced a bill for a fair employment board. I hope that you or your group could critically examine our bill as well, and perhaps Senator Humphrey's bill, and I hope we can establish a continuing liaison with your group rather than to have a one-shot operation where we ask you and you give us your report, so that we might have an ongoing dynamic effort with a distinguished group to refine this concept.

Do you think that is possible?

Mr. WOODCOCK. Yes, sir.

Senator JAVITS. Could we have for the record a list of the members of the group which you described? [1]

Mr. WOODCOCK. Yes; of course.

Senator JAVITS. What is it called [1]

Mr. WOODCOCK. We have our final meeting on the evening of the 26th of February when we will christen ourselves.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you very much.

I want to call to your attention that we have introduced in the past, and it will be reintroduced this year, what we have called the bill of national growth and development, which you may have seen. It is one which I have introduced each year since 1971. Senator Javits and I will be spending some time here, that is looking forward to your report, to pull together hopefully a legislative proposal which will meet some of your requirements.

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[1] See the members and the name of the group, p. 683.

Senator Proxmire.

Senator PROXMIRE. This is a most remarkable prepared statement. You have obviously done a great deal of work and a lot of thinking. I read it last night. I do not think many people appreciate how far you go in asking for a change in our economic policy. I think this is a most dramatic and comprehensive change.

What you are saying is that we can get down to 3 percent unemployment in 18 months if we follow the right policies. You say it was done in World War II and we can do it now. All of the testimony we have had from economists indicate that that is just about impossible unless we follow a series of dramatic policies.

The Joint Economic Committee made recommendations as to what we can do and they proposed a $33-billions tax cut, an increase in social security to match the increase in the cost of living, an increase also in wages for Federal employees to do the same, 1 million public service jobs, 10-percent increase in the money supply and they only got unemployment down to 6.7 percent by 1976.

Now, obviously, to do what you are calling for would require, what, a $100-billion tax cut—would require an enormous increase in spending, would require an increase in the money supply of perhaps 20 percent, and in view of that, would also require, it seems to me, across-the-board comprehensive wage-price controls if you are going to prevent inflation.

That would be my reaction.

Now knock that down, if you would like to indicate how you would do it.

Mr. WOODCOCK. Senator, I will not try to knock it down. If we make a full commitment of our resources, it is possible. These things can be done under ideal circumstances. I do not think it is going to be done in the political circumstances we are facing.

One reason we put that in is that I do not think we should lose sight of the infinite capacity of this economy to meet the desirable social goals. At the same time we must go on to say what the feasible things are that could be done to essentially meet the needs of the society as far as we can and will get the support of the people in implementing the steps.

Senator PROXMIRE. You are asking this committee chartered by the Employment Act of 1946 to change that charter, to change the language and make it unequivocal; so the No. 1 priority is to reduce unemployment, eliminate unemployment in the sense that, as you say, a decent job at adequate pay is available to every American and no hedging on the basis of price stability or anything of the kind not consistent with these other things. That is what you would have us attempt to do; is that correct?

Mr. WOODCOCK. Yes, sir, and with the exception of Canada, every industrial society makes that commitment.

Senator PROXMIRE. Have you made estimates as to how big a deficit we would have to incur in order to do this?

Mr. WOODCOCK. 3 percent in 18 months?

Senator PROXMIRE. Yes, sir.

Mr. WOODCOCK. No, sir. I repeat, that is an expression of an ideal.

Senator PROXMIRE. I think, as Senator Javits has said, it is most helpful to have that view. As you know, the conventional wisdom,

such as it is, is that we are going to have to settle for very high unemployment for a long time even if we proceed with what some people consider to be very liberal policies. But 6.7 percent unemployment is outrageous or would have been considered outrageous a year ago.

Now the Joint Economic Committee says that is the best we can do by the end of 1976, even if we follow the policies which the administration will apparently oppose vigorously.

Now let me come to the other area where you are also very concerned and very expert.

Did I understand you to say that you would agree that we should not relax the environmental standards through the next 5 years? Did you disagree with Mr. Ford that we should maintain the standards set by Congress for reducing air pollution?

Mr. WOODCOCK. No, sir, I did not say that. The UAW is supporting the 5-year pause.

Senator PROXMIRE. You are supporting the 5-year pause?

Mr. WOODCOCK. We have not got a document on that yet because we are examining whether we should support the modified California standards as proposed by the President, which I am inclined to think that we will, or simply hold where we are, which is what the industry is advocating. I may say that we have a distinguished outside consultant who has been working with us now for the last, better than 2 years who is an expert in this field. It is primarily on his advice that we are taking this position.

Senator PROXMIRE. It is unusual for the UAW and for you not to take a position which almost everyone would say is in the public interest. You may be right. This may well be in the public interest. I am sure that, if you disagree with ecologists and environmental proponents, it is because you feel that the price in employment is just too high to pay to get what achievements you would get by enforcing the standards; is that right?

Mr. WOODCOCK. No, sir. This is one of the regrettable things. We came to this basic position on which we began to work long before the car market fell around our ears. We are not in this position because of the economic situation. We have become convinced that we cannot any longer keep going down the same road. Now we have come as far as we can on the emission controls and also make the necessary giant steps we have to make to fuel the economy.

So our position is that it has to be coupled, the pause has to be coupled with a mandated fuel economy, not simply a promise, plus mandated research on further emission controls so that when we come to the end of the pause, we are in a position to say what further needs to be done and can be done. That research should not simply be done by the industry, but also under Government auspices so there is a monitoring form.

Senator PROXMIRE. You say you support mandated fuel economy. Does that mean the Nelson bill? Are you aware of that? Are you familiar with it?

Mr. WOODCOCK. In general, and I think what we are putting forward as possible standards is not too far from the numbers that Senator Nelson proposed.

Senator PROXMIRE. You think it is realistically practical to try to achieve a 57 percent savings within 5 years in fuel economy, 75 percent by 1985? That is roughly what the Department of Transportation and the EPA estimate.

Mr. WOODCOCK. As I remember Senator Nelson's figures, they would take us to 22 miles per gallon by 1980 and 28 miles per gallon by 1985.

I am satisfied that we can do better than 22 miles per gallon on a sales weighted average quite quickly. I think the gaps between our numbers and Senator Nelson's numbers are not that great. But our method is that there needs to be some Federal agency to develop what are feasible goals which should be the mandated goals.

Senator PROXMIRE. The only other point I would like to make, a question I would like to ask, is relating to that estimate that our committee has made that we cannot get unemployment down below 6.7 percent until 1976.

I think somehow that has not really dawned on the country. They think that this is something that is a matter of coming to some sort of reasonable policy with the Congress and the President. If they compromise this so that we can get part of our policy and part of the President's policy, we will still have unemployment above 7 percent in 1976. If we follow the UAW kind of policy, we will be moving at least in the direction of, say, 5 percent unemployment.

But the policies required to do that are so far beyond anything we have done in the past in terms of the size of the deficit, in terms of the money supply, perhaps in terms of wage-price controls except for that one brief period we had in 1971–74 when an unsympathetic administration followed a policy which made wage-price controls not work well.

I wonder if there is any kind of practical recommendation that you can make to us that falls in between the ideal situation which you very well argue and what you think we can really accomplish.

Mr. WOODCOCK. Of course these project out. To say if we do this, this, and this, you will come down with 6.7 percent by year X—I am not so sure that the assumptions made are necessarily valid because I do not know of any economist who, not so very long ago, was predicting the kinds of numbers we have generated now. Their assumptions were not equal to the developing impact of the slide that we are going through.

So I am not positive that the assumption that they are making in the other direction might not be equally as incorrect because I still have some optimistic feeling about the regenerative ability of this economy given the necessary stimulus.

Senator PROXMIRE. Yes, that is right. But you see, what is restraining us, the Congress and the President, is the haunting fear of setting off another tremendous inflation increase. We have gone through that. We do not want to have double-digit inflation indefinitely, or worse. And I think that that is what is making it very difficult for us.

Mr. WOODCOCK. Obviously, that is what is making it difficult for the country.

Senator PROXMIRE. You see, labor is, as you know far better than I do, in a difficult position here because wage-price controls really

hurt labor, as you know, in the 1971-74 period. Real wages were sharply reduced because they worked to keep wages down without prices being held down, especially in phase III.

We have an administration which has a somewhat similar attitude now and if we try to protect this program, an explosive program which would restore jobs but risk inflation, we are going to have to protect it with wage-price controls—you have the same players, the same coach, the same kind of attitude at least on the part of the coach maybe under a little different name, and therefore, a real dilemma.

Mr. WOODCOCK. I would suggest, Senator, if the Congress were to do the necessary things to put quickly into operation the necessary stimulative matters with regard to tax policy, public service employment, and put the necessary pressures, if I may use that word, on the Federal Reserve Board to have a proper monetary policy, and if the coach is fouling up the game, get a new coach in not too long a time.

Senator PROXMIRE. Thank you very, very much.

I thank you. Mr. Chairman.

Chairman HUMPHREY. Mr. Woodcock, I am going to turn to Congresswoman Heckler. Some of them may not want to change the coach.

Representative HECKLER. Mr. Woodcock, I want you to know that I am very impressed with your statement and I also was somewhat heartened by your responses in terms of the highway trust fund and the Nelson bill as well.

Last week, as you probably know, this committee enjoyed the opportunity to listen to administration witnesses, and it seems to me that while our society is afflicted by the twin devils of recession and inflation, my greatest concern as a Representative is the question of recession and unemployment, and those are the issues that I try to develop with the witnesses.

After listening to you today, you are obviously just as concerned about unemployment as I am and you have made your proposals and they deserve a great deal of consideration.

However, you do not resolve my nagging doubts about the question of inflation. Just last week in Boston a very distinguished economist, David Babson, presented a paper in which he projected the current trend of spending in the United States to the year 2000, and he said by that time 65 percent of the American people will be on the Government payroll either as employees of the Government or as taxtakers through welfare or through other programs, and they will be supported by the remaining 35 percent of society. So the productive people will be bearing this enormous burden and that situation is certainly grossly inequitable and ripe for revolution, I would say.

Now we are not dealing with the year 2000. We are dealing with a very difficult year. I do not know how we address the problem of inflation. The terms of your statement, most of your programs I would support, I would want to support. I can see the need for them, the justification. But I am wondering what will be the budget impact. And of all your suggestions apart from the tax changes, what item would you assess the highest priority to?

Mr. WOODCOCK. I have one overriding priority which is paramount and that is we have to do something about this recession which is reaching depression, and take our chances on the rest of it.

One can take present projections and shoot them out over the next 25 years and that could make anyone's flesh creep. But life does not work like that. It does not just go in a straight line: based on what is today and continuing for 25 years.

This society, I think, has the necessary strength and can have the internal determination to correct those things which need to be corrected. The problems causing inflation at the present time—oil is a big problem and we have no ready answer to that, and to make the problem even more inflationary, what the President is proposing, goes in the opposite direction. Food is a problem, something like we have never had, certainly since World War II. And unfortunately, this country does not have an agricultural policy. All we are saying to the farmer is go out for all-out production, but we will not protect you against family bankruptcy.

That problem, which we do not mention in the prepared statement, certainly has to be met. But a society that is pledged to long-term mass unemployment is a society which will be radically changed.

Representative HECKLER. Have you completed a figure as to the cost or the budget impact of the social security changes which you propose in your prepared statement?

Mr. WOODCOCK. We expect in the near future to have some specific proposals relative to the social security situation. Typically, when one looks at social security taxation, if we were taxing all of the people who received salaries and wages at the same rate now as we did when social security came on board in 1936, which was 96 percent of the total, we would not have a ceiling of $14,100. We would have a ceiling somewhere in the neighborhood of $24,000. That is where our difficulties come.

Most of the people who pay my wages pay 5.85 percent on every penny they get. I do not pay 5.85 percent because I quit paying after I reached $14.100. I do not know whether we have the political courage to look at that, but if we do, we can take the onerous burden, which is on the lowest income groups, off the bottom and do it without undue burden on the Treasury.

Representative HECKLER. You have suggested changes in social security and I can see the need for looking into that problem. You have also suggested the Federal assumption of the unemployment compensation costs, an extensive CETA program, and an extensive public service jobs program, which I support as well. But the question is can we do everything?

I wonder which of the two you would prefer. It seems to me that looking at the CETA program in terms of my district, it is fine to make the announcement x number of jobs will be available and then the waiting list begins and more people are rejected than hired, so that it is rather creating unfulfilled expectations which lead to disappointment.

Rather than the CETA program, would not the full expansion of unemployment compensation provide broader benefits for more people in terms of helping people meet the real cost of what they are doing today, the real problems that they face in terms of many

States going out of business, running out of funds for unemployment insurance, et cetera?

Mr. WOODCOCK. We speak here of the federalization of the unemployment insurance system. I would consider Federal standards that took out this really disgraceful competition between the States for a declining number of jobs as being an adequate answer to that.

Obviously, we had a decent unemployment insurance program but the two have to go together. And getting back to Senator Proxmire's point about the 3 percent over 18 months, before the Japanese bombed Pearl Harbor we would all have said we could not have possibly done what we did. But when the Japanese bombed Pearl Harbor, this nation said, "Our life is at stake," and anything became possible. We did not know what our possibilities were. And we look at big numbers but we do not relate them, for example, the deficit numbers, to the size of the economy.

If we could just put those in percentages, we would begin to react to them. Maybe Secretary Simon would not be horrified all the time. He must have many sleepless nights worrying about the deficit. But if he could just think about the size of the economy and the relationship of that deficit to the economy, he might see it a little differently.

This Nation does not know its capacity. We have proved that in the past. That is what that reference really was in this document.

Representative HECKLER. One more question, Mr. Chairman.

Chairman HUMPHREY. Please go ahead.

Representative HECKLER. You have made an allusion to the Kennedy-Corman health bill here and do not directly say whether you think we should pass it this year or not. My question is, "What is your opinion in terms of the ability and its priority?" How would you feel about that particular bill in addition to your other suggestions?

Mr. WOODCOCK. I react negatively to your use of the term "laundry list." We use that in the labor movement to indicate a list which includes a lot of things that you are not going to get. We have a very decent, pared-down list. We stand for the enactment of the national health insurance bill, hopefully in the House in this session. Let me say with respect to our support of S. 675, which would provide ongoing hospital medical protection for those who are receiving unemployment insurance, I have no doubt in my mind that this is going to impede the effort for national health insurance.

But the terrible thing is we are the only country in the world that has neither national health insurance nor national health service. We put all of the burden on the American worker, who is the highest paid in the world, but also the most insecure in the world. When he loses his job, he loses his ability to protect his family against illness. That is not true in any other country, I do not care what the level of their industrial production. And why this should be in the richest country in the world passes my understanding. The trouble is we should have done something on national health insurance 5 or 6 years ago.

Chairman HUMPHREY. Twenty years ago.

Mr. WOODCOCK. I will buy that, Mr. Chairman.

Representative HECKLER. I would say we should have done it 20 years ago as well, but I would not specifically state that that particu-

lar bill should have been passed 20 years ago. But certainly a major piece of major legislation should have been passed.

In view of the total number of problems and the strains that we are experiencing in this recession and this unemployment and in fighting inflation and with the energy crisis, which is certainly burdening our society, I do not know if we can do everything at once. I just do not know.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you very much, Congresswoman Heckler. We appreciate very much your questions and participation.

Mr. Woodcock, I want to make just a couple of observations here. In reference to Senator Proxmire's numbers which he gave to you relating to the Joint Economic Committee figures on the possibility of the reduction of unemployment within the time frame of 1 year to 2 years, I think it should be noted that was being referred to were the Wharton forecasts; that is, University of Pennsylvania Wharton's Business School's forecast. We had the expert here from Wharton, Mr. Rowe, just last week.

His forecasts are based on a simulation study, as you know, computer printouts of the statistical materials that are fed into the computer, but they take no consideration of such things as public attitude, confidence, the intangibles, the possibility of a very substantial response on the part of the American economy once confidence has been restored in any degree.

It is my judgment, and I can only speak for myself, that when the Congress of the United States starts to legislate and gets away from cogitating to legislating, we are going to restore some confidence. and it would be even better if there could be some meeting of the minds between the President and the Congress, and that is what it took after Pearl Harbor, you know, people just had to put away some of these old ideas that we had and face up to new situations.

As Abraham Lincoln once said, "disenthrall ourselves."

We have a lot of people around this town in high position in both the legislative and executive branch who still have not comprehended what is happening to this economy, both in terms of its productivity and its unemployment, its indebtedness, and all of the other factors which relate to what we call our economic system. They are still wrestling around with old numbers.

Many times we refer to what we called the Great Depression. There is no comparison even in statistics, you know. This is an entirely different ballgame. And I am under the opinion that when we start to look at what the facts are, we will come up with some new answers.

For example, just to relieve the horrification that seems to grip my good friend, Secretary Simon, I am sure that he was not particularly horrified with the Eisenhower administration, and yet, the budget deficit in the Eisenhower administration in 1958 was the same percentage of the budget as the budget deficit is in the Ford administration in 1975, percentagewise. And in terms of the gross national product the budget deficit in the Eisenhower period of 1958, 1957–58, was about the same percentage of the gross national product as the budget deficit is in 1975 of the gross national product in this particular period of time.

So if you put the figures together and take a look at them as a sane, objective person rather than one who is gripped by fiction, mythology, and prejudice, we begin to see that the situation is anything but hopeless.

There is another thing that I think used to be mentioned and you mentioned it in your prepared statement about money supply. When we started to get out of the recession in 1958, just about the time that the economy started to move, the Federal Reserve Board slammed on the brakes again. They have a hard time getting a cruising speed. They are either taking you hellbent down the road at a quick turn or slamming on the brakes at the first intersection where it looks like anyone is moving, and I do not know what we are going to do with that crowd. I really do not. But I am going to harass them.

There is such a thing as political guerilla warfare and I will engage in it until we get some response. And that does not mean that I do not like these men. There is no man that I am more charmed by than Mr. Burns. But you see, that is the problem. He is a tempter.

Well, I will not use any invidious comparisons here but I just have to mention that.

I want to also make a note about projections. I always get a bounce out of these 2000-year projections. First of all, it inspires me to want to last that long if anyone could tolerate me over that continued period of time. But I heard a projection of David Babson. I imagine he may be related to Roger Babson. But David Babson, I am sure, is a respected, fine gentleman. Bu there is no Babson in either the Old or New Testament, and those are the only prophets that I put any faith in that I have heard about for a long time. There are no Humphreys in there either, I might add.

But this is the same kind of projection we got from the Office of Management and Budget. Now who knows what is going to happen by the year 2000. You can say, well, this is my point of view, but when we examined the OMB projections in this committee, we found that they were anything but documented and we are going to ask for all of these news headlines projections that scare the living daylights out of people or feed your prejudices, to be documented, and you cannot document them at all.

What they say is they have a gut reaction. They have some kind of a feeling about it. It really does not mean very much.

I want to call to your attention what your counterpart, Mr. Henry Ford, had to say here today: "In my judgment the American people will not and should not accept policies which would lead to nearly 7 percent unemployment as late as 1978 as the administration has projected."

I gather that here is where the collective-bargaining table finds itself in agreement; is that correct?

Mr. WOODCOCK. That is correct. Yes, sir.

Chairman HUMPHREY. I think it is important to note that if you want to take just the 2-year forecast and not become a longtime prophet, that the administration is looking to 1978 with an over 7 percent unemployment rate, and they have always underestimated two things: Revenue—they cannot count—and unemployment.

Now that is not an exaggerated statement. That is documented by every report that has come to this committee since I have been on it. They are always underestimating the revenue, complaining about the expenditures, and underestimating the unemployment and underestimating the inflation. They have a perfect record of striking out on all of them right down the line.

It is not only a matter of needing a new pitcher; the batters are no good.

Now production: We had calculated what the production last was and let it be for this record. Let us assume that you have about a 4-percent unemployment rate. I think it was 4 percent, 4-percent unemployment rate this year. Or for the calendar year 1974 we lost $109 billion of potential production even with 4-percent unemployment.

Now Norway today has seven-tenths of 1 percent unemployment. Those poor, struggling Norwegians. The Federal Republic of Germany has 2.2 percent unemployment and they are launching a major attack on unemployment by every conceivable method at their command, including not less than an 8-percent increase in the money supply. Those good conservative Germans had a $9 billion trade surplus. They have an inflation rate about one-half of ours. They have an unemployment rate of less than 2½ percent, and they are using every tool of their economy to overcome it. And we are being fed this poppycock that the inflation around here is due to demand, due to a tight labor market.

We even have people convinced around here that we ought to get up to 5½-percent unemployment and accept it as the baseline, which I refuse to accept.

The production lost at 4-percent unemployment is $109 billion last year that we just washed down the stinking Potomac.

In 1975, this year, it is estimated we will put $200 billion down the polluted Potomac, and next year $240 billion, even, Mr. Woodcock, if we could have an employment rate standing at 4 percent.

Now, when people talk about the cost of combating recession, I want them to know that we are throwing down the drain $600 billion of low-cost ability of reclaimed assets, just like you went in and robbed the banks of $6 billion and burned it up, and we have people in Government wondering whether or not we ought to move for fear that we will reignite the fire of inflation.

I repeat what I have said, and I will say it every time. These are like the old doctors who bled the patient in order to cure the fever, and they had more death through bleeding than cures for fevers, and that is what we have here. Recession is like a nervous breakdown.

I read what you had to say about these problems and Mr. Henry Ford II, what he had to say about the problems of overcoming inflation, and we are concerned about how much it takes to get things revved up again. It is like a nervous breakdown. It is not death. It does not mean that you pass out. It means that you have, in a sense, come apart at the seams.

In order to put it together again, it takes time, and this is the tragedy of this period, because of a tight-money and no economic policy—we have had no economic policy. We have been on a lost

weekend, extended for about 6 or 7 years, and then we were on a drunk before that. As a result, we have swerved into a recession but only by the help of the Almighty and good luck will we get out of it in any degree of time to save the lives of millions of people.

I am weary of talking about this rate of inflation around here when I know what is happening to families, and I am pleased with what you have to say today about agriculture, Mr. Woodcock. It is very reassuring to have it come from one of our most eminent labor leaders.

Do you know what the Chairman of the Council of Economic Advisers told us here to make us feel good? He said one of the good news features is that agricultural prices are declining. Jolly. Farmers are going broke, and that is supposed to be good news. I wonder when we are going to start selling cancer. [Laughter.]

I just thought we ought to put a little plain talk into this meeting here today.

Now, the next thing that I would like to draw to your attention is what Mr. Henry Ford had to say. The third essential step on which nearly unanimous agreement has long since been reached, and yet. for reasons which escape my understanding, says this prominent businessman who has had a reasonably good, successful career, nothing has happened. Everyone seems to agree that easier monetary policy is necessary to halt the recession. He said everyone. That is not quite true. The Federal Reserve has announced its intention to provide moderate money growth. There is a widespread impression that monetary policy has already been eased, but this is simply not so.

Did you ever see anyone from the Federal Reserve Board, Mr. Woodcock?

Mr. Woodcock. I will see Mr. Burns this afternoon.

Chairman Humphrey. Give him my regards. [Laughter.]

And tell him what Mr. Henry Ford said here, and tell him what you think.

Now Mr. Burns is a brilliant man. He is a decent man, but like my grandfather, he has got some ideas that do not fit the times, and he is a charmer. I tell you, when he is up here in front of us, I just sit here. As I said. even when I know it is disaster, I sort of enjoy it. It is the sort of thing that you need when there is no hope.

But there is hope, and I want you to speak to him very candidly, and I know I joke about it, but I do it only for a purpose, to emphasize the gravity of the situation. I gave you the report, you maybe heard me this morning, from the St. Louis Federal Reserve Bank.

[Mr. Woodcock nods in the affirmative.]

Chairman Humphrey. Now they give us all kinds of formulas to tell us that the money supply is easing. I tell you, when you will know the money supply is easing, when a small businessman out of my State can step in and borrow money for less than 12 percent interest. He cannot.

The SBA we have around here is about as useful as six ears on a cow. They will not make a loan to anyone anymore. I have businessmen in my State who have been in business for 20 years in towns where they are the major employer who cannot get a loan from the

SBA. What do we need that SBA for if they will not offer what is called commercial loans? That is No. 1.

No. 2, a farmer today cannot get a loan. The National Independent Bankers Association has been coming to committees of this Congress telling us that unless something is done there will be wholesale foreclosures and every bank is loaned up to the top, and they cannot even collect the interest on the loans, and I am no prophet of doom and gloom. I have been known in this city for 25 years as the all-time optimist, congenital.

But I want to tell you, I am getting over it as these people are beginning to destroy my faith, not my faith in what we can do, but they are beginning to destroy what I believe is possible under these current conditions.

Now, what are you going to tell Mr. Burns, Mr. Woodcock, besides my greetings?

Mr. WOODCOCK. He is inviting me, Mr. Chairman.

Chairman HUMPHREY. That is good news.

Mr. WOODCOCK. So first I guess I will listen. I must say that when I hear that the Federal Reserve Board has to be shielded from politics, and I look at the members, and I see that in 1972 when we were electing a President, the money supply was increasing at the rate of 12 percent, and in the December and January just past, with the economy falling around our ears, the money supply is moving in a negative way. I just wonder if it is so nonpolitical as we are led to believe.

Chairman HUMPHREY. Now, Mr. Burns will tell you that is not his understanding. He says that money supply is appreciably increasing. The important thing is, what are banks doing with it?

Ole Swenson from Minnesota does not get down here to see Arthur Burns. He has got to go to the local bank. That is where he has got to go, and when he goes there the bank says, sorry, because they are loaned way up.

So I hope when you talk to him that you will do better than I did last time. I looked at my own questioning last time, and I flunked. I did not do very well. Mr. Burns is very brilliant.

Did you ever have a labor man on the Federal Reserve Board? Do you know of any labor leaders who have been on the Federal Reserve Board?

Mr. WOODCOCK. I am sure there have not been.

Chairman HUMPHREY. Do you think we ought to have a consumer-type person on there, a producer-type person?

Mr. WOODCOCK. I would think it would be helpful.

Chairman HUMPHREY. I think we ought to examine every Federal agency to take a look at their balance of representation of the American public. When did it get to be that only lawyers, brokers, and accountants, and bankers should have anything to say about the money supply?

Would you like to make some recommendations to the Congress on these things? I think the whole structure of the Federal Reserve System needs to be carefully examined, particularly as to the appointment of persons to that Board. What is the term, 14 years? Almost as good as being a Federal judge—14 years handling the most sensitive part of the economic structure, and Mr. Woodcock, I want to

tell you something. If we appropriate an additional $100 billion—which I do not think we will do—it will not have as much effect on this economy as lowering the interest rates by 2 percent.

Mr. WOODCOCK. I agree with that.

Chairman HUMPHREY. That is what you have got to get done. Until they quit this hocus-pocus Mickey Mouse stuff that we are going through, nothing is going to happen, and we will be around here holding hearings, and it will be the biggest fake this town has ever had until we get money available.

Until we get interest rates down, we are conning the public and fooling ourselves, and that is the worst thing in the world. It is bad enough to fool the public, but to fool yourself and the public is absolutely indefensible, and that is exactly what is going on.

And Mr. Henry Ford came here today with you—I think its very interesting—two of the great men of our country, and I say that in all truth. Two men who are highly regarded in their respective fields have come here and have said exactly the same thing, basically, on the tax policy, on unemployment matters, and on monetary policy, and I think you are saying it because you have got sense, and you have been out in the real world, where you look at people and see that when they are unemployed, they are brokenhearted, families are destroyed, income goes away. You are being told you are not needed. You are being told that this country does not want you, and this is the biggest tragedy of our times.

To think that we have a government who says that we can get by with 7-percent unemployment and sit around here like a stunned, paralyzed ox and let it happen is beyond me. I guess I ought to quit. No sense in going any further. Just thought I would get it off my chest again, and I will do it every time I am here until everyone throws me out of here.

Do you have anything you want to say, Mr. Woodcock?

Mr. WOODCOCK. I am just happy that I was the audience, Mr. Chairman.

Chairman HUMPHREY. I am happy you were here. You inspire me, sir. Thank you very much. The committee stands adjourned.

[Whereupon, at 12:55 p.m., the committee adjourned, subject to the call of the Chair.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 26, 1975

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

The committee met, pursuant to notice, at 10:10 a.m., in room 1318, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey and Javits; and Representative Hamilton.

Also present: Loughlin F. McHugh and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; Robert D. Hamrin, L. Douglas Lee, and Carl V. Sears, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbharr, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Mr. Lynn, we are going to start. We will have some of our colleagues come in here just a little later.

I am sure you know that the Joint Economic Committee has a responsibility under law to make analysis and evaluation of the President's budget. We will present that analysis and evaluation to the congressional Budget Committees sometime in the early part of March and therefore under the rules that we operate by, we have asked you to come here to discuss the budget for our record so that some of the questions which have been raised by members of the committee and staff can be presented to you for your comment.

This morning the Joint Economic Committee resumes its annual hearings on the President's economic proposals and the budget with testimony from the Director of the Office of Management and Budget, Mr. James T. Lynn. Mr. Lynn, as you already know, it is a pleasure to welcome you before this committee in your new capacity as Budget Director. You have been a very busy man and we appreciate very much your willingness to accommodate this committee with your presence because there are limits to anyone's time. That I know. You are placed in what some might consider the awkward position of having to explain and defend a budget which you did not prepare. That may not be of any worry or concern to you but I think we should make note for the record that this was a budget that was prepared under your predecessor, of course, under the basic direction of the President.

However, I personally have every confidence that you are more than equal to the task of speaking to us about the budget and giving a deference of the proposals therein.

This year's budget document contains many new features, including the 5-year forecast of output, prices, and employment which has confounded and dismayed everyone with its gloomy predictions of extremely high unemployment through 1980. Let me say that at least we now have some elements of forecasting in the budget document which I think is very useful, very helpful. This is a part of our budget legislation.

Senator Javits and myself were somewhat instrumental in getting this included in the budget proposal.

In this budget we also have 5-year projections of budget authority and outlays, again approaching what I hope will develop into a better planning mechanism for our Government. And, of course, the estimates of tax expenditures are in the budget and new functional spending categories. So our budget message is, I think, much more helpful to the Congress in its responsibility under both authorizations and appropriations.

Might I just indicate that the projections and the budget authority and outlays can be exceedingly helpful to us as we look down the road to the strengthening of planning and forecasting in the Federal Government. We are going to spend some time in this committee on this subject of planning and forecasting. We will look forward to both private consultation with the OMB, you, Mr. Lynn, and also with some public hearings. I just wanted to let you know that it has been decided both with the majority and the minority of the committee that we want to look ahead to the possibility of the creation of some structures within the Government for national growth and development planning, within not firm structure, not firm lines, but within general guidelines.

In short, this year's budget is a very meaty document. I think it is the best one that we have had in terms of organization. It will take some time to digest this extra meaty document and we will not be able to cover everything that we would obviously like to cover this morning.

Therefore, I would say to you, Mr. Lynn, that various subcommittees of this committee will undoubtedly be calling on you and possibly calling you back to testify in greater detail on such things as these 5-year projections. That will come later on.

One question we do want to explore this morning is this. Where is the stimulus in this budget? I see the word "stimulus" used over and over again. However, speaking for myself, when I add up the numbers, I reach the conclusion that on balance the President's budget proposals add almost no stimulus, or at least very little stimulus, to that which would be provided by the automatic stabilizers and the normal growth of spending if we had no budget policy changes whatsoever.

I should make not here that some of those stabilizers that have been placed in legislation have been modified by this budget proposal to which we will direct some attention. Both the Budget of the United States and the economic report contain tables which purport to measure the stimulative impact of the President's economic pro-

gram. I went into this in some detail with Mr. Alan Greenspan, the Chairman of the Council of Economic Advisers, when he testified here. I discovered that these tables leave out the restrictive effect of the proposed $17 billion in spending cuts. If allowance is made for the restrictive impact of these budget cuts, the stimulus in the President's program is limited almost entirely to the third quarter of this year. Even then it is equal only to about one-half of 1 percent of the GNP.

I think it is only fair to ask how that is going to turn around or have any stimulative impact upon a $1.5 trillion economy which is now operating at an 8.2 percent unemployment rate?

I am not arguing that some of the President's requests to restrain spending may not be good. I believe we have to look at the President's budget with complete objectivity, recognize that the proposals that are there have been argued about and thought through with considerable care. I am opposed to the 5-percent ceiling on social security increases. There are others of the President's expenditures reduction proposals which I may very well want to support but the point is this: We should not kid outselves about the degree of stimulus contained in this program. And simply to have the word "stimulus" in the budget message doesn't either excite me or stimulate me.

The economy is very weak and it will take the most purposefully and skillfully executed policies to restore its strength. Therefore, we need to evaluate the overall impact of the President's budget more completely than is done in either the Budget of the United States or the economic report.

Mr. Lynn, as you can imagine, we will return to this in the question period. But right now we look forward to hearing what you have to say and I want to say I surely welcome you here. You have one of the most difficult jobs in the Government but you are a man of considerable competence and ability and I am sure that you will be able to fulfill this responsibility with great ability and we welcome you to the committee.

STATEMENT OF HON. JAMES T. LYNN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY PAUL H. O'NEILL, DEPUTY DIRECTOR; JOHN A. HILL, ASSOCIATE DIRECTOR; DONALD G. OGILVIE, ASSOCIATE DIRECTOR; DALE R. McOMBER, ASSISTANT DIRECTOR FOR BUDGET REVIEW

Mr. Lynn. Thank you, Mr. Chairman. It is both a pleasure and an honor to be here before this distinguished panel.

Mr. Chairman, I have a prepared statement, with your permission, I would like to have inserted in the record. I will limit my oral remarks to excerpts from that statement.

Chairman Humphrey. Would you identify your associates for the record.

Mr. Lynn. The gentleman on my right is Mr. Paul O'Neill who is the Deputy Director of OMB. The gentleman on my left is Mr. Dale McOmber who is our Assistant Director for Budget Review.

Chairman Humphrey. Mr. Paul O'Neill? Is that right?

Mr. LYNN. Paul O'Neill and Mr. Dale McOmber. We also have other colleagues from OMB here today. I would suggest that as I reach a point in the testimony where I have to call on them for help, I will identify them. I think that would be the best way to be helpful to the committee.

Chairman HUMPHREY. That is fine. Thank you very much.

Mr. LYNN. Mr. Chairman, at the beginning of my prepared statement I refer to the various initiatives of the President in the budget. You touched on stimulus. We do refer to specific things in the budget that we believe are providing stimulus to the economy, as well as measures that are directed toward solving our energy problems in the country.

Let me start with a few words on the budget and the economy.

The budget is designed to deal with three serious economic problems facing us today: Recession, inflation, and energy.

Through the deficit, the budget provides a stimulus to the economy that should help lead to a bottoming out of the recession toward the middle of calendar year 1975 and to significant real growth thereafter. Table 2 of my prepared statement shows the deficit by half years on a national income accounts—(NIA)—basis. The Federal deficit—(or surplus)—on an NIA basis is perhaps the best single measure of fiscal stimulus or restraint. As table 2 indicates, there is a sharp increase in the NIA deficit. From an annual rate of $2 billion to $3 billion in fiscal year 1974, the deficit increased to a $12 billion annual rate in the first half of fiscal year 1975, and is projected to increase sharply to over $50 billion at an annual rate in the second half of that fiscal year and to $75 billion in the first half of fiscal year 1976 before decreasing in the second half of 1976.

The deficits proposed in the 1976 budget are partly the unavoidable consequence of the recession we are experiencing and partly the result of the proposed economic stimulus included in the budget to combat that recession—primarily a tax cut. Aid to the unemployed, which includes both benefit payments and public service jobs, will be $9 billion larger in 1975 and $12½ billion larger in 1976 than in 1974. In addition, the softening of the economy will result in substantially lower tax receipts. Tax receipts would be $30 billion larger in 1975 and $40 billion greater in 1976 if the economy were as fully employed as it was during 1974. Finally, the President's economic stimulus proposals—which are a response to the recession—will also contribute to the deficit, decreasing receipts by $6 billion in 1975 and $10 billion in 1976. In the absence of these factors, the budgets for 1975 and 1976 would be in surplus.

The deficits projected for fiscal years 1975 and 1976, together with other government-related activities, will make heavy demands upon the financial markets. Direct Federal borrowing from the public is expected to grow from $3 billion in fiscal year 1974 to nearly $45 billion in 1975 and $65 billion in 1976. In the latter 2 years, Federal plus federally assisted borrowing will total nearly $140 billion if the plan proposed by the President is adopted. The tax plan being considered by the Congress and congressional disapproval of the outlay reductions proposed by the President could push these financial requirements to $160 billion or beyond, of which nearly $100 billion would come in 1 year—1976.

In periods of slack, such as we are experiencing now, the financial markets should be able to absorb very substantial Federal and federally assisted borrowing. Even in these periods, however, a point is reached at which Federal and federally assisted borrowing becomes excessive. Such excessive borrowing would force up interest rates and reduce the availability of credit to the Nation's businesses, housing, farmers, and to State and local governments. If this happens, the ability of these sectors to support a resumption of economic growth though investment will be impaired. The President has not overlooked this problem, and it is a major reason why he is urging the Congress not to increase deficits beyond those already contemplated.

The budget is also designed to avoid longer run excessive stimulus that would again raise the rate of inflation. Inflation continues to be unacceptably high, though the situation is improving. As demand has fallen, there have been significant declines in prices of crude industrial materials. Indeed, because of weaknesses in these and other prices, the aggregate wholesale price index has declined for 2 consecutive months. Simultaneously, there has been a slowdown in the rate of price advance among major categories of goods in retail markets. By late in calendar year 1975, the annual rate of price increase shown by the deflator for the gross national product, and including the effect of the President's energy proposals, should taper off to somewhat about 7 percent. In our effort to stimulate the economy, we must not forget that inflation—and efforts to bring it under control—were a major cause of the recession of 1974–75. In 1975 and 1976 we must support the economy in a manner that will prevent another cycle of inflation/recession a year or two ahead.

The President's energy program will raise the relative price of energy in order to reduce energy consumption and encourage the development of additional energy sources. In short, it proposes to let the market system perform the function that it carries out best. At the same time, the budget provides direct outlays for increased research, and it returns the increase in energy costs to the economy through income tax reductions and direct Federal expenditures, thus leaving real purchasing power in the economy as a whole largely unchanged. With the President's program in effect, the United States should be largely invulnerable by 1985 to disruptions like the embargo of last winter.

A word or two on budget trends which I know is of great interest to this committee, as you indicated in your opening statement, Mr. Chairman.

In recent decades there has been a significant shift in the composition of the Federal budget. The national defense function has decreased from 56 percent of the budget in 1956 to 27 percent in 1976. At the same time, Federal benefit payments for individuals have increased substantially, from under 20 percent of the budget in 1956 to 44 percent in 1976. Moreover, in constant dollars—that is, after adjusting for the effects of inflation—national defense has decreased nearly 20 percent over the decade ending in 1976, while payments for individuals have increased 150 percent. Our Nation's security will not be served well if defense programs decline further to offset increases in benefit payments.

The tremendous growth of our domestic assistance programs in recent years has, in large part, been consistent with a shift in our national values. Much of the burden of aiding the elderly and the needy has been shifted from private individuals and institutions to society as a whole, as income transfer programs have expanded their coverage. These programs cannot, however, continue indefinitely to expand at the rates at which they have grown over the past two decades. Spending by all levels of government now makes up a third of our national output. Were the growth of domestic assistance programs to continue for the next two decades at the same rates as in the past 20 years, total government spending—again including all levels of government—would grow to more than half our national output.

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

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

These are the subjects—the countercyclical impact of the budget, the effect of Federal and federally assisted borrowing on credit markets—and, thereby, on investment opportunities, housing, and long-range economic growth—energy, inflation, and budget trends—that I trust will be high on the agenda of your committee.

Thank you.

[The prepared statement of Mr. Lynn follows:]

PREPARED STATEMENT OF HON. JAMES T. LYNN

Mr. Chairman and members of the committee, the President's budget for 1976 is designed to meet both our short-term economic problems and long-term national needs. The President's budget recommendations will help to restore healthy economic growth while minimizing the likelihood of increased inflation. They will reduce our dependence on imported oil. These recommendations include:

Income tax relief of $16 billion in 1975 and 1976 ($12 billion for individuals and $4 billion for businesses);

Greatly increased aid to the unemployed, totalling $17.5 billion in unemployment insurance benefits and $1.3 billion for public service employment;

An import fee on oil, and taxes on domestically-produced petroleum and natural gas and on their producers;

A rebate to compensate for the resulting higher price level, with special provisions for ensuring that low-income Americans and State and local governments are compensated equitably;

An increase in outlays for defense and military assistance of $8.0 billion in order to maintain preparedness and preserve force levels in the face of rising costs;

A one-year moratorium on new Federal spending programs other than energy programs; and

A temporary 5% ceiling on increases in pay for Federal employees, and on those Federal benefit payments to individuals that are tied to the cost of living.

We would face a substantial deficit even without the added stimulus that the President is proposing through tax reductions. Therefore, it is important to elimi-

nate lower-priority spending in order to concentrate on direct efforts to speed economic recovery and to restrain the long-term growth of Federal spending. Hence, the budget recommends no new programs other than in the energy field. Further, the budget—as submitted—recommended reductions of $17 billion for fiscal year 1976. With the release by the President of additional highway funds and of Hill-Burton funds, and actions by the Congress prohibiting the planned change in the food stamp program, the total reductions currently proposed are $15.3 billion.

Despite these reductions, total budget outlays are now estimated to increase $37.4 billion over 1975 to $351.2 billion in 1976. However, because of the slowdown in economic activity and the proposed tax reductions, receipts are estimated to increase by only $18.8 billion over 1975 to $297.5 billion. Therefore, the 1976 deficit is now expected to be $53.7 billion if all of the President's budget proposals are accepted by the Congress. To the extent outlay reductions are rejected and the tax cuts are increased by the Congress, the budget deficit will be correspondingly larger. The deficit must be kept under control this year and steps must be taken to reduce or eliminate it in the future.

TABLE 1—BUDGET TOTALS

[In billions of dollars]

Description	1975 actual	1975 estimate	1976 estimate
Budget receipts	264.9	278.8	297.5
Budget outlays	268.4	313.8	351.2
Deficit	3.5	35.1	53.7

THE BUDGET AND THE ECONOMY

The budget is designed to deal with three serious economic problems facing us today: recession, inflation, and energy.

Through the deficit, the budget provides a stimulus to the economy that should help lead to a bottoming out of the recession toward the middle of calendar year 1975 and to significant real growth thereafter. The following table shows the deficit by half-years on a national income accounts (NIA) basis. The Federal deficit (or surplus) on an NIA basis is perhaps the best single measure of a fiscal stimulus or restraint. As the table indicates, there is a sharp increase in the NIA deficit. From an annual rate of $2 billion to $3 billion in fiscal year 1974, the deficit increased to a $12 billion annual rate in the first half of fiscal year 1975 and is projected to increase sharply to over $50 billion at an annual rate in the second half of that fiscal year and to $75 billion in the first half of fiscal year 1976 before decreasing in the second half of 1976.

TABLE 2.—RECEIPTS AND EXPENDITURES IN THE NATIONAL INCOME ACCOUNTS

[In billions of dollars; seasonally adjusted annual rates]

	July to December 1973	January to June 1974	July to December 1974	January to June 1975	July to December 1975	January to June 1976
Receipts	265	283	299	284	281	330
Expenditures	267	286	311	336	356	370
Deficit	2	3	12	52	75	40

The deficits proposed in the 1976 budget are partly the unavoidable consequence of the recession we are experiencing and partly the result of the proposed economic stimulus included in the budget to combat that recession—primarily a tax cut. Aid to the unemployed, which includes both benefit payments and public service jobs, will be $9 billion larger in 1975 and $12½ billion larger in 1976 than in 1974. In addition, the softening of the economy will result in substantially lower tax receipts. Tax receipts would be $30 billion larger in 1975 and $40 billion greater in 1976 if the economy were as fully employed as it was during 1974.

Finally, the President's economic stimulus proposals—which are a response to the recession—will also contribute to the deficit, decreasing receipts by $6 billion in 1975 and $10 billion in 1976. In the absence of these factors, the budget for 1975 and 1976 would be in surplus.

The deficits projected for fiscal years 1975 and 1976, together with other Government-related activities, will make heavy demands upon the financial markets. Direct Federal borrowing from the public is expected to grow from $3 billion in fiscal year 1974 to nearly $45 billion in 1975 and $65 billion in 1976. In the latter 2 years, Federal plus federally-assisted borrowing will total nearly $140 billion if the plan proposed by the President is adopted. The tax plan being considered by the Congress and congressional disapproval of the outlay reductions proposed by the President could push these financial requirements to $160 billion or beyond, of which nearly $100 billion would come in one year—1976.

In periods of slack, such as we are experiencing now, the financial markets should be able to absorb very substantial Federal and federally-assisted borrowing. Even in these periods, however, a point is reached at which Federal and federally-assisted borrowing becomes excessive. Such excessive borrowing would force up interest rates an dreduce the availability of credit to the Nation's businesses, housing, farmers, and to State and local governments. If this happens, the ability of these sectors to support a resumption of economic growth through investment will be impaired. The President has not overlooked this problem, and it is a major reason why he is urging the Congress not to increase deficits beyond those already contemplated.

TABLE 3.—NET BORROWING FROM THE PUBLIC BY GOVERNMENT, GOVERNMENT-SPONSORED ENTERPRISES, AND GOVERNMENT-GUARANTEED BORROWERS

[In billions of dollars]

	1974 actual	1975 estimate	1976 estimate
Budget deficit	3.5	35.1	53.7
Deficit of off-budget agencies	2.7	13.9	10.6
Less means of financing, other than borrowing from the public [1]	3.1	5.1	−1.0
Subtotal, direct government borrowing from the public	3.1	43.9	65.3
Net borrowing of Government-sponsored enterprises	14.8	13.6	7.7
Net Government-guaranteed borrowing from the public	6.2	.8	7.7
Total Federal and federally assisted borrowing from the public	24.1	58.3	80.7

[1] Includes changes in cash and monetary assets, checks outstanding, and deposit fund balances; seigniorage on coins; and—in 1974 only—the increment on gold.

The budget is also designed to avoid longer-run excessive stimulus that would again raise the rate of inflation. Inflation continue to be unacceptably high, though the situation is improving. As demand has fallen, there have been significant declines in prices of crude industrial materials. Indeed, because of weaknesses in these and other prices, the aggregate wholesale price has declined for two consecutive months. Simultaneously, there has been a slowdown in the rate of price advance among major categories of goods in retail markets. By late in calendar year 1975, the annual rate of price increase shown by the deflator for the gross national product, and including the effect of the President's energy proposals, should taper off to somewhat above 7%. In our effort to stimulate the economy, we must not forget that inflation—and efforts to bring it under control—were a major cause of the recession of 1974–75. In 1975 and 1976 we must support the economy in a manner that will prevent another cycle of inflation/recession a year or two ahead.

The President's energy program will raise the relative price of energy in order to reduce energy consumption and encourage the development of additional energy sources. In short, it proposes to let the market system perform the function that it carries out best. At the same time, the budget provides direct outlays for increased research, and it returns the increase in energy costs to the economy through income tax reductions and direct Federal expenditures, thus leaving real purchasing power in the economy as a whole largely unchanged.

With the President's program in effect, the United States should be largely invulnerable by 1985 to disruptions like the embargo of last winter.

BUDGET TRENDS

In recent decades there has been a significant shift in the composition of the Federal budget. The national defense function has decreased from 56% of the budget in 1956 to 27% in 1976. At the same time, Federal benefit payments for individuals have increased substantially, from under 20% of the budget in 1956 to 44% in 1976. Moreover, in constant dollars—that is, after adjusting for the effects of inflation—national defense has decreased nearly 20% over the decade ending in 1976, while payments for individuals have increased 150%. Our Nation's security will not be served well if defense programs decline further to offset increases in benefit payments.

TABLE 4.—BUDGET PRIORITIES

[Percent of outlays]

Description	Actual 1956	1960	1964	1968	1972	1976 estimate
Domestic assistance:						
Payments for individuals:						
Direct[1]	17	22	22	22	30	38
Indirect (grants-in-aid)	2	3	3	3	6	5
Other grants-in-aid[1 2]	3	5	6	7	9	11
Total domestic assistance	22	29	31	32	46	55
Direct Federal operations:						
National defense function	56	49	44	44	33	27
Net interest	7	8	7	6	7	7
Other	14	14	18	17	14	11
Total direct Federal operations	78	70	69	68	54	45
Total outlays	100	100	100	100	100	100

[1] Excludes military retired pay and grants classified in the national defense function.
[2] For recent years, consists primarily of grants for water pollution control, highways, education and manpower, and general revenue sharing.

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

The tremendous growth of our domestic assistance programs in recent years has, in large part, been consistent with a shift in our national values. Much of the burden of aiding the elderly and the needy has been shifted from private individuals and institutions to society as a whole, as income transfer programs have expanded their coverage. These programs cannot, however, continue indefinitely to expand at the rates at which they have grown over the past two decades. Spending by all levels of government now makes up a third of our national output. Were the growth of domestic assistance programs to continue for the next two decades at the same rates as in the past 20 years, total government spending would grow to more than half our national output.

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

It is no longer realistically possible to offset increasing costs of domestic programs by further reducing military programs and strength. Therefore, the budget proposes an increase in defense outlays and a halt in the relative decline of defense spending and a slowdown in the growth of human resource programs.

These are the subjects—the counter-cyclical impact of the budget, the effect of Federal and federally-assisted borrowing on credit markets (and, thereby, on investment oportunities, housing, and long-range economic growth), energy, inflation, and budget trends—that I trust will be high the agenda of your committee.

My colleagues and I will be glad to answer any questions that members of the committee may have.

Chairman HUMPHREY. Thank you very much, Mr. Lynn.

Just a point or two of clarification before some more specific questions.

You talked about the benefit payments to individuals and you give us the percentage there. Doesn't that include benefit payments such as food assistance and all—over and beyond social security?

Mr. LYNN. Yes, it does, Mr. Chairman.

Chairman HUMPHREY. It is the total benefit payments to the individuals?

Mr. LYNN. Yes, it is. It includes social security, railroad retirement, medicare, medicaid, unemployment assistance, veterans benefits, Federal employee retirement, public assistance, and other similar programs.

Chairman HUMPHREY. All right. Now, one of the points that you make at the conclusion of your testimony is one that we have heard again and again from spokesmen for the administration, and I read from your prepared statement:

Were the growth of domestic assistance programs to continue for the next two decades at the same rate as for the past 20 years, total government spending would grow to more than half of our national output.

It is our judgment, sir, that that statement is very much of a fiction, not supported by any demonstrable facts. First of all, one of the reasons for the increase in outlays for individuals is that more individuals have been covered. I mean we have greatly expanded the coverage of individuals and there is a limit to when you finally run out of individuals to cover. So that the total outlay on the numbers is already fixed into the budget and the question now is how much does each individual receive in terms of the total outlay. And that kind of projection does not lead to the conclusion that is in your prepared statement.

Actually, when we have looked over the past years to the percentage of the GNP that goes into these different categories like expenditures for individuals, it has been rather level as you relate it to the gross national product, not as you relate it to the budget but to the gross national product which, of course, is the true wealth of the country. I want to come back to this statement but I want to point out to you that one of the reasons for your type of projections is that you keep assuming that we are going to be including more and more and more and more people and if you are going to do that, then you are assuming that the economy is going to be more and more and more depressed because of the reasons for the outlays to more and more people is that people that are in the category of the poor and the elderly are the ones that receive the major share of the outlay.

I guess to put it another way, there is a segment of the population that has been covered by Federal programs. That segment has expanded greatly over the last 20 years which was absolutely necessary. We have increased the coverage on Social Security. We have increased the coverage on disability insurance. We have increased the coverage on unemployment compensation. There are

perimeters or there are lines beyond which you do not go—and from here on out that growth will be much slower than it has been in the past 20 years.

Mr. LYNN. Mr. Chairman, responding to your points:

First: Let me say that we would be happy to discuss with the committee or its staff the exact data and projections that underline the statements I made.

Second: We agree with you totally that the rapid growth of payments for individuals do not reflect just a pattern of additional people becoming eligible for programs that existed 20 years ago. This growth rate comes about through two factors. One is the increasing number of people eligible for programs that were on the books 20 years ago, 10 years ago, and 5 years ago. The other is new programs being enacted into law. These have extended benefits to different classes of people or increased benefits to the people that have already been helped. The growth rate would have been much smaller if there were not changes in the authorizing legislation to add beneficiary groups or to increase benefits.

Mr. O'NEILL. Senator, just one further point. In making these estimates, in trying to call them to the attention of the public, we are trying to indicate that if we were to create new classes of beneficiaries over the next 20 years or 25 years at the same rate as we have over the last 20 or 25 years, and/or if we were to increase the real benefits going to people who are already entitled to various benefits at the rate they have increased in this period, then the consequences the Director has suggested will automatically flow. It is a very straightforward arithmetic calculation.

I, for one, very much hope that you are correct in your analysis, and that we are not going to be creating new beneficiary groups and higher real benefits at the rates we have over the last 20 or 25 years. I think the results would be untenable. If you look at the implication of this growth, we would have to have a very great increase in taxes to go along with the increase in beneficiaries and higher benefit payments.

Chairman HUMPHREY. Well, let me tell you why I have put the choke rein on you and this, because I think that this sort of jargon and talk frightens the living daylights out of people and it doesn't take into consideration the realities. It takes into consideration the possibilities, if you just go on mathematical computerized calculation

For example, speaking of your numbers, how they can be manipulated: If you had taken data from the 1935–55 period and used it to project to 1975, I can assure you that the figures which you are using today in 1975 would be vastly different from what actually occurred in 1975. These projections are related to a kind of a mathematical automatic situation which really belies what truly happens in the world of reality and I want your staff and the committee staff here to settle this because I am not going to let the electronic network and the printing press keep carrying stories to the public that in the year 2000 we will have—what does your statement say—if they continue for the next two decades at the same rate as in the past 20 years, total government spending growing to more than half of our national output.

For example, the projections on the rate of defense spending are very, very loose and subject to every possible consideration. In fact, I have here in my hand a written analysis of that by a staff member which challenges your figures completely. I mean, just simply denies the validity of your figures. Again what I am getting at is that while projections are useful, I think that also looking at possibilities of policy are also useful and I do believe that we have to be very, very careful here. I don't think we ought to sit here and say that you have deliberately mislead us any more than you would say that we are deliberately trying to refute your projections without fact. But I am going to insist that we get together here and I believe that, Mr. Lynn, you said you would like to do that.

Mr. LYNN. Absolutely. I would insist on it too, Mr. Chairman. The one thing I always like to do is get together on facts—both from my training before I came with government and since I have been in government these past 6 years. I have always wanted to be in a position where any statement I made we could back up. I feel that we can.

Let me say this, though, and emphasize it once again. These projections are not based on things that happened 20 or 30 years ago. They are based upon what has happened in recent periods. Frankly, we didn't use a period like the last decade because people would have claimed we were being distortive if we had used only the last 10 years.

I detect from your comments a real desire on your part, which I share, for us to look at the programs we already have on the books, plus our projections as to GNP, and see how much we can accommodate without increasing the taxes on the American people. All of us want to do more for people who can't help themselves, but, on the other hand, we want to have programs that do not get us into the situations I refer to in my testimony.

Now, take social security, for example. I think Mr. O'Neill had a point to make, if he might, Mr. Chairman.

Mr. O'NEILL. Senator, your opening statement indicating the value of looking forward and trying to anticipate where we are going, supports the idea we had in mind when we did this analysis. We have, for some time, been sounding the alarm about what is happening in social security. The amount in the trust fund is declining relative to how we are spending for benefits and promising people benefits in the future. I think a report prepared by the House Ways and Means Committee the other day nailed that down, and indicated that indeed we do have a serious problem.

It is not our intent nor was it our motivation, as you indicate, to scare the living daylights out of anybody. But we think it is terribly important that the general population have some notion of where we could be going unless we change the path that we have been on. I, for one, would be delighted to sit down with the staff of the committee and go through the analysis that we have done. I think they will find we have approached it in a very professional way.

Chairman HUMPHRY. Yes, we will, our committee staff, for example, estimates that if you project the rate of government spending based on the period 1955 to 1974 out to the year 2000, that for all

governments, Federal, State, and local, it would be about 30 percent of the GNP.

Now, of course, you have got to project what you think the GNP will be.

Mr. LYNN. You also have to project what you think new programs enacted into law will be. As I said, the figures in question do not just assume existing programs continue. They assume that we will get new laws adding new benefits and new classes of beneficiaries at the same rate that they have been added by new laws in the last 10 to 20 years.

Chairman HUMPHREY. But it also takes a period in which more people have been added than any comparable period in our history, the 1955 to 1975 period, and you will have to go some to beat what has been done in that period of time.

Mr. LYNN. I would sincerely hope we won't try to go so far.

Chairman HUMPHREY. This is a period of great growth and expansion and I must also call to your attention that I think most of the estimates on GNP have been generally off. They really have. The estimates which have been made in the past have been very, very poor on gross national product just as the estimates that have been made on revenue. Your estimates on GNP have generally been too low and your estimates on revenue have generally been to high. That is the evidence we have heard.

Mr. O'NEILL. I don't think anybody would want to claim that we see so very well into the future, even into the short-term future. However, for this analysis we have made a realistic assumption that gross national product in real terms will grow at 3½ percent per year. Certainly there will be variation as we go through economic ups and downs. But I think professional economists would agree that 3½ percent is not a bad yardstick for our potential capability for real GNP growth.

Chairman HUMPHREY. Very good. I just want to sort of give you a forewarning that one of the things—it is an old trick in government—is to try to frighten people as to what things are going to cost the Government. Now, government, by the way, also provides services and sometimes, for example, a national health insurance program in government would be, let's say, $150 billion. But we spend over $100 billion privately already, so that when you add it to government spending, it sounds like it is a whole new cost to the American people.

It is not a whole new cost at all. There may be some additional cost to the American people but that is paid for by certain kinds of people.

For example, the social security. I don't think the social security fund ought to be paid entirely by social security taxes. I think as we go along you are going to have to dip into general revenues in part. That happens to be Senator Humphrey's point of view. I have believed this for a long period of time.

I happen to believe there ought to be a larger share of the education bill paid out of the Federal revenues and that means that less of it will be paid out of the local revenues and therefore it makes it appear that the Federal Government spending is considerably

higher. But the taxpayer, he is just a taxpayer. He pays taxes to the township, the country, the State, the town, the city, and he pays it to the Federal Government. Taxpayers are taxpayers. The problem around here is that we always go around and say there are Federal dollars. There aren't any such thing as Federal dollars. There are taxpayer dollars, people's dollars.

I think we have got to make sure when we get offsets, when you start talking about what the Government pays for, you also have to ask yourself what don't I pay for as an individual. In other words, if your government paid for all education, the tuitions, and so forth, obviously it would be a larger education bill but it would be much less of a private bill. If the Government took care of our health costs, through an insurance system, it would be undoubtedly that individuals would pay a good deal less individually. But the tax would be up here at the Federal Government level or the revenues and expenditures at a government level which would be paid possibly on the basis of the ability to pay, which I believe is the fair way.

I see no reason, for example, why a man earning $50,000 a year should have social security payment taxes stop at $14,100. I think that is a very regressive tax system we have in social security.

My time has expired and I will be back to you.

Mr. LYNN. Without getting into specifics on social security reform, let me just say I think we have another issue that is involved.

The reason we referred to government as a percentage of GNP was the very point that you make, Mr. Chairman, which is that we have expenditures by all levels of government.

Chairman HUMPHREY. Yes.

Mr. LYNN. And you will note the prepared statement very carefully said that total government expenditures would, if we stayed on the path of the last 20 years, exceed 50 percent of GNP. That was not the Federal Government alone. That also included the others.

Chairman HUMPHREY. I understand.

Mr. LYNN. My other point is that you reach a point where you have to say to yourself, "How much do we in government want to decide how money is spent by the American people?" If we reach a point where we are taking in taxes at all levels of government of 40 or 50 percent of every dollar of income in this country, we are then making a deliberate choice that we will decide how a very large part of a man's or woman's paycheck is distributed. We are not allowing those people to make that decision. I do think at some point that creates a real problem.

Second, we have had an enterprise system in this country. To the extent that we, the Government, decide to control savings and use savings, there is less savings for the private sector to use for new machinery and equipment for plants and the rest.

Chairman HUMPHREY. We will come back.

Mr. LYNN. So I am not saying I see our country not having further benefits for people. Just the contrary. I look to a healthy economy in the future if we all work together, an economy with a growing GNP. Then we will have additional funds to help people that can't help themselves. We should, however, expand benefits in a

rational manner. We should work together so that we preserve the system we have, keep our taxes down, and still provide benefits to people that don't have them as yet.

Chairman HUMPHREY. I just want to leave this thought. When you speak of government, though, generally the people assume when you say government you are talking Federal Government because you are a Federal official. Let the record be clear that Federal expenditures have stayed rather constant in terms of percentage of GNP for the last 10, 15 years.

Mr. LYNN. They have only gone up slightly.

Chairman HUMPHREY. Very slightly.

Mr. LYNN. The greatest growth has been in States and local government expenditures. There is no doubt about it.

Chairman HUMPHREY. Actually from 1954 the percentage of GNP of Federal expenditures was 19.6. In 1974, 19.9. Three-tenths of 1 percent growth in Federal expenditures over a 20-year period—fiscal year 1954 through fiscal year 1974. I just don't want people out in Minnesota and Illinois to speak of them, to hear on the radio or in the press that Federal expenditures have just gone zip! Out of sight in terms of our gross national product because expenditures of an individual relate to his income, and expenditures of the Federal Government relate to GNP.

Senator Javits.

Senator JAVITS. Mr. Lynn, I think all of us welcome you. This is the first time I have had the opportunity to question you in your new role as Budget Director and welcome you and Mr. O'Neill and Mr. McOmber to the economic think committee of the Congress.

I am deeply interested in what you have to say on the positive side. Now, you have told us all about our strains, our expenditures, and how we are outstripping ourselves.

What is the President doing in your judgment, or should he be doing, about the genius of America, which has a potential for growth unknown in the world, which today could be breaking out into a field of enormous benefit to our country in terms of Project Independence and all the Buck Rogers energy concepts that the project contains? What are you fellows doing about the worst figure, which you haven't mentioned, and that is that the rate of productivity has diminished in this country for the first time in 40 years? What do you think the investment tax credit will produce? Is that enough? In short, has there been cranked into all of your equations the American capacity for creating wealth or have you just taken the situation as being static, standing as it is, and given us no wealth production factor which we can stimulate, both by law and by the projects which we undertake?

Mr. LYNN. I could spend a month, Senator, talking about the positive side. This is a strong country. We have problems at the time with respect to recession, but fundamentally it is a strong country.

As you indicated in your remarks, that strength has come about in large measure from productivity increases—which is a fancy way of saying that as the men and women of America work at machines or other labors, they produce more in goods and other services in 1

year than they did the year before. Higher productivity has resulted in turn from a growing investment in equipment for every person who works in this country. The basic plow didn't cost very much money, but it didn't turn over much soil either. The combine costs a lot of money, but it produces one heck of a lot of output of agricultural commodities.

The same thing is true when we are talking about the production of automobiles or the other things we buy.

This investment comes about through our enterprise system. It requires having the position in a market to borrow money and taking risks to make those investments in capital goods and machinery and equipment.

One of the things that the President is trying to do is to arrive at a proper balance between a stimulus to the economy now—which we all know that we need to help pull us out of the recession—and avoiding excess government borrowing in the capital markets of this country to fund the deficit. He wants to avoid borrowing so extensively that we squeeze out the private sector, and prevent it from making the loans and getting the equity capital that it needs to be able to continue the move toward greater productivity by further investment in plant and equipment.

Senator JAVITS. So the positive factor in your judgment is what we can add to American stock of real equipment, machinery, et cetera.

Mr. LYNN. I think that that is something that has been fundamental to the increased standard of living that Americans have enjoyed. What really worries me is that in our efforts to pull us out of the recession that we could do irreparable damage to that flow of capital for investment in the private sector.

You mentioned energy. The President's program I believe will strongly stimulate research, development, and demonstration in the energy area. I read some of the Buck Rogers stuff that is in the budget, and have high hopes for it. When I talk to my scientific friends they say if we play our cards right, and have enough money in the research and development—the right amount meaning the amount we can spend usefully, not just throwing dollars at the problem—then this country can some time after the year 2000 be energy self-sufficient in a way we never dreamed of, with clean forms of fuel that have no real environmental problems, and that are easy to work with.

Now, our immediate problems have to be addressed in a different way. The President's energy program does that through the use of market forces, through trying deliberately to move our use of fuels away from those that tend to present the most difficult problems, like reliance on foreign sources. Hence the move from oil over into areas like coal. That is why he has this program in three phases—a short-term, intermediate-term, and long-term program on energy. I agree with you that where we have areas in which we see that Federal involvement will help foster private initiative, we should act. But what worries me is that I have seen some indications in some quarters—certainly not from you, Senator—that reflect an attitude that the private sector can't be relied on to do it, so let's have the Federal Government do it.

I believe that competition has been a very important ingredient in improved productivity and higher standards of living of America. We don't have competition when the Federal Government does everything.

Senator JAVITS. I gather you would crank into the question of increased productivity the morale of the worker.

Mr. LYNN. Absolutely.

Senator JAVITS. Now, will you tell me why, and I am sure you don't know but I think you ought to look into it, why, in view of the fact that this country is at war, at war on the danger of depression, not just recession, nothing has yet been done to gear up the American industrial machine on the morale side? And the most single example and something I have been pounding for years is the fact that we have failed to re-create the labor machine. We need public counsels to stimulate productivity, to deal with absenteeism, to deal with alcoholism and withdrawing addiction in plants and productive enterprises, and there is a great deal of it, as we did in World War II. Why the bureaucratic resistance to the idea of marshaling the American worker as if we were at war? We had 5,000 of those in World War II and they worked well.

Now, what is the problem down there that keeps that subject from even being considered and that gives us a puny Productivity Commission which is a joke, with $1.5 million or $2 million, when you are talking about a productive machine of $1,350 billion? Will you find out about that if you don't know now?

Mr. LYNN. I certainly will, Senator. I know I have talked to some people in the private sector who have been trying very hard to deal with those questions. The question comes up as to much the Federal Government should be involved. Certainly we will look into it.

The agenda of the Productivity Commission is one that is growing. They have set some priorities as to what they get into. But I agree with you—I have heard Mr. Burns speak on this subject—the problem of absenteeism has been a growing problem in the country. The question is, How much the Federal Government involvement could mean to overcoming it? Just looking at the profit and loss statement may provide a company with incentive for working as effectively as possible with unions and workers to try to solve it.

Senator JAVITS. Now, just one other question on that same line. Has any consideration been given to the Treasury for a renewed drive for public money, not the kind you would get in the marekts in Wall Street or State Street, Chicago, but the money that is held and not circulated effectively, where the velocity is absent, as we would do in war through some form of savings bond which could be indexed, for example, thereby compensating for a lower interest rate? In other words, has there been any inventive genius applied or the idea that you are going to play everything through the middle of the line?

Mr. LYNN. I would hope we wouldn't be like that football player that has one play and does it every time, a la Woody Hayes' "3 yards and a cloud of dust."

Chairman HUMPHREY. You can tell the witness is from Ohio.

Mr. LYNN. That is right, Mr. Chairman, and proud of it. It is a pretty good football team, too, year in and year out.

I have not had a specific discussion on this. I have heard general discussion at the Treasury Department on that but I will pass on your suggestion to them, Senator.

Senator JAVITS. Mr. Chairman, finally, I just had one specific request. I would like to ask unanimous consent that whatever replies the Budget Director gives us may be contained in this record.

We have here an $8 billion figure for defense, an increase in the defense expenditure which I know you try to justify. I am very skeptical about it and I believe that we could delay that 1 year without any undue hardship and that is an unnecessary bulge in the budget. But be that as it may—we will fight about that at the appropriate time—is there anything cranked in here for Cambodia and Vietnam?

Chairman HUMPHREY. Yes, there is.

Mr. O'NEILL. Yes, there is.

Senator JAVITS. How much is in here? How much is in that $8 billion for Vietnam and Cambodia?

Mr. LYNN. One moment, Senator.

Mr. O'NEILL. We will have to supply it for the record, Senator, but it should be considered to be in the total amount for the Defense Department, not the $8 billion increase. It was not budgeted as a marginal expenditure but is part of the President's overall program. We will supply the specific number for the record for you.

Senator JAVITS. In other words, you don't have the number today?

Mr. O'NEILL. I don't have it immediately available but we will work it up for you. Perhaps we can give it to you before we close the record today.

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

ASSISTANCE TO SOUTH VIETNAM AND CAMBODIA IN THE DEFENSE BUDGET

[In millions of dollars]

	Budget authority			Outlays		
	1975	1976	Change	1975	1976	Change
DOD military and military assistance [1]	90,758	106,340	+15,582	84,800	92,800	+8,000
South Vietnam	1,000	+ 1,293	+293	[2] 515	[2] 975	+460
Cambodia	[3] 497	[3] 425	−72	[4]	[4]	

[1] Reference: 1976 budget, p. 338.
[2] Excludes outlays from 1974 and prior year obligations which are not identifiable because military assistance to South Vietnam was not appropriated separately.
[3] Program amount. Precise allocation of budget authority not available by country.
[4] Not identifiable by country.

Senator JAVITS. Senator Humphrey just tells me you are budgeting $800 million for total foreign assistance over the requested figure of last year.

Mr. LYNN. I think it is about an $800 million increase for 1976 over the current estimate for 1975.

Senator JAVITS. So 10 percent of this $8 billion is for an increase, a bulge in foreign aid, is that right?

Chairman HUMPHREY. No. That is separate.

Senator JAVITS. You say $8 billion to maintain preparedness for defense and military assistance. That is why I am asking the question.

Mr. LYNN. When I answered your question "yes," earlier Senator, I thought your question was do we have additional requests for expenditures beyond the budget.

Senator JAVITS. See, in addition to the ——

Mr. LYNN. And you are referring to a different question. If so, I had better have the question again so I can answer it.

Senator JAVITS. I wanted that question answered which you have given me and now I would like to know what part of either the $800 million or the $8 billion is aid to Vietnam and Cambodia?

Mr. LYNN. We will get that for you, Senator.

Senator JAVITS. Break that figure out.

Mr. LYNN. Of the $800 million, if I am not mistaken, it is $300 million in the supplemental for Vietnam.

Chairman HUMPHREY. No, no, you are way off. May I help just a minute. Your budget requests for foreign assistance, exclusive of military aid to Vietnam, is $800 million for last year in authorizations.

Mr. LYNN. It is correct that in the budget, the recommended budget, authority for total foreign aid, including military assistance, is up by about $800 million.

Chairman HUMPHREY. And your budget requests for defense including military assistance to Vietnam is $8 billion more.

Mr. LYNN. That is true. Here you are speaking of outlays not budget authority. And note that both figures include military assistance.

Senator JAVITS. How much of that is for Vietnam, of the $8 billion.

Mr. LYNN. Well, we are requesting budget authority of $1.3 billion for fiscal year 1976, as opposed to a billion dollars even in 1975. That is for Vietnam. I will give you a table that shows all these figures.

Senator JAVITS. That is for Vietnam. Okay. Thank you very much, Mr. Chairman.

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

ASSISTANCE TO SOUTH VIETNAM AND CAMBODIA COMPARED TO TOTAL FOREIGN AID[1]

[In millions of dollars]

	Budget authority			Outlays		
	1975	1976	Change	1975	1976	Change
Foreign assistance[2]	6,077	6,864	+787	6,024	6,880	+856
South Vietnam	1,514	2,095	+581			
Military	1,000	1,293	+293	[3] 515	975	+460
Economic	[4] 460	[4] 725	+265	(5)	(5)	
Food	[4] 54	[4] 77	+23	54	77	+23
Cambodia	686	708	+22			
Military	[4] 497	[4] 425	−72	(5)	(5)	
Economic	[4] 100	[4] 156	+56	(5)	(5)	
Food	[4] 89	[4] 127	+38	89	127	+38

[1] Reference: 1976 budget, page 83, includes military assistance which is also counted in defense.

[2] 1975 Budget amendments submitted since the 1976 budget was printed have increased 1975 budget authority for foreign aid to $6,306 million and outlays to $6,281 million.

[3] Excludes outlays from 1974 and prior year obligations which are not identifiable because military assistance to South Vietnam was not appropriated separately.

[4] Program amount. Precise allocation of budget authority not available by country.

[5] Not identifiable by country.

Chairman HUMPHREY. Congressman Hamilton.

Representative HAMILTON. Mr. Lynn, when the President gave his state of the Union address, the budget deficit was estimated to be $47 billion. That was subsequently raised to about $51.9 billion in the budget message. This morning you tell us the deficit is $53.7 million. Now, that is an increase of about $6.7 million since January 15, about 6 weeks ago.

I certainly would not want to criticize you for revising your estimate. Indeed I commend you for it, but you throw a lot of projections around to us and to the American public and if you are going to revise that deficit statement by $6 billion every 6 weeks, we will end up with a deficit even much larger than you have given us today.

Mr. LYNN. Well, Mr. Congressman, I would hope we won't have to revise it too much because of certain factors. Let me explain if I might. This budget deficit assumes that on the remaining deferrals and recessions, and on the proposed legislative changes that the President has proposed, there will be total concurrence by the Congress.

Representative HAMILTON. I understand that.

Mr. LYNN. If the Congress were to reject all of those, we would have $15 billion in fiscal 1976.

Representative HAMILTON. I might say, Mr. Lynn, it doesn't increase my confidence in the ability of your office to make projections if you are going to change the budget deficit a $1 billion every week.

Mr. LYNN. Well, part of it reflects the congressional rejection of the President's proposal for a change in food stamps. The Congress rejected that proposal and we thought it was only honest bookkeeping to show that fact. There is additional money for that.

Representative HAMILTON. How much of the $7 billion is related to the food stamp action?

Mr. LYNN. An addition of $650 million over what we published in the budget. Now, at the time the President gave his state of the Union address, we were still dealing with estimates. When the final figures were worked out, the deficit came out to $51.9–52 billion.

Mr. O'Neill, you helped prepare that budget, do you want to add anything to it?

Mr. O'NEILL. Right. As I recall, the date of the President's state of the Union address was January 15 and the budget came to you on February 3. We broke our backs to make sure that the data we printed in the President's budget was up to date. Indeed the number did change from that earliest statement.

Representative HAMILTON. I am not criticizing you for changing the deficit figure. It is a shifting target all the time. It is difficult for us to keep up with it.

Mr. LYNN. We hope we will be able to hold the line at the number you have, but that depends very much on how the Congress responds to the President's request.

Representative HAMILTON. The major portion of the revision is not due to acts by the Congress at this point? Only the food stamp projection is changed?

Mr. LYNN. The change from the $47 billion to the $51.9 billion was the result of taking final figures. During those last weeks before the

budget appeared there were changes and there were increases. The major portion of change from the $51.9 billion that was in the budget stems from two items. One billion dollars comes from the President's release of highway funds. The President, in talking with the Governors, found that by letting some contracts now, people would be put to work within a very short period of time. The other main component of the increase is the rejection of the President's food stamp proposal.

Representative HAMILTON. What proportion of it relates to a more pessimistic assessment of the economy than you originally projected?

Mr. LYNN. Are we talking now about the change from the state of the Union message to the published budget, or the changes since the budget was published?

Representative HAMILTON. I am talking about the change from the $47 billion to the figure you give us today, $53.7 billion. What proportion of that relates to a more pessimistic view of the economy and therefore decreases in receipts?

Mr. LYNN. Let me ask Mr. McOmber to answer that. I wasn't involved at that point in the budget preparation.

Mr. McOMBER. Mr. Hamilton, it is correct to say that the difference between the figure mentioned in the state of the Union message and the one that appeared in the printed budget basically came about because of an up-to-date assessment of the economy just before the budget was put to bed. It was largely, if not entirely, due to the cause you have named.

Representative HAMILTON. Now, as I understand it, your latest revision does not change the receipt estimate at all.

Mr. McOMBER. That is correct.

Representative HAMILTON. Now, there is a good possibility that the unemployment is going to go higher than you have projected, even as late as last month. What impact is that going to have?

Mr. O'NEILL. It will lower revenues to the extent unemployment exceeds the estimate we used. In addition, outlays will be higher as a result of automatic stabilizers, especially the unemployment insurance accounts.

Representative HAMILTON. Given what you know about the economy now, the eunemployment rate now, and prospects of recovery or lack thereof in the economy, woulld you say this $53.7 billion dollars is too low an estimate of the deficit?

Mr. O'NEILL. I would say from my own point of view——

Representative HAMILTON. Looking at it from the receipts side.

Mr. O'NEILL. The most serious threat to the deficit estimate which has been put forward today is the possibility that Congress will disagree with the President and will fail to take actions to effect most of the $17 billion of reductions he proposed.

Mr. LYNN. Let me deal more directly with your question. I testified with Dr. Greenspan about a week ago before the House Appropriations Committee. After giving the proper caution with respect to forecasts generally, he said, I believe, that on the basis of the figures that we have—at least thus far—he saw no need to make changes. We will, of course, watch the economic data, week by week, month by month, and make revisions when and if they seem appropriate. Not only will we make revisions in figures, but we will also

be flexible in our pragmatic attack on the situation, either with more or less, as needed.

Representative HAMILTON. Can you give me some kind of a formula for estimating the loss in receipts to the unemployment. If you have a percentage increase in the unemployment, what kind of a decrease do you have in revenues? Is there a formula of some kind that operates there?

Mr. LYNN. I really do not know whether there is, Mr. Hamilton. When I hear the economists talk, it has seemed to me that they base receipts estimates on a broader variety of indicators than just the unemployment rate.

Representative HAMILTON. There are some people who are writing now that a tax cut, of and by itself, just will not be sufficient to get us back to full employment. We are going to have a massive tax cut which will stimulate the economy, and I am certainly not speaking against the tax cut now, but these persons are looking at the more fundamental problems, I think perhaps some of the problems Senator Javits mentioned.

How do you respond to that? In other words, a tax cut is going to be a little bit of stimulus, it is going to help, but it is really not dealing with the fundamental problems in the American economy. How does that strike you? What kind of comments do you have about that?

Mr. LYNN. Well, I ask you, if I might, sir, to be a little bit more specific. I will say this, I have seen no dispute that a tax stimulus of some amount is desirable. It is. Let us get that tax cut to the American people as soon as we can. I trust and I know that the view of the Congress will be to move as expeditiously as possible. All we have now is a discussion of tax stimulus but we don't have a law that has become operative.

Representative HAMILTON. I understand, Mr. Lynn, but it seems to me the focus of the debate is so much now on should it be $20 billion or $30 billion stimulus, and so on. For the moment, I want to put that question aside. I recognize the need for stimulus. You obviously do in your prepared statement. I am suggesting that maybe the problem is more fundamental than that. Maybe we need some other things. Is anybody thinking about that?

Mr. LYNN. Of course, the President in his proposal has talked about the need to get out of—to get rid of some of the built-in redtape and counterproductive features that we have built into our laws or into our regulations. I think there is an emerging consensus both in the Congress and elsewhere that we have to take a hard look at our regulatory activity in the transportation industry—and others. This regulation may be holding back productivity in this country, and substantially suppressing competition. That competition, if allowed to flourish a little bit more, could mean a heck of a lot better break for the consumer in the marketplace. It would free up funds and profits to make more investments.

Representative HAMILTON. You would include in that, then, a massive expansion of funds for investment in certain directions, presumably?

Mr. LYNN. Well, when people say to me in certain directions, their next point usually is that we will have somebody in the Federal

Government decide how credit shall be allocated in the United States—how much for housing, how much for roofing materials, how much for education, how much for petrochemical plants, how much for a refinery, how much for public utilities, and so on. I am saying to you that I really believe that once we get into that kind a morass we are never going to get out of it.

Representative HAMILTON. I think my time is up. Thank you, Mr. Chairman. I do have some other questions.

Chairman HUMPHREY. Yes. We'll come back for a second round here.

Mr. Lynn, let me tell you what I personally think about the budget calculations and deficit. I think that this deficit is grossly underestimated by the administration and I regret to say purposely because the administration knew, No. 1, that nobody in this Congress was going to limit social security benefits to 5 percent. That would be a betrayal of contract, law, and decency.

No. 2, it was quite obvious that the Congress was overwhelmingly going to reject an increase in the food stamp price. It was clearly known. Nevertheless, this was phased into the budget and therefore the budget had a deficit in round numbers when it came to us of $52 billion, knowing full well that no member of Congress could go home and face his constituents and violate the law that we had passed about a cost-of-living increase for the social security recipients. Not only that, it would have been immoral, cheap, unforgivable, unacceptable, and irresponsible. So that is out. There is no more chance of Congress limiting social security to 5 percent then there is for me to walk out of this room and be the next astronaut to the moon. I think that is just playing games.

Now, more importantly, playing games with budget deficits.

More importantly, I look back here and find your budget estimates were based on an unemployment rate of 7.2 percent. Isn't that a fact? Wasn't that the unemployment rate in January?

Mr. LYNN. No, sir.

Chairman HUMPHREY. What are they based on?

Mr. LYNN. Mr. Chairman, if you look at the table on page 41 of the Budget of the United States you will see the assumption of an unemployment rate of 8.1 percent average in 1975 and 7.9 percent in 1976. The only comment I have heard about those figures from my friends is shock at the size of those figures.

Chairman HUMPHREY. All right. But first of all, the 8.1 percent is not a realistic figure either. Your own people today, Mr. Greenspan and others, estimate that that unemployment rate will be above 9 percent.

Mr. LYNN. I have not heard Mr. Greenspan say that at all.

Chairman HUMPHREY. But always Mr. Greenspan said it would be above—between 8.5 and 9 percent.

Mr. LYNN. I have heard Mr. Greenspan talk about the uncertainty of forecasting what a rate will be, and that he had made a prediction that the peak could be in the vicinity of 8.5 percent. It might be higher.

Chairman HUMPHREY. That is right.

Mr. LYNN. I have never heard him mention another specific figure. The 8.5 percent had been his testimony on the high point. His point

also was that he looked to the greater significance of what the trend line of that unemployment rate would be when we get further on into the year. I heard him express the hope and the belief that as we move into the second half or toward the end of the year, unemployment will be trending downward.

Chairman HUMPHREY. All right. But now every private estimate without regard to whether they are for the Congress, regardless of their so-called political preferences which they have never been asked to tell us, that unemployment rate is going to be above 9 percent, considerably. And all the facts so indicate. Not only the full-time unemployment rate; that is the unemployment rate of full-time people who have no job at all, but the part-time unemployment rate is very significant; 3.8 million workers part time. And that figure is projected to increase.

Now, my point is that as the unemployment rate goes up, the expenditures for unemployment compensation go up, which has not been factored into your budget.

Secondly, that the revenues go down, and I point out something else. You have not calculated in this budget the drop in farm income.

Mr. LYNN. I am sorry.

Chairman HUMPHREY. You have not calculated into this budget the drop in farm income which is precipitous. You know what the prices are on the farms today as compared to when you were preparing this budget.

Mr. LYNN. I think there has been a downward trend in farm prices.

Chairman HUMPHREY. You think? There has not only been. You think there is, and Mr. Greenspan sat where you are sitting and said one of the bits of good news we have had is that farm prices are dropping.

Mr. LYNN. I suppose, sir, from the farmers' standpoint the prices that we had some time ago—which were alltime records—were the best in the world. But I say that to the American consumer they were too high.

Chairman HUMPHREY. Mr. Lynn, let me say to you that that is unacceptable. Let me tell you that Mr. Farmer today is getting a very raw deal and when I see that between 80 and 90 percent of the cost of the increase in food prices is nonagricultural, I don't think we ought to be pinning the monkey on the farmer's back.

Today corn is $2.40 a bushel. Soybeans are below $5. Beef products are so low that the farmer is losing $150 to $200 on every carcass. Dairy prices are depressing and depression prices.

Now, I am simply saying when you calculate a budget you have got to figure this in your estimates and revise those estimates as you go along about what the real facts of life are.

The reason I am saying this is I know 6 months for now somebody is going to say the reason the budget is worse than it is now is because Congress went bananas here and spent money here and there. The real truth on all of the budget problems we have had on deficits is that the estimates on revenue by the administration's projectionists have always been higher than the revenue that came in and you examine that back from 1969 on up. Your revenue estimates with one exception, I believe, have been substantially higher than the revenues that came in. I am of the opinion that we have got another big game going on here where the revenue estimates are

higher in this budget than the revenues are going to be for the following reasons.

No. 1: Your unemployment is up and is going to be higher, and all the estimates that we get indicate so.

No. 2: Farm income is considerably lower.

No. 3: Production is down, industrial production is down. So that you are going to have an automatic increase in the budget deficit, and I just want the record to be clear because I know that it is going to be said that the reason that this budget deficit is larger is because the Congress of the United States has gone wild.

Now, we will take our responsibility where we have to make choices.

The next thing is that there are rescissions and deferrals in this budget. On the one hand the administration wants a stimulus in the economy. You have projected at least up to December 31 some public service jobs. But no projection after December 31, based on the fact that you want to analyze how the plan was working. That is the language in the budget.

Mr. LYNN. For new contracts, right.

Chairman HUMPHREY. Yes. Now, State and local government officials tell us that they want this program. They tell us they have got to have this program after December 31. So we have to figure in something extra for public service jobs. I think that has to go into the budget which will aid, of course, to the deficit. There is no doubt about that.

But my most serious concern is, what I said in my opening statement, the stimulus effect of the budget. I think that this budget message, using the words stimulative and stimulus, has facts and figures that belay the validity of the word. There is very little stimulus in this budget and in fact I am going to ask that you present to this committee a complete analysis of the stimulus in the President's program comparing it to a baseline budget which assumes no change in taxing or spending policies and give us your analysis of the economic impact of the extra untaxed profits which would go to the energy producers and give us the timing of the program, the quarters in which there is stimulus and the quarters in which there is none.

Now, our analysis, and I went over this with Mr. Greenspan, is that the only stimulus in your program is in the third quarter of calendar year 1975. You have a stimulative impact of $18,900 million in your tax program, composite, and you have a restrictive impact, I think your new figures this morning are $15,300 million in rescissions, deferrals, and reductions. A net stimulus of $3,600 million on a $1,500 billion economy.

I submit that that amount of stimulus of $3,600 million is so negligible that it will not even cause a figure that would indicate any amount in the economy to scarcely move at all.

Now, would you like to comment to me and to this committee on what you see in this budget which shows—you have several pages there, starting at page 55 through page 58 of the Budget of the U.S. Government—what you feel that the stimulative effect will be contrary to what I said?

Mr. LYNN. I would like if I could, first, Mr. Chairman, go back to some of your comments with respect to playing games. Do you

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believe that the President of the United States would bite the political bullet of suggesting only a 5-percent increase in social security if he were playing games? Do you think he wants to take the kind of comments that I am hearing today for something that has no chance in the Congress?

Chairman HUMPHREY. Well, you know, it doesn't.

Mr. LYNN. Let us give him a little credit. If he thought there were no chance, he would not have done it. He is as aware as you are of the millions of people that are on social security today, so I don't understand the logic of that statement. If he thought it was hopeless he would not have proposed it at all. He believed it.

Chairman HUMPHREY. He might understand the logic of it but his logic is cockeyed, absolutely wrong.

Mr. LYNN. You are entitled to your views and I would hope the American people would understand that if we look at the relative burden of the present period on various sectors of the American people, we would see his policy is fair. Page 15 of the Budget of the U.S. Government points out that even with the limitation of a 5-percent increase this year, the increase in the social security benefits of the individual recipient will total 77 percent from 1970 to 1976 while the increases in the cost of living are 51 percent in that period. So there has been a substantial overall net gain during the same period.

Chairman HUMPHREY. You break that down into what a social security recipient gets in his monthly check and then start to spell that out to the senior citizens of my State, will you? Five percent increase in social security, 14 percent increase in their cost of living. Absolutely unacceptable, unfair, unworkable, immoral, and it will not be done.

Mr. LYNN. Well, all I can do, sir, is show you our calculations. If you wish to disagree with those calculations, we would be happy to consider your proposed changes in what we have reported.

The other thing I would report is that if we look at real disposable personal per capita income from fiscal 1970 to 1976, the increase is only 7.5 percent during that 6-year period. The increase in average real spendable weekly earnings is only 2 percent. Even with the ceiling of a 5-percent increase on social security benefits, social security recipients are ahead of the rest of the population.

Chairman HUMPHREY. Oh, Mr. Lynn, please. Really, I don't want to argue with you. All I can say is my goodness, please go out with my Congressman to see his senior citizens. Please go and see what they are going through. I want to tell you I don't—I really don't want to argue with you because to me this is a pitiful, disgraceful argument we are having. These people are the major victims of this inflation.

Mr. LYNN. If that deficit becomes too big, inflation will be worse, and the elderly will be hurt more.

Chairman HUMPHREY. Wait a minute. You always are saying with your $50 billion deficit the inflation rates goes down next year. You can't have it both ways.

Mr. LYNN. What will happen a year or two years from now as Mr. Greenspan said when he testified——

Chairman HUMPHREY. That is why we put a cost-of-living escalator clause in social security. It is fair.

Mr. LYNN. We don't want to be chasing our tails for the next 2 years. If we get the deficit too high, then we will stimulate another round of inflation 6 months, a year, or a year and a half from now, resulting not only in inflation but possibly also another recession. But we will take care of the older people by trying to increase payments again. I am saying to you that what the older people in this country need, what all the people in this country need, is for us to take rational steps to pull us out of the recession. In our desire to see who cares the most, we must not put so much stimulus into this thing that we just repeat the cycle of inflation and recession another year or so from now. We all care about the elderly. What scares me to death is a combination of one committee and then another adding something and the total being much too much. One says, "After all, it is jobs, isn't it? Let us add more public service jobs." Another says, "Let us add a public works program." Others would add a little more here, and add to the tax stimulus too.

Earlier we admitted that we raised the amount of deficit from $47 billion to $51.9 billion between the time the President delivered the state of the Union address and the time the budget came out in order to recognize a changing economic scene. If the economic scene changes as you are discussing, we will change our budget again. To accuse us of bad faith in this regard I think is a terrible mistake. If we were in bad faith, we would have stuck with the President's earlier figure and not changed it to $51.9 billion. But if you turn out to be correct and the deficit is understated, then I say to you that is even more deficit that has to be financed in the capitol markets. Secretary of the Treasury Simon has testified that, even with the budget as we have proposed it; that is, even with the Congress going along with the billions of dollars of reductions the President proposed, he will be asked to go to the markets of this country for more money than has ever been raised in a single year by both the public and private sectors combined. As you increase the deficit by all kinds of specific categorical methods, to show, that we care, I only ask that you take a look at what the financial markets of this country can stand.

Chairman HUMPHREY. Mr. Lynn, that is the finest testimony I have ever heard to the failure of the economic management of this economy by the administration. You have fully fortified all the thoughts that I have had.

Now, this budget deficit is the result of the economic policies which have been pursued or the lack of economic policies that have been pursued plus the world energy crisis but largely the economic policies of tight money, of poor financial management, of off and on phrases and freezes and humanity and that is what we have been into.

Now, all we are arguing about the deficit is whether or not in that deficit you have cranked in the kind of escalators which are happening to us; namely, the increase in unemployment, the drop in industrial production, the drop in farm income, and I tell you that I didn't see that properly projected.

Now, we hope you will come back with new estimates, not that we will like the larger budget deficit, and I say again that there was no

reason for the OMB or anybody else to advise the President to assume that the Congress of the United States is going to keep social security benefits at 5 percent, and I am here to tell you that all the figures that you can give me of the generalities of the 26 percent in energy increases or whatever it is a lot of hogwash when you get on out to see the people who are paying the rent and buying the food, who are having to take care of themselves and see their medicare costs go up. Under this administration's proposals they don't have enough to live on, Mr. Secretary of the Treasury and Mr. Director fo OMB, and I am not going to let you come here and give us a lot of figures and delay what is happening out there in the countryside and finally I give you the fact that the stimulus in this budget is negligible and I want you to demonstrate what the stimulus in this budget really is. If we give you the benefit of all the doubts in the budget, all of them, it runs up to about $8 billion and $8 billion is like a drop of sweat on the hot desert insofar as stimulating an economy of $1,500 billion. Now, if you can show me more than $8 billion worth of stimulus in this budget you have won the argument. But you go ahead and show it.

Mr. LYNN. First of all, let us pledge to you, as we must to the President of the United States, that as figures evolve, bad figures or good, it would be our intention to keep the Congress up to date with respect to those changes. Very frankly, in my judgment it is essential we keep you up to date because you must have a running box score, just as the President must, on increasing Federal deficits so that you can make judgments as to how much we can afford to finance in the marketplaces of this country.

I worked at HUD, as you know, for 2 years, Mr. Chairman, and just as I was leaving the place—I do not know whether that is symbolic or not—the money started coming back into the savings and loans, which means, I would hope, that we would see, over the months ahead, some recovery in housing and a good trend upward.

Chairman HUMPHREY. Only if you get the interest rate down.

Mr. LYNN. Interest rates have been going down and we want to to keep them going that way, if we can, to what ever extent is possible. The one thing that would kill the housing recovery would be if Mr. Simon, Secretary of the Treasury, has to go to the market for too much money.

Now, I will agree with you, first of all, that no one knows precisely how much is too much. I have heard economists talking about this. Some people say you have got a soft sector on the private side, so there is plenty of room for Federal borrowing, but I have heard other people say that that room finally becomes fully occupied.

Second, unlike past recessions, industry, because of inflation, has to borrow increasing amounts of money just to stay even. To finance what they wanted to do, or had already scheduled, or even less than they had scheduled, they have to borrow more.

Again I say, we want to keep you up to date. We want to do that very much, and please accept our pledge that we want to keep you up to date, as well as the President.

Chairman HUMPHREY. Thank you.

Mr. LYNN. As to the amount of stimulus, I had one course in statistics in college; perhaps I should have had more. There are all

different ways of presenting figures. There is a thing called the "current services budget", for example, in which all you do is trend out into the indefinite future a continuation of existing programs.

Well, very frankly, it is hard to say where that gets you. If you look at any budget of the United States for the past 20 or more years, it is never a current services budget. Every President, Democratic or Republican, has known you cannot put together a budget on that basis. But if you went on a current services basis, I suppose you would get a different amount of stimulus than we present in our tax table. We will be happy to work with your staff to see whether or not our figures agree with yours. Then you can package it on a current service basis or whaever different concept you like and can argue your position, and we will argue ours.

To repeat my statement, the NIA budget is the best measure. Our presentation of it is set forth on page 18 of the "Special Analyses of the Budget." But I have a suspicion our problem is not with the figures and how they add, but on the concept of what constitutes a stimulus—whether it is the total amount of the deficit, which does take into account some subtractions from a current service projection, or whether it is the difference between a current services budget and the President's proposal. He does feel that there are things that should be cut back, but he is also proposing $16 billion worth of tax cuts. He is proposing or does have public service jobs through the period immediately ahead; and there is a large amount of money for unemployment compensation benefits, not only to extend the period of time of people already covered but also to add people to the coverage that were not covered before.

There is, we think, a substantial amount of stimulus. But I think that a lot depends on what you choose to include in or out.

On the public service jobs——

Chairman HUMPHREY. We will put you together with our experts up here. We have got to put some fight in them. I would like to bet you a good dinner that I am closer to it than what you estimated in your——

Mr. LYNN. You do not have to bet me, Mr. Chairman. I would enjoy that.

Chairman HUMPHREY. Bring along that budget deficit. Go ahead, Senator Javits.

Senator JAVITS. Mr. Lynn, I think even though we all admire the give and take of your defense of the President, and Senator Humphrey's spirit, which we love here, and which the country loves.

Mr. LYNN. I do, too, Senator Javits.

Senator JAVITS. It is a fact that these were completely unrealistic assumptions that he has mentioned and there just is not any use in drawing a budget on that kind of assumption. It just will not happen.

I would just like to join him by saying I am confident, just as he is, we will not put the cap on social security, and we will not reduce the food stamp operations. I think it is fatuous to think we will. So I think you ought to recalculate your situation.

Now, the thing, that is a very fundamental argument in this country, which I would like to ask you about, is what debt we can stand. Let us, for the moment, lay aside the question of marketing

securities. I believe the Federal authorities appraise that—personally, I think we are underestimating the absorptive capacity of America for investment, if America is convinced we are on the road up and the two hang together. That is why you are cranking in—still cranking into this day some factor of inflation in your interest rates.

But, is it not a fact that the debt which we owe, that this is a basic question between the liberal and more conservative elements in the country? Would you agree with that, how much we owe?

Mr. LYNN. You mean on the amount of the Federal debt?

Senator JAVITS. As regular Federal debts.

Mr. LYNN. I must admit I look at the tens of billions for interest, and it strikes me as a large amount of money, but I will leave to my friends at the Treasury and the others to say how much is too much. As a percentage of the GNP, the debt has been declining greatly over the long run.

Senator JAVITS. Well, that is just——

Mr. LYNN. But I do not want to pass over, Senator, the issue of what the markets can stand in the next year or two, and when you are finished I would like to go back to that.

Senator JAVITS. Okay. But that is my fundamental point. If you were at war today, would you have any compunction as a citizen—let alone a budget director—to borrow $100 billion a year, no matter how many years it took? We did it in World War II. Would not do it today?

Mr. LYNN. Yes. I want to win the war.

Senator JAVITS. That is right.

Mr. LYNN. And so do you.

Senator JAVITS. Right.

Mr. LYNN. And that is where the problem comes in. Let me paint one picture for you.

Senator JAVITS. First, let us get the facts out.

Mr. LYNN. Okay.

Senator JAVITS. The fact is that in 1956, roughly 20 years ago, the debt of the country was $224 billion in the public sector—in the aggregate of $270 billion, and that the percentage of the gross national product of that figure was roughly 74 percent. When you come down to 1974, you have now cut it down—if you take the aggregate, that is—to $486 billion including what is in the hands of trust funds, et cetera, it is down to 36 per cent of the gross national product, and as to the debt in the hands of the public, it is down to 25.7 percent.

Now, the question of solvency, credit worthiness or noncredit worthiness, is heavily dependent upon those facts, is it not?

Mr. LYNN. I really hesitate to answer it only because I have never looked upon myself as a global economist in this area. I have to say, as a personal view, that I would think there is relevancy of the GNP as to the amount of the debt.

I just have to say that as yet, Senator, I do not know enough about the interrelationships of those two figures to really give you a terribly intelligent expression of views on it.

Senator JAVITS. Well, is it not a very drastic reduction? I mean, you are talking now about one-half, literally one-half, of the impact on our gross national product of the national debt from what it was 20 years ago.

Mr. LYNN. Well, let us return to the earlier question I had—and point that the greatest growth in government in the United States over recent periods has been at the State and local level. I do not know what the total GNP percentage is that is represented by Federal, plus State and local debt, and I would say to you that is relevant. It may not show much of a definite pattern, frankly, but I just do not know.

Mr. O'NEILL. Senator, may I add one more thing?

Chairman HUMPHREY. A little louder, please.

Mr. O'NEILL. It seems to me very important in this area, as in many other areas, that when we talk about what the Federal Government is doing, that we think not just about the Federal Government, or, even the Federal, State, and local governments, but that we try to take into consideration what our country is doing totally. I do not have figures in my head, but there have been some stories recently showing what we, as a society, are doing by way of promising ourselves we are going to pay back debts later. My recollection is that those studies show that there has been a significant increase in the amount of debt that is owed by individuals and government and institutions in our society, over the last several years. There is a real interest in the question of how much we can continue to promise into the future.

I heard a story last night indicating that one of the major credit card companies had bad debts last year of well over $200 million, one single credit company.

Senator JAVITS. But what was their volume? That is what you fellows always throw at us. You throw up your hands and say, "God, we owe $65 billion." So what? No corporation looks at it that way. They want to know what you have got but what they—do not scare us.

Mr. LYNN. I wish people would ask that question when they are talking about increases in profits, too. We will see figures on profits of American companies. They say there were $140 billion of corporate profits in 1974. And my question also is, what does that represent as a return on invested capital in the company? Is it what a savings and loan company pays or not?

Senator JAVITS. Well, with all respect, Mr. Lynn, I agree with that thoroughly, and I think that profits are grossly low for what our country needs to do.

Chairman HUMPHREY. So does the chairman. And I agree with this.

Mr. LYNN. Good.

Senator JAVITS. But you are certainly not going to get them up pursuing negative policies of fear, and that is what Senator Humphrey and I are talking about—negative policies of fear. This country has got to have some muscle and some moxie and some confidence, and you are not going to get it by pulling in the whole economic policy, and what we are trying to do with our questions and our points is to try to get some feeling of expansiveness about it, not to be so scared. You know, the only route to recovery is not to make people go on unemployment, instead of having jobs that pay them twice as much, and yet that is what we are doing.

Mr. LYNN. Senator, if I might respond to that. First of all, we do not think that there is stimulus built into this budget. We

think the stimulus comes not only from the deficits that are there, which the chairman thinks are going to be bigger. We also think specific Presidential actions are stimulative. These include $16 billion of tax cuts, and there are some other things he has done as well. We do agree that stimulus is necessary, and we do want to have the economy pull out of the situation it is now in. But what I am very much afraid is that the following situation might occur: In our desire to pull out of the downturn and to show that we care, we might get many different approaches without any priorities being set and any total being kept. We will have one group pushing for more tax stimulus. We will have another group arguing for more public service jobs. We will have another group in State and local government saying, "Make reparations to us, and pay us more money." We have another group of people that are public works oriented that say, "Put more in." And when all these groups get their programs I fear that we will end up with a budget deficit that, when we go to finance it, result in interest rates going up. Not only that, but as interest rates go up, we will start knocking companies out of the market. They will be unable to borrow at all. These companies will then start faltering and put us in worse shape. The housing recovery will be aborted because interest rates have gone up. Then I fear a congressional response that will say the private system is not working, even though the reason it is not working is that we as a government have cared too much, and have put too much stimulus into the budget. And the next congressional response will be to federalize finances for the housing industry or segments of industry, and to put the blame on industry when the fault is really ours because we have squeezed them out of the debts markets and out of the equity market by the level of our financing.

Now, whether our amount of stimulus is exactly right—I do not know that—and I do not know that any economists would say that. What we are asking is that as we consider the cumulative size of the deficit, we keep this danger firmly in mind. Reasonable minds differ on how much is too much, and I accept that as a fact of life. But I am really worried that we can reach a point at which an excessive deficit will hurt the very people we are trying to help —the workingman, the people at the lower income levels—by deepening the recession or by generating a quick recovery that looks good for 6 or 7 months and then leads to runaway inflation and another recession shortly after.

I know you do not want that to happen, and we surely do not want it to happen either.

Senator JAVITS. Now, Mr. Lynn, let me ask you these two final questions. One, do you have any study based on this market question: that is, what the market can absorb? For example, my attention is called to a statement of an officer of Salomon Bros., which is the very firm that Bill Simon comes out of, himself, estimating that the credit demand on the market will be down 12 percent in calendar 1975 compared to 1973. And I do not know what Jim Needham's view is. Do you have anything on that?

Mr. LYNN. Well, Senator, I would suggest you look at the last summary page of that same Salomon report. Mr. Simon uses that page in his testimony. This testimony says that it will be difficult

to accommodate even the President's budget. It expresses some concern that interest rates might arise as, I understand it, in the year ahead. If we are thinking of increasing that deficit, and we accept the Salomon Bros.' report, they say we run an increasing risk of the problem that I described occurring.

Now, other analyses have been done by the Treasury Department. I would suggest in that connection you ask the Secretary of the Treasury to give you whatever information he can. I have testified with him, and I do know he expresses the same concern that I am expressing here.

Now, we also intend to watch this credit market week by week and month by month. And we will also look at the unemployment situation week by week and month by month, because we have certainly seen some large and unanticipated changes over the last 3 or 4 months. There was hardly anyone at the summit meetings back in October who foresaw the magnitude of the downturn. There have been quite substantial changes from what our models predicted. The President has said to us in OMB—and I know you people want to act this way also—that we have to be flexible as to what we do, depending upon what happens.

I want to be certain that the program we devise will not be so unflexible that if the worse is not realized, and the economy does start reviving, we have not built in so much stimulus that we cannot turn it off. We do not want those poor people that the chairman and you and we want to help to be left with double-digit inflation.

Senator JAVITS. Now, this study, are you using any specific set of findings respecting your analysis of what the market can absorb in added Federal debt?

Mr. LYNN. Senator, my discussion with the Treasury and the Fed, and other places, indicate they do not have any exact way of calculating this. Our financial markets are very complex, and I really believe no one can identify the dividing line with precision, and it moves from moment to moment. So we have to just do it by feel. Both you people and us.

Senator JAVITS. In any case, your answer is no, you are not.

Mr. LYNN. I am not aware of any specific econometric model that tries to tell you much is too much.

Senator JAVITS. The next question I would like to ask, and then that is all because my time is up. What analysis do you have—if any —on the debt questions which Mr. O'Neill referred to? That is, the relevance or the relationship of the gross national products' aggregate debt in the United States, public and private, and to global government debt at all levels, and, of course, we have the analyses of the Federal debt. Do you have anything on that?

Mr. O'NEILL. We can supply that for the record, Senator, or for you directly, if you prefer, the studies that have been done on the subject. We have not done any independent surveys of our own but there may be good ones——

Senator JAVITS. Let us see whatever you are using. I do not care about all the studies but give us whatever you consider to be probably usable in your calculations.

Mr. O'NEILL. Yes, sir.

Mr. LYNN. The Treasury, from which I take most of my guidance here, is not discussing the problem in the context of whether the

Federal debt is too big. Of course, there are long-term concerns in that direction, and I would think we could use some more study in this area. Their concern is for the large net financing in the short term, over a year or a year and a half. I hear this concern also from Alan Greenspan.

Senator JAVITS. Thank you very much.

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

BORROWING, DEBT AND THE GNP

For figures on borrowing and debt—Federal, State and local, and private—the Committee has at its disposal the Salomon Brothers report mentioned in the hearings. Attached are several tables prepared by the Treasury Department that provide information on the subject.

The desirability of viewing these various flows of funds and debt balances together, rather than looking at Federal transactions in isolation, has not been a subject for a significant volume of studies. However, the point is rather simple. Investors—both institutions and individuals—generally can choose among various securities. Hence, excessive borrowing by one type of debtor tends to reduce the availability of funds to all others.

Similarly, the advantage of comparing these flows of funds and debt balances to the GNP also has not been a subject of much writing. However, the need to adopt some such scaling is clear. In a growing economy the net borrowing and total debt outstanding of each type of borrower, like most measures of financial and economic activity, will tend to grow. The financial practice, and financial analysis, of private firms reflects the desirability of scaling according to size by its use of concepts such as the ratio of earnings to assets or of dividends or interest to earnings. For the economy as a whole, the GNP—or related concepts like national income—are frequently used as referents. For particular sectors, it might be instructive to look at debt or borrowing in terms of measures of the sector's size. For example, the ratio of total corporate debt (or borrowing) to total corporate profits or assets might be of interest.

TABLE 6.—NET FUNDS RAISED IN THE CAPITAL MARKETS BY MAJOR SECTOR

[In billions of dollars]

Fiscal year	U.S. Treasury and financing bank	Federal and sponsored agencies	Total Federal sector	State and local	Corporation and foreign [1]	Total securities	Federal sector as a percent of total securities	Government sector as percent of tota securities [2]
1954	3.6	1.7	5.3	5.5	3.4	14.2	37.4	76.0
1955	1.7	-.1	1.7	5.4	2.6	9.7	17.4	73.1
1956	-4.3	.6	-3.7	4.6	3.3	4.1		21.0
1957	-3.6	.9	-2.7	4.0	5.7	7.0		18.6
1958	6.3	.8	7.1	5.1	6.9	19.2	37.1	63.9
1959	8.0	1.4	9.3	5.7	4.7	19.7	47.5	76.4
1960	.8	2.0	2.8	5.7	3.5	12.1	23.5	70.7
1961	2.0	.1	2.1	4.9	5.0	12.0	17.7	58.5
1962	8.8	2.4	11.2	6.0	5.5	22.7	49.4	75.6
1963	6.4	1.1	7.6	5.5	5.5	18.6	40.7	70.3
1964	2.7	1.5	4.2	5.2	3.8	13.2	31.8	71.4
1965	3.1	2.2	5.4	6.9	5.2	17.5	30.8	70.4
1966	-1.0	6.7	5.7	7.3	9.2	22.2	25.8	58.9
1967	.6	2.6	3.3	6.0	12.2	21.5	15.2	43.3
1968	18.2	5.5	23.8	7.2	15.1	46.1	51.6	67.3
1969	-1.9	5.7	3.8	12.0	14.7	30.5	12.4	51.8
1970	6.8	8.1	14.9	9.7	14.8	39.4	37.9	62.4
1971	20.5	2.7	23.2	15.0	23.0	61.3	37.9	62.4
1972	19.6	8.7	28.2	15.6	15.8	59.7	47.2	73.5
1973	18.5	14.3	32.8	12.6	10.5	55.9	58.6	81.2
1974	2.1	21.3	23.3	16.7	15.6	55.6	41.9	72.0
1975e [3] [4]	43.9	17.6	61.5	12.5	26.3	100.3	61.3	73.8
1976e [3] [4]	63.7	14.7	78.4	14.6	22.7	115.7	67.8	80.4

[1] Bonds issued by nonfinancial corporations.
[2] Increases State and local as part of Government sector.
[3] Estimated.
[4] Assumes adoption of President's budget program, with budget deficits of $35 billion in fiscal year 1975 and $52 billion in fiscal year 1976.

Source: Fiscal years 1954–74 data based on Federal Reserve Board "Flow-of Funds."

TABLE 7A.—FEDERAL AND FEDERALLY-ASSISTED CREDIT AS PERCENT OF TOTAL FLOW OF FUNDS IN U.S. FINANCIAL MARKETS, BY TYPE OF CREDIT,[1] FISCAL YEARS, 1975 AND 1976 PROJECTED

[Dollars in billions]

Net funds raised	Fiscal 1975 Total	Fiscal 1975 Federal Government	Fiscal 1975 Percent Federal	Fiscal 1976 Total	Fiscal 1976 Federal Government	Fiscal 1976 Percent Federal
Long-term funds:						
Mortgages:						
Residential	$35.3	$10.4	29.5	$43.7	$8.5	19.5
Commercial	7.9			8.7		
Farm	4.6	6.9	150.0	5.2	3.8	73.1
Total	47.8	17.3	36.2	57.6	12.3	21.3
Corporate securities:[2]						
Bonds	29.1	2.0	6.9	26.9	1.6	5.9
Stocks	5.3			7.9		
Total	34.4	2.0	5.8	34.8	1.6	4.6
Total long-term	82.2	19.3	23.5	92.4	13.9	15.0
Government securities:						
U.S. Government	43.9	43.9	100.0	63.7	63.7	100.0
Federal agencies	17.6	17.6	100.0	14.7	14.7	100.0
State and local governments	12.5	2.2	17.6	14.6	1.9	13.0
Total	74.0	63.7	86.1	93.0	80.3	86.3
Other funds:[3]						
Business credit	36.8	6.1	16.6	41.1	7.9	19.2
Consumer credit	3.2	.1	3.1	7.0	.3	4.3
Security credit	−.4			1.0		
Other loans, including foreign	1.9	4.0	210.5	9.2	5.3	57.6
Total	41.5	10.2	24.6	58.3	13.5	23.2
Total funds raised	197.7	93.2	47.1	243.7	107.7	44.2

[1] Based on Federal Reserve flow of funds (through 3rd quarter 1974) and Special Analyses C and E, U.S. budget, fiscal year 1976.

[2] Including foreign.

[3] Includes bank term loans and long-term Federal credits.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, Feb. 7, 1975.

TABLE 7B.—FEDERAL AND FEDERALLY-ASSISTED CREDIT AS PERCENT OF TOTAL FLOW OF FUNDS IN U.S. FINANCIAL MARKETS, TYPE OF CREDIT,[1] FISCAL YEARS, 1973 AND 1974

[Dollars in billions]

Net funds raised	Fiscal 1973 Total	Fiscal 1973 Federal Government	Fiscal 1973 Percent Federal	Fiscal 1974 Total	Fiscal 1974 Federal Government	Fiscal 1974 Percent Federal
Long-term funds:						
Mortgages:						
Residential	$55.7	$10.9	19.6	$45.3	$12.9	28.5
Commercial	16.7			15.9		
Farm	3.3	3.2	97.0	4.5	2.1	46.7
Total	75.7	14.1	18.6	65.7	15.0	22.8
Corporate securities:[2]						
Bonds	15.5	.2	1.3	17.4	.6	3.4
Stocks	12.2			7.1		
Total	27.7	.2	.7	24.5	.6	2.4
Total long-term	103.4	14.3	13.8	90.2	15.6	17.3

See footnote at end of table.

TABLE 7B.—FEDERAL AND FEDERALLY-ASSISTED CREDIT AS PERCENT OF TOTAL FLOW OF FUNDS IN U.S. FINANCIAL MARKETS, TYPE OF CREDIT,[1] FISCAL YEARS, 1973 AND 1974

[Dollars in billions]

Net funds raised	Fiscal 1973 Total	Fiscal 1973 Federal Government	Fiscal 1973 Percent Federal	Fiscal 1974 Total	Fiscal 1974 Federal Government	Fiscal 1974 Percent Federal
Government securities:						
U.S. Government	18.5	18.5	100.0	2.1	2.1	100.0
Federal agencies	14.3	14.3	100.0	21.3	21.3	100.0
State and local governments	12.6	2.2	17.5	16.7	1.9	11.4
Total	45.4	35.0	77.0	40.1	25.3	63.1
Other funds:[3]						
Business credit	53.1	4.5	8.5	72.3	6.8	9.4
Consumer credit	23.3			16.3	.1	.6
Security credit	−4.8			−3.7		
Other loans, including foreign	13.2	3.2	24.2	13.8	2.4	17.4
Total	84.8	7.7	9.1	98.7	9.3	9.4
Total funds raised	233.6	57.0	24.4	229.0	50.2	21.9

[1] Based on Federal Reserve flow of funds accounts and special analysesjC and E, U.S. budget for fiscal years 1975 and 1976.
[2] Including foreign.
[3] Includes bank term loans and long-term Federal credits.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, Feb. 7, 1975.

TABLE 7C.—FEDERAL AND FEDERALLY-ASSISTED CREDIT AS PERCENT OF TOTAL FLOW OF FUNDS IN U.S. FINANCIAL MARKETS, TYPE OF CREDIT,[1] FISCAL YEAR 1972

[Dollars in billions]

Net funds raised	Total	Federal Government	Percent Federal
Long-term funds:			
Mortgages:			
Residential	$43.7	$11.2	25.6
Commercial	12.6		
Farm	2.6	2.3	88.5
Total	58.9	13.5	22.9
Corporate securities:[2]			
Bonds	21.6	.2	.9
Stocks	15.5		
Total	37.1	.2	.5
Total long-term	96.0	13.7	14.3
Government securities:			
U.S. Government	19.6	19.6	100.0
Federal agencies	8.8	8.8	100.0
State and local governments	16.2	1.9	11.7
Total	44.6	30.3	67.9
Other funds:[3]			
Business credit	26.7	3.3	12.4
Consumer credit	15.2		
Security credit	9.5		
Other loans, including foreign	9.4	2.9	30.9
Total	60.8	6.2	10.2
Total funds raised	201.4	50.3	25.0

[1] Based on Federal Reserve flow of funds accounts and Special Analyses C and E, U.S. budget for fiscal 1974.
[2] Including foreign.
[3] Includes bank term loans and long-term Federal credits

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, Feb. 7, 1975.

Chairman HUMPHREY. Congressman Hamilton.

Representative HAMILTON. Thank you, Mr. Chairman.

Mr. Lynn, maybe this question is more correctly addressed to Mr. McOmber. I know the Joint Economic Committee has used as a rule of thumb that a 1 percent point raise in unemployment will reduce receipts by about $12 to $15 billion. Is that an accurate rule of thumb?

Mr. McOMBER. Those figures seem accurate as a rule of thumb.

Representative HAMILTON. You accept that. So, if we have an unemployment rate of, say 9 or 9.1 percent, a whole percentage point over what you are projecting, you anticipate receipts will be of roughly $12 to $15 billion?

Mr. McOMBER. We would have to answer yes, very roughly. We have to stress the fact, Congressman Hamilton, as Mr. Lynn did earlier, that the unemployment rate is not a particularly good variable for determining changes in receipts. Personal income and other factors have a more direct effect.

As a matter of fact, one way to look at it is this. If you were to say that the unemployment rate was going to dip, let us say, half a percent, we would have to say that that in itself, is only an indirect measure of those factors that would have significant effect upon receipts. We would also have to stress the fact that the unemployment rate is not necessarily the best measure, the most appropriate single measure, for identifying changes in the economy. We would have to look at a number of other changes in order to figure out those effects.

Representative HAMILTON. I can appreciate that, but you did indicate earlier that the $12 to $15 billion figure is not an unreasonable expectation.

Mr. McOMBER. It is not unreasonable.

Representative HAMILTON. Mr. Lynn, let me ask a couple of questions that are extraordinarily elementary and may be too much so. This question goes in exactly the opposite direction of everything we have been talking about, but I spent a week in Indiana recently. Like you, I come from the Midwest. People there do not understand deficit spending well and all this talk about huge budget deficits stimulates fear. It is related to the whole question of confidence, and I know you appreciate it.

I would like you to spell out for me if you would, in simple terms, what would be the impact of a balanced budget this year?

Mr. LYNN. Achieved how? [Laughter.]

Representative HAMILTON. Well, let us put that aside. Let us put that aside. What would be the impact?

Mr. LYNN. I do not know of anyway of putting it aside. Are you saying, assuming we had an economy that was so healthy that we had that lost $40 billion——

Representative HAMILTON. All right. Let me——

Mr. LYNN [continuing]. In revenues?

Representative HAMILTON. Do not treat the question lightly, sir.

Mr. LYNN. I am not. I am a little——

Representative HAMILTON. This is a serious matter.

Mr. LYNN. Seriously, I do not know how to answer unless we stipulate how the balance is achieved.

Representative HAMILTON. They say let us cut Government expenditures. Suppose if you balanced the budget by cutting Government expenditures by whatever it required, what would be the impact then on the economy? I am really asking you to answer the question that I have to answer to a lot of my constituents.

Mr. LYNN. The problem from where I sit, to put it on the table, Congressman, is that we have three people that regularly testify, your friends, I trust, Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisers and his fellow advisers, and the Secretary of the Treasury, Mr. Simon. The economic projections we use are done jointly by staff of the Council of Economic Advisers, the Treasury, and OMB. So I cannot give you an authoritative answer. I will take a rough crack at it, but I could be dead wrong. The general effect would be a dampening influence on the general economy because Federal expenditures buy goods and services in the market the way a private citizen would. If you took away that buying power it would decrease total purchases of goods and services by that amount.

Now, the effect would be large, but just how large and for how long, I do not know. That is about as much as I can say on that issue.

Representative HAMILTON. I do not want to try to put words in your mouth, but would you agree that such an impact at the moment would be disastrous for the American economy?

Mr. LYNN. My guess would be it would have a rather severe effect.

Representative HAMILTON. Yours is a much more diplomatic phrase, Mr. Lynn, than I used.

Mr. LYNN. I am trying to learn from the people that deal specifically with these issues.

Representative HAMILTON. One other question. And this is just a matter of information. To what extent do you coordinate your work on the budget with Federal Reserve monetary policy? Do you have any regular consultation and coordination with the Federal Reserve or when you work on the budget do you operate in a world apart from monetary policy?

Mr. LYNN. We first of all have excellent staff liaison on statistical matters between our staff and the Federal Reserve, as indeed we do with the Treasury Department and the Council of Economic Advisers' staff on a statistical basis. In other words, we are in touch with them on whether we have our numbers right, on whether we have the best and latest information on trends, and that type of thing.

Now, when it comes to overall policy—which I think is what you are driving at—I meet informally with Mr. Burns—I did when I was Secretary of HUD—and continue to do that in my new role as Director of OMB. If you are asking whether I ask the Fed chairman, "What precisely are you going to do?" or "What do you expect the Open Market Committee to do at the next meeting?" the answer is no.

Representative HAMILTON. Thank you very much, Mr. Lynn. Thank you, Mr. Chairman.

Chairman HUMPHREY. Well, we are coming down the line here. I would like to make just a personal comment on the deficit. I think

Congressman Hamilton has posed a question that we are all asking and one of the reasons for hearings like this, despite our obvious differences, is to get some economic education. The word "deficit" frightens people.

Mr. LYNN. It certainly does.

Chairman HUMPHREY. Just like some of the other things that we have heard frighten people. Of course, we have known, for a long period of time that our economy is a credit economy. It is not a cash-and-carry economy. We do not have a sensible Federal budget structure. We do not have a capital budget. We are the only industrialized nation in the world that does not have a capital budget where you separate operating expenditures from what you call your capital outlays. Some day we will get up to date and there is not one other country left in the entire industrial world that has this kind of a budget. But we will have to get at it. And, by the way, I thought when we had Mr. Burns here I believe he felt this was a necessity and I hope that we can move on it in the Congress.

Mr. LYNN. Mr. Chairman, we have taken a crack at it.

Chairman HUMPHREY. Yes, I understand you have come closer this time.

Mr. LYNN. On page 59 of the Special Analyses volume of the budget we separate investment from current outlays. There is a whole special analysis on the subject. There are some very difficult questions here. But that does not mean we should not keep at it.

Chairman HUMPHREY. I think this is something that your office and this committee ought to give some attention to and it is one of the things we ought to look down the road at because I think we begin to argue about apples and oranges here when we ought to be looking at very separate types of items. There are various things that are really just cash outlays, expenditures that are repetitive in terms of operating costs and other things that really are investment problems, and so forth.

On the matter of the deficit, whatever it will be, there are two ways to reduce that deficit as I see it. One, Congressman Lee Hamilton has mentioned, you can cut the budget. I think if you cut the budget the amount to reduce the deficit, it would have what has been indicated here as a severe impact or a disastrous effect. I mean if you balanced the budget. I might also——

Mr. LYNN. First of all, I do not know how we would do it, Mr. Chairman, without cutting back on a number of programs so severely that we would be hurting many people who are presently served by these programs.

Chairman HUMPHREY. Right, but you see, when you are out with the folks this is what you hear repeatedly, we should balance that budget.

Mr. LYNN. And I incidentally have the greatest sympathy for them—as to the goal over a period of years. I think we could use some years in this country in which we not only balance the budget, but actually have a surplus. There has not been enough of that in recent years.

Chairman HUMPHREY. I could not agree more and I hope we can get the economy revved up so we can do that.

Now, there are two ways to balance the budget. One is to cut expenditures and then you have to ask yourself what is that going to do to the economy, and that boils down as far as the Federal Government is concerned, what it does do to revenues. The problem is it is like a dog chasing its tail, that as you cut, cut, cut, you reduce the economic activity, which in turn reduces the revenues, which in turn causes a budget deficit, which in turn calls for another reduction in the budget outlays, so it really is self-destructive. It destructs. Self-destructive mechanism.

The other way is to get the economy moving, to produce, and I happen to be one of those people that believes in a little of both. I think that you can watch and should watch what you spend and this is why, for example, some of us take a very dim view on some expenditures. We have different priorities. And there will be arguments about where those cuts ought to be made.

That is, I think it is unrealistic in the budget in light of the temperament of the Congress, in light of the needs of the American economy, to contemplate an $800-million increase in foreign assistance over and above what you asked for last year. It is just ridiculous. It is not going to happen. I handled the foreign-aid bill we passed last year by one vote and I am for foreign assistance as you know. I support these measures. But it is not going to happen. I mean, it is just foolish. So we are going to make some cuts there which will permit either reduction in the deficit or a change of some priorities.

Now, Senator Javits mentioned the $8 billion stay in the different outlays. I think we have to watch our defense budget. I believe we have been drawing down a great deal on defense supplies and it may very well be that we can not make a cut as large as some people would like to advocate, but the way, therefore, to reduce the deficit is either to reduce outlays or expenditures or to increase the economy. Because it is the velocity of money that brings in the revenue and I go back to pointing out that I am afraid that the stimulation that is provided in this budget is not updated.

Now you can talk about the budget deficit being updated or the budget figures due to unemployment or due to whatever is happening to the economy, but the question I put is have you updated since the President put his original economic package to us, have you taken a look to see whether the stimulus effect of that, because it was based upon putting a stimulus into the economy, is adequate since the unemployment rate went up 1 percent in 1 month and the sharpest increase in unemployment in the past 3 months, since the great depression? I think that we have to ask the question does the President's program for tax reduction, his energy program which we can talk about here, does it have the stimulus effect now coming into the first of March that it had when that message was prepared and given to the Congress?

Mr. LYNN. Well, let us take a look at the time sequence. The budget was submitted on February 3.

Chairman HUMPHREY. But it was prepared earlier.

Mr. LYNN. Except as the early discussion indicated, we had a change in the last 12 days or something like that—after the Presi-

dent's state of the Union message—when we raised the deficit from $47 billion, I guess——

Chairman HUMPHREY. That is deficit?

Mr. LYNN. Deficit, right.

Chairman HUMPHREY. But the President's television message, and we have been getting a lot of that, television message and on his economic program was in the middle of January.

Mr. LYNN. Yes; that is right.

Chairman HUMPHREY. That is correct, so all the figures that the President had for that television show were prepared before the 15th of January?

Mr. LYNN. That is right.

Chairman HUMPHREY. Of course, it had to be.

Mr. LYNN. That is right.

Chairman HUMPHREY. That obviously had to be. Now, between January 1 and February 1, an additional million people were unemployed.

Mr. LYNN. But, on the other hand, the President did have advice at that time as to what the trend would be. And, as we have indicated, that information was updated again toward the very end of the budget preparation process, and the budget revised accordingly.

Chairman HUMPHREY. I see. So you feel——

Mr. LYNN. Now, going to your basic point, Mr. Chairman, let me emphasize I cannot agree with you more—and I know the President would agree with you totally—that we do have to watch the economy as we move along, and see what happens to the forecasts that were used in the preparation of the budget, and in formulating the President's proposal for stimulus. We all must remain flexible.

The President's tax proposal shows this flexibility. His approach was to take a 1-year tax cut now, and look at the situation again to see what further might need to be done in the future. The lack of flexibility is one reason I worry about the public works approach. We have seen so often that once you start building a dam or other public works project, work goes on for quite a period of time beyond the time that you have your economic problem.

Again I say we have to work together week by week, and month by month, and see how much stimulus we need. If it is more, there should be more. If it is less, we should have the capacity with the laws and programs that are put into effect, to reduce it. I would also say at the same time, let us constantly watch the total deficit and how much we are seeking to finance to see whether the markets can accommodate it, and whether or not we are heading for an inflationary spiral again.

I know that is the intent of the committee, and the intent of the Congress. Let us see whether we can get that intent translated into action.

Chairman HUMPHREY. Mr. Lynn, I do not find myself in disagreement with that. I just simply point out, and I hope it is looked at in the executive branch as well as the legislative——

Mr. LYNN. It most certainly will be.

Chairman HUMPHREY. We have witness after witness here and each of them has been asked one set of questions and we asked each

witness this question. If you take a look at the quality of the witnesses we have, both from the general public as well as from government, I think you will agree that they are good top grade people. They know their business. Every one of them has been asked this question. Do you think that the President's economic program is adequate to meet the recession? And I believe that I—I may be in error but I would like to have you look at the testimony or have some one look at it. I believe all witnesses that were from the general public, with one exception, said to that question they did not believe that the President's program was adequate to meet the dimensions of the recession. Many of them were much more explicit than that.

Now, my point is not to argue about that. I hope that that kind of testimony gets to the Government. It is not to the benefit of the public that we have a scrap here. What is important is that the advice we receive is listened to.

Now, we got the advice from Mr. Greenspan, for example, and I have a high regard for Mr. Greenspan. He knows that.

I want to incorporate in the testimony right here the letter that I have from him dated February 19 in reference to the alternatives that we presented for the examination by the Council of Economic Advisers, our economic alternatives, and he has some doubt about our economic alternatives but in the main he said, for example, that he felt—I will read—"Our alternative of a larger tax reduction in the sum of $30 billion would not have an immediate," as he put it, "inflationary effect, but it would have a considerably larger stimulating effect."

Mr. LYNN. He also said, Mr. Chairman, "a 10-percent growth in M_1"—cash and checking deposits—"if maintained for 2 years will inevitably lead to a recurrence of high rates of inflation in 1977, if not in 1975." In fact, he says, "great instability in the rate of growth in the money supply would eventually turn out to be a cause rather than a cure for recession." Then he goes down in the next paragraph he says, "that the forecasts that were used neither reflect nor adequately evaluate the risk of a financial backwash from the very large Federal deficit."

Chairman HUMPHREY. Right.

Mr. LYNN. But let me say to you——

Chairman HUMPHREY. Just hold it a minute. I want to be sure that we place the letter from Mr. Greenspan in the record at this point.

[The letter follows:]

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS,
Washington, D.C., February 19, 1975.

Hon. HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee,
U.S. Congress, 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, a $1 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 quartely forecasting models. I believe that the results of the simulations are at best only partial answers to your questions. The models do not contatin 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 1½ 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 government expenditure. Both models show that thee $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 1 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 1½ 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 fast 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 Presidnt'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 financial 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 HUMPHREY. All right, go ahead.

Mr. LYNN. On the issue of discussion with other economists, we share your own view, that we should get many opinions and the best expert advice we can. We are in no way in a cocoon in this regard. The members of the Council of Economic Advisers, Secretary Simon, William Seidman, and I seek a variety of economic advice and information. If we do not meet with people, we get reports from our staff who have met with them, and we read what is being said. We try our best to stay up to date.

I will say, though, that I have found a tremendous range of opinions by economists as I have worked in this job and other jobs in the Government. I do not envy them. They have a very difficult task, and the breadth of their opinions, the diversity of those opinions reflects, I think, the difficulty of their task.

Chairman HUMPHREY. Might I add that setting up strawmen and knocking them down was a good old game and no one has been advocating that M_1 be expanded at 10 percent for 2 years.

I have not heard anybody advocate that at all but if you want to set it up and say that you can do it, it is sort of like saying if you want to take an example like using aspirin, if you can take 12 aspirin tablets every 6 hours for 2 years you will be dead. That is true. It will get you. But if you take two aspirin tablets every 4 hours for the next 2 years you maybe would not have any headache. That is not to say it cures you, do not misunderstand me, but it would not kill you.

I am simply saying again that I know what Mr. Greenspan's philosophy is and what worries me is that there is a foot-dragging operation here. One of the reasons we bear down pretty heavy is that there is such a concern over what they call the reigniting of the fires of inflation which is a matter of concern, of course, but such a concern that you timidly approach the immediate problem of growing recession and I want to tell you that there has to be enough intelligence in this Government to balance out a program of expansion on the one hand and growth and at the same time to apply some kind of restraint upon the possibility of reigniting inflation. That is what we talked to Mr. Burns about and I am happy to say that Mr. Burns yesterday before the Senate Banking Committee now says that they do have to stimulate the money supply, they do have to increase it. He recognized that they had to be slow in doing it and he said now we are making extraordinary efforts.

That is what we have been talking about here. That is what we have been saying here and every year—here is Mr. Paul McCracken who is not exactly leading any revolution and is surely no economic radical, to the contrary, a very sensible, responsible, relatively conservative man. What did he say? He said that the rate of money growth should be between 8 and 10 percent and possibly up to 12 for this year, in parts of this year, and that is his opinion. I think it is important that the Government, that our President through men like yourself and through Mr. Simon, and Mr. Greenspan, start to get some advice that gives him the tools and the suggestions and the proposals to deal with this growing recession. When you get the figures this March, when we get those again, we are all going to gasp once more. Just as surely as we are in this room now, no one expected the unemployment rate to go up like it did in January, and no one expected the drop in industrial production but there are lots of disturbing scenes and it is interesting to me that some of the top industrialists, financiers, are begging this Government to take a look at what the immediate problem is and the immediate problem is the sharp decline in production and income and revenues, and if we do not do something about it we are going to be in one big jam.

I have got a series of simple questions.

Mr. LYNN. Mr. Chairman, if I might, we do ask that something be done about it. The President has proposed a tax cut. The Congress may do what it feels it should do and that is its constitutional responsibility. But I think the people of the country are looking for some prompt action. I, therefore, would urge the Congress to move as expeditiously as possible on at least the proposals that the President has made. If you disagree with him on the amount of the tax reduction, then stress that disagreement——

Chairman HUMPHREY. That has been done.

Mr. LYNN. By passing legislation and bringing it to his desk so he can consider it. We do need prompt action.

Chairman HUMPHREY. Might I say that it is a lot easier for the President to give a speech or go down to Hollywood or some place else and meet with the mayors than it is to get 535 Members of Congress organized. Established in their committees, listen to the

testimony, evaluate the testimony for a bill which the House of Representatives under the Constitution must do under the tax bill. It must start in the House Ways and Means Committee. That bill is up and will be up for vote this week and it will be processed promptly here in the U.S. Senate and, by the way, I am not for adding on any reforms in the first bill. I believe in getting a bill out that is a simple tax reduction bill and we will argue about the amount. There is not any great argument with the President about a tax reduction bill. There is on energy and I want to say that the Congress, if ever we did anything that is worthwhile for this country, it was to put brakes on this colossal misjudgment and miscalculation of the energy policy on the basis of tariffs on the importation of crude oil which will only increase the unemployment, raise the cost of living, and cause a deeper recession. We obvioulsy have to come up with another answer and we have prepared one from this committee. We have prepared what I think is the sensible way of approaching this highly difficult, complex problem of the energy policy in this country.

What did we propose? We tried to face the facts, No. 1, that on the tax measure we thought we would be able to get together promptly and pass a tax bill, and I think we will. I expect a tax bill to be passed before the end of April and I would hope sooner, most likely by mid-April, on the energy bill.

Mr. LYNN. I would hope it would be done even sooner than that, Mr. Chairman.

Chairman HUMPHREY. I hope so too. I hope by April 1, but give a week one way or another.

No. 2, on the energy situation, we are at loggerheads. The President has got his proposal. He continues to advocate it. We have yet to find very many witnesses outside the administration that think it ever should be adopted. Some features of it, of course—I am talking about the tariff features on crude oil and we now find ourselves figuring on a veto on the action of the Congress and whether or not we can override it, so we are going to be in a battle role.

We have proposed that to the President, and I want to bring it to your attention because I do not think—we have not yet received an answer, have we? I do not think we have received an answer. The letter was dated January 25; 14 members of this committee after examining with great care the President's proposal, made a proposition to the President. We said, "Mr. President, let us put down the battle arms here and let you appoint a task force in your Administration and then you ask the majority and minority leaders of the House and Senate to appoint another task force of people in our Congress that feel that we all have some competence in the energy field and in the next 60 days let us work out a mutually acceptable energy policy.

Now, that is the only way it is going to be done unless we just have a knockdown, dragout fight. I hope you will take that message to the President.

Mr. LYNN. I will, but as you understand, there have been some superseding events within the Congress since that time. The Senate on the majority side has been putting together a proposal.

Chairman HUMPHREY. Yes.

Mr. LYNN. The House has been putting together a proposal.

Chairman HUMPHREY. Right.

Mr. LYNN. There are numerous proposals. I think the President's position was a rather straightforward, simple one and a logical one. His position is that we have to have something to discuss. Let the Congress come forward with a proposal, and the President will be, not just willing, but eager, to sit down and work out a program that will be in the best interest of the American people. But if we were to have a task force, what would it be working on? Where is that congressional proposal? I saw a good sign in the activity of the Congress the last week or two. There have been hearings to put together a proposal, so that there is something to work with between the President and the Congress.

Chairman HUMPHREY. Those same task forces could have been sitting down during this same period of time, during the executive branch task force, and we would have had, I think, greater production.

Mr. LYNN. May I just say, Mr. Chairman, with all respect, I have the feeling that the process the Congress is going through now is a process that would be necessary to have enough unification on positions to even make discussion with the executive fruitful.

Chairman HUMPHREY. Are you prepared to recommend to the President that after these task forces of the Congress have completed their work that they join together and have a task force from the executive branch and a joint one from the two Houses of Congress to work out an energy policy and on this monstrosity that has been advanced here in the wings and have something to work on?

Mr. LYNN. Before I advise the President on this issue, I would have to see what is the status of the work in the Congress. Is there a proposal that has been agreed to, whether formally or informally, by the Congress? It might be the kind of situation that requires the acid test of congressional action first. I just do not know but I would certainly keey my mind open in that regard as to what I would advise the President.

Chairman HUMPHREY. I think you might also keep in mind in energy, when the Congress is criticized for not having come up with proposals, what would have happened to this committee if the Congress had rubberstamped the President's request for a 5-percent increase in taxes that he made in October.

Mr. LYNN. As I said before——

Chairman HUMPHREY. Thank God we do not move that way.

Mr. LYNN. I will not get into speculation as to what was the reason why Congress did not move. But I will say this, I am glad we did not either. But I will also——

Chairman HUMPHREY. Would you care to speculate why the recommendation was made?

Mr. LYNN. Economists, including some of those outside economists for whom you were referring, were for the administration's view at that time.

Chairman HUMPHREY. I regret to say that is not true.

Mr. LYNN. That is not true? I sat through the summit meetings and I heard a number of them say that inflation was then the No. 1 problem in the country.

Now, we have had quite a few changes in our economy since that time. As I said earlier, the President believes we must be flexible as events change. The events changed, and so did his proposals.

Chairman HUMPHREY. Do you remember what Congressman Conable said in his summation for the Republican side? I made the summation for the Democratic side. He said one thing we have agreed on, all of us, is for a tax cut for low- and moderate-income people. Would you like to look at that.

Mr. LYNN. I do not recall it but I would certainly take your word for it.

Chairman HUMPHREY. It is right. We are not fooling you at all here. In the budget on summer employment for young people, knowing that 40-some percent of black teenagers are unemployed and 20-some percent white teenagers are unemployed, is there anything in the budget for a summer employment program for young people?

Mr. O'NEILL. As you know, Mr. Chairman, last December the Congress passed the Comprehensive Employment and Training Act. The amount requested for this year for title I and title II—the basic State and local programs—is equal to the amount provided last year. There are no longer earmarked amounts for any particular purposes. But the Congress included in the planning requirements that State and local prime sponsors submit plans including a designation of how they plan to spend their money.

Chairman HUMPHREY. Right. So you are saying that the total comprehensive manpower programs grant to the States is equal to what it was last year?

Mr. O'NEILL. Yes, sir.

Chairman HUMPHREY. I thought it was absolutely below——

Mr. O'NEILL. And consistent with the law that was passed and signed by the President, it is now left up to the State and local people—who are closer to the situation—to decide how those billions of dollars should be distributed among on-the-job programs, institutional training programs, summer youth programs, and public service jobs. Every dollar that is approved under those authorizations can be used for any of those purposes, as determined by the people at the State and local government level.

Chairman HUMPHREY. Actually the manpower program activities, on page 121 of the Budget of the U.S. Government, show that you are down about $100 million, even though the rate of unemployment is sharply up, and the cost of living has gone up. So there are not any funds budgeted.

Mr. O'NEILL. That is a result of the fact that the Emergency Employment Act that was passed in 1971 and expired in 1972, the Congress approved $250 million even after the act had expired and the President had not proposed anything further for that act.

Chairman HUMPHREY. Well, the President can make proposals in his budget for things not included in current legislation. You know that.

Mr. O'NEILL. I do, sir, and also recall very well that it has only been since December that the Congress acted and the President has provided funds for a combination of public service jobs and unemployment compensation. As Director Lynn suggested earlier, aid to the unemployed will increase from the $6 billion range in 1974 to a recommended 1976 expenditure of over $18 billion.

Chairman HUMPHREY. For unemployment?

Mr. O'NEILL. A combination of unemployment compensation and public service jobs.

Chairman HUMPHREY. A lot of these people have not had any jobs. They cannot get unemployment compensation.

Mr. O'NEILL. And for public service jobs.

Chairman HUMPHREY. Well, in 1971-72 we provided in the Neighborhood Youth Corps for 600,000 jobs. Now, when you talk about the total amount of money for manpower activities of $18 billion, you know that most of that is for unemployment compensation.

Mr. O'NEILL. Yes, but——

Chairman HUMPHREY. And that does not relate at all to youth unemployment.

Mr. O'NEILL. That is right. The key number——

Chairman HUMPHREY. Do not try, you know——

Mr. O'NEILL. The key numbers related to public service jobs and summer youth are——

Chairman HUMPHREY. Let us just simplify it. You have not got more money in here for job programs have you?

Mr. O'NEILL. Certainly. We have got more than previous year's levels.

Chairman HUMPHREY. You have?

Mr. O'NEILL. We have estimates, as you suggested in your opening statement, that provide for a level number of public service jobs through the end of this calendar year, but we are on a growth trend right now. The last figures I saw said that we had 167,000 individuals on public service jobs at the end of January and we are heading toward a level for the rest of this year of 310,000. We think we will reach that level sometime in the month of June.

Chairman HUMPHREY. Let me just read you the figures. I may be a little thick here. Manpower, manpower training, we look—the total——

Mr. O'NEILL. What page are you reading from?

Chairman HUMPHREY. Page 121 of the Budget of the U.S. Government. Subtitle "Manpower training," total amount of manpower training in estimated outlays for 1976, total for everything, that includes Federal, State employment service, work incentive programs, management employment assistance, manpower program activities, temporary employment assistance. The whole thing is up from $4,118 million to $4,241 million but your budget recommendation for fiscal year 1976 is $3,302 million.

Mr. O'NEILL. Senator, but look at the number right next to the one you just read. In outlays for 1975 we spend $4.1 billion. The President has already recommended that we spend $4.2 billion in fiscal year 1976. As you indicated in your opening statement the

President indicated in his budget he has not approved anything for public service jobs beyond the beginning of calendar 1976. As Mr. Lynn has been stressing, we are going to be evaluating the situation, and if more stimulus is required he is going to come forward with it.

Chairman HUMPHREY. The simple fact is, that related to the rise in unemployment, the figures are inadequate, based upon your own calculations from last year, compared to last year. The unemployment rate last year was 5.5 percent. It is 8.2 percent and going up, and teenage unemployment in the ghetto for the black is over 40 percent and for whites, young whites, around 22 to 25 percent. We do not have a summer youth program. You have it in comprehensive training programs which mostly is for young adults and adults.

Mr. O'NEILL. No, sir. That is a choice of the local sponsors.

Chairman HUMPHREY. Yes, but the heavy pressure is on society for the heads of families that you can imagine what State governments are going to have to do. Now, that is why we have always earmarked a certain amount of money, and Senator Javits has been leading here in this, I have been a cosponsor with him, and we have always had the same old fight. It is like we are against kids and old people around here, and this program—we are going to have to do something about teenage unemployment, just got to. The cost of crime, vandalism, the result of idleness and unemployment among teenagers, is far greater than any amount of money that we are going to be spending on these teenage employment programs.

Mr. O'NEILL. I think, Senator, if I may, I will just say one thing on that point. I am troubled by the logical path that that follows. It suggests that somehow we know better here how many dollars should be distributed for summer youth employment, how many should be for the heads of families, and how many should go to institutional training. It suggests we know this better than mayors, better than Governors, better than the county officials.

Chairman HUMPHREY. No, I do not think we do, and I just met with the conference of Mayors and you know what they recommended.

Mr. O'NEILL. Certainly.

Chairman HUMPHREY. No. Wait a minute. They recommended a summer youth program.

Mr. LYNN. Among many other things, sir.

Chairman HUMPHREY. I know, but they are States, they are right out there on the firing line. Just a minute. You were just saying a moment ago, Mr. O'Neill, that we are trying to pretend that we know more than the country's citizens. No. I am taking my advice from them. They came in here and spelled it out. I do not say we can appropriate as much as they want. That is the argument, but they want a youth unemployment program.

Mr. LYNN. I also said at the same time, Mr. Chairman, that they would like very much for the executive branch and Congress to get together to have fewer categorical programs and give them more flexibility in the way they spend their money.

Chairman HUMPHREY. I could not agree with you more.

Mr. LYNN. All they are saying is if you have got to go to categories give us more here, there, and everywhere. But the thing they

keep telling me both formally and informally is to give greater flexibility so they can attend to problems as they occur, and so they can have the flexibility to change their own local economy. I agree with them as far as giving them that kind of flexibility.

Chairman HUMPHREY. I could not agree more and they also want to be sure they have got enough money in the pot so when they make a block grant they have something to use. What worries me here is we are arguing about numbers rather than taking a look at what is happening and you are defending a budget and I am here telling you that I do not believe the budget is adequate in this area and what I think is most important is for people of our competence and ability to come forward and take a look at what the facts are out in the city and say does this budget meet those facts? If you can assure me, Mr. O'Neill, that those budget figures here on manpower training and manpower activities meet the facts that were given to us by Mr. Shiskin 2 or 3 weeks ago in this committee on youth unemployment, if you can assure me that your budget figures for manpower activities meet the requests that you have come in here from Governors, from their own resolutions this week and the U.S. Conference of Mayors and the National Association of County Officials that met here yesterday—they were in my office today and yesterday—if you can assure me of that, I will say more power to you, but I want to tell you you had better talk to them. I have been over in that executive branch and I have watched how budgets have been presented. I had to handle preparations of a budget one year, coordinate it, and I want to tell you you do not talk to many outsiders. You talk to yourselves.

Mr. O'NEILL. Senator, I can remember very well when you were in the executive branch. My office was only about two doors away from yours.

Chairman HUMPHREY. And I had the same battle with OMB that I have got now. The fact is that sometimes when we get behind those big walls there often we do look at those budget figures and forget that there are some other facts developing outside.

Mr. O'NEILL. Senator, we are talking to the people.

Chairman HUMPHREY. I know you are. I am not calling you heartless or anything like that. I am just saying I do not believe you have listened to the Conference of Mayors, National League of Citizens and the National Association of County Officials on youth programs.

Mr. O'NEILL. Senator, everybody is listening to them, largely I would say, as a result of the leadership you demonstrated when you were the chairman of the President's Council on Youth Opportunities. I think the Federal Government has become sensitized to this, very much so. But it has been my experience since the days you were the chairman of that President's Council that every year —no matter how many dollars were approved for this particular categorical program—there were always requests for more.

Chairman HUMPHREY. Of course, because we were a bunch of penny-pinchers then.

Mr. O'NEILL. I do not think that really squares with the facts. In the years I have been in the Federal Government, I have never sat

down with a single interest group and had them tell me that they had enough or that they had too much.

Chairman HUMPHREY. We know that.

Mr. O'NEILL. There is not a single interest group in the whole country that thinks it has got enough. They all think they deserve more, and should have it directly given to them by the Federal Government.

Again, though, I assure you that we are talking to the State and local officials. I was delighted to have an opportunity to sit down with Governor Anderson from your own State a few weeks ago and find out that his budget situation is very good. This suggests to me that he, for example, had the wherewithal to deal with some of the problems in a more direct way than we can. Many State officials are in that same fortunate circumstance. I think we need to be thinking about other levels and institutions in our society than the Federal Government and how they can respond to the needs in these difficult times.

Chairman HUMPHREY. My job is to think about it down here. The Governor is a very personal friend of mine. I know what the condition of the Minnesota budget is. It is very good. They have got severe limitations in their constitution as to what they can do but I have people coming to see me every day and, you know, when I look at what I see in unemployment in the Chicano communities, unemployment in the union community, black community, among young teenagers, I don't mind telling you it is my job and your job to figure out what we can do about it. I know there are limits to anything you can do, but I also know you referred back to the days of the youth community employment. I know, in other words, to get any money the President of the United States had to call them all in and bump their heads and say to them, look you are not an independent entity. You are going to give money over to the youth opportunity employment and we did get some.

We have gotten actually double the rate of unemployment, 3.5, 4 percent. Then we were worried about the problems in the ghettos at that time primarily because of the social unrest. I am here to predict to you unless we look at those problems, face up to it, there is going to be more social unrest. I don't want it. I went through that period. No one suffered more individually or physically than I did during that period. I walked those ghettos. I went into every one of them and I can tell you that we cannot tolerate the kinds of youth unemployment we have this coming summer and I just want to get the OMB and Congress together and let's take a look at it.

I submit to you, and it is my very prejudiced judgment obviously, that the present figures in the budget are inadequate for that amount, inadequate, because the figures don't add up to enough in light of what has been happening in the last months.

Enough of that. I don't think we disagree as to the need. I think we disagree as to how we best approach it and what we can do.

I just note here that we have got 4.5 million young people that will come out of high school and college in June. That is another little group that we are going to have on us that is not in the present calculations.

Mr. O'NEILL. Mr. Chairman, on that very point, you put your finger on the answer a little earlier. The answer is that we have to get the economy going so that there are jobs. They should not be make-work jobs to any extent greater than we have to have them. They should be jobs in the regular mainstream of our country, both in the private sector and in the governmental sector. We can not possibly substitute in the Federal sector every job that is lost in the private sector. Nor can Uncle Sam employ all the people that are coming into the labor force. We certainly want to take a look at all of the issues you raised. But I would hope is you will look with us at the overall figures. The total of the measures adopted to stimulate the economy must not be so great that for a short-term gain when we fool people into thinking everything is becoming rosy because we see some nice figures for 6 months or a year, we wind up with another cycle of inflation and recession.

Chairman HUMPHREY. Nobody wants to do that.

Mr. O'NEILL. I would say this committee as well as the Budget Committees and the Appropriations Committees should particularly watch that overall score card on the deficit as we try to help the people in this time of need. The best solution here is going to be one that pulls us out as fast as we can, but does not get us into that cycle of inflation and recession again in another year or year and a half. We want to work very closely with you toward these goals that we both share.

Chairman HUMPHREY. Very good. I will just conclude this hearing today by noting for this record once again that the projected loss of income, gross national product and income, for 1974, because of unemployment and recession for 1974, if you would assume an unemployment rate as acceptable of 4 percent, over and above the 4 percent, the loss in potential, $109 billion, has been flushed right down the sewer that nobody ever got a chance to use. For the year 1975, $250 billion estimated and for 1976, $240 billion. This is assuming that we even had an unemployment rate of 4 percent. It indicates to us tragic loss of human production and being needed in this country. The deficits that I worry about are not only the Federal deficit. I think, may I say most respectfully, that this country can not have, as Henry Ford put it here, a continuing unemployment rate that is projected as in this budget and have it be acceptable or in anyway tolerate it. The deficit of individual income is serious and more so than the Federal deficit. The Federal deficit is an indication of what has happened in our economy but what is more significant to me is the fact that some 7.5 million people have been told in this calendar year of 1975 for the month of January that they are not needed, they are not wanted, there is no place for them. They are told, "You just get hold of an unemployment compensation check and put yourself on the shelf," and more are going to be told that next month.

That kind of an economy does not breed respect and love of country and respect for an economic system. I love the country as you do and I am a capitalist. I believe in our private enterprise system and I want to make it work.

I sat yesterday with some of the entrepreneurs from Sweden, big businessmen, and let me say that in Sweden, despite what you have read, 90 percent of all of the industrial output of Sweden is privately owned. What do they say to us when we asked them. They said you are too timid in America when you approach your economic problems.

I sat not long ago with the Chancellor of the Federal Republic of Germany. The German record is unbelievable. They don't have any unemployment. They have got a little now. They are very worried about 2.2 percent. They even declared that they would expand their money supply, they announced it, 8 percent from the Bundesbank, 8 percent, and we are worried here that 8 percent will trigger inflation. They have a tight labor market. They have to import over 80 percent of all their energy. They had a trade surplus of $9 billion. They have got a rate of inflation that is approximately half ours. And I think we might very well ask them how they did it because we sit around here so afraid if we do anything we are going to reignite the forces of inflation. I worry about it every time a witness comes from the executive branch because I am afraid that you do not see that one of the real causes of inflation is recession because it lowers productivity, as Senator Javits said when he started his questioning here. Productivity is down. Unit costs go up. Recession fuels inflation. And inflation can fuel recession. They chase each other.

Therefore, what we need is to, first of all, take a look at what is the immediate problem that we need to get at.

Mr. O'Neill. I certainly agree.

Chairman Humphrey. And I think it is recession.

Mr. O'Neill. I certainly agree with you that we do have to help in whatever way we can and pull this economy out as quickly as we can. I would say that Germany started its stimulus from a different position than we have. It had a different export-import situation than we have had. It started without the inflation that we have had—because of some discipline they had imposed with regard to their own economy which, I understand, required quite hard measures over a period of 2 or 3 years. So their situation is somewhat different than ours.

In Sweden, I don't know. Do they have a better inflation rate than we do?

Chairman Humphrey. A little less than we have, just slightly.

Mr. O'Neill. A number of other countries in the same area have quite a different situation. France and Italy have gone the opposite way.

Chairman Humphrey. I agree.

Thank you very much. We are adjourned.

[Whereupon, at 12:50 p.m., the committee adjourned, subject to the call of the Chair.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 27, 1975

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

The committee met, pursuant to notice, at 10:10 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey and Javits; and Representatives Bolling 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; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. The meeting of the Joint Economic Committee will come to order. We are still continuing the review of the President's economic message and the Economic Report and the budget message.

This morning we have two very important witnesses appearing before the Joint Economic Committee, Mr. Albert Rees, Director of the Council on Wage and Price Stability, and Mr. Frank Zarb, the Administrator of the Federal Energy Administration.

Mr. Rees, this is your first appearance before this committee, I believe, and we welcome you.

Mr. Zarb, you have been very much on the firing line of the heated national debate over energy policies, and as I said to you a moment ago, I am sure you feel that every one of these appearances is like a rerun. But for us, it will be new and original, and we welcome you.

Mr. Rees, by contrast, has been able, to some extent, to insofar as the national debate is concerned, to sort of lie low, as we have put it. The Council on Wage and Price Stability, however, has very important responsibilities; but it is my judgment that it has not received all of the attention that is properly due to it. Most especially, the Annual Report of the President's Council of Economic Advisers surely set some kind of record for its lack of attention to wage-price policy.

We in this committee are required under law to review the President's Economic Report and to make our assessment for the Congress, just as we are required to make an assessment of the President's budget for the Budget Committees of the Congress.

Mr. Rees, this committee has not forgotten the fact of the existence of the Wage and Price Stability Council. We remain convinced that an active, voluntary price and income policy is every bit as crucial an element of overall economic policy as are fiscal and monetary policies. We have repeatedly in the past urged your Council or a similar council to step up its activities. We have done our best to give you or to encourage a larger staff for your organization, and some additional authority.

We have invited you here this morning to give your assessment of the price outlook and the role which price-incomes policy can play in getting the rate of inflation down at the same time that we are struggling to get output and employment up.

Once again, we underline what we know is the difficulty of these assignments and the uniqueness of the economic situation which plagues our country today with inflation, and yet at the same time with recession and rising unemployment, with a price stickiness or inflexibility at the time of recession. I think we have good reason to hope that the rate of inflation can be reduced this year, and perhaps might I add, reduced a good bit more than many of the forecasts indicate.

I hope that that is some note of prospective good news, but this will happen, as I see it, only if we follow appropriate policies.

One step that we should take is to reject, as I see it, Mr. Zarb, the President's proposals for new fuel conservation taxes and for complete decontrol of oil and natural gas. I thought I would forewarn you of some of the prejudices, at least of one member of this committee, and then we can go to it a little bit later. That action, as I see it, will save us at least 2 to 3 percentage points on the inflation rate. But we do recognize the need to conserve fuel. I also recognize that there are ways to do this, or at least I believe so, without touching off a major round of inflation; and those are the ways that we must choose. We will welcome, of course, your comment in the conservation area, particularly.

Another step that we must take to fight inflation is to get this economy growing again. This will give us the productivity gains which hold down costs.

Yesterday, Senator Javits in participating in our discussions, emphasized the importance of the productivity gains as a way of alleviating or moderating the inflationary forces. Again, I shall take the liberty to poll some questions on behalf of Senator Javits, if he is unable to get here, because he believes very strongly in the productivity council, its activities and of the necessity of fortifying it with additional resources.

A third and very important element in an effective anti-inflation policy is the kind of firm and forceful, but voluntary, price-incomes policy which we hope Mr. Rees is going to conduct. This policy is just as necessary in a time of recession as it is at a time of full employment, because, as we now see it, we have some industries, concentrated industries with strong market power, which just go

on raising prices no matter what. In fact, in some of my private discussions with industrialists and economists of late, I have heard that there is the fear that we may very well be able to sort of get the economy moving again, but in the meantime, that the price structure remains high. As that economy starts to take off, the fear is that the price structure will rise again because there has been no real moderation in prices.

The index of wholesale industrial prices went up 0.5 percent in January, far better, to be sure, than in the past months, but it is difficult to see why it went up at all in a month when unemployment hit 8.2 percent. I do not believe we can point to another comparable period in our economic history when you have had such a high rate of unemployment and still a climb in the price structure. The pattern has been a rather sharp decline, or at least a moderate decline in the price structure as the unemployment rate increased. Mr. Rees, I believe you expressed yourself some surprise and some concern over that price increase, and we want to discuss that with you in the question period.

Now, Mr. Rees, I have mentioned to both you and to Mr. Zarb, that we would like you, sir, to proceed first, and then Mr. Zarb. We will hold our questioning, Congressman Bolling and I; we will wait until you have finished your statements, and then we will proceed with the questioning to both of you as it comes along. You are at liberty, may I say, to use your statement as you wish, either in full or to do it on a rather abbreviated basis. Go right ahead. We welcome you.

STATEMENT OF HON. ALBERT REES, DIRECTOR, COUNCIL ON WAGE AND PRICE STABILITY, ACCOMPANIED BY JAMES BLUM, DEPUTY DIRECTOR

Mr. REES. Thank you very much, Mr. Chairman. I am accompanied here this morning by the Deputy Director of the Council on Wage and Price Stability, Mr. James Blum.

I am pleased to have this opportunity to appear before the Joint Economic Committee to discuss the current outlook for wages and prices. This is no doubt the only topic an economist can be pleased to discuss at the moment, for prices are the one relatively bright spot in a gloomy economy. The seasonally adjusted wholesale price index has now declined for 2 months in a row, and the rate of increase of the consumer price index has abated.

The consumer price increase rose 0.6 percent seasonally adjusted from December to January. This is the smallest rate of increase since last April, and is less than half the rate at which this index was rising in August and September. Retail prices fell from December to January for several important groups of commodities, including meat, poultry, and fish; dairy products; apparel; and cars.

We would be happier still about the moderation of inflation if it had been brought about by an increase in the supply of goods, rather than by an abrupt decrease in demand. In the long run, we must still develop ways to achieve the combination of rising output, high employment, and stable prices that has eluded us for so long.

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Even if appropriate monetary and fiscal policy combined with the natural recuperative forces of the economy produces an upturn in economic activity in the second half of 1975, I would expect the rate of inflation still to be declining at the end of the year. The slack and excess capacity that are checking the rise in prices will not be immediately removed by an upturn; in the great majority of industries slack will persist for some time into the recovery.

The Budget of the U.S. Government for 1976 contains a table on page 41 giving economic assumptions in which there is a line showing percent change in the consumer price index. In the column headed 1975, the figure shown is 11.3 percent, a number that has been widely misinterpreted. This is the estimated change from the 1974 index average to the 1975 index average, and more than half of that change has already occurred. The corresponding forecasts for the change during the calendar year 1975, or December to December, is below 10 percent, and was made before some recent favorable price developments. Although I have not engaged in price forecasting through the use of formal econometric models, it would not now seem unreasonable to expect the CNI to be rising at 7 to 8 percent for the year as a whole, and at a rate of 6 percent or less by the end of the year.

The improvement in price behavior, as measured by official indexes, understates to some unknown extent the true change in the price situation. The widespread belief that Congress intends to reenact price and wage controls is still deterring business from cutting list prices. Instead, price cuts are coming in large part through special promotions, rebates, and discounts, not all of which are reflected in official price statistics. Whatever Congress intends to do about wage-price policy—and I hope and believe that it will not be to reimpose controls—it would be desirable to do it quickly, so as to remove the doubts and uncertainties that are adversely affecting pricing policies.

The special factor to which I have just referred reinforces the natural tendency of concentrated industries with administered prices to adjust list prices slowly and with a lag. This lag tends to keep administered prices lower than their highly competitive counterparts during a boom, and to keep them higher during a recession. The council on wage and price stability is currently studying the pricing policies and costs of several concentrated industries, including steel, aluminum, metal cans, rubber tires and tubes, and some industrial chemicals, and we may make recommendations based on these studies.

It is no surprise that inflation is abating during a deep recession. The surprise is that inflation has not abated sooner and more substantially. I should like to address the rest of my remarks to the reasons why prices are still rising as much as they are. My views on this have been formed by discussions with many people in the private sector to whom we talk during the process of wage and price monitoring.

One of the main forces tending to keep prices high is the need of American industry to invest in new facilities to keep pace with the long-run growth of demand at a time when the costs of con-

struction and equipment are very high, when borrowing has been difficult and expensive, and the stock market has been severely depressed. Corporations that question their ability to raise large amounts of new capital from the sale of bonds or stock seek to raise more of it internally by maintaining substantial profit margins or by seeking to widen them. Further declines in long-term interest rates and further improvement in equity markets will help to relieve this concern, as will enactment of a liberalized investment tax credit.

A second source of rising prices is the increasing cost of energy, not all of which has yet been passed through to final prices paid by consumers. The cost of energy would be increased somewhat more by the adoption of the President's energy program.

Our agency has not been directly involved in formulating or analyzing this program. However, we did have a study of its impact on prices done for us by Data Resources, Inc., and a copy of that study has been furnished to the Joint Economic Committee. The study estimates that by the fourth quarter of 1975 the President's energy program would raise the consumer price index by 1.6 to 1.9 percent above what it would otherwise be. That is somewhat lower than some of the other estimates that have been made.

An even more important source of rising prices is the continued rise in unit labor costs produced by the combination of the sustained rise in wages and a substantial decline in productivity. In the fourth quarter of 1974, output per man-hour in the private economy was 3.7 percent below the fourth quarter of 1973, and unit labor costs were 14.0 percent higher.

During 1974, prices rose more than wages, and real wages fell. As the rate of inflation decreases, this will no longer be true, and the real wages of employed workers will begin to rise again.

Ordinarily, we expect and get a rise in real wages each year, and this is the principal way in which our economy distributes to workers the gains in productivity that result from improved technology and investment in physical capital and employee skills. In some multiyear collective bargaining agreements this is reflected in wage increases that are called annual improvement factors. But in 1975, we have no increased output to distribute. On the contrary, output is expected to decline for the year as a whole, even though it may be rising in the second half.

For the urban population, the situation is worse still. Not only is there an overall decline in output, but a larger share of the reduced output is going to pay for oil, sugar, coal, grain, and other resource-based products produced in rural areas or in other countries. Attempts to raise the real wages of urban workers under these circumstances must result in further increases in unit labor costs and in prices, which will further cut the standard of living of the retired, the unemployed, and other nonearners.

I am a great admirer of the American system of collective bargaining and democratic trade unions. One of the strengths of this system is its ability to adapt to changing circumstances. Some unions are adapting their demands to the circumstances of 1975, but unfortunately, others are not. In the same industry, construction,

one can find examples of both sorts. Some unions have lowered their wage rates for residential construction to encourage more work for their members, or some have renewed collective bargaining agreements with no general wage increases. Others, in the face of widespread unemployment, have negotiated wage and benefit increases of $1.50 an hour, $2 an hour, and even $3 an hour, on top of existing compensation of $10 to $15 an hour. Collective bargaining enjoys a privileged position under Federal law, particularly in construction, but abuse of such privilege invites reexamination of its sources.

We must also remember that there are two parties to collective bargaining and that just as responsible unions will not make excessive demands, responsible managements will not agree to them. This is a time when hard bargaining is appropriate, and it is more relevant to justify wage increases through cost savings than by comparisons with what some other group of workers achieved in very different economic circumstances 6 months or a year ago.

The most important collective bargaining agreement coming up in the months ahead is that between the U.S. Postal Service and the unions of postal employees. The Council on Wage and Price Stability intends to monitor these negotiations in an attempt to insure that they will not be the cause of inflationary increases in postal rates or heavy subsidies from taxpayers.

Many of the wage increases of 1975 will come about through the operation of cost-of-living adjustments or escalator clauses. It is understandable that such clauses are widely used in times of inflation, and they are now present in more than half of our major collective bargaining agreements. The protection they offer against inflation is the price that organized labor has been demanding for signing multiyear agreements. But such clauses have the potential for extending the forces of inflation beyond the period that gave rise to them. What began as an excess demand inflation continues as a cost-push inflation after the shortages have been replaced by recession. The Council on Wage and Price Stability will undertake a detailed study of escalator clauses, and may wish to make some recommendations about them at a later date.

Just as this is a bad time for increases in costs produced by large wage increases, it is also a bad time for increases in costs caused by new legislation, rules, and regulations. We share with Congress and the American people the desire to achieve clean air, pure streams, safe workplaces, and wholesome foods, to mention just a few of the benefits sought by regulation.

In some cases these benefits to be obtained by regulation are so great that the costs are clearly justified. In other cases, the benefits may be more questionable, or can be achieved in less costly ways. Our rate of progress toward desirable goals must be governed to some degree by the capacity of the economy to absorb the costs involved. Where jobs would be eliminated or prices would be raised by proposed regulations, alternatives must be carefully considered. We will be engaged in reviewing proposed rules and regulations of the agencies in the executive branch, using the powers given to us under Executive Order 11821. Together with the Office of Management and Budget, we are currently working with the agencies to

develop appropriate criteria for evaluating the inflationary impacts of their proposals.

At the present time, the main concern about the economy that all of us share is how to end the recession. But continuing to fight cost-push inflation does not conflict with efforts to halt the decline of economic activity. On the contrary, everything we can do to lower costs and prices helps to promote an earlier and stronger recovery. It helps to insure that tax cuts and easier money will generate increased output and employment, rather than being dissipated in price increases. For this reason, I hope that the Joint Economic Committee will sustain its interest in price and wage stability, which it has shown so effectively in the past.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you very much, Mr. Rees, for a very constructive statement. We will come back to you in the questioning period.

Mr. Zarb, we appreciate your being with us today and welcome your comments and discussion.

STATEMENT OF HON. FRANK G. ZARB, ADMINISTRATOR, FEDERAL ENERGY ADMINISTRATION

Mr. ZARB. Thank you, Mr. Chairman.

Mr. Chairman, the substance of my prepared statement has been received by the committee in one form or another in previous sessions. It would take too long to read it, but I, with your permission, would submit it for the record.

Chairman HUMPHREY. It will all be incorporated in the record at the end of your oral statement.

Mr. ZARB. It will probably take me twice as long to summarize it, so I will not attempt that, either. But I would like to make several comments.

Chairman HUMPHREY. Please. Cite for us at least the points of emphasis in your prepared statement, Mr. Zarb.

Mr. ZARB. Mr. Chairman, you were quite right in your opening statement that we are now engaged in a great national debate on the question of what we do with the energy problem. I think that is a very healthy, constructive, and good thing. We are finally focusing on an issue that has been vaguely defined and discussed over the last 2 or 3 years by all parts of government and others in our society without coming to grips with whether we agree on the size and shape of the problem, much less the directions of solutions.

The fact that we are having this national debate on this very important problem, in my view, is the good, healthy American way to solve this national problem, and I am delighted it is happening. We seem to also have some broad and general agreement. There emerges the conclusion that we do have a problem and that something must be done about the problem. There even is some agreement that whatever the solution is, we will have some degree of pain or sacrifice or change that must occur if we are going to solve it.

Now, I think all of these agreements and all of this discussion is very, very good, and a positive development. We do run the very dangerous risk, however, that this discussion and debate will result

in polarization, and that at the end of its period we might end up with no program at all or no national consensus at all.

I think that probably is the most significant risk that this Nation faces in energy in the coming months. We must resolve the energy problems, and we must agree on a plan. We must be able to go back to the American people and say your government has looked at the problem, we understand it, and now we have a program that we all agree will move towards a solution.

The most important areas of discussion have surrounded the program for conservation. The President has put forward a program where the value of energy in our economy would be raised to a different level, and that over a period of 5 to 10 years the economy would make decisions with respect to its investment and consumption patterns against that new value, and that those decisions day-in and day-out by the homeowner or by the driver or by the factory manager will result then in a new energy ethic.

The new energy ethic, it occurs to us, is a simple statement of the economy using energy for its real value, rather than a concept of lesser value. So, the disagreement that appears to emerge seems to be exclusively in the conservation area, although there are some disagreements on some of the other details within the President's program. But I would venture to say that on 70 percent of that total program that we have sent up, there has been a minimal amount of disagreement. I think our ability to reach agreement on those points is within our grasp.

On the conservation question, we have those who say that perhaps we should not attempt to conserve at all, partially for economic reasons and partially for other reasons. There are those who have said we ought to accept some pain in this program, but I do not like this variety of pain, show me another form.

We have those who say we should conserve, but we should conserve less. I think there are those who say that we should conserve, but we should conserve slower. That amounts to conserving less over some unit of time.

I think these are legitimate arguments, and those who put them forward put them forward with the point of view that should be recognized and thoroughly considered.

We ought to examine the economic impacts of the President's program, but we also ought to examine the economic impacts of the other alternatives. If we do nothing or if we conserve less, we ought to examine the economic impact of an embargo in 1976 or one in 1977, if it were fully effective and we allowed our expansion of imports to continue and our vulnerability to increase.

What would be the unemployment factor after 3 to 6 months of a fully effective embargo?

What would be the state of the economy in the State of Florida or southern California or New England if the cartel countries were able to apply a fully effective embargo during that period of time?

Where would those people be who now say we should do nothing, or much, much less at that moment when the Los Angeles County came to a complete halt?

That sounds like an overstatement, Mr. Chairman, but it really is not. We will expand our imports as we are now, and by the end of 1977 we will probably be importing 2 million more barrels a day, almost all coming from the Mideast and partially from Africa.

When we endeavor in these deliberations and look at the various forms of goals and methodology, and look at the President's programs for their economic impact, we should examine also the economic impact of these other alternatives. I think only then can we compare one to the other and make a rational long-term decision. It is not easy, simple, or clear. Mr. Chairman, no one has solved an energy crisis before. There is not even a university course in solving energy crises. So we are, to some extent, going through new ground. To that extent we should listen, talk, and learn. Nobody has all of the answers, and testimony such as this at hearings such as these can only add to the national body of knowledge and help us conclude this period with a program that we honestly believe in, and one that will get the job done. The job, in my view, is to begin immediately to limit the imports of oil, to back out of our commitments to the cartel countries, and to end up no later than 1985 with a set of circumstances where we are completely invulnerable to what could be a disastrous economic attack or to the kind of political leverage that has applied to us in the past.

That is all I have, Mr. Chairman.

Chairman HUMPHREY. Thank you very much, Mr. Zarb.

[The prepared statement of Mr. Zarb follows:]

PREPARED STATEMENT OF HON. FRANK G. ZARB

Mr. Chairman, Members of the Committee, I appreciate this opportunity to appear before you today to discuss the President's energy program and its economic impact.

I'm sure that we all agree that the present energy situation requires broad, decisive and prompt government action to prevent continued erosion of our economic vitality and national security. The challenge we jointly face is to promptly implement a coordinated national energy policy which restores our energy independence.

The scope of the task suggests its wide-ranging and long-lasting significance. The lives of the American people—indeed, those of the people of much of the world—will be seriously affected by what we do, or fail to do, in the days ahead. And they will not be affected just for 5 or 10 years, but for generations to come.

Our economic system is strong and resilient. However, the impact on other countries much more dependent on oil imports has been correspondingly greater. The United States can be profoundly affected by severe economic crisis abroad. We must show our leadership among the industrialized nations and demonstrate our willingness to take the hard and expensive steps in energy conservation and development of new energy resources. The President's program is an outstanding example to other countries of America's determination to reverse the trend towards dependency. Reducing our vulnerability to supply interruption and price manipulation must be given the highest priority.

The President has prescribed tough action to cure our energy ills. He has outlined three time-phased goals.

One: In the short-term, a cut in our oil imports of 1 million barrels per day by the end of this year and of 2 million barrels per day by the end of 1977.

Two: By 1985, imports of no more than 3–5 million barrels per day—and the capability of immediately replacing that amount from storage and standby measures in the event of a supply disruption.

Three: Accelerated development of energy technology and resources so that the United States can meet a significant share of the energy needs of the free world by the end of this century.

ACTIONS TO MEET SHORT-TERM GOAL

In the first crucial years, there are only a limited number of actions that can increase domestic supply. We must develop and increase production from the Elk Hills, California, Naval Petroleum Reserve. The President has submitted legislation for this purpose.

The administration has also submitted a set of comprehensive amendments to the Energy Supply and Environmental Coordination Act of 1974 to ultimately increase the number of oil burning facilities that can be converted to coal in the coming year.

These are the only supply actions that can have much effect during the next 2 to 3 years. Therefore, we must rely heavily on energy conservation and it is clear from our experience that voluntary conservation measures are not adequate to do the job. We cannot wait months or years for long-term conservation measures to achieve our national goals. Therefore, as you know, the President has raised the cost of all imported petroleum products by imposing a $3 per barrel import fee as a first step to reducing demand. This fee began February 1, and will be applied in three consecutive monthly $1 increments. The revenues raised thereby will be returned to the economy through the President's recommended tax program.

I want to emphasize that these increased import fees are only temporary and will be adjusted to $2 when Congress enacts the President's comprehensive tax legislation which includes an excise tax of $2 per barrel on all crude oil and petroleum products.

To ease the impact on regions heavily dependent on imported petroleum products, such as the Northeast States, the President's program provides for a much lower fee rate on products than on crude oil.

In addition, a proposed excise tax of 37¢ per thousand cubic feet on all natural gas would be equivalent to the $2 oil excise tax, and would, with deregulation of natural gas as proposed by the Administration, serve to reverse the trend of dwindling natural gas reserves, unemployment due to curtailments, and prevent industrial switching from oil to already scarce natural gas.

In addition, the President will take steps to administratively decontrol the price of old domestic crude oil on April 1. Accordingly, congressional enactment of the windfall profits tax by that time is urgently required to prevent excess profits accruing to the industry. However, care must be taken to inhibit the needed amount of capital required to find and develop new oil and other contiguous energy sources.

A program of income tax reductions and rebate measures to return to the economy the roughly $30 billion estimated to be raised this year through these provisions has been proposed. Most of this money is to be restored directly to consumers, with special measures to provide funds for the poor.

The use of import fees, excise taxes and decontrol of oil prices to foster large-scale energy conservation has attracted much attention and criticism.

I would like, therefore, to spend a few moments discussing alternatives. First, there is the alternative of doing nothing. No action only postpones the tough decisions we have to make. Without conservation, our tab for imported oil, which was $3 billion in 1970, and $24 billion last year (1974), would reach $32 billion in 1977. A brief respite of a year or so will only increase the vulnerability of the world to a crippling embargo by the producers.

The Arab embargo of 1973 resulted in a significant drop in our Gross National Product and the unemployment of perhaps one-half million members of our labor force. Today, even more of our imports are coming from Africa and the Middle East than did a year ago. Now over half of our petroleum imports come from sources outside of the Western Hemisphere. And, unless we do something, this dependence on African and Middle Eastern sources will continue to grow. By 1977 imports will reach 8 million barrels per day, as compared with 6 during the last embargo. Because all of the increase will come from insecure sources, we may well be just as vulnerable as we were last winter. This is simply unacceptable.

Every month we hesitate will make it that much harder to achieve our 1985 goals. Those who say action is too expensive should reflect on the future cost to the nation if we do not act expeditiously.

There are those who believe that raising prices of energy at home will not help us cut back on consumption. They are wrong. While a comparison of our

present consumption with that of last year's shows that we are actually using slightly more now, more importantly, we are using much less than we would if prices had not risen 400 percent in the last year. This is a clear demonstration of price elasticity of demand, or consumption of certain items decreasing as their prices rise relative to other prices. Present consumption would have been at least 1 million barrels a day more if prices had not risen so sharply. Furthermore, although the cartel has cut back on production by about 9 million barrels a day, there is still a surplus of oil on the world market. There is concrete evidence all around us that price is indeed effective in reducing demand.

The other alternative to inaction is the greater use of government controls—whether import quotas, allocation systems or rationing, or on another level, Sunday closing of gasoline stations, no driving days, etc. We looked at all of those last year during the embargo. We chose some and rejected others. And our reasoning for choosing those few conservation measures was good for a short-term crisis. We now face a longer-term one. Each of these alternative would involve some form of self-imposed shortages as well as built-in inefficiencies, burgeoning bureaucracies and regulatory proliferation and disruptions in the lives of all American citizens. And remember, to be effective, controls must be in place for a long-term of up to 10 years. I doubt that the American people would be willing to put up with such alternatives nor should we subject them to this long lasting pervasive control over almost every aspect of their lives. Furthermore, most of the controls would involve higher costs to everyone. Gasoline taxes, for example, would have to be increased about 40¢ per gallon to save 1 million barrels of oil per day. Instead, the crude oil price increase, distributed across all of the products from a barrel of oil, will raise the price of gasoline about 10 to 15¢ per gallon. This seems a more effective and more equitable solution.

I think it's unnecessary for me to dwell on this at any greater length. Suffice it to say, we should allow the free market to work to the maximum extent possible. This is what the energy conservation taxes and fees would do. And the rebates would assure no significant loss of consumer purchasing.

MID-RANGE (1975–1985)

The second of three goals addressed in our energy program is the elimination, by 1985, of our nation's vulnerability to economic disruption by foreign suppliers. In other words, by then our petroleum imports should amount to only 3–5 million barrels per day of our consumption, and we should be able to implement standby emergency measures and draw from storage enough to offset a complete cutoff of these remaining imports.

To attain such a goal, we must start immediately to remove constraints and provide new incentives for domestic production and conservation because most of the measures will take 5–10 years to reach fruition after the necessary laws are enacted. And all of these things must be accomplished through a single program that has the balance to bring about the required reduction in our energy use, the necessary increase in our domestic production, and—equally important among our national goals—the continued economic well-being, environmental quality, national security, and social welfare that the American people demand and deserve. There is no piecemeal program which can provide the balance that is required. Hard decisions must be made from the very outset within the framework of our overall structure.

The President has reaffirmed the intent of this Administration to move ahead with exploration, leasing and production in those frontier areas of the Outer Continental Shelf where the environmental risks are judged to be acceptable. He has also asked the Congress to authorize oil production from the largest of the nation's Naval Petroleum Reserves, NPR–4 in Alaska, to provide petroleum for the domestic economy, with 20 percent earmarked for military needs and strategic storage. According to our estimates NPR–4 could produce 2–3 million barrels of oil per day and commensurately large quantities of gas by 1985.

But, in addition to finding more oil and gas, we must take advantage of our most abundant energy resource, coal. The President vetoed the surface mining legislation passed by the last Congress, but it remains a valuable piece of work. The President has submitted a bill which builds upon S. 425 in such a way as to make it acceptable to the Administration. I and others in the Administration are prepared to work with the Congress to arrive at a sound surface mining law.

The Congress must also act on the Administration's amendments to grant the Environmental Protection Agency authority to suspend emission limitations for powerplants until low sulfur coal can be obtained or stack gas scrubbers can be installed. The nation would thus be permitted to reap the enormous benefit of increased use of domestic coal under appropriate environmental safeguards.

The Congress should also amend the Clean Air Act to deal with the issue of "significant deterioration" of air quality. In this case, as in that of the strip mining legislation, we want Congress, rather than the courts, to make the essential legislative decisions that are required.

To assure rapid coal production from existing leases and to make new, low sulfur supplies available, the President has directed the Interior Department to adopt legal diligence requirements for existing Federal coal leases and to design a new program for accelerated leasing of Federal coal lands.

Of course the market for coal, as well as the availability of all electric power, depends upon the health of the electric utlities industry, and we must address its problems. In recent months, utilities have cancelled or postponed more than 60 percent of planned nuclear expansion and 30 percent of planned additions to non-nuclear capacity. The delays and difficulties this industry is currently experiencing could well lead to higher oil import needs and inadequate supplies of electricity 5 to 10 years from now.

The President has, therefore, proposed legislation to assist the electric utilities through higher investment tax credits; mandated reforms in State Utility Commission practices; and other measures. And to rejuvenate our drive toward more effective use of the potentials of nuclear power we have markedly increased our budget request for nuclear waste disposal and for continued improvements in safeguards.

As we take these actions to increase our energy supplies, we must be aware of some potential problems. Before we achieve our goals of energy sufficiency, actions of oil producing nations, or economic conditions could result in lower—but unstable—price levels that could weaken our continued commitment to greater self-sufficiency. The Federal Government must take actions to encourage and protect domestic energy investment in the face of significant world price uncertatinty. To foster such investment, the President has requested legislation to authorize and require the use of tariffs, import quotas or other measures to maintain energy prices at levels that will achieve full national capability for self-sufficiency and protect our energy industry and jobs.

All of the actions I have mentioned would have the effect of increasing our available domestic supplies of energy. Oil production could reach 13 or 14 million barrels per day versus approximately 9 million today, coal production could double and nuclear generation could increase from a 4 to 30 percent share of our electric generation capacity by 1985.

But, as in the short-term, supply actions are not enough. We must dramatically cut our historical demand growth. We have signed agreements from major domestic automakers to improve gasoline mileage by 40 percent on average by 1980, as compared to 1974 model cars, provided that the Clean Air Act automobile emission requirements are modified for 5 years.

The Energy Resources Council is developing energy efficiency standards for major appliances and will seek agreements from manufacturers to achieve an average 20% improvement in efficiency by 1980. At the same time, draft legislation has been submitted that would require labels on automobiles and major appliances disclosing energy use and efficiency. To move quickly where the problem hurts most, the Federal Government will provide money to the States for the purchase of insulation and other energy conserving devices in homes owned or occupied by low-income citizens, who might otherwise not be able to have such improvements made in their homes. The President's program also sets forth proposals to mandate thermal efficiency standards for all new buildings in the United States. Since energy savings are even greater for existing homes it also includes a proposal to institute a 15% tax credit for insulation investments up to $1,000.

These numerous proposals and actions taken together, can reduce our dependence on foreign energy supplies to 3 to 5 million barrels of oil per day. While this does not seem much less than current consumption, it is down substantially from the 12–13 million which we would have to import if we did not act. To ensure that we could meet any supply disruption of the remaining

imports we must establish legal authority for emergency measures that can be readily implemented to guarantee the equal sharing of shortages and the equitable allocation of supplies at home, and to meet our obligations under the International Energy Agreement abroad. We must also begin as soon as possible to develop a strategic storage capacity of 1 billion barrels of oil for domestic use and 300 million barrels for military use. Only by taking such precautions can we act responsibly both at home and in the international community in a time of future supply interruptions.

ACTION TO MEET THE LONG-TERM (POST 1985) GOAL

For the longer term, our goal is to sustain a position of energy independence, and to enhance it so that the United States will again be capable of supplying a significant share of the Free World's energy needs.

This means that, as a Nation, we must reaffirm our commitment to a strong energy research and development program, aimed not only at developing the capability to tap all our major domestic energy resources but also at improving the efficiency of energy utilization in all sectors of our economy.

Last year, the United States committed itself to a five-year, $10 billion energy-R&D effort. Our 1975 energy R&D budget was twice that of 1974 and three times that of 1973. In 1976, this accelerated effort must continue, and the President has pledged to seek whatever funds are needed for future R&D activities.

Now that we have an Energy Research and Development Administration, a Federal Energy Administration and an Energy Resources Council, we have, for the first time, both the unified Federal organization and the financial commitment to get the job done.

But energy R&D funds and organization are not enough; we also need new incentives to assure that emerging technologies are not only developed in the laboratory, but brought into use in the marketplace. Therefore, the President has announced a National Synthetic Fuels Program which will assure the equivalent of at least one million barrels per day in synthetic fuels capacity by 1985. It will entail a program of Federal incentives designed to reduce price uncertainty, raise capital and overcome unnecessary delays in bringing existing or nearly developed technologies into commercial use. The program will result in the commercial application of technologies of several types and the construction of major new plants, using both oil shale and coal resources.

I would now like to turn to the effects of the program as a whole on the economy. In looking at the economic costs of the program it is important that we keep in mind the alternative costs of doing nothing. In the fall of 1973 and the spring of 1974 we learned that our dependence on increasingly large amounts of foreign oil could prove very costly both in strictly economic terms and in terms of maintaining a flexible foreign policy. The President's Program represents a form of insurance—insurance that our economy will never again face this kind of threat to our political well being. It is our considered opinion that the long-term benefits of the President's Program far outweigh the short-term costs.

Let us take a look at these short-term costs and benefits. The economy will feel the effects of the program through many channels. On the demand side the economy will be stimulated in many ways. The tax reduction and payments to low-income individuals in 1975 will provide a substantial boost to aggregate demand and provide the economy with the kind of stimulus that is needed to return it to a position of strength. Decontrol of domestic crude oil prices, deregulation of new natural gas and the opening up of Federally controlled sources of energy (Outer Continental Shelf, Naval Petroleum Reserves) should lead to a substantial increase in investment and result in increased employment. A final stimulus will occur by reducing our outflow of dollars by reducing the level of oil imports. Instead of being drained from this economy these dollars can be maintained in circulation here to create more jobs.

Of course, there are certain economic costs of the program, which have been the subject of a great amount of discussion. Let us first take a look at the effects on the GNP. Higher oil prices have two effects on demand. They reduce real consumption because consumers will not be able to substitute completely away from the higher cost items. More importantly, however, they cause the pattern of demand to change. Commodities which require much energy to produce or use will become relatively more expensive, while commodities which

use less energy will become relatively cheaper. In addition to creating a powerful stimulus to conserve energy, costs are increased in some industries more than others. Our studies indicate that the paving mixtures, asphalt felts, inorganic and organic chemicals, air transportation, carbon-graphite products and synthetic rubber industries will be affected more by higher energy prices than industry generally. This will require adjustments and some temporary problems. Let me emphasize that any resulting unemployment, while a very real problem, is both small in magnitude and temporary in nature. But let me emphasize that the bulk of the conservation effort will come from a reduction in the waste use of energy both by consumers and by industry. This waste can be trimmed with no increase in unemployment.

Let us now look at the impact of the President's Program on inflation and unemployment. Our estimates indicate that the annual rate of inflation as measured by the Consumer Price Index will rise about two percentage points in 1975. Changes in 1976 and 1977 are minimal—less than a third of a percentage point. While this inflationary impact is important, it must be put into perspective. Normally inflation is a concern because it imposes hardship on those with fixed income; their expenditures rise but their incomes don't. This is not the case with the President's Program. All revenues collected will be rebated to the public, and in fact, those who would be hurt hardest by inflation—the poor and those on fixed incomes—would receive more than they would spend on higher energy prices.

Because of the offsetting influences of stimulation to the economy and higher prices, the President's Program is expected to have a negligible effect on the unemployment rate compared to what would have happened if nothing at all were done. The unemployment rate is expected to peak out during 1975 and fall during 1976.

On balance, therefore, the costs do not seem very great. This is especially true considering the reduction in vulnerability to foreign political and economic influences which will be the result of the President's Program. Even in the case of an embargo, adoption of the President's Program would result in minimal damage to the economy. Add to this large benefit the positive balance of payments effects and the additional flexibility for our foreign policy and you have compelling reasons for adopting the program.

I'd like to close my discussion of the economic impacts by discussing another very important cost—the cost of delaying action. The President's Program will set in motion powerful forces to reduce energy consumption and to substitute domestic for foreign supplies. This, however, cannot take place overnight. Raising prices now has powerful effects on the future as people change the kinds of cars they buy, change the degree of insulation in their homes, change heating and lighting habits, etc. The longer we delay action, the longer it will take for these forces to work. The longer it takes for the forces to work the more vulnerable our economy and our foreign policy becomes.

CONCLUSION

The program the President put forward is a comprehensive one. It will reach the goals the President set forth and which I think the American people want. I have heard much talk and criticism in recent weeks on elements of it, but I still have seen no constructive alternative. We all want an easier way to reach our goals. This program does require sacrifice by all, but it is also equitable. Finally, its impacts are far outweighed by the important benefits it will achieve. I again pledge the full force and cooperation of the agency I represent in working with members of this Committee and with the Congress as a whole to implement a comprehensive and timely national energy program.

Thank you.

Chairman HUMPHREY. Let me just take a few moments with you, Mr. Rees. As I said, I want to express my thanks for a very constructive statement. I also wish to express my thanks for listening to a witness that did not lecture us on what was going to happen to the money markets if we had to finance the deficit which we know we have to finance, and the refinancing of the present public debt.

I have listened to that ad infinitum, and frankly, while I have been impressed with its repetition, I have not necessarily been moved by its logic, because there seems to be such controversy and so much evidence to the contrary.

As I understand, you have said, Mr. Rees, that: "Even if appropriate monetary and fiscal policy combined with the natural recuperative forces of the economy produces an upturn in economic activity in the second half of 1975, I would expect the rate of inflation still to be declining at the end of the year." Now, this has been the basic testimony that we have received from people outside of the Government. Now, I do not expect you to take over the duties or the responsibilities of Mr. Simon or Mr. Greenspan or Mr. Burns or others, but in your work as the Director of the Wage and Price Stability Council, do you see any danger of "reigniting the fires of inflation" by the financing that may be required for the budget deficit, and the easing of the money supply, let us say, in rates that may be between 6 percent and 10 percent?

Mr. REES. I should preface my remarks, Mr. Chairman, by saying that my field of expertise is not monetary policy or financial markets.

Chairman HUMPHREY. That is why I want to hear from you. I have heard from the experts before. They have got too many of those on the Federal Reserve Board. I would like to know—how would you feel, just as an intelligent citizen?

Mr. REES. Well, as an intelligent citizen—or I hope an intelligent one——

Chairman HUMPHREY. You are a very intelligent man.

Mr. REES [continuing]. I would feel that expanding the money supply at a rate of, say 6 percent, would not create a danger of reigniting inflation during 1975. Now, in the long run, 6 percent is a bigger rate of growth of the money supply then we can sustain without inflation, so that if you continued that rate of growth into——

Chairman HUMPHREY. But you see, I did not say that. I do not want to take us off into these lands of fantasy. I want to stay with the hard world of reality. This is a problem. They always get the doctrine of eventuality in here, and I can assure you that—you know, you can kill yourself off of anything if you attempt to continue the remedy after the disease is gone. You know, there is no sense in that. We have just got to knock it off someplace. Somewhere along the line, somebody has got to say, well, we have done what we need to do, and we do not just keep it on. In other words, there may be a time, going down the straight road, when you have to put more power into the car and more gas into the engine, so to speak. But when you get down to where you are on level ground, you do not just go down hellbent for election, unless you just want to collect your life insurance, or have some member of your family collect it .

Now, looking ahead at what you can see for about a year—and that is about at good as most of us can see; as a matter of fact, we have had some experts here that could not see 2 months ahead, because they got way off the track, and I am not too critical of that, except they act so pontifical about, you know, that we are right.

Now, let us assume that we can play around with the next 10 months. Do you expect that if the money supply is eased along the lines that witnesses have testified—6 per cent, 8 percent— that we are just going to reignite the fires of inflation?

Mr. REES. Well. I would not expect that myself. Even 4 percent would look awfully good after the zero of the last 6 months. I think some rate of increase in the money supply, in my personal judgment, is called for. But of course, I am not a member of the Board of Governors of the Federal Reserve System, and I do not have access to all of the information that they have.

Chairman HUMPHREY. Again, I want to thank you, because—I am always reminded of that little boy who wrote to the Library of Congress and said he wanted some information on Finland, and they sent him back a crateful of it. And he wrote back and said, I did not want to know that much about Finland. And I am afraid that we have got so much information at times that we do not want to get around to making a decision. Very good.

I thought there was some good news, and let me just say for the record I am not a pessimist about this economy. I think what is needed more than anything else is an agreement upon policy between the executive and legislative branches. I think there are forces ready to go to work in this economy, if we can once get our own house in order here in Washington. One of the real problems, as I have seen in the past, is that there has been all of this uncertainty about what the Government is going to do, and I do not mean to reuse old phrases; because what we had was these phases and freezes, these starts and these stops, and all of this argument over money supply and et cetera, until no one in the investment world knew what to do. People just could not plan ahead, and the labor force was wondering all the time what was going to happen, because they looked first at wage and price control, and what we call phase II, and then it altered into phase III, and there is all this uncertainty, so that everybody was out, you know, to get their little piece of the action. I think this had a great deal to do with the rise of inflation, and I think it had a great deal to do with the troubles in the stock market, and surely in the investment market. So if I could do one thing for my country today, it would be if the President and the Congress could just agree upon two or three fundamentals, we can argue about all this peripheral stuff afterwards. I think that would really put this econmy on the move, because it is here—and I do not think we ought to badmouth it all the time, and I sometimes worry that I have contributed to that—I am not one that believes we are ready to go down the tube. I think we are just ready to take off if somebody would say, let us go; but you cannot if somebody says go and somebody else says stop. And pretty soon, you get not only schizophrenic personality, but you start to divide into several parts, sort of like Gaul, and how many parts did it have—three, I think at one time.

I noticed the good news, though. You said the corresponding forecast for the change during 1975, or December to December, is below 10 percent. It was made before some recent favorable price

developments. In other words, you are not talking about the budget forecast and the economic message forecast.

Mr. REES. I am talking specifically about the budget forecast on page 41 of the Budget of the United States Government for 1976.

Chairman HUMPHREY. Yes; I had quite a to-do with the Budget Director about those forecasts, because I think they were based upon information that was changing so rapidly that there was no way they could keep up to it. And I think it is just well to admit it. You know, let us not argue about it. Everybody knows that.

You said, "although I have not engaged in price forecasting through the use of formal econometric models, it would not now seem unreasonable to expect the CPI to be rising at 7 to 8 percent for the year as a whole, and a rate of 6 percent or less by the end of the year." I just want to get up and say, hallelujah. I think that is a real possibility, but I think again it depends on whether or not we can come to some agreement on the tax program and on the energy program, and possibly upon the housing program. We have got two great giants in America's economy that are in serious trouble; the automobile industry on the one hand, and, the construction industry on the other, anl I will tell you, I repeat what I have said before. Until we get at that housing, until we can start to move in the housing industry, we are just kidding ourselves. This economy is not going to respond, and this is where I think too little attention is being given in Congress. We are sitting around here arguing about a lot of other things, including rules changes, which does not affect the American public one bit, you know. What we ought to be arguing about is what the rate of interest is going to be, rather than what is the rate to break a filibuster. I have spent 20-some years on that; I am perfectly willing to go another half a day. But I have had about enough of it.

What we need to do is to get that interest rate down, not just three-fifths of the Senators being able to stop a filibuster.

Now, you have given us something here about inmprovement in price behavior, and I would like to just note for everybody's attention where you start there, "improvement in price behavior." And I believe it is important that this committee at least tell people what it believes. I am going to tell you what I believe. I do not want a reimposition of price and wage controls. I think we ought to give to the American public that assurance. If price behavior shows a decline, as it is now, we ought to give an assurance that that the labor movement and the industrial labor/management sector is not going to have wage and price controls. And I hope that will come out clear. And then, we will see whether or not the response that we anticipate is forthcoming. I think it would be. I believe we have got all kinds of evidence that shows us that they are holding up these list prices, using all of the gimmicks of discounts and rebates and special sales, simply because the people in the industry are worried that we are going to slap on these controls. I would like to give the economy a chance to adjust itself, and I think it can, and that is going a long way for somebody that is supposed to have been on the other side. But I never have been much for

wage-price controls. I have not been for wage-price controls any more than I am for having my teeth pulled, or a few other things. I mean, sometimes they are necessary, but I do not think they are now.

The other matter that I wanted to call to your attention is, you read the Library of Congress report on the impact of the President's energy program?

Mr. REES. Yes, sir; I did.

Chairman HUMPHREY. Why is your estimate so different? We always consider the Library of Congress to be a rather objective vehicle of information.

Mr. REES. The Library of Congress report includes a rather large multiplier factor that they apply to the initial impact of the energy program in order to get the final impact. They did not state where that multiplier factor comes from, and frankly, I have not attempted to look into that. We could if you would like us to, but the multiplier effect that they use is very much larger than that used in any of the other studies, and I frankly do not know why.

Chairman HUMPHREY. I think it would be very good, and I want to say here, so that the staff will note it, I am kind of wary about arguing about who is right about this business, whether it is 3 percent or 4 percent or 1.5 percent, or 1.9 percent. Even if we cannot agree on policy, we ought to be able to agree on figures, and so we can quit making speeches about it. Now, I have enjoyed making several speeches about the 3 percent rate of inflation. One of my advantages is, I have indulged in most of these sins, and I think it is about time that we got over some of them.

Mr. REES. Mr. Chairman, Mr. Zarb informs me that his Agency has a detailed analysis of that Library of Congress study that they would be happy to provide for you.

Chairman HUMPHREY. All right. We will assign somebody to argue with you, Mr. Zarb, and then we will see if we cannot negotiate out a figure that people can agree on. There is no sense of our being on different statistical wavelengths here. We ought to know what the facts are, and if there is a difference as to the assumptions we make, they ought to be noted so that we can tell the public the truth.

Mr. ZARB. We have a paper, Mr. Chairman.

Chairman HUMPHREY. Nobody knows what is going on now. Somebody gets up and makes a speech. A good Democrat said it is 3 percent. An administration man says it is 1.5 percent. Mr. Rees comes in and says, I think it is about 1.9 percent.

Representative BOLLING. What is Mr. Zarb's figure?

Chairman HUMPHREY. What do you say, Mr. Zarb?

Mr. ZARB. I was going to say 2 percent, but maybe I better say 1.9 percent, so I do not foul it up.

Chairman HUMPHREY. What were you going to say, Mr. Zarb?

Mr. ZARB. About 2 percent.

Chairman HUMPHREY. I think you are creeping up there.

Mr. ZARB. I think we have a fair analysis of the comparison of the Library of Congress' work and our own. We will leave it with you today, and we can insert it for the record.

Chairman HUMPHREY. Very good. One of the staff men was just saying to me he did not recall there was any basic multiplier factor in the Library of Congress' report. But we are not going to spend time on that. That is detail. I do not want to spend any more time on that.

[The comparison follows:]

COMPARISON OF FEA FIGURES WITH THE LIBRARY OF CONGRESS' CONGRESSIONAL RESEARCH SERVICE'S ANALYSIS OF THE PRESIDENT'S ENERGY PROGRAM

(Technical Report 75-4, F.E.A.—E.A.T.R.—75.4, February 5, 1975, Office of Economic Impact and Office of Quantitative Methods, Federal Energy Administration)

BACKGROUND

On January 23, 1975, the Congressional Research Service (CRS) of the Library of Congress, issued a critique of President Ford's energy program. This critique estimated that the direct costs to consumers of the President's program were in the range of $40-$50 billion and that the inflationary impact would be a 2.7 to 3.3 percentage point increase in the inflation rate. This study's assumptions and analysis have been carefully reviewed, and it appears that there is a substantial overestimate of the cost figures and that the change in the Consumer Price Index (CPI) will be less than that stated in the CRS analysis. This paper documents where the Congressional Research Service's assumptions and conclusions differ from those of the FEA analysis.

COMPARISON OF RESULTS

Total cost

The Congressional Research Service estimates that the cost of the President's program could be as high as $50.3 billion in 1975. Table 1 presents the total cost of the program according to the Administration and to the Congressional Research Service. The portion of the total cost that will be paid by consumers is $19.2 billion. A detailed discussion of the underlying assumptions and support for these figures is presented below.

The Treasury Department estimates that $5 billion of this cost increase applies to state and local governments. The FEA analysis of the macroeconomic effects demonstrates that approximately $7.8 billion will flow into capital goods investments or will be absorbed by reduced markups under forecasted market conditions. Therefore, the net first year costs at an annual rate are $19.2 billion for consumers.

TABLE 1.—COMPARISON OF ALTERNATIVE COST ESTIMATES[1]

[In billions of dollars]

Action	Congressional research service study	FEA cost analysis
Oil:		
Petroleum fees and excise taxes	$12.6	$11.19
Decontrol of old oil	11.0	13.01
Total	23.6	24.20
Natural gas:		
Excise tax	8.36	7.1
Deregulation of new gas	5.40	.7
Total	13.76	7.8
Coal: Price increase	5.2	0
Changes in Utility Accounting:		
Inclusion of construction work in progress (CWIP) in rate base	6.8	
Inclusion of pollution control equipment in rate base	1.0	
Total	7.8	0

[1] Calculations for both studies are contrasted in the section discussing the assumptions of the analyses

Impact on the Consumer Price Index

The Congressional Research Service study further states that given a cost of $50.3 billion in 1975 and given an anticipated 1975 GNP of $1500 billion, the President's program could raise prices by 3 percentage points. A stage-of-processing model was used by FEA to forecast the effect that energy price changes have upon the Consumer Price Index and components of the CPI. The model requires two inputs: (1) forecasts of wholesale energy prices and (2) forecasts of the general wholsale and retail price indices prior to energy price changes. Price information is combined with historical information on the relationship between the stages-of-processing to forecast the effects that energy price changes will have on the prices of crude wholesale goods, intermediate wholesale goods, finished wholesale products, and finally, retail consumer goods and services.

Using this methodology, it is estimated that the CPI will increase 2 percentage points during the first full year of the program. Given the normal, unencumbered economy, the CPI would rise by approximately 2.5 percentage points during the first full year of the program in addition to the normally expected rise. These estimated increases tend to overestimate the affect of the program for two reasons:

(1) The energy price increases that were used as inputs to the model assume a full pass-through of the taxes and import fees. It is unlikely that this will occur because of the tax rebates to industry and because the economy is generally weak. Thus, excess supply would result if industry attempts to pass-through all of the costs.

(2) The stage-of-processing model is based upon historical markup relationships and these may not hold because of the currently poor market demand conditions. That is, demand is currently at such a low level that companies may not be willing to pass on increased costs for fear of further reducing their markets.

Consumer Cost Impacts

The consumer costs that will actually be incured by households has been estimated by the Administration to be $19.2 billion for the first year at an annual rate. Table 2 illustrates the range of costs by income class and contrasts these increased costs with estimates of expected tax relief. No total estimate of the impact on consumers is presented on the CRS study.

TABLE 2.—ILLUSTRATIONS OF PERMANENT TAX RELIEF AND INCREASED ENERGY COSTS AT VARIOUS LEVELS OF HOUSEHOLD INCOME

[In dollars]

Household income	Total increased energy costs	Permanent tax relief plus $80 special payments for adjusted gross incomes equal to household incomes shown	
		Single person (minus)	Family of four persons (minus)
2,000	85	80	160
3,000	110	120	160
5,000	150	250	178
8,000	188	297	337
10,000	228	254	349
12,000	253	190	316
15,000	296	190	221
18,000	318	190	210
25,000	393	190	192
30,000	420	148	151

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Jan. 30, 1975.

DIFFERING ASSUMPTIONS BETWEEN ADMINISTRATION ANALYSIS AND CRS STUDY

There are major differences in some of the assumptions used in each analysis. These are highlighted in this section along with the detail.

Oil

The mix between imported oil and domestic oil is different because our estimates assume that demand reductions and import savings occur. In addition, FEA's inclusion of Natural Gas Liquids is identified separately from aggregate crude oil. However, the total figures are quite similar.

The figures of the Congressional Research Service are repeated as:

	Cost per year in billions of dollars
1. Excise tax: 17.3 MMBD × 365 × $2	12. 6
2. Presently controlled oil: Decontrol: 5.22 MMBD×365×$5.75	11. 0
Total oil	23. 6

The FEA analysis is contrasted as:

1. Import fee: Uses estimate of 5.433 MMBD imports after implementation of President's program. $2×5.433 MMBD×365	3. 966
2. Excise tax on domestic oil:	
Production of 8.7 MMBD. $2×8.7 MMBD×365	6. 35
Equivalent tax of $1.43 per barrel of natural gas liquids (NGL) with 1.66 MMBD. $1.43×1.66 MMBD×365	. 866
3. Decontrol of old oil:	
Assumes 60 percent old oil exclusive of Elk Hills (.1 MMBD annual average), hence 5.16 MMBD of old oil rising from controlled price of $5.25 to uncontrolled price of $11. $5.75×5.16 MMBD×365	10. 83
Assumes NGL price rises equivalent amount of crude oil. Crude increase $4.56 less $1.43 due to NGL tax. $3.13×1.66 MMBD×365	1. 896
Adjustment of +$0.29 billion to account for rounding and refinery gain and to balance calculated increase of product prices of $4.10 and average consumption of 16.17 MMBD	. 29
Total: $4.10×16.17 MMBD×365=$24.2 billion)	24. 198

Natural Gas

The Congressional Research Service study assumes that 1975 natural gas production is 22.5 trillion cubic feet (tcf) and that the amount of new gas subject to deregulation in 1975 will be equivalent to a $5.4 billion initial cost for the first year. In fact, this argument overstates the natural gas impacts for the following reasons:

Approximately 1 trillion cubic feet of contracts for interstate gas would expire and be available for new contracts in 1975, even with decontrol. This is substantially less than that reflected by the CRS study in its $5.4 billion cost for the first year. Without deregulation, very little new gas is going to interstate sales.

The excise tax will be levied on net marketed production and not on total gas production. Hence, only 19.1 tcf will be affected by the excise tax of 37¢. This will result in a much lower total cost attributed to the excise tax.

Deregulation could presumably bring up to .8 tcf of additional gas into the interstate market in 1975. If this occurs, it would tend to replace an equivalent amount of imported oil which would have cost as much, or more, as the new gas prices. The President's program would tend to shift this amount from imports to gas, but would only increase consumer costs by the amount of the excise tax.

The figures of the Congressional Research Service are:

	Cost per year in billions of dollars
1. Excise tax: 22.5 tcf×0.37	8. 3
2. Deregulation of new gas	5. 4
	13. 7

The FEA analysis is contrasted as:

1. New interstate gas: Estimated at 0.91 tcf with equilibrium price of $1.11 compared to average of $0.28 on old gas. Excise tax of $0.37. $1.20×0.91 tcf	1. 092
2. Old interstate gas: Interstate estimated as ⅔ of total gas consumption of 19.1 tcf. $0.37 (19.1×0.667−0.91)	4. 376
3. Intrastate gas: Excise tax on ⅓ of total consumption. $0.37×(19.1×0.33)	2. 322
Total natural gas	7. 800

Coal

The Congressional Research Service analysis assumes that coal produced in 1975 will rise in price by an equivalent of $2 per barrel or approximately $8/ton. We estimate that 80 percent of all coal is under long-term contracts, where prices tend to reflect long-run coal production costs, which do not tend to rise in real terms. Further, our current estimate indicates that coal prices are limited by the inability of gas and oil consumers to convert to coal. As a result even the remaining 20 percent of coal sold in spot markets is likely to sell only at prices necessary to cover overtime pay and other costs of getting out the 1975 rate of production (about 35 mmt more than 1974 because of production lost during the strike). Higher prices for oil would add very little to the amount of conversion to coal. Conversions to coal are estimated at 23 million tons in 1975 and 47 in 1976.

The figures of the Congressional Research Service study are:

	Cost per year in billions of dollars
Price increase: $8×650 mmt	5.2
The FEA analysis is contrasted as:	
FEA assumes no direct increase in coal due to the President's program (see discussion of assumptions)	0

Changes in Utility Accounting

The above costs of the President's program as estimated by FEA consisted of the cost of imposing taxes and fees on petroleum and natural gas and the cost of decontrolling the price of old oil. The costs associated with changes in utility accounting procedures were not included for several reasons:

(1) The need for additional funds to finance electric utility expansion will require some form of rate change. This need for a rate change is independent of the President's energy program. Hence, the costs of any proposals, such as changes in the accounting procedures, should not be included in the costs of a program designed to achieve energy independence.

(2) The changes in accounting procedures presented by CRS allow for the addition of one billion dollars worth of pollution control equipment in addition to the expansion of plant and equipment. This clearly is not part of the cost of achieving energy independence and may not even be the appropriate amount of pollution control from a cost-effectiveness standpoint.

(3) The accounting changes are part of the long-term energy program and will have no effect on short-run energy supplies.

In addition to inappropriately including the utility accounting changes, the CRS has incorrectly estimated the impact of these changes. The Congressional Research Service estimates that the additional 1975 costs will be $6.8 billion by including construction work in progress in the rate base. This is based on an FPC/Office of Economic study, An Analysis of the Electric Utility Industry's Financial Requirements, 1975–79. This cost is incorrect in that the costs of including construction work in progress in the rate base as estimated using the FPC study are $3.4 billion.

Chairman HUMPHREY. Let me ask you, Mr. Rees. Do you think the Council of Wage and Price Stability ought to have any broader powers than it presently has? For example, this Committee has repeatedly recommended subpena power. We recommend the power to impose a 90-day suspension on the wage and price increase while we examined the records. Do you have any feelings about this? Do you want to make any recommendation?

Mr. REES. I testified before the Senate Banking Committee, Mr. Chairman, in opposition to the 90-day delay powers; something of that sort is incorporated in the Proxmire-Stevenson bill S. 409. Our view is that delay powers represent a step back to wage and price controls, which is not necessary or desirable at the present time. Such a step would contribute to this kind of undesirable

pricing behavior, unwillingness to cut list prices, that I referred to in my opening remarks and that you referred to a moment ago.

With respect to subpena powers, there is not a unanimous view within the administration. My personal view is that there are some occasions in which it would be helpful to the Council on Wage and Price Stability to have subpena powers. We would, I think, plan to use them very rarely. We would much prefer to get information submitted voluntarily, in large part because you can get it much more quickly that way. But there have been a few cases in which we have not gotten as much cooperation as we had hoped, and we might occasionally want to make use of subpena powers in conjunction with the disclosure provisions of S. 409, which would require us to disclose to the public confidential and proprietary information received from individual companies.

Chairman HUMPHREY. We thank you for your evaluation there. I have over a period of time supported this idea of the 90-day suspension, but I am openminded. I am interested in getting some action on price flexibility, particularly price reduction during a recession.

Mr. Zarb, I was much moved by your concern for the Northeastern States, and I do not want to be parochial, but I will be for a moment. You say, to ease the impacts on regions heavily affected by imported petroleum products, such as the Northeastern States, the President's program requires a much lower fee rate for crude oil. Have you ever heard of Minnesota, Wisconsin, or Michigan? Have you ever heard that we get all of our oil from Canada? Now, would you like to give us another commitment here, because I want to tell you, I love the Northeastern States, and I want to help them. As a matter of fact, in my political life, they have been very, very good to me, and I will walk the extra mile barefoot even in their cold winters. But have you ever been to Minnesota when it is cold?

Mr. ZARB. Yes, sir.

Chairman HUMPHREY. Do you realize up in our way, our refineries are totally dependent on Canadian oil? Why do you want to stick that fee on that oil?

Mr. ZARB. Senator, I would like to amend my statement to insert the words, "northern tier", in place of "northeast."

Chairman HUMPHREY. Very good. You and I are getting closer together all of the time. That is an official amendment, is it?

Mr. ZARB. I would like to note——

Chairman HUMPHREY. Is that an official amendment?

Mr. ZARB. Well, the same product benefits that accrue to New England would also accrue to the northern tier. Unfortunately——

Chairman HUMPHREY. That is not just a thought, that is a policy. Is that right?

Mr. ZARB. Yes, sir. But I ought to add that that is not going to benefit them very much, because they hardly import any product at all. But the same benefits of imported refined product——

Chairman HUMPHREY. Well, wait a minute. How about imported crude?

Mr. ZARB. They have the same imported crude impact as you do.

Chairman HUMPHREY. Yes.

Mr. ZARB. The difference between the two is their very heavy reliance on imported residual oil for their utilities, and they are probably the only sector of the country, with Florida being a minor exception, that is almost entirely committed to the imported market for the fuel to fire their utilities, and that is what sets them out.

Chairman HUMPHREY. I understand the problem, and I want you to do just what you are doing. I am not antihelp for Northeast at all, but I want to tell you something, my friend; that if we do not get some relief out of the problems that we are now having with Canada, you had better look at that part of America for a lot of subsidy of some kind. We are just not going to freeze to death just because of some edict down here.

Mr. ZARB. Well, as you know, Mr. Chairman, we are working on the Canadian problem, and have spent a lot of time with the delegation from the northern tier to work on the various options, and I think we are making some progress. As you know, there are international negotiating option, as well as some other programs, to deal with the potential shortages.

Chairman HUMPHREY. Why do we have to, if the President's program survives on the tariff, impose a tariff on our good neighbor to the north, on their oil coming in here? There is no security problem. The Canadians have not mobilized as yet to attack us, and they are maybe the most reliable friend that we have.

Mr. ZARB. Well, I certainly would not quarrel with that, Mr. Chairman, although I would point out that their price for a selected clientele are probably highest of anywhere in the——

Chairman HUMPHREY. Exactly right. Do not tell me; I know. To our people out there, these are facts that are literally burned into our hide, even in a blizzard up there. We know that Canadian oil is higher. Now, you want to put a $3 addition on top of that Canadian oil.

Mr. ZARB. Mr. Chairman, the fact that we have to find a way to use less imported oil, I think, is probably best demonstrated by the problem we have in the northern tier and in New England, where we have gotten ourselves into a terrible box. We had better start now to get ourselves out. In the interim, we have promulgated an equalization program which has particularly been designed to benefit refineries in your areas; as a matter of fact, almost exclusively designed for the northern tier area. And we intend to keep that operative, even when the tariff goes on, and that will help again to minimize the difference between the two.

Chairman HUMPHREY. I know it.

Mr. ZARB. I also point out, and that should get into the hearing record, that we have had some very difficult mail from some of your colleagues in the Congress from other parts of the United States, that take great exception to that program, and we are now in the middle of several lawsuits to protect our ability to continue to help the northern tier refineries with the equalization program.

[The following letters were subsequently supplied for the record:]

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., January 30, 1975.

Hon. FRANK ZARB,
Administrator,
Federal Energy Administration,
Washington, D.C.

DEAR MR. ZARB: I am again rather disturbed and perplexed that special consideration and advantages are being given to the Northeastern section of our country at the expense of the pocketbooks of consumers in the Southwest region of our country. Every analysis of the President's energy proposal demonstrates that the economic hardship, number of jobs and income lost and consumer cost will be greatest to the economies of the Southwest. Yet, the Administration continues to be bulldogged by Members of Congress from the Northeast.

I have tried to be understanding and supportive of the Administration's energy tax proposals, as I feel the American people demand action. I have done this even though I recognized that my state would perhaps have to sacrifice greatly under these programs. But it becomes very difficult to justify in my mind and to the people of the Southwest why I would support a policy of special consideration for one region at the expense of another when the facts are that the Southwest region would already be hurt without these special devices to ease the Northeast protest.

It is also hard to understand why the Administration and the FEA continue to kowtow to the New England states when those states refuse to participate in the development of oil and gas off their coastline and those states refuse to accept Administration proposals that would give incentives to greater production of oil and gas. This is rewarding a philosophy of negativism.

On the other hand, when producing states both in the Southwest and other regions, ask the FEA for an exemption for publicly owned oil, the FEA literally gives us the back of its hand. And this pittance which the producing states ask is endorsed by Congressman Torbie MacDonald! (H10772, November 19, 1974).

When the original mandatory allocation proposal came before Congress, I warned of the danger of regionalism, and that the bill would pit section against section on energy matters (H.Doc. 93-531, page 117). I regret that my prophecies have come true.

During the hearings on extending the mandatory oil allocation act, top FEA people testified that the Administration wanted to phase out the allocation program. Yet FEA actions belittle this philosophy, and one wonders who actually has the most input into FEA decisions.

Thus, I strongly urge that the FEA and the Administration reconsider their proposed changes in the President's energy tax package which would bring even more of a burden upon the Southwest region of the United States.

Sincerely yours,

J. J. PICKLE, M.C.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., February 4, 1975.

Hon. FRANK ZARB,
Administrator,
Federal Energy Administration,
Washington, D.C.

DEAR MR. ADMINISTRATOR: Enclosed is a document giving a detailed assessment of the effect on the Texas economy of the President's proposed economic and tax program.

The analysis shows that severe negative impacts on my State may result from implementation of certain of his proposals. This is of special importance because of the great role Texas plays in the national energy picture.

Your study of this analysis and any comments you may wish to offer regarding it will be appreciated.

Sincerely,

E (KIKA) DE LA GARZA, M.C.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., January 30, 1975.

Hon. FRANK ZARB,
Administrator,
Federal Energy Administration,
Washington, D.C.

DEAR MR. ZARB: Press reports indicate that the costs of the Administration's energy conservation program will fall heavier on the State of Texas and the Southwest than on the Northeast and other sections of the country. I wish to protect this policy of trying to minimize the opposition of the Northeast to the Administration's program at the expense of the State of Texas.

Whatever energy program is finally adopted must be based on equity. It is my hope that the Federal Energy Office will consider equity and fairness to all Americans in the construction of its policies.

Sincerely,

RAY ROBERTS, M.C.

Chairman HUMPHREY. Well, let me just underscore, recognizing the difficulties that you face, we face the prospect of being phased out of Canadian oil. Hopefully, the negotiations will prevent that. My esteemed colleague has been up to Ottawa and has done a good job. But we have to rely primarily upon the State Department and your agency and others to consult with the Canadians. In the meantime, we pay a higher price for Canadian oil than all other imported oil, and if we get a $3 tariff on top of that, being where we are located, and problems of travel and of transportation, our industrial costs are going to be prohibitive. We will cease to be a competitive factor.

And let me tell you something. We have got the highest labor productivity in America. Per unit costs are lower in our part of the country than in any place in this country. Our people work, w-o-r-k, and we are wanting some attention from this Government. I do not know why. And, by the way, we have got one of the best energy conservation programs. We have an energy agency in our State that really works on it, and we have reduced consumption, and we get rewarded for all this wonderful work by getting gold stars on our little performance paper, like we used to when we were 6 years old and 5 years old for brushing our teeth. And then we get rewarded by a $3 tariff upon the highest priced oil coming into America, and we have no place else to go, unless you can somehow or other get these pipelines stretched up there from Oklahoma and from the East.

And also, might I add that we have imposed less on the Federal Government for all of these other costs of unemployment compensation, welfare, and so forth. We would like to be self-sustaining. I do not want to give you my Minnesota Chamber of Commerce speech, but it is a pretty good one. But very seriously, I have been reading all about the attention that, because of the effective work that our Northeast States' colleagues have done, particularly the Governors. We do not have as many people out there, thank God, but we have a lot of resources. We have got some hard-working people, and we want some protection from this Government. And I do not think that is an unfair request, might I say, and I use that opportunity for it for you to reassess what can be done in

terms of that import tax; because if we get that $3, if that is put on us plus what we have, I can tell you what is going to happen. And we had an assessment made of what your energy bill will cost our farmers. For a farmer with 350 acres, if he is a dairy farmer, it will add to his cost of next year $1,500. If he is a grain farmer other than corn, it will add $1,200, and if he has to use a high degree of fertilizer, and he produces a corn corp, it will add another $1,500.

Now, have you been reading what the market on corn prices and wheat prices and soybean prices? You talk about a precipitous decline at the time that everything is going up; fertilizer is going up farm repair of machinery parts are not doubled, some of them have tripled. And that energy program that you have proposed, according to a study just made by the Library of Congress for my colleagues and myself, indicates the figures that I have just given you, running from $1,000 to $1,500 per farm in additional tax, unrebatable to my farm people—and by the way, we have got a lot of folks out there like that. So I am here to just let you know what the facts are. I am going to send this report over to you, and I want you—I am sending a copy to Mr. Simon, because he is the big economic adviser—I want him to advise the farmers that were in to see Senator Mondale and Senator Humphrey yesterday morning, 54 of them from 54 counties; and you talk about the embattled farmers at Lexington and Concord. They were sissies compared to the ones that we had breakfast with yesterday. They are ready for the bicentennial—a whole new one. [laughter.]

Mr. Zarb. Mr. Chairman, may I just respond briefly to your comments?

Chairman Humphrey. Yes, please.

Mr. Zarb. The problem on the northern tier is very serious, and it is not only serious over the short term with respect to the national energy program, but it is serious over the long term, because of Canada's decision to completely phase us out of oil in that part of the country. So we have some short-term things that we need to do, and some long-term things that we need to do, so that your part of the country is not left without access to crude oil. And as you know, we are working very hard with the delegation, and with the State Department and the Canadian Government, to try and resolve that situation in our best interest. In the meantime, we have implemented the equalization program, which has gone a long way toward assisting the oil costs in your area, and we will continue that program unless we are prevented to either by the Congress or the courts.

With respect to farmers, I should point out that the President has instructed us to provide with him in the program——

Chairman Humphrey. Who is that, sir?

Mr. Zarb. The President has instructed us to construct a program which we have just about completed, which would enable particularly the small farm, the lesser corporate farm, to achieve a full rebate of off-load increase in cost by virtue of this program, for gasoline and diesel fuel.

Chairman Humphrey. Fertilizer, too?

Mr. ZARB. Fertilizer is not a part of this package, because it has a whole new set of problems. It is not affected by the initial tariff. It is only affected downstream by the natural gas excise tax, and we and the Congress will have ample opportunity to debate that. So the big problem with that is, as you know, a shortage of natural gas that has driven up the price of fertilizer to a very serious extent.

In any case, I did want to point out that the farmers who used 10,000 gallons of oil a year under our program would have a full rebate of the taxes imposed by this particular program. Now, we have not submitted that formally, because we were working out some last-minute details. But you ought to know that that is almost complete, and the reason for that, of course, is that the farmer cannot, as an industry, pass along the increasing cost, as many other elements of industry are capable of doing.

Chairman HUMPHREY. You will share those discussions with us, will you?

Mr. ZARB. Yes, sir.

Chairman HUMPHREY. I mean those studies with us, so that we can get some input, and at least have some opportunity to talk.

Mr. ZARB. This is an awfully good time to do that, when the President has directed us to work with the congressional people from the farm States with this draft program, before he makes his final decisions.

Chairman HUMPHREY. May I ask you to inform both Congressman Foley of the House, and Senator Talmadge of the Senate, as the chairmen of the respective committees on this matter so that we can work together.

Mr. ZARB. Yes, sir.

Chairman HUMPHREY. Thank you very much.

Congressman Bolling.

Representative BOLLING. Mr. Chairman, I was reminded—I have to say it—of the first speech I ever heard you make in 1947, and it was to the Chamber of Commerce in Minneapolis. And it was a good speech then and it is getting better.

Chairman HUMPHREY. It is like wine. [Laughter.]

Representative BOLLING. Mr. Rees, I would love to have the time and be able to discuss in some depth a good many of your points. One that intrigues me a great deal, since for about 20 years I have been worried about the fact that there were only two parties to the collective-bargaining process, due to that how perhaps we might achieve a better result than the one where it is advantageous, both to management and to labor, to pass through to the public an excessive price increase. But I really do not have the time. I will pursue that later in a different situation.

Mr. Zarb, I would like to compliment you on the very mild statement that you made about the need for us to, in effect, reason together. I have been sort of amused by the situation that we have found in this town. The President and those who work with him have had the great advantage of having the only show in town on energy. That has been accompanied by the usual political byplays by people downtown and uptown, about who shot John and what is wrong with this, and all of us at the same time saying that we really are going to get together in the end.

Well I would like to pursue that, perhaps, and perhaps you are the wrong person to pursue it with. How are we going to get together in the end? The scenario goes something like this: The program of the President largely depends on things that he can do without recourse to Congress. Yet Congress can only try to stop. If the President feels strongly enough about their trying to stop him, he can raise the ante from a majority of 1 or more than half to 2 to 1. In other words, he can veto a bill and the Congress has to produce 2 to 1. There is no compromise on that; that is a pretty head-on process.

My impression is—at least, I heard the chairman of the Committee on Ways and Means say today it seemed probable—that the Senate would sustain the President's veto on the postponement for 90 days of the oil tariff. There we do not have a compromise; we have some sort of a head-on deadlock.

Let us assume, for fun, that the Congress cannot come up with a program. How do we then reason together?

Mr. ZARB. Well I did not particularly—I was hopeful you would not make that last assumption, beacuse it makes the process of reasoning very, very difficult, Congressman Bolling. I had hoped that once the President's program was on the table, that we would begin the process of taking it apart, examining it in its parts, analyzing and challenging the assumptions and the facts, and having a good debate over its approach and its goals, and through a series of hearings, wind up with a modified program where the Congress felt that this part or that part was incorrect and should be modified.

Instead, and I do not mean this critically I want you to know, we have evolved into a period where others want to develop their own program, separate and apart from any of the body of knowledge that was built up over a year's work by professional people that led the President to selecting one alternative over another. Now that process has led us to several proposals on the House side, and only one that I know of on the Senate side, and maybe more.

I would really be hopeful that the various proposals on the House side might come together in a way that there is agreement over there, and for those over here the same applies. And then, either we move together at that point to compare the three programs and work toward eventual compromise, or else the Congress gets together on its program—the Senate and the House—and then we sit down and get to work on comparing the two approaches, and hopefully come out of that session with a package that we could all agree to. I think the chairman was awfully correct. It is too bad that we have to have hours and days and pages of newsprint dedicated to the challenge of facts.

Fact is neither good nor bad; it is just simply truth. And it seems to me that we can arrive at the truth by laying it on the table, analyzing the numbers, and coming to a conclusion as reasonable people. Instead, we have this study and that study, and then we find that study was not right, and it had to be adjusted. The number which we have put forward, in my view, have held up against that challenge every time we have sat down with another group that

have come up with a different conclusion. We have found out why we have been able to explain it in a rational way, and a 2-percent inflation rate has held up against these other things.

But that is not important. The important thing is if we get through the first generation of problems, that is a fact. Once we have done that, then we can engage in whether or not we agreed on national goals. There are some that do not believe we should be invulnerable by 1985. Now they have a completely valid point of view. I disagree with it as vigorously as I can, but nevertheless, it is a legitimate point of view based upon their perception.

Representative BOLLING. If I could interrupt you just a minute, and I do not want to interrupt you permanently, but there is one problem that does not precisely lend itself to a hard factual decision. We are dealing with two problems which are related. One is an economy in the most severe recession since—what, 1940? And the other is a brand new awareness of something that has been obvious for 20 years; that we had an acute energy problem.

Now the soft decision that has to be made in there, depends on a great many facts. And it has to do a little bit just with timing. And 1 percent, 1.6 percent, 1.9 percent, 2 percent of, let us say oversimplifying a negative impact on the solution to the one problem, may be of overwhelming importance. But you cannot establish it factually. It is a policy choice. So I do not disagree with your approach to the matter, but it seems to me that we are dealing at a level of difficulty well beyond just the facts.

There probably are a half a dozen programs which, in the abstract, would accomplish the same national goals; a half a dozen that could be conceived by clever people. Now the President came up with a program that is a perfectly valid program from his point of view based on a number of choices that you probably know better than I do. And I do not criticize the President; I am delighted that he came up with a program and that he drew the issue.

The thing that I am concerned about is that the whole situation not degenerate into something that could only be described as a narrow, partisan debate on who shot John. Because the end result is not going to help anybody if we do not figure out on a lower-the-decibel level. And with all due respect to a very old friend of mine, for whom I testified when he was up for consideration as Vice President, it does not seem to me terribly helpful for anybody to be talking about how slow the Congress is moving when it just happens that this Congress is moving a good deal faster than it usually does. And in case you have forgotten, I am probably the most severe critic of Congress in Congress.

Mr. ZARB. Congressman Bolling, I have not forgotten that. I would point this out; we still have a disconnect between fact and the ability to get on with that work and rhetoric. Let me just give you one example. Those that say that moving on energy this abruptly now would be an economic depressant, go on to say that they have two problems or there are two points of view in an area. One says we would be taking money out of the economy and then there would be a lag in terms of putting it back and that would have a depressing effect.

Now it seems to me if that were a problem, and the problem, that we could, with the Congress, work out a formula whereby money could go back into the economy before it was taken out of the economy. But we do not seem to be able to address the problem for its nature. We make the statement and then it gets lost in a lot of rhetoric.

The other question is the abruptness. All of the economists that have testified, have testified about the abruptness. And that is an unknown fear where they say, well we are not quite sure, maybe we are moving too fast, and so on. Well the legitimate argument on that side would be, well maybe we should phase in over a period of time. Now there has to be debate there because when you phase in, you limit your achievement, you are expanding your vulnerability and a national decision has to be made as to how much more vulnerable we are willing to become over the next 2 years.

But it is a legitimate debate. My point is, when the objections are raised at a professional level, that is depressing. We do not sit down and say, well how can we move the program pieces around so it is not depressing. Instead we say it is depressing and then go on to look at some other scheme which, when we look at that other scheme in any depth we find that that is so depressing that we are not even going to talk about it any more. So we go on to some other notion.

Now I do not know how to come to grips with that linkage problem.

Representative BOLLING. Well I think this desire that you are seeking, and you should—a concentration on one program as opposed to a possible seeking of alternatives to the one program—I have no objection to that, and it defines the issue. But it seems to me fairly clear that there is a legitimate function—more than a function, it is an absolute necessity that the Congress, if it is going to be responsible in dealing with this, do precisely what the President did; that is, look at alternatives and make decisions on the basis of what it considers to be best. And inevitably, that takes more time than from sometime in January to sometime in early February. And I am not suffering from being told that the Congress is too slow. I think it is too slow, and I have thought so for 20 years.

But in this particular case, since the only show in town only came in sometime in January, I think our ultimate ability to get together in the end is going to be improved by less conversation about who shot John. Thank you, Mr. Chairman.

Chairman HUMPHREY. Congresswoman Heckler, do you want to proceed?

Representative HECKLER. Thank you, Mr. Chairman. Well I would like to say that I do applaud the President's leadership because he for one has taken a decisive stand on the issue. I do disagree with his stand, coming from New England. And that is not a secret to Mr. Zarb.

But I would like to get to what I see as one of the fundamental problems that we face here, and that is the fact that we acknowledge the fact that there is an energy crisis. A fact that the public is not as willing to acknowledge. There are many inconsistencies. At the same time when there are press releases indicating that we must

change our lifestyle, we must cut back on our gas mileage, and so forth, on the other hand, on another page of the same newspaper, we will read that the gasoline dealers are being goaded into selling more and more gasoline. In fact, they are threatened with extinction if they do not by their own suppliers. So the inconsistencies are very obvious to any cursory reader.

I think one of the real problems is not the question of the desirability of achieving independence. This is obvious to everyone. We should not be relying on foreign suppliers and subject ourselves to exploitation or blackmail. And the case is extremely clear there, and we in New England are far too dependent on imported oil and have been for too long.

But the real problem, as I see it, is how much credence the public gives to the crisis. And it was, I think, underscored by a statement or the presence of Mr. Ikard on "Meet the Press" last year when, as a spokesman for the American Petroleum Institute, he was asked to address the problems for the American people. The Government was calling in a private source which relied upon industry to provide accurate figures, and yet I think that it could be well understood that industry, in providing the figures to the American Petroleum Institute, would also be influenced by competitive market positions.

And therefore, those figures could not be considered to be totally accurate, because they would have to have that other competitive dimension. So it seems to me that the most fundamental need that we have is to acquire reliable energy data so that once and for all, not the question of imported oil, the number of barrels that we import per day and which can be proven easily, but the question of our domestic supply and its potential has to be established by reputable sources within the Government. And I think we have to abolish our dependency on private associations as the only mentors in possession of the facts.

Now until we do this we are never going to have the credibility of the Government or the people. And in fact, we all will continue to be confused by the varying reports from these varying agencies. Now what are you going to do about this, Mr. Zarb? Do you see this as a fundamental need?

Mr. ZARB. Congresswoman Heckler, you are touching on two points, both of which I completely agree with. The first is gaining a common understanding of the size, shape, and scope of the problem. It is difficult to explain to the American people that we have a serious energy problem when they are collecting premiums with a fill-up at the local gasoline station.

I think we all have to reach agreement on the problem and then explain the nature of that problem to the American people. I think it is fairly clear that we pay far too much for foreign oil, that that has been part of our economic problem, and will continue to aggrevate our economy. And the question of vulnerability in the international scene is getting worse every day. It is difficult to explain that to the man on the street when he is used to thinking in terms of a temporary energy shortage as compared to a massive long-term energy problem.

With respect to data, we have the responsibility for collecting the most important base of energy data and making it available. We are committed to achieving independent data sources in every segment of the energy area and have made great progress in that direction. Where we do rely on reporting from the industry, we undertake to conform their reporting through periodic audits and examinations.

The Government must have its own basis for information so that we can develop credibility. It will be good when we have completed our debate on what the national energy program can be, because from that moment on the Government can speak with one voice in explaining it to the American people. That is why it is so important that we get by this period as quickly and as orderly as possible, and wind up with a comprehensive program.

Representative HECKLER. Are you now in the process of forming a totally complete and reliable energy data bank in your Department?

Mr. ZARB. Yes, madam.

Representative HECKLER. Are you ever hampered in your endeavors by the proliferation of jurisdiction and authority in the field of energy in the Federal bureaucracy itself?

Mr. ZARB. No. That has not been one of our problems at all. The Energy Resources Council came into being late last year, chaired by the Secretary of the Interior and I serve as Executive Director of that unit. It has been a vehicle through which I think we have been able to achieve a remarkable degree of orderliness among the various Federal agencies.

We do not always agree, and that is good. But we have a forum for bringing those disagreements to the table and showing the options to the President for his decision.

Representative HECKLER. When do you estimate that an energy data bank will be fully operational in your Department?

Mr. ZARB. Mr. Chairman, this is Eric Zausner, who is our Acting Deputy for the Federal Energy Administration. He can answer that question.

Chairman HUMPHREY. The name again?

Mr. ZAUSNER. Eric Zausner. We already have a relatively complete set of information on petroleum production, stocks, imports, and prices. The area where we are still lacking is with respect to reserves and production potentials. We have a major survey going on in that area right now as a part of the legislation we operate under. By midsummer, that survey will be completed and will be an independent and complete estimate of the oil and gas reserves in this country.

We also monitor market shares to value and evaluate the competitive position of the independents versus the majors. We are now expanding that system into monitoring coal prices and coal quantities, and the development of new energy technology. We have worked very closely with existing departments, such as the FPC and the Bureau of Mines, who also have a comprehensive bank of information.

As you know, we submit very large and comprehensive quarterly reports to the Congress as required by our legislation and, generally, each quarter we add more and more to that.

Representative HECKLER. Of course, as long as your reports are incomplete, they are then inadequate. And until you have a firm hold on all of the data and can be relied upon, you will not be able to answer the problems of this society or the Congress.

Mr. ZARB. Congresswoman Heckler, the latest dispute over the size of the reserves ought to be clarified. The Department of Interior makes its own judgments as to what exists under the Outer Continental Shelf and in other areas based upon its judgments of geological structures and so on.

These are professional people and they have come to one conclusion. The National Academy of Sciences have looked at this same data and have come to a different conclusion. One says we have 40 years of reserves, another says we have 25 years of reserves. For the purposes of the current discussion, this question is not that important.

We have concluded a couple of things. First, these are finite reserves. Second, we have discounted in our calculations the Government's earlier estimates by a quantum amount because not because we disagree with them, but because we thought we should be conservative in estimating what was available for us to accumulate.

So the National Academy of Science's observations and our own assumptions are remarkably close, although we do not mean to degrade the Department of Interior's estimates. We just felt that it was too optimistic.

Chairman HUMPHREY. Could I interrupt?

We had a hearing the day before yesterday with representatives of the Department of Interior, the Geological Survey, the National Academy of Sciences, and so forth, and they are going to try to, they are having a conference sponsored by the resources of the future that will bring together all of these different points of view and try to come down with some more solid information for us.

Mr. ZAUSNER. Mr. Chairman, I might add just one thing. The key element of any program to get a better estimate is to get out there and find out what is really there.

If we find more or less, we can adjust our policies later as that information becomes available.

Representative HECKLER. I would like to ask just one other question and that is on the issue of the reserves at the disposition of the military.

What is your relationship? Do you have an input into the utilization of military reserves, and is there a potential? We feel the problem of oil so intensely in Massachusetts.

Mr. ZARB. I am so glad you asked that question, Congresswoman Heckler.

Representative HECKLER. Why are you smiling? I know I asked the wrong question.

Chairman HUMPHREY. That is a good question.

Representative HECKLER. That is a problem, too. I am surprised I can please both of you.

Mr. ZARB. In our judgment we can bring into the civilian economy from the Elk Hills Naval Petroleum Reserve in California almost immediately, upon approval of the Congress, about 160,000 barrels a day and, over a period of 2 additional years, bring that number to at least 300,000 barrels a day.

We would use a good deal of the revenues from that process to develop a national storage program and, in addition, start development of the pet 4 area in Alaska. And we believe that we can bring 2 million barrels a day to the lower 48 States in a way that can help the northern tier greatly. We have submitted legislation on both items and, hopefully, we can get fast action.

Now the Armed Services Committees in the past have been reluctant to go along with us but this time I think we have come to them with a little different characteristic. That is, as we build the national reserves around the country—we would agree that 300 million barrels of those reserves would be in storage strictly for the military. Pipelines and other delivery facilities would be separated and put under the jurisdiction of the Armed Services Committees.

So now they would not have oil under the ground that has not been drilled as a reserve, oil that would take a long time to develop and deliver in the case of national emergency. Now they would have oil in storage facilities which they could get out right away.

We would be hopeful that that kind of balance will allow them to go along with this plan.

Representative HECKLER. Thank you.

Chairman HUMPHREY. Congresswoman Heckler, the reason I was smiling, I have been on Mr. Zarb's back about Canadian oil this morning and not in anyway deprecating the necessity of relief of Northeastern States, but also, we folks up in the upper Midwest—and I knew that he was going to come in there with that pet 4 project from Alaska and give me the assurance that if you can just wait, Senator Humphrey, we are going to get a pipeline coming right out of Alaska. But you know its gets so cold in Minnesota while we are waiting.

Representative HECKLER. We still do not have the pipeline to Massachusetts. That is what I am upset about.

Chairman HUMPHREY. Senator Javits.

Senator JAVITS. Mr. Chairman, I ask unanimous consent that I may put certain questions in writing to either witness if time does not allow asking them.

Chairman HUMPHREY. Without objection, of course.

Senator JAVITS. Mr. Zarb, one thing that impressed me about your prepared statement, which I read but did not hear you make—I assume you followed the text—which I do not think has been adequately impressed upon the public, and that is the word "temporary"—"I want to emphasize that these increased import fees are only temporary."

Now is it a fact that if the President's expected veto is sustained, the Congress may the next day rescind his import fee? And if they can make that stick on a veto override, it would be rescinded?

Mr. ZARB. Yes, sir.

Senator JAVITS. Congress has complete power at any time?

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Mr. ZARB. Yes, sir.

Senator JAVITS. Is it fair then to describe the President's effort as being simply the first move in getting the bidding started for an energy plan?

Mr. ZARB. Yes, sir.

Senator JAVITS. Now under those circumstances, why did not the President pick up the proposal of a majority of this committee made in writing to appoint or to have the Congress appoint its part of a task force working jointly with the White House task force to produce an energy plan for the country. If he had accepted that, we would have been 30 days underway already.

Mr. ZARB. Senator, I cannot speak for the President. I can only tell you my own perception of the problem, and that is that there has been a grave question downtown as to who represents the Congress. I do not mean that critically.

I just offer that as a possible question.

Senator JAVITS. Well, Mr. Zarb, nobody can represent the Congress any better than you can represent the President. You negotiate, you work out a program and the President has to say okay and the Congress has to say okay. And we have done it dozens of times. I have done it myself, so has Senator Humphrey, and probably Congresswoman Heckler the same, in different bills.

Why is this different from anything else, and why can that not be done? We recommended, just to recapitulate—and I think it is time, Mr. Chairman, that that letter went into the record. We have sat on it long enough and the President has had more than enough time to reply.

Chairman HUMPHREY. Yes. At your request we will include the text of that letter into the record of this hearing.

[The letter referred to follows:]

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., January 29, 1975.

The PRESIDENT,
The White House,
Washington, D.C.

DEAR MR. PRESIDENT: The undersigned members of the Joint House-Senate Economic Committee commend your attempt to cope with the current problems of energy and the economy in a comprehensive fashion. We agree that our economy cannot attain, much less maintain, steady and healthy growth in the absence of a just and effective national energy program. It is equally clear that a reduction in the level of oil imports is essential in meeting this goal. In short, we share your long-term goals and we support many of your energy proposals designed to accomplish these ends.

But we are writing to express our grave concern that the growing confrontation in Congress over your specific energy proposals will prevent the prompt and cooperative action on a tax reduction and 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 fact and they are committed to passing a mutually acceptable tax relief bill.

We regret that similar agreement does not exist in regard to your energy proposals. There is agreement that your energy proposals will be inflationary, but little agreement as to how inflationary. Your own advisors have estimated two percent and others have suggested four percent. The Congress is naturally reluctant to enter on such a course until alternative proposals have been fully explored.

There is disagreement about the impact of your energy proposals on the standard of living of American consumers. Specifically, there are questions as to whether proposed tax reductions will balance off the average increases in energy costs which consumers will be obliged to pay. Estimates of the net outflow of funds from the economy due to higher energy costs vary from $3 billion to $25 billion. There are also differences of view on the reductions in energy consumption that will result from higher prices, the effectiveness of an excess profits tax in stimulating new domestic oil production and the amount of reduction in imports which is immediately necessary.

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, we would propose that you defer imposing further increases in import fees on petroleum products. We would urge that the next 60 days be used to bring together a task force on energy policy made up of representatives in that field from your Administration and a bi-partisan group of Members of the House and Senate selected by the majority and minority leadership of both bodies. It would be charged with developing a mutually agreeable energy policy upon which prompt congressional action might be taken.

If you see merit in this course of action, Congress might move more swiftly to passage of critical tax legislation while continuing a responsible evaluation of your far-reaching energy proposals. It would be our hope that our proposal would result in the most prompt and effective agreement possible on both tax and energy proposals and obtain the maximum support from the American people.

Sincerely,

HUBERT H. HUMPHREY, *Chairman*
WILLIAM PROXMIRE
JACOB K. JAVITS
EDWARD M. KENNEDY
LLOYD BENTSEN
CLARENCE J. BROWN
RICHARD BOLLING
WILLIAM S. MOORHEAD
GILLIS W. LONG
MARGARET M. HECKLER
LEE HAMILTON
ABRAHAM RIBICOFF
HENRY S. REUSS
JOHN SPARKMAN

Senator JAVITS. What we proposed is that the President appoint a group from the White House, two or three, that the Senate leadership and the House leadership, bipartisan, appoint a group and that they sit down and talk and come back with a program which is satisfactory to the President and to these same leaderships, which could then be proposed to the country and the Congress.

And I must say that he wants that anyhow. And an English statesman once said, "The way to resume is to resume." And why is that not still a valid point? Would you be good enough to take it up with the White House accordingly?

Mr. ZARB. Yes, Senator, I certainly will.

There are at the current time task forces in the House and in the Senate, both of which have announced development of energy policies and which are meeting together. Another committee in the House has announced in recent days that it also has a national energy program that it intends to introduce. I think we ought to address the question of how these panels interface with each other.

I would suggest that the staff of this group begin immediately to meet on a staff level with the energy policy people downtown. I am prepared to do that right now. It might get us a leg up.

Senator JAVITS. I think that is very welcome. I appreciate it.

As to getting our own house in order, that is why we had suggested that this be done by the House and Senate leadership on both sides. They can get our house in order and undoubtedly, what you have just mentioned is the machinery here which I understand is essentially on the Democratic side, and the majority side would undoubtedly be adequately represented. Neither Senator Humphrey nor I had any illusions that we would be a task force. The important point was to get properly representative people sitting down to negotiate a deal and thereby leapfrogging weeks of tactical maneuvering, which is all that is going on now.

And so I welcome what you say about the staff and I think we should address ourselves to that now in terms of the respective leaderships so that they get their dots in a row and at least get their staffs meeting on a program for the President. And now this veto thing which is a matter of such dramatic excitement for the press will be put in its proper perspective. It is really not all that consequential, and what the people of this country do not realize, and I think in a sense it is the fault of the media, is that this is not the President's whole program by a long shot. It is nothing but an opening move, and it can be cancelled out in days if the Congress does not like it, even if his veto is sustained, or vice versa.

But if he is overridden, he can do the same thing or something like it the next day, and we would have to do it again. So it is just a ridiculous position on both sides and the country is in such dire straits that it deserves a lot better at our hand.

Now one other thing that strikes me very forceably about your statement is the emphasis which you make about what you gentlemen at the White House think about the American people. When you say—and this is expressing the White House view—in your prepared statement:

> I doubt that the American people would be willing to put up with such alternatives, nor should we subject them to this long-lasting, pervasive control over almost every aspect of their lives.

And you refer in that regard to import quotas, allocation systems, or rationing, Sunday closings of gasoline stations, no-driving days, et cetera. And yet, is it not strange, Mr. Zarb, that all of the polls which were taken indicate that that is exactly the route that the American people want to go, that they do not want rationing by price.

So where do you and the White House, what do you base this information upon that "I doubt that the American people would be willing to put up with such an alternative." As far as we know, absent the plebicite, they say they would. And I tell you this in the way of information.

I ran for reelection last fall on that platform, but I was against rationing by price in any appreciable way, you know, take your own figure that you would have to put 40 cents a gallon on to cut consumption by a million barrels a day.

So where do you and the White House, by saying the same things—what do you base your information on, to say: "I doubt that the American people would be willing to put up with such an alternative?"

Mr. ZARB. The point is that we have looked very carefully at rationing and an allocation system, taking it past the first, second, and third year. We have looked at ways to avoid inequities and unfairness to this segment or that segment, this geographical area, to the New York City resident as compared to a Wyoming resident. And in all of that professional work we have come to the conclusion that both of these programs, absent a national emergency these inequities would cause the American people to react adversely after 1 or 2 years of this Government regulation.

At the conclusion of the WWII rationing system, we see that there were hundreds of thousands of court cases left over in both criminal and civil actions. And we see that rationing was visited on a declining number of automobiles on the road. We probably ended the war with 30 percent of the automobiles on the road that we began with. There was a whole different set of circumstances; there was a feeling of patriotism. And yet, the black marketing and the unfairness that was prevailing in the whole system is clear, and it is in the record.

So we have simply come to the conclusion that in our free market system, absent a national emergency, the Government declaring a shortage for good reason and then going in to manage that shortage would cause the American people to ultimately reject such a system.

We may be wrong. I do not think we are.

Senator JAVITS. Well, I think you have put the matter in proper focus, now. That is what you believe that the American people's reaction will be?

Mr. ZARB. Yes, sir.

Senator JAVITS. But you have no basis for saying that is what they think now?

Mr. ZARB. No, sir.

Senator JAVITS. OK, that is very much better, because then we too have a right to believe what we think the American people will feel.

Mr. ZARB. Absolutely.

Senator JAVITS. And it may be quite different from what you feel.

The last question I would like to ask is about a crash program on energy. Why does it have to take 10 years? It took us 2 years to produce the atom bomb. This country can turn over mountains with its enormous industrial power in war where we had a war production board.

Do we need some equivalent piece of machinery in order to accelerate the process which has been dscribed as Project Independence, or whatever we may legislate as our permanent way to break this dependence?

Now it has been suggested, for example, that we have an energy production board which will really be the czar of the whole operation.

Question: Is that a feasible proposition to consider? I am not asking you to commit the President to it or even yourself, but give us your best judgment as to why we simply accept the fact that you have got 10 years and it has got to run that span, and that there is no way of accelerating the process even if you are willing to spend the money in order to do it. And I do not know of money spent that would have a greater return, by the way, on the cost-benefit ratio

than that kind of money, or that would do more to snap us out of this unemployment situation.

We had to have a war to snap us out of it in the 1930's, and this is the equivalent of a war. Is there enough imagination in the administration to present us with a view on that score?

Mr. ZARB. Senator, there is a lot of creativity and imagination on the part of the American people and that is what is going to get us to where we are going, regardless of what timeframe it turns out to be.

There was an awful lot of pressure to set a deadline of 1980 to achieve our independence because it gave great hope in the near term. Invulnerability or independence means that at some point in the future we have to be importing so little as compared to our total consumption level that an embargo does not have an adverse effect, and we have regained some control over world price.

Senator JAVITS. I agree with that. In other words, I do not define independence as obsolete.

Mr. ZARB. What we need to do, if we are going to be consuming 24 million barrels a day in 1985—giving some projections of a growing economy as compared to the current 17 million barrels—is to have enough domestic energy under our control to make up that difference.

It means using less or using energy more efficiently and developing new resources, and we have calculated both into our equation. We think that we can, using an energy conservation method similar to the one that we have presented, reduce consumption by 3 million barrels a day simply by using energy more efficiently with a different value concept. The other is our getting other energy under our control. Let us look at what the options are.

Let us assume that the Armed Services Committee goes along with Pet 4. We need to drill, develop, bring down a pipeline. Keeping in mind that we are losing production at the rate of 6 to 8 percent a year, we have to make up for that gap as well as generate an increase. That would depend upon when the Armed Services Committee says go ahead and under what constraints we can go ahead. We have to get up there with equipment, put in the environmental studies, and there is no way physically that we can have oil down here in less than 4 or 5 years from Pet 4. That is 2 million barrels a day.

The nuclear contribution to our energy is important. It takes us now 8 to 10 years from the time it is conceptualized to the time that we get the first unit of power from a nuclear plant. There are legal hangups, there are environmental hangups, there is construction that has to occur, and we might improve that by a couple of years, but not much more than that.

And as you know, there are those who are announcing a complete nuclear moratorium until some questions are answered.

We have the issue of coal. Mining it is not particularly a problem. We have let our railroads down over the recent years. Our ability to transport coal from where it is mined to where it can be burned is limited. We have to do a lot of work on the transportation system.

But we also have to make a determination as to where we are going to burn coal, and that is an environmental issue. There are

those who would say that we can liquefy it and put it into gas form and burn it cleanly. That is correct. But there has not been one scientist who has been able to tell me that we could bring the first real, meaningful commercial plant on line within 4 or 5 years if we started now. It is not an issue of money; it is an issue of a lot of other things that have to take place to get the job done.

I have held for one principle in our deliberations—that we present to the American people an honest picture. Now there are those who might look at our assumptions and say, "You are wrong. We can cut a year off here or a year there. If we fund it for another half billion dollars, we can improve the speed." And I would be willing to look at that. But we have not seen that. The President has said that energy is the one area where he is prepared to increase funding, but the critical element simply has not appeared to be money in most of these areas.

Senator JAVITS. Mr. Zarb, thank you. My time is up. I would just like to say this, that if we were at war and had to develop the same program, I would stake my right arm on the fact that we could do it in half the time or less, and that is what I am talking about.

Chairman HUMPHREY. Thank you, Senator Javits.

Mr. ZARB. If we were at war, Senator Javits, the location of the oilfields in the world would be a primary factor in everything that was going on at that moment.

Chairman HUMPHREY. I want to underscore again the thoughts that Senator Javits has expressed here today and the sense of urgency which he indicates in his comment, I think, is one that is shared by a goodly number of Members of Congress.

Mr. Zarb, earlier when I was talking with Mr. Rees, I said I thought that the one thing that would do more for our country right now and our economy is agreement upon certain basic policies. I want to say we have heard all of this argument now about Congress dragging its feet, in which you yourself have participaetd, and the President has chastized us. Of course, the President's energy proposal came to Congress on February 5, and the administration, I worked over in the administration side for 4 years and when I was Vice President and wanted to get something done, all I had to do was call in about 100 people and there they were.

I am a U.S. Senator now and I want to tell you, up until this year working with this committee, I had to work entirely with my own little staff, which tries to handle a volume of mail and visitors that would stagger any executive office in this country, because I know the difference between getting behind the fence and the walls of the Executive Office Building and being in the open galleries of the U.S. Senate.

Believe me, it is a lot different.

So I have been on both ends of Pennsylvania Avenue. But I am not going to refight the battles about the President getting after us and we getting after him. I have got a proposal. Senator Javits mentioned our letter to the President. That letter was dated January 29. Both Senator Javits and myself had a lot to do with that letter, but we had the support of 14 members of the Joint Economic Committee and others that we could not get to.

We sent that off at that time because we wanted to put a halt to what we saw was coming, this conflict confusing the public, charges and countercharges.

On the 5th day of February, Secretary Simon was here and we brought up this letter again. He said he would speak to the President about it that afternoon.

Now I happen to like the President as a human being and as a person and as an old friend. I have disagreements with him on some policies. I would like to keep those within the realm of what we call honest debate and differences, and I think we can do that.

But I do believe it is important that the President take a look at that communication. I want to emphasize what has been said here, that had it been done earlier, I do not think we would be on the course we are on now.

In the meantime, both the House and the Senate, the majority parties in both the House and the Senate, have put together task forces. Those task forces are meeting. I think I had something to do about precipitating some of the action here in the Senate in my participation in the Senate Democratic caucus. I believe we will come up with some rather good and constructive proposals, many of them the same as what the President has.

We have had all kinds of proposals on the international front, the Middle East, and Southeast Asia about a ceasefire. I am going to call for a ceasefire on the energy fight and let us settle down and have some negotiations, bring our respective forces around the table. And really, that is what is needed. What needs to go out of this room today to the American public is that we, not in retreat, not in disarray, not in capitulation, but in the spirit of cooperation, called for a ceasefire of the rhetoric and the political controversy on energy and see if we cannot come up with a program to give the American people the assurance that we are more interested in results than we are in debating points.

I know how to make points in a debate. I also know how to pass legislation, and I am interested in results, just as you are. I am not accusing the other side. I am interested in results.

Now you have honest points of view. You have points of view honestly arrived at after careful consideration. We also have some here in the Congress, in the Senate, and in the House. And it is not bipartisan, by the way. There are Republicans in this body that are just as much opposed to some features of the President's energy program as there are Democrats, and there are some Democrats that have expressed support for certain parts of the President's program.

So my point is, and I just put it in capsule because that is what it takes in this country. Extended logic does not get much attention, as you know. I have been around these halls a long time and you have to kind of drop little bongs around to get any attention. We need some attention. We need to let the public know that there are responsible Members of this Congress that are saying to responsible officials of the executive branch, "Stop, look, listen, cease fire, and let us get down to business because time is awasting."

I agree with that point that you make. I think we have wasted precious time here.

Now we are ready to act on a tax package, despite all of this newspaper talk. The President made a speech down there in Hollywood. If you have got to make a speech, you ought to go to Hollywood for it. I agree with that. I hope to sneak down there myself. I have not been able to get a good forum down there lately. I would like to extend the invitation to the folks down there in that warm climate.

But the President said that we were delaying on the tax package. He has got Henry Kissinger involved in this. Now we are going to act on the tax package. He knows it, we know it, and the people need to know it. I want the business community and the labor community and the consumers of America, the people of America, to know that there are men and women that are sitting on this committee that are ready for the action that will come. But we have to proceed in Congress in a parliamentary manner. We do not have one single voice. God only knows how much effort it takes to bring 535 members around to even agreeing to recess, much less do anything else. We are independent people. If we are not, we are accused of being rubberstamps. It is a hard line to travel around here.

If we accept everything that the President wants, they say that is a rubberstamp Congress. If you stand in the way, it is a bunch of obstructionists. But I do not worry about that a little bit. We can take care of ourselves.

The most important thing is if we can soften a few people over there in the executive branch to the point, not of you abandoning what you talked about, but of recognizing that there are people here that are tired of the battling. And I tell you I have been meeting with so many people lately that I have become deeply concerned that we in the Congress and in the executive branch are just engaging in polemics and the public is getting rooked. And I think it is time to quit it, and I am going to insist that we quit it and get down to business.

So let us let that message go out of here.

Now Mr. Zarb, one thing that you mentioned about this reduction of the oil imports of a million barrels a day to protect us against an early embargo, and we used the Los Angeles County analysis that if an embargo went on, what would happen in Los Angeles County? The real truth is, though, we cannot do anything within the next 6 months that could save us from an embargo, is there?

Mr. Zarb. No question about that. We probably can't do anything of significance within the next 3 years.

Chairman Humphrey. Yes; in other words, he used this example merely to make a point, but the fact is that no matter which program we come up with, whether it is Senator Jackson's or Senator Javits'—and do not worry—we will all have one. I got one too. It did not get much attention, but I have got one, and everybody else has got one. The President has got one.

The fact is that if the OPEC countries want to put on an embargo next year, that all of these programs that we have talked about would not be able to save us from the impact, the economic impact, of such an embargo.

Mr. ZARB. The answer to that question is, yes, Mr. Chairman, but may I just add a word?

Chairman HUMPHREY. Yes.

Mr. ZARB. The point I tried to make was that we are in a position of declining domestic production.

Chairman HUMPHREY. Yes.

Mr. ZARB. And we are importing more oil. If the economy turns up, as I hope it will, imports will escalate. The issue is, if we do certain things now, we can begin to limit the increase in imports. We can limit them to very small amounts. If we do less, we have to accept the fact that we are going to expand our imports. Now, an embargo after 2 or 3 years of expanding imports will be twice as effective as the last one. That is the point I was trying to make.

Chairman HUMPHREY. I understand that. I think it would be well to admonish the oil companies to quit encouraging people to be gluttons.

Mr. ZARB. We are taking some steps on that.

Chairman HUMPHREY. I want to, at some time, to make a statement on that, because you have said some things about the Congress which does not endear anybody to the congressional practices. Do you really think Congress has been dragging its feet, now that we are in the hall here together.

Mr. ZARB. I have had easier questions.

I think the Nation has been dragging its feet, Mr. Chairman, over the last few years.

Chairman HUMPHREY. You think what?

Mr. ZARB. I think we have let ourselves drift into the position we are presently in over the past 15 years.

Chairman HUMPHREY. Yes.

Mr. ZARB. Three years ago it became somewhat popular to begin thinking about energy. We did not really zero in on developing a policy—a program.

I think that we are now getting to the point where we are all looking at the same issues. We have different ideas as to what the problem really is and how to solve it, but we are getting on with the job. We are finally having a national debate, which we should have had a year or two ago, and I quite agree with you; it is time to begin working together to develop national policies, and I am prepared to begin immediately at the staff level with you, and start tomorrow to have these kinds of discussions.

Chairman HUMPHREY. I would think it might be well just to erase from the record the idea that Congress has been dragging its feet any more than we think that the administration has been ganging up on the country. I do not believe the President is trying to gang up on the country, trying to thwart the recovery. We have differences over his policies. I personally think it will add to the cost of living, and I do not think there is much disagreement of that.

I guess what I am trying to say is, let us not try to worry about those headlines and we will get down to business.

Second, I might add that the Arabs did us a great disservice. If they had kept that embargo on about another 6 months, we would have this thing whipped. I am an old fashioned politician. I will

tell you what I found out in my political life: empty stomach, full head; full stomach, empty head—physiological politics, physiological, glandular. Very little intellect goes into the political process. It is the reactions and the emotions. When you have really got the pressure on, as Senator Javits said, if the country were at war—and, in a sense, may I say there is a war on; it is economic war. But if it was one of those shooting wars where they are lobbying over those expensive bombs, we would have buckled down here, and we would have found ways to create energy that only the Lord Himself could have thought of. We would have had it. We did it when we ran out of rubber. We made rubber. When we needed to produce more aluminum, we produced it. When we needed 50,000 airplanes, we porduced 90,000 instead. We really showed them.

When we needed to split the atom, we did it. There are all these things that we can do. The real problem is that we were just getting around to being serious about doing something about energy, and those producers looked over and said, you know, those darn fool Americans might do it. We had better stop.

And I think what is the most important thing for us to realize is they could do it to us again. That is correct, and we ought to presume that they could do it to us again, just exactly as we built a defense structure knowing that some day somebody might try to do something to us. So we keep our defenses.

Now, Mr. Rees, I see I have got an itchy staff man back here that wants to get me out of here, but I want to ask you a question.

Now, you say the rate of increase in the consumer price index would be down to 6 percent or less by the end of this year, is that right?

Mr. REES. Well, I said it could be.

Chairman HUMPHREY. It could be.

Mr. REES. It could be.

I think to get to that level, we would have to have good crops, and we have not had good crops in some recent years. Maybe it is our turn to get good crops. But I think it would only be as low as 6 percent by the end of the year if we have a good harvest.

Chairman HUMPHREY. Let us not get ourselves into the mental philosophy that the way to reduce the cost of living is to have farmers go broke.

Mr. REES. No, I would not want to do it that way, Senator.

Chairman HUMPHREY. I keep mentioning that here, because Mr. Greenspan came in and told us that one bit of good news is that farm prices were falling, and I want to tell you that is just like saying one bit of good news for the workers is that wages are falling, or for the consumer, is that profits are falling.

You know, our poor agriculture people do not get much attention around these economic hearings. Occasionally, they drag in somebody just to show that we still have got somebody thinking about them, but when you get right down to it, the one thing this country has had going for it—and it is the one thing—is the production of food and fiber and our exports.

Now, you indicated that the energy proposals that had been advanced would add an estimated 1.6 to 1.9 in the CPI?

Mr. REES. That is one of several estimates. It happens to be the one that was done at our request. I do not want to say that it is better than any of the others.

Chairman HUMPHREY. Might I ask, is that 1.6, 1.9 percent, would that be included in your Consumer Price Index, let us say of 7 percent or 6 percent at the end of the year if things go well?

Mr. REES. Well, that would depend on when the energy program was implemented. I said it would be rising at a rate of 6 percent during the fourth quarter. That assumes that the energy program was implemented earlier than that. If it happened to be implemented during that quarter, then I would want to add 1.6 to 1.9 percent to the fourth quarter rate.

Chairman HUMPHREY. Well, let us say that the energy program were implemented in, let us say, in July, would that therefore include that cost of living in your 6 or 7 percent?

Mr. REES. Well, if the energy program were implemented during July, we could still have prices increasing at a 6 percent rate during the fourth quarter.

Chairman HUMPHREY. During the fourth quarter.

Mr. REES. But the rate for the year as a whole, I think, would then be closer to 8 percent.

Chairman HUMPHREY. I got your point.

So another way of saying it is that if you did not have the energy proposals that increase the cost of living, that you could have a 4 percent inflation rate at the end of the fourth quarter?

Mr. REES. No, sir. I think you misunderstood me. I think you could subtract—if you are talking about implementing the energy program in July——

Chairman HUMPHREY. That is right. Let us say June and July.

Mr. REES. You can subtract that 1.5 to 2 percent, or whatever the number is, from the change for the year as a whole, but you cannot subtract it from the change during the fourth quarter.

Chairman HUMPHREY. What I am talking about—I am not talking about the annual rate, now; I am talking about the fourth quarter. That is the point that you put the 6 percent, possible 6 percent, and if you had your energy program in effect before the fourth quarter, and then let us assume that you could repeal—or let us assume that you did not have any energy program the likes of which has been advanced, then what would be your inflation rate in the fourth quarter?

Mr. REES. It would still be 6 percent, sir.

Chairman HUMPHREY. It would, how come?

Mr. REES. Because I am assuming that the energy program is implemented in a different quarter. In other words, it is essentially a once and for all impact.

Chairman HUMPHREY. Yes, but let us assume that it is repealed, then what happens?

Mr. REES. Oh, if the repeal becomes effective during the fourth quarter?

Chairman HUMPHREY. Yes.

Mr. REES. Then you would get 4 percent, yes.

Chairman HUMPHREY. All right, let us put it another way. If yo[u] did not have the program at all, then would it not be possible t[o] have it 4 percent in the fourth quarter?

Mr. REES. Well, I have to know something about what you put in its place, and Mr. Zarb has prepared——

Chairman HUMPHREY. Let us assume you do not put anything in effect that increased the price, that we did not use price as a rationing way.

Mr. REES. If we have no alternative to the energy program?

Chairman HUMPHREY. Not the energy program, the tax part of it.

Mr. REES. The tax part of it, oh.

Chairman HUMPHREY. The tariffs, the tariff.

Mr. REES. If we had, say, rationing and allocation in place of the tax and the tariff?

Chairman HUMPHREY. No; let us assume that we had other means. Let us assume that the Congress decided—now, you gentlemen, do not share too much there. I want to get you one at a time.

Let us assume that the Congress decided that it would engage in other forms of energy conservation other than following the administration's proposal of using the price mechanism for the purposes of conservation.

Mr. REES. Then you would not get that effect on the price indices. but you would get other costs. You would get the hidden costs of rationing and allocation, and you might get an increase in unemployment.

Chairman HUMPHREY. I am not talking about rationing and allocation. I am talking about, let us say, for such things as, oh, you would promote insulation; you would have smaller cars, that you would maybe give a rebate on smaller cars, that would have a tax on bigger cars that are guzzlers, that you——

Mr. REES. Senator, with all respect, I do not see how those programs could have much effect as soon as the fourth quarter of 1975. In the long run I think they are highly desirable.

Chairman HUMPHREY. All right, you mean on conservation, but I am talking about price. We are talking CPI. Get out of the conservation field, Mr. Rees. Stay in your bailiwick. If we did not put those tariffs on, is it not a fact that your calculations on the cost of living index, that is the rate of inflation, in the fourth quarter would not be 6 percent but could be down to 4.5 or 4 percent?

Mr. REES. We are back to the same misunderstanding, sir, that we had a moment ago, that that will be true only if you assumed that the program is implemented during the fourth quarter.

Chairman HUMPHREY. Let us assume that there is no program implemented. Just get out of the energy field for awhile, Mr. Rees.

Let us just pretend. Let us get the worst of all situations here, that the Congress refuses to go with the President; the President refuses to go with the Congress, which I hope is not the case. But, in other words, the President's energy tax, tariff proposals, the President's energy proposals, in terms of tariff and excise taxes, is not passed, and it is one of those things that happens around here, where things get left.

have said to me that the cost of living, that the rate could go down as low as 6 percent in the fourth quarter.
ou, first of all, did that figure include the fact that there
s an energy program in it.

Rees. Yes, it did, and it assumed that the energy program
be implemented earlier than that.

airman Humphrey. All right.

ow, if there was no energy program that had tariffs in it, or let assume that it was repealed, either one, would it not be the case hat the cost of living—I mean that the rate of inflation could go down as low as 4 and 4.5 percent?

Mr. Rees. Senator, I do not mean to be stubborn, but my answer to that remains, no. I would be happy to lower my estimate of the rate of inflation for the year as a whole and instead of saying 8 percent, say it would be 6 to 7 percent for the year as a whole.

Chairman Humphrey. Well, I guess I am a slow learner, Mr. Rees. I always just figured that if you added something in and then took it out, that the figures came out about the way that you would expect them.

In other words, if you added $2—if you have got $4 in the pot and you add $2, it goes up to $6. If you take out $2, it comes back to $4. That is my arithmetic. But maybe that is not the way it works now. There is a new math.

Mr. Rees. Well I hope not.

Chairman Humphrey. Let me give you another option, and then we will quit.

Would it make any difference at all to the rate of inflation in the fourth quarter if there was no energy tax?

Mr. Rees. Yes, it would make some, because even if you implement the program in an earlier quarter, some of its effects would spill over into the fourth quarter. However——

Chairman Humphrey. Let us presume that you did not implement it at any time. Let us presume that there was no dollar put on in January, February, and March. Then would your calculation as to the rate of inflation be different than the 6 percent that you have given us this morning?

Mr. Rees. What would be different, Mr. Chairman, is my estimate of the level of the consumer price index. That would be 2 percent lower, but it would be changing at the same rate.

Chairman Humphrey. And what would be the rate of inflation, then, that you would calculate for the fourth quarter?

Mr. Rees. Six percent, sir.

Chairman Humphrey. I love you, but do not keep my books.

I thank you very much. I can see that you and I have to have a private visit, Mr. Rees.

Mr. Rees. I welcome that.

Chairman Humphrey. May I thank you very much today for your participation. I may want to later on have you gentlemen return. There will also be some inquiries posed to you as a result of things that were not answered today. I have a number of written questions here that we would like to present. We would hope that you might respond in reasonably good time. We understand the pressures on you.

Mr. REES. We will certainly try.
Mr. ZARB. We will do likewise.
[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF HON. ALBERT REES TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN HUMPHREY

Question 1. You say the inflation rate should still be declining at the end of the year. Would you like to stick your neck out and say what lies ahead in future years? What is your best guess? Is there anything to stop us, over several years, from getting back to the kind of price stability which we enjoyed in the early 1960's?

Answer. Forecasting prices is at best a hazardous task, and the record of the economics profession in this area is not good. Nevertheless, I would venture to say that I can see no reason why the rate of inflation should not decrease further in 1976 and the years beyond, and eventually return to the levels of the early 1960's. It should be remembered, however, that unemployment in the early 1960's was consistently above 5 percent, and that it may be extremely difficult to match this price performance at lower unemployment rates.

Any long-run forecast of the rate of inflation must depend less heavily than short-run forecast on particular events such as harvests and changes in energy policy, and correspondingly must depend more heavily on assumptions about monetary and fiscal policy. An optimistic long-run forecast would assume that monetary and fiscal policy succeed in keeping output rising, so that we benefit from productivity gains, but also that they keep enough slack in the economy to avoid widespread shortages and excess demand for products and labor.

Question 2. You refer to studies you are making of concentrated industries, including steel, aluminum, tires, chemicals. When will these studies be completed? To what sort of recommendations might these studies lead?

Answer. Price monitoring is an ongoing activity that does not necessarily involve a completion date. For some of the industries mentioned, we may issue reports, but these should be regarded as interim reports. For some, we may decide to hold public hearings. We will in any event publish accounts of these activities in our quarterly reports.

The studies will not all result in recommendations. However, in some cases we may make recommendations to the industries concerned to reduce certain prices or to avoid further price increases.

Question 3. Much of the increase in wholesale prices last month was in the category called "machinery and equipment." Construction machinery and equipment showed an especially large gain (4.3 percent in 1 month). Isn't the construction industry among the most depressed sectors of the economy? How in the world can they be raising prices like that? Are you conducting any studies of the machinery and equipment industry? If not, why not?

Answer. We are finding a number of cases in which industries with falling demand are nevertheless raising prices because of increases in their costs. Although construction equipment had a rather large 1-month price increase in January, the record over 1974 was similar to that for all industrial commodities.

From December 1973 to December 1974, wholesale prices of construction equipment rose 26.8 percent and all industrial commodities in the WPI rose 25.6 percent.

Much construction equipment is made by the same industry that makes farm tractors and other farm machinery. It is a relatively concentrated industry—in 1963, the four leading firms produced 43 percent of farm machinery output. Although we may decide to study this industry, the limited size of our staff requires us to be selective in choosing industries for study.

Question 4. You mention several ambitious study projects you have underway or intend to pursue: A study of concentrated industries, a study of cost-of-living escalators, a review of government rules and regulations, and so forth. Do you have enough staff to carry out these studies and do so in a timely fashion? Should Congress give you a larger appropriation so you can equip yourself to do your job properly? I see in the President's budget that there is a recommendation to increase your budget authority by $600,000. How do you plan to

utilize that additional amount? Will it be enough to enable you to do your job properly? How large is your professional staff now? How much do you plan to enlarge it?

Answer. Some of our studies are conducted by consultants rather than by our own staff. Our present staff is 40 people, including 28 professionals. The appropriation requested in the President's budget would keep the staff at about its present size. The difference of $600,000 between the 1975 appropriation of $1 million and the request for 1976 represents the difference between operation for part of the year and for a full one.

If the amount appropriated exceeded the amount requested, we could expand our staff to handle more simultaneous studies. However, too rapid expansion could result in a dilution of staff quality.

Question 5. You refer in your statement to the desire of many companies to maintain substantial profit margins to finance investment. It seems to me this is something you should be monitoring closely. Profits in general won't be very good this year, but there still may be some industries which are trying to maintain higher profit margins than is really necessary. Are you monitoring profits? Have you requested profit margin data from firms? Have they supplied everything you requested? Would you find it helpful to have subpena power?

Answer. When we monitor prices in an industry, we always study profits in that industry as part of the price monitoring process. We have no difficulty in obtaining profit data for corporations as a whole, but sometimes experience difficulty in getting profit margin data for particular activities or lines of business.

In some of these cases it might be helpful to have subpena power though we would hope to use it sparingly and as a last resort. We would be willing to use subpena power only if we were still permitted to keep confidential any proprietary data submitted by individual firms.

Question 6. How do you feel about being given the power to delay price increases in problem situations for, say, 60 days? Would such a provision give you a useful opportunity to analyze the merits of a price increase before it took place and perhaps try to head it off? Would businessmen see this move as a step toward controls?

Answer. We are opposed to having the power to delay price increases for 60 days. Businessmen would regard this as a step back toward controls, and rightly so. I am enclosing for the records of the Joint Economic Committee a copy of my statement of February 5 before the Senate Committee on Banking, Housing, and Urban Affairs concerning S. 409, a bill to amend the Council on Wage and Price Stability Act. This statement gives my views on delay powers in more detail.

Question 7. In your statement you describe what you regard as exorbitant wage gains by some construction unions. You go on to say, "Collective bargaining enjoys a privileged position under Federal law, particularly in construction, but abuse of such privilege invites re-examination of its sources."

What do you mean by that? Do you think our labor laws require change? Is that statement intended to put the construction trades on warning? If they do not heed the warning, what action would you contemplate taking? Or recommending?

Answer. The National Labor Relations Act, as amended, is as I understand it, intended to promote equality of bargaining power between organized labor and management. At the present time, many representatives of management in industries such as construction and retail trade, where many firms are small, feel that there is a preponderance of bargaining power on the side of unions, and that management is relatively powerless to resist excessive bargaining demands.

A continued rapid raise in wages during a severe recession might be regarded as evidence tending to confirm this view and might lead Congress to consider changes in the law. However, I am not prepared to propose specific changes at this time.

The special protection afforded construction unions is that provided by the Davis-Bacon Act Excessive wage increases in collective bargaining agreements in the construction industry could be considered by the Secretary of Labor in the administration of the Davis-Bacon Act.

Enclosure.

STATEMENT OF HON. ALBERT REES, DIRECTOR OF THE COUNCIL ON WAGE AND PRICE STABILITY, BEFORE THE SENATE COMMITTE ON BANKING HOUSING, AND URBAN AFFAIRS FEBRUARY 5, 1975

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before this Committee to express my views concerning S.409, a bill to amend the Council on Wage and Price Stability Act. I was particularly gratified to note, Mr. Chairman, that in introducing this bill in the Senate, you reiterated your opposition to across-the-board wage and price controls on the grounds that they create shortages and black markets and that a large bureaucracy would be required to administer them. I am in full accord with these views, as I indicated in my letter of December 19, 1974, to Senator Sparkman commenting on the Mansfield bill, S. 4174, a bill to stabilize prices, rents, wages, salaries, dividends, and other economic transfers. Mr. Chairman, with your permission I should like to ask that this letter be made part of the record of this hearing.

This would be an especially inopportune time for the reimposition of wage and price controls because of the rate of inflation is subsiding and can be expected to subside further in the coming months. Indeed, inflation would probably be subsiding even faster were it not for the widespread fear that Congress will reimpose wage and price controls. This fear makes business reluctant to cut prices and labor unions reluctant to moderate their wage demands, lest they be frozen in an unfavorable position by a new controls program.

In examining whether the Council on Wage and Price Stability needs additional powers, it is useful to review briefly what we have been able to accomplish during our short existence using the powers already at our disposal. This is particularly appropriate because this is the Council's first appearance before this Committee.

The Council was created by law on August 24, 1974. I was appointed Director on September 30, and began to recruit a staff. We now have a staff of 35, still somewhat below our authorized strength of 41. We have been fortunate in securing the services of some very able people, several of whom are here with me this morning. However, we have been severely hampered in recruiting by the very short authorized life of the agency. In transmitting our first quarterly report to the Congress, the President indicated his intention to request an extension of the life of the agency. This would also be accomplished by S. 409, though for a longer period than the President suggested.

On November 13, 1974, the Council, together with the Office of Consumer Affairs. held hearings on the repricing of shelf inventory in retail stores, especially food stores. It later issued a report and recommendations on this subject.

On November 25 and 26, 1974, the Council held public hearings on the very sharp increases in the price of sugar. A report summarizing the findings of these hearings will be issued this month. We also worked actively with the press and with food processors and distributors to encourage the conservation of sugar and the promotion of sugar-free products. Since then, the price of sugar, though still too high, has fallen substantially. Consumer resistance, which we helped to mobilize, has been largely responsible for this price reduction.

In December, in response to a request from the President, we investigated price increases announced by three major steel producers. We were successful in persuading these producers to roll back the increases by approximately 20 percent. The increases announced later by the rest of the industry were much smaller, and within the limits set by the rollbacks by the first three companies. This action saved users of steel an amount well in excess of $100 million a year. The balance of the price increase in steel appears to be justified by increased costs, including higher wages and sharply increased costs of purchased raw materials. The United States Steel Corporation pledged in late December not to increase steel prices for six months, unless forced by "unforeseen economic events." The other two companies pledged not to increase before June 1, 1975, any prices increased in December.

In January, we began an investigation of the pricing policies of the aluminum industry, an industry which is maintaining or increasing the price of its products despite sharp decreases in demand and output. We have requested information from the seven largest companies in the industry and are beginning to receive the data we have requested.

On January 13, we filed comments in a proceeding before the Interstate Commerce Commission requesting it to broaden the definition of private motor carriage so that one subsidiary of a parent corporation can charge another such subsidiary for carrying loads without having a common carrier certificate. This action would help diminish wasteful empty backhauls by private motor carriers.

On January 23, we filed with the Federal Communications Commission a request that they hold hearings on the 7 percent rate increases filed by the American Telephone and Telegraph Company for interstate services. Although we commend the company for its proposed move toward a cost-based rate structure, it is our view that the overall size of the rate increase sought is excessive.

We have been involved in several matters with the National Highway Traffic Safety Administration, including proposed standards for improved air brake systems on trucks and buses, passive restraint systems (airbags) for automobiles, and automobile bumpers. On December 26, we filed formal comments with NHTSA requesting that the implementation of the air brake standard be postponed pending an analysis of its cost and benefits. NHTSA decided that the standard should be implemented as planned, but has committed themselves to undertake the type of analysis we have requested. They have assured us that, should the results of such a study warrant it, the standard can be modified. In all of these matters, our concern has been to make sure that the costs of the proposed new or revised standard do not exceed the benefits, and to make certain that it is not possible for the benefits to be obtained in a less costly way.

In the months ahead, we plan to continue an active voluntary wage-price policy. We will extend our price monitoring to a number of additional industries, including metal cans, and rubber tires and tubes. This afternoon, we will begin our first investigation of a proposed wage increase by holding a meeting with mechanical contractors from the San Jose and San Mateo, California, area concerning bargaining demands by plumbers and pipefitters.

On November 27, 1974, the President signed Executive Order 11821 requiring the submission of inflation impact statements by executive departments and agencies proposing new legislation, rules, and regulations. On January 28, 1975, the Director of the Office of Management and Budget issued OMB Circular No. A-107 implementing this order. The circular gives the Council on Wage and Price Stability a major role in helping agencies assess the impact of new rules and regulations on costs and prices, and in determining whether the costs are justified. We look forward to participating in this important effort.

Let me now turn to the major changes in our powers proposed by S. 409, which are the proposed powers to delay wage and price increases. The intention of these provisions appears to be to give the Council time to undertake a more thorough investigation of proposed price and wage increases than would be possible without such powers. It is very difficult to oppose thorough investigations. Nevertheless, the proposed powers raise serious problems.

A company experiencing rising costs may decide to raise prices sooner if it knows the proposed increase could be delayed. In those cases in which the increase was in fact delayed, this would not have any adverse effect. But S.409 quite wisely would not require the Council to delay routinely all proposed increases, even by large companies. Where delay powers are used selectively, one must ask whether the cost of encouraging earlier price increases that are not delayed exceeds the benefits in the cases where increases are delayed.

It should also be noted that there are some situations within the area of price monitoring where delay powers cannot be helpful. For example, one could not use them in the case of supermarket chains or other large retailers who make hundreds of price changes every day. Nor are they helpful in a case like our present investigation of aluminum, where the relevant question is not "Why are you raising your prices?" but "Why don't you lower them?"

The most serious problems of delay authority, however, concern proposed wage increases. Most of the wage increases that might contribute substantially to inflation are those arrived at through collective bargaining. S. 409 provides for notification of wage increases agreed upon through collective bargaining and affecting more than 5000 employees "not more than 5 days after the agreement with respect to that increase has become effective or has been reached, whichever is later."

This provision, in my judgment, is no improvement over our present authority. It is far more difficult to moderate an excessive wage increase after it is in effect than before. The proper time to influence the bargaining process is before a final agreement has been reached. In the case of the San Jose and San Mateo pipefitters, we are beginning our investigation more than two months before the old collective bargaining agreements expire.

Even more serious problems are presented when an agreement is reached following a strike. Suppose that a union agreed to end a strike in return for a large wage increase, and that the Council delayed this increase. Would the strikers return to work? Or would S. 409, if enacted, have the effect of increasing industrial strife? It is true that strikes decreased under the Economic Stabilization Act of 1970, but that act provided comprehensive controls, not just delays. One may also ask whether, if wage increases are delayed, they will not be restored through retroactive payments after the delay period.

I dwell upon the wage side because in my judgment wage increases will soon be a more important element in the inflationary process than they have been in the recent past. In 1974, price increases were larger than wage increases. In 1975, wage increases are quite likely to be larger than price increases, at least in the sectors of the economy covered by collective bargaining.

In introducing this bill, Mr. Chairman, you stated that during the delay period "The President can and should bring the parties in and have a face-to-face talk with them in the Oval Office. He can examine their defense contracts, their Federal subsidies, the allocation of scarce materials to them, and the myriad of concessions, privileges, franchises, and other favors the Federal Government has to bestow upon them". I have reflected carefully on these remarks, and I can only construe them as a suggestion that the Executive Branch invent penalties for companies and unions that incur its displeasure. Mr. Chairman, if that is indeed your intent, I most respectfully disagree. This is a Government of laws and not of men, and the Executive Branch should not impose any penalties except as provided by law. A voluntary wage-price policy should rely on persuasion without threats or *ad hoc* punishment.

S. 409 includes provisions concerning the price of oil that are clearly in conflict with the President's energy program. Our agency does not now have any responsibility for that program, and I trust that the Committee will obtain the Administration's views on this matter from other witnesses.

S. 409 includes a number of other provisions affecting the Council. It grants authority to issue subpoenas and require periodic reports, it requires that we publicly disclose information acquired through subpoenas and reports, it increases our annual budget authorization to $4,000,000, it extends our life to September 30, 1977, and it requires confirmation by the Senate of future Directors of the Council. With your permission, Mr. Chairman, I should like to submit for the record a staff analysis giving the arguments for and against these provisions. I would be happy to respond to questions about any of these provisions.

In concluding, let me say that I view the prenotification and delay powers in S. 409 as a step back toward general wage and price controls, and feel certain that they would be so viewed by business and labor organizations. Such a view could encourage counterproductive wage and price behavior. The Administration believes that such a step backward is unnecessary and unwise under present circumstances.

RESPONSE OF HON. FRANK G. ZARB TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN HUMPHREY

Question 1. John Sawhill, who was Administrator of FEA at the time President Ford announced his 1975 conservation goal of 1 million barrels per day, testified before this committee that FEA had *no* role in formulating this goal and that he had no knowledge of its origin. Can you clarify for us now how this objective was devised and whether any analysis of its economic consequences was made?

Answer. On October 8, the President in his energy message announced a goal of reducing petroleum imports by 1 million barrels per day by the end of 1975. This goal was to be achieved primarily through voluntary conservation in the transportation, buildings and industry sectors, and through coal conversion in electric powerplants and certain industries. The goal itself was formulated by

the economic policy advisers, but was based on preliminary results of the extensive economic analyses performed by FEA and other participating agencies in the development of the *Project Independence Report* (PIR).

This goal to reduce 1 million barrels per day by the end of 1975 was based on a series of predominately voluntary conservation measures which were later submitted to Congress in November of 1974, in the Comprehensive Energy Plan. The Comprehensive Energy Plan consisted of a report transmitted to Congress in response to section 22 of the Federal Energy Administration Act of 1974.

An estimate of the economic consequences of the achievement of such a goal was made by White House staff members based on the *Project Independence Report* results. Essentially, the success of the program was dependent on the degree of participation by consumers and industry leaders in the voluntary conservation measures proposed. Expected level of participation associated with each measure was included in the Comprehensive Energy Plan. However, since the *Project Independence Report* draft indicated substantial savings in these sectors by eliminating energy waste, it was estimated that the 1 million barrels per day goal could be achieved with *no* adverse impact on the U.S. economy. The voluntary program was not successful and it soon became clear that more was needed.

The President's energy program proposed in his state of the Union message in January, 1975, reduced the dependency on a high degree of voluntary participation in these conservation measures. Instead, the President proposed extensive use of the price mechanism coupled with the ongoing coal conversion program in utilities to effect similar import savings by the end of 1975.

Question 2. The administration's strategy of conservation through higher energy prices will work toward its goal in part by forcing curtailment of energy-intensive industries through raising their costs, and by encouraging reallocation of their resources to other sectors. This means creating additional unemployment, just as last year's oil price boost has contributed to the present unemployment. Have you or anyone in the administration estimated how much additional unemployment the President's energy program will cause in this way, and what kind of jobs would be effected, and where? In particular, what would be the total (direct and indirect) effects of the proposed new taxes and price decontrol on costs, production and employment in various regions in the following sectors:

(*a*) Petrochemicals:
(*b*) Agriculture (including effects of fertilizer prices and fuel prices);
(*c*) Transportation industries, from taxis to airlines;
(*d*) Utilities;
(*e*) Basic metals industries and cement;
(*f*) Major petro-chemicals using industries (e.g., autos, tires, textiles, plastics, fertilizers, etc.);
(*g*) Public institutions (hospitals, schools) and public services;
(*h*) State and local governments; and
(*i*) National defense?

Answer. The effect of the President's energy program is neither designed to nor should it result in additional unemployment. In the short term there will be selected, temporary dislocations that may result in an aggregate 6.1 to 6.2 increase in the U.S. unemployment rate. Anticipated production effects like anticipated unemployment effects are minor in the short run and should be negligible in the long run.

The cost effects of the President's energy program are discussed in the two reports attached: "The Economic Impact of the Energy Program Proposed by the President in the State of the Union Message" and "Impact of the Proposed Energy Deregulation/Tax Program on Selected Industries." These two reports contain the results of FEA's analysis in this area to date.

Concerning the list of industries provided by you, FEA acknowledges significant cost and resultant price effects for the short run in the petrochemical and air transportation industries, and to a lesser extent on the fertilizer, cement, paper and contract construction industries.

The other industries you listed are not covered by FEA's reports, since our analysis indicates that the President's energy program will have a neutral or minimal effect on these sectors (national defense, State and local government, and so forth) in the short run (1975–1977) and a positive effect in the long run (1980–1985).

Question 3. Some energy-conserving activities would create employment. These would include upgrading insulation, improving fuel efficiency of industrial plants, rehabilitating the railroads, and such measures. Have you estimated how many persons might be employed in its way through the effects of the program?

Answer. The net effect of energy-conserving activities on employment will vary extensively depending on the industry or demand sector impacted and on the type of conservation activity adopted. For example, as you have indicated, the effect on employment resulting from insulation upgrading of residential homes and commercial buildings could, based on FEA's latest estimates, increase employment by at least 10,000 jobs in 1976.

On the other hand, conservation measures designed to reduce overall automotive use could have a large negative effect on the auto industry, while conservation measures oriented to improving the fuel efficiency of automobiles could have a largely neutral effect.

Studies on the economic and employment impact of conservation measures on various demand sectors, are being conducted within and outside of FEA. Unfortunately the results are not yet available. This data on the employment impact from rehabilitating the railroads or improving fuel efficiency in industry, as well as other conservation activities, are not yet available.

Question 4. Is it not true that natural gas producers are not subject to the proposed windfall profits tax but would stand to gain handsomely from gas deregulation? Intrastate producers would benefit from oil decontrol even without deregulation of gas. Is it not also true that coal producers would not face any tax increases but would benefit from the proposed higher oil prices? Has the administration, on the other hand, backed away from President Ford's statement in October that he would favor repeal of the depletion allowance for oil and gas along with any decontrol of prices?

Answer:

Natural gas windfalls.—The administration has not proposed windfall profits taxes for natural gas. "Old" gas supplies, the major source of potential windfalls, would continue to be regulated under the administration's energy program. Higher prices for "new" natural gas supplies would provide strong incentives to increase supply, discourage excess demand, induce producers to sell new gas supplies on the interstate market, and allow producers a source of capital for exploration and development of additional natural gas reserves. Due to the long (3 to 4 years) lead time necessary to develop new sources of supply, the amounts of "new" gas that could be marketed at interstate, unregulated prices would increase gradually limiting the possibilities for excess profits in the next few years. Over the long-range increased domestic production of all energy sources as a result of the President's program will lower energy prices.

Intrastate producers.—Intrastate producers of natural gas will not derive excessive benefits from oil decontrol. New supplies of natural gas sold on intrastate markets are currently commanding prices ($1.50–$2.00/MCF) which compared to imported oil per BTU would not increase as the result of deregulating old oil prices. Natural gas is traditionally sold under long-term contracts (20 years is not unusual). The prices of old gas on intrastate markets are therefore inflexible.

Coal windfalls.—Abundant domestic supplies of coal can be extracted at relatively (compared to imported oil) low production costs. Large profits in producing coal can exist temporarily and serve the desirable economic function of attracting new producers into the industry and inducing increased production from new and existing mines. The resulting increases in coal production will tend to hold coal prices down. Excessive profits in the coal industry are therefore unlikely to exist over any long period. Attempts to control coal prices or limit short-run profitability could seriously hamper supply incentives in the industry.

Question 5. OPEC oil is selling at some $10.50 or so before transportation of refining. Yet the production costs and OPEC taxes—mainly the latter—take all but about 50 cents of this from the oil company that produces and exports the oil. In the United States, however, we were told a year or two ago that prices in the range of $4 to $5 would be ample to stimulate oil development. Perhaps development costs have gone up since then, but it is reasonable to assume that industry would tap the lowest cost opportunities first. Even if costs are now $6 for new oil selling at, say, $10, then profits are $4 per barrel, or *8 times the profit from an OPEC barrel.* And, of course, we permit producers

to release a barrel of old oil from controls for each new barrel lifted from any lease, doubling this profit in many cases.

Is it not clear therefore that oil production is much more profitable in the United States than anywhere else in the world? Wouldn't this also be true at $7 per barrel?

Answer. Domestic oil reserves are significantly depleted; very few opportunities remain for discovering oil fields in the United States which are both economical to produce and contain enough petroleum to greatly improve our supply posture. The bulk of future domestic production will come from high-cost propositions such as deep wells. Even existing production is costly, especially compared to areas in the Mideast where most of the petroleum derives from shallow and prolific reservoirs. In order to develop the remaining domestic reservoirs, producers need to invest large sums of money at the beginning of the project and suffer a long delay before the oil begins to flow. Thus, the costs of today's high interest rates and of foregone opportunities require a higher price for oil than in countries with more profitable circumstances.

Question 6. It is true that oil development costs are increasing rapidly. But let's look at what is going on here. Profits from U.S. development are very high, but the amount of skilled labor and equipment available with which to pursue these profits is pretty tightly limited for the present. So these high profits are used to bid up the prices of these inputs rapidly. This is also true of oil leases.

But these cost increases do not increase the rate of development, which is limited by physical equipment. Beyond a certain point, they do not contribute anything more even to the future availability of inputs either.

Are present prices of new domestic oil not excessive in this sense?

Is it not true then that high U.S. oil prices themselves comprise the strongest thrust behind escalating oil exploration costs and that by keeping prices high and pushing them higher we are just building up a cost structure in our energy industry that will be hard to bring back down?

Answer. While it is regrettable that the increased demand for drilling and production materials and labor has tended to increase the costs of these items, this trend is merely temporary and natural economic phenomenon. Once suppliers have had time to increase their capacity, prices will become more competitive. Furthermore, this adjustment to higher levels of exploration and production is absolutely essential if the United States is to reduce dependence on foreign energy sources. Since there is often a very long time lag between initial exploration activities and the onset of the new production, it is imperative that we begin the effort as early as possible. Through pricing policies, the Cost of Living Council and the Federal Energy Administration have acted to smooth out this transition as much as possible.

Question 7. Most projections of oil output show very little increase in production at prices above $7 per barrel. The MIT energy laboratory projects an increase for 1980 from 10.6 to 10.9 million barrels per day (3 percent) as a result of increasing prices from $7 to $11. It shows a concomitant decline in natural gas output due to this increase in oil prices.[1] The National Petoleum Council shows absolutely no change in output of either fuel from such a price change.[1] FEA documents indicate that most of the increase in potential oil reserves from such a price increase would be from tertiary recovery of oil from already depleted wells in the contiguous 48 States, but this committee is informed by expert witnesses that technology for tertiary recovery is not yet adequate and that further research is needed to perfect it.

Why, then, should a ceiling not be imposed on new oil prices in the range of $6 to $8 per barrel? Or, if we wish not to reduce the conservation incentive of higher consumer prices, why should we not levy a permanent windfall tax on revenues from prices above this level instead of one that phases out over 5 years, handing the windfalls back to the industry over this period? Then, if necessary, direct subsidies might be extended to tertiary recovery projects.

Answer. The characteristics of each oil producing property vary dramatically from one to another. Some important variables are the volume and grade of oil remaining in the ground, the nature of the geological formation, containing the oil and the availability of other materials, such as water or chemicals to assist and/or augment the flow of oil. Obviously, with such a wide range of

[1] *Energy Self-Sufficiency: An economic evaluation by the MIT Energy Laboratory*, published by the American Enterprise Institute, Washington, 1974.

situations, any change in price will cross the economic threshold of some projects. At the very least, a $4/Bbl price increase would yield substantial increases in production just from extending the economic limit and hence the producing life of each well, not to mention the new and expanded production that would result.

Regarding tertiary recovery, the reason that the technology has not been fully perfected is that until very recently, the economics have been so poor as to virtually rule out the necessary large scale commercial applications. The way to perfect tertiary recovery techniques is to permit a selling price conducive to an adequate rate of return on investment, not to continue the restraints which have so far discouraged research and development.

The windfall profits tax was designed with a phase-out provision so that producers contemplating a project with a long lead time (i.e., tertiary recovery) would be only minimally influenced by the tax measure. A permanent tax could endanger these projects. Furthermore, the administration believes that the free market should prevail whenever feasible and that programs such as the windfall profits tax should have a time fuse built in to ensure that the artificial economics are not perpetuated.

Question 8. Is there not much to be said for reducing disparities in producer prices between new and old oil and between new oil and new natural gas, even if this means rolling back the price of new oil to reduce the impact on price levels and consumers? Would not such action reduce the danger of ratcheting up energy development costs and help to reduce the arbitrary cost of the energy crisis to people and regions that happen to depend on oil relative to those depending on gas?

Would the administration consider favorably a ceiling on new oil if it were part of a package to increase the price of new natural gas to a comparable ceiling? Would this combination not yield greater future domestic fuel production than today's pricing policies?

Answer. It is true that much can be said for reducing disparities in producer prices between old and new oil and natural gas, however, rolling back the price of new oil may not be the best means to do this. This approach could discourage the development of alternate fuels such as shale oil and coal gasification. You suggested that a ceiling on new oil and an increase in new natural gas prices be linked as part of an energy package.

Question 9. What justification is there for decontrolling old oil prices? It socks the consumer in the jaw again. It is not needed to provide adequate incentives to producers, for we all know that the incentives to produce new oil already are very great. What would be achieved by whalloping the economy with another huge increase in energy prices in this way?

Answer. The administration is not proposing a windfall profits tax in order to provide incentives to producers. Quite the contrary, the tax is designed to recover excess profits and to return them to the consuming public via rebates and tax cuts. Thus, the consumer is adequately protected from the higher energy costs resulting from decontrol. The advantages lie in the stimulus afforded to the production of alternate fuels due to increased prices of petroleum.

Enclosures.

The Economic Impact of The Energy Program Proposed by the President in the State of the Union Message

(Technical Report, 75-13, F.F.A.—E.A.T.R.—75-13, March, 1975, Office of Economic Impact, Office of Analysis, Federal Energy Administration.)

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SUMMARY

This paper contains estimates of the economic effects of the energy program proposed by the President on January 15, 1975. The program includes a $2 per barrel fee on all imported petroleum along with a $2 per barrel excise tax on domestic petroleum production and a 37 cent per mcf excise tax on domestic natural gas. In addition, all tax and tariff revenues are returned to consumers according to the amount of taxes paid by income class so that there are no real income effects; petroleum and natural gas prices are decontrolled; and it is assumed that the program is implemented May 1, 1975. The final major part of the program is an interim measure where import fees on crude oil are increased from $1 per barrel to $3 per barrel over the three month period. February 1 to April 1, 1975 and an import fee is levied on refined petroleum products of 0.60 in March and 1.20 per barrel in April.

Finally, all analyses in this paper assume that the OPEC cartel maintains currently high petroleum prices through 1977 and then adjusts them downward consistent with revenue maximizing behavior. The major findings are:

1. Petroleum and natural gas prices increase immediately in 1975, the price of coal is not expected to change as a result of the President's program and electricity prices will increase but the percenteage change will be much smaller than that for natural gas and petroleum.

2. Petroleum import savings that result because of the conservation effects of the tax and tariff measures and because of increased development of domestic reserves are about 700,000 barrels per day by the end of 1975, 2,200,000 by 1977 and 7,500,000 barrels per day by 1985. These levels of import reduction offset the petroleum imports from countries where there is high risk of future embargoes (see page 367 of the Project Independence Report). This does not mean that imports will not come from insecure areas but that the program would reduce the pressure to import from such countries.

3. The long-term effects of the President's program on the structure of energy consumption is to reduce total energy use by 6.7 (6.4%) quadrillion BTU's (Quads) in 1985 with coal consumption increasing by 2.3 quads and petroleum and natural gas decreasing by 9.0 quads.

4. The effects of the President's program on consumer prices will be to increase the Consumer Price Index by about 2 percentage points during the first full year of the program. Although FEA forecasts indicate that this will occur during 1975, it may occur over a longer period (2 to 3 years).

5. The short-term effects of the program on economic output and employment will be greater than the long-term effects. The short-term effects will be to increase unemployment by .1 to .2 points and to drop in annual GNP by about $1 to $6 billion (GNP is given in constant 1958 dollars throughout this paper). In the longer-term (beyond 1977) the President's program will not have a significant effect on the level of GNP or employment.

When weighed against the costs of possible future embargoes the short-term economic costs of the energy program are small. FEA analysis indicates that the cost of a six month embargo would be about $47 billion in 1977 and would grow to approximately $120 billion by 1985 if no energy program were enacted.[1]

6. Direct fuel purchases per household are expected to increase by about $171 on average as a result of the President's program during the first full year after it is implemented. There may be some small increases in the second and third years ($10 to $15 per household) but in the longer term consumer costs should fall as the world price of oil goes down.

Consumption expenditures will also increase because of the indirect effects of higher energy costs (ripple effects). These are the energy costs that are embodied in consumer goods and services such as drugs, steel, plastics and airline travel. Total consumer cost increases per household (direct and indirect) during the first year of the program are estimated to be about $275.

7. In the short-term (1974–77) all geographic areas will experience fuel cost increases, ranging from 14 percent to 18 percent per household, as a result of the President's program. The largest cost increases will occur in New England primarily because of fuel oil and gasoline price increases and in West Central and Mountain Regions because of gasoline and natural gas price increases. However, in terms of percentage increases, New England has the smallest increases (14%) because of current high costs.

8. In the longer term (beyond 1977), because of fuel substitution and the lower reliance on imports, the regional BTU costs differentials (for all sectors—transportation, household, and so forth) are not affected significantly by the President's program. The central parts of the country with the exception of East South Central have relatively lower prices and the coastal areas have higher prices.

9. The major effects of the President's program on sectors that provide goods and services are: substitution effects outweigh price effects in the electrical generation sector (fuel consumption increases); a moderate decrease in fuel consumption occurs in the household, commercial and industrial sectors; and because of its strong dependence on petroleum (without adequate substitutes), the transportation sector is projected to reduce its fuel consumption significantly.

Natural gas intensive industries (brick, structural clay tile, structural clay products, lime, and cement) show the largest percentage changes in product prices due to natural gas price increases. For large petroleum users the largest increases are projected for those industries involved in paving mixtures, asphalt felts, industrial inorganic and organic chemicals, air transportation, carbon-graphite products and synthetic rubber.

I. INTRODUCTION

The President's economic and tax program proposed in the state of the Union address of January 15, 1975, outlined the Administration's campaign against recession, inflation, and energy dependence. This paper focuses primarily on the energy-related provisions of the President's program and on the probable impacts on the economy as a whole, on certain important segments of the

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[1] The estimates of the costs of future embargoes are based upon methodology that is reported in *Forecasting the Costs of Future Petroleum Import Disruptions*, T. H. Tietenberg, FEA, Working Paper 75–2, Macroeconomic Impact Division, Office of Economic Impact, March 19, 1975.

economy, and on prices both in the short and long run, together with the resulting effiects of these price changes on consumers and producers.

A. *Energy Program Assumptions*

This paper contains estimates of price and price-associated economic effects of the proposed energy tariff and excise tax program. The program includes a $2 per barrel fee on all imported petroleum production and a 27 cent per mcf excise tax on domestic natural gas. In addition, all tax and tariff revenues are returned to consumers and distributed by income class in such a way as to produce no aggregate decrease in real income; petroleum and natural gas prices are decontrolled; the excess profits that result from the decontrol of oil and natural gas prices are taxed away with an excess profits tax; and the program is implemented May 1, 1975. The final major part of the program is an interim measure by which import fees on oil are increased from $1 per barrel to $3 per barrel over the three-month period, February 1 to April 1, 1975, and part of the import fees on refined petroleum products rebated: $1 in February, $1.40 in March, and $1.80 in April.

All evaluations assume that the OPEC cartel maintains the current price of imports through 1976 and then adjusts the prices to $7 per barrel (in constant 1973 prices) during 1977. This is approximately equivalent to $8.32 in 1975 prices. Finally, the base against which the President's program is compared assumes that price controls on "old" domestic oil and interstate natural gas are continued indefinitely.

B. *Mechanisms for Initiating and Transmitting Price Changes*

The President's energy program will affect the costs of energy resources and these changes will be either partially or fully passed on to consumers in the form of higher prices.

The prices of other products will also be affected both directly and indirectly by changing the costs of the inputs used in the production of these other products such as steel, chemicals, and air transportation.

The proposed initiatives will affect the prices paid in energy markets primarily because of three factors: First, the tax and tariff measures will raise the prices that energy producers must receive before they are willing to provide a given quantity of output. Second, the proposals will not affect all energy supply relationships equally. For example, the supply prices of petroleum and natural gas will be increased more than the supply prices of coal and nuclear energy. Because of these changing relative prices, the demand for related sources of energy will be shifted. (The amount of coal and nuclear power that is demanded by consumers at any price will increase because the prices of petroleum and natural gas have increased.)

Finally, the prices of natural gas and petroleum will rise because energy price controls are removed by the President's program. Petroleum prices will increase to the level of import prices and natural gas prices will rise to a level that equates domestic supply and demand (there are essentially no natural gas imports).

Higher energy prices will affect the economy through supply and demand channels. The prices of energy and energy intensive goods will increase relative to non-energy intensive goods. This will result in higher costs to producers and consumers and shifts in the composition of demand between energy and non-energy related goods. The changes in costs (supply) and demand will result in changes in employment and economic output.

There is also a temporal dimension to the effects of the energy program. Although there will be an immediate rise in energy prices, the supplies which are called forth will appear gradually over a number of years. In a similar manner the effects of the program on the spending patterns of consumers and producers will change over time. Initially there will be reductions in energy use through actions such as less driving and the lowering of temperatures. In the longer run more efficient cars will be purchased, houses will be better insulated and business will purchase capital that is more energy efficient. Because of these lags and because the effects will be different in the short term and in the long term this report covers both.

C. *An Overview of the Statement*

The next section discusses how the prices of basic energy resources are expected to be affected for selected years within the next decade and explains the sources of these price changes. Section III presents the expected changes in energy consumption. Section IV compares the projected economic situation

with and without implementation of the program (inflation and economic output are considered). The final sections then trace out the likely industrial and regional economic impacts of the program, insofar as they can be specified, and evaluates the effects of the program on consumer groups both regionally and by income class.

II. DIRECT PRICE EFFECTS ON ENERGY SOURCES

A. *Energy Price Effects*

The energy price effects of the program as a whole are given below in Tables 1 through 3. The values in Table 1 show the effects of the program in 1975 and Tables 2 and 3 show the longer term effects (through 1985). Table 2 shows the long-term time path of prices with and without the President's program, and Table 3 shows the percent change in prices due to the President's program.

TABLE 1.—SHORT-RUN ENERGY PRICE PATHS WITH THE PRESIDENT'S ENERGY PROGRAM [1]

[Wholesale prices]

Energy source	January	February	March	April	May [2]
Crude petroleum	8.44	8.99	9.54	10.09	13.00
Refined Products	10.15	10.16	11.16	11.72	14.25

[1] The short-run or interim part of the President's energy program affects only petroleum prices.
[2] It is assumed that the permanent part of the program (the $2 import fee and excise taxes) will be implemented May 1, 1975.

The general impressions conveyed by Tables 2 and 3 are that prices will be generally higher through 1977 as a result of the energy program, then fall (with the exception of natural gas) as the world price of oil falls.

The basic logic behind the assumption that the world price of oil will fall after 1977 is that the long run revenue maximizing price level of the cartel is likely to be lower than the currently high prices. Based upon analysis done for Project Independence, oil exporting countries will be faced with an increasingly stagnant international oil market if current oil prices prevail into the 1980's.[2] The exporting countries will be faced with the choice of reducing prices or having considerable surplus production capacity. However, if the currently high pricing practices are continued it is likely that the effectiveness of the cartel will be greatly reduced. Assuming that the members of the cartel wish to maximize revenues, it is in the cartel's interest to establish a price which is higher than $4 (long run supply price) but low enough to ensure that all members will follow the general pricing practices of the group.

The price trends shown in Table 2 illustrate that the price adjustments by the cartel would affect petroleum prices the most. Coal and natural gas prices are not expected to change significantly as the cartel lowers price; and electricity prices will change relatively less than petroleum prices. To better understand these price changes and trends, it is necessary to consider the sources of the changes.

TABLE 2.—LONG-RUN WHOLESALE ENERGY PRICE TRENDS WITH AND WITHOUT THE PRESIDENT'S ENERGY PROGRAM—1975 TO 1985

[1974=1.0, wholesale prices]

	1975	1977	1980	1985
Without President's program:				
Refined petroleum	1.08	1.22	1.18	1.50
Coal	1.08	1.22	1.42	1.81
Electricity	1.08	1.22	1.64	2.09
Natural gas	1.08	1.23	1.48	2.04
With President's program:				
Refined petroleum	1.51	1.68	1.55	1.91
Coal	1.08	1.22	1.42	1.81
Electricity	1.15	1.41	1.49	1.90
Natural gas	1.43	1.57	1.90	2.81

Note.—Measured as the ratio of current price to 1974 price in current dollars.

[2] Chapter VII, Project Independence Report, November 1974.

TABLE 3.—PERCENT CHANGE IN WHOLESALE ENERGY PRICES DUE TO THE PRESIDENT'S ENERGY PROGRAM[1]

Type of energy	1975	1977	1980	1985
Refined petroleum	+40	+38	+32	+28
Coal	NC	NC	NC	NC
Electricity	+11	+16	−9	−9
Natural gas	+32	+28	+29	+37

[1] Calculated as the ratio of price with the program to price without the program −1.0×100.

Note.—NC denotes no change is due to the energy program.

B. *Petroleum Prices*

The effects of decontrol and the imposition of a $2 tariff on imports and a $2 excise tax on domestic production would be to raise the domestic price to the free market level plus the amount of the tax, and to raise the cost of imports by the amount of the tariff. For refined products, it is assumed that the price change would be the same. The price forecasts for 1976–85 are simple multiplications of the 1975 level by the assumed inflation rates. In the scenario in which the cartel lowers prices, it is assumed that prices will fall by the end of 1977 to the $7 level (in 1973 prices). It is also assumed that the domestic free market price will be equal to the world free market price.[3]

C. *Non-Petroleum Energy Prices*

Future long-run coal prices are derived from the Project Independence Evaluation System (hereafter referred to as PIES) and are estimated to be $15.33 per ton in 1973 dollars.

Electricity price forecasts for 1977, 1980 and 1985 are based on PIES. The short-term wholesale electricity price response (for 1975) is based upon the increased costs of petroleum and natural gas in the production of electricity.[4]

Wholesale natural gas prices were also estimated using PIES and estimates of the number of long-term natural gas price contracts that will expire each year through 1985. The prices were adjusted to reflect average and not marginal supply levels thus better estimating the true wholesale price levels. Based upon FEA analysis, natural gas prices are not expected to be affected by changes in the petroleum market.[5]

III. DIRECT PETROLEUM CONSUMPTION EFFECTS

This section presents the forecasted effect of the President's energy program on petroleum consumption for both the long and short run by fuel component.

Table 4 below summarizes the projected supply and demand situations for 1975, 1977, and 1985. The assumptions and methodology that underlie these forecasts are as follows:

1. The short-run forecasts are based upon FEA's short-term demand forecasting system and reflect the effects of energy price changes and changes in the real incomes of consumers (money incomes adjusted for general price changes). The forecasts also reflect that:

Domestic production increases by 160 mbd by the end of 1975 and 300 mbd by the end of 1977 due to the development of Elk Hills;

Petroleum demand is reduced by 98 mdb in 1975 and 288 mbd in 1977 due to switching from oil to coal; and

Increased petroleum demand due to natural gas curtailments ceases after May 1, 1975, due to the deregulation of new natural gas and the imposition of a 37¢ per mcf excise tax.

2. The estimates of the long-term effects of the program are based upon FEA's Project Independence Evaluation System. Both the base forecast and the forecast of the President's program assume that the world price of oil falls to $7 per barrel at the end of 1977. The base forecast also assumes that petroleum and natural gas prices are controlled domestically and the $7 per barrel business as usual scenario is used as a proxy for this situation.

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[3] For details of the petroleum price calculations see *National Petroleum Product Supply and Demand. Revised Base Case Forecast and the President's Program Forecast.* The Federal Energy Administration, Technical Report 75–2, February 1975, pp. 10–11.

[4] Analysis of the short-term consumer costs associated with changes in electricity prices is contained in Appendix B.

[5] Appendix A is an FEA paper on the impacts of the deregulation of natural gas.

The following additional assumptions also underlie the 1985 forecast of the President's energy program.

Outer continental shelf leasing resulting in 1.5 mmb/d.
Development of Naval Petroleum Reserves No. 4, 2.0 mmb/d.
Coal conversion, 0.6 mmb/d.
Oil shale leasing, 0.3 mmb/d.
Auto efficiency goals, 1.0 mmb/d.
Appliance efficiency goals, 0.1 mmb/d.
Insulation tax credit, 0.3 mmb/d.
Thermal standards, 0.3 mmb/d.

TABLE 4.—SUMMARY OF THE PETROLEUM SUPPLY-DEMAND SITUATION

[Million barrels per day]

	Shortrun		Longrun
	1975 [1]	1977 [2]	1985 [3]
Demand (all products):			
Base	16,735	18,256	23,920
President's program	16,187	16,318	20,638
Supply (domestic):			
Base	10,653	10,300	11,534
President's program	10,754	10,565	15,738
Imports:			
Base	6,082	7,956	12,386
President's program	5,433	5,753	4,900
Import savings	649	2,203	6,486

[1] Source: National Petroleum Product Supply and Demand: Revised Base Case Forecast and the President's Program Forecast, Technical Report 75-2, Federal Energy Administration.
[2] Source: National Petroleum Supply and Demand 1975–1977: Revised Base Case Forecast and Policy Option Forecast, Federal Energy Administration Technical Report 74–9.
[3] Source: The Forecasts for 1985 were made using the long-term energy modeling system developed for Project Independence. The base case assumes no new actions are taken and domestic prices continue to be controlled (it is assumed that the $7 business as usual, BAU, case is representative of this case). The President's program assumes that the world price of oil falls to $7 per barrel (in 1973 prices) and that certain conservation and energy development options are undertaken (see the text for further discussion).

Table 4 illustrates that the short-term effects of the energy program are a moderately increased domestic supply and reduced domestic demand through the price mechanism. These actions stabilize the increasing import situation and stop the increase in imports from areas where there is potential for import cut-offs.

In the longer term, the President's program has more dramatic effects. First, it causes a large fall in imports relative to the case where no action is taken. Second, petroleum demand is reduced by about 3.3 mmb/d. Third, domestic supply is increased 4.2 mmb/d. Finally, the energy program results in considerable energy independence even though imports are fairly large. This is true because the program includes a one billion barrel emergency storage program (3.0 mmb/d) and an emergency standby allocation program of 1 to 2 mmb/d. Import vulnerability with these programs is in the range of 0 to 1.0 mmb/d even in the unlikely possibility that all imports are embargoed.

The long-term effects of the energy program on the structure of consumption by type of energy are shown in Table 5. Petroleum and natural gas usage are discouraged because of the excise tax.

TABLE 5.—THE LONG-TERM EFFECTS OF THE PRESIDENT'S ENERGY PROGRAM ON THE STRUCTURE OF ENERGY CONSUMPTION

[Quadrillion British thermal units in 1985]

	Energy source			
	Coal	Petroleum	Natural gas	Nuclear
Base ($7 BAU) [1]	19.9	47.9	23.9	12.5
President's program	22.2	41.3	21.4	12.5
Difference	+2.3	−6.6	−2.4	0

[1] The $7 BAU scenario is a good approximation to the continued control scenario with a world oil price of $7 per barrel.

More coal is used than in the base case primarily because of the higher prices of alternative sources of energy and the mandated coal conversion program. The consumption of nuclear power is not affected.

IV. NATIONAL ECONOMIC EFFECTS

From an aggregate point of view, higher energy prices will cause structural shifts in the pattern of demand for goods in the economy and it is expected that the shifts will be different in the short run than in the long run. The immediate effects of the program are to raise the prices of energy intensive goods relative to other goods and to cause some unemployment. In the longer term there is evidence that the short-term problems are temporary and that economic output and employment are not significantly affected by the President's energy program. This section addresses two important questions—what effects will the program have on prices; and what are the expected changes in the level of economic activity?

A. *Inflation*

The President's energy program will affect the aggregate price level and the rate of inflation for the U.S. economy in two ways. First, there will be increases in energy prices, as discussed in the preceding section; and second, the direct effects of higher energy prices will lead to increases in he prices of products and services that depend upon energy as an input (causing indirect or ripple effects). Table 6 shows the Consumer Index (CPI) effects anticipated for the proposed tariff/excise tax policies (and assumed decontrol of petroleum and natural gas prices).

The numbers reported in Table 6 were generated with the following procedures.

1. A price model was run using the energy prices anticipated if current controls are continued. This yielded CPI price level forecasts for each quarter-year period between 1975 and 1985.
2. The price level forecasts obtained in Step 1 were used to compute fourth-quarter to fourth-quarter annual rates of change.
3. Step 1 was repeated using the energy prices anticipated with the tariff/excise tax deregulation policy.
4. The price level forecasts obtained in Step 3 were used to compute fourth-quarter to fourth-quarter annual rates of changes forecasts.
5. The fourth-quarter to fourth-quarter annual rates of change obtained in Step 2 were subtracted from those obtained in Step 5.

TABLE 6.—*Changes in annual rate of consumer prices caused by the President's energy program*

[Percentage Points]

Year:	*Consumer price index*
1975	2.0
1976	.3
1977	.2
1978	.5
1979	—.1
1980	—.2
1981	—.1
1982	0
1983	0
1984	0
1985	0

NOTE.—The small, 0.1 percentage point changes should not be considered significant since they are statistically indistinguishable from 0.

There are several points to keep in mind when reading Table 6. First, it reports impacts on the *rates of change* of the levels of the CPI, not on the actual levels of the CPI. Thus, the lower rates of inflation foreseen in certain years with the

tariff/excise tax policies do not imply that price levels will also be lower in those years if the program is adopted.

Secondly, the price level forecasts obtained in Steps 1 and 3 depend crucially on a number of assumptions about the behavior of non-energy prices over time. However, these non-energy price assumptions cancel out and are not nearly as important when looking at the differences between price level forecasts as when examining the future price levels.

Thirdly, the equations in the price model are adjusted for energy price changes based upon weights from 1967 input/output table published by the Department of Commerce. These linkages do not allow for time lags that are certain to exist between energy price changes and the resulting effects on other prices. Consequently, the model overestimates the near-term effects and understates the longer term effects.

Fourthly, Table 6 reports the fourth-quarter to fourth-quarter annual rates of changes in the CPI obtained in the steps outlined above. For reasons discussed above, the absolute levels of these inflation rate forecasts are subject to considerable uncertainty.

Finally, the changes that will take place in the structural composition of the demand for goods (a shift from energy to non-energy goods) partially invalidates the interpretation of the CPI as an indicator of the cost of living. Conceptually, the CPI is based upon a fixed basket of goods and services, and changes in the quantities of goods in the basket makes it difficult to compare the cost of the goods in one time period with the costs in another time period. However, this is not a serious shortcoming since the shifts are at least partially from one form of energy to another (oil to coal, for example), and most of the changes in demand take a number of years to occur while most of the price changes happen in the first year or two.

B. *Economic Growth*

The economy will feel the effects of the program through many channels. On the demand side there are countervailing effects. The tax reduction in 1975 will provide a substantial boost to aggregate demand and provide the economy with the kind of stimulus that is needed to return the economy to a position of strength. A similar stimulus will occur through the proposals to decontrol domestic crude oil prices and deregulate natural gas. Coupling these actions with the opening up of federally controlled sources of energy should lead to a substantial increase in investment by the domestic energy industries. A final stimulus will occur by reducing our outflow of dollars due to oil imports by reducing the level of imports. Instead of being drained from the economy these dollars can be maintained in circulation here to create more jobs.

There are restraining effects on GNP as well. The higher prices have two effects on demand. They reduce real consumption because consumers will not be able to substitute completely away from the higher cost items. More importantly, however, they cause the pattern of demand to change. Energy intensive commodities will become relatively more expensive while commodities which don't depend on much energy for their production or use will become relatively cheaper. This, of course leads to a powerful stimulus to conserve energy. In the process it will increase costs in some industries more than others. Our studies indicate that the paving mixtures, asphalt felts, inorganic and organic chemicals, air transportation, carbon-graphite products and synthetic rubber industries will be particularly affected by the cost rise. This will cause some temporary structural unemployment while workers shift from the industries producing energy intensive commodities to the energy industries and industries producing commodities with little energy content. It is important to emphasize that this structural employment, while a very real problem is both small in magnitude and temporary in nature. The bulk of the conservation effort will come from a reduction in the waste use of energy both by consumers and by industry. This waste can be trimmed with no cost in increased unemployment.

Table 6A provides quantitative estimates of the short-term impact of the President's program on economic output and unemployment.

Because of the offsetting influences of the fiscal stimulus and higher prices the President's program is expected to have a small effect on the unemployment

rate compared to what would have happened if nothing at all were done. The unemployment rate is expected to peak out during 1975 and fall during 1976 assuming the tax cut legislation is forthcoming soon.

TABLE 6A.—ESTIMATED SHORT-TERM IMPACT OF THE PRESIDENT'S ENERGY PROGRAM ON ECONOMIC ACTIVITY[1]

Quarter	Real gross national product (billions of 1958 dollars)	Percent unemployment
75:1	0	0
75:2	−2.0	+.1
75:3	−3.5	+.1
75:4	−6.8	+.2
76:1	−4.0	+.2
76:2	−1.6	+.2
76:3	−.1	+.1
76:4	−.1	+ 1

[1] Calculated as the difference between the Date Resources Incorporate, macroeconomic simulations: "No Stimulus Dec. 28 relative to "Accom Fiscal and Energy Jan. 15".

The more serious problem is with the major long-run determinate of economic growth, productivity. Much less is known about the effects of higher energy prices on productivity. What is known is that energy is an input to production and some desired level of usage on capital, labor, and energy has been established based upon relative costs and productivity of each of these factors. Productivity is a function of costs and investment. Increased costs are going to shift the desired mix of factors of production thus changing output. At the same time the President's program will cause investment to increase in energy and decrease in energy intensive consumer goods industries. The overall effect on productivity will depend on how the level of investment is affected and how it is allocated between high labor productivity and low labor productivity industries.

Analyses of alternative energy price scenarios have provided valuable data concerning the effects of higher energy prices on economic growth, and while the growth effects of decontrol and the tariff/tax proposal are uncertain, some general relationships can be identified from the price/growth data.[6] Based upon a comparison of the annual rates of growth between 1973 and 1980 for the $7 Project Independence scenario versus the $11 scenario, the higher oil prices have effects on long-run growth. (This $4 real price effect is roughly equivalent to the effect that the proposed energy program will have on prices and imports). However, these negative growth effects are associated with external or world petroleum price increases and they cause money to flow out of the economy. The price rises caused by the energy program do not cause world prices to increase and thus they do not cause leakages from the economy. As a result, the President's energy program is expected to have very minor impacts on long-run economic output and the impact will be positive if world petroleum prices remain high. This statement must be qualified. There is one uncertainty associated with these and other economic growth estimates and additional work is currently being done to further refine the forecasts. However, the economic growth changes that are caused by changes in productivity will be very small if negative at all.

Because the world price of oil is assumed to adjust downward in 1977, there is little uncertainty that there will be no effect of the energy program on economic growth for the period beyond 1977. That is the growth of GNP in the long run (beyond 1977) should be close to a rate that would occur with energy price controls.

It does not appear that there is a tradeoff between lower import vulnerability and economic growth. The proposed tariff and taxes will cause only limited if any restraining effects on growth in the short term (between 1975 and 1977), and higher energy prices result in conservation and greater supply in the longer run without reducing economic output.

[6] A report will be published soon by the Office of Economic Impact that documents the analysis of the energy price/economic growth relationship. The preliminary analysis was summarized in Chapter 8 of the Project Independence Blueprint.

V. SHORT-TERM SOCIO-ECONOMIC IMPACT OF THE PRESIDENT'S ECONOMIC AND ENERGY MEASURES

A. *Introduction*

The dual aspect of the President's program should be noted before attempting assessment of its impact on different income groups. On the one hand, a one-time income tax rebate or *decrease* is offered, estimated at $16 billion. On the other, tax *increases* (some $30 billion) resulting from energy conservation measures (increased new taxes on oil and natural gas) are proposed, with the provision that such revenue be subsequently *returned to the economy*—the total dollar benefit to the economy is noted as $46 billion for the fiscal year of the program.

The accompanying diagrams assist in distinguishing the temporary from the permanent parts of the program. Variations in the timing of taxes and rebates and in the anticipated time span of the program are of considerable importance in estimating economic impacts.

The benefits of the 1974 "one-shot" income tax rebate program arise from its speedy implementation, which will depend upon Congressional action if the funds rebated are spent and not saved so that demand is stimulated, those of low income will benefit the most because they are the most liable to be unemployed in a slack economy.

In addition to this anti-recession purpose, however, the 1974 tax proposal also has some energy-related consumer advantages. The tax rebate benefits the consumer in the short run when he is faced with higher energy prices and before he has had an opportunity to adjust to these prices, such as by use of smaller cars, public transport, insulated homes, and warmer clothes.

The timing of the one-time rebate is important. Particularly for the coastal regions which depend heavily on imported oil. Some of the higher energy prices will affect all consumers, including the poor, immediately by virtue of the President's power to impose tariffs. The tax rebate will be available only when Congress acts. Delayed action would cause a mismatch between the time when the rebate is received and the increased expenditures are incurred.

In income terms, those of low income benefit very little from this 12 percent rebate of taxes due for 1974 (as contrasted with subsequent rebates) since they paid little or no tax. Since the tax rebate benefits only taxpayers, with a limit of a $1,000 rebate, the proposal is neutral with respect to regressivity or progressivity for all taxpayers up to $40,000 per annum. Progressive for incomes above and regressive for those of non-taxable, low income. The last point somewhat diminishes the stimulative effects of the rebate proposal since the highest multiplier benefit would come from giving the funds to those with the higher marginal propensity to consume, namely the lowest income group. The progessivity and stimulus effects are, however, achieved very fully in the proposals affecting 1975 taxes as discussed below.

This section presents the impacts of the President's energy program on consumer energy bills by region, type of energy product, and income class.

B. *National Direct and Indirect Consumer Costs*

1. *Direct costs.*—The impact of the President's program on the cost of direct energy purchases by households has been estimated for each type of fuel used. Table 7 presents expenditures by fuel type without the program and the estimated impact of the energy program on these expenditures. Figure 1 shows this information graphically.

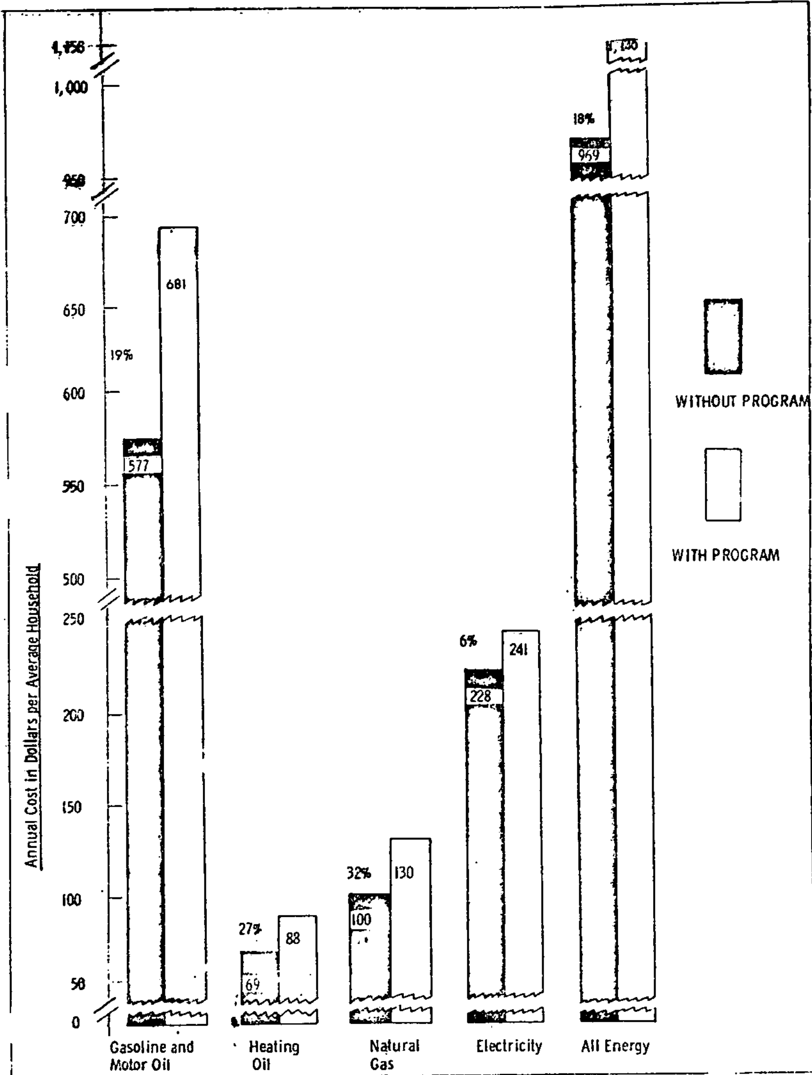
TABLE 7.—IMPACT OF THE PRESIDENT'S ENERGY PROGRAM ON DIRECT ENERGY EXPENDITURES FOR 1975

[Dollars per year per household]

	Energy costs without the program	Energy costs with the program	Increases due to the program	
			Amount	Percent
Gasoline and motor oil	572	681	$109	19
Heating oil	69	88	19	27
Natural gas	100	130	30	32
Electricity	228	241	13	6
Total	969	1,140	171	18

Figure 1

Impact of President's Program on Direct Energy Expenditures



The estimates in Table 7 were derived as follows:

Gasoline. Consumption estimates without the program have been derived from a November 1974 Bureau of Labor Statistics (BLS) survey of gasoline use by region. These were aggregated and divided by the total number of households (70 million) to give consumption per household. The current average price of gasoline is approximately 52¢ per gallon. An increase of 10¢ per gallon to 62¢ per gallon represents a 19 percent increase in the price of gasoline. Hence a 19 percent increase in expenditures or gasoline and motor oil to $681 per household per year. Moreover, this increase in costs due to the program is an overstatement in that it is assumed that there is no sharp reduction in consumption in response to the higher prices.

Heating oil. Consumption estimates were obtained from a BLS survey in the same manner as for gasoline. The current average price of heating oil is approximately 37¢ per gallon. An increase of 10¢ per gallon to 47¢ per gallon represents a 27 percent increase in the price of heating oil. This 27 percent increase in heating oil prices increases energy costs for heating oil to $88 per household per year. A small amount of residual fuel oil is also used by households (mainly by large apartment buildings). This quantity (about $6 per year per household) was obtained from the BLS survey and included in the heating oil estimates.

Natural gas. The quantities and prices for natural gas were obtained from analyses that are being performed by the Office of Economic Impact, the Federal Energy Administration. The increase in the average price of natural gas is estimated to be 37¢ per mcf for intrastate gas and 43¢ per mcf for interstate gas. Interstate sales of natural gas are currently regulated (by the Federal Power Commission) whereas intrastate sales are not. The excise tax of 37¢ is levied on all gas. The average price of interstate gas should increase 6¢ per mcf because of the deregulation of new gas.

Electricity. Electricity cost increases were estimated by the Office of Data, the Federal Energy Administration. These estimates account for the effects of increased fuel costs and do not consider the effects of higher rates of return or accounting practices that would effectively raise utility costs.

2. *Total costs.*—The total price impact of the President's energy program will extend beyond the direct energy purchases to any non-energy products or services that require significant amounts of energy in their production or distribution. Chemicals, metal and foods products are examples of areas in which the indirect or ripple energy price effects might be great. The indirect price effects are uncertain and are difficult to forecast. Most price models that measure and forecast these effects depend on historical experience to estimate the responses of various markets to changes in the costs of inputs. The models attempt to capture the extent that costs are passed on to purchasers and the extent that profit margins are adjusted up or down.

The approach used by the Federal Energy Administration to forecast the indirect price effects of the President's program was to use a stage of processing model developed by Data Resource Incorporated (DRI) and to use this estimate to derive total increased consumer costs. The indirect costs are then calculated as the difference between the direct and total cost estimates.

A modified vertion of the DRI stage of processing model was used to forecast the effect that energy price changes have upon the CPI and components of the CPI. The model requires two inputs: (1) Forecasts of wholesale energy prices; and (2) forecasts of the general wholesale and retail price indices prior to the energy price changes. Price information is combined with historical information on the relationships between the stages of processing to forecast the effects that energy price changes will have on the prices of crude wholesale goods, intermediate wholesale goods, finished wholesale products, and finally retail consumer goods and services.

Using the methodology described above, it is estimated that the CPI will increase 2 percentage points during the first full year of the program. Given a normal unencumbered economy, the CPI would rise by approximately 2.5 percentage points during the first full year of the program in addition to the normally expected rise; and there would be small increases of 0.3 and 0.2 percentage points in the second and third years. These estimated increases tend to overstate the effect of the program for two reasons: First, the energy price increases that were used as inputs to the model assume a full pass-through of the taxes and import fees. It is unlikely that this will occur because of the tax rebates to industry and because the economy is generally weak. Thus excess supply will result if industry attempts to pass through all of the costs. (Only if demand was totally nonresponsive to price changes would firms and businesses be able to pass all of the increases to consumers.) Secondly, the stage of processing model is based upon historical mark-up relationships and these may not hold because of the currently poor market demand conditions. That is, demand is currently at such a low level that companies may not be willing to pass on increased costs for fear of further reducing their markets.

For a 2 percentage point increase in the CPI, the total and indirect costs to the household would be $275 and $104 respectively. Table 8 summarizes the steps taken to make these estimates.

TABLE 8.—ESTIMATED TOTAL AND INDIRECT CONSUMER COSTS

1. Estimated personal consumption per household:
   a. Estimated 1975 personal consumption=$966.8 billion. [1]
   b. Estimated number of households = 70 million.
   c. Consumption per household = 13,810.
2. Estimated costs (per household per year):

	Total [2]	Indirect [3]
High estimate	$345	$174
Best estimate	275	104

[1] From DRI long-term forecast.
[2] Estimated as 2.5 percent×$13,810 for high estimate and 2 percent×$13,810 for best estimate.
[3] Calculated as total less direct ($171).

This table shows the total costs are likely to be $275 per household with direct cost being about $171 on average and indirect costs being about $104.

C. *Regional Direct Consumer Costs.*

The regional impacts of the President's program upon household energy costs are shown in Tables 9 and 10 and Figure 2. These data were all derived from the same sources as the data in Table 7 and were calculated by dividing the total regional energy cost increase by the number of households in each region.

Table 10 illustrates that the New England, West North Central, West South Central, and Mountain areas have the greatest relative impact. In all of these areas the primary cause of the large increase is higher gasoline prices. In the New England and Middle Atlantic areas a second major factor is heating oil costs.

D. *Direct Consumer Costs and Tax Reductions by Income Class.*

1. *Direct consumer costs.*—The most substantial immediate impact of the energy measures to affect the consumer is that of the price increase in oil, and in gasoline in particular.

Graph 1 shows the data from the last published Consumer Expenditure Survey (1960–61), giving expenditures by income group on gasoline. In this graph, prices have been adjusted to levels of 1973, 1974, and a projected increase above January, 1974 of 25 percent. The graph shows that insofar as consumption patterns have remained the same (an important, and possibly untrue caveat) the greatest burden of higher gasoline prices falls on those in the income groups from $4,500 to $12,000. Similar data for fuel oil and coal, showing a totally different pattern of expenditure, nevertheless shows a similar pattern of greatest burden (see Graph 2).

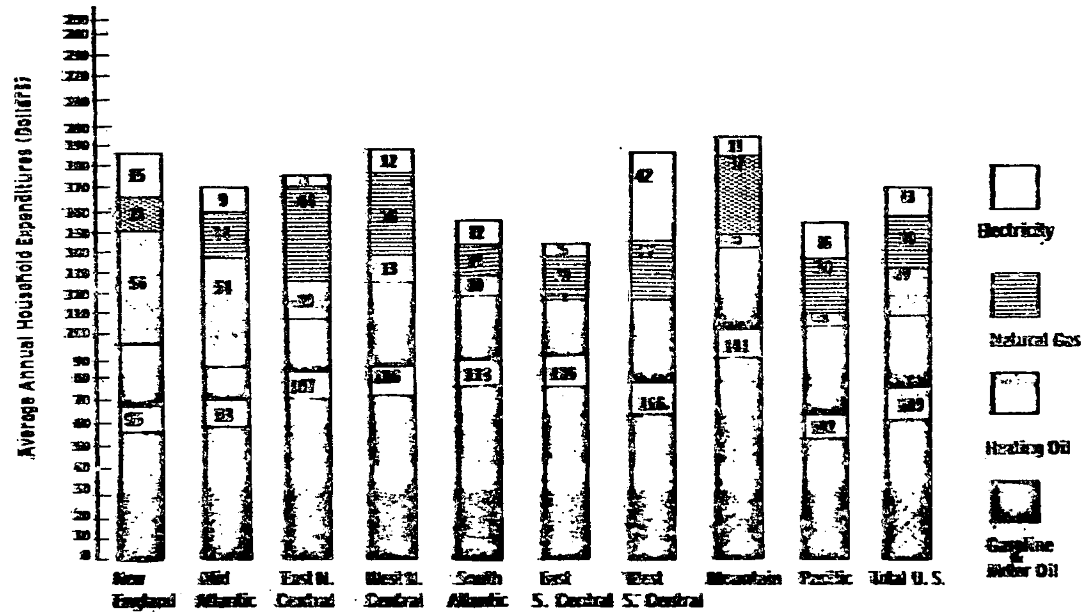
TABLE 9.—TOTAL DIRECT ENERGY COSTS PER HOUSEHOLD BY REGION BEFORE THE PRESIDENT'S ENERGY PROGRAM

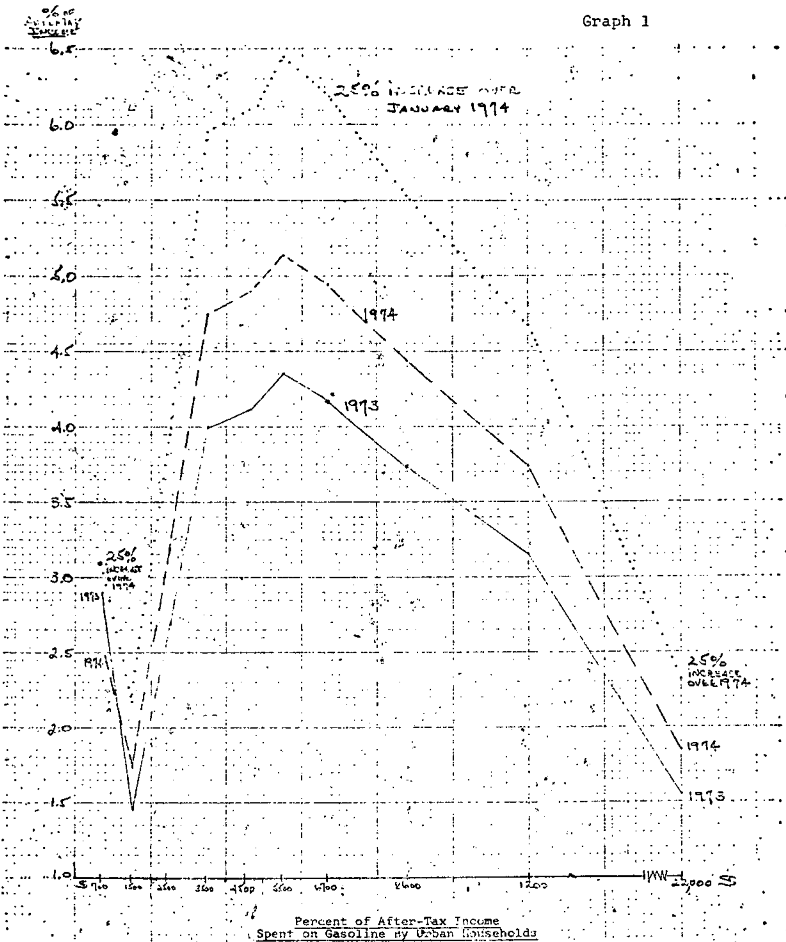
	Gasoline	Heating oil	Natural gas	Electricity	Total
New England	502	420	90	236	1,248
Middle Atlantic	439	201	111	234	985
East North Central	562	71	144	219	996
West North Central	661	49	110	225	1,045
South Atlantic	620	37	57	259	973
East South Central	612	6	59	228	905
West South Central	610	1.4	73	246	930
Mountain	743	11	101	207	1,062
Pacific	538	11	94	184	827
Total, United States	572	69	100	228	969

TABLE 10.—REGIONAL DISTRIBUTION OF THE INCREASED DIRECT ENERGY EXPENDITURES PER HOUSEHOLD

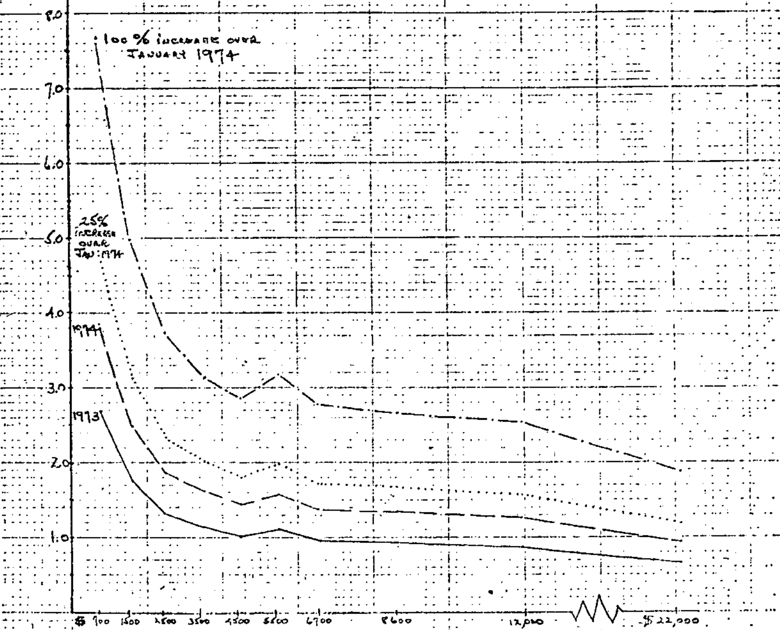
	Gasoline and motor oil	Heating oil	Natural gas	Electricity	Total
New England	$95	$56	$14	$15	$180
Middle Atlantic	83	54	24	9	170
East North Central	107	19	44	4	174
West North Central	126	13	36	12	187
South Atlantic	118	10	14	12	154
East South Central	116	2	19	5	142
West South Central	116	0	27	42	185
Mountain	141	3	37	10	191
Pacific	102	3	30	16	151
Total United States	109	19	30	13	171

Figure 2
Regional Distribution of Direct Energy Expenditures per Household





Calculations made in FEA from BLS Consumer Expenditure data for 60-61, adjusted to January, 1973 and 1974 prices and showing a projected 25 percent increase. For further information contact Pamela Kacser, FEA.



Percent of After-Tax Income
Spent on Fuel Oil and Coal
by Urban Households

Calculations made in FEA from BLS Consumer Expenditure data for 1960-61 adjusted to January 1973 and 1974 prices and showing projected 25 and 100 percent price increases.

A more recent source of data is the survey, Life Styles and Energy, conducted for the Ford Energy Project by the Washington Center for Metropolitan Studies. No national average figure can be easily obtained from their published figures, but certain useful information can be calculated for four separate income groups, as given in Table 11. Using WCMS data arranged into the four income groups, together with their estimates of expenditure for each group on gasoline, fuel oil, natural gas, and electricity in May, 1973 adding coal, and adjusting these for appropriate price increases up to September, 1974 and including the increases arising from the proposed program, we can obtain another and more recent set of estimates of proportions spent on the various forms of energy, and these are given in Table 11 below. This source, too, shows that a larger proportion of income and a smaller absolute amount is spent by lower income groups on energy. Within these income groups there will be considerable variation in impact for people in areas having higher energy consumption levels, such as the West, and the colder regions of the country, plus those areas heavily depending on imports, such as the Northeast. Similarly certain occupational groups may be adversely affected, such as salesmen, truck owner-operators, doctors, and construction workers, and those in rural areas.

Some parts of the proposals will principally benefit higher income groups. Tax credits for insulating houses will benefit those able to afford the expenditure, and mandatory auto efficiency standards will tend to benefit higher income groups, since these groups contain the bulk of the new car purchasers. (Only to the extent that operating costs are reduced by more than the potentially higher purchase prices caused by the standards.)

The indirect consequences of higher prices (price rises in nonenergy products) may adversely affect those of low income more than those of higher incomes because they spend a larger proportion of their income on items which may be particularly affected. Higher oil prices will affect gasoline expenditure on farms, and will affect fertilizer costs. Thus there will be an indirect effect on the price of food, the largest item of expenditure, one-third, in the budgets of the poor. Since those of low income spend more (save less) of their income than other groups and also spend more on goods compared with services, it is likely the indirect effects of higher energy prices will affect them the most. If this is true the estimated $97 rebate shown in Table 11 may not cover their total increased costs.

2. *The 1975 energy rebate proposals.*—The return to the economy of $30 billion received in special taxes and import fees on oil and gas represent that part of the program most directly beneficial to lower income groups.

TABLE 11

	Lowest income group $3,000 average income	Lower/middle income group $9,600 average income	Upper/middle income group $16,800 average income	Highest income group $29,400 average income
	Current direct energy costs without the President's program [1]			
Gasoline	$173	$432	$778	$914
Heating oil	66	66	66	83
Natural gas	91	108	117	140
Electricity	160	203	259	319
Coal	16	16	16	16
Total	506	825	1,236	1,472
Percent of average income	16.9	8.6	7.4	5.0
	Direct energy costs with President's program [2]			
Gasoline	$206	$514	$925	$1,088
Heating oil	83	83	83	105
Natural gas	120	142	154	184
Electricity	170	215	275	338
Coal	16	16	16	16
Total	595	970	1,453	1,731
Percent of average income	19.8	10.1	8.6	5.9

TABLE 11—Continued

	Lowest income group $3,000 average income	Lower/middle income group $9,600 average income	Upper/middle income group $16,800 average income	Highest income group $29,400 average income
Average increase in energy costs	$89	$145	$217	$259
Average rebate	97	341	217	155
Net energy costs	498	629	1,236	1,576
Percent of average income	16.6	6.6	7.4	5.4

[1] In general, these data are based on direct energy consumption expenditures by income groups derived from a 1973 survey by the Washington Center for Metropolitan Studies. Additions and revisions have been made in FEA's Office of Economic Impact to include all important energy sources and to reflect price and income changes for 1975. As a result of the revisions these statistics vary from those reported in tables 3 through 5 of Technical Report 75–9.
[2] Estimated by applying percent price increases for each type of energy from table 7 to the energy costs in table 3.

While the regressive nature of the across-the-board 1974 tax rebate slights the little-or no-income taxpayer, proposals under energy conservation single him out for cash payments and/or greater reduction of tax rates from 1975 on for as long as the energy program lasts.

A cash payment of $80 for single adults earnings $2,250 or less is proposed with those earning up to $2,750 receiving lesser amounts. Amounts are doubled for couples. These cash payments are estimated to total $2 billion. The program also anticipates the return to the economy of $16.5 billion through 1975 income tax reductions. Low and middle income groups are scheduled to receive the greatest proportionate reduction.

A third provision for individual tax relief relates to consumer expenditures for fuel-saving. At an estimated cost of $500 million, a 15% tax credit would be allowed (to a maximum of $150) for home insulation expenses. Additionally, grants of up to $100 are proposed for insulation of low income homes. $55 million is requested for this purpose. Each of the above directly benefits low income groups, but with differences in timing.

VI. REGIONAL ECONOMIC EFFECTS

A. *Regional Energy Price Effects*

This section examines the projected effects of the President's program on the average regional BTU prices of energy products in 1985. Energy price data are estimates from the FEA Project Independence Evaluation System (PIES) for the import fee program and are compared to the business as usual (BAU) case assuming $7 and $11 prices of crude petroleum imports. Prices are estimated for nine census regions (Figure 1) and seven energy products. The energy products are coal, electricity, natural gas, and petroleum products including gasoline, distillate, residual, and other refined petroleum.

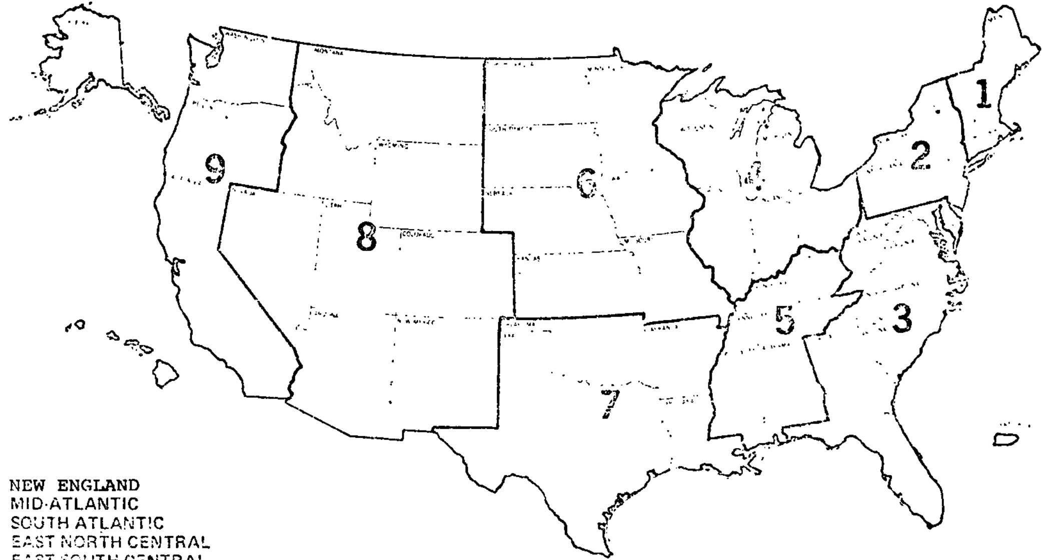
The estimates for 1985 are for long-run equilibrium after demand substitutions among energy products and regions and supply adjustments have taken place. No estimates are made of the time path of long-run equilibrium prices between 1975 and 1985 or of short-run equilibrium prices for any year. Prices are expressed in 1973 dollars and in BTU's rather than physical quantities, to permit comparisons of regional and product prices.

Regional prices include production and transportation costs and varying portions of distribution and marketing costs for different energy products. The projected prices differ among regions because of regional differences in these product costs and thus product prices, and differences in the type and amounts of energy products used in regions. Prices are estimated for the final consumption of energy products by all sectors (household and commercial, industrial, transportation, and electrical utility) for each region.

Business as usual (BAU) projections of product and average national and regional BTU prices are shown in Table 12. The projections are made assuming a continuation of existing energy policies with no new actions to stimulate energy development. Phased deregulation of natural gas is assumed. Projections are made both for $11 per barrel price of crude petroleum imports and a lower $7 per barrel price. BAU energy prices are generally expected to be lower for the $7 than the $11 import price (Table 12).

FIGURE 1

CENSUS REGIONS



1. NEW ENGLAND
2. MID-ATLANTIC
3. SOUTH ATLANTIC
4. EAST NORTH CENTRAL
5. EAST SOUTH CENTRAL
6. WEST NORTH CENTRAL
7. WEST SOUTH CENTRAL
8. MOUNTAIN
9. PACIFIC

Average regional BTU prices are lowest in the middle United States and increase toward the East and West coasts. They decrease from North to South. Prices are highest in the New England and East South Central regions and lowest in the East North, West North, and West South Central regions. The differences in energy prices among regions is significant. For example, the $11 BAU average price for New England in 1985 is expected to be 32 percent higher than the price expected in the West South Central Region.

1. *Effect of the import fee program.*—The President's energy program combines energy development and conservation measures with import fee, tax, and deregulation measures. The energy development and conservation parts of the program assume oil shale and outer-continental shelf leasing programs, development of Naval Petroleum Reserve #4, coal conversion, increased air to and appliance efficiency and more efficient use of energy for space heating. The development and conservation measure are designed to increase domestic energy production and reduce energy consumption and imports. They also tend to soften the increases in energy price that are otherwise expected during 1975–1985 (Project Independence Report, pp. 326–332). The import fee, tax, and oil and natural gas deregulation measures put upward pressure on domestic oil and natural gas prices. Higher energy prices serve to reduce energy consumption and imports and to encourage domestic production.

The BAU projections in 1985 for $7 and $11 crude import prices are used as baseline figures in estimating the effects of the import fee program. Effects on energy prices are calculated by subtracting the BAU projections from comparable $7 and $11 estimates for the import fee program. These estimates measure the impact of the import fee program assuming a given import price of crude petroleum. Both the BAU and import fee program projections include the effects of natural gas deregulation, so the impact of this part of the President's program is not reflected in the measures of program effects.

The effects of the President's program on average regional and national energy prices and on energy product prices in 1985 are shown in Table 13. The program increases energy prices in 1985 when the petroleum import price is $7, but it reduces price somewhat at an $11 import price. The expected price impacts of the program in 1985 are small. Natural gas deregulation is not considered in the impact estimates and it would increase the positive price effects of the import fee program at $7 and reduce the negative effects at $11.

TABLE 12.—AVERAGE REGIONAL AND NATIONAL BRITISH THERMAL UNIT PRICES: IMPORT FEE AND BASELINE FORECASTS AT $11 AND $7, 1985[1]

[1973 dollars per million British thermal units]

Regions	$11 Crude import price		$7 Crude import price	
	Baseline	Import fee	Baseline	Import fee
New England	2.87	2.77	2.30	2.45
Mid-Atlantic	2.57	2.52	2.14	2.26
South Atlantic	2.73	2.63	2.27	2.42
East North Central	2.18	2.06	1.96	2.08
East South Central	2.76	2.74	2.43	2.62
West North Central	2.17	2.02	1.83	1.91
West South Central	2.18	2.19	1.91	2.08
Mountain	2.33	2.20	2.02	2.10
Pacific	2.62	2.49	2.24	2.36
Nation	2.43	2.35	2.09	2.23
Energy products:				
Coal	.68	.69	.67	.67
Electricity	6.62	6.59	6.50	6.64
Natural gas	.98	.73	1.06	.83
Gasoline	2.13	1.67	1.36	1.41
Distillate	2.15	1.76	1.65	1.61
Residual	1.84	1.69	1.32	1.35
Other refined petroleum	2.22	2.45	1.42	1.89

[1] Projections of energy prices are from the FEA PIES model described in the FEA Project Independence Report, U.S Government Printing Office, November 1974, pp. 405–421.

TABLE 13.—EFFECTS OF THE IMPORT FEE PROGRAM ON ENERGY PRICES, 1985[1]

[1973 dollars per million British thermal units]

	Crude import price	
	$7	$11
Effects on average regional and national prices:		
New England	+0.15	−0.10
Mid-Atlantic	+.12	−.05
South Atlantic	+.15	−.10
East North Central	+.12	−.12
East South Central	+.19	−.02
West North Central	+.08	−.15
West South Central	+.17	+.01
Mountain	+.08	−.13
Pacific	+.12	−.13
Nation	+.14	−.08
Effects of energy product prices:		
Coal	0	+.01
Electricity	+.14	−.03
Natural gas	−.23	−.20
Gasoline	+.05	−.46
Distillate	−.04	−.38
Residual	+.03	−.15
Other refined petroleum	+.47	.23

[1] Effects are calculated by subtracting $7 and $11 BAU prices from corresponding prices for the import fee program.

The projected energy prices result from the offsetting influences of the energy development and conservation measures the import fee, tax, and deregulation measures in the President's program and changes in the type and amounts of energy products used in regions. Changes in relative energy product prices cause changes in regions' use of energy products. Relatively lower-priced energy products tend to be substituted for relatively higher priced products (Table 14).

TABLE 14.—EFFECTS OF THE IMPORT FEE PROGRAM ON THE STRUCTURE OF ENERGY CONSUMPTION, 1985

[Quadrillion British thermal units per year]

	Energy source			
	Coal	Petroleum	Natural gas	Nuclear
$7 Crude import price:				
Business as usual	19.9	47.9	23.9	12.5
Import fee program	22.2	41.3	21.4	12.5
Difference	+2.3	−6.6	−2.5	0
$11 crude import price:				
Business as usual	22.9	38.0	24.8	12.5
Import fee program	23.6	34.4	22.0	12.5
Difference	+0.7	−3.6	−2.8	0

2. *Effects of a lower petroleum import price.*—The import price of crude petroleum for the United States and other petroleum importing countries may fall because of political and economic factors that now exist among petroleum producing countries. A reduction in the crude import price is not certain. It will depend on the cohesiveness of the organization of petroleum export countries in maintaining current world oil prices, on the net revenue gains and losses by petroleum exporting and importing countries, and on the ability of importing countries to reduce petroleum use and to substitute alternative sources of energy for petroleum imports.

The effects of a reduction in the crude import price from $11 to $7 on energy prices can be estimated by comparing the $7 and $11 projections for the BAU and import fee program in 1985. The projected effects of a lower import price for the BAU and import fee program cases are shown in Table 15. (The effects are calculated by subtracting $11 projections from comparable $7 figures for each

case.) These impact measures show the effect of a lower import price for different strategies assuming all else is held constant. They do not show the impacts of both the strategies and a decrease in import price.

A reduction in crude import price from $11 to $7 causes lower average regional, national and energy product prices for both the BAU and import fee program projections. High energy-price regions show larger reductions than low-price regions and the negative price effects of the BAU case are larger than those for the import fee program. This reflects the upward pressures on energy prices from the import fee, tax, and deregulation measures that are included as part of the President's program.

3. *Regional price disparities.*—Regional energy prices are expected to follow the same geographic pattern for the import fee program as they do for the BAU projections. High-price regions remain high-price regions. Low-price regions remain low-price regions (Table 16).

Regional price disparities persist at different petroleum import prices and for the assumptions of the President's energy program. However, the program increases regional price disparities slightly (Table 17). Energy price differences among regions for the BAU and import fee program are somewhat smaller at a $7 import price. The reduction in price disparities is small for the BAU case and negligible for the import fee program.

TABLE 15.—EFFECTS OF A REDUCTION IN CRUDE IMPORT PRICE ON AVERAGE REGIONAL AND NATIONAL BRITISH THERMAL UNIT PRICES AND ENERGY PRODUCT PRICES, 1985[1]

[1973 dollars per million British thermal units]

Regions	Business as usual	Import fee program
New England	−0.57	−0.32
Mid-Atlantic	−.43	−.26
South Atlantic	−.46	−.21
East North Central	−.22	+.02
East South Central	−.33	−.12
West North Central	−.34	−.11
West South Central	−.27	−.11
Mountain	−.31	−.10
Pacific	−.38	−.13
Nation	−.34	−.12
Energy Products:		
Coal	−.01	−.02
Electricity	−.12	+.05
Natural gas	+.08	+.05
Gasoline	−.77	−.26
Distillate	−.50	−.16
Residual	−.52	−.34
Other refined petroleum	−.80	−.56

[1] Effects of an import price reduction from $11 to $7 are calculated by subtracting the estimated prices at $11 from these at $7 for the business as usual and import fee policies.

TABLE 16.—RELATIVE AVERAGE REGIONAL ENERGY PRICES, 1985[1]

[In percent]

Regions	$11 crude import price		$7 crude import price	
	Business as usual	Import fee	Business as usual	Import fee
New England	118	118	110	110
Mid-Atlantic	106	107	102	101
South Atlantic	112	112	109	109
East North Central	90	88	94	93
East South Central	114	117	116	117
West North Central	89	86	88	86
West South Central	90	93	91	93
Mountain	96	94	97	94
Pacific	108	106	107	106

[1] Relative prices are calculated as average regional British thermal unit price as a percent of the average national British thermal unit price.

TABLE 17.—ABSOLUTE DIFFERENCES AMONG REGIONS BETWEEN MAXIMUM/MINIMUM BRITISH THERMAL UNIT PRICES FOR BUSINESS AS USUAL AND IMPORT FEE PROGRAM, 1985

[1973 dollars per million British thermal units]

	Business as usual	Import fee program
Average regional British thermal unit prices:		
$11 Crude import price	0.70	0.75
$7 Crude import price	.60	.71
Energy product British thermal unit prices:		
$11 Crude import price:		
Coal	.40	.35
Electricity	1.37	1.54
Natural gas	.29	.29
Gasoline	.09	.14
Distillate	.06	.14
Residual	.26	.19
Other refined petroleum	.04	.15
$7 Crude import price:		
Coal	.32	.37
Electricity	1.21	1.23
Natural gas	.29	.28
Gasoline	.09	.11
Distillate	.13	.13
Residual	.18	.21
Other refined petroleum	.04	.10

Changes in relative price positions of regions occur for highest and lowest-price regions with a change in the petroleum import price (Table 16). The New England and East South Central regions switch positions as the highest price region at the $7 and $11 crude import price. New England as an intensive user of petroleum, is favored at the $7 price compared with the East South Central Region which relies more heavily on coal, electricity, and natural gas. The West South and West North Central regions switch as the lowest-price region. The two regions use comparable amounts of coal and electricity. The West North Central region is favored by the $7 petroleum import price because it is a relatively heavy user of petroleum and relatively less intensive user of natural gas than the East South Central region.

B. *Regional Economic Problems*

Energy developments that affect the national economy will impact differently among the Nation's regions. For example, the negative consequences of the oil embargo (winter of 1973 to midsummer of 1974) were felt most severely in the middle-West which absorbed about two-thirds of all energy-related unemployment. Michigan, with its concentration of auto and auto-related manufacturing; was particularly hard hit.

The process of increasing domestic energy supplies will also impact unevenly among the region of the country. The new mining developments in Wyoming, as an example, have caused tremendous spurts of economic activity as well as tremendous adjustment problems.

1. *Short-run regional impacts.*—The 1973 petroleum embargo impacted differently upon different regions of the country. A look at the embargo data provides insight about the potential regional economic effects of the proposed higher energy costs. During the embargo, employment declined in certain industries as the result of actual or anticipated shortages of gasoline and other petroleum products. Reduced industrial employment also occurred as the patterns of consumer demand changed. Industries demonstrating sensitivity included gasoline stations, transport, auto manufacturing, auto sales, and hotel and motels. Chemical manufacturing is also sensitive to changing supplies or prices because of the importance of petroleum as a production input. The same is of course true of petroleum refining.

The Bureau of Economic Analysis, U.S. Department of Commerce has projected earnings by 37 industrial categories for 173 Economic Areas. These areas consist of a central place (usually a Standard Metropolitan Statistical Area) and surrounding counties. Selecting the BEA industrial categories that represent energy-sensitive sectors, the economies of the areas shown in Table 18 could show considerable sensitivity to changes in energy supplies or prices. This table shows that the chemical industry is located in the South Eastern area with some concentration in the North Central states. Petroleum refining is in the Central and South Central part of the United States and the production of motor vehicles and related equipment is located primarily in the North Central section.

TABLE 18.—INDUSTRIAL EARNINGS AS A PERCENT OF TOTAL AREA EARNINGS[1]

Economic area	Industry					
	a	b	c	d	e	f
Buffalo, N.Y			5.7			
Philadelphia, Pa	4.5					
Roanoke, Va	7.0					
Richmond, Va	4.1					
Wilmington, N.C	5.3					
Asheville, N.C	4.0					
Greenville, S.C	4.0					
Columbia, S.C	4.6					
Augusta, Ga	5.2					
Miami, Fla	6.0				6.2	2.7
Pensacola, Fla	8.6					
Atlanta, Ga			2.4	2.7	3.6	
Chattanooga, Tenn	5.5					
Knoxville, Tenn	10.8					
Huntington, W. Va	6.8					
Louisville, Ky	2.8		2.4	2.0		
Terre Haute, Ind	6.3					
Indianapolis, Ind	3.1		6.1	2.4		
Munice, Ind			8.9			
Cincinnati, Ohio	4.1		3.0	3.0		
Dayton, Ohio			4.7			
Columbus, Ohio	3.1		1.3	2.0		
Youngstown, Ohio			7.5	2.5		
Cleveland, Ohio	2.1		4.7	2.3		
Lima, Ohio			11.2			
Toledo, Ohio			8.4	2.2		
Detroit, Mich			22.5			
Saginaw, Mich	9.1		11.9			
Lansing, Mich	2.3		14.7			
Fort Wayne, Ind			9.0	2.0		
South Bend, Ind	2.1		5.2			
Chicago, Ill	2.2			2.1		
Rockford, Ill			10.3			
Milwaukee, Wis	1.2		3.9	2.1		
Billings, Mont		2.7		2.5		2.1
Kansas City, Mo	1.5		3.0	2.6	2.4	
St. Louis, Mo	3.2		3.9	2.6		
Tulsa, Okla		2.5		2.1	3.9	
Odessa, Tex	3.6	1.6		1.8		
Dallas, Tex				2.2	2.5	
Tyler, Tex	4.1		1.4			
Mobile, Ala	3.9			1.2	2.2	
New Orleans, La	4.7	1.4		1.5	4.6	
Lake Charles, La	4.1	4.2			2.9	
Beaumont, Tex	11.1	17.7			3.3	
Houston, Tex	5.2	2.8		1.8	2.3	
Corpus Christi, Tex	3.2	2.1				
Grand Junction, Colo						3.3
San Francisco, Calif					3.5	
Alaska					4.0	
Hawaii						9.1

[1] Projected 1980 ratios but applicable to current industrial composition as well.

Industry definitions:
- a=Chemicals and allied products manufacturing.
- b=Petroleum refining manufacturing.
- c=Motor vehicles and equipment manufacturing.
- d=Trucking and warehousing transportation.
- e=Other transportation and services.
- f=Lodging places and persona lservices.

2. *Long-run regional impacts.*—Three accelerated development programs are considered here: Outer Continental Shelf (OCS) Leasing, Oil Shale Leasing, and Naval Petroleum Reserve (NPR) #4 Development.

OCS. Accelerated leasing of the Federal OCS would affect frontier areas of Alaska, the Atlantic and Pacific Coasts, and the Gulf of Mexico. Development would occur because of natural gas and crude production, power generation, refining, and associated transportation. Economic benefits would include higher area employment and income, increased state and local government revenues from the growing tax base, and increased Federal government revenues from lease bonuses and royalties. The costs would include private and public capital investment; disrupted economic, institutional, and social structures; and increased demands on state and local government services. In some cases, unemployment could actually rise as job seekers migrate into the area. The construc-

tion phase of development could cause instability in the overall labor market, and rapid growth could cause shortages in housing, educational and health facilities. Many likely impact areas are now sparsely populated.

Oil shale. The development of oil shale would occur almost exclusively in three states: Colorado, Utah, and Wyoming. Economic costs and benefits are similar to those under OCS development. Wyoming has experienced problems caused by rapid energy related developments. There is concern that oil shale development could bring on too rapid growth in sparsely populated areas of Colorado and Utah similar to that now being experienced in Wyoming. State and local governments will have difficulty managing such growth. States will receive 37.5 percent of bonus payments, rentals and royalty fees paid to the Federal government. These payments will help in the adjustment process.

NPR #4. The regional economic impact of NPR #4 development would be slight, but its development along with other petroleum and natural gas developments scheduled for Alaska would have a profound impact on the Alaskan economy. Income in Alaska should grow at a rate well in excess of the national average over the next decade.

VII. INDUSTRY IMPACT

A. *Highlight Considerations*

The policy options under consideration by the Federal Government imply sharply higher prices for fuels and for energy-intensive goods and services. The effects of a government policy that includes some combination of these options will not be neutral: economic units—industrial sectors, businesses, public entities, households, and individuals will be affected differently. The purpose of this section is to relate the projected effects of the policy options on a national basis to potential impacts by broad energy consuming groups and then to specific industries.

In order to identify industries likely to be most affected by the Federal policies under consideration, it is necessary to understand both the policy goals and the way in which the programs are likely to operate. The policy goals are to conserve energy, particularly petroleum, and to discourage imports while at the same time to stimulate domestic production. This would be brought about by a series of actions—deregulation, tariffs, excise taxes, and excess profits taxes—resulting in sharply higher prices for fuels, particularly petroleum, and natural gas, and thus, reduced demand.

The amount by which demand falls will be determined lagrely by the collective actions of individual consumers—purchasers of the final goods and services produced by the economy. The decontrol of crude petroleum and natural gas will result in higher market-determined prices and these increases and the increased costs of tariffs to importers and of excise taxes to domestic producers will be at least particularly passed forward. The consumer will be faced with higher prices for fuels and for the products in which fuels are embodied. Initially the consumer's money income will be unchanged, so that his real income—purchasing power—will fall.

However, as the income which will have accrued to the Government through increased tax revenues is rebated, the purchasing power of consumer will be partially restored to its original level.

Two important changes will have occurred as a consquence of the events described above: First, real incomes will have changed for individual consumers; increased energy related costs will not be identically offset for all individuals—some will be better off and some worse off. Secondly, all consumers will be facing a new set of relative prices; that is, prices of petroleum and natural gas fuels may be expected to rise the most relative to all other prices, and the prices of energy-intensive goods and services may be expected to rise less than fuels, but more than less energy-intensive products.

Individual consumers will be forced to re-evaluate their entire preference schedules for goods and services, including substitution possibilities, and determine the new collections of goods and services that they wish to consume. The aggregate of these demands will determine the impacts on the various producing industries.

The strength of consumer demand for products produced and responsiveness of this demand to price change will be the big factors in determining absorption, dollar for dollar pass through, or greater than dollar for dollar pass through of increased fuel costs. These are also the factors that will determine impacts on specific industries.

B. *Fuel Consumption Effects by Major Sectors*

1. *Long term effects.*—Table 19 presents fuel consumption under alternative policy scenarios for $7 oil and $11 oil.[7] It is apparent that total fuel consumption will decline, 4.7 to 5.4 percent (from the baseline of $11 oil) or 6.3 to 7.0 percent (from the baseline of $7 oil). Among the fuel inputs, the consumption of coal will increase as petroleum and natural gas consumption decreases. This indicates that substitution of fuels will occur among consuming sectors. However, the overall effect of the President's program for both assumed crude oil prices will be a decrease in energy consumption, and with the decrease more pronounced under $7 oil and $11 oil.

TABLE 19.—EFFECT OF THE PRESIDENT'S ENERGY PROGRAM ON FUEL CONSUMPTION BY TYPE OF FUEL, 1985

[Trillions of British thermal units]

	$11 World oil price			$7 World oil price		
	Baseline $11 oil	Import fee $11 oil	Difference from base, percent	Baseline $7 oil	Import fee $7 oil	Difference from base, percent
Coal	22,863	23,607	+3.2	19,888	22,151	+10.2
Petroleum	37,976	34,432	−9.3	47,918	41,345	−13.7
Natural gas	24,775	21,978	−11.2	23,947	21,404	−10.6
Other fuels[1]	17,306	17,306	0	17,306	17,306	0
Total gross energy inputs	102,920	97,324	−5.4	109,059	102,206	−6.3

[1] Nuclear power, hydroelectric power.

Table 20 presents the consumption of basic fuels (coal, petroleum, natural gas, nuclear and hydroelectric) by four major sectors (household and commercial, industrial, transportation, and electrical generation). With the energy program, the electrical generation sector shows an increase in demand for fuels as coal consumption is increased vis-a-vis petroleum and natural gas. The demand for fuels declines to a greater extent in the transportation sector where substitution of coal for oil and gas is much less feasible (12.8 to 12.9 percent with $11 oil, 17.2 to 18.2 percent with $7 oil). Both the household and commercial and the industrial sectors show overall declines in fuel consumption. In addition, the relative efficiency of the tariff upon these consuming sectors is more effective under the $7 oil case than $11.

In Table 21 total fuel consumption, including electricity, is presented for the three major sectors (household and commercial, industrial, and transportation). Electricity is consumed largely by the household and commercial and the industrial sectors and only in very small amounts by the transportation sector. Thus, because the production of electricity actually increases as a result of the energy program (Table 20), its distribution to the consuming sectors dampens the impact on total fuel usage in the household and commercial and the industrial sectors (Table 21).

TABLE 20.—EFFECT OF THE PRESIDENT'S ENERGY PROGRAM ON FUEL CONSUMPTION BY THE 4 MAJOR CONSUMING SECTORS, 1985

[Trillions of British thermal units]

	$11 world oil price			$7 world oil price		
Consuming sector	Baseline $11 oil	Import fee $11 oil	Difference from base, percent	Baseline $7 oil	Import fee $7 oil	Difference from base, percent
Household and commercial	16,912	15,835	−6.4	17,865	16,529	−7.4
Industrial	24,880	22,640	−9.0	25,751	24,104	−6.4
Transportation	21,934	19,116	−12.8	24,545	20,301	−17.2
Electrical generation	39,194	39,733	+1.4	40,898	41,272	+1.0
Total 4 sector inputs	102,920	97,324	−5.4	109,059	102,206	−6.3

Note.—Basic fuel is defined here as including coal, petroleum, natural gas, nuclear, and hydroelectric. Electrical power is considered a secondary source of energy.

[7] The data in Tables 19–21 were generated by the Integrating Model at FEA.

TABLE 21.—EFFECT OF THE PRESIDENT'S ENERGY PROGRAM ON TOTAL FUEL CONSUMPTION BY THE 3 MAJOR SECTORS, 1985

[Trillions of British thermal units]

Sectors	$11 world oil price			$7 world oil price		
	Baseline $11 oil	Import fee $11 oil	Difference from base, percent	Baseline $7 oil	Import fee $7 oil	Difference from base, percent
Household and commercial	25,106	23,861	−5.0	25,926	24,466	−5.6
Industrial	28,984	27,019	−6.8	30,359	29,047	−4.3
Transportation	21,971	19,154	−12.8	24,583	20,338	−17.2
Total 3 sector inputs	76,061	70,034	−7.9	80,867	73,851	−8.7

The decrease in fuel consumption stays about the same in transportation. Again, the policy options are more effective in decreasing fuel consumption in the case of $7 oil than in the $11 oil case.

In summary, the major anticipated results under the President's energy program are: substitution effects outweigh price effects in the electrical generation sector, a moderate decrease in fuel consumption takes place in the household and commercial and industrial sectors, and, because of its strong dependence on petroleum (without adequate substitutes), the transportation sector is projected to reduced its fuel consumption significantly. Further, fuel consumption is reduced more (but from higher levels) under $7 oil than $11 oil implying that the tariff and excise tax are relatively more effective in the former case.

2. *Short-term effects.*—The results of recent projections presented in Technical Memoranda 74–9 and 75–2 prepared by the Office of Quantitative Methods, The Federal Energy Administration, are shown in Table 22. The impact of a policy to decontrol crude petroleum prices and the imposition of the $2 tariff and tax package is presented.

TABLE 22.—THE EFFECTS OF THE PRESIDENT'S ENERGY PROGRAM ON PETROLEUM DEMAND

[Million barrels per day]

Year	Base	Policy option (base)	Percent difference from base
1975	16,735	16,187	−3.3
1977	18,256	16,318	−10.6

The decrease in petroleum demand is immediate with the implementation of the program and will be greater in 1977 under both options as substitution of other energy sources for oil becomes feasible. Even though petroleum demand by major consuming sectors is not provided in this forecast, the decrease in petroleum consumption would be similar to the $11 oil, import fee scenarios for 1985. That is, the demand for petroleum products is less in each of the consuming sectors, but the relative decline is greater in the transportation sector.

C. *Direct Price Impact on Selected Energy Senitive Industries*

In order to understand better the flow of petroleum, natural gas, coal, and electric utilities through the economy and to identify those industries most likely to be affected by the President's energy proposals a set of input/output tables has been used. They are based on 1967 input/output tables for the U.S. prepared by the Bureau of Economic Analysis, U.S. Department of Commerce.

Industries were selected and ordered according to total energy consumption. To this end, the petroleum, natural gas, coal, and electric usage coefficients (per

unit of output) were aggregated and a list of the 18 most energy sensitive industries was compiled. Based on projected energy price changes, the direct effect on the output prices and the effects on the economy were calculated.

1. *Projection of fuel prices: 1975, 1977, 1985.*—Table 23 shows prices by type of fuels projected to 1985. Refined petroleum products experienced a large price increase up to 1974 (114% for the 1967–1974 time period). However, in the periods 1974–1975, 1974–1977 and 1977–1985, the price increases are smaller, (51%, 68%, 14% respectively), though they are still substantial. Coal prices, likewise, experienced large price increases up to 1975 (253% for the 1967–1974 time period). However, in the periods 1974–1977, 1974–1975 and 1977–1985, coal prices increases are much smaller (8%, 22%, 48% respectively). Electric prices increased 51% from 1967 to 1974, with smaller increase in the periods 1974–1975, 1974–1977 and 1977–1985 (15%, 41%, and 35% respectively). And, natural gas price increased 78 percent from 1967 to 1974 and are expected to increase 80% in 1975, 117% in 1977 and 121 percent in 1985 if the President's energy proposal is enacted.

TABLE 23.—HISTORICAL AND EXPECTED FUTURE INDUSTRIAL ENERGY PRICE CHANGES WITH THE PRESIDENT'S ENERGY PROGRAM

	1967	1974	Percent change in price (1967–74)	1975	Percent change in price (1974–75)	1977	Percent change in price (1974–77)	1985	Percent change in price (1977–85)
Refined petroleum products	4.40	9.42	114	14.25	51	15.83	68	18.02	14
Coal	4.79	16.89	253	18.21	8	20.56	22	30.49	48
Electricity	13.89	20.94	51	24.18	15	29.50	41	39.78	35
Natural gas	.36	.64	78	1.15	80	1.39	117	3.07	121

Source: Based upon price trend analyses being done by the Office of Economic Impact, the Federal Energy Administration.

TABLE 24.—IMPACT OF THE PRESIDENT'S PROGRAM ON ENERGY SENSITIVE INDUSTRIES' PRICES, 1974–75

[In percent]

	Change due to petroleum	Change due to coal	Change due to electric	Change due to gas	Total change in industry prices
Paving mixtures	10.24	0.04	0.18	0.72	11.18
Asphalt felts and coverings	6.98	.009	.19	.48	7.66
Industrial, inorganic and organic chemicals	5.06	.03	.27	1.32	6.68
Lime	.29	.36	.45	4.76	5.86
Cement, hydraulic	.33	.25	.83	3.41	4.82
Brick, structural clay tile	.46	.04	.48	6.23	7.21
Structural clay products	.37	.03	.28	5.30	5.98
Carbon-graphite products	2.18	.03	.42	1.0	3.63
Air transportation	3.73	0	.02	.05	3.80
Clay refractories	.23	.002	.21	3.81	4.25
Manufactured ice	.32	.02	1.37	.24	1.95
Pipeline transport	.87	0	.79	.98	2.64
Synthetic rubber	2.12	.006	16	.72	3.01
Wet corn milling	.06	.06	.57	.53	1.22
Glass containers	.15	.002	.23	2.47	2.85
Wallpaper-building paper	.28	.042	.44	1.10	1.86
Blast furnaces-basic steel	.19	.202	.20	.95	1.54
Gypsum	.34	.333	.30	1.83	2.80

Note.—The output price changes were developed from the U.S. Department of Commerce input/output tables (1967 version). First, the value of the energy input was divided by the value of the industry's output. This proportion was then multiplied by the percent change of the energy input price (see table I) to get the percent change of the industry's output price.

TABLE 25.—IMPACT OF PRESIDENT'S PROGRAM ON ENERGY SENSITIVE INDUSTRIES' PRICES, 1974–77

[In percent]

	Change due to petroleum	Change due to coal	Change due to electric	Change due to gas	Total change in industry prices
Paving mixtures	13.65	0.11	0.50	1.05	15.31
Asphalt felts and coverings	9.30	.02	.51	.70	10.53
Industrial, inorganic and organic chemicals	6.75	.07	.75	1.93	9.50
Lime	.39	.98	1.24	6.96	9.57
Cement, hydraulic	.44	.68	2.26	4.98	8.36
Brick, structural clay tile	.61	.12	1.14	9.11	10.98
Structural clay products	.50	.10	.75	7.75	9.10
Carbon-graphite products	2.91	.08	1.14	1.46	5.59
Air transportation	4.98	0	.04	.07	5.09
Clay refractories	.31	.006	.57	5.60	6.49
Manufactured ice	.42	.06	3.74	.35	4.57
Pipeline transport	1.16	0	2.16	1.42	4.74
Synthetic rubber	2.82	.02	.45	1.05	4.34
Wet corn milling	.07	.17	1.57	.77	2.58
Glass containers	.20	.006	.64	3.61	4.46
Wallpaper-building paper	.37	.11	1.19	1.61	3.28
Blast furnace-basic steel	.26	.55	.55	1.39	2.75
Gypsum	.46	.02	.83	2.68	3.99

Note.—The output price changes were developed from the U.S. Department of Commerce input/output tables (1967 version). First, the value of the energy input was divided by the value of the industry's output. This proportion was then multiplied by the percent change in the energy input price (see table I) to get the percent change of the industry's output price.

TABLE 26.—IMPACT OF THE PRESIDENT'S PROGRAM ON ENERGY SENSITIVE INDUSTRIES' PRICES, 1977–85

[In percent]

	Change due to petroleum	Change due to coal	Change due to electric	Change due to gas	Total change in industry prices
Paving mixtures	2.81	0.25	0.43	1.09	4.58
Asphalt felts and coverings	1.92	.05	.44	.72	3.13
Industrial, inorganic and organic chemicals	1.39	.17	.64	1.99	4.19
Lime	.08	2.18	1.06	7.20	10.52
Cement, hydraulic	.09	1.50	1.93	5.15	8.67
Brick, structural clay tile	.13	.28	.98	9.42	10.81
Structural clay products	.10	.22	.64	8.02	8.98
Carbon-graphite products	.60	.19	.98	1.51	3.28
Air transportation	1.02	0	.04	.07	1.13
Clay refractories	.06	.01	.49	5.79	6.35
Manufactured ice	.09	.14	3.19	.36	3.78
Pipeline transport	.24	0	1.84	1.47	3.55
Synthetic rubber	.58	.04	.38	1.09	2.09
Wet corn milling	.02	.38	1.34	.79	2.53
Glass containers	.04	.01	.54	3.73	4.32
Wallpaper-building paper	.08	.25	1.02	1.67	3.02
Blast furnaces-basic steel	.05	1.21	.46	1.44	3.17
Gypsum	.10	.05	.71	2.77	3.63

Note.—The output price changes were developed from the U.S. Department of Commerce input/output/tables (1967 version). First, the value of the energy input was divided by the value of the industry's output. This proportion was then multiplied by the percent change of the energy input price (see table I) to get the percent change of the industry's output price.

2. *Impacts on product prices: 1975, 1977, 1985.*—The impact of these price trends is reflected in the percentage change of output prices of the most energy sensitive industries (Tables 24–26). It can be seen that the natural gas sensitive industries (brick, structural clay tile, structural clay products, lime, and cement), show the largest percentage changes in their output prices due to gas price increases, especially in the 1977–85 period. The large jump in petroleum prices in the 1967–74 period is reflected in the output price changes in the petroleum sensitive industries (paving mixtures, asphalt felts, industrial, inorganic and organic chemicals, air transportation, carbon-graphite products and synthetic rubber). It should be noted that due to smaller petroleum price increases in 1974–1977 and 1977–85 (about half the price increase of 1967–1974), the percentage increases of output prices are only about one half of those experienced in the 1967–1974 period.

The large percentage increase of coal products prices in the 1967–1974 period is reflected in the coal sensitive industries (basic steel, lime, cement). Of course, the percentage increase in the output prices of these industries are minor in the 1974–1977 and 1977–85 period, due to small coal price changes.

Since no industry with the possible exceptions of the manufactured ice and cement industries, is particularly sensitive to electric consumption, the relatively moderate increases in electric prices are reflected in small output price changes.

3. *Impact on the wholesale price index: 1975, 1977, 1985.*—Assuming that the energy sensitive industries will pass the full cost of higher prices through to the consumer an estimate can be made as to the effect that these industries will have on the wholesale price index (Tables 27–29). Due to the large WPI weight of the Industrial Chemical and Basic Steel Industries, their output price increases have a significant impact on wholesale prices. Other major contributors to wholesale price increases are paving mixtures, cement, and asphalt felts and coverings. It is estimated that the direct increase in the WPI attributable to the selected industries will be .372 percentage points in 1975, .548 percentage points in 1977, and .365 percentage points in 1985.

TABLE 27.—IMPACT ON THE WHOLESALE PRICE INDEX OF THE PRESIDENT'S ENERGY PROPOSALS, 1974–75

	Wholesale price index weight: Percent of 100 percent	Impact on wholesale price index [1] (percent)				
		Petroleum	Coal	Electric	Gas	Total
Paving mixtures	0.192	0.0197	0.0001	0.0003	0.0014	0.0215
Asphalt felts & coverings	.122	.0086	0	.0002	.0006	.0094
Industrial, inorganic and organic chemicals	3.369	.1705	.001	.0091	.0445	.2251
Lime	.034	.0001	.0001	.0002	.0016	.0020
Cement, hydraulic	.304	.0010	.0008	.0026	.0104	.0148
Brick, structural clay title	.126	.0006	.0001	.0006	.0078	.0091
Structural clay products	.023	.0001	0	.0001	.0012	.0014
Carbon-graphite products	.054	.0012	0	.0002	.0005	.0019
Air transportation						
Clay refractories	.134	.0003	0	.0003	.0051	.0057
Manufactured ice						
Pipeline transport						
Synthetic rubber	.114	.0024	0	.0002	.0008	.0034
Wet corn milling	.152	.0001	.0001	.0009	.0008	.0019
Glass containers	.276	.0004	0	.0006	.0068	.0078
Wallpaper-building paper	.132	.0004	.0001	.0006	.0015	.0026
Blast furnances-basic steel	4.09	.0078	.008	.0082	.0389	.0629
Gypsum	.091	.0003	.0003	.0003	.0017	.0026
Total	9.213	.2135	.0106	.0244	.1236	.3721

[1] Wholesale price index weight multiplied by the price change of output due to President's energy proposals.

TABLE 28.—IMPACT ON THE WHOLESALE PRICE INDEX OF THE PRESIDENT'S ENERGY PROPOSALS, 1974–77

	Wholesale price index weight: Percent of 100 percent	Impact on wholesale price index [1] (percent)				
		Petroleum	Coal	Electric	Gas	Total
Paving mixtures	0.192	0.0262	0.0021	0.0010	0.0020	0.0313
Asphalt felts and coverings	.122	.0113	.00002	.0006	.0009	.0128
Industrial, inorganic and organic chemicals	3.369	.2274	.0023	.0253	.065	.3200
Lime	.034	.0001	.0003	.0004	.0024	.0032
Cement, hydraulic	.304	.0013	.00206	.0069	.0151	.0117
Brick, structural clay tile	.126	.0008	.00015	.0014	.0115	.0139
Structural clay products	.023	.0001	.00002	.0002	.0018	.0021
Carbon-graphite products	.054	.0016	.00004	.0006	.0008	.0030
Air transportation						
Clay refractories	.134	.0004	.000008	.0008	.0075	.0087
Manufactured ice						
Pipeline transport						
Synthetic rubber	.114	.0032	.00002	.0005	.0012	.0049
Wet corn milling	.152	.0001	.00026	.0024	.0012	.0040
Glass containers	.276	.0006	.00002	.0018	.0100	.0124
Wallpaper-building paper	.132	.0005	.00014	.0016	.0021	.0043
Blast furnaces-basic steel	4.09	.0106	.02225	.0225	.0569	.1123
Gypsum	.091	.0004	.00002	.0008	.0024	.0036
Total	9.213	.2846	.029708	.0668	.1808	.5482

[1] Wholesale price index weight multiplied by the price change of output due to President's energy proposals.

TABLE 29.—IMPACT ON THE WHOLESALE PRICE INDEX OF THE PRESIDENT'S ENERGY PROPOSALS, 1977–85

	Wholesale price index weight: Percent of 100 percent	Impact on wholesale price index[1] (percent)				
		Petroleum	Coal	Electric	Gas	Total
Paving mixtures	0.192	0.0054	0.00048	0.0008	0.0021	0.0088
Asphalt felts and coverings	.122	.0023	.0006	.0005	.0009	.0038
Industrial, inorganic and organic chemicals	3.369	.0468	.0057	.0216	.0670	.1411
Lime	.034	0	.00074	.0004	.0034	.0045
Cement, hydraulic	.304	.0003	.00456	.0059	.0157	.0265
Brick, structural clay tile	.126	.0002	.00035	.0012	.0119	.0137
Structural clay products	.023	0	.0005	.0001	.0018	.0020
Carbon-graphite products	.054	.0003	.0001	.0005	.0008	.0017
Air transportation						
Clay refractories	.134	0	.00001	.0007	.0078	.0085
Manufactured ice						
Pipeline transport						
Synthetic rubber	.114	.0007	.00004	.0004	.0012	.0023
Wet corn milling	.152	0	.00058	.0020	.0012	.0038
Glass containers	.276	.0001	.00003	.0015	.0103	.0119
Wallpaper-building paper	.132	.0001	.00033	.0013	.0022	.0039
Blast furnaces-basic steel	4.09	.0020	.04948	.0192	.0589	.1296
Gypsum	.091	.0001	.00004	.0006	.0025	.0032
Total	9.213	.0583	.06255	.0567	.1867	.3653

[1] Wholesale price index weight multiplied by the price change of output due to President's energy proposals.

APPENDIX A.—AN ANALYSIS OF THE ECONOMIC IMPACT OF NATURAL GAS DEREGULATION

SUMMARY

Natural gas accounts for about one-third of the Nation's total energy requirements. In addition to being the dominant energy source for U.S. industry, it also provides heat for fifty-five (55) percent of the Nation's homes.

The Federal Power Commission (FPC) has been regulating the wellhead price of natural gas sold interstate as a result of a divided Supreme Court interpretation in 1954 of legislative language in the Natural Gas Act of 1938. A decade of declining real prices in the gas fields has resulted in declining levels of new discoveries because it has failed to provide the incentives to explore for and develop the more costly gas reserves. The availability of natural gas is headed for a sharp decline in the years ahead, as noted in the FPC staff report, "A Realistic View of U.S. Natural Gas Supply," unless long term trends relating to drilling and discovery are reversed. At the same time, regulated field prices along with other advantages of gas (e.g., its convenience and clean-burning characteristics) have escalated the demand for this fuel, especially in the industrial and the electric utility markets which account for about 60 percent of gas consumption. By increasing the amount of gas demanded and decreasing the amount supplied, FPC price ceilings have been instrumental in creating a costly shortage of the Nation's cleanest fuel.

If new gas prices for gas sold interstate are not deregulated, the effect on the Nation will be deleterious in six major areas: (1) there will be further unemployment and reduced national output as a result of cutbacks to industrial consumers; (2) the swing fuel is oil, and the volume of oil imports needed to replace gas could rise to an estimated 4 million barrels per day (MMB/D) by 1985; (3) cost increases will become more pronounced as the industrial switch from gas to oil will involve higher energy costs; (4) electric heating at higher cost is being used where homeowners were unable to obtain gas service, which involves inefficient use of energy where fossil fuels are used to generate the electricity; (5) to the extent that natural gas is not available, air quality standards will be lowered by the use of oil or coal, and water quality will be adversely affected by nuclear generating plants; (6) consumers in the interstate market will continue to be disadvantaged because the interstate pipelines that serve them will be unable to maintain even current sales levels.

Although the average *wellhead* price would rise more slowly under continued regulation, the regulated price to the consumer will rise significantly without the addition of new domestic gas supplies. Gas pipeline technology requires a substantial gas volume in order to supply the demand regions at a reasonable

cost. With continued regulation, gas curtailments will rapidly become much more serious, and the transmission costs per unit of delivered gas will escalate. Last year's experience with rising prices and gas curtailments indicate that the pipeline cost of continued regulation to gas users is substantial and might even exceed that of deregulation.

Substitutes for domestic natural gas will raise the consumer's bill much higher than deregulated gas. Within the gas-utility distribution system, foreign liquified natural gas (LNG) and synthetic natural gas (SNG) from coal or petroleum will add substantially to the costs of being a gas utility customer Those customers who cannot be supplied by gas utilities will be forced to other fuels, primarily imported oil. The relative abundance of coal in the ground makes it preferable to natural gas for boiler fuel. Coal production is at 1940 levels, however, and it is not a near-term solution. The use of oil as a long-run substitute for lost natural gas production with continued regulation would cost over 21¢ per thousand cubic feet (mcf) more than deregulated gas in 1985.

The deregulation of new natural gas would allow the average *wellhead* price to increase more rapidly than under continued regulation. However, the effect on natural gas prices paid by the residential customer would be small and gradual for two reasons. First, interstate gas is sold under contracts of 15 to 20 years. In 1975, only about 8 percent of interstate gas would be negotiable at the new deregulated price. By 1980, the proportion of new gas would still be only 40 percent. Hence, average interstate prices are only 6¢/mcf higher under deregulation in 1975 and 30¢/mcf in 1980. Second, less than one-fifth of the residential price can be attributed to the price in the gas field. This means that the 6¢/mcf increase due to deregulation in 1975 is only 4 percent of the total residential price under continued regulation. If price controls on new natural gas were lifted, effective the beginning of 1975, the impact on the average annual residential bill would be $6.38 in 1975, $10.21 in 1976, $13.30 in 1977, $19.15 in 1978, $25.07 in 1979, $30.52 in 1980 and $52.32 in 1985. The percentage increases for those years are 3.9, 6.2, 8.0, 11.5, 15.0, 18.2 and 28.4, respectively.

Higher gas wellhead prices potentially increase the prices of a number of other goods and services. However, the overall effect on the Consumer Price Index (CPI) and the Wholesale Price Index (WPI) is minimal as demonstrated by the results of a stage-of-processing price impact model.

I. INTRODUCTION

This paper presents estimates of the price impact of the deregulation of new interstate natural gas contracts. Average wellhead prices are calculated for interstate and all gas based on our best estimates about production, market prices, and old volumes subject to the Federal Power Commission price ceilings. These results are used to estimate the effect of deregulation on industrial and residential prices by specifying the dependence of each consuming sector on the interstate and intrastate markets. The residential impact is also expressed as the additional dollars that the average homeowner might expect to pay per year, assuming that he consumes the same physical gas volume as in 1974. Although the residential customer is heavily dependent upon interstate gas, the effects of rising wellhead prices for new contracts are lessened by: (a) the large proportion of interstate gas that remains under Federal Power Commission control during the first several years, and (b) the small percentage of the residential cost that represents the price paid to the gas producer. The paper also discusses such issues as the impact on the nation's energy costs, the Consumer and Wholesale Price Indices, the residential bill of different income groups, and the various regions of the Nation.

II. PRICE AND VOLUME

The estimates are based upon free market prices and total gas production that have been derived from Project Independence's integrating model. The levels of total production under both the deregulation and continued regulation cases are considerably more pessimistic than have been found in some other studies.[8] However, the substantial difference between the two cases remains clear. Under a deregulation policy, total production remains constant with a small expansion in the 1980-85 period. With continued regulation, available gas volume declines substantially.

[8] For example, see MacAvoy and Pindyck, *The Economics of the Natural Gas Shortage (1960–1980)*, American Enterprise Institute, forthcoming.

The deregulation estimates are derived from the base case that assumes an $11 per barrel landed price for oil and business-as-usual without conservation. In that case, marketed volume declines from the 22.6 tcf produced in 1973 to 21.0 tcf in 1977.[9] Thereafter, production increases gradually to 22.4 tcf by 1980 and to 24.0 tcf by 1985. EEstimated market wellhead prices are 108, 105, and 93¢/mcf (in constant 1974 dollars). These are derived by subtracting the model-generated transportation costs from the weighted average (by volume) of the market-clearing, city-gate price in each of the nine demand centers.

The continued regulation case is based upon estimates derived from the natural gas supply curves that were used in Project Independence's integrating framework. The assumed market price for new contracts is 42¢/mcf, which was the FPC national price ceiling at the time these estimates were made.[10] Using that price for new interstate gas in all years, the estimated volumes are 19.6, 17.3, and 15.2 tcf for 1977, 1980, and 1985, respectively.

III. ASSUMPTIONS

The calculation of an average wellhead price for gas is based upon the preceding discussion of market prices and volumes as well as upon the following assumptions.

1. Sixty percent of marketed production under deregulation is allocated to the interstate market.

2. Field use is netted out of the remaining forty percent, and the result is allocated to the intrastate market.

3. Under the regulation case, the intrastate volume remains essentially unchanged from the deregulation case, while the decline in production is absorbed by the interstate market.

4. The old volume remaining under FPC control is all gas that has been dedicated to the interstate market prior to January 1, 1975. These estimates are based upon Table A-5 in the Foster Associates, *The Impact of the Deregulation of Natural Gas Supplies*. Their figures were for contracts under FPC control prior to January 1, 1973. An estimated 0.6 tcf of new sales has been added to the interstate market in long-term contracts between that date and January 1, 1975.[11] Consequently, the estimates of old volumes are assumed to equal 0.6 tcf plus the Foster Associates' estimates.

5. These old interstate volumes sell for 28¢/mcf, whether or not deregulation occurs. The 28¢ figure is the recently reported average price for all interstate contracts in late 1974. This price is assumed to remain unchanged, in constant dollar terms, throughout the analysis.

6. New volume is any gas that, beginning January 1, 1975, is sold either for the first time in interstate commerce or under an expiring contract that is renegotiated in the interstate market.

7. Under deregulation, new interstate contracts receive the market price. The year-by-year price series used here is based upon the previously discussed prices derived from the Project Independence model.

8. Under continued regulation, new interstate contracts sell for 42¢/mcf, which was the price that generated the volume under the regulation case. (See footnote 10).

9. All intrastate gas sells for an average price of 34¢/mcf in 1974. This price increases by 6¢/mcf per year during the 1974–1980 period and to 93¢/mcf (the market price) in 1985. The price rise in this market occurs because new contracts that are being negotiated at the market price are gradually replacing the existing, lower-priced contracts. The 1974 figure for all intrastate gas is based upon the recent price of industrial gas in the West South Central region, after adjusting for the relatively small transportation costs.

Average Wellhead Price

The numbers used in the computation of the average wellhead prices are reported in Table 1. The last two columns of that table show the calculated

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[9] Federal Energy Administration, *Project Independence Report*, Statistical Appendix, p. 41.

[10] In December 1974, this ceiling was raised to 51¢ mcf. This does not change the estimates of production under the regulation case, because the original ones (reported in this paper) were generated by assuming that new interstate prices are allowed to rise to the 40–49¢/mcf range (in constant 1973 dollars). Adjusted for inflation, the 51¢ figure would lie well within this range. If the 51¢ figure is used in the calculation of the average wellhead price, the costs of continued regulation would be only slightly greater than the ones reported here.

[11] Estimated news sales in 1973 were 0.35 tcf and 0.18 tcf through the first half of 1974. In the last several years, long-term contracts have tended to be concentrated in the first half of the year. Thus, the 0.6 tcf figure has been chosen. Source: Federal Power Commission, *Gas Supply Indicators: Second Quarter 1974*, p. 26.

average wellhead prices for interstate and total gas.[12] The deregulated average interstate price is 6¢/mcf greater than the regulation one in 1975 and this difference increases to 13, 30, and 51¢/mcf in 1977, 1980, and 1985, respectively. For all gas, the impact of deregulation is 4¢/mcf in 1975, 8¢ in 1977, 16¢ in 1980, and 25¢ in 1985.

IV. INDUSTRIAL AND RESIDENTIAL IMPACT

Two important gas customers are homeowners and industry. They secure their gas supplies from very different sources. About 90 percent of all residential gas is transported by pipelines in the interstate market.[13] The industrial users, on the other hand, rely on the intrastate market to provide about half of their needs.[14] This varying degree of dependence upon the interstate market has been accounted for in the following estimates of the impact on residential and industrial customers.

For the twelve-month period ending in the third quarter of 1974, the average industrial price is 62¢/mcf, which is considerably below the residential price of 141¢/mcf for the same period.[15] This wide discrepancy in price for these two users reflects: (a) the heavy concentration of industrial customers in the Southwest where transport costs are low, and (b) the interruptible status of many industrial users in the interstate market that permits them to buy gas more cheaply at the risk of being curtailed.

TABLE 1.—TABULATION OF PRICES AND VOLUMES USED IN THE CALCULATION OF THE AVERAGE WELLHEAD PRICE FOR INTERSTATE AND ALL GAS

[Constant 1974 dollars]

Year	Volume (trillion cubic feet)			Price (cents per million cubic feet)			Average wellhead price (cents per million cubic feet)	
	Old volume[1]	New volume[2]	Intrastate volume	Old price	New price	Intrastate price	Interstate[3]	All gas[4]
Deregulation:								
1974	13.3		6.0	28		34	28.0	29.9
1975	12.0	1.1	6.0	28	110	40	34.9	36.7
1976	11.1	1.7	5.7	28	110	46	38.9	41.1
1977	10.4	2.2	5.5	28	108	52	42.0	45.0
1978	9.6	3.2	5.7	28	107	58	47.8	50.9
1979	8.8	4.3	5.9	28	106	64	53.6	56.8
1980	8.0	5.4	6.1	28	105	70	59.0	62.5
1985	0	14.5	6.6	28	93	93	93.0	93.0
Regulation:								
1974	13.3		6.0	28		34	28.0	29.9
1975	12.0	.6	6.0	28	42	40	28.7	32.3
1976	11.1	.8	5.8	28	42	46	28.9	34.5
1977	10.4	.8	5.7	28	42	52	29.0	36.8
1978	9.6	.8	5.8	28	42	58	29.1	39.4
1979	8.8	.8	5.9	28	42	64	29.2	42.4
1980	8.0	.8	6.1	28	42	70	29.3	45.9
1985	0	6.2	6.6	28	42	93	42.0	68.3

[1] Old volume is gas that has been dedicated to the interstate market prior to Jan. 1, 1975.

[2] New volume is gas that has been dedicated to the interstate market on or after Jan. 1, 1975, either as gas sold for the first time or gas sold under an expiring contract that is renegotiated. Under continued regulation, the only source of new gas in the 1975–80 period is the offshore Federal domain. On the basis of the past few years, new gas is a very small amount. Moreover, offshore drilling is declining. This situation explains the small increase in new gas: to 800,000,000,000 ft³ by 1977 and negligible increments thereafter through 1980. The 6,200,000,000,000 ft³ figure in 1985 reflects the assumption that the interstate market attracts as rededicated gas any volume that is not absorbed by the intrastate market. (See assumption 3 in sec. II.)

[3] Weighted average of old and new gas.

[4] Weighted average of old, new, and intrastate gas.

[12] The effects of using alternate assumptions about market prices and "old" volume definitions are explored in the Appendix. Under alternate assumptions, the initial price increase might be slightly higher and later price increases slightly lower than estimated.

[13] American Gas Association, *Gas Facts 1973*, p. 79.

[14] *Report of the Future Requirements Committee, 1973*, p. 7, Table 3. Industrial use was calculated as the sum of "industrial firm" and interruptible other than utility power generation. Intrastate market includes Kansas, Oklahoma, Louisiana, Texas, and New Mexico in addition to about 1.0 tcf that is sold by interstate pipelines as direct sales to industrial users. FPC does not directly regulate the price for such sales.

[15] American Gas Association, *Juarterly Report of Gas Industry Operations*, September 1974.

The impact estimates for residential and industrial prices that are reported in Table 2 assume that the wellhead price increases are passed completely through to the consumer. The increase in the residential price due to deregulation is approximately 80 percent greater than its industrial counterpart for all years. This occurs because the residential consumer is very dependent upon interstate gas, which is the sector affected by rescinding FPC's control over new contracts. However, when this increase is expressed as a percentage of the price under continued regulation, the effect on the two sectors is remarkably similar. Although the absolute size of the price impact is greater in the residential sector, its base price is also greater. This emphasizes an important point about the residential market. In 1973, the residential consumer paid 129¢/mcf, of which about 23¢/mcf represented the gas producer's price.[16] Thus, about 18 percent of the homeowner's cost can be attributed to the price that the pipeline pays to the producer.

In table 2, the impact, as a percentage of the price under the regulation case, rises to 18 percent by 1980 for both users. In the 1980–85 period, the impact rises more slowly to 25.4 percent for industries and to 28.4 percent for homeowners. The bottom portion of Table 2 documents the declining rate at which the deregulation price exceeds the regulation one: from about 3 percent per annum during 1974–80 to 1.2 percent (industrial) and 1.7 percent (residential) during 1980–85.

V. ANNUAL RESIDENTIAL GAS BILL

Table 3 translates these figures into dollars to be paid by the average residential user by assuming that the consumer purchases the same physical gas volume as in 1974 even though the price is higher. The bill increases by about $6 over the continued regulation bill in the first year and by $13 after three years. The difference between the deregulated and regulated residential bill grows most rapidly during the following three years as it rises to $30 per year in 1980. By 1985, this difference is $52.

Although this is not the exorbitant amount that is sometimes feared, it does represent substantially higher fuel bills for homeowners who presently use natural gas. However, with continued regulation, less than half of today's interstate gas would be available in 1985 (see Table 1). Consequently, the extra $52 per year must be viewed as the homeowner's payment to maintain his use of natural gas. Whether this is a good purchase depends upon the availability of alternate fuels and is the subject of Section VI.

It should also be emphasized that the costs of continued regulation have been considerably understated. If the interstate market sales were allowed to deteriorate to 8.8 tcf in 1980 and 6.2 tcf in 1985, the unit costs of transportation would rise substantially. Unit transmission costs rise with less volume because: (a) fixed pipeline costs are distributed over fewer gas units; and (b) greater compression is required to offset the decreased pressure resulting from less volume. Moreover, gas curtailments require the use of liquified natural gas and synthetic gas, which are substantially more expensive than natural gas itself.

A cursory review of this last year's experience with rising prices and gas curtailments suggests that the cost of continued regulation to gas users might even exceed that of deregulation. Residential prices increased from 126¢/mcf to 141¢/mcf between the third quarters of 1973 and 1974, while residential sales (in physical volumes) declined 7.6 percent.[17] Five cents of this increase can be attributed to the increase in average wellhead prices in the interstate market.[18] The remaining 10¢/mcf can be attributed essentially to increased unit costs because gas utilities are regulated on a cost of service basis. From the analysis, interstate gas volumes will be reduced 36 and 55 percent of the 1973 sales by 1980 and 1985, respectively. If 10¢/mcf is added to the annual bill under regulation for every 7.6 percent reduction in volume, the additional costs of regulation equal $54 in 1980 and $83 in 1985. Both of these exceed the effects of deregulation that are shown in Table 3 as $30 and $52 for 1980 and 1985, respectively. The increased costs of a 7.6 percent reduction in gas sales can be as low as 6.4¢/mcf and the

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[16] The source for the residential price is the American Gas Association, *Gas Facts, 1973*, p. 96. That for the wellhead price is Foster's Associates, *Energy Prices, 1960–73*, p. 19.

[17] American Gas Association, *Quarterly Report*, September 1974.

[18] The currently reported FPC price for the major pipelines purchasing gas in the interstate market is 28.4¢/mcf. The November 1973, price was reported as 23.8¢/mcf in Foster's Associates, *Energy Prices*, p. 19.

regulation bill would remain more expensive than the one under deregulation for both 1980 and 1985. Therefore, serious doubts can be raised about the contention that regulated gas would necessarily be cheaper than deregulated gas, particularly in the later years. Further refinements are needed before a definite dollar figure be given to the increased utility costs of gas curtailment under the regulation case.

TABLE 2.—IMPACT OF DEREGULATION ON INDUSTRIAL AND RESIDENTIAL PRICES, 1974–80 AND 1985

[Constant 1974 dollars]

Year	Industrial prices (cents per million cubic feet				Residential prices (cents per million cubic feet			
	Deregulation	Regulation	Difference[1]	Percent	Deregulation	Regulation	Difference[1]	Percent[2]
1974		62.0				141.0		
1975	68.5	65.4	3.1	4.7	147.8	142.3	5.5	3.9
1976	73.5	68.6	4.9	7.2	152.0	143.2	8.9	6.2
1977	78.0	71.7	6.3	8.9	155.4	143.9	11.6	8.0
1978	83.9	74.7	9.2	12.3	161.2	144.6	16.6	11.5
1979	89.9	77.8	12.1	15.5	167.1	145.3	21.8	15.0
1980	95.6	80.9	14.7	18.1	172.6	146.1	26.5	18.2
1985	124.0	98.8	25.2	25.4	205.4	159.9	45.5	28.4
	Rate of price increase[3]							
1974 to 1977	8.0	5.0	3.0		3.3	0.7	2.6	
1977 to 1980	7.0	4.1	2.9		3.6	.6	3.1	
1980 to 1985	5.3	4.1	1.2		3.5	1.8	1.7	

[1] The deregulation price minus the regulation 1.
[2] The price difference as a percent of the price under regulation.
[3] Compounded rate of increase.

TABLE 3.—IMPACT OF DEREGULATION ON THE AVERAGE ANNUAL RESIDENTIAL BILL, 1974–80 AND 1985

[Constant 1974 dollars]

Year	Deregulation	Regulation	Difference	Percent
1974		162.20		
1975	170.01	163.63	6.38	3.9
1976	174.87	164.66	10.21	6.2
1977	178.77	165.47	13.30	8.0
1978	185.45	166.29	19.15	11.5
1979	192.20	167.13	25.07	15.0
1980	198.51	167.98	30.52	18.2
1985	236.21	183.89	52.32	28.4
	Average annual increase (dollars per year)			
1974 to 1977	5.52	1.09	4.43	
1977 to 1980	6.58	.84	5.74	
1980 to 1985	7.54	3.18	4.36	

VI. IMPACT ON ENERGY COSTS

The preceding discussion of the increased costs to natural gas users did not account for the people and industries who were forced by the gas shortage to purchase more expensive foreign substitutes. In the short run, some residential demand is being satisfied by imported liquified natural gas which is many times more costly than domestic natural gas. Curtailed industrial use causes firms to substitute propane and other expensive fuels such as synthetic natural gas (SNG) made from oil or naptha. Both liquified natural gas and propane are currently being imported at prices greater than or equal to that of foreign oil. In the longer run, reduced gas consumption is likely to be absorbed by oil imports as more people and firms convert to fuel oil.

The present approach is to compute the price of two comparable energy packages in 1985. One purchase is comprised of natural gas in a deregulated market that fulfills all desired demand with domestic gas.[19] The other includes as much gas as can be produced under continued regulation. The difference between the unregulated and regulated gas volumes would be met in this second package by imported fuel oil. The landed price of foreign oil and the wellhead price of domestic gas are not comparable because the latter does not include the price of transporting the gas to the demand regions. In late 1973, the average gas transmission cost was 28¢/mcf,[20] which would be 31¢/mcf when converted to constant 1974 dollars.[21] Consequently, the natural gas prices including transportation would be 31¢ higher, or 124.0¢/mcf under deregulation and 99.3¢/mcf under continued regulation by 1985. Foreign oil is assumed to be priced at the $11 per barrel level used in the Project Independence Model, or 216¢/mcf in constant 1974 dollars.

The average price under deregulation in 1985 is 124.0¢/mcf for 21.1 tcf. The price under continued regulation is 99.3¢/mcf for 12.8 tcf of gas and 216¢/mcf for an amount of imported oil equivalent to 8.3 tcf of gas. The weighted average price for the regulation case in 1985 is 145.2¢/mcf, which is 21.2¢/mcf greater than the deregulation case.[22]

The continued regulation case also imposes another burden on the nation's economy. The 8.3 tcf difference in gas volumes represents greater imports of 4.03 million barrels per day, which equals two-thirds of our present oil imports. In 1974 dollars, this would be an increase of $17.93 billion per year in the nation's imports.[23]

A final cost, which is not quantified here, is the environmental one. Natural gas is a clean burning fuel that is particularly desirable in heavily-polluted areas. Its production and increased development would involve some environmental problems, but these are controllable and are generally considered to be less than the long-term consequences of using other fuels.[24]

VII. RELATIONSHIP OF NATURAL GAS PRICES TO THE CONSUMER PRICE INDEX AND THE WHOLESALE PRICE INDEX

The potential effect of higher wellhead gas prices on the major price indices for the U.S. economy is shown in Table 4. This estimate incorporates the amount of natural gas that is required to produce an industrial or consumer good (both directly and indirectly) and the amount that is directly used by residential consumers. For example, higher gas prices would increase the costs not only for household purposes (i.e., heating and cooking) but also for a variety of industrial and consumer products including petroleum refining, steel production, food processing and industrial chemicals. Natural gas is also used as a fuel in electric power generation, although about 60 percent of this use is confined to the Southwest or intrastate market. The estimate in Table 4 is based upon a stage-of-processing model that traces through the different levels of production of these direct and indirect changes due to an increase in the natural gas price.

It should be emphasized that Table 4 cannot be interpreted as an inflationary impact statement. The model measures the change in a standard market basket of goods (1974) over time under two different policy cases. However, the policy options themselves substantially change the composition of that standard market basket. Specifically, although wellhead gas prices rise less slowly with continued regulation, there is a dramatic shift from gas to more expensive fuels. (See the

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[19] There are no natural gas imports in the 1985 results generated in Project Independence's $11 oil business-as-usual without conservation case.

[20] In November, 1973, the average interstate citygate price (which includes transportation but excludes distribution costs) was 51.8¢/mcf. The wellhead price was 23.8¢/mcf. The wellhead price was 23.8¢/mcf. Source Foster Associates, *Energy Prices*, p. 19.

[21] Using the conversion that gas prices in 1974 were 1.102 times the 1973 prices. Source FEA, Energy Demand Model.

[22] This 21.2¢/mcf is equivalent in oil prices to $1.20 per barrel. Lost consumer revenue equals (.212×21.2) = $4.49 billion.

[23] Conversion for this paragraph:

(8.3 tcf)×(.1772 bbl/tcf) = 1.471 B. bbl or 4.03 M bbl per day.
(8.3 tcf)×(216¢/mcf) = $17.93 billion.

[24] See Federal Energy Administration, *Natural Gas Task Force Report*, Chapter VII.

previous section). Thus, energy costs rise more rapidly in the regulation case than is indicated by the change in natural gas prices alone. Even if the costs of continued regulation are totally discounted, Table 4 shows that the potential effect of the deregulation of new interstate gas contracts is relatively small at both the retail and the wholesale levels as seen by the changes in the CPI and WPI, respectively. A similar estimate has been done for a higher market price, and this shows only a slightly larger increase in the price indices.[25]

TABLE 4.—CHANGES IN MAJOR PRICE INDICES DUE TO NATURAL GAS DEREGULATION BASED ON PROJECT INDEPENDENCE PRICE ESTIMATES

[In percent]

Index	1975	1976	1977	1978	1979	1980
1. Consumer Price Index total	0	0	0	0	+0.1	0
a. Food	0	0	0	0	0	0
b. Durables	0	0	0	0	0	0
c. Fuel	+.5	+.2	+.2	+.5	+.4	+.3
2. Wholesale Price Index total	0	0	0	+.1	0	0
a. Finished goods total	0	0	0	0	0	0
Fuel	0	0	0	0	0	0
b. Intermediate goods total	0	0	0	0	0	0
Fuel	+.3	+.1	+.1	+.2	+.2	+.1
c. Crude materials total	+.1	0	+.1	+.2	+.1	+.2
Fuel	+2.2	+1.0	+.8	+1.6	+1.4	+1.4
3. Forecasted rates of change:						
a. Consumer Price Index	9.3	6.3	5.0	4.0	4.8	5.0
b. Wholesale Price Index	11.0	7.1	5.9	3.0	4.2	4.2

Note.—The numbers illustrate the percentage point difference in the rate of increase in the Consumer Price Index and Wholesale Price Index, or the relevant component, between the deregulation and regulation cases. Where the difference is less than 0.05, it is shown as 0 because the change cannot be distinguished from forecasting errors.

VIII. INCOME DISTRIBUTION

Over half the homes in the United States (55 percent) are heated by natural gas. This compares with 26 percent that are heated by fuel oil and other liquid fuels, 7.7 percent by electricity, 6.0 percent by bottled gas, 2.9 percent by coal, and 1.3 percent by wood.[26]

Expenditure on natural gas for heating, as a percentage of income, is greatest for those with the lowest income and declines for successively higher income groups. This is shown in Table 5, which is based on an analysis by the Washington Center for Metropolitan Studies. Their figures on gas consumption per user were converted to a per household basis, i.e., multipled by the percent of all households that were users. In addition, their 1973 figures were adjusted for price increases to September 1974.

Table 6 indicates the increase in the annual bill due to deregulation for the four income groups. This was calculated by multiplying the 1974 expenditure level for each group by the percent increase in the annual bill as given in Table 3. The deregulation proposal would increase the proportion of income that was allocated to gas for heating more rapidly for the poor than for the other groups. By 1985, this group would be spending 1.1 percent more of their income for gas as compared to 0.3, 0.3, and 0.1 percent more by the lower middle, upper middle, and well-off households respectively.

A full analysis of the impact of deregulation on income groups should incorporate the burdens under continued regulation of a gas shortage and the curtailments policy that seeks to ease it. First, what income groups are most prone to losing their jobs under continued regulation because their employers are unable to obtain natural gas? And secondly, what groups are most likely to be forced to use more expensive fuels than natural gas in their homes?

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[25] See the Appendix for a discussion of the market price used and its effect on the CPI and WPI.

[26] U.S. Census of Housing, 1970. "Detailed Housing Characteristics," HC(1)–B1, Table 24.

TABLE 5.—IMPACT OF DEREGULATION ON INCOME GROUPS[1]

	Poor	Lower middle	Upper middle	Well off
Mean income, 1974	$2,500	$8,000	$14,000	$24,500
Gas expenditures per household, 1974[2]	91	108	117	140
Dollars per year impact:				
1977	8	9	9	11
1980	16	20	21	25
1985	26	31	33	40
Gas expenditures, percent of income:[3]				
1974	3.6	1.4	0.8	0.6
1977	4.0	1.5	.9	.6
1980	4.3	1.6	1.0	.7
1985	4.7	1.7	1.1	.7

[1] Source: WCMS survey for 1972–73, adjusted for price increases to September 1974.
[2] Gas expenditures on a per household basis and not on a per user basis.
[3] Based on income prior to tax.

TABLE 6.—LOCATIONAL DISTRIBUTION OF SELECTED INDUSTRIES, 1967 PERCENTAGE OF VALUE OF SHIPMENTS BY REGION

Region	2,818 organic chemicals	29 petroleum	2,621 paper	20 food
New England	3.4	0.4	7.2	3.3
Middle Atlantic	2.3	13.3	16.2	15.2
East North Central	13.4	17.1	25.6	22.4
West North Central	2.7	5.3	2.9	17.5
South Atlantic	17.4	2.7	11.0	10.7
East South Central	9.1	3.1	8.0	5.5
West South Central	45.4	42.2	7.0	8.4
Mountain	.6	2.9	(1)	3.2
Pacific	4.8	12.9	(1)	13.8

[1] Denotes omission because of disclosure rule.
Source: Census of manufacturers, 1967.

Alternatively, what groups, who have traditionally used other fuels, face higher and greater uncertainty because natural gas is not available? An apparent loser in this respect is the rural household in a sparsely populated area who uses propane. The present gas shortage has induced firms with interruptible contracts to stockpile propane, thus making it expensive or difficult to find for these rural households. Although these are important dimensions to the distribution problem, a more thorough discussion is outside the scope of this paper.

IX. REGIONAL EFFECTS

The production of natural gas is concentrated in Louisiana, Oklahoma, Texas, New Mexico, and Kansas. In contrast, major markets for natural gas can be found in almost every region of the United States. The imposition of ceiling prices on gas sold in interstate commerce has distorted the allocation of supplies between producing and non-producing states as well as discouraged exploration and development of new sources of natural gas. Deregulation would, therefore, alter the price and availability of gas in various areas of the country. Most importantly, the higher wellhead price in the interstate market will increase the supply of gas in the non-producing areas. The remainder of this section discusses some potential regional effects by concentrating on the present geographical distribution of industrial and residential use.

Fifty-three (53) percent of industrial natural gas is used by petroleum refining, industrial chemicals (including organic and inorganic), cement hydraulic, and papermills (including paperboard mills).[27] Hence the geographical distribution of such major gas-consuming industries will be influential in determining regional

[27] These numbers are based upon 1971 data from the Department of Commerce.

industrial dependence upon natural gas. For example, Table 6 shows a regional profile of four industries that together use 40 percent of industrial gas. These industries appear to be most concentrated in the East North Central, Middle Atlantic, and the South Atlantic in addition to the West South Central.

TABLE 7.—IMPORTANCE OF NATURAL GAS IN MANUFACTURING BY REGION IN 1971

Region	Thousand cubic feet used per—					
	Employee	Rank	Production worker	Rank	1,000 of shipments	Rank
New England	36.9	9	54.3	9	1.35	9
Middle Atlantic	146.8	8	221.0	8	4.48	8
East North Central	269.2	6	384.6	6	6.81	6
West North Central	342.6	4	501.4	3	7.69	5
South Atlantic	180.2	7	236.8	7	5.48	7
East South Central	379.2	3	477.8	5	11.17	3
West South Central	2059.9	1	2886.9	1	45.16	1
Mountain	560.4	2	819.6	2	13.60	2
Pacific	323.8	5	487.7	4	8.33	4

Source: Bureau of the Census, U.S. Department of Commerce, 1972 Census of Manufacturers. (1) "Fuels and Electric Energy Consumed" (for data on industrial gas use). (2) "General Statistics for Geographic Divisions and States" (for data on employment and value of shipments).

A more aggregate view of natural gas importance in regional economics is provided in Table 7, which shows the mcf of industrial gas per employee, per production worker, and per $1000 of shipments for all manufacturing enterprises in that region. The mcf per employee is one measure of the potential vulnerability of the region's jobs to abrupt changes in natural gas supplies.[28] The first and third columns indicate that the Mountain and East South Central states are the non-producing areas that appear to depend most on a secure supply of natural gas.[29]

About 18 percent of marketed natural gas is used in electric power generation.[30] Under a deregulation policy, higher gas prices would mean greater fuel-adjustment charges on customers' electricity bills. However, almost 60 percent of gas use by electric utilities is located in the five states that essentially comprise the intrastate market, which is already deregulated.

Most residential gas sales occur outside the major producing states. Table 8 reports the expected change in residential dollar expenditure per household in 1977, 1980, and 1985, assuming that the average household in each region consumes the same yearly volume of gas as it did in the 12-month period ending September 30, 1974. These figures are based upon per household rather than per customer consumption (as was done in Section V). This approach accounts for the percentage of homes that use natural gas as well as for the amount that each customer consumes. The last column of Table 8 shows that by 1985, as a percentage of the regulated bill, deregulation has its largest price impact on the Mountain and West North Central regions, followed closely by the East South Central and East North Central.

These tables suggest that those non-producing regions that are heavily dependent upon industrial gas are, in general, the large consumers of residential gas. Consequently, the tradeoff between job security and higher residential bills appears to be a decision affecting groups within a region rather than in different regions.

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[28] This measure has been suggested, with qualifications on its application, by Ronald E. Kutscher and Charles T. Bowman, "Industrial Use of Petroleum: Effect on Employment," *Monthly Labor Review*, March 1974.

[29] These regions do have a greater proportion of firm contracts (as opposed to interruptible ones) than either the South Atlantic or the West North Central states. (See American Gas Association, *Gas Facts, 1973*, p. 86.) However, the interruptible status is usually elected by those enterprises that can substitute other fuels if the gas should be curtailed. It would appear that jobs would be less vulnerable in these situations and that the mcf-per-employee measure is a better indicator of the potential impact on a region's employment level.

[30] Electric utility data is from American Gas Association, *Gas Facts, 1973*, and *Federal Power Commission News Release*, October 1974.

TABLE 8.—POTENTIAL IMPACT ON ANNUAL REVENUE PER HOUSEHOLD BY REGION IN 1977, 1980, AND 1985

[Constant 1974 dollars]

Region	Increased annual revenue per household (dollars per year [1])			Percent impact [2]
	1977	1980	1985	1985
New England	4.50	10.28	17.65	18.2
Middle Atlantic	7.98	18.24	31.31	26.0
East North Central	14.56	33.26	57.12	35.4
West North Central	11.47	26.20	44.98	38.5
South Atlantic	4.16	9.50	16.32	28.1
East South Central	5.93	13.54	23.26	36.8
West South Central [3]	0	0	0	0
Mountain	10.97	25.07	43.04	41.0
Pacific	9.06	20.70	35.55	35.4
United States [4]	7.95	19.15	31.10	28.4

[1] Calculated as the product of : (1) The average residential gas volume per household in each region for the 12-month period ending the third quarter of 1974; and (2) the increase in the average interstate price due to deregulation as reported in table 1.

[2] Increase in revenue per household divided by the 1985 regulated bill. The latter is estimated for each region as the sum of: (1) The revenue per household in each region for the 12-month period ending the third quarter of 1974; and (2) the increase in the residential bill per household for the 1974–85 period under continued regulation. This 1974–85 increase is calculated as the product of: (1) The increase in the average interstate wellhead price under continued regulation from 1974–85 (14¢/MH3), and (2) the residential gas volume per household in each region.

[3] No impact assumed on intrastate gas.

[4] National figures are based upon the change in residential prices (as reported in table 2) rather than the change in the interstate price, which is used on the computations for the nonproducing regions.

APPENDIX: ALTERNATIVE ASSUMPTIONS ABOUT MARKET PRICES AND OLD VOLUMES

This section explores the residential and industrial impact when a higher market price and/or a different definition of old volume is assumed. These assumptions are introduced separately into the analysis.

Two important points are demonstrated about the effects of deregulation. First, in the initial few years, the percentage of all gas that is old is the most important determinant of the impact in these calculations. And secondly, as long as there is no early termination of existing contracts, greater market prices do not have a substantial impact until after 1980.

Market Price

The market prices that are used in the text were generated by the Project Independence model. In that analysis, consumer's responses to the prices of natural gas and other fuels (e.g., oil) were integrated with the supplies of natural gas and other energy sources that were anticipated to be available at different price levels. In this manner, a gas price that cleared the market was estimated.

For comparative purposes, a wellhead price of 135¢/mcf has been used. This is the price that would raise the natural gas retail price to an oil-equivalent level.[31] The results of this assumption with the same definition of old interstate contracts are shown in Table A–1. The effect of a higher market price operates gradually over time. In the first year (not shown), the average interstate wellhead price increases 8¢/mcf due to deregulation rather than 6¢/mcf in the first case. This 2¢/mcf difference in average interstate prices due to a higher-free market price increases to 5¢ by 1977, 12¢ by 1980, and 42¢ by 1985.

Uncertainty about the price of new contracts under deregulation is greatest during the initial year or two after enactment of the policy. This is due to the transitional problems of removing some controls on an industry that has been heavily regulated for a long time. In addition, the large volumes that remain under FPC control may make the price of the small amount of new gas quite volatile. However, these are also the years when the price of new contracts have a relatively minimal effect on consumer prices.

Old Volumes

The principal reason for the gradual effect of a higher assumed market price is the large volume under old interstate contracts during the initial years. The

[31] This price is based on the retail price difference between fuel oil and gas in twelve metropolitan areas in the Northeast and Midwest for October 1974. The average difference for the twelve areas was 103¢/MMBTU, or 106.2¢/mcf, which was added to the present average interstate wellhead price of 28.4¢. Thus, wellhead prices would have to rise to 135¢/mcf in order that retail oil and gas prices were equivalent on a BTU basis. Source: Bureau of Labor Statistics, "Retail Prices and Indexes of Fuel and Electricity," October 1974.

definition of old contracts in the first two cases includes all existing interstate contracts that would remain under FPC price ceilings assuming that there are no early terminations. This is the definition in the Administration's bill to deregulate new interstate contracts.

In order to demonstrate the importance of the Administration's definition of old contracts in limiting the impact of deregulation, an alternative assumption is made that frees more gas from the FPC price ceiling. This includes as old gas only those agreements that allow either no price increase or limited price escalation that would maintain the rates below or equal to the FPC price ceiling.[32] This definition would add to new gas those contracts, which might be terminated early and then rededicated, because both buyer and seller had agreed previously to a price greater than the FPC ceiling. This situation might prevail if the definition of old gas did not specifically rule out the early termination of existing contracts. Alternatively, if all interstate contracts were to be decontrolled, the price of some of the gas would not rise much above the present level because the buyer and seller have legally agreed to limited price escalation during the contract period. In either situation, it is useful to consider the second assumption about old contracts.

The average interstate prices would rise quickly in the initial year: by 33¢/mcf compared to the original 6¢/mcf for a 110¢/mcf market price in 1975. Table A-2 reports the effects of using this definition of old contracts with each of the market prices in 1977, 1980, and 1985. A comparison of Tables A-1 and A-2 for the Project Independence market prices shows that the second definition of old contracts produces a substantially greater impact than the first in 1977 (e.g., the deregulated residential bill is 23 percent greater than the regulated one as compared to 8 percent). The difference between the two cases declines in the later years. When all old contracts have expired by 1985, the two cases produce identical results.

The largest impact occurs when the higher market price and the lower number of old contracts are assumed. It should be emphasized, however, that fewer old contracts and more new contracts would remove some of the pressures for a highly volatile price being negotiated for a small number of new contracts in the first year or two. Although the assumptions about new contract prices and proportion of old volumes have been treated independently of each other, they are, in fact, related.

CPI and WPI With the Higher Price

Table A-3 shows the effects on the CPI and WPI of using the second market price with the original definition of old contracts. The impact is only slightly greater than that generated by the Project Independence estimates.

TABLE A-1.—COMPARISON OF THE IMPACT OF DEREGULATION USING THE 2 MARKET PRICES AND ASSUMING NO EARLY TERMINATION OF EXISTING CONTRACTS: 1977, 1980, AND 1985[1]

[Constant 1974 dollars]

	1977		1980		1985	
	P=$1.08	P=$1.35	P=$1.05	P=$1.35	P=$.93	P=$1.35
Price (cents per thousand cubic feet):						
Interstate (wellhead)	13.0	17.7	29.8	41.8	51.0	93.0
All gas (wellhead)	8.2	11.2	16.5	22.9	24.7	45.0
Industrial	6.4	8.7	14.7	20.6	25.1	45.8
Residential	11.6	15.8	26.5	37.3	45.5	83.0
Annual residential bill (dollar per year)	13.30	18.14	30.52	42.93	52.32	95.40
Percent change:						
Industrial price	8.9	11.3	18.1	22.6	25.4	38.2
Residential bill	8.0	10.9	18.2	25.2	28.4	50.4

[1] The numbers indicate the difference between the deregulation and regulation cases expressed in cents per thousand cubic feet, dollars per year, and percentages. For each set of numbers, the first column reports the results of using the Project Independence estimates for market price while the second one reports the $1.35/M ft³ estimate.

[32] This definition of old gas is based upon an extensive study of existing contracts by Foster Associates and reported in their *Impact of Deregulation of Natural Gas Supplies*, p. 4. For each year, the sales at fixed prices below the FPC price ceiling were divided by all contracts that had not terminated. These percentages were then multiplied by the total number of existing contracts (p. A-17, Table A-5) to provide an estimate of old volumes, assuming that some early termination of existing contracts is allowed to occur.

TABLE A-2.—COMPARISON OF THE IMPACT OF DEREGULATION USING THE 2 MARKETS PRICES AND ASSUMING THE EARLY TERMINATION OF CONTRACTS WITH PRICE ESCALATION ABOVE THE FPC CEILING: 1977, 1980, AND 1985 [1]

[Constant 1974 dollars]

	1977		1980		1985	
	MP=1.08	MP=1.35	MP=1.05	MP=1.35	MP=.93	MP=1.35
Price difference (cents per thousand cubic feet):						
Interstate (wellhead)	37.7	50.8	47.6	58.1	51.0	93.0
All gas (wellhead)	25.5	34.2	28.8	39.9	24.7	45.0
Industrial	18.6	25.0	23.4	32.8	25.1	45.8
Residential	33.6	45.3	42.4	59.4	45.5	83.0
Annual residential bill (dollars per year)	38.70	52.11	48.80	68.32	52.32	95.40
Percent change:						
Industrial price	26.0	32.4	29.0	36.0	25.4	38.2
Residential bill	23.4	31.2	29.0	40.1	28.4	50.4

[1] See table A-1.

TABLE A-3.—CHANGES IN MAJOR PRICE INDICATORS DUE TO NATURAL GAS DEREGULATION USING A NEW CONTRACT PRICE OF $1.35/M ft³

Index	1975	1976	1977	1978	1979	1980
1. Consumer Price Index total	0	0	0	0	+0.1	0
a. Food	0	0	+.1	0	0	0
b. Durables	0	0	.1	0	0	0
c. Fuel	+.7	+.4	+.2	+.7	+.6	+.5
2. Wholesale Price Index total	0	+.1	+.1	+.1	.1	0
a. Finished goods total	0	0	0	0	0	0
Fuel	0	0	0	0	0	0
b. Intermediate goods total	0	0	0	0	0	0
Fuel	+.3	+.2	+.1	+.3	+.3	+.2
c. Crude materials total	+.2	+.1	+.1	+.2	+.2	+.2
Fuel	+2.8	+1.5	+1.0	+2.2	+2.3	+2.0
3. Forecasted rates of change:						
a. Consumer Price Index	9.3	6.3	5.0	4.0	4.8	5.0
b. Wholesale Price Index	11.0	7.1	5.9	3.0	4.2	4.2

Note.—The numbers illustrate the percentage point difference in the rate of increase in the Consumer Price Index and Wholesale Price Index, or the relevant component, between the deregulation and regulation cases. Where the change is less than 0.05, it is shown as 0 because the change cannot be distinguished from forecasting errors.

APPENDIX B.—THE IMPACT OF THE PRESIDENT'S OIL AND NATURAL GAS PROPOSALS ON AVERAGE ELECTRIC UTILITY BILLS

The impact of the President's proposals for deregulating oil and new natural gas prices, combined with a $2 per barrel oil equivalent excise tax on these fuels was investigated. Of necessity, given the quick response nature of the analysis a number of simplifying assumptions are made, as described below.

The analysis is presented in three parts:

The average increase in electric power generating cost per KWH is computed for the total US and for each of nine census regions plus Alaska and Hawaii

The 1974 annual electric power consumption and utility bills are next computed for the "average" residential customers in each of the 12 regional categories

Finally, the absolute dollar and percentage increases in 1975 annual bills due to higher utility fuel costs are computed for average residential customers, by regional category.

Table I through VI present the results of these analyses.

I. INCREASE IN ELECTRIC POWER COST DUE TO HIGHER OIL AND GAS PRICES

The analysis begins by computing the increase in oil and gas prices due to the combined effects of the excise taxes and price deregulation actions. It is assumed

that refiners will allocate their increased crude costs to refined products on a volumetric basis, i.e., a gallon of gasoline and a gallon of heating oil, made from the same barrel of crude, experience equal price increases. The increase in resid and distillate prices in each of the regions of interest depends on the relative amounts of the product derived from imported vs. domestic crude, since the former increases by $2.00 per Bbl and the latter by about $5.60 per Bbl, based on the current 65/35 ratio of "old" (price controlled) crude to "new" (uncontrolled) crude.

Since the excise tax will apply equally to imported crude and product, in terms of resid price increases it matters little whether the foreign crude is refined here or abroad. The analysis which follows only examines residual fuel because electric utilities in those regions significantly dependent on oil consume over 95% of it in this form. Furthermore, in the other regions virtually all the distillate and resid is domestically refined.

The sources of the residual fuel oil consumed in each census region are shown in Table I. These estimates are derived from Bureau of Mines data covering shipments into PAD Districts and the crude runs to refineries in the BOM Refining Districts. Because the PAD and Refining districts do not exactly coincide with the census districts, several of the latter were combined and the data averaged over these larger areas. This was only done for those regions where utilities are not heavy oil users. In the Mountain region, Arizona and Nevada account for almost all of the oil used by electric utilities and these states are classified in PAD V which also includes the entire Pacific census region.

Using the relative percentages of domestic and foreign oil, as shown in Table I, the weighted average price increase in residual oil is calculated for each census region. The results are presented in the first column in Table II. Also shown there are the anticipated price increases in natural gas, by consuming region, as projected by the FEA's Office of Economic Analysis. Natural gas prices increase by more than the 37¢ per MCF excise tax in all regions outside the West South Central (which contains the major gas producing states) and Alaska because new gas is deregulated and co-mingled with the gas under old contracts. Since gas consumed in the West South Central and Alaska is sold intrastate, and thus not price controlled, the price of gas in these areas would not be affected by the deregulation action.

The oil and gas price increases are next combined with the power plant heat rates typical of each region to arrive at the incremental cost per KWH of electric energy produced from each of these fuels. The results constitute the balance of Table II. They are then weighted on the basis of each region's electric power generation from oil and natural gas to arrive at the average cost increase per KWH to be passed on. This is shown in Table III. In addition, the following assumptions underly the computations:

The regional fuel mixes used to generate electric power will remain unchanged from 1974

The heat rates of oil and gas-fired power plants in each region will remain unchanged from 1974

All oil and gas price increases will be passed on directly to customers through the fuel adjustment clause to be uniformly adopted by all states

Increased fuel costs will be passed on to all classes of customers on a direct cost basis.

II. AVERAGE 1974 ELECTRICITY CONSUMPTION AND RELATED UTILITY BILLS

Regional data on electric power consumption and utility bills are not yet available for 1974. Accordingly, these data are estimated by proportionately scaling up 1973 consumption figures. The utility rate factor used is based on the ratio of 1974 nationwide average cost per KWH to residential customers. Electric power consumption is assumed to follow the same pattern as in 1973, since nationwide consumption has not grown appreciably over the last twelve months. Table IV contains statistics describing the regional pattern of consumption in 1973 while Table V updates the average residential utility bills for each region.

III. AVERAGE INCREASE IN 1975 ELECTRIC BILLS DUE TO HIGHER NATURAL GAS AND OIL PRICES

It is assumed that total residential consumption will grow very little in 1975 over the previous year. Recent econometric studies are in reasonable agreement as

to the long-run price elasticities of electricity. The most recent results of work done for the FPC by Chapman and Mount[32] are shown below.

Factor	*Long-run elasticity (residential customers)*
Population	1.01
Real per capita income	.61
Electricity price	−1.17
Natural gas price	.03
Fuel oil price	.61

Population will grow by about one percent and real per capita income will probably remain constant or possibly decline slightly. Electric power rates will increase by at least 12 percent, and possibly as much as 20 percent, as a result of both higher utility fuel costs and general rate increases based on inclusion of CWIP in the rate base and a speed up of the rate review process. Natural gas and fuel oil prices will increase by about 25 percent and 30 percent, respectively. Weighting each factor change with the associated elasticity, and taking into account the response time, yields estimates of 1975 consumption ranging from .6 percent below to 2 percent above the 1974 figure. These changes are too small to significantly affect the estimates being derived in this analysis; it is thus assumed that total 1975 consumption will be equal to that in 1974. To these data are applied the regional incremental generating costs, presented in Table III, to obtain the average increase in annual customer bills. The results are shown in Table VI, both in dollars and as a percentage increase over 1974.

IV. CONCLUSIONS

The President's Program for a permanent excise tax on oil and natural gas, combined with associated price deregulation actions, if implemented, will increase residential electric bills about 6 percent nationwide. This rather modest increase is not equally borne by all citizens however. Consumers in Alaska, the Gulf States and Hawaii are more heavily impacted, while those residing in the Midwest and Mountain states are affected relatively less. Contrary to popular belief, New England is not the most heavily impacted by the President's energy program. This region will experience electric power cost increases which are only moderately greater than the national average.

TABLE I.—SOURCES OF RESIDUAL OIL IN EACH CENSUS REGION[1]

Region	Millions barrels per day				Percent residual from domestic crude (percent)
	Imported residual[2]	Residual refined domestically from foreign crude[3]		Residual from domestic crude	
		Local	From PAD III		
Northeast	259	0	4	18	6
Middle Atlantic	600	125	9	61	8
East North Central, West North Central	14	44	6	156	71
South Atlantic	519	9	4	15	3
East South Central, West South Central	25	48	0	270	79
Mountain, Pacific-contiguous	51	142	0	228	54
Alaska	0	0	0	(4)	100
Hawaii	3	(4)	(4)	0	0

[1] Figures are the average flows during the first 8 months of 1974.
[2] Mineral Industry Surveys, "Availability of Heavy Fuels by Sulfur Levels," August 1974, Bureau of Mines.
[3] Mineral Industry Surveys, "Crude Petroleum, Petroleum Products, and Natural Gas Liquids," January–August 1974, Bureau of Mines.
[4] Not required.

[32] Chapman, D., *et al.*, "Power Generation: Conservation, Health, and Fuel Supply," Submitted to the Task Force on Conservation and Fuel Supply, National Power Survey, FPC.

TABLE II.—UNWEIGHTED INCREASES IN GENERATING COSTS

Region	Heating oil price increase (dollars per barrel)	Natural gas price increase (dollars per thousand cubic feet)	Powerplant[1] heat rates: Oil (kilowatt-hours per barrel)	Powerplant[1] heat rates: Gas (kilowatt-hours per thousand cubic feet)	Incremental generation costs: Oil (cents per kilowatt-hour)	Incremental generation costs: Gas (cents per kilowatt-hour)
Northeast	2.20	0.43	570	66	0.38	0.65
Middle Atlantic	2.30	.43	543	71	.42	.61
East North Central	4.05	.43	517	79	.78	.54
West North Central	4.05	.43	434	83	.93	.52
South Atlantic	2.10	.43	568	80	.37	.54
East South Central	4.85	.43	525	83	.92	.52
West South Central	4.85	.37	572	96	.85	.39
Mountain	3.95	.43	558	89	.71	.48
Pacific (less Alaska and Hawaii)	3.75	.43	621	101	.60	.43
Alaska	5.60	.37	430	61	1.30	.61
Hawaii	2.00		575	NA	.35	

[1] Based on FPC News Release, "FPC Issues Power Production, Fuels Data for October 1974", Dec. 27, 1974. FPC Data for September 1974 yielded very similar results.

TABLE III.—INCREASE IN REGIONAL ELECTRIC UTILITY RATES DUE TO HIGHER FUEL PRICES

Region	Percent generated[1] from oil	Percent generated[1] from natural gas	Average cost increase (cents per kilowatt-hour)
New England	68	0.7	0.27
Middle Atlantic	35	3	.17
East North Central	4	3	.05
West North Central	2	29	.17
South Atlantic	26	6	.13
East South Central	2	4	.04
West South Central	6	87	.39
Mountain	5	21	.14
Pacific (except Alaska and Hawaii)	19	19	.19
Alaska	12	57	.51
Hawaii	99	0	.35

[1] Based on 1973 fuels usage as reported in the Statistical Year Book of the Electric Utility Industry for 1973, Edison Electric Institute, November 1974.

TABLE IV.—AVERAGE RESIDENTIAL RATES, UTILITY BILLS AND KILOWATT-HOURS CONSUMPTION IN 1973

Region	Dollar sales[1] (millions)	Kilowatt-hours (millions)	Customers[1] (millions)	Average rate (cents per kilowatt-hour)	Average kilowatt-hour	Average bill (dollars)
Northeast	798.7	26,169	4.059	3.05	6,447	196.77
Middle Atlantic	2,279.6	70,729	11.690	3.22	6,050	195.00
East North Central	2,476.0	96,164	13.556	2.58	7,094	182.65
West North Central	1,066.9	42,146	5.683	2.53	7,416	187.74
South Atlantic	2,371.5	106,750	10.940	2.22	9,758	216.77
East South Central	861.0	51,958	4.528	1.66	11,475	190.15
West South Central	1,350.8	62,205	6.586	2.17	9,445	205.10
Mountain	523.9	23,375	3.036	2.24	7,699	172.56
Pacific (less Alaska and Hawaii)	1,395.2	72,354	9.069	1.93	7,978	153.84
Alaska and Hawaii	71.1	2,321	.291	3.06	7,976	244.33
Alaska	22.7	743	.081	3.06	9,173	280.25
Hawaii	48.4	1,578	.210	3.07	7,514	230.48
Total United States	13,194.8	554,171	69.438	2.38	7,981	190.02

[1] Source: Statistical Year Book of the Electric Utility Industry for 1973, Edison Electric Institute, November 1974.

Note: The average U.S. electric utility rate in 1974 to residential customers was 2.85 cents per kilowatt-hour.

TABLE V.—ESTIMATED AVERAGE ANNUAL CONSUMPTION AND UTILITY BILLS IN 1974

Region	Residential	
	Kilowatt-hours	Dollars
New England	6,447	236
Middle Atlantic	6,050	234
East North Central	7,094	219
West North Central	7,416	225
South Atlantic	9,758	260
East South Central	11,475	228
West South Central	9,445	246
Mountain	7,699	207
Pacific (less Alaska and Hawaii)	7,978	185
Alaska	9,147	336
Hawaii	7,511	277
Total United States	7,981	228

TABLE VI.—INCREASE IN 1975 AVERAGE RESIDENTIAL ELECTRIC BILLS DUE TO HIGHER GAS AND OIL PRICES[1]

Region	Increase per customer	
	Dollars	Percent
New England	17.41	7.4
Middle Atlantic	10.29	4.4
East North Central	3.55	1.6
West North Central	12.61	5.6
South Atlantic	12.69	4.9
East South Central	4.59	2.0
West South Central	36.84	15.0
Mountain	10.78	5.2
Pacific (less Alaska and Hawaii)	15.16	8.2
Alaska	46.64	13.9
Hawaii	26.29	9.5
Total United States	12.86	5.6

[1] These price increases reflect the President's excise taxes and deregulation proposals covering petroleum and natural gas.

APPENDIX C.—NOTES ON TABLE 11

Extensive calculations made from a survey, *Life Styles and Energy*, conducted by the Washington Center for Metropolitan Studies in 1972 and 1973.

This survey provides the most recent information concerning expenditures on energy products by income groups. Since the prime purpose of the survey was concern with those below the low income level, data in the survey were presented in that form, that is, those below the low income level, the non-poor up to incomes of $12,000 p.a., those with incomes from $12,000 to $16,000 and those with $16,000 and above.

These data were adjusted in FEA to standard income classifications. Thus, 7.2 percent of the low income group, or 1.3 percent of the sample moved into the $5,000 to $12,000 p.a. of income and 6.3 percent of the lower middle group moved into the lowest group.

TABLE 1.—DISTRIBUTION OF HOUSEHOLD BY INCOME CLASS

	Money income class (in thousands of dollars)			
	0 to 5	5 to 12	12 to 16	16 and over
Survey distribution (percent)	18	42	19	20
Adjusted distribution (percent)	23	37	19	20

All of the estimates in Table 11 require Congressional action, the passage of legislation, and implementation which takes time. 1975 income tax reduction will initially benefit the poor in decreased withholding taxes. This may or may not match the timing of increases in energy costs. The total $16.5 billion reduction, while giving the greatest percentage reduction to low income groups, gives by far the greatest dollar reduction (78.5%) to groups included in the $7,000-$50,000 income classes. Including the $2 billion for cash payments to the poor, the share of income groups up to $5,000 of the $18.5 billion tax and cash relief is approximately $3.4 billion or 18.4 percent.

TABLE 2.—ESTIMATED 1975 TAX REDUCTIONS BY INCOME CLASS [1]

[Dollars in billions]

Adjusted gross income class (in thousands)	Income tax paid under present law	Amount of income tax reduction	Percentage reduction in income tax
0 to 3	$3.0	$0.25	83.3
3 to 5	1.8	1.20	66.7
5 to 7	4.0	1.96	49.0
7 to 10	8.9	3.38	38.0
10 to 15	21.9	4.72	21.6
15 to 20	22.8	2.70	11.8
20 to 50	44.4	2.15	4.8
50 to 100	13.5	.11	.8
100 and over	13.3	.03	.2
Total	130.9	[1] 16.50	12.6

[1] Does not include payments to nontaxpayers.

Source: The White House Fact Sheet, Jan. 15, 1975, p. 18.

As of March 1974, 23 percent of all households had incomes less than $5,000. Thus, this group is not receiving back a share equal to its proportion in the population.

Although the proposed energy rebate program bears more heavily on those of low income than on other groups, it is unique in that it marks the first time Federal monies would be paid out through the tax system directly to those of low income. It could, thus, if implemented, become the basis of a system of welfare reform.

Impact of the Proposed Energy Deregulation/Tax Program on Selected Industries

(Technical Report, 75–10, (Revised), F.E.A.—E.A.T.R.—75–10, April, 1975, Office of Industrial Programs, Office of Conservation and Environment)

This Technical Report contains preliminary research results which are subject to change. It is distributed for purposes of communication and to solicit comment. It is intended for internal distribution only.

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I. SUMMARY

The President's energy proposals imply sharply higher prices for fuels for 1975:

PERCENTAGE PRICE INCREASE IN FUELS TO INDUSTRIAL CONSUMERS

[In percent]

	Coal	Oil	Gas	Electricity
Oil tax/price deregulation and gas tax	0	32.1	82.1	8.7
Above with increase in coal prices	37.7	32.1	82.1	14.8

In the short run the general economic effects on the industry should be less severe than the results of the 1973 and 1974 oil embargo because: (1) Fuel cost adjustments due to imported crude are relatively small compared to the embargo related fuel cost increases; and (2) reduced final demand to softness in the economy.

Most industries are not energy intensive, but energy sensitive. Since fuel costs are small compared to labor and material costs, availability rather than price is the critical factor in the short run.

Some fuel and feedstock substitution effects will be observed.

As shown for 1985, the energy policy will result in a substantial decrease in energy consumption. The transportation sector will absorb the greatest impact. Efforts to conserve energy by industry will clearly be stimulated by the policy package.

FUEL CONSUMPTION BY 4 MAJOR SECTORS, 1985: DIFFERENCE FROM BASELINE ESTIMATE

[Trillions of British thermal units]

	$11 oil	$7 oil
	Percent	Percent
Household and commercial	−6.4	−7.4
Industrial	−9.0	−6.4
Transportation	−12.8	−17.2
Electrical generation	+1.4	+1.0

Elasticity of demand for products produced will be the big factor in determining absorption, dollar for dollar pass through, or greater than dollar for dollar pass through of increased fuel costs.

For the broad industrial groups listed below, there will be a substantial increase in average fuel costs which could result in significant price increases.

IMPACTS ON 6 ENERGY INTENSIVE INDUSTRIES, 1975

[In percent]

	Average increase in fuel costs	Average increase in product prices
Steel	12.3-26.8	2.4- 5.2
Chemicals	42.7-44.2	4.2- 4.4
Petrochemicals	41.7-43.9	8.4- 8.9
Paper	19.0-23.0	3.8- 4.4
Aluminum	21.2-33.4	5.6- 8.8
Cement	25.0-36.0	8.0-11.5

Based on projected energy cost increases for 1975, 1977, and 1985, 18 four-digit SIC industries have been identified as being energy sensitive. Percentage increases in industry prices are given in the following table.

INPUT/OUTPUT DIRECT REQUIREMENTS: TOTAL PERCENT CHANGE IN INDUSTRY PRICES, ENERGY SENSITIVE INDUSTRIES, 4-DIGIT SIC

	1974–75	1974–77	1977–85
Paving mixtures	10.81	14.30	11.56
Asphalt felts and coverings	7.409	9.85	7.62
Industrial, inorganic and organic chemicals	6.54	8.99	7.79
Lime	5.91	9.52	11.10
Cement, hydraulic	4.98	8.32	9.61
Brick, structural clay tile	7.16	10.93	11.47
Structural clay products	5.97	9.05	9.46
Carbon-graphite products	3.63	5.37	5.09
Air transportation	3.647	4.72	3.63
Clay refractories	4.26	6.48	6.68
Manufactured ice	2.28	4.51	5.16
Pipeline transport	2.79	4.64	4.81
Synthetic rubber	2.954	4.12	3.64
Wet corn milling	1.355	2.57	3.05
Glass containers	2.383	4.43	4.62
Wallpaper-building paper	1.951	3.34	3.57
Blast furnaces—basic steel	1.578	2.72	3.47
Gypsum	2.536	3.95	4.11

II. INTRODUCTION

The policy options under consideration by the Federal Government imply sharply higher prices for fuels and for energy-intensive goods and services. The effects of a government policy that includes some combination of these options will not be neutral: economic units—industrial sectors, businesses, public entities, households, and individuals will be affected differently. The purpose of this study is to relate the projected effects of the policy options on a national basis to potential impacts by broad consuming groups and then to specific industries.

In order to identify industries likely to be most affected by the Federal policies under consideration, it is necessary to understand both the policy goals and the way in which the programs are most likely to operate. The policy goals are to conserve energy, particularly petroleum, and to discourage imports while at the same time to stimulate domestic production. This would be brought about by a series of actions—deregulation, tariffs, excise taxes, and excess profits taxes—resulting in sharply higher prices for fuels, particularly petroleum, and natural gas, and thus, reduced demand.

The amount by which demand falls will be determined largely by the collective actions of individual consumers—purchasers of the final goods and services

produced by the economy. The decontrol of crude petroleum and natural gas will result in higher market-determined prices and these increases and the increased costs of tariffs to importers and of excise taxes to domestic producers will be passed forward. The consumer will be faced with higher prices for fuels and for the products in which fuels are embodied. Initially the consumer's money income will be unchanged, so that his real income—purchasing power—will fall.

Some, but probably not all, of this income will have accrued to the Government through increased tax revenues. But as the Government rebates the revenues from tariffs and taxes, the purchasing power of consumers will be partially restored to its original level.

Two important changes will have occurred as a consequence of the events described above: First, real incomes will have changed for individual consumers; increased energy related costs will not be identically offset for all individuals—some will be better off and some worse off. Secondly, all consumers will be facing a new set of relative prices; that is, prices of petroleum and natural gas fuels may be expected to rise the most relative to all other prices, and the prices of energy-intensive goods and services may be expected to rise less than fuels, but more than less energy intensive products.

Individual consumers will be forced to re-evaluate their entire preference schedules for goods and services, including substitution possibilities, and determine the new collections of goods and services that yield maximum satisfaction. The aggregate of these demands will determine, finally, the impacts on the various producing industries.

The impact of the energy program on industry output and employment depends on the changes in relative prices of all goods and services that follow from changes in fuel prices and on the relative strength of consumer demand for various goods and services. With respect to changing prices, the economic sectors and industries producing the goods and services likely to be most affected are identified in the following sections. Unfortunately, much less is known about potential consumer reaction to these price changes.

Section III analyses the impact of the energy program on fuel prices for 1975 under different assumptions as to the behavior of coal prices. The first case represents the impact on fuel price while holding coal prices constant. The second case looks at a coal price increase as well.

Section IV gives the projected impact of the program on energy consumption by broad energy categories. Short term estimates are based on an assumed continuation of the high world oil price over the 1975–1977 period. The long term estimates look at both $11 and $7 world oil price cases.

Section V focuses first on the economic impact of the expected energy price increases on five energy-intensive industry groups: (1) steel; (2) chemicals and petrochemicals; (3) paper; (4) aluminum; (5) and cement. Then an input-output analysis is made of the impacts on the eighteen most energy sensitive industries (four digit SIC).

Section VI further analyses aspects of the above industries and provides background information and pertinent characteristics within the industries. In addition, there is a discussion of the impacts on the contract construction industry.

III. IMPACT OF THE ENERGY CONSERVATION TAX PROGRAM ON BASELINE FUEL PRICES (1975)

The major elements in the President's proposed energy conservation tax program included:

(1) Deregulation of domestic oil currently subject to price restrictions;

(2) Price deregulation of new natural gas supplies; and

(3) Energy excise taxes on crude oil, imported oil, natural gas liquids and natural gas of $2.00, $2.00, $1.45 per barrel and $.37 per thousand cubic feet, respectively.

The projected impact of these changes on fuel prices is outlined below.

A. *Baseline Energy Prices*

Baseline energy prices have been derived from national price statistics shown in Table III-1. When considering specific industries, these prices have been adjusted to reflect factors which differ from industry to industry. The estimates provided in Table III-1 are based on August 1974 prices paid by electric utilities. These data were used because they were current and considered to be relatively accurate proxies for prices paid by large industrial users.

TABLE III-1.—AVERAGE FUEL PRICES NATIONWIDE, SEPTEMBER 1974

[Cents per 1,000,000 Btu's]

Coal [1]	Oil [1]	Gas [1]	Electricity [2]
79.1	195.4	52.4	644.8

[1] Source: FPC News, Dec. 27, 1974, vol. 8, No. 52. Prices for coal, oil, and gas reflect average prices paid by utilities in September 1974.
[2] Source: Typical Electric Bills, Federal Power Commission. The average rate charged to large industrial users with demands in excess of 1,000 kW and monthly requirements of over 400,000 kWh.

B. *Oil Prices*

The President has proposed to deregulate old oil prices and impose an excise tax of $2.00 per barrel on crude oil and imported products. The impact on oil product prices will depend on a number of factors which cannot be projected with certainty at this time. For the purpose of this analysis, domestic crude oil prices were assumed to increase to the world price of $11.00 per barrel. With the addition of a $2.00 per barrel excise tax, this would increase the average acquisition cost of crude oil to refineries by roughly 47.7 percent, as shown in Table III-2.

TABLE III-2.—EXPECTED CHANGE IN CRUDE OIL ACQUISITION COST [1]

Category	Market share (percent)	Pretax price per barrel (dollars)	Deregulated tax price per barrel (dollars)
Domestic oil	67.8	7.52	13.00
Imported oil	32.1	12.58	14.50
Total	100.0		
Average		9.14	93.50
Percent increase			47.7

[1] Source: FEA Monthly Energy Review, November 1974.

The impact of the project increase in the average acquisition cost of crude oil on product prices depends in part on the price of imported products. The most important imported products are residual and distillate fuel oil. Recent price statistics tend to support the hypothesis that there is some competition between domestic and off-shore refiners for domestic distillate markets. For the purpose of this analysis, it has been assumed that heating oil prices would increase to imported prices. In effect, this places a limit on the increase in residual and distillate oil prices which will have to be recovered by domestic producers through larger increases in other product prices. Table III-3 shows the impact on residual and distillate oil prices. Under these assumptions, they would be expected to increase by 30.4 and 32.4 percent, respectively.

TABLE III-3.—IMPACT OF PRESIDENT'S PROGRAM ON FUEL OIL PRICES

	Distillate		Residual	
	Percent distributed [1]	Dollars per barrel [2]	Percent distributed [1]	Dollars per barrel [2]
Baseline:				
Domestic	90.0	11.20	46.0	9.75
Imported	10.0	12.80	54.0	13.80
Average		[3] 11.35		[3] 12.00
Price impact of tax deregulation:				
Domestic		14.80		15.80
Imported		14.80		15.80
Average		14.80		15.80
Percent increase:				
Domestic	32.2		62.1	
Imported	15.6		14.5	
Average	30.4		32.4	

[1] Distribution based on statistics from FEA's Monthly Energy Review for November 1974.
[2] Prices based on refined product price statistics from Dec. 7, 1974 Oil and Gas Journal.
[3] Approximate.

Overall oil price increases for each of the major products are shown in Table III–4. Distillate and residual prices were constrained to the price changes shown in Table III–3. Natural gas liquids were assumed to increase in proportion to crude oil and jet fuel was treated the same as distillate fuel oil. These assumptions result in forcing the price of motor gasoline to an increase relative to other petroleum products, assuming that refiners will attempt to recover all the additional costs associated with the program.

TABLE III–4.—NATIONAL AVERAGE OIL PRICE INCREASES DUE TO ENERGY CONSERVATION TAX PROGRAM

Fuel category	Domestic[1] yield, percent	Projected, dollars per barrel	Price, cents per gallon	Increase, dollars per 1,000,000 Btu's
Crude		4.36	10.3	0.775
Motor gasoline	49.4	5.28	12.6	1.007
Jet fuel	7.1	3.45	8.2	.627
Distillate	21.8	3.45	8.2	.595
Residual	8.6	3.80	9.1	.619
Natural gas liquids	13.1	3.10	7.4	.775

[1] FEA Monthly Energy Review, November 1974.

C. *Gas Prices*

The impact of deregulating new natural gas prices is not expected to be as large as the impact on oil prices. FEA projects that allowing new natural gas prices to rise to market clearing prices will increase the average cost of natural gas by approximately $.06 per MCF. This would be in addition to the $.37 per MCF excise tax on gas consumption, therefore, natural gas prices are expected to increase by roughly $.43 per MCF over current prices. This would represent an 82 percent increase in the average price of natural gas.

D. *Coal Prices*

Although coal is not directly affected by the energy conservation tax program, some experts believe that coal prices tend to follow oil prices. There is some support for this hypothesis. Between October 1973 and September 1974, coal prices increased from 41.9 to 79.1 cents per million BTU, or by roughly 5.4 percent per month. It is impossible to determine the casual effects of this increase because, in addition to the rapid escalation of oil prices during this period, the nation faced the threat of a long-term coal strike. This forced spot market prices up as coal users attempted to stockpile supplies. For the purposes of this analysis it has been assumed that, if the energy conservation tax program is imposed, coal prices would increase to around $25.00 per ton. This should not be viewed as a prediction. Rather, the purpose is to show the sensitivity of product prices to the potential impact of higher coal prices.

In order to distinguish between the impact of the energy conservation tax program and the assumed increase in coal prices, two cases are presented. Case 1 represents the impact of fuel price increases while holding coal prices constant. Case 2 allows coal prices to increase.

E. *Impact of Fuel Price Increases On Electricity Rates*

The impact of fuel price increases on electrical rates is dependent on the distribution of fuels consumed in generating electricity. Table III–5 shows the nationwide distribution for 1974.

TABLE III–5.—NATIONAL DISTRIBUTION OF ELECTRICITY PRODUCTION BY FUEL SOURCE

[In percent]

	Coal	Oil	Gas	Other[1]
Nationwide distribution	43.0	16.3	19.4	21.1

[1] Includes nuclear and hydroelectric.

The nationwide average price increase has been calculated assuming full pass through of additional fuel costs. The impact stated in terms of mills per kilowatt hour and dollars per million BTU under Case 1 and Case 2 assumptions are shown in Table III-6.

TABLE III-6.—IMPACT OF ENERGY CONSERVATION TAX PROGRAM ON NATIONWIDE AVERAGE ELECTRICITY RATES

	Price increase	
	Mills per kilowatt-hour	Cents per 1,000,000 Btu's [1]
Baseline	22.00	644.8
Case 1	23.92	701.1
Percent increase	8.7	8.7
Case 2	25.30	740.5
Percent increase	15.0	15.0

[1] Electricity valued at its thermal equivalence of 3,412 Btu/kHh.

Source: FPC News, Nov. 29, 1974.

F. *Summary*

The impact of the energy conservation tax program and assumed increase in coal prices on average industrial fuel costs are shown in Table III-7. These price changes should be viewed as illustrative of the potential impact of the program. Detailed price impact projections have been calculated for each of the industries covered in this study. In some cases, the projected fuel price changes differ from those shown in Table III-7 because of factors unique to each industry.

TABLE III-7.—POTENTIAL IMPACT ON NATIONWIDE FUEL PRICES

[Cents per 1,000,000 Btu's]

	Coal	Oil [1]	Gas	Electricity
Baseline	79.1	195.4	52.4	644.8
Percent increase				
Case 1	79.1	258.1	95.4	701.1
Percent increase		32.1	82.1	8.7
Case 2	108.9	258.1	95.4	740.5
Percent increase	37.7	32.1	82.1	14.8

[1] Prices shown correspond to residual fuel oil.

IV. FUEL CONSUMPTION EFFECTS BY MAJOR SECTORS

A. *Long Term Effects*

Table IV-1 presents fuel consumption under alternative policy scenarios for $7 oil and $11 oil.[1] It is apparent that total fuel consumption will decline, 4.7 to 5.4 percent (from the baseline of $11 oil) or 6.3 to 7.0 percent (from the baseline of $7 oil). Among the fuel inputs, the consumption of coal will increase as petroleum and natural gas consumption decreases. This indicates that substitution of fuels will occur among consuming sectors. However, the overall effect under each policy option and for both assumed crude oil prices will be a decrease in energy consumption, with the decrease more pronounced under $7 oil than $11 oil.

Table IV-2 presents total fuel consumption by four major sectors (household and commercial, industrial, transportation, and electrical generation). With the energy program, the electrical generation sector shows an increase in demand for fuels as coal consumption is increased vis-a-vis petroleum and natural gas. The demand for fuels declines to a greater extent in the transportation sector where substitution of coal for oil and gas is much less feasible (12.8 to 12.9 percent under $11 oil, 17.2 to 18.2 percent under $7 oil). Both the household and commercial and the industrial sector show overall declines in fuel consumption. In addition, the relative efficiency of the tariff upon these consuming sectors is more effective under the $7 oil case than $11.

[1] The data in Tables 1-3 were generated by the Integrating Model at FEA.

TABLE IV-1.—FUEL CONSUMPTION, 1985

[Trillions of British thermal units]

	$11 world oil price			$7 world oil price		
	Baseline $11 oil	Tariff $11 oil	Difference from base, percent	Baseline $7 oil	Tariff $7 oil	Difference from base, percent
Coal	22,863	23,607	+3.2	19,888	22,151	±10.2
Petroleum	37,976	34,432	−9.3	47,918	41,345	−13.7
Natural gas	24,775	21,978	−11.2	23,947	21,404	−10.6
Other fuels [1]	17,306	17,306	0	17,306	17,306	0
Total gross energy inputs	102,920	97,324	−5.4	109,059	102,206	−6.3

[1] Nuclear power, hydroelectric power.

TABLE IV-2.—TOTAL FUEL CONSUMPTION BY 4 MAJOR SECTORS, 1985

[Trillions of British thermal units]

	$11 world oil price			$7 world oil price		
	Baseline $11 oil	Tariff $11 oil	Difference from base, percent	Baseline $7 oil	Tariff $7 oil	Difference from base, percent
Household and commercial	16,912	15,835	−6.4	17,865	16,529	−7.4
Industrial	24,880	22,640	−9.0	25,751	24,104	−6.4
Transportation	21,934	19,116	−12.8	24,545	20,301	−17.2
Electrical generation	39,194	39,733	+1.4	40,898	41,272	+1.0
Total 4 sector inputs	102,920	97,324	−5.4	109,059	102,206	−6.3

In Table IV–2 total fuel consumption, including electricity, is presented for three major sectors (household and commercial, industrial, and transportation). Electricity is consumed largely by the household and commercial and the industrial sectors and only in very small amounts by the transportation sector. Thus, because the production of electricity actually increases as a result of the energy program (Table IV–2), its distribution to the consuming sectors dampens the impact on total fuel usage in the household and commercial and the industrial sectors (Table IV–3).

The decrease in fuel consumption stays about the same in transportation. Again, the policy options are more effective in decreasing fuel consumption in the case of $7 oil than in the $11 oil case.

In summary, with the President's energy program substitution effects outweigh price effects in the electrical generation sector, a moderate decrease in fuel consumption takes place in the household and commercial and industrial sectors, and, because of its strong dependence on petroleum (without adequate substitutes), the transportation sector is projected to reduce its fuel consumption significantly. Further, fuel consumption is reduced more (but from higher levels) under $7 oil than $11 oil implying that the tariff and excise tax are relatively more effective in the former case.

TABLE IV-3.—TOTAL FUEL CONSUMPTION BY 3 MAJOR SECTORS, 1985

[Trillions of British thermal units]

	$11 world oil price			$7 world oil price		
Sectors	Baseline $11 oil	Tariff $11 oil	Difference from base, percent	Baseline $7 oil	Tariff $7 oil	Difference from base, percent
Household plus commercial	25,106	23,861	−5.0	25,926	24,466	−5.6
Industrial	28,984	27,019	−6.8	30,359	29,047	−4.3
Transportation	21,971	19,154	−12.8	24,583	20,338	−17.2
Total 3 sector inputs	76,061	70,034	−7.9	80,867	73,851	−8.7

B. *Short Term Effects*

The results of recent projections presented in Technical Memorandum 74–9 and 75–2 prepared by the Office of Quantitative Methods are shown in Table IV–4. The impact of a policy to decontrol crude petroleum prices and the imposition of the $2 tariff and tax package is presented.

TABLE IV-4.—PETROLEUM DEMAND

[MBD]

Year	Base	Policy option (base)	Percent difference from base
1975	16,735	16,187	−3.3
1977	18,256	16,318	−10.6

The decrease in petroleum demand is immediate with the implementation of the program and will be greater in 1977 under both options as substitution of other energy sources for oil becomes feasible. Even though petroleum demand by major consuming sectors is not provided in this forecast, the decrease in petroleum consumption could be similar to the $11 oil, nominal tariff scenario for 1985. That is, the demand for petroleum products is less in each of the consuming sectors, but the relative decline is greater in the transportation sector.

V. IMPACT OF ENERGY PROGRAM ON SELECTED INDUSTRIES

Any attempt to analyze industry impacts requires that some degree of selectivity be exercised. The first part of this section analyzes the impact of fuel price increases projected for 1975 on six industries which have been selected not only because of their importance in the economy but also because of the energy-intensiveness of their operations: (1) steel; (2) chemicals and petrochemicals; (3) paper; (4) aluminum; and (5) cement. These industry groupings, are at a broad level of aggregation represented by two and three-digit SIC codes. Within these groupings, impacts were computed on product prices and industry profits.

An input output analysis approach used in the second part of this section was different in that it attempted to look at the price impacts on a much more disaggregated level of a four-digit SIC code. The purpose was to identify which industries, out of all industries represented in the input-output table, were the most energy sensitive. Calculations were done not only for 1975 but also for 1977 and 1985. In addition, impacts on the WPI as a result of price increases were computed for the identified industries.

A. *Analysis of Five Energy Intensive Industries for 1975*

This section focuses on the economic impact of the expected energy price increases on five energy intensive industries: 1) steel, 2) chemicals and petrochemicals, 3) paper, 4) aluminum, and 5) cement.

The impact of the tax program on product prices depends on three factors:

1. The distribution of fuel consumption within each industry
2. The impact of the program on fuel costs; and
3. The amount of energy required to produce each dollar of output.

These price increases will in turn impact upon industry profits. An evaluation is then made of the proposed reduction in the corporate tax rate from 48 percent to 42 percent and its effect of after tax profits.

1. *Energy consumption distribution by industry.*—Table V–1 shows the distribution of energy consumption for each of the five industries and the petrochemical subsector of the chemical industry. Although, these industries account for roughly 15 percent of the nation's total energy requirements, they are much less dependent on oil than the remainder of the economy. Oil accounts for approximately 17.6 percent of their energy requirements, compared to the nation at approximately 45 percent. Natural gas is a much more important source of energy, accounting for almost 40 percent of total consumption. Overall, these industries depend on natural gas and oil products for roughly 57 percent of total cosumption. The excise tax and deregulation program will increase the price of these fuels.

2. *Impact of program on average fuel costs.*—Table V–2 presents estimates of the impact of the proposed tax program on the fuel costs for each of the five industries.

TABLE V-1.—ENERGY CONSUMPTION DISTRIBUTION BY FUEL AND INDUSTRY

Industry	Total consumption [1] (10^{12} Btu)	Distribution by fuel type (percent of total energy)				
		Oil [2]	Gas [3]	Coal	Electric [4]	Other [5]
Steel	3,031.0	8.0	20.0	62.3	4.4	5.4
Chemicals	4,888.0	22.7	59.0	10.3	8.0	
(Petrochemicals)	(3,854.0)	(26.6)	(60.1)	(7.1)	(6.2)	
Paper	2,130.0	22.0	21.0	12.0	5.0	41.0
Aluminum	586.0	11.0	37.0	1.0	51.0	
Cement	514.0	15.0	43.0	35.0	7.0	
Total	11,149.0	[6] 17.6	[6] 39.2	[6] 25.4	[6] 8.7	[6] 9.3

[1] Data for steel, paper, aluminum, and cement correspond to 1973 consumption. Chemical and petrochemical estimates correspond to 1974.
[2] Includes fuel oil and oil-derived feedstocks.
[3] Includes natural gas and natural gas liquids.
[4] Electricity valued at its thermal equivalence of 3,412 Btu kWh.
[5] Nonmarketable fuels such as wood chips and pulping liquors.
[6] Average.

Source: Energy and Environmental Analysis, Inc., estimates.

TABLE V-2.—ESTIMATED INCREASE IN AVERAGE FUEL COSTS

	Estimated baseline prices (dollars per 1,000,000 Btu's)	Case 1, tax deregulation program (percent increase)	Case 2, coal price rise (percent increase)
Steel	1.39	12.3	26.8
Chemicals	1.37	42.7	44.2
(Petrochemicals)	(1.40)	(41.7)	(43.9)
Paper	1.40	19.0	23.0
Aluminum	1.88	21.1	33.4
Cement	1.20	25.0	36.0
Average	1.40	27.7	34.4

The baseline fuel costs were calculated using utility fuel purchase data. Many firms within these industries may be paying prices higher, or even lower, than those shown. The reason for showing baseline price estimates is to give some indication of the relative operating cost burden placed on these industries as a result of the proposed program.

The aluminum industry has the highest average baseline fuel cost at $1.88 per million BTU. This high fuel cost is a result of the industry's dependency on electricity for over 50 percent of its delivered energy requirements. Steel, chemicals and paper all fall in the $1.40/MMBTU range. Cement has the lowest average cost at $1.20/MMBTU.

The proposed tax program is estimated to increase the average fuel bill to these industries by something on the order of 28 percent. On a percentage basis, the chemicals industry is the most heavily impacted with fuel costs rising by over 40 percent. If coal prices tend to follow price increases in oil and gas products, average industry-wide fuel costs will increase by an additional 6.7 percent. The industries most severely affected by coal prices are steel, aluminum and cement.

In the near term, it is doubtful that many of these industries would be able to avoid these large fuel price increases. Energy conservation could contribute to reduced costs, but many short term housekeeping measures have already been employed to reduce the effect of price increases resulting from the embargo. Capital equipment purchases that could reduce overall energy requirements are planned but such changes take time. Conversion from oil and/or gas to coal might also provide some limited relief, but any major conversion effort would require a minimum of three to five years. Therefore, in the near term, these higher fuel costs would either have to be passed on in higher product prices or absorbed in reduced profits.

3. *Potential impact on product prices.*—Table V-3 shows the potential impact of these fuel price increases on production costs relative to current output prices.

TABLE V-3.—POTENTIAL IMPACT OF FUEL PRICE INCREASES ON AVERAGE OUTPUT PRICES

	Absolute fuel price increase (cents per 1,000,000 Btu's)		Energy/output coefficient[1] 1,000,000 Btu's per dollar output)	Implied increase in product prices (percent increase)	
	Case 1	Case 2		Case 1	Case 2
Steel	17.0	37.2	0.140	2.4	5.2
Chemicals	58.5	60.6	.072	4.2	4.4
Petrochemicals	58.4	61.5	.144	8.4	8.9
Paper	26.6	32.2	.139	3.8	4.4
Aluminum	39.7	62.8	.140	5.6	8.8
Cement	30.0	43.2	.267	8.0	11.5

[1] Energy consumption relative to 1974 product prices.

Source: Energy and Environmental Analysis, Inc.

The industries that would be most affected by the energy conservation tax program would be petrochemicals and cement. Both are major users of oil and natural gas. Petrochemicals exhibits the largest cost increase relative to current price, increasing by over 8 percent. The main reason that the cement industry is so heavily impacted is the relatively low ratio of value added to final product price. The amount of energy consumer per dollar of output is almost twice as large for cement as compared to the other industries. This high ratio of energy consumption to the final value of products is the main reason for the significant cost impact. The next most severely affected industry is aluminum. Most of the price increase in the aluminum industry would result from higher electrical rates under the assumption of full pass through of higher fuel costs. If the pass through includes charges for reduced capacity utilization in the utility industry, the impact could be more severe than that shown.

If coal prices follow increases in oil and gas prices, all of these industries will experience cost increases in excess of 4 percent. The industries most affected by coal price rises are steel, aluminum and cement, all major consumers. In this case, the impact on the aluminum industry of the combined fuel price increases is almost equivalent to the impact of the proposed energy conservation tax program on petrochemicals.

Under either Case 1 or Case 2 assumptions, the impact of the proposed program is quite significant. The cement industry would be the hardest hit, followed by petrochemicals and aluminum. Undoubtedly, the projected impacts shown in Table V-3 will vary between firms within each industry. These estimates should be viewed as averages. Some firms would experience larger increases, while others which rely on captive supplies or are larger consumers of hydro or nuclear power would be able to avoid the full impact.

4. *Impact on sales and profits.*—The impact of the estimated cost increases on sales and profits is extremely difficult to determine. The information needed to analyze the effects is generally not available from public documents. The sales impact depends on the extent of the cost pass through, the shape of the relevant cost schedules, and the price elasticity of demand for these products. The impact on profits, in addition to the above factors, depends on the relationship of fixed to variable costs and the effect of the proposed reduced corporate tax rates on after-tax profits. A simplified example of these relationships is represented by the generalized equations below. Let:

O = output
f_i = before tax profits per unit output in period i
f_j = before tax profits per unit output in period j
T_i = nominal corporate income tax rate in period i
T_j = nominal corporate income tax rate in period j
F_i = after tax profits in period i
F_j = after tax profits in period j
Σ_p = price elasticity of demand
Δ_p = change in price resulting from higher energy costs
i = pre-energy conservation tax environment
j = post-energy conservation tax environment

Then after tax profits in the absence of any changes would equal:

$$O(f_i)(1-T_i)=F_i \qquad (1)$$

Once the program goes into effect, after tax profit would equal:

$$O(1+\Sigma_p\Delta P)(f_j)(1-T_j)=F_j \qquad (2)$$

The critical question in this analysis is the impact of the energy conservation tax program on before tax profit margins. The change in before tax unit profits can be represented by the following equation:[2]

$$f_j-f_i=(P_j-TC_j)-(P_i-TC_i) \qquad (3)$$

Assuming that only the higher energy costs are passed on in the form of higher product prices, then:

$$P_j=P_i+C_e \qquad (4)$$

where C_e is the increase in production costs associated with higher energy prices.[3] At this point, it should be recognized that a decline in output due to price increase will tend to raise fixed costs per unit output. Fixed costs per unit of output in period j can be represented by:

$$C_{Fj}=\frac{C_{Fi}}{1+\Sigma_p\Delta P} \qquad (5)$$

Generalizing equation (3) and assuming that variable costs are constant ($C_{vi}=C_{vj}$), then the change in before tax profits per unit can be approximated as:

$$f_j-f_i=\left(P_i+C_e-C_{vj}\ \frac{C_{Fi}}{1+\Sigma_p\Delta P}-C_e\right)-(P_i-C_{vj}-C_F) \qquad (6)$$

simplifying:

$$f_j-f_i=\left(C_F-\frac{C_F}{1+\Sigma_p\Delta P}\right)=C_F(1-\alpha)\text{ where }\alpha=\frac{1}{1+\Sigma_p\Delta P} \qquad (7)$$

or:

$$f_j=f_i+C_F(1-\alpha) \qquad (8)$$

Substitution in equation (2) results in the following equation:

$$O(1+\Sigma_p\Delta P)(f_i+C_F(1-\alpha))(1=T_j)=F_j \qquad (9)$$

Equations (1) and (9) can be used to solve for the changes resulting from the increase in production costs that would leave after tax profits constant. Figure V–1 illustrates the relationship between fixed costs, product price changes and the price elasticity of demand. For example, if the price change were 5 percent, and the elasticity of demand were —.5, fixed costs would have to exceed 30 percent of the price before the impact of the program would lead to reduced after tax profits.

Another way to view this question is to work out some case examples based on the expected price changes in each industry. Table V–4 shows the impact on the expected after tax profit margins of this program under the assumption that fixed costs are 30 percent of total costs, and the price elasticity of demand is —0.5.

Under these assumptions, and assuming coal prices do not increase, three industries—steel, chemicals and paper—are relatively better off under the proposed program. There is a marginal adverse impact on aluminum, while petrochemicals and cement are severely affected. If coal prices increase (Case 2), only paper and chemical exhibit higher after tax profits. The impact on steel, petrochemicals and aluminum ranges between a 7.9 and 12.2 percent decrease in after tax profits. Cement experiences the most severe impact with profits decreasing by almost 23 percent.

[2] P refers to price, TC to total costs per unit output. C_v to unit variable costs, and C_f to fixed costs per unit.
[3] This pass through equation hinges on the assumption that the industry supply curve is perfectly elastic.

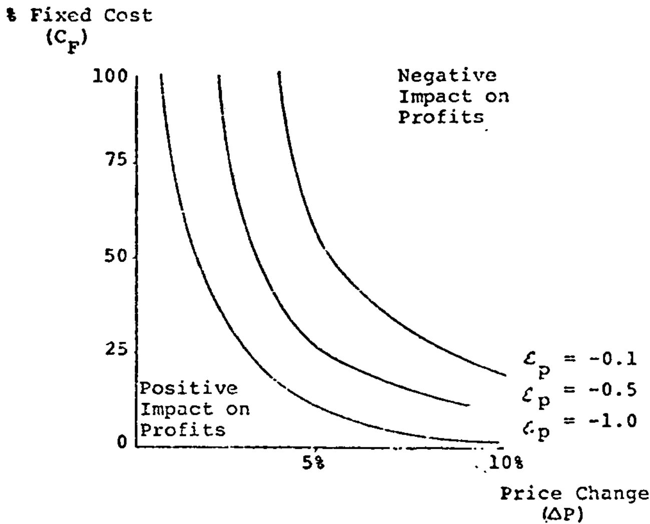

FIGURE V-1.—RELATIONSHIP BETWEEN FIXED COST AND PRICE CHANGES ON PROFITS

TABLE V-4.—SAMPLE CALCULATION OF THE IMPACT ON INDUSTRY PROFIT MARGINS

	Expected change in price [1] (percent increase)		Baseline [2] after tax profit margin (percent of sales)	Tax deregulation [3] after tax profit margins (percent of sales)	
	Case 1	Case 2		Case 1	Case 2
Steel	2.4	5.2	2.78	2.85	2.56
(Percent change)				(+2.5)	(−7.9)
Chemical	4.2	4.4	6.03	6.23	6.21
(Percent change)				(+3.3)	(+3.0
Petrochemical	8.4	8.9	4.51	4.08	4.04
(Percent change)				(−9.5)	(−10.4
Paper	3.8	4.4	5.02	5.17	5.10
(Percent change)				(+3.0)	(+1.6)
Aluminum	5.6	8.8	4.02	3.87	3.53
(Percent change)				(−3.7)	(−12.2)
Cement	8.0	11.5	3.56	3.11	2.76
(Percent change)				(−12.6)	(−22.5)

[1] From industry studies above.
[2] Data Resources, Inc., Long Term Forecast, May 1974. 52 percent of projected before tax profit margins.
[3] Assumes that fixed costs are 30 percent of total costs and that price elasticity of demand is −0.5.

These impacts should be interpreted as illustrative of the relative impact of the program. With the present state of the economy, it is not clear what the potential impact might be. The estimated profit margins used in Table V-1 were projected prior to May 1974 and may hold no relationship to the outlook facing these industries. The sample calculations do however serve to illustrate that the impact could be quite severe, especially in the petrochemicals, aluminum and cement industries.

B. *Input-Output Analysis of the Eighteen Most Energy-Sensitive Industries*

In order to understand better the flow of petroleum, natural gas, coal, and electric utilities through the economy and to identify those industries most likely

to be affected by the President's energy proposals a set of input/output tables has been used. They are based on 1967 input/output tables for the U.S. prepared by the Bureau of Economic Analysis, U.S. Department of Commerce.

These industries were selected and ordered according to total energy consumption. To this end, the petroleum, natural gas, coal, and electric usage coefficients (per unit of output) were aggregated. A list of the 18 most energy sensitive industries (sensitive in all four energy sources) was compiled. Based on projected energy price changes, the direct effect on the output prices and the effects on the economy were calculated.

1. *Projection fuel prices: 1975, 1977, 1985.*—As shown in Table V-5, price increases were forecasted to 1985. Refined petroleum products experienced a large price increase up to 1974 (13% for the 1967-74 time period. However, in the periods 1974-75, 1974-77 and 1977-85, the price increases were smaller. (49%, 63%, 48% respectively), though they were still substantial. Coal prices, likewise, experienced large price increases up to 1974 (252% for the 1967-1974 time period). However, in the periods 1974-77, 1974-75 and 1977-85, coal price increases were much smaller (8%, 21.7%, 48% respectively).

Electric prices increased 52.9% from 1967 to 1974, with minor change in the rate of increase over the years. Also, natural gas price increased 79 percent from 1967 to 1974 and would increase 79% in 1975, 117% in 1977 and 121% in 1985 if the President's energy proposal is enacted.

2. *Impact on product prices: 1975, 1977, 1985.*—The impact of these price trends is reflected in the percentage change of output prices of the most energy sensitive industries. (Tables V-6, 7, 8) Brick, structural clay tile, structural

TABLE V-5.—CURRENT PRICE CHANGES OF ENERGY WITH DECONTROL AND INCREASING TARIFF AND EXCISE TAX, 1975, 1977, AND 1985 [Calculations prior to 1985 for benchmark purposes]

	1967	1974	Percent change in price (1967-74)	1975	Percent change in price (1974-75)	1977	Percent change in price (1974-77)	1985	Percent change in price (1977-85)
Refined petroleum products	[1] 4.40	10.17	131.0	15.14	49	17.10	63.0	25.35	48
Coal	[2] 4.79	16.89	252.6	18.21	8	20.56	21.7	30.49	48
Electricity	[3] 13.89	20.94	52.9	24.95	19	29.50	40.8	43.76	48
Natural Gas	[4] 36	64	77.0	115	79	139	117.0	307	121

[1] A simple average was taken for 1967 prices of gasoline, residual, distillate and other refined products to derive the refined products 1967 base. Source: Comprehensive Energy Plan Prices for 1967.
[2] Source: Comprehensive Energy Plan Prices for 1967.
[3] Source: Comprehensive Energy Plan Prices for 1967.
[4] Cents per 1,000 ft³.

TABLE V-6.-1975 IMPACT ON ENERGY SENSITIVE INDUSTRIES' PRICES DUE TO PRESIDENT'S ENERGY PROPOSAL[1]

	Percent of change due to—				Total percent change in industry prices
	Petroleum	Coal	Electric	Gas	
Paving mixtures	9.83	0.04	0.23	0.71	10.81
Asphalt felts and coverings	6.70	.C09	.23	.47	7.409
Industrial, inorganic, and organic chemicals	4.86	.03	.35	1.3	6.54
Lime	.28	.36	.57	4.7	5.91
Cement, hydraulic	.32	.25	1.05	3.36	4.98
Brick, structural clay tile	.44	.04	.53	6.15	7.16
Structural clay products	.35	.03	.35	5.24	5.97
Carbon-graphite products	2.09	.03	.53	.98	3.63
Air transportation	3.58	0	.02	.047	3.647
Clay refractories	.22	.002	.26	3.78	4.26
Manufactured ice	.30	.02	1.73	.23	2.28
Pipeline transport	.83	0	1.00	.96	2.79
Synthetic rubber	2.03	.006	.207	.711	2.954
Wet corn milling	.05	.06	.725	.52	1.355
Glass containers	.147	.002	.294	2.44	2.383
Wallpaper-building paper	.269	.042	.55	1.09	1.951
Blast furnaces-basic steel	.186	.202	.25	.94	1.578
Gypsum	.008	.333	.385	1.81	2.536

[1] The output price changes were developed from the U.S. Department of Commerce input/output tables (1967 version). First, the value of the energy input was divided by the value of the industry's output. This proportion was them multiplied by the percent change of the energy input price (see table I) to get' he percent change of the industry's output price.

TABLE V-7.—1977 IMPACT ON ENERGY SENSITIVE INDUSTRIES' PRICES DUE TO PRESIDENT'S ENERGY PROPOSAL[1]

	Percent of change due to—				Total percent change in industry prices
	Petroleum	Coal	Electric	Gas	
Paving mixtures	12.65	0.11	0.49	1.05	14.30
Asphalt felts and coverings	8.62	.02	.51	.70	9.85
Industrial, inorganic, and organic chemicals	6.25	.07	.74	1.93	8,99
Lime	.35	.98	1.23	6.96	9.52
Cement, hydraulic	.41	.68	2.25	4.98	8.32
Brick, structural clay tile	.56	.12	1.14	9.11	10.93
Structural clay products	.45	.10	.75	7.75	9.05
Carbon-graphite products	2.69	.08	1.14	1.46	5.37
Air transportation	4.61	0	.04	.07	4.72
Clay refractories	.28	.006	.57	5.60	6.48
Manufactured ice	.39	.06	3.71	.35	4.51
Pipeline transport	1.07	0	2.15	1.42	4.64
Synthetic rubber	2.61	.02	.44	1.05	4.12
Wet corn milling	.07	.17	1.56	.77	2.53
Glass containers	.19	.006	.63	3.61	4.42
Wallpaper-building paper	.34	.11	1.18	1.61	3.34
Blast furnaces-basic steel	.24	.55	.54	1.39	2.72
Gypsum	.43	.02	.82	2.68	3.95

[1] The output price changes were developed from the U.S. Department of Commerce input/output tables (1967 version). First, the value of the energy input was divided by the value of the industry's output. This proportion was then multiplied by the percent change of the energy input price (see table I) to get the percent change of the industry's output price.

TABLE V-8.—1985 IMPACT ON ENERGY SENSITIVE INDUSTRIES' PRICES DUE TO PRESIDENT'S ENERGY PROPOSAL[1]

	Percent of change due to—				Total percent change in industry prices
	Petroleum	Coal	Electric	Gas	
Paving mixtures	9.64	0.25	0.58	1.09	11.56
Asphalt felts and coverings	6.56	.05	.29	.72	7.62
Industrial, inorganic, and organic chemicals	4.76	.17	.87	1.99	7.79
Lime	.27	2.18	1.45	7.20	11.10
Cement, hydraulic	.31	1.50	2.65	5.15	9.61
Brick, structural clay tile	.43	.28	1.34	9.42	11.47
Structural clay products	.34	.22	.88	8.02	9.46
Carbon-graphite products	2.05	.19	1.34	1.51	5.09
Air transportation	3.51	0	.05	.07	3.63
Clay refractories	.21	.01	.67	5.79	6.68
Manufactured ice	.29	.14	4.37	.36	5.16
Pipeline transport	.81	0	2.53	1.47	4.81
Synthetic rubber	1.99	.04	.52	1.09	3.64
Wet corn milling	.05	.38	1.83	.79	3.05
Glass containers	.14	.01	.74	3.73	4.62
Wallpaper-building paper	.26	.25	1.39	1.67	3.57
Blast furnaces-basic steel	.18	1.21	.64	1.44	3.47
Gypsum	.32	.05	.97	2.77	4.11

[1] The output price changes were developed from the U.S. Department of Commerce input/output tables (1967 version). First, the value of the energy input was divided by the value of the industry's output. This proportion was then multiplied by the percent change of the energy input price (see table I) to get the percent change of the industry's output price.

clay products, lime, and cement show the largest percentage changes in their output prices due to gas price increases, especially in the 1977–85 period. The large jump in petroleum prices in the 1967–74 period is reflected in the output price changes in the petroleum sensitive industries (paving mixtures, asphalt felts, industrial, inorganic and organic chemicals, air transportation, carbon-graphite products, synthetic rubber). It should be noted that due to smaller petroleum price increases in 1974–77 and 1977–85 (about half the price increase of 1967–74), the percentage increases of output prices are only about one half of those experienced in the 1967–74 period. The large percentage increase of coal products prices in the 1967–74 period is reflected in the coal sensitive industries (basic steel, lime, cement). Of course, the percentage increase in the output prices of these industries are minor in the 1974–77 and 1977–85 period, due to small coal price changes.

Since no industry with the possible exceptions of the manufactured ice and cement industries, is particularly sensitive to electric consumption, the relatively moderate increases in electric prices are reflected in small output price changes.

3. *Impact of WPI: 1975, 1977, 1985.*—In order to determine the possible magnitude of the price impact on the economy, it is assumed that these energy sensitive industries will pass the full cost of higher fuel prices through to the consumer. This computation is intended to give the possible effects, not necessarily the probable effects. Using the Wholesale Price Index (WPI) weights of these industries, the impact of the industry's price change can be translated to changes in wholesale prices. Due to the large WPI weight of the Industrial Chemical and Basic Steel Industries, their output price increases have a large impact on wholesale prices. Other large contributors to wholesale price increases are paving mixtures, cement, and asphalt felts and coverings. Consequently, it is estimated that the maximum direct increase in the WPI attributable to the selected industries will be .360 percent in 1975, .527 percent in 1977, and .5271 percent in 1985. (See Tables V–9, 10, 11)

TABLE V–9.—1975 IMPACT ON WHOLESALE PRICE INDEX, ECONOMY, OF PRESIDENT'S ENERGY PROPOSALS

	WPI weight: Percent of 100 percent	Impact on WPI [1] (percent)				
		Petroleum	Coal	Electric	Gas	Total
Paving mixtures	0.192	0.02	0.0001	0.0004	0.0014	0.0219
Asphalt felts and coverings	.122	.008	0	.0003	.0006	.0089
Industrial, inorganic, and organic chemicals	3.369	.16	.001	.01	.043	.214
Lime	.034	.0001	.0001	.0002	.0016	.002
Cement, hydraulic	.304	.001	.0008	.003	.0102	.0152
Brick, structural clay tile	.126	.0006	.0001	.0007	.0077	.0091
Structural clay products	.023	.0001	0	.0001	.0012	.0014
Carbon-graphite products	.054	.001	0	.0003	.0005	.0018
Air transportation						
Clay refractories	.134	.0003	0	.0003	.0051	.0057
Manufactured ice						
Pipeline transport						
Synthetic rubber	.114	.002	0	.0002	.0008	.003
Wet corn milling	.152	.0001	.0001	.001	.0008	.002
Glass containers	.276	.0004	0	.0008	.0067	.0079
Wallpaper-building paper	.132	.0004	.0001	.0007	.0014	.0026
Blant furnaces-basic steel	4.09	.007	.008	.01	.038	.063
Gypsum	.091	0	.0003	.0004	.0016	.0023
Total	9.213	0.201	0.0106	0.0284	0.1206	0.3608

[1] Wholesale Price Index weight multiplied by the price change of output due to President's energy proposals.

TABLE V–10.—1977 IMPACT ON WHOLESALE PRICE INDEX, ECONOMY, OF PRESIDENT'S ENERGY PROPOSALS

	WPI weight: Percent of 100 percent	Impact on WPI [1] (percent)				
		Petroleum	Coal	Electric	Gas	Total
Paving mixtures	0.192	0.024	0.0021	0.00094	0.0020	0.02715
Asphalt felts and coverings	.122	.0105	.00002	.00062	.0009	.01204
Industrial, inorganic, and organic chemicals	3.369	.21	.0023	.025	.065	.3023
Lime	.34	.00012	.0003	.00042	.0024	.00324
Cement, hydraulic	.304	.00124	.00206	.00684	.0151	.01524
Brick, structural clay tile	.126	.0007	.00015	.00143	.0115	.01378
Structural clay products	.023	.0001	.00002	.00017	.0018	.00209
Carbon-graphite products	.054	.00145	.00004	.00061	.0008	.00290
Air transportation						
Clay refractories	.134	.00037	.000008	.00076	.0075	.0087
Manufactured ice						
Pipeline transport						
Synthetic rubber	.114	.00297	.00002	.0005	.0012	.0047
Wet cornmilling	.152	.0001	.00026	.00237	.0012	.0039
Glass containers	.276	.00052	.00002	.00174	.0100	.0122
Wallpaper-building paper	.132	.00045	.00014	.00156	.0021	.0043
Blast furnaces-basic steel	1.09	.0098	.02225	.0221	.0569	.111
Gypsum	.091	.00039	.00002	.00074	.0024	.0036
Total	9.213	.26232	.029708	.0658	.1808	.52714

[1] Wholesale Price Index weight multipled by the price change of output due to President's energy proposals.

TABLE V-11.—1985 IMPACT ON WHOLESALE PRICE INDEX, ECONOMY, OF PRESIDENT'S ENERGY PROPOSALS

	WPI weight: Percent of 100 percent	Impact on WPI[1] (percent)				
		Petroleum	Coal	Electric	Gas	Total
Paving mixtures	0.192	0.0185	0.00048	0.0011	0.0021	0.0222
Asphalt felts and coverings	.122	.008	.00006	.00085	.0009	.0093
Industrial, inorganic, and organic chemicals	3.369	.160	.0057	.0293	.0670	.2824
Lime	.034	.0009	.00074	.00049	.0034	.0038
Cement, hydraulic	.034	.0009	.00456	.00805	.0157	.0292
Brick, structural clay tile	.126	.0005	.00035	.00169	.0119	.0145
Structural clay products	.023	.00008	.00005	.0002	.0018	.0022
Carbon-graphite products	.054	.0011	.0001	.000724	.0008	.0027
Air transportation						
Clay refractories	.134	.00028	.00001	.00089	.0078	.0090
Manufactured ice						
Pipeline transport						
Synthetic rubber	.114	.0023	.00004	.00069	.0012	.0041
Wet corn milling	.152	.00007	.00058	.00278	.0012	.0046
Glass containers	.276	.00038	.00003	.00204	.0103	.0128
Wallpaper-building paper	.132	.00034	.00033	.00183	.0022	.0047
Blast furnaces-basic steel	4.09	.00735	.04948	.02617	.0589	.1419
Gypsum	.091	.00029	.00004	.00086	.0025	.0037
Total	9.213	.201	.06255	.077084	.1867	.5271

[1] Wholesale Price Index weight multiplied by the price change of output due to President's energy proposals.

VI. DETAILED INDUSTRY ANALYSIS AND CHARACTERISTICS

Discussion of the impacts of energy policy on specific industries cannot be done out of context of characteristics specific to the industry. This section draws together, for some of the industries identified above, a set of background data on such items as concentration ratios, values of shipments, cost structure, etc. It is hoped that this will assist in the overall evaluation of energy policy impact. In addition, specific energy related issues are highlighted for some of the more vulnerable industries such as cement.

A. *Aluminum* (*SIC 3334*)

1. *Industry structure.*—The aluminum industry includes 12 companies operating 30 aluminum production plants. It is extremely concentrated with 4 firms accounting for over 75 percent of total U.S. production. The major producers are all integrated from bauxite mining to ingot production. Aluminum is produced in three stages: bauxite ore, alumina (reduction), and primary aluminum. Most of the bauxite used in domestic production is imported, primarily from Jamaica (62%), Surinam (23%), and the Dominican Republic (78%).

In 1971, Major end-use markets for aluminum in the United States were building and construction which accounted for 28 percent; transportation, 18 percent; electrical, 15 percent; packaging, 15 percent; and consumer durables, 10 percent. It should be noted that aluminum competes with most other metals, particularly steel, copper, and zinc. However, under existing technological conditions new markets may emerge for aluminum and present ones could experience further growth (packaging and transportation).

2. *Key indicators.*—Primary aluminum value of shipments was approximately 1.9 billion dollars in 1973 and employment over 26,000 workers. Primary aluminum production was in excess of 8 billion pounds while production capacity is about 9.3 billion lbs.

TABLE VI-1.—PRIMARY ALUMINUM VALUE OF SHIPMENTS AND EMPLOYMENT, 1964–73

	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
Value of Shipment (Millions of dollars)	1,191	1,364	1,496	1,608	1,724	1,816	1,757	1,644	1,700	1,900
Percent change		14	9.6	7.4	7.2	5.3	−3.2	−6.4	3.4	11
Employment (Thousand)	17.0	18.6	19.9	21.7	21.9	24.7	25.6	24.3	23.8	26.0

Source: Annual Survey of Manufacturers.

During times of surplus such as 1969 to 1971, the primary producers sold aluminum ingot at a discount price.

Data available on capital expenditures for primary aluminum indicate a 19.4 percent increase in 1972.

TABLE VI-2.—CAPITAL EXPENDITURES

	1964	1965	1966	1967	1968	1969	1970	1971	1972
Expenditures (millions of dollars)	51.8	60.5	65.8	151.7	120.3	128.4	117.3	48.5	142.6
Percent change		16	8.7	130	−20	6.7	−11.7	−58	194

Source: Annual Survey of Manufacturers, 1971.

Since the 1960 over supply years, the inventory sales ratio was at its highest level in 1971.

TABLE VI-3.—INVENTORY TO SALES RATIO, PRIMARY ALUMINUM

1964	1965	1966	1967	1968	1969	1970	1971	1972
0.11	0.08	0.07	0.11	0.09	0.08	0.13	0.16	0.12

Source: Annual Survey of Manufacturers, 1971.

The following table presents a cost breakdown for an integrated aluminum complex during 1970 and indicates that annual capital costs (depreciation and interest) for one ton of aluminum are about 33 percent of average total costs. In addition, electric power accounts for 13.1 percent of average total costs. Raw materials and transportation costs account for approximately 30 percent of total production costs.

TABLE VI-4.—1970 COST BREAKDOWN, INTEGRATED ALUMINUM COMPLEX

Input	Dollars per ton of output	Percent of total
Bauxite	40.99	8.0
Caustic soda	11.39	2.2
Steam	7.89	1.5
Electric power	66.82	13.1
Fuel oil	6.20	1.2
Fluoride	31.95	6.3
Carbon	32.50	6.4
Labor	64.27	12.6
Operating and maintenance supplies	27.62	5.4
Capital cost (depreciation and interest)	164.86	33.0
Miscellaneous	52.03	10.2
Total	506.53	100

It should be noted, however, that the nature of the industry induces prices to respond more rapidly to changing market conditions (demand) than to cost (supply).

TABLE VI-5.—ALUMINUM: FINANCIAL DATA FOR 3 LARGE PRODUCERS[1]

	1967	1968	1969	1970	1971	1972	1973	January 1973	March 1974
Net profits (millions of dollars)	214	194	249	193	78	118	194	34	79
Net profits to sales (percent)	7.2	6.3	7.0	5.5	2.2	3.0	3.9	3.1	5.4
Return on equity (percent)	10.3	8.8	10.6	7.7	3.0	4.5	7.1		

[1] Alcoa, Reynolds, and Kaiser.

Source: Department of Commerce.

The aluminum industry profits gained 62 percent during 1973 and increased further in 1974. As indicated in table VI–5, profits per gallon of sales were 3.9 percent and return on equity 7.1 percent which is an improvement from previous levels.

3. *Energy considerations.*—In the primary aluminum industry, output prices will increase, as shown below, due to the increase in the price of energy inputs. This relationship was derived from the DOC Input-Output Tables (Direct Requirements) in the following manner:

$$\frac{\text{Value of Energy Input}}{\text{Value of Total Industry Output}} \quad \text{multiplied}$$

by the energy input percentage price change equals the percentage output price change. This analysis assumes an exact pass-through of the increased costs.

TABLE VI-6.—CHANGE IN ALUMINUM PRICE DUE TO PRESIDENT'S PROPOSALS

	1975	1977	1985
Percent change due to petroleum	0.4	0.50	0.38
Percent change due to coal	0	.02	2.40
Percent change due to electricity	1.0	2.04	.05
Percent change due to gas	1.3	1.87	1.93
Total percent change	2.7	4.43	4.76

ATTACHMENT 1

ALUMINUM PRICES IN THE POSTWAR PERIOD

[Cents per pound]

Year	List price of aluminun ingot [1]	Price of secondary ingot [1]	Price of scrap clippings [1]	Long run cost index of aluminum production [1]	Capacity utilization (noncommunist world) [2]
1947	15.00	14.61	8.63	13.62	NA
1948	15.73	21.00	11.82	14.87	NA
1949	17.00	17.35	11.40	14.87	NA
1950	17.71	21.03	13.16	15.08	NA
1951	19.00	25.02	15.53	16.97	NA
1952	19.40	19.43	10.40	16.97	NA
1953	20.93	21.54	12.57	18.22	0.926
1954	21.78	20.01	13.12	18.43	.947
1955	23.67	28.49	17.93	18.22	.931
1956	26.01	28.96	16.99	18.85	.899
1957	27.52	22.47	14.07	19.90	.833
1958	26.89	21.62	12.97	19.06	.748
1959	26.85	22.94	14.40	19.69	.805
1960	27.23	24.17	13.55	20.11	.857
1961	25.46	22.06	11.92	19.69	.805
1962	23.88	21.10	11.05	19.90	.834
1963	22.62	21.26	11.56	19.90	.878
1964	23.72	22.30	12.29	20.11	.951
1965	24.50	24.46	14.68	20.11	.937
1966	24.50	24.99	12.76	20.95	.963
1967	24.98	25.00	10.49	21.37	.934
1968	25.58	25.15	10.08	22.62	.902
1969	27.78	27.64	13.04	24.30	.954
1970	28.72	28.70	10.94	25.49	.944
1971	29.00	28.92	8.34	NA	NA
1972	26.45	27.81	7.52	NA	NA
1973 [3]	25.00	28.30	NA	NA	NA

[1] Annual average.
[2] Annual production divided by end-of-year capacity.
[3] July 1973.

Note.—Price of scrap clippings, represents dealers buying price.

Source: Metals Statistics and report prepared for Council on Environmental Quality, 1971.

B. *Cement (SIC 3241)*

1. *Industry structure.*—The Cement Industry in the United States consists of 49 companies that manufacture cement in 169 plants with a combined annual capacity of 89.1 million tons of finished cement.

The U.S. Cement Industry employs only 29,000 workers. With this relatively small number of workers and some of the largest, most complex production equipment in heavy industry cement manufacture is highly capital intensive. Each ton of new production capacity requires about $60 million for a modern 1-million-ton annual capacity plant/and such a plant can be operated by a relatively small work force. The Cement Industry has a net worth of about $2.6 billion or $90,000 per employee and annual ratio (net mill value) of $1.85 million or $64,000 per employee.

Cement is a regional, highly competitive industry. Because cement is a commodity manufactured to universally accepted specifications with little variance from one brand to another and especially because of its low value-to-weight ratio, cement plants tends to be located within 100 to 150 miles of their principle markets. Although company size ranges from a single small plant to as many as 14 plants, no U.S. cement producer accounts for more than 2.5% of the total national market. The five largest producers account for 30.3% of total sales and the 10 largest supply 50.7% among both single and multiplant companies.

Cement is the essential ingredient to at least 90% of all construction. In 1972, cement use by major construction category was:

	Percent
Residential	31
Industrial/commercial	24
Nonbuilding	17
Highways	16
Public buildings	7
Principle	5

The proportionate share of total cement use by major customer groups in 1972 was as follows:

	Percent
Ready-mix concrete	63
Concrete products	13
Highway contractors	9
Building materials dealers	9
Other construction	3
All others	3

2. *Key indicators.*—Cost of materials were $564.9 million or 37% of value of shipments. During the period 1958–1965, materials averaged 32–33% whereas during the period 1966–1969, the range increase to 36%. The most important factor in the recent relative increase in material costs has been fuels. In order to meet air pollution standards, firms were forced to use more low sulfur coal. As prices of low sulfur coal increased firms started switching to natural gas and oil which, in recent times has become more expensive relative to coal. Wages of production workers in 1970 represented 16% of value of shipments. During period 1968–1970, wages represented a low of 14%, 16% in 1958, 1960, 1970, and 15% in all other years. Presently, wages represent 20% of value of shipments, industry average are as follows:

$$\frac{\text{Direct Labor}}{\text{Total Cost}} = 19\%$$

$$\frac{\text{Direct Materials}}{\text{Total Cost}} = 20\%$$

$$\frac{\text{*Other Manufacture or Service Costs and Other OPER Expenses}}{\text{Total Costs}} = 61\%$$

The range in various companies is quite extreme:

Labor/Total Cost=9–31%.

Materials/Total Cost=4–39%.

Other Manuf. or Service Costs and Other OPER Expenses=36–87%.

Fixed Costs Constitute about 70–75% of Total Costs.

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*Other costs: Fuel, distribution expense, freight, parts, supplies, maintenance, and pollution abatement.

Cement prices traditionally vary regionally largely as a function of the ratio between current installed capacity and current cement consumption in each region. Strong price competition, which held down prices during the 1960's reflected the underutilization of capacity when expected levels of demand failed to materialize.

Slow demand growth and some capacity overbuilding in the past have resulted in lower mill net prices in New York and Pa. than in the now rapidly growing areas of the North and West. In 1969, the industry operated at about 82% of its stated capacity of 511 million barrels, and in 1970 at about 80% of rated capacity, which are about typical of the industry operating rates for past 30 years. Over the 1958–1966 period, WPI rose at an annual average rate of only 0.9% although actual decreases occurred in the years 1961–1969. Starting in 1970, the index began to show substantial price rises of 9.6% in 1970, 7.7% in 1971, and 5.9% in 1972.

3. *Energy considerations.*—The Cement Industry is the most energy intensive industry in the U.S. The industry uses all principal forms of energy—electric power, coal and petroleum products, including natural gas, gasoline, middle distillates and residual fuel oils. Most amounts of energy are required in the cement making process. A rule of thumb is that 1 million BTU of heat are required for one barrel of cement. At current or recent energy costs, it would require $0.50 of energy to produce a $4.00 barrel of the cement. A new dry-process cement making capacity could cut the energy cost in half. The principal investment problem of the cement industry in light of natural gas and petroleum shortages and their rapidly escalating costs is the fact that 55% of the installed U.S. capacity is wet-process. Therefore, it appears that the most significant step industry would take to conserve fuel would be to convert older wet-process plants, which require up to 1.2 to 1.4 million BTU per ton of production, to the dry process per heater method requiring 800 to 900 thousand BTU per ton. Conversion would require a capital expenditure of approximately $2 billion to convert the existing 49 million tons of wet process capacity, based on an estimated conversion cost of $41 per ton.

The Cement Industry's energy problems are likely to become acute and the costs of conversion to dry process capacity ascented by increased costs of converting to oil or coal as alternative fuels for those plants dependent on natural gas. A conversion costs of $35 million for 11 million tons of capacity dependent on gas, on an estimated conversion cost of $3.00 per ton.

Since energy is a major cost in the manufacture of cement any increase in the cost of energy and energy-related raw materials would certainly affect the cement industry, its profit margin, and its capital expenditures program. The demand for cement is tied closely to levels of construction activity. Historically, cement consumption has kept price with growth in construction volume. An increase of 20% to 30% in the energy costs would result in a product price increase of 9–12%. However, the cement industry is highly regionalized and highly competitive. This factor with the downturn in the construction industry would make price pass through impossible in the range of 9–12%. The need for capital in the cement industry to convert plants in carrying out energy conversion plans is evident and large. A total figure of 5.3 billion dollars in short term capital needs is a realistic figure in order to solve problems related to capacity expansion, technological renovation, energy conservation, and environmental control.

C. *Fertilizer (SIC's 2873, 2874, 2875)*

1. *Industry structure.*—A distinguishing characteristic of the companies in the fertilizer industry is their high degree of diversification. For these companies, fertilizer sales as a percent of gross sales may be relatively small. For example, Allied Chemical Company, a major producer of ammonia, realized only 7.4% of its gross revenues from fertilizer sales in 1973. In addition to the large, diversified companies, there are three other types of firms engaged in basic production of fertilizer chemicals. These are: (1) the cooperatives, which are also diversified into other agriculture-related products; (2) smaller chemical companies primarily engaged in the production of fertilizers; and (3) manufacturers of unrelated products who have byproduct chemicals which move into fertilizer production.

The phosphate and potash segments of the fertilizer industry are concentrated within relatively few companies in comparison to the ammonia segment of the industry. This is necessarily so because of the dependence on mined products

which are found in a limited number of locations. On the other hand, natural gas for the production of ammonia has been readily available, and therefore are a greater number of participants in the industry.

Ammonia is produced by 58 companies in 87 manufacturing plants in the United States. The farm cooperatives have made significant investments in the past 10 years and now own about 20% of the total capacity.

The phosphate segment of the industry includes 17 phosphate rock producers, excluding Tennessee, mining in 23 locations and 27 phosphoric acid producers who manufacture acid in 33 locations. (Rock and acid production go hand in hand.) Twelve of the phosphate rock producers also produce phosphoric acid and solid fertilizers. These 12 companies control approximately 50% of the total phosphoric acid production capacity while the 15 other companies control the remainder. Cooperatives own approximately 20% of the total phosphoric acid production capacity, though as yet, they have not integrated back to phosphate rock except through long-term purchase contract. The 11 largest phosphate rock producers control 82% of the total production capacity while the 11 major phosphoric acid producers control 80%.

The potash industry, including United States and Canada, is comprised of 15 companies. The top companies represent 89% of the total North American production capacity.

The fertilizer industry is also characterized by a high degree of integration. This includes vertical integration, both backward to raw material production and forward to the manufacture of mixed fertilizers, and to the retail distribution of fertilizers to the farmer-user.

In addition, there is a significant degree of horizontal integration by fertilizer companies into the production of several fertilizer products, i.e., phosphate, nitrogen, and potash.

2. *Key indicators.*—Despite being relatively small, the fertilizer industry is nevertheless a critical input for food production. According to the latest census of manufacturers figures (see Table VI–7), the industry had estimated value of shipments in 1972 of $2.7 billion. Costs of materials were about 60 percent of the value of shipments. In addition, the industry employed approximately 36,000 workers.

3. *Energy considerations.*—The Fertilizer Industry in the United States is extremely dependent on natural gas as an energy source and feedstock. Of the total hydrocarbon energy sources used by the industry (excluding electric power), natural gas represents over 95%, with fuel oil and coal representing insignificant usage. Only in the manufacture of ammonia and the mining of sulphur is the cost of fuel a significant portion of total manufacturing cost. In general, it is the ability to obtain fuel that far outweighs the significance of price.

While the rate of natural gas use by an ammonia plant depends on the design,

TABLE VI–7.—FERTILIZER INDUSTRY COST FACTORS FOR 1972

	Nitrogen		Phosphate		Mixing only			
	Millions of dollars	Percent	Millions of dollars	Percent	Millions of dollars	Percent	Total	Percent
Costs of materials, fuels, etc	388.1	46	726.3	63	[4] 542.1	72	[4] 1,656.5	[4] 60
Production workers [1]	66.4	8	91.3	8	42.0	6	199.7	7
Other employees payroll [2]	41.6	5	43.0	4	40.4	5	125.4	5
All other costs and profits	340.0	41	287.0	25	129.1	17	756.1	28
Value of shipments [3]	836.5	100	1,147.6	100	753.6	100	2,737.7	100
Employees:								
Production workers	6,300		10,700		7,100		24,100	
All employees	9,800		14,800		11,300		35,900	

[1] Does not include fringe benefits. It refers to man-hours paid worked or paid at the plant, including overtime but excluding hours paid for vacations, holidays or sick leave when the employee was not at the plant.

[2] Includes all forms of compensations and fringe benefits and represents the difference between all employees payroll and production workers wages.

[3] Value of shipment minus cost of materials, fuels, etc.

[4] Considerable double counting here. Many of the raw materials for the "Mixing" industry are products of the Nitrogen and Phosphate Industries.

Source: 1972 Census of Manufactures, Preliminary Report, Industry Series 2873, 2874, and 2875, USDC, Washington, D.C.

age, size and operating capability some estimates of the impact of higher gas prices can be made. For example, assuming a reasonable level of 38 Mcf per ton of ammonia produced, an increase in the price of gas of 1¢ per Mcf will add 39¢ per ton to the cost of ammonia. At the estimated production for 1973 of 15.5 million tons, a 1¢ increase in gas price could add $6.0 million to the cost of the industry. The extent of the impact resulting from higher gas prices is unclear since current ammonia, and consequently fertilizer prices, bear little relation to costs and are more responsive to supply/demand conditions. Undoubtedly with the current shortfall (estimated 6 to 8 percent in nitrogen) condition, fertilizer producers will be in a position to pass on at least a portion of their increased costs in the form of higher fertilizer prices. However, in view of the current high profits, firms may be inclined to absorb a greater proportion of increased costs in the short run.

D. *Petrochemical Industry*

1. *Industry structure.*—The value of shipments in the petrochemical industry in 1974 was over $35 billion or nearly 40 percent of total chemical industry sales with a value added of $13 billion. Basically, major sectors of the industry are broken down as follows:

	Value of shipment (million)
2821 Plastics materials and resins	7,630
2822 Synthetic rubber	3,260
2824 Organic fibers	4,995
2865 Cyclic intermediate and crude	4,350
2869 Industrial organic chemicals	13,325
2873 Nitrogenous fertilizer	2,036
2895 Carbon black	425

In 1972, approximately 286,000 people were employed at 1,215 producing plants in this industry. A 1972 comparison of the petrochemical industry with other major manufacturing industries is presented in Table VI–8.

There are 8,000 to 10,000 commercial petrochemicals produced. Many of these are intermediates for other petrochemicals. The bulk of the petrochemical industry output is produced by large, multiline chemical companies and petrochemical divisions (or subsidiaries) of the major oil companies. Many of these are multinational organizations, with some being headquartered outside the U.S. There are hundreds of smaller companies specializing in a limited line of intermediates or end product chemicals.

The petrochemical industry presently consumes about 200 million barrels per year of crude oil fractions for both feedstock and energy. The petrochemical industry also consumes about 2.3 billion cubic feet of natural gas per year. Although the petrochemical industry's sales are only 40% of the total chemical industry's sales, the petrochemical industry consumes about 48% of the coal, 44% of the fuel oil, and 58% of the gas purchased by the chemical industry.

2. *Key indicators.*—In 1972, total cost of direct raw materials represented 48% of the sales dollar while labor and capital related costs were 34% and 18% respectively. Large increases in the cost of energy and energy-related raw materials occurred in 1973 and 1974. Direct material costs increased from 48% in 1972 to 59% in 1973 and 62% in 1974 in relationship to the sales dollar. Labor costs have

TABLE VI–8.—THE PETROCHEMICAL INDUSTRY COMPARED TO OTHER MAJOR MANUFACTURING INDUSTRIES, 1972

	Value of shipments (Billions of dollars)	Employment	Value added (Billions of dollars)
Petrochemical industry (excluding first stage fabricated derivatives)	21.0	286,000	11.2
Chemical industry (including petrochemicals and a number of fabricated product areas)	57.1	831,000	32.4
Petroleum refining	25.9	100,600	4.6
Paper and allied products	28.2	633,000	12.9
Textile mill products	27.9	949,000	11.6
Primary iron and steel	34.4	771,300	15.6

decreased in relationship to the sales dollar since 1972. Also capital related costs in relationship to the sales dollars has decreased as seen in following figures:

PERCENT OF SALES

	1972	1973	1974
Labor	34.0	29.0	24.
Capital related costs	18.0	12.0	13.

3. *Energy considerations.*—The petrochemical industry is very sensitive to rising raw material costs since it uses a great deal in its feedstock of natural gas and crude petroleum products as well as a considerable amount of fuels in the production process. The combined petrochemical price increase from tariff, excise tax, and decontrol will total 2.2%. Total impact of policies related to natural gas would result in a 7.4% increase. Combining the oil cost and natural gas cost increases the end result would be a 9.6% average annual price increase for the petrochemical industry.

In the short run, the decline in the economy has acted and will probably continue to act as a deterrant to price increases. In addition, some of the increased cost from the new energy policy will be absorbed by the producing companies, because the marketplace in the soft present economy cannot support higher prices. In the long run (beyond 1975) the petrochemical industry will probably pass on most of the higher costs. In the short run profits will be affected adversely as the producing companies are forced to absorb the higher costs.

The most important effect of the policy package may well be on international trade. The U. S. has experienced the benefit of comparatively cheap raw materials. This cost advantage has enabled the petrochemical industry to compete very effectively in the world markets. More costly raw materials and energy will decrease but not remove this advantage and make the international marketplace more competitive with American firms.

E. *Contract Construction*

1. *Industry structure.*—Construction is one of the nation's most complex and important industries. In 1970, total activity in the U. S. construction industry reached a level of $122.2 billion (13 percent of GNP), while spending on structures alone totaled $92.4 billion. Approximately 31 percent of the total construction in 1970 was paid for by the government sector.

Out of a total of 370,000 construction establishments in the U. S. the 100 strongest contractors (those having annual revenue of $20 million or more) realized a combined $32.4 billion in construction income. That is, approximately 1 percent of the firms undertook about 35 percent of the total construction volume while 99 percent of the construction companies realized an estimated 65 percent of the total industry revenues. About 55 contractors (the giants of the industry) each took in a minimum of $100 million in annual revenues.

In terms of employment, construction is the largest single industry in the U. S. Nearly 3.3 million workers were employed by the construction industry in 1970, representing 4.7 percent of total nonfarm employment.

Out of the total reservoir of construction workers, close to 3,000,000 were union members—affiliated primarily with 17 national unions included in the AFL-CIO buildings and construction contracting firms are identified as sole proprietorships. Only 3 percent of the construction firms in the industry has 50 employees or more and only 1 percent have 100 or more employees.

2. *Key indicators.*—Typically, materials and labor represented approximately 60 percent and 40 percent, respectively, of the portion of the total bidding price remaining after profits and overhead have been deducted.

Despite the fact that costruction operates in an environment that has many contingencies, such as strikes, soil constraints, and failures, the industry is profitable. As with all forms of business enterprise, the abilities of the contractors differ widely with respect to managing profits, purchasing materials at best prices, or scheduling major construction events. In terms of economic downturn, construction activities usually are hit hard and the small, uncapitalized, less well managed companies tend to fail.

In addition, construction is an important leading economic indicator and is

very sensitive to changes in and the cost of mortgage money. The market for new family residences is dependent on the availability of mortgage financing, the rate of interest, and the employment situation as much at upon cost of construction and land.

Pricing in the construction industry is established in a general way through a competitive bidding system. Lump sum and cost-plus are the two basic types of construction contracts.

There is a strong trend toward an increased level of factory produced construction components. Within 15 years, at least two-thirds of all houses produced are expected to be from manufactured components, compared with 40 percent currently. This trend toward moving construction from the job site to the factory is substantial.

3. *Energy considerations.*—There is no evidence that the policy package will cause significant disruptions of construction activities. Even though the fuel needs for construction are small—massive unemployment and economic disruption could occur if construction projects are denied the relative small amount of needed fuel. For most forms of construction, on site energy use amounts less than 2 percent of total cost. But because the construction industry is so large it accounts for approximately 2 percent of the total consumed in the U.S. The on-site energy used is believed to be less than the energy consumed in the fabrication of the materials employed by the construction industry.

Localized impacts may vary with the size of the contractor; local and specific nature of a contractor's activities. Medium and small operations will be hit harder by higher fuel cost than major firms.

Overall, the section of the industry hardest hit appears to be construction of streets and highways (Table VI-9). The greater sensitivity of this industry is understandable, since road building employs fuel at a rate per dollar of output of about three (3) times greater than other construction operations. In addition, this industry depends heavily on asphalt which is a petroleum-based end product. Because many construction materials are derived from petrochemical feedstocks or are energy intensive in their manufacture, it may be assumed that a potentially significant impact on material prices may occur.

Energy awareness and rising fuel costs may result in contractors becoming increasingly aware of economic advantages to be obtained from effective equipment maintenance programs.

In the highway construction industry, output prices will increase, as shown below, due to the increase in the price of the energy inputs.

Although changes in construction practices within the next 3- to 5-year period are barely discernible, there is obvious evidence of a long term trend toward substitution of energy consuming equipment for labor. It seems unlikely that increases in fuel cost from the President's policy package will provide sufficient incentive to reverse this trend.

F. *Paper and Allied Products (SIC 26)*

1. *Industry structure.*—In 1972, this industry was composed of almost 6,000 firms of varying sizes and degrees of operations. Most of the major companies are highly integrated and produce pulp, paper and other products as well as structural wood products. Based on value of shipments data, the 8 largest pulp producing companies accounted for 70% of the nation's pulp output; the 20 largest companies accounted for 97%. Most of the nation's pulp production is captive pulp, that is, integrated with paper production either at the same location as the pulp mill or at other company-owned paper mills. However, concentration is lower in paper production than in pulp because there are a large number of small paper mills that purchase their pulp requirements. In paper, the 8-firm ratio was 43% and the 20-firm ratio 65%.

TABLE VI-9.—CHANGE IN OUTPUT PRICE DUE TO PRESIDENT'S PROPOSALS FOR HIGHWAY CONSTRUCTION

	1975	1977	1985
Percent change due to petroleum	1.7	2.20	1.68
Percent change due to coal	0	0	0
Percent change due to electricity	.01	.02	.024
Percent change due to gas	.01	.006	.008
Total percent change	1.72	2.226	1.712

2. *Key indicators.*—The nearly 6,000 firms in SIC 26 represent 1.89% of the number of firms in the total U.S. manufacturing sector. Value of shipments in 1972 was $28.167 million or 3.74% of total U.S. manufacturing value of shipments. Their 633,000 employees (3.35% of total U.S. non-agricultural income). In addition, capital expenditures during 1972 were 1.39 billion, 6.06% of total U.S. manufacturing's capital expenditures.

TABLE VI-10.—1972 PAPER AND ALLIED PRODUCTS INDUSTRY

	SIC 26	SIC 26 as a percent of total manufacturing
Number of firms	5, 967	1. 89
Value of shipments (millions of dollars)	28, 167. 4	3. 74
Number of employees (thousand)	633	3. 35
Payroll (thousand)	5, 984	3. 45
Capital expenditures (millions of dollars)	1, 388	6. 06

Source: 1972 Census of Manufactures, 1972 Preliminary Report.

G. *Blast Furnaces and Basic Steel Products (SIC 331)*

1. *Industry structure.*—The United States Steel Industry included 966 firms of varying sizes in 1972. Although this amounted to only .31% of all manufacturing firms, the industry employed over 553,000 workers or 2.93% of total manufacturing employment. The wage bill for these workers totaled 6,395 billion dollars or 3.69% of total U.S. manufacturing payroll.

TABLE VI-11.—1972 U.S. STEEL INDUSTRY—SIC 331

	SIC 331	SIC 331 as percent of total U.S. manufacturing
Number of firms	966	0. 31
Value of shipments (millions of dollars)	28, 670. 5	3. 81
Number of employees (thousand)	553. 5	2. 93
Payroll (millions of dollars)	6, 395. 0	3. 69
Capital expenditures (millions of dollars)	1, 058. 3	4. 62

Source: U.S. Census of Manufactures, 1972.

In addition, value of shipments in the steel industry amounted to 28.67 billion dollars; capital expenditures exceeded 1 billion dollars in 1972.

The major integrated steel producers, classified in in SIC 3312, manufacture a broad range of products and because of their size and market power, are able to exercise price leadership. It is generally recognized that the steel industry is able to pass through cost increases more or less on a dollar for dollar basis. Although the steel companies do not disclose details of the decision-making process in changing steel prices, it is believed that their general policy is to maintain prices at the expense of volume rather than to meet low prices of imported steel.

2. *Energy considerations.*—It is obvious that the general economy is sensitive to the pricing actions of the steel industry; although the estimated price impact is modest, the ripple effects will magnify its intensity. The cost-push pressures on other sectors will aggravate an already serious problem but even here, the magnitudes will not be great.

In the short run, the increase in fuel costs will not be a sufficient inducement for fuel conservation in the steel industry. Steel producers are traditionally reluctant to adopt new technologies and long lags in conservation efforts can be expected. Fuel costs are not a sufficiently important component of total operating costs to illicit a strong conservation response.

H. *Petroleum Refining Industry*

1. *Industry structure.*—This industry consists of establishments primarily engaged in producing gasoline, kerosene, distillate fuel oils, residual fuel oils,

lubricants, and other products from crude petroleum. In 1972, the industry included 316 establishments. However, the industry is relatively concentrated; in 1967 the eight largest companies produced 57% of the value of shipments in the industry. The fifty largest companies totaled 96% of the industry's value of shipments.

2. *Key indicators.*—In 1972, 3.44% (almost 26 billion dollars) of U.S. value of shipments was accounted for by SIC 2911. Over 100,000 persons were employed by the industry in 1972 or .53% of the U.S. manufacturing sector. Payroll costs exceeded 1.2 billion dollars in that year. Capital expenditure were also large in 1972 totaling over one billion dollars or 4.65 percent of the U.S. manufacturing sector.

TABLE VI-12.—1972 PETROLEUM REFINING INDUSTRY—SIC 2911

	SIC 2911	SIC 2911 as a percent of manufacturing sector
Number of establishments	316	0.09
Employees (thousands)	100.6	.53
Payroll (millions of dollars)	1,244.8	.72
Value of shipments (millions of dollars)	25,883.3	3.44
Capital expenditures (millions of dollars)	1,066.5	4.65

3. *Energy considerations.*—In the primary petroleum refining industry, output prices will increase, as shown below, due to the increase in the price of energy inputs. This relationship was derived from the DOC Input-Output Tables (direct requirements).

TABLE VI-13.—CHANGE IN PETROLEUM REFINING DUE TO PRESIDENT'S PROPOSALS

	1975	1977	1985
Percent change due to petroleum	NA	NA	NA
Percent change due to coal	0.002	0.005	0.01
Percent change due to electricity	.1	.21	.24
Percent change due to gas	.8	1.23	1.27
Total percent change	.92	1.49	1.52

Chairman HUMPHREY. Mr. Zarb, sir, I would hope that you would take very seriously what we have suggested here in your consultations with the President, with Mr. Simon, with others. Quite honestly, it must be taken up with the President. These are major policy decisions we are talking about, I can assure you. Both Senator Javits and I have discussed these matters with our leadership here in the Congress at the Senate level, and I know that Congressman Bolling has also discused it with the leadership at the House level.

So I am not asking for an olive branch, because I think that that always causes some problems. But I am asking for, what we used to say back in other days, come, let us reason together. Even if Isaiah is not here, we can do it.

Thank you very much.

Mr. ZARB. Thank you, Mr. Chairman.

Mr. REES. Thank you, Mr. Chairman.

Chairman HUMPHREY. The committee stands recessed until tomorrow.

[Whereupon, at 12:22 p.m., the committee recessed, to reconvene at 10 a.m., Friday, February 28, 1975.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 28, 1975

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

The committee met, pursuant to recess, at 10:12 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Sparkman, Proxmire, Kennedy, Javits, and Percy; and Representatives Reuss, Hamilton, Brown of Ohio, and Rousselot.

Also present: John R. Stark, executive director; John R. Karlik, Loughlin F. McHugh, and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; L. Douglas Lee, professional staff member; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. We are continuing our annual hearings on the President's budget, the President's economic program and the report from the Council of Economic Advisers.

This morning we have a very distinguished panel of private witnesses, Mr. Philip Klutznick from the Committee for Economic Development, an old friend and a gentlemen we respect and admire very much; Mr. Robert Nathan from Nathan Associates, who likewise is one of our longtime friends, a highly regarded man in the field of economics; and Mr. Arthur Okun, formerly of the Council of Economic Advisers and presently with the Brookings Institution; and we have a fourth party who is——

Mr. SCHIFF. Frank Schiff.

Chairman HUMPHREY. I have just a very brief opening statement to give you some of the background and the environment under which we have been working in these hearings.

This year, as you gentlemen know, we began our annual hearings before the President's budget and Economic Report were released. We had some excellent testimony from men like Gardner Ackley, Paul McCracken, Hendrik Houthakker, George Perry, John Sawhill, Charles Schultze, and many others.

However, these gentlemen did not have the full details of the budget and the Economic Report, which have now become available, nor did they know about the January data on production and employment which were so discouraging that they have required everyone to reassess their view of the outlook and policy needs.

Thus we are especially pleased to have this panel this morning to bring us up to date and to give us an overall assessment of the state of the economy and what you think we should do about it.

Mr. Okun, I notice that in your prepared statement you cite your recommendations for a tax cut going back to February of 1974. I want to join you in this chorus of I told you so's. This committee took your advise last year. We recommended a tax cut in our annual report last March. We recommended it again in our special report that was commissioned by the Congress last December. I have myself suported tax cut legislation on the Floor of the Senate in the last Congress and again in this one. We have not had support from the other end of Pennsylvania Avenue, up until recently.

Last September the President was proposing a tax increase. It was not until this January that he moved on to the tax cut bandwagon. I welcome him, and he would be a more congenial fellow passenger if he did not make any statements putting the blame on Congress for delaying the tax cuts. But yesterday I said that we ought to have a truce on this business, and I am going to abide by that

I think the most important thing that is needed, and I repeat, is sort of a cease fire between the two ends of Pennslyvania Avenue and a meeting somewhere along the middle to see if we can not work things out. Senator Javits, you will be pleased to know that yesterday I moved in the Democratic caucus that we instruct our leader, Senator Mansfield, to contact the leadership in the House and to ask the President for a conference on the subject of energy and tax legislation. As you know, there is such a meeting scheduled for today.

I should note for the witnesses that Senator Javits has been a moving force in this field, and each time he has had the opportunity he has asked the witnesses from the administration to encourage the White House to meet with the leadership of the Congress.

We prepared a letter from this committee, signed by 14 members of the Joint Economic Committee, asking the President to meet with an appropriate task force of both the House and the Senate, with a task froce from the executive branch to work out in particular the energy program on tax legislation. We are really not too far apart.

Now, I would like to ask our witnesses this morning to try to keep their statements at reasonable length, 10 to 15 minutes, and then we will ask questions. We get so much more out of you when we probe you a little bit. All of your prepared statements that exceed the limits that I have indicated will be placed in the hearing record.

I am going to ask Mr. Klutznick if he will speak first.

Mr. Klutznick is chairman of the Research and Policy Committee of the Committee for Economic Development, a great organization. He is past chairman of the Executive Committee of Urban Investment and Development Corp., and has served with great distinction in many governmental positions at national and international levels. It is a real pdeasure to have you here this morning, Mr. Klutznick. I prefer to call you Phil, but I have to be more formal.

STATEMENT OF PHILIP M. KLUTZNICK, CHAIRMAN, RESEARCH AND POLICY COMMITTEE, COMMITTEE FOR ECONOMIC DEVELOPMENT, ACCOMPANIED BY FRANK W. SCHIFF, VICE PRESIDENT AND CHIEF ECONOMIST

Mr. KLUTZNICK. Mr. Chairman, members of the committee and the panel, thank you for your very gracious remarks. I prefer to call you Hubert, but I will call you Mr. Chairman. We have filed with the committee the full prepared statement, and as you have said, Mr. Chairman, I am here in a representative capacity. I have cut as much as I can cut out of it and still stay true to our committee.

Now I am pleased to appear before your committee to discuss the President's Economic Report and other economic messages on behalf of the CED's Research and Policy Committee. Our committee has presented testimony on the Economic Report since these annual reviews were initiated. At no time during this period has our country faced a more difficult or complex economic situation than at the present. The momentum of the economic decline has been extraordinarily rapid. The key issue is not merely the direction of current policy. The prime question is whether the goals of policy are adequate and appropriate to the country's needs and potential. Having determined this, then it is necesary to consider whether the proposed program of action is capable of achieving such goals. On both counts, the strategy outlined in the President's economic messages seems grossly deficient.

The basic economic assumptions underlying the adminstration's program are vividly expresed in the table appearing on page 41 of the Budget of the U.S. Government for fiscal year 1976. This table, after taking account of the likely effects of the President's proposed action program, envisages slack U.S. economy for the remainder of the decade, with inflation continuing at relatively high, though diminishing rates. The table forecasts average unemployment rates of about 8 percent in 1975 and 1976, and projects only a gradual tapering off to about 7 percent by 1978 and 5½ percent by 1980. These averages, of course, imply that various industries, regions, and groups in the economy, and especially minority groups, would for several years continue to experience far higher unemployment rates, creating serious risks of sharply intensified social unrest. The table also assumes that the rate of increase in the GNP deflator will still be around 6½ percent in 1977 and will not reach 4 percent until 1979 to 1980.

Mr. Chairman, the scenario depicted by these figures is neither inevitable nor tolerable. It virtually accepts stagnation as the basis for policy planning. Moreover, there is nothing in either the budget or economic report to indicate that the prospects depicted by the projections are viewed as simply unacceptable or that they give rise to a determined and comprehensive effort to make certain they will not come true.

I am in no way trying to minimize the importance of overcoming the corrosive forces of inflation. But I question several of the premises that apparently underlie the council's analysis and that

seem to have led it to the view that a very long period of high unemployment must be endured if inflation is to be brought under control.

First: It is not correct to assume that severe recession or prolonged stagnation is the only way to beat inflation. On the contrary, such a course is more likely to exacerbate the inflationary problem in the longer run, by throttling the incentives for needed long-term investment and by depriving the economy of the productivity gains that come with adequate capacity utilization and sound economic growth.

Second: There is no reason to rely on a narrow range of anti-inflationary weapons as the Council's report seems to contemplate. An important share of our current inflation problems stems from cost-push and supply-related factors, and cannot be cured by fiscal and monetary measures alone. To deal with such problems, numerous other policy approaches must be brought into play. These include, in particular, the continuing use of voluntary wage-price policies, a subject which is virtually ignored in the council's report.

Third: It is difficult to agree with the administration's apparent premise that the preferred patterns of economic revival should be one of relatively slow growth in real economic activity over the next 2 years, averaging around 5 percent, with an accelerated rate of expansion later in the decade. It would make much more sense to encourage a more rapid economic revival in the near-term future, when the economy will still be far below capacity levels and inflationary risks from rising demand will be relatively small, and then to aim for more moderate expansion rates once the economy moves closer to high employment.

In sum, the policy strategy that is needed currently calls for stronger stimulative action than the President has proposed, coupled with a much more forceful and comprehensive program to deal with inflation than is suggested in the council's report.

Permit me now to turn in a bit more detail to the policies needed to halt the recession and stimulate a healthy economic revival.

TAX REDUCTION

In a speech before CED's Research and Policy Committee which I delivered on January 9, I called for net fiscal stimulus of about $25 billion. This amount of stimulus seemed justified in light of the fact that the high employment surplus had been rising rapidly since mid-1973 and was, according to the council's estimate, running at about $30 billion in late 1974 despite the sharp decline in economic activity. As you know, CED studies over the years have convinced us that a large high employment surplus, especially one that is rising, acts as a depressing influence on the economy.

I recommended that about $20 bilion of the total stimulus should be devoted to a personal income tax cut. The proposal was geared to give principal assistance to low- and middle-income wage earners. More specifically, I called for a 3 percent tax credit against the first $15,000 of earnings. I also had in mind a significant rise in the investment tax credit, involving a revenue loss of $3 to $4 billion.

Since January 9, when I made these proposals, the economy has deteriorated even more rapidly than anticipated. Quite frankly, the risk of a continuing cumulative downslide can no longer be discounted. At the same time, the need for speedy action to cut taxes and channel additional purchasing power into the hands of consumers is even more urgent. I would therefore support tax cut proposals that differ from my own if they stand a better chance of quick adoption, provided they serve similar objectives. In particular, there is merit in making part of the personal income tax reduction a prompt and one-time rebate against 1974 incomes. In addition, a rebate may provide a special boost to durable goods and other large ticket purchasers. But I feel strongly that a significant part of the tax reduction package should be of a continuing character and take the form of lower withholdings from current incomes.

Permit me to make one further observation on this subject in light of developments. Given the rapid changes in the current economic situation, there is a distinct chance that the magnitude of any tax cut on which the Congress may agree after completion of the necesary legislative procedures may appear inadequate not long after the tax cut has been enacted. In light of this possibility, it may be appropriate for the Congress to enact not merely a basic tax reduction package, but also a contingency tax cut which could be promptly activated at a later date if unemployment rates exceed specified levels or, preferably, upon passage of a joint congressional resolution affirming the need for such a cut. While it is unwise to be panicked by the gravity of the course of decline, I suggest it is equally unwise not to be prepared if the tendency continues downward.

With respect to expenditures, as the President's messages emphasize, the need for fiscal stimulus must not become a license for relaxing needed disciplines over current Federal expenditures or for jeopardizing longer term prospects for keeping Federal spending under control. Waste should be exorcised wherever possible. But, given the deteriorating economic situation, some net increase in budgetary outlays over the proposals in the budget would seem necesary.

In general, antirecessionary expediture programs should involve activities that will automatically end, or can be readily terminated, once the recession has run its course. This is a built-in defense against future demand inflation. In this connection, our committee strongly suports the use of anticyclical public service employment programs that are triggered to start or terminate when unemployment rates attain specified levels. At the same time, it needs to be emphasized that the administration of these programs should be very carefully monitored to insure that they do not exacerbate the existing inflationary cost-push presures in the public sector. Moreover, the program must be carried out in ways that do not interfere with urgently needed efforts to improve productivity in regular governmental services.

But, if employment rises further, additional Federal funding for public service employment should be considered. However, there

is something to be said for providing at least part of such extra funding in the form of emergency recession grants to cities with high unemployment rates and unusually large shortfalls in revenues from normal levels. This suggestion merely recognizes that all cities are not similiarly affected by the current exigencies, and some may need special help to keep their public services going.

Now, with respect to monetary policy and emergency sources of liquidity, a shift to a clearly stimulative monetary policy is an essential ingredient of the strategy for economic revival. Indeed, unless monetary policy is sufficiently accommodative to encourage a strong recovery and permit the financing of prospective Federal deficits at reasonable interest rates, the beneficial effects of stimulative fiscal policies could well be aborted. This means that the monetary authorities must permit much larger increases in money supply growth than have been experienced for many years.

It is also imperative that there be adequate provisions for emergency sources of liquidity that can be made available to avoid liquidity crises involving companies in essential industries and to avert any cumulative distress conditions in financial markets. The granting of such emergency funds should be placed on a systematic basis; should not depend on successive special actions by the Congress; and they should be carried out by an institution especially established for the purpose.

Now may I take a few moments on defenses against inflation. As indicated earliier, a vigorous attack on the recession problem should be paralled by an equally vigorous effort to contruct strong defenses against inflation.

In the demand management area, as already noted, this calls for built-in procedures to assure that expansionary policies do not overshoot their mark; for example, reliance on expediture programs that are self limiting and inclusion of temporary elements in the overall tax relief package. In the monetary field, it means readiness by the Federal Reserve to shift gears promptly when the need for renewed restraint becomes apparent. In addition, and this is my personal view, the monetary authorities should be given substantially increased authority to impose selective restraints on credit expansion in place of restraints that seem to arise periodically by default.

A second key area for antiinflationary action involves the use of voluntary wage-price policies. At the present time, a major element of cost-push pressure stems from the understandable efforts of labor to secure wage increases that will fully compensate workers for past, or even anticipated, losses in real arning power due to inflation. However, the gains from the recent inflation have to a considerable extent gone to the OPEC countries and other commodity producers rather than to the firms now faced with rising wage demands. Hence, in many areas attempts to meet such demands can lead only to still higher prices.

Enactment of a major tax cut geared toward lower and middle-income groups provides an excellent opportunity for breaking out of this vicious circle. While the kind of tax reduction here proposed would not make up for the full loss in workers' real incomes over

the past several years, it would more than compensate them for the net drop of nearly 3 percent in their real earnings in 1974. It is thus not unreasonable to ask for significant moderation in current wage demands.

I was delighted to read Mr. Meany's quote of the other da" that he felt that that was going to happen because of condition'

I believe that any legislation authorizing the tax cut should include an explicit declaration, clearly backed by the President as well as by the Congress, which states that the reduction is being made as part of a social compact among business, labor and government to restrain future inflation. For labor, the compact might call for limiting wage increase to an additional 4 to 5 percent. This would be in line with the proposals that the President has already made with respect to Federal employees.

Business should do no less on prices. Sellers large and small should dehydrate their prices. Business should remove from prices the water that has been pumped in to flood the next round of price control. But these steps should be taken in exchange for an understanding that wage and price controls will not be reimposed.

To reinforce these measures, I favor a strengthening of the Council on Wage and Price Stability. The Council should be given more adequate funding and staff as well as greater powers to obtain necesary information. It should, however, continue to rely essentially on voluntary cooperation.

There are numerous other ways for stepping up the war against inflation. Let cite a few of these only briefly.

We need far more active and effective policies to deal with imbalance in supply. The attack on inflation can be reinforced by appropriate measures in the international area. Worldwide cooperation in dealing with problems of supply scarcities can help to avoid inflationary scrambles for raw materials.

As discussed in detail in our 1972 policy statement "High Employment Without Inflation," a far more concentrated effort is required to strengthen competitive forces in the economy, eliminate restrictive practices in both product and labor markets, and stimulate productivity.

Much more should be done to reduce the inflationary pressures that can stem from the Government's own operations.

Finally, we need to take a wide range of steps to assure that this country will be able to meet its enormous needs for physical and financial capital in coming years.

Now, may I take just a few moments on energy policy. The long-term goals of the President's energy program are quite similar to our recommended target in achieving energy independence, of reducing oil imports to no more than 10 percent of the total energy consumption by 1985, and to limiting the average annual growth in energy demand during 1972 to 1985 to slightly less than 3 percent. We are also in general accord with numerous other recommendations in the President's program, including the deregulation of the wellhead price of natural gas and the removal of price controls on old oil. Such deregulation will permit dismantling of the allocation apparatus now administering a two-price system. If a windfall

profits tax is imposed in connection with the lifting of oil-price controls, it should apply to profits on old oil only and should be rebated if such profits are invested in new energy production capacity.

We are also in general agreement with the desirability of initiating a wide range of special measures to encourage more efficient energy use.

But I have serious reservations about the President's proposals to achieve a sharp near-term cutback in energy consumption and imports through the sudden imposition of stiff import fees and excises that would be piled on top of the price increases associated with oil and gas price decontrols.

Mr. Chairman, and members of the committee, in the midst of a badly deteriorating economic situation, the Nation can ill afford to experiment with a program that runs the risk of adding excessively to both inflation and recession. This emphatically does not mean that we can afford to ignore the energy problem until the economy recovers. What it does call for, in my view, is a publicly announced policy and program for decontrol of old oil and deregulation of natural gas. I would also attach considerable importance to the development of a consistent national policy for applying a higher tax to higher fuel consumption motor vehicles.

The important thing is that such a program be clearly announced and agreed upon so that both business and the public can adapt their plans to the reality of higher energy prices in future years. Our economy is resilient enough to support major changes, such as these, over a reasonable period of time. If these and related devices do not result in a sufficient energy cutback and an emergency arises, I believe that they should be temporarily supplemented by more quantitative methods, including gasoline rationing. I understand the fear of some that the use of rationing is a difficult task. But, in an emergency, it seems to me that the Government has no choice but to use powers which it can command, if only temporarily, even if it is at some risk.

At the same time, we must make sure that higher energy prices will in fact stimulate increased output. This means that in addition to price decontrol, various other steps need to be taken to reduce the uncertainty that now impedes production. These should include establishment of more efficient environmental controls; streamlining procedures for leasing Federal oil, coal, shale, and natural gas resources and for siting energy facilities; and leasing environmentally acceptable sites for extraction of oil, gas, coal, and oil shale as rapidly as exploration can be undertaken. We also believe that if private commitments to build adequate synthetic fuel facilities are not made very soon, the Government should encourage investment by contracting to buy a substantial quantity of synthetic fuels.

May I conclude. In all this there exists a key ingredient. In any program for bolstering our sagging and inflation-ridden economy, the basic need is confidence. Like my predecessors in CED over 30 years ago, I have faith that confidence can and will be restored if the goals for policy are set high enough to win our battle and there is prompt and vigorous action to achieve these goals. Half-hearted

or partial action which accepts high levels of unemployment and inflation for too long can become self-fulfilling prophecies which could tear apart the fabric of our free system. What is required is convincing evidence that the President, the Congress and the public are united in an all-out, simultaneous, and fully credible attack on the triple problems of restoring prosperity, ending inflation, and achieving energy independence.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you very much, Mr. Klutznick.

[The prepared statement of Mr. Klutznick follows:]

PREPARED STATEMENT OF PHILIP M. KLUTZNICK

Mr. Chairman, Members of the Committee, and fellow panelists, my name is Philip M. Klutznick. I am pleased to appear before your Committee today to discuss the President's Economic Report and other economic messages on behalf of CER's Research and Policy Committee. Our Committee has presented testimony on the Economic Report since these annual reviews were initiated. At no time during this period has our country faced a more difficult or complex economic situation than at present.

The momentum of the economic decline has been extraordinarily rapid. National unemployment has reached the shocking level of 8.2 percent, the highest since 1941, and further declines in employment are in prospect. Price increases, though showing some slowdown, remain in the double-digit range. The energy problem confronts the nation with extremely difficult choices, none of which are palatable. Our financial system is plagued by serious distortions. There is danger that the need for long-term capital investment in key sectors of our economy—both private and public—may not be adequately met.

In commenting on this situation, and on the remedies proposed in the President's Economic Report and Budget, I shall mainly be guided by the positions that our Research and Policy Committee has taken in its published policy statements. In some instances where CED positions have not yet developed, I shall present my personal views. However, the main thrust of my remarks will be in the broad tradition of CED's policy statements as they have evolved over a period of more than thirty years, supplemented by work in process.

Because of its relevance, I will take a moment to comment on the essence of that tradition. It began in 1942, when CED was founded by a group of far-sighted and public-spirited businessmen—men like Paul Hoffman, Beardsley Ruml, Marion Folsom, William Benton and Ralph Flanders. The United States was at war and there was no immediate problem of rising unemployment. But then, as now, widespread fears existed that the country—and, indeed the world— faced a period of years when economic stagnation and large scale unemployment would be the rule. Moreover, then, as now, there were many who believed that little could be done to avert such an outcome.

What united the founders of CED was a profound conviction that this gloomy prospect was neither inevitable nor acceptable—a conviction that proved to be justified in the light of subsequent events. These men had an abiding faith that a proper blend of private initiative and enlightened public policies could indeed succeed in creating a healthy economy characterized by high employment and sound economic development. They acted on this faith and exerted extraordinary efforts to make these goals come true. Thus, the Committee played a leading role in the development of the Employment Act of 1946 and in the forging of major initiatives for postwar international cooperation, including the Marshall Plan.

In more recent years, the principal economic challenge has been not only to achieve high employment but to fight unemployment and inflation simultaneously. Here again, our Committee has refused to accept the widespread notion that this is a battle which cannot be won. In a series of policy statements—most recently the 1972 statement on *High Employment Without Inflation*—it has outlined a wide range of steps for a comprehensive attack on both the recession and the inflation problems. Some months back we launched a new study in this area. While I have high hopes it will break new ground, I believe that most of our earlier recommendations will still be relevant.

GOALS AND STRATEGY OF ECONOMY POLICY

With this background, let me first turn to the basic diagnosis and strategy outlined in the President's Economic Report and Budget, leaving aside for the moment the special problem of energy policy. These documents are commendably frank in assessing the seriousness of the current economic situation and in presenting the economic assumptions underlying the President's proposals. Moreover, the policies that are proposed—and in particular the recommendations for personal and business tax cuts—generally move in the right direction.

The key issue, however, is not merely the direction of current policy. The prime question is whether the goals of policy are adequate and appropriate to the country's needs and potentials. Having determined this then it is necessary to consider whether the proposed program of action is capable of achieving such goals. On both counts, the strategy outlined in the President's economic messages seems grossly deficient.

The basic economic assumptions underlying the Administration's program are vividly expressed in the table appearing on page 41 of the budget document. This table, after taking account of the likely effects of the President's proposed action program, envisages a slack U.S. economy for the remainder of the decade, with inflation continuing at relatively high, though diminishing rates. The table forecasts average unemployment rates of about 8 percent in 1975 and 1976 and projects only a gradual tapering off to about 7 percent by 1978 and 5½ percent by 1980. These averages, of course, imply that various industries, regions, and groups in the economy—and especially minority groups—would for years continue to experience far higher unemployment rates, creating serious risks of sharply intensified social unrest. The table also assumes that the rate of increase in the GNP deflator will still be around 6½ percent in 1977 and will not reach 4 percent until 1979–80.

Mr. Chairman, the scenario depicted by these figures is neither inevitable nor tolerable. It virtually accepts stagnation as the basis for policy planning. While the numbers cited are merely labelled as "forecasts" or "projections" in the budget document, it is difficult to avoid the conclusion that they are in fact also being viewed as provisional goals on which to base programs. Thus, the Budget describes the figures for 1977–80 as "projections consistent with moving gradually toward relatively stable prices and maximum feasible employment." Moreover, there is nothing in either the Budget or Economic Report to indicate that the prospects depicted by the projections are viewed as simply unacceptable or that they give rise to a determined and comprehensive effort to make certain they will not come true.

I am in no way trying to minimize the importance of overcoming the corrosive forces of inflation. But I question several of the premises that apparently underlie the Council's analysis and that seem to have led it to the view that a very long period of high unemployment must be endured if inflation is to be brought under control.

First, it is not correct to assume that severe recession or prolonged stagnation is the only way to beat inflation. On the contrary, such a course is more likely to exacerbate the inflationary problem in the longer run, by throttling the incentives for needed long-term investment and by depriving the economy of the productivity gains that come with adequate capacity utilization and sound economic growth.

Second, there is no reason to rely on a narrow range of anti-inflationary weapons as the Council's Report seems to contemplate. An important share of our current inflation problems stems from cost-push and supply-related factors and cannot be cured by fiscal and monetary measures alone. To deal with such problems, numerous other policy approaches must be brought into play. These include, in particular, the continuing use of voluntary wage-price policies—a subject which is virtually ignored in the Council's Report.

Third, it is difficult to agree with the Administration's apparent premise that the preferred pattern of economic revival should be one of relatively slow growth in real economic activity over the next two years (averaging around 5 percent), with an accelerated rate of expansion later in the decade. It would make much more sense to encourage a more rapid economic revival in the near-term future—when the economy will still be far below capacity levels and inflationary risks from rising demand will be relatively small—and then to aim for more moderate expansion rates once the economy moves closer to higher employment.

In sum, the policy strategy that is needed currently calls for stronger stimulative action than the President has proposed, coupled with a much more forceful and comprehensive program to deal with inflation than is suggested in the Council's Report.

POLICIES FOR ECONOMIC REVIVAL

Let me now turn in more detail to the policies needed to halt the recession and stimulate a healthy economic revival.

Tax reduction.—In a speech before CED's Research and Policy Committee which I delivered on January 9, I called for net fiscal stimulus of about $25 billion. This amount of stimulus seemed justified in light of the fact that the high employment surplus had been rising rapidly since mid-1973 and was, according to the Council's estimates, running at about $30 billion in late 1974 despite the sharp decline in economic activity. As you know, our studies over the years have convinced us that a large high employment surplus, especially one that is rising, acts as depressing influence on the economy.

I recommended that about $20 billion of the total stimulus should be devoted to a personal income tax cut. The proposal was geared to give principal assistance to low and middle-income wage earners. More specifically, I called for a 3 percent tax credit against the first $15,000 of earnings. I also had in mind a significant rise in the investment tax credit, involving a revenue loss of $3 to $4 billion.

While the emphasis on tax reduction as the primary anti-recession weapon was very much in line with CED's tradition, this was not true of the form of the proposed tax cut. We have normally advocated that tax reductions made for cyclical reasons should involve equal percentage cuts for different income groups. In the present situation, however, there is ample justification for giving larger percentage tax cuts to persons in the middle and lower-income groups. In a sense, this procedure merely compensates for the uneven impact of inflation. These are the groups that have been especially hard hit by the type of inflation we have recently experienced and by the tendency of inflation to push these taxpayers into higher income tax brackets while their income buys less.

Since January 9 when I made these proposals, the economy has deteriorated even more rapidly than anticipated. Quite frankly, the risk of a continuing cumulative downslide can no longer be discounted. At the same time, the need for speedy action to cut taxes and channel additional purchasing power into the hands of consumers is even more urgent. I would therefore support tax cut proposals that differ from my own if they stand a better chance of quick adoption, provided they serve similar objectives. In particular, there is merit in making part of the personal income tax reduction a prompt and one-time rebate against 1974 incomes. This approach would recognize that the total tax reduction under current conditions may have to be larger than a permanent tax cut that the economy can afford in the longer run. In addition, a rebate may provide a special boost to durable goods and other large ticket purchases. But. I feel strongly that a significant part of the tax reduction package should be of a continuing character and take the form of lower withholdings from current incomes.

Permit me to make one further observation on this subject. Given the rapid changes in the current economic situation, there is a distinct chance that the magnitude of any tax cut on which the Congress may agree after completion of the necessary legislative procedures will appear inadequate not long after the tax cut has been enacted. In light of this possibility, it may be appropriate for the Congress to enact not merely a basic tax reduction package but also a contingency tax cut which could be promptly activated at a later date if unemployment rates exceeded specified levels or, preferably, upon passage of a joint Congressional resolution affirming the need for such a cut. While it is unwise to be panicked by the gravity of the course of decline, it is equally unwise not to be prepared if the tendency continues downward.

Expenditures.—As the President's messages emphasize, the need for fiscal stimulus must not become a license for relaxing needed disciplines over current federal expenditures or for jeopardizing longer term prospects for keeping federal spending under control. Waste should be exorcised wherever possible. But, given the deteriorating economic situation, some net increase in budgetary outlays over the proposals in the budget would seem necessary.

In general, anti-recessionary expenditure programs should involve activities

that will automatically end—or can be readily terminated—once the recession has run its course. This is a built-in defense against future demand inflation. In this connection, our Committee strongly supports the use of anti-cyclical public service employment programs that are triggered to start or terminate when unemployment rates attain specified levels. At the same time, it needs to be emphasized that the administration of these programs should be very carefully monitored to insure that they do not exacerbate the existing inflationary cost-push pressures in the public sector. Moreover, the program must be carried out in ways that do not interfere with urgently needed efforts to improve productivity in regular governmental services.

If unemployment rises further, additional federal funding for public service employment should be considered. However, there is something to be said for providing at least part of such extra funding in the form of emergency "recession grants" to cities with high unemployment rates and unusually large shortfalls in revenues from normal levels. This would keep such cities from having to dismiss policemen, firemen, and other regular employees whose jobs could not be legally financed under the existing public service employment programs. Strong safeguards would have to be provided to assure that recession grants are automatically terminated when the economy recovers and municipal revenues return to more normal levels. This suggestion merely recognizes that all cities are not similarly affected by the current economic stringency.

For a sound economic revival, some reordering in the proposed budget priorities also seems desirable. There is a strong case, for example, for providing additional funds for subsidized housing programs; for enlarging scheduled expenditures in areas of critical importance for the nation's long term needs, notably mass transportation; and for rescission of scheduled cuts in food stamp programs and social security benefits that hit excessively at those groups in our society who are least able to defend themselves against the impact of inflation. Indeed, there need be no blanket rule against new budget initiatives provided the Congress, with the aid of its new budget committees and procedures, acts effectively to keep the overall budget on target.

Monetary policy and emergency sources of liquidity.—A shift to a clearly stimulative monetary policy is an essential ingredient of the strategy for economic revival. Indeed, unless monetary policy is sufficiently accommodative to encourage a strong recovery and permit the financing of prospective federal deficits at reasonable interest rates, the beneficial effects of stimulative fiscal policies will be aborted. This means that the monetary authorities must permit much larger increases in money supply growth than have been experienced for many years.

It is also imperative that there be adequate provisions for emergency sources of liquidity that can be made available to avoid liquidity crises involving companies in essential industries and to avert any cumulative distress conditions in financial markets. The granting of such emergency funds shsould be placed on a systematic basis; should not depend on successive special actions by the Congress; and should be carried out by an institution especially established for the purpose.

DEFENSES AGAINST INFLATION

As indicated earlier, a vigorous attack on the recession problem should be paralleled by an equally vigorous effort to construct strong defenses against inflation.

In the demand management area, as already noted, this calls for built-in procedures to assure that expansionary policies do not overshoot their mark—for example, reliance on expenditure programs that are self-limiting and inclusion of temporary elements in the overall tax relief package. In the monetary field, it means readiness by the Federal Reserve to shift gears promptly when the need for renewed restraint becomes apparent. In addition—and this is my personal view—the monetary authorities should be given substantially increased authority to impose selective restraints on credit expansion in place of restraints that arise by default.

A second key area for anti-inflationary action involves the use of voluntary wage-price policies. At the present time, a major element of cost-push pressure stems from the understandable efforts of labor to secure wage increases that will fully compensate workers for past (or even anticipated) losses in real earning power due to inflation. However, the gains from the recent inflation have to a considerable extent gone to the OPEC countries and other commodity

producers rather than to the firms now faced with rising wage demands. Hence, in many areas attempts to meet such demands can lead only to still higher prices. At the same time, business firms have in many cases added unduly to their prices—or are failing to cut them sufficiently—because of the expectation of rising costs and fear of reimposition of compulsory price controls.

Enactment of a major tax cut geared toward lower and middle income groups provides an excellent opportunity for breaking out of this vicious circle. While the kind of tax reduction here proposed would not make up for the full loss in workers' real incomes over the past several years, it would more than compensate them for the net drop of nearly 3 percent in their real earnings in 1974. It is thus not unreasonable to ask for significant moderation in current wage demands.

I believe that any legislation authorizing the tax cut should include an explicit declaration, clearly backed by the President as well as by the Congress, which states that the reduction is being made as a part of a social compact among business, labor and government to restrain future inflation. For labor, the compact might call for limiting wage increases to an additional 4 to 5 percent. This would be in line with the proposals that the President has already made with respect to Federal employees.

Business should do no less on prices. Sellers large and small should dehydrate their prices. Business should remove from prices the water that has been pumped in to flood the next round of price control. But these steps should be taken in exchange for an understanding that wage and price controls will not be reimposed.

To reinforce these measures, I favor a strengthening of the Council on Wage and Price Stability. The Council should be given more adequate funding and staff as well as greater powers to obtatin necessary information. It should, however, continue to rely essentially on voluntary cooperation.

There are numerous other ways for stepping up the war against inflation. I can cite these only briefly.

We need far more active and effective policies to deal with imbalances in supply. Much stronger machinery must be created for anticipating and overcoming supply bottlenecks. To render the economy less vulnerable to sharp inflationary pressures from sudden reductions in the supply of agricultural commodities or energy, greater emphasis must be placed on the creation of reserve stocks and reserve production capacity, as stressed in our recent policy statements on *A new U.S. Farm Policy for Changing World Food Needs* and *Achieving Energy Independence.*

The attack on inflation can be reinforced by appropriate measures in the international area. Worldwide cooperation in dealing with problems of supply scarcities can help to avoid inflationary scrambles for raw materials. Judicious interventions in foreign exchange markets that strengthen the value of the dollar can assist in reducing prices on imported goods. Trade policy can anticipate tariff negotiations by a unilateral reduction of tariffs to ease their inflationary impact. The occasional use of selective export restraints, carried out in accordance with internationally agreed-upon criteria, can moderate food and commodity price increases.

As discussed in detail in *High Employment Without Inflation,* a far more concentrated effort is required to strengthen competitive forces in the economy, eliminate restrictive practices in both product and labor markets, and stimulate productivity. In this connection, there is urgent need for speeding up the work of the National Commission on Regulatory Reform.

Much more should be done to reduce the inflationary pressures than can stem from the government's own operations. We welcome the President's initiative in requiring executive agencies to prepare inflation impact statements, a procedure that our Committee first proposed in 1970. Such statements should be actively used as an early warning system against the potential inflationary consequences of important governmental actions. Furthermore, there is scope for much more imaginative and systematic efforts to improve productivity in government at all levels, a subject to which one of our subcommittees is currently devoting intensive study.

Finally, we need to take a wide range of steps to assure that this country will be able to meet its enormous needs for physical and financial capital in coming years. In my view, this will among other things call for new or changed institutions, must importantly the revival of something like the old RFC. This, too, is a subject which we are now studying in depth.

ENERGY POLICY

My final comments relate to the President's energy program. We applaud the President's emphasis on the need for a forceful, comprehensive and multi-pronged national effort to deal with energy. We strongly urged such an approach in the policy statement, *Achieving Energy Independence* issued in December 1974. We welcome the fact that many elements of the President's program largely conform with our recommendations. The long-term goals of the President's energy program are quite similar to our recommended target of reducing oil imports to no more than 10 percent of total energy consumption by 1985 and to limiting the average annual growth rate in energy demand during 1972–1985 to slightly less than 3 percent. We are in general accord with numerous other recommendations in the President's program, including the deregulation of the wellhead price of natural gas and the removal of price controls on old oil. Such deregulation will permit dismantling of the allocation apparatus now administering a two-price system. If a windfall profits tax is imposed in connection with the lifting of oil price controls, it should apply to profits on old oil only and should be rebated if such profits are invested in new energy production capacity.

We are also in general agreement with the desirability of initiating a wide range of special measures to encourage more efficient energy use, including labelling of the energy-usage of appliances and limited reliance on tax credits to encourage better insulation of homes; with substantially enlarged Federal support for energy research and for the development of synthetic fuels; and with prompt action to minimize the country's vulnerability to another oil embargo, including passage of standby emergency authority to curtail demand in such a crisis and development of a practical energy storage system.

But I have serious reservations about the President's proposals to achieve a sharp near-term cutback in energy consumption and imports through the sudden imposition of stiff import fees and excises that would be piled on top of the price increases associated with oil and gas price decontrols. Whatever else one might say about these proposals—and the related recommendations for offsettting tax relief—they are highly complex and their effects on the economy are quite uncertain. For one thing, there is a risk that the price impact of the package will be substantially greater than the Administration has estimated. If one takes account of indirect "ripple" effects of the program on wages and other costs of doing business, the program could well add 3 to 4 percentage points to the consumer price index rather than the 2 percent the Administration has estimated. If the energy program is to be kept from putting an extra damper on total spending, this could also mean that offsetting tax cuts would have to be much greater than the President has proposed. There is the additional risk that energy consumers will feel the sharp pinch of higher energy taxes and prices well before they can benefit from the relief of a tax cut.

Mr. Chairman, in the midst of a badly deteriorating economic situation, the nation can ill afford to experiment with a program that runs the risk of adding excessively to both inflation and recession. This emphatically does not mean that we can afford to ignore the energy problem until the economy recovers. What it does call for, in my view, is a publicly announced policy and program for decontrol of old oil and deregulation of natural gas. I would also attach considerable importance to the development of a consistent national policy for applying a higher tax to higher-fuel-consumption motor vehicles.

The important thing is that such a program be clearly announced and agreed upon so that both business and the public can adapt their plans to the reality of higher energy prices in future years. Our economy is resilient enough to support major changes, such as these, over a reasonable period of time. If these and related devices do not result in a sufficient energy cutback and an emergency arises, I believe they should be temporarily supplemented by more quantitative methods, including gasoline rationing. I understand the fear of some that the use of rationing is a difficult task. But, in an emergency, it seems to me that the government has no choice but to use powers which it can command, if only temporarily, even if it is at some risk.

At the same time, we must make sure that higher energy prices will in fact stimulate increased output. This means that in addition to price decontrol, various other steps need to be taken to reduce the uncertatinty that now impedes production. These should include establishment of more efficient environmental controls; streamlining procedures for leasing federal oil, coal, shale, and natural

gas resources and for siting energy facilities; and leasing environmentally acceptable sites for extraction of oil, gas, coal, and oil shale as rapidly as exploitation can be undertaken. We also believe that if private commitments to build adequate synthetic fuel facilities are not made very soon, the government should encourage investment by contracting to buy a substantial quantity of synthetic fuels.

CONCLUSION

In all this there exists a key ingredient. In any program for bolstering our sagging and inflation-ridden economy, the basic need is confidence. Like my predecessors in CED over thiry years ago, I have faith that confidence can and will be restored if the goals for policy are set high enough to win our battle and there is prompt and vigorous action to achieve these goals. Half-hearted or partial action which accepts high levels of unemployment and inflation for too long can become self-fulfilling prophecies which could tear apart the fabric of our free system. What is required is convincing evidence that the President, the Congress and the public are united in an all-out simultaneous and fully credible attack on the triple problem of restoring prosperity, ending inflation and achieving energy independence.

Chairman HUMPHREY. We are going to proceed on the basis of having the three witnesses make their statements and then we will go to the questioning. We want to thank you very much, though, for a thoughtful and constructive statement, Mr. Klutznick, and I particularly want to express my thanks for your expression about the necessity of coming to some agreement on policy goals, and hopefully, this will stimulate the kind of release of the great energies of our economy to afford or to bring about a recovery.

Mr. Nathan, you have been before this committee on many occasions, so we are just going to ask you to give us the benefit of your wise counsel.

STATEMENT OF ROBERT R. NATHAN, ROBERT NATHAN ASSOCIATES, INC.

Mr. NATHAN. Thank you very much, Mr. Chairman.

I would like to just summarize my prepared statement and speak extemporaneously to those points which are emphasized in that prepared statement.

Chairman HUMPHREY. We will include the entire text of the prepared statement in the record at the end of your oral statement.

Mr. NATHAN. Thank you, sir.

First, Mr. Chairman, may I recall an instance which I am sure you remember, and that took place the last day of the economic summit meeting at the Washington Statler here on December 28. One of the important points you emphasized then was that the Employment Act of 1946 was still the law of the land, and it was that Employment Act which was the source of this very committee itself. I have a deep concern. Mr. Chairman and members of the committee, that in essence that Employment Act is being breached in reality and truly ignored and, if anything, being violated.

I was kidding somebody before and said that if the courts could be an appropriate source of going after those who violate some laws, I suspect, there are many who might very well be convicted of violating the Employment Act of 1946 in the policies which have been adopted recently, and even if I may, some of the policies that are being proposed at the present time.

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I think that the administration's proposed program falls very, very far short of seeking to maintain or to even restore sustained high levels or high levels of production and employment and income. And as Mr. Klutznick indicated in referring to page 41 of the Budget of the U.S. Government for fiscal 1976, submitted by the President, there are projections there which are so contrary to these basic objectives of the Employment Act of 1946 as to be a source of the deepest concern. And those projections are termed as being, and I quote: "Projections consistent with moving gradually toward relatively stable prices and maximum, feasible employment."

I think that this country would be in dire straits and really serious difficulties if that were truly accepted as the goal; namely, maximum feasible employment and not falling in any significant measure below 7 percent through 1978 and then only to 5½ percent by 1980.

Mr. Chairman and members of the committee, there are really two important aspects to this whole economic program that has been forthcoming. One is this lack of responsibility for achieving and maintaining high levels of production. But I think the other, and this is a very basic problem, and I am glad that Mr. Klutznick dealt with it also, and that has to do with the resort to recession as the only real means to fight inflation.

I happen to agree that inflation is a very, very serious problem and has been for some years and has distorted our economy to a major and harmful degree. I think that this idea of inflation or recession as a fundamental policy is a regrettable one. As a matter of fact, on the second page of the President's state of the Union message this year, he said: "The emphasis of our economic efforts must now shift from inflation to jobs." And this has implications, if you take one or the other and you use recession as a means to fight inflation and you use the soft economy as the way to achieve price stability. I think this is sort of a sick economic game, and I hope that we will not accept it and I hope we will pursue both price stability and high levels of economic activity simultaneously.

Let me just say as a trustee of the CED, I am tremendously impressed with the statement Mr. Klutznick made and, true, in the CED they always have the right to dissent and that is one of the great virtues of it, that you get all kinds of views.

My major difference, I guess, is that I would be a little bit stronger myself, or somewhat stronger, in the fight against inflation. I believe that while we go all out for recovery in this economy, we ought to break this inflation spiral now for once and for all and not wait until 1980 to try to get down to a 4-percent rate of price inflation .I have a feeling we would get down to a 3- or 4-percent rate in inflation much quicker even than we would get back to a 7-percent or 6-percent or 5-percent rate of unemployment, and that we ought to use this period of softness now to give some real strength to this Council on Wage and Price Stability to break out of this spiral quickly and completely and effectively. I do not know what Al Rees said yesterday or whether he wants more authority or not. But I think he ought to have it and he ought to use it and we ought to break this spiral and use this social contract, use all kinds of other measures we can to get rid of this virus that has been eating at the heart of the economy.

I would say that even selective controls will be far less distorting and far less costly and result in far less misallocation of resources than the inflation and the recession that we have had. Resorting to recession as the only way to fight inflation means we are going to have exactly this kind of scenario that is laid out on page 41 of the Budget of the U.S. Government for fiscal 1976; namely, long-run waste of resources, and very slow progress.

Now let me turn briefly to the recovery program which I think is so tremendously important, along with the battle of inflation.

I cannot help but conclude that, analyzing all of the proposals that have come forth from the administration, we really have a no-recovery program presented to the Nation and to the Congress. The only meaningful and significant stimulative proposal was the combination of the tax rebate and the increase in the investment credit.

Now I think both of these measures were very appropriate, they were belated but essential and highly desirable, but the total program really does not add up to a recovery measure because there are two major offsets to the expansionist aspects of the tax rebate and the investment credit. One has to do with the spending side and in the President's statement we have a very strong expression against any kind of a Government expenditure program.

Also, Mr. Chairman and members of the committee, every analysis that has been made by knowledgeable people indicates that the President's energy program is an antiexpansion program, that it is going to take more money out of the hands of individuals and business than it will put back.

In other words, that it is not a $30 billion symmetrical fiscal program, but rather $40 billion to $50 billion taken out and perhaps $30 billion put back. One does not need to be a fiscal expert to recognize that as a contractionist measure. It appears that the President's fiscal approaches to energy will take a lot of money out before the money is put back into the economy. If at this stage of our economic development and this stage of the economic crisis and the recession one undertakes a program which has a lag in the stimulative side behind the contractionist side, that is hardly a recovery measure.

So that I regrettably come to the conclusion that, as we add up the whole picture, we do not have submitted to us in the Economic Report of the President or in the budget any kind of a recovery program and I do not think it is an exaggeration to call it a no-recovery set of policies.

Now let me just talk briefly about the expenditure side, Mr. Chairman and members of the committee, because I think this deals with a rather basic philosophical point as well as with the problem of recovery.

Generally, I agree that when the country enters into what may well be a relatively short recession, one can achieve a more rapid response and an easier response by going the tax cut route, and even going the tax reduction route exclusively. But in this particular instance it now appears that we are going to be in this recession for a very considerable period of time just because of the nature and the character of the policies that brought it on. It was designed,

it was planned as an anti-inflation effort. This recession just did not come out of the blue. I think it was a designed approach to fight inflation. Just because nothing has been done for so long we are now on the verge of certainly 10 percent labor force time loss, if not 10 percent unemployment in the next several months. I think unemployment probably will reach 10 percent and, I think it is going to take us quite awhile to get out of this. The argument then that an expansion program arising out of expenditures may come too late—loses a fair amount of its force under these present circumstances.

It is for that reason, Mr. Chairman, that I feel the total emphasis of the program on the tax side, and very little, by the way, and against any increase in expenditures has little validity and no justification.

I must say it has been a long time since I have encountered a program of such bad equity as the one that proposed a tax rebate up to $1,000 on the one hand and then a cut in the real income of the social security recipients and others by sticking to the 5-percent adjustment clause. I think that was not just a regrettable program from the fiscal point of view, but I think even more serious from an equity point of view.

On the expenditure side, let me say, Mr. Chairman, that we are now in the first quarter of 1975 experiencing a gap between GNP potential and actual GNP of over $200 billion at an annual rate, current prices. You take that right out of the Business Conditions Digest and you just project what the first quarter of 1975 was going to be in GNP and you take your potential and you adjust it, the 1958 prices to current prices, and you get something over $200 billion, or a little more, as the present gap.

Mr. Chairman, I say that when we had $200 billion and nearly 10 percent of our labor force idle in January, $250 million loss with the labor force idle, I think it is challenging for us to use some of those resources for essential needs.

For instance, why should we not intensify R. & D. development activities in the energy field at this time when a lot of technicians are unemployed? Why should we not take vigorous steps to enhance mass transit when we are concerned about energy needs? Why should not the Government buy buses in substantial numbers? That would help the auto industry on the one hand and help mass transit on the other and help reduce the use of private cars, or in the current period, savings of gasoline? Why should we not undertake incentives to stimulate the expansion of gas drilling equipment?

We are told now that there is a 5-year gap or a 5-year lag in providing oil drilling equipment. Why should we not use funds to produce railroad cars for coal transit so that we can increase our coal production from 600 million tons a year to a billion or a billion and a quarter tons a year, now when the resources are idle?

Why should we not use these resources by making available financing for housing? Instead of having a million housing starts, we could have 2 million housing starts going in a few months if funds were made available at reasonable terms. The public utilities are cutting back because funds are not available. Interest rates are very

high and the public utility commissions, being concerned about inflation, do not want to raise the rates.

Let me say, Mr. Chairman and members of this committee, if we have blackouts 3 or 4 or 5 years from now, which is entirely possible, it will be attributable to what I would regard as pretty stupid policies today of permitting these wasted resources to occur and not doing anything about overcoming the shortages. A year ago we were talking about shortages throughout the economy and why not now? I do not care whether you enlarge the investment credit even more or you make lending on a selective basis at lower rates, but we ought to now use some of these idle resources in anticipation of some of these later bottlenecks. There are a whole range of things of this nature on the managerial or stimulative side which will be compatible with preparing for expansion, not inflationary growth, and getting out of this recession quickly.

Also, Mr. Chairman, there are very serious problems in the State and local governments. We all know that when we have a recession, State and local governments run into declining revenues. They do not have the ability to engage in deficit financing like the Federal Government, and so then they cut their expenditures like mad. Then when you have a recovery, their revenues go up and suddenly they have surpluses because there are leads and lags there. I think we ought to very seriously consider some substantial countercyclical revenue-sharing measures.

CED talked about recession emergency grants. I do not care whether it is through that channel for selective cities or is general. What we ought to do is something on the positive side that would be meaningful in terms of helping.

Now let me just make one or two points more. One, as far as the monetary policy is concerned, I have a great respect for Arthur Burns, who is an economist and a policymaker, but I must say when the Chairman of the Federal Reserve said the other day that there is plenty of money around but there is a lack of confidence, he was saying something that had validity. But the economists have been saying for a long time that it is much easier to effectively exercise monetary policy on the restraint side than it is on the expansion side once you get into a real recession. It is hard to push a string, and you can make money available, but when people do not have confidence, it is hard to get them to borrow.

But why is there a lack of confidence today? It is because our policies, monetary and fiscal, were so bad for the last 15 months or more that we brought on a recession by design, and now, of course, people are very much concerned because there is a lack of borrowing power, there is a lack of demand, there is a lack of confidence. You saw what happened to these building bonds in New York City. You have a whole range of companies tottering and of course if you want to create a recession to reduce demand in levels of economic activity, you have confidence of a very, very weak nature that has truly been arranged and organized and planned. I regret to say that it is going to be difficult to reverse that.

One final point before closing and that has to do with energy. I do believe, Mr. Chairman and members of this committee, that one

ought to separate, and I am glad the Congress is now doing that, this energy program and the recovery program. I think that the energy program is tremendously important and the suggestions that have come out in the press for the conservation, about discouraging the big gas guzzlers, about proceeding directly where the savings could be visible and sizable, where one could identify the impact rather than just putting in a big tax and excises at the bottom and just sort of let them flow through somewhere, and where they come out, nobody knows, and pursuing elasticities that nobody really understands—we do not know what the elasticity of supply is going to be. I have grave doubts about decontrol of natural gas because I have grave doubts as to how much more natural gas is going to be forthcoming. I am not sure in this time of continuing inflation it is a good idea to see natural gas prices increase threefold or fourfold, which in my judgment is going to happen because they tend to move toward the liquefied natural gas levels unless the supply increase is sizable, and I doubt if it will be.

So I think on the energy program we have a lot of very complicated measures and we ought not to wait until we solve and organize recovery measures. I am glad we are moving ahead with the program generally.

I just came back from abroad about 10 days ago, Mr. Chairman and members of this committee, and I just want to say one word about that trip. I was deeply distressed because the United States is "exporting its recession." This is not purposeful. We do not want to hurt our friends; we do not want to hurt our allies; but when there is a recession in the United States, we cut our production; we cut our inventories, we cut our imports; at a time when, especially as a consequence of the higher oil prices, the oil importing countries around the world are trying desperately to be able to finance those oil imports by increasing their exports. The trade problems are very difficult and these are exceedingly intensified by a recession in the United States. I think we ought to take cognizance of the fact that the pursuit of price stability through a recession is not going to help us gain or win friends throughout the world.

And just as a final point, Mr. Chairman, I hope that in these hearings in 1975, you will give special emphasis to the purposes of the Employment Act of 1946 and I hope that you remind all of the administration's witnesses that that still is the law of the land and that we ought to have programs geared to relate those objectives which are still legal, proper, and required.

Thank you very much.

Chairman HUMPHREY. Thank you very much, Mr. Nathan. I want to assure you that from time to time as chairman of this committee I am mindful that there is the Employment Act of 1946 and I hold this Government in violation of that act deliberately. I do not think it is just recent, either. I think Government officials over a long period of time have though that it was nothing more or less than a Mother's Day declaration, and they have not paid much attention to the fact that it was public law. Maybe we ought to put the IRS in charge of it. They seem to know how to hunt people down. Or maybe the FBI. It has been working people over lately.

Do you want to allude to your charts?

Mr. NATHAN. Yes. I beg your pardon. I attached two charts to my prepared statement. I did not refer to them in my testimony. The two charts are designed to show what actually happened in the last 15 years on the inflation side, and I showed consumer prices and all wholesale prices and wholesale prices and wholesale industrial prices, and I show at the bottom of the chart what happened to prices during the phases of controls.

It is very interesting as we look at phase 1, which was the freeze in the latter part of 1971. Obviously, you had a real price stability then, but all during 1972, for 13 months, consumer prices and wholesale industrial prices were very, very stable, if anything, slightly down. There was a rise in 1972, starting about the middle of the year in the all-wholesale price index entirely attributable to agricultural prices. That is what our friend, Walter Heller, termed the "Great Grain Steal," and I do not know who started that term but it was that agricultural sharp jump in the middle of 1972 as a result of the Soviet Union grain deal. I hate to look back and say that prices were a mess and controls were hopeless. I think we would not have been in this mess maybe today if we had held them on a little longer and used them more judiciously.

The second chart is a chart just to show what is happening in the economy. Arthur Okun termed this the "Economic Discomfort Index." Others term it an "Economic Mismanagement Index." But what this is is a combination of unemployment plus inflation. The measure of inflation I use in this chart is the percentage increase in consumer prices over the same month a year earlier. I remember when we used to argue whether we should sort of resign ourselves to 8 or 9 percent as the combination of unemployment and inflation and trade off 5 and 4, 5 percent unemployment, 4 percent price and the like, but now we have 8 percent unemployment percentage over the previous year of 12 percent prices. We can see what a deterioration or mismanagement of the economy we have suffered from.

Thank you.

Chairman HUMPHREY. Thank you, Mr. Nathan.

[The prepared statement of Mr. Nathan follows:]

PREPARED STATEMENT OF ROBERT R. NATHAN

Mr. Chairman and members of the Joint Economic Committee, I am especially grateful for this opportunity to discuss economic conditions and prospects because the Committee's review of the Economic Report of the President comes at a time when our economy is so gravely challenged.

It is certainly not essential to cite many statistics to dramatize the severity of the present economic crisis. The data included in the President's Economic Report and in his Budget amply serve that purpose. But what is essential is to recognize what policies got us into this economic chaos. The hardships increasingly imposed on the unemployed and the mounting wastes of manpower and capital resources attest to the disastrous economic policies which have been pursued in recent years and which continue to be proposed and pursued by the Administration.

President Ford and some of his associates deserve to be commended for telling the story as it really is, but the prescriptions do not fit the diagnosis. We are in deep trouble but all the Administration is prescribing is patience and puny correctives for ailments that daily grow more serious.

Mr. Chairman, the President's economic program should be evaluated in rela-

tion to what you yourself stated in September 1974 at the final session of the President's Economic Summit meeting when you called attention to the fact that the Employment Act of 1946 is still the law of the land. I then shared with you the conviction that the principles and purposes and practices required under that law were being largely ignored, if not negated. In effect, the policy-makers are still breaking that law.

The Administration's proposed program is not truly designed to restore or maintain high levels of production, employment and purchasing power. The fact that the program will not contribute significantly to these goals is forthrightly revealed in the table on page 41 of the Budget, showing the "projections consistent with moving gradually toward relatively stable prices and maximum feasible employment."

These projections reveal a level of unemployment averaging near 8 percent in 1976, well above 7 percent in 1977 and barely below 7 percent in 1978. Unemployment is projected at 5.5 percent even in 1980. Despite all that unemployment, consumer prices are assumed to rise at a rate of more than 5 percent through 1978. The gross national product, in 1974 prices, would fall some trillion and a half below potential in these depressed intervening years.

Two important messages can be read into the President's program and into these figures. One is the abdication of the responsibility of the government to achieve and maintain high levels of production and employment. The second is the exclusive reliance on a depressed economy as the principal means of fighting inflation. That fight is projected to be a long and costly and only partly successful battle.

We need to break that inflation spiral now and to do it quickly and effectively and we should resort to all feasible efforts. We need to fight the recession vigorously and to get recovery underway promptly. The Administration is not prepared to conduct the war on inflation and the war on recession at the same time. As a matter of fact, in his state of the Union message the President said, "The emphasis of our economic efforts must now shift from inflation to jobs."

If ever there were a time when we ought to be able to get rid of inflation and restore reasonable price stability, it is now when the economy is soft; and it ought to be done without keeping the economy soft for several years as called for in the "sick" game plan offered in the Economic Report.

We do not need across-the-board price and wage controls, but we do need enough intervention to eliminate inflation expectations and to intervene when increases are excessive or unwarranted, and no explosive cumulative forces will be built under foreseeable demand-supply relations. The tragedy is that the horrible mismanagement of wage and price controls during Phase III and IV and the lack of evenhandedness between wage and price restraints have led to a feeling that (a) nothing can be done through government intervention to move more rapidly toward price stability, and (b) any intervention will be inequitable. I disagree completely with these conclusions. We can have firm and fair and effective intervention on an equitable basis, and we should not give up the battle on inflation nor conduct the fight only through the means of massive and wasteful unemployment and other idle resources. Also, I should emphasize that a deep and prolonged recession and continued, though declining, inflation will cause more distortions and hardships and waste than even across-the-board controls.

When netted out, the President's economic program is not a recovery program. The two-phased rebate of $12 billion in personal income taxes plus the $4 billion reduction in corporate taxes in the form of a larger investment credit are in themselves expansionist measures and steps in the right direction. However, these steps are largely if not more than fully negated by reductions in expenditures plus the net contractionist fiscal impact of the President's proposed energy program. The President's energy fees and taxes would take much more money from the private community than it would put back into private hands to spend. Thus the fiscal and energy programs proposed by the President add up to a "no recovery" policy.

This tendency to give with one hand and take it back with the other also applies to the inflationary aspects of the energy program. The President seeks to fight inflation with a recession. Yet at the same time his energy program seeks to solve the energy problem largely by raising prices. Higher prices of fuel and energy are pursued by design as a way to achieve fuel and energy conservation. Continuation of the "either inflation or recession" approach will

bring a deeper recession to fight the aggravated inflation resulting from the energy measures. The program adds up to a strange economic wonderland.

What we need, Mr. Chairman, is a big recovery program instead of the "no recovery" program the President has proposed. We need a combined individual income tax rebate, individual income tax reductions, increased investment credit allowances, and special tax relief for small business, aggregating some $30 billion in calendar 1975 or at the latest in fiscal 1976, with the rebate being a one-time repayment and initiated at the earliest possible date. Some payments should be made to those with incomes below the income taxation level. The tax cuts ought to become effective no later than July 1, and preferably earlier.

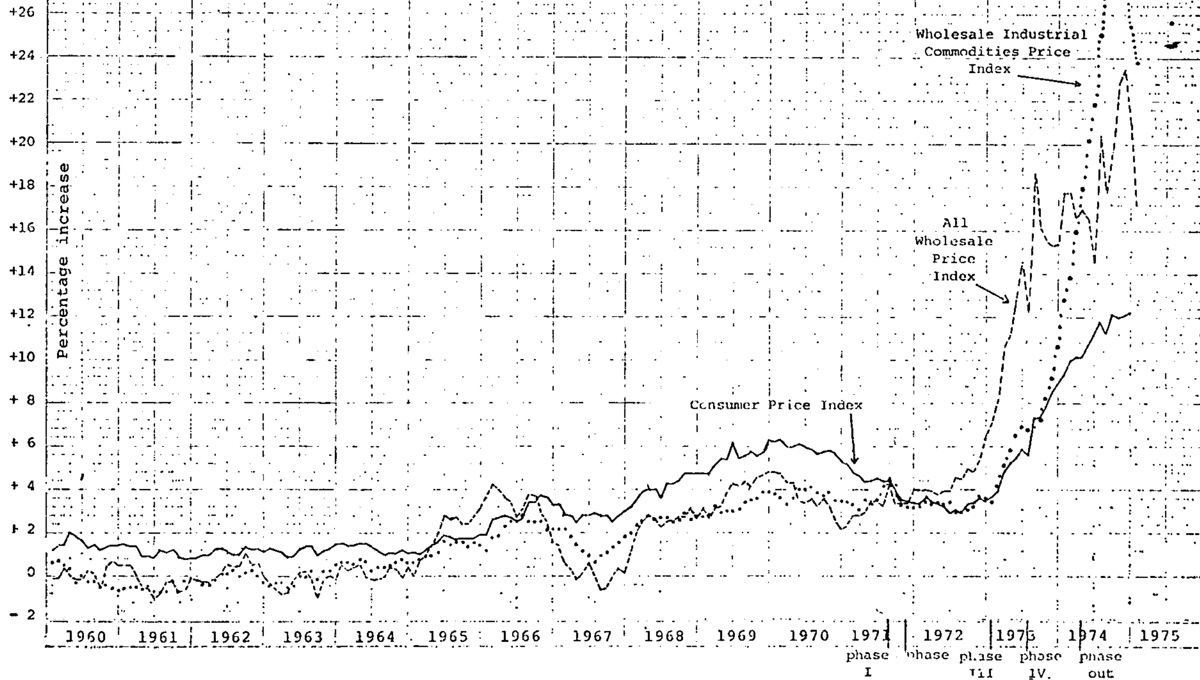
In addition to tax cuts, some stimulative direct or indirect spending programs should be undertaken. The Congress must not go along with the President in cutting the buying power of social security beneficiaries and others who have been victims of the inflation or the recession or both. It is wholly insensitive to propose tax rebates as high as $1,000 and at the same time reduce the purchasing power of many of our citizens in greatest need.

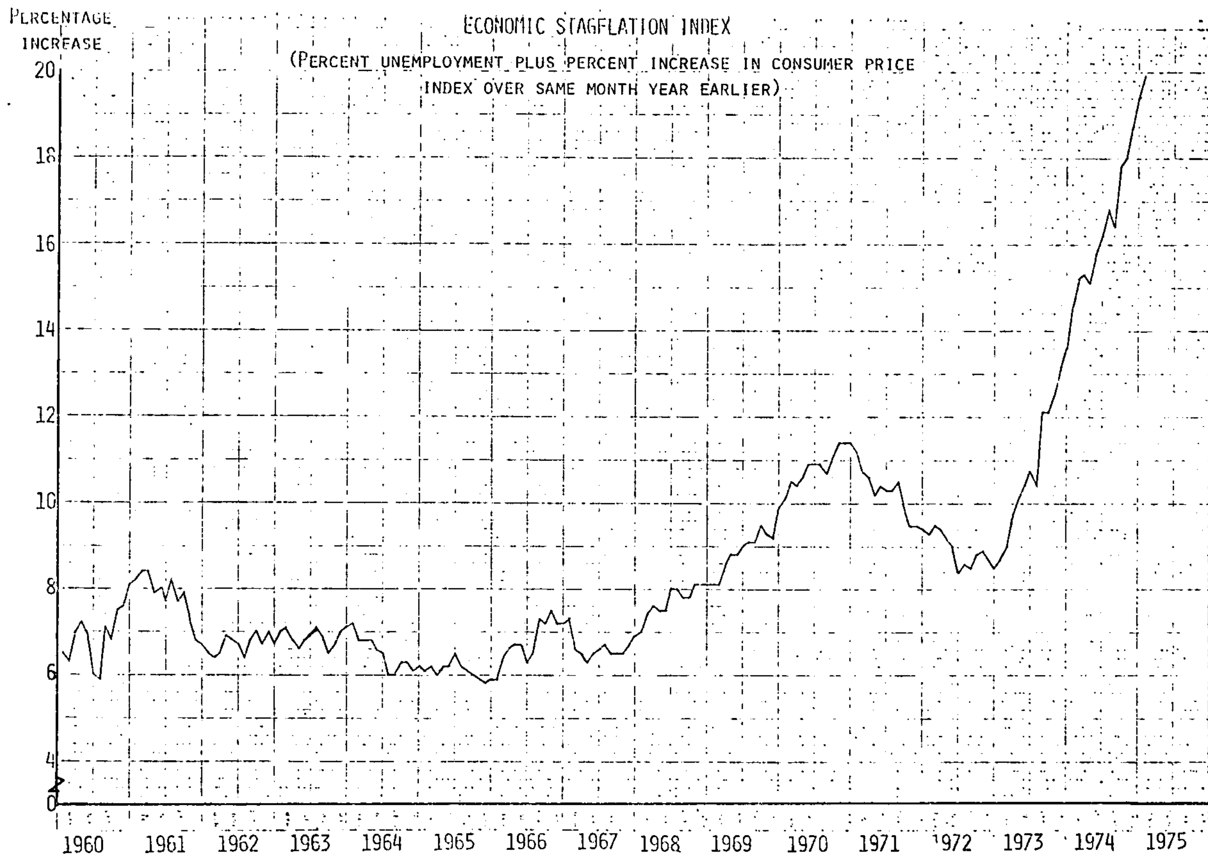
Also, Mr. Chairman, I strongly believe that when our gross national Product is operating at $200 billion below potential and when the percent of time lost by the labor force is rapidly approaching 10 percent, the government should provide attractive financial incentives to use these idle resources for needed purposes. We should support aggressive resource and development programs to solve our energy problems. We should expand the supplies of equipment needed to drill for oil and gas and to mine and transport coal. We need to increase industrial capacities and to overcome shortages likely to emerge early in the recovery period. We need to stimulate further expansion in industries especially hurt by inflation and recession such as the housing industry and public utilities. It is irrational to have vast idle resources and not pursue a flow of credit for home construction and home ownership which will put idle resources back to work and help meet the needs of our population.

President Ford's unbalanced program favors private spending and attacks public spending indiscriminately. The purpose of the tax cuts is to increase private spending. At the same time the President exhorts us to avoid any additional public spending and even to reduce committed public expenditures. Our people need both public and private goods and services. Our states and localities need more funds to provide essential services. The programs I have suggested above plus counter-cyclical revenue-sharing measures would put us on the road to recovery and to limiting the horrible waste of industrial capacity and of manpower now imposing hardships on our people.

I was recently abroad and I feel compelled to tell this Committee that the United States is exporting its recession. Many countries around the world continue to be severely hurt by having to pay sharply higher prices for oil, which have cut deeply into scarce resources needed for development. To pay for the needed oil, they have had to intensify efforts to increase exports. Enlarged trade has been made much more difficult by the fact that we have resorted to a planned recession as the only means of fighting inflation. The present inventory liquidation means that we are importing even less of imported materials than are being used in producing the goods being sold to consumers. Many of those countries which like to regard us as friends are badly hurting. We cannot make and influence friends by exporting our recession. It is high time we recognized what we are doing to our posture and image around the world by these designed recessions to which we resort in the pursuit of price stability.

Mr. Chairman and members of the Committee, let me conclude by expressing the view that implementing the Employment Act of 1946 now imposes grave responsibilities on this Committee. I hope that in reviewing what President Ford has proposed and in formulating new programs you fight to preserve the integrity and influence of this important legislation under which this very Committee was created and given authority.


PERCENT INCREASE OF WHOLESALE PRICE INDICES AND CONSUMER PRICE INDEX
OVER SAME MONTH ONE YEAR EARLIER
ROBERT R. NATHAN ASSOCIATES, INC.
1200 Eighteenth Street, N.W.
Washington, D. C. 20036
Percentage increase
+30
+28
+26
+24
+22
+20
+18
+16
+14
+12
+10
+ 8
+ 6
+ 4
+ 2
0
- 2
Wholesale Industrial
Commodities Price
Index
All
Wholesale
Price
Index
Consumer Price Index
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
1970
1971
1972
1973
1974
1975
phase
I
phase
phase
III
phase
IV.
phase
out


ECONOMIC STAGFLATION INDEX
(PERCENT UNEMPLOYMENT PLUS PERCENT INCREASE IN CONSUMER PRICE
INDEX OVER SAME MONTH YEAR EARLIER)
PERCENTAGE
INCREASE
20
18
16
14
12
10
8
6
4
0
1960
1961
1962
1963
1964
1965
1966
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1975

Chairman HUMPHREY. Mr. Okun, we welcome you. You have served as the Chairman of the Council of Economic Advisers. We hold you in the highest regard and we welcome your testimony this morning. We will just ask you to proceed and then following your testimony there will be questions by the members of the committee.

STATEMENT OF ARTHUR M. OKUN, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. OKUN. Thank you, Mr. Chairman, members of the committee. At the start of the prepared statement I list some of the times in the past year that I have played an unaccustomed role as a Jeremiah. I must confess that at this point I am running out of slogans and epithets. I have to fight the temptation to raise my voice in frustration and the inclination to throw up my hands in despair.

I find it incredible and deplorable that to date, no significant action whatsoever has been taken to rescue the economy after 15 months of recession and 5 months of a dizzying and frightening plunge. This is surely the saddest episode in economic policymaking since the enactment of the Employment Act of 1946. The toll of idle men and idle machines is growing with the end nowhere in sight. It becomes ever more likely that the history books will record this episode as a depression rather than merely a recession. It would take a miracle to stop unemployment below 9 percent, and it is close to an even bet that it will reach 10 percent.

Although homebuilding and auto sales may be near bottom, a massive inventory correction and a slashing cutback in plant and equipment spending will pull the economy down to even lower depths. History simply offers no guidance as to when and how the economy would pull out of its tailspin if left alone. The present experience is unprecedented, and the forecasters are forced to operate off the charts. As Phil Klutznick aptly put it, the risks of a continuing, cumulative downslide can no longer be discounted.

The main causes of this recession have been the shrinkage of consumer real disposable income and the impact of astronomical interest rates. These are diseases that economists know how to diagnose and know how to cure, and the prescriptions for the cure are right in the hands of the policymakers. Tax cuts are the basic prescription to be used at the present time.

The administration made one constructive initiative to boost consumer income in recommending a $12-billion rebate on personal income tax bills, even though the proposal to split that certainly would dilute its impact. The Congress is responding to that request, but it is acting as though this were just another tax bill instead of a declaration of war against recession. Congress ought to separate the rebate from all other tax issues and enact it immediately at a level at least matching the $12 billion proposed by the President, and I would hope for a larger sum. That rebate will do us more good in the next 6 months than any other stimulative measure we can take.

The rebate should be followed by a further tax cut working through the withholding system that provides perhaps $10 billion during the second half of 1975, and another 10 billion in 1976. With a rise in

the investment tax credit, I am urging a total tax reduction of at least $26 billion in calendar 1975, and about half that amount in 1976.

At a time when purchasing power is so urgently needed, it would be an economic as well as a social atrocity to cut the purchasing power of the poor, the elderly, and the Federal employees by changing the established rules of the game for determining social insurance benefits, Federal pay, and food stamp costs. Because of its $17 billion of expenditure cutbacks, the administration's program essentially neutralizes any benefits of tax reduction, and it turns out, as Robert Nathan put it, to be a no-recovery program.

On the other hand, the recession must not create an open season for the expenditure side of the budget. The recession can not be fought with public works projects, and I would not alter them at all in light of what is going on in the economy. Moreover, in my judgment, public employment programs can play a limited, but only a limited role constructively, because they, too, take time to be geared up. I do not see how States and cities could conceivably add 1 million nonprofessional, nontechnical workers to their payrolls in a year, as some suggest, when that is 3 or 4 times their average annual increase.

Thus, I see only limited possibilities for supplementing tax cuts as the basic antirecessionary cure. I would mention one appealing possibility that has been advanced by my colleague, Charles Schultze. He has suggested a temporary cyclical increase in general revenue-sharing based on the level of the national unemployment rate and so constructed that it would phase out automatically when prosperity is restored. The proposal that Phil Klutznick made is similar.

What I am saying is that big deficits, huge deficits, in fiscal years 1975 and 1976 have become inevitable, and that they are the only route back to prosperity and to appropriate antiinflationary budget balancing in the years ahead.

We should learn from 1972 and 1973 that pumping the fiscal gas when the economy is roaring ahead can worsen inflation problems. But the lesson of 1974 is that efforts to balance the budget in a recession can produce a severe plunge in the economy and a massive deficit in the budget. It should be clear that the architects of the so-called horrifying deficits we face today are the people who balanced the budget during the recession last year. Their failure to take a stitch in time left the economy in tatters. Every cent of the $52 billion deficit in the administration's budget stems from the impact of the recession in eroding Federal revenues because of the collapse of private income, and in expanding Federal bills for unemployment benefits and similar automatic antirecessionary expenditures.

All in all, if I abstract from the energy program and compare my other recommendations with the President's budget, I am recommending roughly $10 billion more tax reduction, and roughly $12 to $15 billion more Federal expenditure in fiscal year 1976. The resulting deficit would be about $80 billion. Let us face the fact that, because of the mistakes of the past that have plunged this big economy into a deep recession, there is no cutrate recovery program.

I am confident that our debt managers can finance this huge deficit without encountering serious problems. Indeed, I wish we had no economic problems more serious than that of financing the deficit.

Let me turn now to monetary policy. Since the middle of 1974, the Federal Reserve has permitted a recession inducing collapse of private credit demands to be reflected in gradually declining interest rates. But it has worked harder to make that descent of interest rates gradual than to promote the decline. Put simply and bluntly, monetary policy has not been fighting the recession.

The Federal Reserve has operated very differently in the past 8 months than in the first half of 1974. In that earlier period, pursuing a vigorously restrictive policy, the Federal Reerve refused to let the money stock grow rapidly, even though that refusal led to an abrupt rise in interest rates to stratospheric levels. Since midyear of 1974, however, the Federal Reserve has virtually ignored the money stock, allowing it to stagnate, in order to avoid an abrupt decline of interest rates. Neither of these strategies has served the Nation well. The greatest damage to the economy came from the policy of the first half, which singlemindedly pursued money targets and ignored the impacts of soaring interest rates on top of fiscal restraint.

Staying on a money track in that period was a terribly serious mistake, but the excessive focus on staying on an interest rate track since mid-1974 is also imposing a growing burden on the Nation. The level of interest rates continues to be too high for an economy in a tailspin. A shift from gradualism to decisiveness in lowering the Federal funds rate and the discount rate can help to hasten and promote the recovery in homebuilding, and to contain the extent and duration of the inventory liquidation.

Finally, let me add that I see absolutely no need in the foreseeable future for credit allocation devices. The general monetary situation ought to be sufficiently relaxed to permit any borrower with a legal use of funds to exercise his demand in the marketplace.

On the inflation side, I am concerned about it and I have thought a good deal about it. I am convinced that by no stretch of the imagination would the fiscal and monetary policies that I am recommending create a danger of demand inflation. Outside of energy, every industry in every sector will continue to have more labor and capital than they can use, and their only shortages this year and next year will remain shortages of jobs and customers.

Nonetheless, inflation will remain a serious problem for the American people. To be sure, the weakening of markets has made a difference. It is lowering the prices of farm products and of other raw materials. It is also lowering down sifinicantly the advance of nonunion wages. We may already be out of double-digit inflation.

But that is not a satisfactory rate of improvement for so weak an economy. When demand was stronger than supply, prices went up. Now that it is weaker than supply, production schedules and payrolls go down.

The American people should be looking for a less expensive, more humane, and prompter end to inflation that, I believe, must include greater efforts to curb increases in prices and wages in those areas that are not responding to the weakness of markets today.

I think all three of us have expressed the conviction that more needs to be done to curb inflation, although we vary in our approach to the problem. But more direct action on wages and prices is necessary in

order to at least get the consolation prize of ending inflation out of this severe recession.

Finally, let me turn to energy. I agree with the President on the need for a program to curtail oil imports, beginning now. To be sure, over any short period, the least costly policy to the United States is the line of least resistance; just pay the inflated monopoly price set by the oil cartel. But over the long run that passive policy can be very costly. It would accept the drain on U.S. purchasing power. It would commit us to offering financial assistance to weaker oil-consuming countries in order to preserve international monetary order. It would encourage a proliferation of cartels in other products. It would prolong U.S. trade deficits and budgetary deficits. It would embolden the cartel to raise its prices further. Most of all, it would enhance the political power of OPEC at the expense of our own national security.

I see the recession as no excuse for a delay in curtailing imports, and those who use it as an excuse sound to me like the proverbial fat man who is ready to diet, but insits on starting tomorrow rather than today.

Although I approve of the President's objectives, I regard his program for achieving them as sorely defective in several ways:

First: It assumes, but does not ensure, that cutbacks in U.S. consumption of petroleum will reduce inports on a one for one basis. Our large companies have to decide whether to get their oil from abroad or domestically today. They have to bargain with oil producing countries, they have to placate those host countries, and they can not hold their own at the bargaining table. Hence, I believe that the most urgent step in national petroleum policy is to achieve Federal control over oil imports through a quota system.

Second: The administration's effort to cut imports ignores many opportunities for stepping up domestic production rather than restricting consumption. We need an energy production authority. More generally, we need to develop a set of rules of the game for the domestic energy industry, with proper incentives and disincentives to encourage them to produce as much as possible, as rapidly as possible, and as competitively as possible. But even with strong measures to expand domestic supply, some curtailment of energy consumption will be necessary, and some increases of prices in energy will in turn be necessary to achieve that.

But the administration's program seeks to achieve that cut in consumption in ways that are seriously inflationary, and that is its third error on my scorecard. We can have higher energy taxes, and avoid inflationary effects, if we recycle the revenues from those taxes into reductions of price-raising taxes on other products—for example, by giving the States and localities money to lower their sales taxes or other taxes that enter directly into consumer prices.

I have mentioned this proposal a dozen times in the last 4 months. I would love to go into it in greater detail, if anybody here shows any interest.

While the antirecession program has an urgency of hours and days, the development of an energy program should take a few months. It is complex and novel and requires study. Congress must rebuff un-

reasonable demands for quick rubber-stamping, and it should emphatically resist the administration's gamble with depression in order to pry loose an energy bill. The possibility of imposing a $3 tariff and decontrolling old oil prior to the enactment of any offsets just frightens me. It would be an economically runious program.

On the other hand, Congress should act on energy with all deliberate speed, and should resist the temptation to use the recession as an excuse for avoiding tough and controversial decisions.

The significance of the decisions now before the Congress extends far beyond their impact on real GNP, the inflation rate, the unemployment rate, for these decisions are major test of the responsiveness, soundness, and rationality of our political and economic institutions. The economic policymaking of 1975 must improve on the unfortunate record of 1974.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Okun.

[The prepared statement of Mr. Okun follows:]

PREPARED STATEMENT OF ARTHUR M. OKUN [1]

A year ago, on February 21, 1974, I told this Committee that we were in our sixth post-war recession and needed fiscal stimulus "to contain the damage in output and employment." On March 20, I urged the Senate Finance Committee to cut income taxes in order to "alleviate the pinch on consumer purchasing power," supply "a landing net for our recessionary economy," and ensure against "a prolonged and sharp slide in employment and output." During the Summit in September, I advanced a number of alternative measures of selective tax reductions to support the economy and reduce inflation. On October 16, testifying again before this Committee, I reported that the economic outlook had deteriorated faster and farther in the previous few months than at any time in my professional career. On December 11, before the Senate Committee on the Budget, I characterized this deterioration as "frightening." On January 28, I urged the Committee on Ways and Means "to recognize the present situation as a national economic emergency," and to enact effective "anti-depression insurance."

After a year of playing this unaccustomed role of Jeremiah, I have run out of slogans and epithets. I have to resist the temptation to raise my voice in frustration and the inclination to throw up my hands in despair.

It is incredible and deplorable that, to date, no significant action whatsoever has been taken to rescue the economy. The recent experience is the saddest episode in economic policymaking since the passage of the Employment Act of 1946. It stands not only as a blemish on the records of the Administration, the Congress, and the Federal Reserve; but, more seriously, as a questionmark on the adequacy of the policymaking processes of our democracy.

The nation's rate of production is currently running some $175 billion below the levels that would be generated by an average prosperity with a 5 percent unemployment rate. That is the present toll of idle men and idle machines, and it keeps growing with the end nowhere insight. It becomes ever more likely that the history books will record this episode as a depression rather than a recession. It would take a miracle to stopunemployment below 9 percent, and it is close to an even bet that it will reach 10 percent.

Although homebuilding and auto sales may be close to hitting bottom, an inventory correction of major proportions and a slashing cutback in plant and equipment spending are clearly in prospect; these will pull the economy down to even lower depths in the months ahead. History offers no guidance as to when and how the economy would pull out of its tailspin, if left alone. The present experience is unprecedented, and the forecasters are operating off the charts.

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[1] The views expressed are my own and are not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

The main causes of the recession have been: (1) The shrinkage of consumer real disposable income resulting from higher food and fuel costs and from strongly restrictive budgetatry policies; and (2) the impact of astronomical interest rates on homebuilding and other credit-financed expenditures. These are diseases that economists know how to diagnose and how to cure. And the prescriptions for the cure are right in the hands of the policymakers.

TAX CUTS

The Administration made a constructive initiative to boost consumer income in recommending a $12 billion rebate on personal income tax bills from 1974. But it makes no sense to dilute that tonic by administering it in two doses split between May and September. The Congress is responding to that request, but it is acting as though this were just another tax bill instead of a declaration of war against recession. It ought to separate the rebate from all other tax issues and enact it immediately at a level at least matching the $12 billion proposed by the President. And it ought to order the Internal Revenue Service to gear up to pay the rebate checks on a 24-hour day, 7-day a week basis. That rebate will do us more good in the next six months than any other stitmulative measure.

With consumers hanging on to their standards of living by their fingertips. they will use any support that comes their way through tax reduction. It will bolster their spending on goods and services, and thereby help end the plunge in sales, production, and employment that has gripped our entire economy. And the proposed rise of $4 billion in the investment tax credit for 1975 would help to bolster business spending and contain the slashes in capital budgets.

But even a $12 billion one-shot tax cut for consumers does not provide enough anti-depression insurance. It should be followed by a further tax cut working through the withholding system that provides $10 billion during the second half of 1975 and another $10 billion in 1976. The increase in the investment tax credit should also be extended through 1976. All in all, I am urging a total tax reduction of $26 billion in 1975 and about half that amount in 1976.

EXPENDITURE POLICY

At a time when purchasing power is so urgently needed, it would be an economic, as well as a social, atrocity to cut the purchasing power of the poor, the elderly, and federal employees by changing the established rules of the game for determining social insurance benefits, federal pay, and food stamp costs. An overwhelming bipartisan majority of the Congress showed its wisdom in rejecting the Administration's proposal for raising the cost of food stamps. I trust the Congress to display equal wisdom in rejecting emphatically the Administration's proposals on federal pay and social security benefits.

On the other hand, the recession must not create an open season for the expenditure side of the budget. The recession cannot be fought with public works projects. Through five post-war recessions, we have made efforts to gear up anti-recessionary public works; but they have yielded only pennies of added expenditures during the recession and dollars of added expenditures during the next period of prosperity when the economy least needed them.[2] Similarly, the evidence of five years of experimentation with public employment programs suggests that they can play only a limited role because they too take time to be geared up. I do not see how states and cities could conceivably add one million nonprofessional workers to their payrolls in a year (as some suggest), when that is three or four times their average annual increase.

Thus, I see only limited possibilities for supplementing tax cuts as the basic anti-recessionary cure. One appealing possibility has been advanced by my colleague, Charles Schultze. He has suggested a temporary cyclical increase in general revenue-sharing based on the level of the national unemployment rate and so constructed that it would phase out automatically when prosperity is restored. If the Congress is convinced that such an added flow to states and cities would prevent recession-induced slashes in expenditures and increases in taxes (rather than merely have Uncle Sam do the borrowing for the other governments), it should enact this proposal.

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[2] See the record of the 1962 accelerated public works program detailed by Nancy Teeters in *Brookings Papers on Economic Activity (1:1971)*, pp. 232–33.

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In general, I am pointing to two key tests of a valid anti-recessionary proposals: Does it really stimulate production and jobs during the recession? Does it stop stimulating the economy during the recovery as prosperity is regained? Although it is hard to imagine an excessive fiscal stimulus during 1975, it is easy to imagine mistaken efforts that would stimulate the economy for too long and contribute to another round of rising inflation toward the end of the decade.

Big deficits in fiscal years 1975 and 1976 are the only route back to prosperity and to appropriate anti-inflationary budget balancing in subsequent years. We should learn from 1972 and 1973 the lesson that pumping the fiscal gas when the economy is roaring ahead can worsen inflation problems. But the lesson of 1974 should remind us that efforts to balance the budget in a recession can produce a severe plunge in the economy and a massive deficit in the budget. The architects of the so-called horrifying deficits we face today are the people who fought for and nearly succeeded in balancing the budget during the recession last year. The failure to take a stitch in time left the economy in tatters.[3] Every cent of the $52 billion deficit in the Administration's budget stems from the impact of the recession in eroding federal revenues and expanding federal expenditures. As private incomes have contracted, so have the tax bills of individuals and corporations, while the federal bills for unemployment benefits and similar anti-recessionary transfers have soared.

All in all, if I abstract from the energy program and compare my other recommendations with the President's Budget, I am recommending roughly $10 billion more tax reduction and roughly $12 to $15 billion more federal expenditure in fiscal 1976. The resulting deficit would be about $80 billion. In view of the mistakes of the past that have plunged this big economy into a deep recession, there is no cut-rate recovery program.

I am confident that our debt managers can finance this huge deficit without encountering serious problems. Indeed, I wish that we had no economic problems more serious than financing the deficit. One of the most salient characteristics of recent months is the collapse in private credit-financed expenditures for homes, automobiles, other consumer durables, inventories, plant, and business equipment. Indeed, the abrupt weakening of private credit demands is the Federal Reserve's explanation for the failure of the money stock to grow significantly since the middle of 1974. There is ample room in both private and Federal Reserve portfolios for good, safe, short Treasury securities. Any problems posed to the Federal Reserve in preventing temporary money market congestion due to Treasury financing should not even be comparable to those it handled so adeptly last year when it temporarily extended several billion dollars worth of credit in connection with the crisis of the Franklin National Bank.

MONETARY POLICY

I am suggesting that, since the middle of 1974, the Federal Reserve has merely permitted a recession-induced collapse of private credit demands to be reflected in gradually declining interest rates. It worked to make that descent of interest rates gradual rather than to promote it. Put simply and bluntly, monetary policy has not been fighting the recession.

The Federal Reserve has operated very differently in the past eight months than in the first half of 1974. In the earlier period, pursuing a vigorously restrictive policy, the Federal Reserve refused to accommodate demands for credits that tended to make the money stock grow more rapidly than 6 percent, even though its refusal led to an abrupt rise in interest rates to stratospheric levels. Since midyear, however, the Federal Reserve has virtually ignored the money stock (and allowed it to stagnate) in order to avoid an abrupt decline of interest rates. Neither of these strategies has served the nation well. The greatest damage to the economy came from the policy of the first half which singlemindedly pursued money targets and ignored the impacts of soaring interest rates and fiscal restraint. But the excessive focus on stabilizing the decline of interest rates since mid-1974 is also imposing a growing burden on the nation. What borrowers have to pay for credit is the level (and not the recent change) of interest rates, and that level continues to be too high for

[3] The $35 billion swing toward restraint in the Federal budget from 1973–I to 1974–III is ably documented by the Council of Economic Advisers in its *Annual Report*, 1975, pp. 63–65.

an economy in a tailspin. More active Federal Reserve policy can help to hasten and promote the recovery in homebuilding and to contain the extent and duration of the inventory liquidation.

I know of no formula for the money stock, interest rates, or any other monetary indicator that would tell the Federal Reserve just how to improve its performance in the months ahead. It should shift from gradualism to decisiveness in bringing down the interest rate on federal funds and the discount rate. And it should keep those rates down until the money stock recovers from its large recent shortfall. That shortfall since mid-1874 of "uncreated money" is nearly $10 billion compared with a normal average trend and even larger compared with an appropriate anti-recessionary trend.

Finally, I see absolutely no need in the foreseeable future for credit allocation devices. The general monetary situation ought to be sufficiently relaxed to permit any borrower with a legal use of funds to exercise his demand in the marketplace.

INFLATION

By no stretch of the imagination would the fiscal and monetary policies that I am recommending create a danger of demand inflation. Even with this program, we would have to be extremely lucky for the unemployment rate to get down to 7 percent sometime in 1976. And that means the economy will be operating between $100 and $200 billion below average prosperity levels. Outside of energy, every industry and every sector will continue to have more labor and capital than they can use, and their only shortages will remain shortages of jobs and customers.

Nonetheless, inflation remains a serious problem for the American people. The weakening of markets has made a difference; it is lowering the prices of farm products and of other raw materials that are traded in auction markets and promptly reflect changes in supply and demand; it is also slowing down significantly the advance of nonunion wages. We may already be out of double-digit inflation.

But that is not a satisfactory rate of improvement for so weak an economy. When demand was stronger than supply, prices went up; now that it is weaker than supply, production schedules and payrolls go down. The same business firms that raised their prices in response to strong demand during 1973 and 1974 ought to be lowering them in response to weak demand today. The Budget presented one five-year scenario with prolonged and severe unemployment through the rest of the decade, supposedly required to get the inflation rate down. For the whole period of 1974–80, that scenario involved a loss of production of nearly $1 trillion compared with a normal prosperity path. That scenario may be too pessimistic. But if that is close to the price of old-time religion, the American people should be looking for a less expensive and more humane way to end inflation—and I suggest that that route must involve greater efforts to curb increases in prices and wages in those areas that are not responding to the weakness of markets today.

ENERGY

I agree with the President on the need for a program to curtail oil imports, and I regard his target for the cutback—1 million barrels a day by the end of the year—as feasible, although perhaps a bit over-ambitious and not at all sacred. Failure to adopt some significant cutback would be short-sighted. To be sure, over any short period, the least costly policy for the United States is the line of least resistance; just pay the inflated monopoly price set by the oil cartel. But over the long run, that passive policy is very costly: it accepts a drain on U.S. purchasing power; it commits us to offer financial assistance to weaker oil-consuming countries in order to preserve international monetary order; it encourages a proliferation of cartels in other products; it prolongs U.S. trade deficits and budgetary deficits; it emboldens the cartel to raise its prices further; and, most of all, it enhances the political power of OPEC at the expense of our own national security.[4]

If, in concert with other oil consuming countries, the United States curbs its oil imports from OPEC, it will help to bring about the only happy ending for

[4] See the detailed discussion of these costs in my testimony of February 5, 1975 before the Subcommittee on Multinational Corporations of the Committee on Foreign Relations, United States Senate.

this saga—the elimination of the cartel as a potent monopoly force. Some critics of the Administration's cutback program sound like the proverial fat man who is ready to diet but insists on starting tomorrow rather than today. The recession offers no excuse for delay—it is, in reality, an easier time to start the diet than a period of recovery or of prosperity.

Although I approve of the President's objectives, I regard his program for achieving them as sorely defective in several ways.

First, it assumes, but does not ensure, that cutbacks in U.S. consumption of petroleum will reduce imports on a one for one basis. For many large oil companies, a cut in their U.S. marketing needs may lead them to work less hard to pump oil domestically while maintaining their normal procurement from foreign sources. Those companies have to bargain with oil-producing countries, and they cannot hold their own at the bargaining table. Hence, I believe that the most urgent step in national petroleum policy is to achieve federal control over oil imports through a quota system.

Second, the Administration's effort to cut imports ignores many opportunities for stepping up domestic production rather than restricting consumption. We need an energy production authority. And more generally, we need to develop a set of rules of the game for the domestic energy industries, witth incentives and disincentives that encourage them to produce as much as possible, as rapidly as possible, and as competitively as possible. That will require domestic energy capability to be one of the most profitable areas in which to invest capital, develop technology, and commit human talent for the decade ahead. But it will also require disincentives to investment in OPEC and in nonenergy mergers and disincentives to holding back production.

If we take strong measures to expand domestic supply, we will not need to cut our consumption deeply in order to achieve a reasonable target of cutting imports. But some curtailment of consumption will be necessary, and some increase in prices of energy will, in turn, be necessary to achieve that. But the Administration program seeks to achieve the cut in consumption in ways that are seriously inflationary, and that is its third error on my scorecard. We can have higher energy taxes—on crude oil or gasoline or anything else—and avoid inflationary effects, if we recycle the revenues from those taxes into reductions of price-raising taxes on other products. The best option I see for that lies in a novel, but nonetheless feasible, special revenue-sharing program. Suppose a $20 billion energy-tax program is enacted and that simultaneously $100 per capita is offered to states and cities that reduce equivalently their sales taxes or other taxes that enter directly into consumer prices. (The few states that now obtain less than $100 per capita from price-raising taxes would collect the full $100 by bringing them down to zero.) With this plan, the consumer price index would not be pushed up, and no inflationary ripples into wages or other costs should be expected.

While the anti-recession program has an urgency of hours and days, the development of an energy program should take a few months. It is complex and novel and requires study. Congress must resist Administration efforts to confront it with a fait accompli and must rebuff unreasonable demands for quick rubber-stamping. And it should emphatically resist the Administration's gamble with depression in order to pry loose an energy bill. A $3 tariff combined with decontrol of "old" oil (prior to the enactment of offsets) would be an economically ruinous program. But Congress should act on energy with all deliberate speed and should resist the temptation to use the recession as an excuse for avoiding tough and controversial decisions.

The decisions now pending before the Congress will determine whether we prevent a depression that could emerge from inadequate consumer purchasing power and a prolonged economic and political drain that could emerge from excessive oil-producer power. The significance of these decisions extends beyond their impact on real GNP, the inflation rate, and the unemployment rate, for they are major tests of the responsiveness, soundness, and rationality of our political and economic institutions. The economic policymaking of 1975 must improve on the unfortunate record of 1974.

Chairman HUMPHREY. We are very much indebted to all of you for being here this morning. You have presented statements that are thoughtful and provocative, and they will elicit questions from us now.

Senator Javits has another engagement, and I am going to yield my 10-minute questioning time at this point to Senator Javits, and then when he is through I shall come back and ask you some questions. Then we will move in a regular sequence here.

Go ahead, Senator.

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

I would like to thank Senator Percy, our ranking member who is here, Congressman Brown, on the minority side, and my majority colleagues for allowing me to proceed out of order. I shall be very strict about the 10 minutes.

First, I should like to thank the witnesses for unusually illuminating testimony that has sustained on all three witnessess. It has been most extraordinary.

Second, I think they do the country an enormous service by pointing out that we are hung up on traditional remedies for dealing with the recession, to wit, by suffering oil privation, and also hung up on a hangup, which seems inconceivable to me, against any form of government regulation, that everything has to happen by itself, and these two twin poles of trouble have simply got to be exorcised if we are going to get anywhere now. I am grateful to the witnesses for pinpointing it so very, very sharply.

Now, the one thing I would like to ask you, Mr. Klutznick, is about the investment tax credit. If you combined what you said in the beginning of your prepared statement on that subject with what you say later on in your prepared statement; that is, the urgent necessity for stimulating housing, how do you feel, or the CED, or both, about endeavoring to pinpoint the investment tax credit to those items which are the most urgent for us; to wit, for example, in housing, perhaps railroad reconstruction which is urgently necessary, or any other area which is very seriously suffering and perhaps is operating at less than what it could do, even in the present framework, because of the inaedquacy of equipment, et cetera? In other words, shall we or any of us here—I am very interested in doing it myself—seek to confine the investment tax credit to the increased rate, or perhaps even increase the inducement through the credit to stimulate particular industries; to wit, first and foremost, housing?

Mr. KLUTZNICK. Senator Javits, I think that that question I must answer as an individual. I think the investment credit applied to housing in its traditional form would not be too productive. On the other hand, with utilities, which are suffering most unfortunately in this situation, it could be quite productive. Why do I say it cannot be quite as productive in housing? Most of the housing in the country is still produced, with the exception of a few companies, by small business operations, where the amount of investment that they would be entitled to get a credit against is relatively small in relation to what they produce; whereas in the utility field, the demand for major investment of the type that Bob Nathan has been talking about ought to be encouraged in every way possible. In railroads it is a shambles. It ought to be encouraged there. Should it be completely pinpointed? Well, I am not prepared to say. I should say I believe that there ought to be an allocation and use of the power of government to differentiate between the things that need doing and the things that can wait

awhile. I pick those two examples. The housing business, which I think I know best, needs a marketable product. That is a product which is produced at a marketable level, as determined primarily by the interest rate.

Let us not delude ourselves. There is evidence that the costs of production are going down right now. Contracts that are entered into today for any kind of construction are down from where they were a month ago, and they are going down quite radically in some kinds of business. But in our country, the ability of a person to buy a house or rent a house is dependent, in the main, on the level of credit and interest rates and terms of amortization. That is where the greatest success could come in that field.

Senator JAVITS. I am very cognizant of the fact that in order to have the investment tax credit meaningful, it has to be given to people who are making money, because if you have losses, you do not get anything out of the investment tax credit. So, I thoroughly agree with you. The railroads is one starting example. So few of them are making anything.

I would like to ask one other question of you and then get the comment on both from the other witnesses. That is about an RFC which I see you mentioned or employ in your prepared statement in terms of a general financing mechanism, and then specify although in rather brief form in your prepared statement, where you actually call for an RFC, and I quote: "In my view, this will, among other things, call for new or changed institutions, most importantly the revival of something like the old RFC."

Now, can you help us with any specificity on that score? Incidentally, I am deeply convinced that that is what we have to do. Is there any specificity you can give us on that?

Mr. KLUTZNICK. Let me start first with a simple proposition. Senator Javits, I do not agree that there is plentiful money available for the people who need it, even today. On credit allocation I do not agree completely with either Mr. Burns or Mr. Okun. I sit on the board of a couple of banks. Unfortunately the people who need credit the most—and at a time when they need it most, in order to stay alive in business—are not preferred credit risks even yet. It will be some time before they get it, if at all.

Now, when I referred to an RFC, I said an RFC type. I am reminded that during the Great Depression, and I hope that Arthur Okun is not completely right and that we do not live through something worse and call it that, we created an HOLC, we created an RFC. I was intimately concerned with the HOLC because I was present when it was liquidated. It is a very interesting thing, what we did. We violated every rule of crediting, and we came out paying back every cent at the end of the run. My recollection was we ended up with a $69 million profit.

Only the Government can take those kinds of risks. The Federal Reserve can speak easily about available money, but if you sit on the board of a bank, and you get a Federal Reserve report on some of the credit risks you have taken, the next time you do not make the loan. The next time the poor fellow that comes in who needs $100,000 to stay alive, just is not going to get it because you do not want to

have classified loans in your portfolio. I can anticipate that over the next year or two with plentiful money, those types of businesses that are essential to the economy, not just small businesses that qualify for small business loans, but those who need early and quick credit are going to have a hard time getting it. Consequently I would say an institution modeled after the RFC, but with more limited authority, will be badly needed no matter how much money is available. This institution would not have to engage in some of the exploratory ventures that the RFC got into during the war, but would be limited to the business of providing essential credit, where you throw away the rule book to save an essential business or a segment of an essential business.

But banks are frightened today in extending certain types of credit, and justly so in light of what has happened.

Senator JAVITS. Mr. Nathan, I have 2 minutes.

Mr. NATHAN. Thank you, Senator. I happen to be on the board of a bank, too, and I agree with what Phil Klutznick said. I just do not feel that under the present situation you are going to wave a wand with the big word confidence on it, and people are going to be responsive, either on the lending or borrowing side of it.

I think, Senator Javits, that the investment tax credit is a useful device, but I do not think we ought to fail to recognize that it has some aspects of a number of thumbs, rather than sensitive abilities to adjust. There are an awful lot of companies in this country that are going to get a windfall out of it. If we in my own little firm happen to buy equipment this year or whatever we do this year, if we get the benefit of the investment tax credit, it does not mean anything to us; we will buy it whether we get credit or not. But I think this is one of the problems that is not selective. But on the other hand, the real question is, How do you define incentives with a selective element? Who is going to make the decision? This we recognize.

So I myself would favor an expansion of the investment tax credit. I must say, having testified before in many public regulatory agencies for utilities. I thought the first suggestion that had been made in the House, by the President, of going to even 12 percent in investment credit for utilities for a couple of years, made a lot of sense. They are in such trouble. Most people do not even have any idea of the degree of severity or difficulty that is facing the utilities in this country. I would carry it somewhat longer and not drop it back.

I do think one of the things, Senator Javits, that would make investment tax credit more useful—because you are absolutely right, a tax credit does not mean anything unless you have profits—may be a longer averaging period. If you average back a little longer, you would make that investment credit somewhat more attractive.

But I feel very strongly that something additional is needed, I would suggest, maybe not an RFC, because it should not be only a bailing out operation. I think maybe we should have a development finance corporation, or possibly even two—one, a development finance corporation of a general nature where shortages arise; and the other, a very special energy finance corporation which would be concerned primarily with coal and coal cars and equipment, and drilling equipment, and oil and shale, and experimenting in the short markets—a whole variety of measures to try to expand our energy capacity.

One of the major problems that does concern me, and if I were trying to write the legislation I would be very much concerned about this, is that you want to be careful—I think we did this in the RFC. I happened to be around when it was formed and when it was operating; in the same building most of that time in the thirties—is that you do not want the borrowers or even the equity sellers, if the development financer or RFC were to buy equity—you want to be very careful that they do not lose their own legs and rely totally on the crutches, because we do not want government ownership of the utilities. At least I hope we do not. And I think there is a real problem.

But one of the great difficulties is not only the lack of credit for some, but the long-term interest rates are going to be sticky. Unless the rate of inflation goes way, way down, the inflation premium is not going to let long-term rates fall as rapidly as short-term rates. This has posed a very real problem on the utilities and others, because the debt-equity ratio has risen so high that the interest coverage is low and their bond ratings have gone down. Ithink you need something like this, because to rely only on interest rates in the next few months is not going to be helpful enough.

So, I would strongly urge the development of one corporation or two, which would engage in selective availability of funds a attractive rates.

Senator JAVITS. Thank you very much, Mr. Nathan. I am going to have to leave it to my colleagues whether they will allow Mr. Okun to answer as well.

Chairman HUMPHREY. Yes, please go ahead.

Mr. OKUN. I will try to be brief, Senator. I agree with Bob Nathan on the investment tax credit. I have often thought about ways to make it selective—there are some real attractions in that—but I have never found a way that seem quite satisfactory. One the one hand, where there are special social priorities for investment, as in transportation and energy, some promotion of that would perhaps be better accomplished on the expenditure side of the budget rather than by taxation. Second, I do think that the evidence of recent years has been that capital spending tends to go where it is needed in a prosperous economy. At the beginning of last year it looked very encouraging that there were very large increases in the capital budgets of the chemical, steel, other metals industries, and the paper industry. The industries that had experienced shortages were responding by expanding capacity. One of the longer term costs of the recession is that we are losing that incentive to invest where there is no final market and no profits to finance the expansion.

I think we really should raise the investment credit across the board, recognizing that any purchases of producers' equipment at this point is good for creating jobs and income, and for stimulating the economy.

I find the RFC type of proposal one of the most perplexing things. I think there are real dangers in opening up a bailout. It would encourage more risky activities that should not be undertaken, because businesses would feel that they have this to turn to if their activities do not go well.

However, there are some cases where, even though we do not want to bail out management or bail out stockholders necessarily, the whole society depends on their activities, and we have to handle them. I am not sure whether we can do better by institutionalizing it than by dealing with it on an ad hoc basis. It is unfortunate to have particular pleas and particular special bills come up time after time. Maybe, properly administered, an RFC type of institution can be utilized, but it is important to develop a set of criteria of how it would operate to make sure that it did not just become a general landing net for people who pulled tricks on high wires.

Senator JAVITS. Thank you very much, gentlemen, and thanks to the chairman and my colleagues. You have been very indulgent.

Chairman HUMPHREY. Now, gentlemen, I would take just a few moments of your time, and we will proceed in the regular order on the questioning.

I gather that all three of you feel that the antirecessionary program, or the stimulative program that the President has presented, both the tax policy and the energy policy is inadequate for the troubles that beset us. Am I stating it correctly, or do you wish to indicate to the contrary? Mr. Okun.

Mr. OKUN. You are stating it euphemistically.

Chairman HUMPHREY. All right.

Mr. NATHAN. It is an understatement, if anything.

Chairman HUMPHREY. Mr. Klutznick.

Mr. KLUTZNICK. Mr. Chairman, I find myself in the uncomfortable position in the CED of finding businessmen more eager for a progressive antirecessionary program than the Government; and therefore, I think you are saying it very well.

Chairman HUMPHREY. So, the sum and substance of your testimony is that more needs to be done, particularly on the stimulative side, as an antirecession program. Mr. Klutznick, you indicated that the fear of reimposition of controls is making businessmen reluctant to cut prices. Is that correct?

Mr. KLUTZNICK. I did not hear that completely.

Chairman HUMPHREY. You indicated in your testimony that the fear of the reimposition of wage and price controls is making it more difficult for industry or business to cut prices.

Mr. KLUTZNICK. In my judgment, the overhanging fear does contribute, not to a cut in price, but I think may well have watered a lot of prices in the last 6, 8 months.

Chairman HUMPHREY. Yes, I think you used the analogy that water has been pumped in, and you would like to see it squeezed out.

Right at the heart of all of this discussion today is the whole subject of monetary policy and interest rates. There are so many questions that we can talk about, but I thought I would just pick out one or two. How do you get interest rates down, and not just short term, but long term? Because when they are talking interest rates, it is the long term that has the effect upon investment. Particularly, is this true in capital goods, and it is also true in housing; and what we need here is some guidance, and indeed some instruction and counsel, on just what kind of policies need to be pursued to bring these interest rates down. We know that short-term rates are down. I think

it is fair to say, as you have indicated today, that the Fed has been easing on the money supply, insofar as at least where the liquidity of the banks is concerned. I have noticed from my observation that the Federal Reserve System always takes care of the banks first, as they did with Franklin National; and I am not opposed to the fact that they did that. I think not to have done so might have triggered some kind of a panic, or at least some real difficulties in the banking structure. But how do we get at this key problem that one of you just alluded to a moment ago, of the longer term interest rates?

Mr. Okun.

Mr. OKUN. Basically, a more drastic cut in short rates is the way to get at long rates. I do not think there are independent mechanisms of great significance that could improve the responsiveness of long-term interest rates. Short rates are still too high. Certainly, the prime interest rate of banks is far too high, and so is the Federal Reserve discount rate. The Federal funds rate ought to be at unsustainably low levels, maybe 3 percent or 4 percent, in order to encourage more portfolio action by the banks. The Federal Reserve could help directly in a limited amount by buying long-term government notes. But basically, there is a linkage between short-term interest rates and long-term interest rates—you are going to get a small fraction of a decline in long-term interest rates for the decline in short-term interest rates, so you have to make the decline in short-term interest rates very large.

Chairman HUMPHREY. Are you saying, in other words, then, that the Federal Reserve Board has not done enough, or that it can do more?

Mr. OKUN. I certainly do believe it has not done enough. I would characterize monetary policy as not having done anything to fight the recession, which has simply led to a collapse of private credit demands, bringing credit rates down. I interpret their behavior as trying to cushion the decline, rather than to promote that decline. I think much more decisive action in bringing down short-term interest rates was called for all along, and is still called for.

Chairman HUMPHREY. As I viewed it, it appears that the Federal Reserve Board has been setting for us what our output and employment targets ought to be, rather than the Congress. The Employment Act of 1946 calls upon the Congress and the executive branch and the agencies of government to maximize employment, production, and income; that is, to have a policy that pursues the course of maximum employment, income, and production. But apparently, we have been relying upon the Federal Reserve Board to set those target goals, and they have set them in the style which has not used the word "maximum." Do you disagree with that, or do you have any observations, Mr. Okun?

Mr. OKUN. That has been the effect of their policies. I do not think you mean to imply that they have literally sat down and thought of what the targets for employment and production should be. I suspect that, if they had done that, they would have realized that more had to be done in order to reverse this avalanche in the economy.

Chairman HUMPHREY. In all fairness, I think that they are about the only agency that has acted in any one way or another. The rest of the Government has been sort of letting things slide.

Mr. Nathan.

Mr. NATHAN. I would think——

Chairman HUMPHREY. I want you to also address yourself to that long-term interest rate thing.

Mr. NATHAN. I think, Mr. Chairman, that this problem of the inflation and the psychoses and real concern that permeated our whole economy, and the failure really to do the job against inflation that should have been done, lies at the heart of a lot of these measures. First of all, I think there is a significant linkage between short and long range rates, but it does not always work very quickly and easily, especially in a period of serious inflation. I think you do have an inflation premium in long rates, and people are crazy to lend money at 10 percent when prices are rising at 12 percent. You know you are going to get back lower value dollars than you put in, and your interest does not even cover the deterioration of the buying power. But people do anticipate, over a long run, well, maybe we will overcome this inflation. But I think we are going to have a bigger lag between short and long rates than has historically been true until you get the inflation really down. That is why I would like to see some intervention to get us down to 3 or 4 percent inflation within the next 12 months. I think it could be done, and if we do that, you will find long rates will be coming down.

Now, what has happened, of course, in recent years, is that a lot of businesses who normally finance long-term capital through long-term sources of funds and loans have gone short. They have borrowed short in anticipation that longer rates will go down sooner or later, and they will shift to readjust their demands or needs through the normal channels. But now, I think you are going to have even an intensification of that effort, as the gap or the lag between long and short has grown. I think that the Fed ought to have loosened up a lot more, a lot earlier. I think it would have a salutory effect on long rates over time. But if you want to really see long rates go down quick, let us get down to a 3 or 4 or less percent.

Chairman HUMPHREY. How do you bring those prices down, Mr. Klutznick? You addressed yourself to that.

Mr. KLUTZNICK. Mr. Chairman, as you know, I am not an economist. As a businessman, I could not disagree more with some of the statements that the economists have been giving us in recent years. We have in our business long-term rates that are yet at 8½ to 9 percent, and we have been paying 14 and 15 percent for short terms. There are more businesses that have gotten into trouble because of the short-term rate in the last 18 months than because of the long-term rate. They borrowed short to take care of a long-term need, and we had the phenomenon in this country that the short-term rate went higher, almost for a year, than any long-term rate that you could borrow at. You could even get insurance company money at 9½ percent and 10 percent. when you were paying 14 and 15 percent with all the add-ons for short-term money.

Now, here I fall out of bed altogether with some of my colleagues. I have long been concerned about the whole Federal Reserve System, which we tried to look into in the Commission on Money and Credit in 1958, 1959, 1960; and we filed a report. In that report, we said that

the Fed has always been late going up and going down, and has always done too much or too little. Now, the other night, I met with a group of businessmen, and lo and behold, one of the great economists in this country—so recognized by some—said that all over again. And I said, you said it 15 years ago, has it been going on for 15 years more? Yes, and he says, the people in the Fed are the greatest people I have ever known. I said, there is something wrong with your conclusion. Either the system is wrong, or the people are wrong, and we have never taken a good look at the Fed in these situations. All we have ever done is to complain about the Fed.

Now, there was a suggestion made that there should be—and the Congressman who made the suggestion is present—that there ought to be some allocation of credit by the Fed under certain circumstances, and everything broke loose; as if you were going to destroy the independence of the Fed. The Fed has been allocating by default in every crisis we have had, because the very nature of the Fed operation means that it has to work through the open market, to reach everything else. And that means it just cannot work too fast. It is not the fault of the people who are there. Maybe we ought to take a look, in your committee or elsewhere, at the whole way in which we finance. I do not believe that I have ever seen—now, what is it, 40 years—in the construction business off and on, public and private, a relationship which reverses itself as rapidly as the one between short rates and long rates; and in a situation where it bankrupted a whole business—the REIT business——

Chairman HUMPHREY. What is that one?

Mr. KLUTZNICK. The Real Estate Investment Trusts, that went to the public. It bankrupted one after another. They, too, were borrowing short, and short rates went up. If we are going to solve this problem by sitting back and waiting and not doing anything about it, I am not so sure that there is a relationship any longer in our economy between short rates and long rates that used to exist traditionally. Maybe it should not, but I think it ought to be examined very carefully, because there are businesses that cannot live on short rates.

Chairman HUMPHREY. Well, I hope you men can help us more on that. My time has expired.

Congressman Hamilton.

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

Gentlemen, I was impressed by your comments on income or wage-price policies. This is a day when we are hearing a lot about stimulation, but I noticed each of you took some time to talk about how to deal with inflation, and I want to go into the specifics of that with you.

Mr. Klutznick, you talk in terms of a voluntary program in your prepared statement. Mr. Nathan, you talked in terms of not needing across-the-board wage and price controls, but you have said several times today that we need some kind of intervention. Mr. Okun, I think you were not very specific in addressing yourself to it, but I would like to give you the opportunity now to be as specific as you can. What kind of intervention? Will voluntary wage price policies

work, as Mr. Klutznick has suggested? If you have intervention, how do you do it? What kind of a mechanism do you use, and when do you intervene?

Mr. OKUN. To begin with, a question is raised any time a manufacturing firm today raises prices at the same time that it is cutting back on employment and production, particularly if that is the same kind of firm that engaged in substantial price increases in the last few years. I would want to, in effect, ask for a moratorium on price increases by those large firms that have control over their prices, and that are in the process of cutting back production and payrolls. I would appeal for that on a voluntary basis. I certainly would want to investigate, to have some accounting for why price increases should be taking place contrary to the pressures of the market under those circumstances. That would also apply to collective-bargaining contracts in industries where employment is shrinking while wage increases are accelerating. I would focus perhaps on that. The presumption of a competitive economy is that, in a period where there are downward market pressures, an effect ought to show up in prices just as much as it does in an upward market state. This asymmetry that I call attention to, that when demand is strong prices go up, but when demand is weak production and payrolls go down, is inconsistent with the way the private enterprise system ought to function.

Representative HAMILTON. When you have the asymmetry that you talk about, what does the Government do?

Mr. OKUN. It takes what we are in right now—a lot of recession, a high cost of idle men and machines—to try to finally get some inflation out of the system.

Representative HAMILTON. What I am really interested in is the degree and form of Government intervention in the pricing policies of private industry, the extent that you think the Government ought to intervene, and under what circumstances.

Mr. OKUN. What I would like to see is something which is hard to legislate. If I were advising a President, I would urge him to stand up tomorrow morning and say, this is a time to call a halt to price increases in those areas of the economy that are operating well below capacity. This is going to hurt for awhile, but it is the only way out of it, and I am asking you to take that. Now, maybe you have a severe problem. Perhaps you cannot make ends meet without some price increase. Perhaps you have had major cost increases of raw materials. Then come talk to my people and tell them why you have to raise prices, but let us see you before you do it.

I would try to set some rules of the game for collective-bargaining increases along the same lines. I would expect a very good response to such a voluntarist effort.

Representative HAMILTON. You would give the President the power to declare a moratorium, the power to roll back and to intervene in fairly substantial ways?

Mr. OKUN. I would.

Representative HAMILTON. Mr. Nathan.

Mr. NATHAN. I certainly would. I think we are in a crisis of economic proportions unprecedented since the Great Depression,

and you are going to have, Mr. Congressman, a lot of people continue to fight inflation with whatever means they can. And recession is the nicest, easiest, most costly and damaging, and that is what they are going to do. I do not see how Al Rees, with his Council of Wage and Price Stabilization, can do much with 40 or 50 people. I do not know what his staff is, but I remember Senator Proxmire was chairing the committee when I was testifying on the same day, and I think he said he was going to have 40 or 50 people. And he said he would ask for more if he needed them. I do not know if he has got any more.

Senator PROXMIRE. He has 40 now, as I understand; professionals.

Mr. NATHAN. Well, I think he needs 400. I do not think we need it across the board—namely, wage and price controls—but I certainly think the minimum you need is subpena power, hearing power, delaying power; and under the most critical circumstances, even some rollbacks. If you cannot break this inflation spiral with 8-, 9-, 10-percent unemployment, and really break it, then we are in a hopeless situation; and as far as the short-term concern is facing us, I would give some real authority on all of these fronts to this Council, give them some staff, and the President the authority to do something. But, I tell you, unless the President stands up with moral indignation and attacks price increases and excessive increases anywhere, even on costs or on wages, then I think we are going to get nowhere. You have got to have that kind of leadership in fighting inflation.

Now, Congressman, there are some long-run things that I think we could start very quickly. I have been suggesting for quite awhile that somebody ought to set up a new TNEC. In 1934 or 1935, old Joe Manning, the Senator from Wyoming, chaired a Temporary National Economic Committee, and in 2 or 3 or 4 years, they did the most magnificent, thorough, comprehensive job on the nature and character of our economic system that we have ever done. And there are more studies that served for many years to characterize and describe and analyze and understand prices, administered pricing, competition, concentration, than we ever did. And today, with our computers and today with added data, we really could begin to understand what is going on. It is my conviction that we have more administered pricing today in the economy than we have ever had, more ways and means of working together and having this stickiness on the downside, and we ought to learn about it. How is it done? What are the techniques, what are the devices, what are the procedures? Does the antitrust law apply, is it effective? What kind of variations and measures ought there to be? I would like to see us take a start in the immediate future, give it plenty of funds, plenty of time to thoroughly understand what the nature of our economy is. And where we do not have competition, we do not have a real function in the marketplace—then, we may have to have some kind of intervention in those administered areas. If we are going to have socialism, we are going to have public socialism, not private socialism. Let us get rid of it; I do not want private socialism, either, which is what monopoly is. I think a TNEC—Temporary National Economic Committee—kind of undertaking would make

a tremendous contribution to understanding what the devil we do to get away from inflation and maintain high levels of production at the same time.

Representative HAMILTON. Mr. Klutznick.

Mr. KLUTZNICK. Congressman, you know, in late 1971, we in CED were so concerned about what even then seemed to us clearly an issue of critical importance, that we got the highest-level committee together that we could to determine what could be done to achieve high employment without inflation. Mr. Nathan, you were on the committee. Our policy statement, "High Employment Without Inflation" was published in July 1972, and we discussed this very question in detail. Mr. Okun, I think you were one of the advisers on that. We did a 6-month job where we would normally take 18 months. It was clear then that wage and price controls, which were at that point governmental, were going to have to be phased out; and the businessmen on our committee were recommending that there be a wage and price board that would promulgate a set of voluntary standards, and would stay in there and watch what was happening.

What was more, we felt then—and now it is even more certain—that the critical condition that faces the country is such that it was time to take advantage of the crisis, at least; as Mr. Okun said, let us at least get something out of this crisis. We built in structural impediments to the proper workings of competitive forces in both product and labor markets in the depression of the 1930's, and some of those have not even been looked at since then. And it is time that we do the kind of thing that Mr. Nathan is talking about; we ought to take a look at the built-in impediments with an inflationary bias that exist today which were built in against another day. And in this emergency atmosphere, we might be able to do something about them.

Representative HAMILTON. Mr. Klutznick, do you disagree with Mr. Okun and Mr. Nathan with regard to the kind of intervention that they describe? Your prepared statement leads me to think that you would, with the emphasis on voluntary.

Mr. KLUTZNICK. Well, my prepared statement was made on behalf of the Committee for Economic Development, and our emphasis is on voluntary cooperation. Our views on the procedures that might be followed are spelled out more fully in our 1972 statement. I do not disagree with the basic notion that government should play a role in promoting wage-price stability. I do not detest our Government. I think our Government is something that is good, and should be used in the proper place.

Representative HAMILTON. Thank you very much.

Chairman HUMPHREY. Senator Percy.

Senator PERCY. Mr. Nathan, in your prepared statement you indicate that you want to see us continue to fight on inflation. I believe that is a terribly important assertion, and I think it is implied in all of the testimony. I think just as important would be if we relinquish now, and just went hell-bound without regard for the environment. There has to be a balance, and certainly, the destruction of confidence on the part of everyone working today, with the

utter knowledge they have, no matter how big their wage increase, they are going to drop in real income and purchasing power for the first time in years, except last year—that destroys confidence. We have got to keep after both of these in consistent patterns, and I am delighted to see that. It is just one of many, many points that have been brought out this morning that I think is the reason we have 10 members of our committee here. I cannot recall when we have had as big an attendance, and I think it is a great testimony to the quality of the witnesses that we have.

I would like to ask, Mr. Nathan, about your statement on tax relief for small business; you just mention a "special tax relief for small business." I have introduced this year a bill, S. 639, which simply increases the 22-percent rate for small business from $25,000 to $100,000. After all, part of those profits are inflationary, anyway. They are paper profits; $100,000 today is equivalent to $25,000 10 years ago. Would that be a way of increasing a stimulant for small business in a very simple manner? The bill is one sentence long.

Mr. NATHAN. Well, yes. I must say I must be very careful about a conflict of interest because I run a small business corporation.

Senator PERCY. All right. Now that you have declared it, go ahead. You know something about it.

Mr. NATHAN. I think that to do that would be entirely correct. A lot of people are now recognizing that one of the difficulties that we got into in this very rapid rise in revenues and full employment surplus was attributable to the fact that with the inflation, there was an upward shift in monetary incomes, and people were thrown into higher brackets. I think you are absolutely right on the business side, and whether the 22 percent to $100,000, or maybe 22 percent to $50,000, and 30 percent to the next $100.000 might be of graduated nature. I certainly believe that something in the nature of this would be a stimulant and encouragement to small business.

Senator PERCY. I accept that modification. I will refer this testimony to the Finance Committee, then, for their guidance.

Mr. Klutznick, I will confine most of my comments on the first round to you, and I will hope to come back on the second round if we do, because I would like to talk, also, to Mr. Okun. But I would like to say this marks my 30th anniversary now of affiliation with the Committee on Economic Development. I started right in with Paul Hoffman when I came back from the war. I was excited when I was away in the Navy that here we're not a bunch of pessimists, but we're optimists; and I have been working with the Committee for Economic Development ever since. I think it is one of the most remarkable organizations that we have supported essentially by American business today.

In your prepared statement, Mr. Klutznick, you have said that you place considerable importance to the development of a consistent national policy for applying a higher tax to higher fuel-consumption motor vehicles. This morning I noticed that, unanimously, the Democratic Party has adopted a policy that they intend to carry to the President this afternoon at 3 o'clock, urging that only a tax on gas-guzzling dinosaurs, but a credit for cars that supply greater mileage.

I introduced a bill last year, and then reintroduced it this year, as S. 635, which provides a sliding scale, increasing in incentive and penalty every 2 years. But it starts out with a tax up to $1,000 on an automobile that provides less than 9 miles per gallon, and a credit of $300 for a car that gives 27 miles per gallon or above. It is self-liquidating; I figured it out so it would not cost the Government anything.

Those who want the privilege of driving those big cars around that are gas-inefficient will pay. Everyone else who is willing to have a more efficient car, and we ought to start right away. Knowing human nature, do you think that is going to motivate Detroit to move a little faster and the consumers to move much faster than this exhortation to do it at the earliest possible time? I think it will put their feet to the fire in a way they will really understand.

Mr. KLUTZNICK. Senator, first of all, may I thank you for the glowing things you said about the CED. Second, I think you should know—you might be suspicious otherwise because of my party affiliation, with which you are acquainted—I had nothing to do with what the Democratic National Committee decided. This was written before they made the decision. I just want to be sure that you understand that.

Senator PERCY. Well I hope they realize that their proposal is going to be bipartisanly supported at 3 o'clock, even though I will not be there with them.

Mr. KLUTZNICK. Sir, I think the tax is a supportable thing, but it is a very interesting thing that I have found. I have had to put a car away. A 1973 Chevrolet, with all of the emission controls on it, a small one, produces less mileage than a 1975 Cadillac per gallon of gasoline. I think there is a lot you have to go into to put Detroit's feet to the fire. I think the tax is one element in it. I think we have to get sensible environmental controls, and I do not mean by that giving up the standard of not polluting our atmosphere. But it is ridiculous to drive a small car that gives you 8 miles to the gallon because it has all the controls, when you can drive a big one that gives you 14 miles to the gallon. So we have a lot of mechanical things to go into this as well, Senator.

Senator PERCY. The other questions that I have, I think if you would like, you can supplement your answers. I would rather have brevity now, but I will provide secretarial help before you leave the building if you would like to supplement for the record.

The question you raise on confidence; the basic need is confidence. I am a little worried about the big tax rebate. I have talked to thousands of people in the last few weeks. They are very conscious of a $35 billion deficit and a $52 billion projected deficit. They think it is going to be bigger. They are going to worry, getting back from the Government $100, $200, when the Government is going deeper in debt to give it back. Do you think there are other factors that can establish confidence, other than just giving money back to people?

For instance, a settlement in the Middle East. If we could really resolve this question this year, and Secretary Kissinger leaves in a few days, if we could resolve that we would know there would be

no oil embargo. Do you think intangible evidences of world leadership like that that can help restore confidence to us, and not just taxes.

I support a tax rebate at the lower end, as you do, but do you think it is a myriad of things now that have to be done to give people faith back in leadership, both in the Congress and in the executive branch?

Mr. KLUTZNICK. Senator, I agree completely that any evidence that there is going to be peace in the Middle East or anywhere else, would make a lot of people feel a lot better; and I certainly would favor that. I am not sure, however, that we have not been mislead about the significance of the cartel. I am one of those who believe that more important than the possibility or threat of an embargo, as serious as that is, is getting that price to a level where it no longer imposes an excessive tax on our economy. Having it forced on us overnight probably did more damage than people have realized.

Now let me just say one other thing here, because I have been holding this for a spot, and this may be just as good as any. This morning, coming down on the plane, I was reading some more statistics from Henry Kaufman of Salomon Bros. And you cannot expect people to have any confidence—you think they worry about the deficit? Not as much as they worry about a statistic that comes out here that aggregate demand fell 9½ percent in the last quarter. And Henry Kaufman, then, says if you extrapolate that over four quarters you have nearly a 40-percent drop in aggregate demand.

But more damaging than that is a set of statistics that he made up on the elements of the aggregate financial assets and liabilities of households. If you look at them, you can understand why people do not have confidence. He accumulated all of the important facts, including investment insurance, income and whatnot, and comes up with the conclusion at the end of 1974 the aggregate value was $974 billion. The year before it was $1.234 trillion, and in 1972 it was $1.512 trillion. The thing that masses of people are worrying about is that they are seeing their investments evaporate; they are seeing the value of their insurance going down; and they are seeing their life's work disappearing through inflation and nobody seems to worry about it.

Now I think if, as I said at the end, Senator, if the President and the Congress get together and give us a sensible long-term program, we will get the confidence back. If the stock market quits behaving as if the United States had already quit operating; and if as a result of that, some of these people and some of these institutions can look at values that will give them courage, I think that will influence them more than the size of the deficit. You know, when you get to a deficit of $58 billion, if you do not mind my saying so, my children do not even know what it means. But they do know what it means when they do not have enough income that year as a result of inflation or other things, when they have to reduce their standard of living—that, they know.

I think we can absorb a reasonable deficit until we get back on our feet.

Senator PERCY. Thank you very much. My time is up; I hope to be back after I am on the floor to pose other questions.

Chairman HUMPHREY. Thank you very much again, Mr. Klutznick. I want to say, as I turn this over to Congressman Reuss, that this is the finest testimony that I think we could ever have. We are indebted to you, just in case I forget to say it; it is just amazing, and I deeply regret that we do not have, in instances like this, full radio, particularly, coverage, because the public needs this education. The whole purpose of these meetings is to educate ourselves and to educate the public.

Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman. I would associate myself with what Senator Percy and Senator Humphrey have just said about all of the testimony, and particularly, I am delighted Mr. Klutznick with your testimony on behalf of the CED organization, which I have admired for a long time.

Having said that, Mr. Klutznick, you have in your prepared statement one sentence that I am not sure I agree with and I want to ask you about that. That is not bad out of 17 pages, however, the rest of which I agree with.

In your prepared statement, when you were talking about international measures, you say, "Judicious interventions in foreign exchange markets that strengthen the value of the dollar can assist in reducing prices on imported goods." Now the Federal Reserve, abetted by the Bundesbank and the Bank of Italy, is now engaged —and I regret to say it has been for several weeks—in a godlike operation to try to straighten out the flagging dollar abroad by rigging the market by doing, what in any other form of endeavor, would land one in jail, and I wondered whether this is wise. I think the reason the dollar is somewhat sick abroad is for the reasons which you just outlined when you were talking about confidence a moment ago and the fact that the Government of this country seems to be running in circles instead of getting down to what it ought to be doing.

When the Federal Reserve, abetted by the Italian and German central banks, goes into the foreign exchange market to raise the international value of the dollar because they believe it is too low— who revealed this to them, I do not know—what happens to the automobile worker in Detroit who looks out at the unemployment offices and sees the fairgrounds full of unsold compacts? What does he think when his own Government goes out to reduce the price unnaturally what the market has not been doing to reduce the price of Volkswagens and Fiats?

I think it is a very dangerous thing for the Federal Reserve to do this without, so far as I know, having made the slightest analysis of the differential effect of artificially raising the external value of the dollar on our imports. Sure, you say it reduces the prices of imported goods. With the Arabs moving out of dollars, I do not think it is going to reduce the price of oil, so do you in the CED really want to encourage the Federal Reserve in its monetary rinkydinks abroad? Why do they not stick to the business of bringing about full employment without inflation in this country, which I

think would be the best guarantor of the rising dollar in the world exchange markets we could possibly want. Why rig the market?

Mr. KLUTZNICK. Well, Congressman, the word that was used here that apparently in our discussion has been lost somewhere, is judicious interventions.

Representative REUSS. Right. the rigger always says it is judicious.

Mr. KLUTZNICK. Well that is one of the problems. Mr. Nathan just said he came back from abroad; I just came back too, and I must tell you that if you sit in Geneva—and I happen to be on the board of an institution there—and you buy dollars worth of coffee —a pot of coffee costs you now $2——

Chairman HUMPHREY. How much was that?

Mr. KLUTZNICK. $2.

Chairman HUMPHREY. I had breakfast at the Pierre Hotel yesterday—excuse me for the intervention here—morning in New York with my aide, Mr. Spiegle. We had two glasses of orange juice, two cups of coffee: $6.40.

Mr. KLUTZNICK. Well you go to very expensive places, Mr. Chairman.

Chairman HUMPHREY. I stop at the wrong places, I guess.

Mr. KLUTZNICK. I still buy——

Representative BROWN of Ohio. It wasn't on the committee budget, was it?

Chairman HUMPHREY. No, it was on HHH.

Mr. KLUTZNICK. May I finish my thought on this for just a moment. You see, we do have to live with these other countries. I am not suggesting by any manner or means that the CED, which has not spoken precisely on this subject, or Phil Klutznick, who is speaking precisely on this subject, would consider it judicious to encourage imports of automobiles at this time. I would try to find a way to encourage a reduction in cost in certain products that we need to keep our industry alive today.

Now whether it is done by rigging the market, as you say, or otherwise, we are paying exceedingly high prices for some things we bring in. The oil embargo frightened me less than the $30 billion to $50 billion of drag on this country that was created by what was done to the oil price. Now you cannot expect to stay competitive in the world by being passive. Bob Nathan put it well—our problem has not only arisen because of our habits; it also exists because we have shown a kind of fright internationally. We show no leadership. Now judicious intervention would mean leadership, intervention in the proper areas that would help us and, perhaps incidentally, help some of our neighbors.

I would not consider the example that you have cited as being judicious, sir.

Representative REUSS. Well the trouble is, you cannot intervene to jiggle the price up or down of the dollar without a very generalized effect. Sure, it may sound nice to boost the price of the international dollar upward because then you would pay less for your outrageously priced pot of coffee in Geneva. But the same act—obviously intended—raises hell with the autoworker in Detroit, and it raises hell with the fellow at Allis-Chalmers in Milwaukee, who

is trying to sell some exports and finds himself priced out of the export market.

All I am saying is, I do not think that the Fed knows what it is doing in this matter of judicious intervention. They started out, they were going to do it to keep markets orderly, and the next thing you know, they are all distressed—as you are—at the fact that the dollar is on its back. Well I am making an enormous mountain out of one sentence of a superb prepared statement. Let us just say—let us both think it over.

Now as to the rest, I liked very much what you, as a builder-housing man, had to say about the cost of housing. If I heard you right, you told Senator Javits that, sure, the price of land, the price of housing labor, the price of materials has gone up, but the real roadblock to building homes nowadays, and getting the building industry off its back, is the exhorbitantly high interest rates.

Mr. KLUTZNICK. I did not make the introduction that you make. I did not say that the price of land has gone up. As a matter of fact, the price of land has been coming down again.

Representative REUSS. Well even to a greater extent than in my paraphrase, you laid the fault at high interest rates, did you not?

Mr. KLUTZNICK. Well traditionally—and I have been in this business long enough to know one thing—it is the monthly costs that determine the salability of a house. It is not its capital costs. Everybody should do everything he can to cut that capital cost down, because it contributes in a measure to a reduction of the monthly costs. But the largest single item in the house for the regular market is the interest rate. We are selling houses today to rich people; they have no problem. If the interest rate is 9 percent or 10 percent, they get a tax benefit.

But for the market at the $15,000, $20,000 level—and you have to have two incomes at the $15,000 level in order to be able to qualify anybody for a mortgage—high interest rates obviously reduce the salability. It is the interest rate that has more to do with salability over the years in our American system, than any single item.

Representative REUSS. So would you agree that anything this committee can do, and anything the Senate and the House Banking Committees can do, to bring down this mortgage interest rate you are talking about, both by fighting inflation generally and by gently urging the Federal Reserve to use its monetary tools in that regard, is something that we should be doing?

Mr. KLUTZNICK. By all means. I would add one thing. I remember in 1958, when this same problem arose, the Government even committed itself to buying VA mortgages—a billion dollars worth of them—below the interest rate that was then prevailing in order to stimulate the industry. If the industry needs stimulation, it needs it at the lower level where people are being deprived of an opportunity. It does not need stimulation at the upper level.

Representative REUSS. Thank you very much for a wonderful answer. Let me just ask Mr. Nathan and Mr. Okun whether they would in general, agree with what Mr. Klutznick has just said?

Mr. NATHAN. I do not have any doubt that I do not think a billion in mortgages is nearly enough. I think we ought to intervene

in either a secondary mortgage purchase when the savings and loan support goes out or direct lending if we increased our housing starts by a million, and I think the average price now is somewhere around $30,000, on houses, if it were $30,000 at the construction site there it would be a $30 billion stimulus. I think if you want to go on the positive side rather than just the tax-cutting side, give a real shot in the arm to the housing and we will see this economy turned around in a hurry.

Representative REUSS. Mr. Okun, I am quite sure I know your answer, but let us have it for the record.

Mr. OKUN. Yes, I agree wholeheartedly that the basic factor accounting for the tremendous collapse in home building has been high interest rates and a lack of availability of mortgage credit. I think the credit area is the place to turn it around.

Representative REUSS. My time has expired. Thank you gentlemen.

Chairman HUMPHREY. Congressman Brown of Ohio.

Representative BROWN of Ohio. Thank you, Mr. Chairman. I, too, want to talk about confidence and those interest rates, and I would sort of predicate this, I guess, with Mr. Kaufman's statistics which you mentioned.

I assumed the reason that the value of those investments have fallen is because investments are worth only the chance that one has to make a profit, and that the prospect of limited profits may have reduced the value of those investments. That people who assess whether the investment is worth putting money into feel they are not going to get an adequate return on their investment, and so the profit of the investment value has come down.

Now what I would like to ask all three of you is—and this is a series of questions—how much fiscal deficit can we afford to add at the Federal level in 1 year? Could you give me, short of a ballpark figure, the maximum that would be desirable in 1 year, or perhaps which we could add in the way of deficit before we begin into some kind of counterproductive problem?

Then I want to talk about the nature of the counterproductive problems. We will start with Mr. Okun, and just move down the panel.

Mr. OKUN. It seems to me that limiting the deficit is basically the question of what degree of stimulus which would make the economy go too far and too fast. I think that is the only limitation. There are further limitations that I spoke about, limitations on actions of a deficit creating character today that would commit us to deficit in the years ahead. But as far as fiscal year 1976 is concerned, the only question is at what level to you begin to worry about overstimulating the recovery? Reaching that level would require a much larger stimulus than recomended by the administration

As I indicated in my prepared statement, doing the things that I think are appropriate for recovery means an $80 billion deficit, and we ought to face up to it. I think the people have to understand what this is; that it is an inevitable consequence of mistakes made in the past.

Representative BROWN of Ohio. Well, let me just stop you there, because I do not want to blame all the mistakes to the past. I just want to get a figure here that the financing of the $80 billion deficit—if we could address ourselves to that too in response.

Mr. Nathan.

Mr. NATHAN. I do not think there is a literally limited amount, Congressman Brown. I think if President Ford had persisted in his programs in the fall of cutting expenditures and increase in taxes, as opposed to a tax cut to balance the budget while the economy is declining, I think we would have had a $100 billion deficit in fiscal 1976. Frankly, I think we would have had such a recession that revenues would have just fallen through the floor.

Representative BROWN of Ohio. We are talking about past events again, but it did not happen. Neither one of those things have happened, so could we talk about how much the deficit should be and how much we stand to finance, because of course it will have to be financed.

Mr. NATHAN. It depends at first how much the deficit should be. I agree with Arthur Okun, the deficit ought to be big enough to give you the stimulus so that you do not get yourself into an irreversible overcompensation which is a very little danger now, to the point where it is counterproductive.

As far as the financing is concerned, if the Federal Reserve will accommodate in its performance I think it would be over the $80 billion that Mr. Okun has suggested.

Mr. KLUTZNICK. Congressman Brown, I start from a different premise on this. It depends on what you want the deficit for, and what you are going to produce. The word stimulus is not enough for me. It seems to me that if you can project that, as a result of an $80 billion deficit, next year's returns in taxes and so on are going to be increased because you have an expanding economy, then the deficit is worthwhile.

In business, it is not the deficit in the capital investment that bothers us, it is the return. You said it before, if $800 billion gets us a balanced economy, and maybe a surplus 2 years hence, then it is worth it. If you are going to just fritter it away, then it is not worth it, just the same as I think that cutting out certain social programs may be desirable if they are not needed.

On the other hand, I worked in this Government long enough to know this is a good time to take a look at other programs that perhaps ought to be cut down in order to be able to reduce the deficit.

Representative BROWN of Ohio. Let me go on and suggest that we seem to have a problem. If this is Keynesian economics—and I assume that it is—that we are pursuing, or at least some kind of Keynesian economics, so that we stimulate to get us out of the depression, or recession, how do we avoid the inflationary bias of never really taking the edge off of any of our booms in this country with the recognition of a full-employment surplus?

In other words, we are always in a full-employment deficit situation, it seems to me, in terms of when we have full employment. I am not talking about this year's pattern. I am talking about

the pattern of when we have full employment, we still maintain a rather sizable deficit. My problem is with the financing of this $80 billion of borrowing.

Now, should I not be concerned about that, because it seems to me that that draws money out of the private money markets, it draws it out of the savings and loans, and the banks, and it puts the Government one step ahead of all of the private investment areas, such as the New York Stock Exchange, and the savings and loan back on Main Street, my end of town, and even the bank back there, and soaks up the available capital for folks that might have some confidence, and maybe that is why they do not have too much.

Mr. OKUN. I should infer that none of us regard financing the deficit as a teribly serious problem in the year ahead.

Representative BROWN of Ohio. Well, now, could I just get you to stop there, because if that is what all of you concur in, why then I would like to go on to the next point. Do you concur in that, Mr. Nathan?

Mr. NATHAN. I see no really mechanistic or procedural problem in financing the deficit next year.

Mr. KLUTZNICK. Well, everybody agrees on that generally, as a matter of fact.

Representative BROWN of Ohio. OK, so there is no problem with how we finance this deficit. It will be borowed, or it will be printed out in terms of money, is that correct?

Mr. OKUN. Well, the reason it can be borrowed is the reason that we have a deficit. It is because private credit-financed expenditures have utterly collapsed. People are not taking credit. Consumer installment credit outstanding is actually shrinking for the first time in the postwar era, and business bank loans have turned down. Thus, we have private saving far exceeding private investment, and private borrowing demands down so far. That is why we have the recession and why we need Government stimulation. I think we will find that, for lack of alternative investment opportunities, there will be a tremendous appetite for Treasury securities as this year progresses.

Representative BROWN of Ohio. The reason for my concern is that we had some testimony from Mr. Reagan of Merrill Lynch, who is also in the New York Stock Exchange, the board of the New York Stock Exchange, who indicated that he thought the top limit was $70 to $80 billion without it having a depressing effect on the growth of the economy. Now, my sort of summary question here—and I would like to have each of you address yourselves to that, and I hope my time does not run out in the process—is this: With the massive deficit to be financied, how do we reduce inflationary pressures by Federal intervention? What kind of monetary intervention can work, and if it is to be massively expansive, then will not long-term interest rates stay high to indicate the sort of double-barrel inflationary pressure of both fiscal and monetary policy, and will not that, in fact, destroy confidence? Because it looks as if to me all of the chance for a heavy return is in the Federal Government's hands; that is, the money that they pay in terms of interest and

the average little business is going to have no chance to expand, no chance for profits, no chance for much in the way of spending.

Now, could I get a comment from each of you on that?

Mr. NATHAN. Well, let me just say one thing: It is hard to get inflation, no matter how big a deficit you have got, when you have got a lot of idle resources, in other words, when your demand for manpower and your demand for raw materials and your demand for capital goods is as weak as it is now, and unless you have administered pricing and rigidity in the economy, it is hard to really get inflation, no matter how you finance this.

Representative BROWN of Ohio. Well, we have got it. We have got it in long-term debt. Now, why is that? Is there not a message in that somewhere?

Mr. NATHAN. Well, long-term interest rates are high because we still have very little confidence that we are going to break this inflation spiral.

Representative BROWN of Ohio. That is exactly my point.

Mr. NATHAN. Yes, but you do not break the inflation by keeping into a recesion. This is a real problem. If you do it that way, often it is counterproductive.

Representative BROWN of Ohio. You do not break the inflation spiral by having the Federal Government absorb all of the resources for expansion in this country, do you?

Mr. NATHAN. But when the demand of private areas for that expansion does not exist, and it does not now—how many businesses are cancelling investment? Do you know there are hundreds and hundreds of millions of essential expansion—I term it essential because we need it for a growing economy over time—even in the public utilities hundreds of millions are being cancelled because of the recession, not because the funds are not available. but because they do not see the demand. They are uncertain. The rates are too high.

I think the general belief that if we have a big deficit, and that deficit has to be financed by monetary expansion in considerable measure, that is going to result in inflation. I do not believe that is at all a logical conclusion. It depends, however, on what private demand is.

Now, the whole concept of compensatory policy is when private demand increases, the public demand ought to recede, and when private demand is low, let the Government come in, let the Government cut taxes, let the Government spend, let the Government pick up that activity, and when private demand begins to expand, then I think the Government expenditures ought to be reduced, taxes increased, so you do have that balance in funds available.

Representative BROWN of Ohio. Given that, why do we not have the long-term rates of interest dropping sharply? Can you explain that to me because that seems to have been the case in previous recessions, and we have gone into this recession from a base of high inflation rates, and that is a little different from the 1930 situation.

Mr. NATHAN. Inflation is very different. Inflation has made a lot of difference.

Mr. OKUN. The response in long-term interest rates has been

about what one would expect in the last several months. They never move as rapidly as short rates. If you look back to 1957-58, you will find them lagging substanially behind then too.

Let me say that I have complete confidence that you will have more private investment this year by supporting the consumer with deficit tax cuts, bringing him back to the market to provide some incentive for businessmen to invest, than by making available all of the funds that you can for business investment. I agree with Mr. Nathan that the cutbacks in investment and inventory that we are getting now are certainly not because credit is tighter than it was 6 or 12 months ago. To the contrary, it is in the face of easier credit conditions that businessmen do not have the incentive or the need for expansion because their markets are not there. You have to bolster those markets after the major decline that they have experienced.

If I could add just one valid proposition of economic research—statistically you cannot find an independent influence of deficits on interest rates. If I tell you the unemployment rate, the GNP, and the money stock, and ask you to guess the interest rate, you cannot improve on that estimate by knowing the Federal deficit.

Mr. KLUTZNICK. Congressman, in my statement, I emphasized, not once, but several times, that the stimulus that we are talking about need not stop us from fighting inflation. Quite the contrary, we think the tools for fighting inflation are there and they should be used.

Now beyond that, the statement that Mr. Nathan has made is good if the Congress and the administration acts on it. I think it is almost inescapable that you continue to get a decline in the inflation, and with proper stimulation, 1976 ought to be a good year for business, a real good year. The year 1977 perhaps ought to be better yet.

The danger comes when it becomes a good year, and the Federal Government does not move out and still continues to pile on, do you see.

Representative BROWN of Ohio. Well, my time is up, but that has always been the problem. We do not pull out. We keep in; we keep stimulating.

Mr. KLUTZNICK. Well, the figures do not show it. The deficits do drop. Maybe they do not drop enough, and maybe we do not time our fiscal and monetary policy as well as we should. We have not used them properly, too. That is something we ought to look at.

Chairman HUMPHREY. Senator Proxmire, you have been a patient man for having been chairman of this committee for so long. I know what penitence means. [Laughter.]

Senator PROXMIRE. I do not feel *at all penitent. I came in late*, and I deserve to sit, but this has been most interesting and helpful to me to hear these distinguished men. I think what they have told us has been very helpful.

Mr. Okun, in your prepared statement you say that the key test of any antirecessionary policy is will it stimulate jobs and production during the recession and stop stimulating after the recession? I want to know whether or not you can apply this to monetary policy.

In the last few days we have had some very good testimony before the Banking Committee on this. Senator Humphrey participated in that; Mr. Burns did. We had four very distinguished monetary economists testify yesterday.

I get the feeling from Mr. Burns, particularly, that he represents a sentiment that perhaps Congressman Brown shares; that if we provide too vigorous an attempt to increase the money supply under the present circumstances when demand is as weak as it is, that we build up factors in the financial system that could haunt us later. I get the impression that he feels that right now it is very difficult for the Federal Reserve Board to increase the money supply because the bankers are not taking him up on it, and the lenders are not, and if they try too hard, they are going to create a situation that, when the economy recovers, there would be an inflationary explosion of credit.

There will be a basis there for a very rapid, perhaps too rapid expansion of the money supply.

I happen to disagree with Mr. Burns on that, as the monetary economist who appeared on that, but I would like to hear your view.

Mr. OKUN. I share your disagreement. What we know about the impact of increased liquidity is that the effects on the economy may be spread over 6 or 12 months or at most 18 months. But we have a clear horizon of underutilization, serious high unemployment, and unused capital over the entire period on which today's monetary actions could have an effect. I have never seen a time when we could feel so confident—that we would not be taking any significant risks on the other side by stepping up the growth of money and reducing interest rates. For the same reason the Federal Reserve should be acting more strongly now; it may have to act more strongly and in a more timely fashion 3 or 4 years out to contain an economy that——

Senator PROXMIRE. Well, you see, this is exactly what presents us with our real economic dilemma, as far as policy is concerned. The Fed has one view; Congress—and I think an overwhelming majority—I could be wrong, but I think an overwhelming majority of economists, as well as Mr. Ackley, Mr. McCracken, and others who are either moderate or conservative economists have another view.

The view of the Fed obviously is going to be the policy we are going to follow. They sit at the monetary switch. They are going to control monetary policy, and for that reason, among others, I have introduced a resolution, along with Senator Humphrey and others, to do the following things: No. 1, to call on the Fed to stimulate the economy more vigorously than they have by increasing the money supply more rapidly, without giving a number.

No. 2, to aim at a long-range, more stable relationship between the money supply and the growth to aim at the increase in the money supply and the preferred growth rate in the economy.

And finally—and this is by far the most important part of this —to ask the Federal Reserve Board, not the Congress, the Federal Reserve Board, to give us their monetary goals, so that we know

what they intend to do with the money supply over the next 6 months or so. If they tell us that—now, I am not saying we should dictate it. They should tell us where they are going. They tell us that; then we will have the basis for a specific discussion of monetary policy.

You see, what we are told constantly by Mr. Burns—and Chairman Martin was the same way—they are going to provide the monetary supply necesary for recovery and to prevent inflation. That does not mean anything. If they give us a figure, a goal, then we will have the basis for some kind of meaningful discussion. How do you feel about that?

Mr. OKUN. On the one hand, I think the time has come for Congress to give some clearer indication to the Federal Reserve of its interpretation of the role of monetary policy in fulfilling the Employment Act objectives. It has been very disapointing to see the Federal Reserve lag behind as much as it has, failing to take significant steps to combat the recession. So I agree with you in principle, and I think the concurrent resolution may be a way to convey the message which has been so difficult to convey across town.

My one reservation about it, Senator Proxmire, is that it does put a lot of emphasis on a single indicator of monetary policy; namely the money supply, and on money growth targets.

Senator PROXMIRE. Well, supposing we modify it, and I am willing to do that, and I think perhaps Senator Humphrey would agree, to make it money supply and monetary aggregates, so that it is a broader range of objectives. I think you may be right, although we did get a pretty emphatic consensus that M_1 is the best measure. M_1 is something they could control.

We could be wrong about that. Supposing in addition to M_1, we asked for a broader measure, series of measures?

Mr. OKUN. I would not limit it to quantities. I think it is inappropriate to ask the Federal Reserve to forecast private interest rates.

Senator PROXMIRE. No, we are not asking them to forecast interest rates.

Mr. OKUN. Consistent with that it is quite appropriate for the semiannual hearings to focus on what the Federal Reserve would see as the path of the Federal funds rate. So I would broaden the resolution further to include not only the money supply and monetary aggregates, but also credit conditions and Federal Reserve controlled interest rates; namely, the discount rate and the Federal funds rate.

I say this because I feel that the most serious mistakes of monetary policy in the last half-a-dozen years were made in the first half of 1974, when the Federal Reserve stayed exactly on its money-growth track. You could not have asked for a better performance in terms of making money grow at a 6 percent rate. If they had come here in January, you might have accepted a 6-percent growth target; yet it turned out to be a disaster.

Let me make it clear that the reason housing starts are a million today is not because of a failure of money to grow in the last 8

months, but because of the failure to accommodate any of the oil inflation and the food inflation during the first half of 1974 when money should have been allowed to grow a lot faster.

Senator PROXMIRE. You see, Mr. Okun, what I am aiming at is not necessarily a criticism of what has been done in the past. What I want is understanding and knowledge so that we can proceed more constructively in the future, some specific—look, we know what our budget policy is going to be.

Mr. OKUN. Right.

Senator PROXMIRE. We know what we are trying to do, at least in the area of wage-price policy, whether we have a program, now that we know what we are trying to do. We do not have any idea about monetary policy. As one witness said the other day, it is ridiculous to have the Council of Economic Advisers come in here and tell us what they expect to have for an economic policy and have no idea, really, what kind of monetary policy that is necessary along with it, so we are asking that they give us the goal, so that we know what it is in numerical terms, not language that anybody can interpret any way they wish.

Mr. OKUN. I could not agree with you more. I think the contrast is becoming even more pronounced and incomprehensible. This year a quarterly flight path on the budget, on the national incomes account basis, was put into the budget document. We know it will not come out just that way, but it does give us a flight path of what fiscal policy is.

Senator PROXMIRE. You see, here we have two of the most distinguished bank economists in the country appearing before us, Mr. Olson and Mr. Sprinkle. We had Mr. Francis of the St. Louis Federal Reserve. We had also Mr. Meltzer, who is a distinguished monetary economist.

We had before us just before that Senator Buckley and Senator Humphrey, shoulder-to-shoulder, agreeing on something in economics and agreeing that it was right, and then we have gotten a great deal of support from economists with varying views, not on the notion that we should have one monetary policy, or the other, but that Congress, which has the monetary responsibility in the Constitution, ought to know where it is going and what it is doing, and we do not know now.

Mr. OKUN. The list of economists that you named are distinguished people, and include some good friends of mine. But they are people who place an inordinate and unjustified emphasis on the money stock as an indicator of monetary policy, and I am concerned about the future.

Senator PROXMIRE. Well, I would agree that we might need a broader range.

Mr. OKUN. And for that reason, I would take a much broader range. Jim Duesenberry of Harvard has laid out in print a suggestion on how a flight plan for monetary policy could be constructed involving a great many indicators including credit market conditions, the Federal funds rate, and the discount rate, as well as the aggregates. If you do that, I am 100 percent behind you.

Senator PROXMIRE. All right, fine.

Let me just point out, and I would like to ask the comment of Mr. Nathan and Mr. Klutznick on this, too—we are proposing—Congressman Reuss in the House, and I am proposing it in the Senate, an emergency housing program. They are a little different in their approach, but what my housing program would do would be to take advantage of the fact that short-term rates are low, and that the Government average borrowing cost is only about 7 percent.

The Government then would borrow, or would be in a position to be able to buy mortgages—about 1 million mortgages at $30,000 average cost per mortgage, about $30 billion—make them available at 6 percent; on the basis I think it would fly; that is, you have houses built. If this achieves its goal, 2 million people are employed, because there are two man-years per house.

Now, one of the principal concerns here is what this does to the money market. You are going to have a deficit of $70 to $80 billion, and then have another borrowing of $30 billion. Again, we move then to a new position where Congressman Brown's very reasonable concern is such that we may be moving too fast.

One reaction I have on that is that if we can get that kind of a program going, you can reduce the deficit in a hurry. If you get 2 million people to work on that momentum, you are not going to have an $80-billion deficit because your revenues are going to increase.

Mr. NATHAN. Well, I think the real problem is what the Federal Reserve policy will be in the interim, how accommodating they are going to be.

Senator PROXMIRE. In the interim, right.

Mr. NATHAN. I do not think there is any question in relation to what you were saying and what Congressman Brown was saying before, if you can get the housing starts up from a million now, around that, to 2 million by the end of the year, that is an industry where the expendable magnitudes are all there, without running into real shortages quickly. You get that up, you will not have as big a deficit as is being projected.

The whole story is when you get the economy moving, the revenue rises very rapidly, so that you have compensating factors, but in the meantime, in order to avoid squeezes, I think the Federal Reserve has to be accommodating, and that is a real problem.

Mr. KLUTZNICK. Senator, this reminds me of the 1958 action. I went to see Secretary Anderson at that time with our Commision on Money and Credit. The Government had bought $1 million worth of VA's, and we were sitting and talking to the Secretary and asking him, there is a $12-billion deficit, you know, contemplated that year—I guess that is $50 billion today, and we survived it very nicely—but included in that $12 billion was $1 billion which he called a part of the deficit for the $1 billion worth of VA's that he had bought I think at 3⅞ percent or something, and I said to him, Mr. Secretary, how could that be a $1 billion deficit? You have got an asset. All right, discount it. Maybe it should be discounted 3 percent or 4 percent, so the most you could have is a loss of 3 to 4 percent, and that is not a deficit; that is investment, and we had one devil of an argument over it.

Chairman HUMPHREY. Oh, yes, I can imagine.

Mr. KLUTZNICK. I say to you, if you buy—and I am not sure—I do not agree with Mr. Nathan that you can get another million starts quite as fast as he thinks. This industry has been down for a long while. It was closed down when the freeze was put upon certain parts of the Housing Act a few years ago, and it has not been moving up so fast that——

Senator PROXMIRE. Well, it was up that high though, only a relatively short time ago, a year and a half ago.

Mr. KLUTZNICK. It was up to 2.6 million, including trailers or mobile homes, if you want to count them. I never counted them, and some of them have disappeared in the meanwhile. You can get up to the figure Mr. Nathan cited, but I do not think you can do it in 6 months or 9 months.

The point that I am making is if there is an investment of that size at whatever the rate is then—let us say 7 percent—if we keep our rates low enough, that is not a part of the deficit. You could get back but a very little of it in the sale of it.

Senator PROXMIRE. No, no. I am not talking about the deficit because the annual cost to the Government, as I figure it, would be about $300 million, which is really peanuts when you consider what you are getting, but that you do have the borrowing. You would have the borowing.

Mr. KLUTZNICK. It would add—look, you have that borrowing. It is the same money. If you want to get a million houses going, the question is when. If you want to get them in a hurry, your plan has some advantages. If you want to take it more slowly, you will wait until the interest rate goes down.

Senator PROXMIRE. Well, people are out of work now. You have got 15 percent unemployment in construction. You have lumber which is piling up available to do it. You have available resources.

Mr. KLUTZNICK. Listen, if we could be building a building now that we are finishing now, we could save $20 million on it, because those things are available.

Senator PROXMIRE. I just have one other question.

Mr. KLUTZNICK. May I finish my point because I think it is important. I think the question on monetary policy cannot be fully answered without looking at fiscal policy and without looking at the capacity of the Congress to act quickly in the fiscal area.

I think the Congress and the President have a responsibility in addition to the Fed, to keep the ship of state going.

Senator PROXMIRE. There is no question about that. That is right. Now, I would like to ask you one other question.

In your prepared statement you referred to strengthening the economy and wage-price stability, and giving it more adequate funding. But you would still operate on a voluntary basis.

I agree with that largely. But what we propose is this: That where a large firm; that is, a firm with $250 million or more sales a year, or a big labor union which involves more than 5,000 persons, asks for a wage increase, then the Council on Wage and Price Stability would have the authority, if they wish to do so—to hold up that wage or price increase until they could determine whether

or not it was inflationary and cost justified. Then they would be in a position to permit the President to jawbone it; the Congress, if they wish to do so, to take action on a rifle-shot basis on the particular industry. And that is it.

We would not have an across-the-board program. We would not have a program that would interfere with the overwhelming majority of business. But in view of the fact that there are concentrated businesses which have enormously increased their prices—steel, 45 percent in the last year; chemicals 60 percent, and so forth—and may continue to. Why would this not be a reasonable option, even though it is not voluntary. It would be necessary for them to submit it and possible then to roll back the price.

Mr. KLUTZNICK. Senator, it is true that my prepared statement only says we believe that the Council on Wage and Price Stability ought to be strengthened. However, our more specific views on the methods that a board of this type should follow were outined in our 1972 policy statement "High Employment Without Inflation."

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

Chairman HUMPHREY. Congressman Rousselot.

Senator PROXMIRE. I would like to say, Congressman Rousselot, just for a minute; I want to commend you, Mr. Nathan, on this superb chart. I hope that all members of the committee have a chance to look at it. The economic stagflation index showing that when you add employment and inflation together, you get this colossal change here. I am sure we have not had a thing like that since the depression, and maybe it would be even greater than that at that time. It is very helpful.

Chairman HUMPHREY. We are including those two charts, Mr. Nathan, in the record. I think earlier we included the wholesale and consumer price chart, but we will have both of them in the record.

Congressman Rousselot.

Representative ROUSSELOT. Thank you, Mr. Chairman.

Gentlemen, I appreciate, although I was late, the chance to glance through your prepared statements and listen to several of your remarks. I guess my problem is I am still learning about finance. Even though I have been in Congress, my fifth term on the Banking and Currency Committee, that we are still having to learn what is good. I guess I read from all of you that it really does not bother you too much, the massive presence of the Federal Treasury in the marketplace to finance a deficit that really is not an add-on deficit of $80 billion. One of you even said, I think Mr. Nathan, that it could be more as far as you are concerned, up to $100 billion?

Mr. NATHAN. It could be.

Representative ROUSSELOT. And that that really does not drain that much from the general marketplace; even though we have been told that in 1974 the Treasury took probably 60 percent out of the marketplace to recycle old debt or finance new debt, that this add-on of $80 billion or $100 billion—Mr. Burns is now predicting a much higher deficit than obviously the $52 billion which has been predicted. None of this bothers you as to housing and to other things. The little old ladies who are not going to take out their savings and put it in the 91-day Treasury bills and other things?

Mr. NATHAN. The problem, I think, Congressman, what bothers me especially, is why we have the deficit of $70 or $80 billion and that is because the economy is crippled.

Representative ROUSSELOT. We understand that.

Mr. NATHAN. The important thing is to get that money out, to stimulate the economy and production, and that will generate tax revenues which reduce the deficit. It will generate savings which put more money in the hands of the banks and the building and loan associations. So what you have is, you have your recovery. You at the same time generate the savings which will make this possible, plus private investment.

Representative ROUSSELOT. Well now, we got that kind of advice back in 1966, 1967 and 1968, Mr. Okun, from you, that deficits really did not totally matter that much, when you were working for President Johnson. Then we had full utilization capacity. We had all of these other items that you say are now down, and the end result of that was not all as flowery as you now tell us it is going to be, in 1970 when we had a real money crunch.

Mr. OKUN. I would only dispute that in terms of my own personal record. I do not remember issuing any reassuring statements about the consequences of a deficit in a full employment, and indeed, overfull employment, economy. I hope I did not.

I think the record is clear. President Johnson said later that his economists were telling him, beginning in December 1965 and repeatedly thereafter, that there was an urgent need to produce a surplus in the budget. That was my feeling through that period. I think that 1966 experience was the second worst fiscal policy we have had in the last 15 years, topped only by the record of 1974 where we had a $35 billion swing toward restraint in the face of a recession.

There is a time for surpluses and there is a time when we have to accept deficits. We have often played it very wrong. The years 1966–68 were a time for balance or indeed surplus, and 1974 was a time where a more significant deficit might have provided us with a stitch in time.

Mr. KLUTZNICK. Congressman, I do not want you to get the impression that I am sitting here and am happy about a deficit. I do not think that would be a fair interpretation.

The question is, What are the alternatives? And my mind goes back to the time that I served in Government.

Representative ROUSSELOT. If I could interject for just a moment. Two of you have indicated that even an $80 billion deficit does not bother you too much at this juncture.

Mr. OKUN. Compared to the other problems which it is necessary to relieve.

Mr. KLUTZNICK. The question is, What are the alternatives, Congressman? Let me explain this further, if I could complete this statement for a moment. In 1946 when everybody—Mr. Nathan, I think you were predicting 10 million unemployed or something.

Mr. NATHAN. Eight million.

Mr. KLUTZNICK. Eight million. I sat in the Congress when a man who was called a conservative, Senator Taft, stood up in support of

the post war housing bill; and he said the trouble with our analysis of this situation was that we were treating it as if it is solely an ecenomic problem. The fact is that the American public will not tolerate anything below a certain minimum level for the necessities of life. When I listened to that, it was one of the most amazing, and forthright, and correct statements. This is a mixed question of tolerance, economics, social and political action, and no one who pays taxes should welcome a large deficit.

But when you sit in a business board room, or when you sit where you are sitting today, you have to make decisions, you have to choose alternatives, then that sort of deficit is justified; when the economy recovers and we get to a surplus position, the Congress and the administration can proceed to act in the manner in which Mr. Okun has suggested.

Representative ROUSSELOT. Well then, your point is that by tolerating these substantial deficits we look forward to surpluses?

Mr. NATHAN. We can have surplus if we get back to full employment and we behave responsibly.

You see, I think the question is, you said, are we bothered? I am bothed by an $80 billion deficit. But the other question is, is it manageable?

Representative ROUSSELOT. Even though it adds on to the interest charge?

Mr. NATHAN. It certainly does. But on the other hand a continued recession has a tenfold impact on the deficits relative to what——

Representative ROUSSELOT. Even though to finance that deficit the Treasury will probably have to dry up, probably 80 percent of the total private market in order to do that?

Mr. NATHAN. The private market is not there.

Representative ROUSSELOT. And you are concerned about housing. My point is, is it not really going to compete for that same money that normally might go to housing?

Mr. OKUN. It is true that the United States——

Representative ROUSSELOT. It was not in the past?

Mr. OKUN. As I said to Congressman Brown earlier, it is the best judgment of economic research that interest rates are not independently affected by the deficit. There is no evidence that they are; 1958 was a year of very low-interest rates and of the largest peacetime deficit as a proportion of GNP, because it was a recession year.

A few months ago it was argued that this recession was different, that we were going to see strong private credit demands despite the recession. That thesis was just totally incorrect. We have seen a complete collapse of private credit demands, again, not in response to anything that has happened in the credit markets but in response to what has happened to income and demand conditions in the economy. I think it is important to remember that the U.S. Treasury does not sit on the funds it borrows; it spends them.

Representative ROUSSELOT. Yes, we understand that. We understand it spends it.

Mr. OKUN. Well, the recipients do things with the funds. Either they put it back into the credit markets or else they spend it on goods and services. We hope they do mostly the latter, but somewhere along

the line this is stimulating the economy. It is producing a flow of income and product that is necessary to correct the nearly $200 billion deficit in our production today.

Representative ROUSSELOT. Well, I am sorry we do not have any other alternatives other than this huge deficit. I am not sure I agree, but I am glad to have all of your assurances that this kind of massive deficit financing is apt to lead toward surpluses. That is a new pitch.

Mr. OKUN. I think that is essential. We have emphasized throughout that we want the stimuli to take the form of thing that are self-limiting and self-terminating, that do not commit us to huge permanent tax cuts and that do not commit us to long-term projects that might plague us in the next expansion. That is why I so strongly am opposed to doing things like public works projects that would have very long gestation periods. In trying to fight a recession we have to watch out for that.

Representative ROUSSELOT. You have all indicated in some place in the discussion today that even though we ought to probably be encouraging Government expenditure in some ways and Government intervention, there probably are some places where we could maybe even cut expenditures.

Do you want to indicate, each of you, where you think we could cut?

Mr. KLUTZNICK. You know, if I did that off the cuff, I would be irresponsible. There are any number of items in the budget that have been around a long time, and maybe the time has come to take a look at these.

You are going to have to make some rough choices. But I certainly would not cut at a point where you might create great unrest in the country.

Representative ROUSSELOT. I think we would be delighted to have your comments, even if it might take some extra time, to have those in writing, and if all three of you would like to do it. Do any of you want to venture to give us an indication where we might cut?

Mr. OKUN. The trend to releasing highway funds just strikes me as the most unconstructive way to fight the recession in both its economic effects and its impact on social priorities for the future. I do not think that is where the Nation's needs lie today, and I do not think that is the way to create the jobs that we would need in the months and years ahead.

I get into very difficult problems in discussing social priorities, because I do not feel completely qualified in that area. The defense budget looks big, but I don't know how much could be cut out of that.

Representative ROUSSELOT. I think your advice would be helpful. Everybody talks about cuts, but nobody is willing to specify.

Now, I think we need that kind of advice. Many of our panel members have all complimented you on your expertise. Where could we cut?

Mr. NATHAN. Well, let me just say one thing in terms of timing. I would agree. I do not think we need more highways. I would much rather see that money go into buses, mass transit, and the like. But I think the need for budget pruning is far more serious when you have excess demands in the economy than you do at this time. The main

thing is, one might say, well you might go into certain kinds of research in an area that is being undertaken. At this time, any expenditure cuts, unless they are really waste, and I am for eliminating waste, I think it is just going to add to the unemployment problem. But when we get up to a point when that housing demand is there, private investment is there, and private demand, then we ought to do a much tougher pruning. And I think that is the time when the criteria could be much harder than now.

Representative ROUSSELOT. My time is up, but I would like to have in writing from each of you those thoughtful areas where you think we can try. I think we need to think about that. We always talk about cutting, and nobody really wants to do it.

If you would want to comment maybe on some of our foreign aid areas.

Mr. KLUTZNICK. I think, Congressman, there are two areas. First, the Congress now has a new budget procedure, and maybe that is going to show up a lot of things that did not show up before.

Representative ROUSSELOT. We hope so.

Mr. KLUTZNICK. Second, we keep talking about cutting. What I would rather talk about is that which you can cut, and that which you can defer. There are things that you can defer, and that gives you temporary relief until a later date when it can serve a different purpose. That calls for very careful study, however, and I would not be prepared to give an offhand opinion on individual items.

Representative ROUSSELOT. I would appreciate all of your comments because I think they would be helpful.

Chairman HUMPHREY. Senator Kennedy.

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

I just have a few areas.

I would be interested, Mr. Okun, in what you think is a realistic goal for reducing unemployment by the end of 1976. When you give a figure, could you also relate it to the danger of overheating the economy?

Mr. OKUN. Well, I think that depends so much on how far down we go and when we turn up. I recognize the importance of the climb back that we make. But at the present time we are just sliding downhill. We do not know where the bottom is going to be. From the bottom of the recession, one might hope to get a 2-point cut in unemployment over a period of 12 months as a probable maximum feasible effort.

Now if I am right in thinking that the bottom is likely to be in the 9–10 percent range, it really means that we are facing unemployment rates that are going to stay above 7 percent throughout 1976, and that is a very bleak prospect. That would mean that we would have 24 continuous months of unemployment rate over 7 percent, whereas in the whole of the previous 30 years I think we have had about 6 months of unemployment rates scattered through three recessions, where the unemployment rate was above 7 percent.

But, at a time when economists could not judge the January unemployment rate on February 5 within a half a percentage point, trying to put a precise estimate on how much we can do on the way back up would be kidding you, sir. The economy is really behaving

in a way that is not fitting historical track records. We just do not know how far we are going down. For that reason it is awfully hard to set targets for the way back up.

Senator KENNEDY. Do the others generally agree?

Mr. NATHAN. I think we are going to reach 10 percent. I hope not but I think we will, and I think it is going to be later rather than earlier, probably into the early fall, and if we do, and we take into account, what I hope will happen is on the upturn we will get a real rise in productivity. Productivitly today is practically what it was 3 years ago, and I think when the economy turns we are going to get a lot of that increase in production out of increased productivity. I think we will have a sizable entrance into the labor force of people who are now dicouraged from even looking. If we hit 10 percent early this fall, we will not reach 7 percent on the way down by the end of 1976, in my judgment. I do not think it is possible, because to do that I think you would have a rate of growth that probably would exceed an annual 10 percent rate of growth. That may not be sustainable.

Mr. KLUTZNICK. An amateur can comment on this with a great deal more assurance. I think there is something in business that we learn from. If you go down fast maybe you don't come back as slowly as in some other periods, maybe you come back faster. Maybe you are building up what might be a demand factor which will surprise the curve makers. This happens constantly in any production. If you get to a certain point and you are down at the bottom and you get your strength together, you shoot up a little faster.

I believe we have had the experience of seeing the economy go to a lower level than expected, and we really do not know the rate at which it could come back. My own suspicion is that going down this far has frightened enough people so that we are going to get a lot of energy released when we start going up. The rate of upturn may be more then has been traditional. At least I would try for it.

Senator KENNEDY. Mr. Okun, you recommended, I believe, a $26 billion cut this year. Is that a conservative estimate? Is it a bare bones minimum?

What is the range which we could responsibly have this year?

Mr. OKUN. I was trying to be prudent and conservative and not wind up with deficit figures that were any more frightening than the ones that are already in this program.

In my judgment, particularly a margin the size of the initial rebate, trying to——

Senator KENNEDY. Would you have more front end load? A heavier stress on the rebate?

Mr. OKUN. The front end, yes. The name of the game now is to stop the avalanche. If I thought it were politically feasible and acceptable, I would add another $8 billion or $10 billion, perhaps. A $20 billion initial rebate is perfectly consistent with a safe trajectory for economic activity over the next 18 months.

Senator KENNEDY. But your impression from the House bill is that there should be greater portion of the stimulus at the beginning? Do Mr. Nathan and Mr. Klutznick agree?

Mr. NATHAN. Yes.

Mr. KLUTZNICK. I think it would be a good time, Senator, also to

do something we have been trying to press the Congress to do for a long while, and really test it, at least, to tack on the provision that would give you the capacity by joint resolution to increase the cut rather than take it all at once, in the event that circumstances get worse.

This is a suggestion that we think ought to be considered, and maybe we ought to go back 2 years ago and try to convince the Congress that ought to get into a position to move fiscally a lot faster than it moves when situations like this arise, both creating a surplus to slow down and creating a deficit to accelerate.

Senator KENNEDY. Mr. Okun, just finally what is your reaction to the efforts of the Secretary in attempting to establish a floor price of $7 a barrel for oil over a prolonged period of time?

Mr. OKUN. I view that as a total confusion of ends and means, Senator. It seems to me that the objective is to provide energy for ourselves in the least expensive way from politically secure sources. It is possible that the world oil market will change, will become competitive, and that the enormous monopoly power of the cartel will break. In that event we should be able to take advantage of the change to get petroleum at a price that is more nearly what a competitive market price would be.

I think there is an element of truth in the proposition that there are some energy investments we would like to see private enterprise make in this country that will not be made under those uncertain prospects.

But that is only a small fraction of the total energy investments we need. It may be concentrated on shale, on particularly high cost, high risk projects. For those things we ought to look at Federal guarantees and Federal procurement; the C. E. D. statement refers to the possibility of Uncle Sam's offering to buy synthetic fuels. That is a sensible rifle-shot technique of getting at the projects that really need the support, rather than putting a floor under everything. The overall floor would threaten to make the Department of Interior in the 1980's what the Department of Agriculture was in the 1950's.

Senator KENNEDY. Do you believe that we ought to rely on market forces, even international market forces, rather than write any kind of treaty or agreement with the $7 a barrel figure, even though that figure is $3½ cheaper than the price at which we are importing oil at the present time?

Mr. OKUN. I do not want any treaty or bargain with the OPEC countries that legitimatizes the world oil monopoly and essentially solidifies their power in collective bargaining.

Senator KENNEDY. Is this an economic viewpoint or a philosophical one?

Mr. OKUN. It is economic in the broadest sense. I think a danger exists that the success of OPEC will create a world trade environment of proliferating cartels. It is one of the most serious prospects that we ought to face up to. For the same reasons that the United States does not cartelize the export of grain or soybeans, we should refuse to go along with the cartelization of other products.

In the future as the monopoly power of OPEC is reduced there are going to be good opportunities to make bilateral bargains with

individual oil producing countries based on a kind of mutual interdependence—where they need something from us and we need something from them—which can be politically secure. In that event we can afford to depend to a limited extent on imports from politically secure sources. And with a return to competition in the world oil market, those imports need not be high cost.

But there is a principle, and I am stating, that we have been for essentially competitive trade. That served the world well in the past generation, and we ought to be willing to fight for that outcome here.

Senator KENNEDY. My time is up. I want to thank you, Mr. Chairman, and the panel very much. It has been an enormously constructive morning. I want to thank all of you.

Chairman HUMPHREY. Just a couple of summations here. I want to call your attention, particularly you, Mr. Okun, because of your comments about what you think is a serious decline in our economy, the release of Thursday, February 27, from the U.S. Department of Labor, Bureau of Labor Statistics.

It says:

> The most significant revision in the fourth quarter measures occurred in the manufacturing sector where output was adjusted downward. This measure, which is based on the Federal Reserve Board's Index of Industrial Production showed a fourth quarter decline of 13.4 percent rather than 12.9 percent decline previously recorded. This change is reflected in the revision of the fourth quarter productivity movement in manufacturing, which now shows a decline of 0.1 percent instead of the increase of 0.6 percent, which was based on preliminary figures.

So that your productivity down below the line and your total industrial production decline of the most recent figures shows an even more precipitous decline.

This morning the Department of Commerce economic indicators again show economic developments which are very depressing and distressing. I have emphasized this matter repeatedly with administration witnesses because I am afraid that many of the assumptions on which their economic policy was based have now been shattered. The rate of decline in production is much more severe than had been anticipated. The rate of increase in unemployment is much sharper and larger than had been anticipated, and I think you are seeing that even the rate of inventory liquidation is slower than had been anticipated.

So there are all kinds of assumptions that were made here just a few weeks ago—and I say only weeks ago, that have literally been blown out of the ballpark. They just do not hold water any longer.

I want to just quickly ask and have very brief response because it will be a brief question—the tax reduction, I shall be introducing a measure that will provide approximately $10 billion of, well, it will provide $10 billion plus dollars of tax rebates for 1974, and a $20 billion tax reduction for 1975 and going into 1976. This is larger than you have recommended. Your total was $26 billion, as I recall, Mr. Okun.

Mr. OKUN. I am not sure it is. I was limiting myself to the calendar year in 1975 when I got to $26 billion. I was talking about another $13 billion or thereabouts for calendar 1976. I think we are on the same wavelength, Mr. Chairman.

Chairman HUMPHREY. Well, within the same ballpark.

Mr. OKUN. Yes, indeed.

Chairman HUMPHREY. The thing that disturbs me, and I say this to you as witnesses, that I have been participating in caucuses on the economic program and I must say that while there are supposedly party differences, partisan differences, over economic philosophies, I find many of my fellow Democrats to be very, very worried about the size of increase in the tax program and being terribly upset about the deficit without placing, as I think, the deficit in proper perspective in light of our GNP on the one hand and also what the deficit will be used for.

I mean, as you have said here, Mr. Klutznick, to what do we target this money? The question was raised and I do not think it was properly answered, or fully answered, let me put it that way. Senator Proxmire brought forth today in a preliminary fashion his emergency housing proposal. We have worked very hard on this, a number of us. Senator Proxmire is chairman of that committee and will, of course, be the lead sponsor. I shall hopefully be permitted to cosponsor that proposal. It would provide possibly a $30 million mortgage operation but a very modest amount of government subsidy in terms of interest rates because the Government can buy the money at about 7 percent. It would loan it out at around—it would have mortgages at 6 percent.

The question was that if you go into the money markets now having to finance the deficit, which is going up, by the way—even the administration's calculation of the deficit goes up every week—if you have to step into the money market and finance the deficit plus the normal, what you hope will be some private investors coming into the money market to do something about capital investment, and then you have to come into the money market to finance the mortgages, can this be done under the current conditions relating to the amount of savings which are being accumulated on the one hand, and the low amount of borrowing on the private sector on the other hand? Can we do it safely?

Mr. NATHAN. I think you can do it safely. First of all, one has to recognize that we are talking now about a deficit starting 4 months from now and running to 16 months from now when you are talking about this fiscal 1976 deficit. If we go on down, you know, from a point of view of savings, savings are going to shrink unless we turn this economy around.

Chairman HUMPHREY. That is right.

Mr. NATHAN. I think it very largely depends on what the Federal Reserve does. If the Federal Reserve continues to hang tight, then I think you are going to have a problem financing the deficit, let alone the mortgage or anything else. If the Federal Reserve is reasonably cooperative, then I think the major approach is going to be one of accommodating and making the market responsive.

I think Arthur Burns probably deep inside of him, and nobody can interpret anybody else, I think would loosen up a hell of a lot if we had some kind of intervention on the wage-price area, and he had more confidence that we would reestablish inflation. If inflation did not come back, I think you would find a monetary expansion that made sense in the context of the recession.

Chairman HUMPHREY. Mr. Klutznick.

Mr. KLUTZNICK. Senator, it depends entirely on how this is structured and how it is fed into the market. You cannot possibly feed it all in at once.

Chairman HUMPHREY. No, I think that is very important that we understand the timing.

Mr. KLUTZNICK. Yes, and you have to keep yourself loose to make sure you are not just substituting a 6 percent rate at, let us say, 30 years for what the market would absorb at 7 percent for 40 years. You do not want to replace normal financing that might become available if the rates go down.

Therefore, it seems to me that you want to be careful about your timing. You want to be careful how it is used. And you want to be very careful that you are not replacing what might otherwise be made available through normal resources. I do not know.

Chairman HUMPHREY. Mr. Okun, do you have any comment?

Mr. OKUN. I think it is manageable. I agree with them.

Chairman HUMPHREY. The thing we are all trying to get at, gentlemen, so that you understand, there is a great concern here amongst a number of us in the Congress about the housing industry because of its ripple effect, its ramification through the whole economy.

I happen to be one that believes that we ought to have a national housing policy that does not always just equate itself to the money market. I mean I think it is important from a social point of view, from a political stability point of view, from the total economic point of view, to have a housing policy which permits people to be able to buy and own a home, and to be able to buy it under interest rates that make it possible for those monthly payments, as you have said, Mr. Klutznick, to be such that they can handle that, that you can handle those monthly payments. That is what the average person looks at.

I know that when my sons look at whether they want to buy a home or not, they do not only look at how much it is ultimately going to cost; they look at about how much is it each month. Can they handle it on a monthly basis? And that is the important thing.

Just this final observation. Mr. Okun, you really crack down pretty hard on accelerating public works, and you know that there are a number of people in Congress that feel that it is much better to have people at work than it is to have them not at work drawing compensation. I am one of those old-fashioned people and I have my doubts, may I say about how much public service employment we can absorb. I think there are limits to that. We may very well reach those limits quicker than we thought.

But does it not appear that this recession is rather long term? I do not know how to use the word "long," but it surely is not going to be one to get out of within a year, or even most likely, 2 years.

Therefore, if you do have some public works projects that are worthwhile, is there not a justification for it as a part of the total economic program?

Mr. OKUN. I am not opposing those public works that could be justified on the basis of social priority. I do not think the recession

really argues for a lot of projects that you would not undertake otherwise, unless you have some confidence they could be done in the next year or two. You are right that the horizon is longer than it was in 1961 or 1970. We are looking at a deeper, more prolonged period of extreme slack in this economy.

On the other hand, I look back at the record. I referred in a footnote in my prepared statement to the record that Nancy Teeters compiled of how we did with that 1962 accelerated public works program. This was designed to go fast. We wound up spending more money in that program in fiscal 1966 than in fiscal 1963 on a program enacted in October 1962. We were still spending money until fiscal 1970, and that was the accelerated public works. If we cannot do better than that, let us not do anything.

Chairman HUMPHREY. I think you make some valid points. The reason I raise these questions is I participate in a number of what we call group meetings among fellow partisans here of the Senate. We have had more caucuses amongst Democrats in the last year than we have had in the last 20. The real truth of the matter is that I am afraid we are still mouthing a good deal of the rhetoric from the other years and not really getting down to what you gentlemen are talking about.

I consider this testimony this morning some of the best and most constructive that I have ever heard, and this is not to flatter you. I think it has been extremely helpful. The problem is that you have maybe got some converts around here but you have got a lot of people that you need to pray with and to talk to because I am afraid that we are still somewhat bent on some of the old directions and not particularly related to the new facts. The new facts are very disturbing: Inflation, recession, administered prices, lots of things, the stickiness in these long-term interest rates.

There are no magical formulas here. It is a question of how we approach it.

I think I had better let you go, and I do thank you very, very much. You have been so patient and I compliment you.

Thank you.

The committee stands recessed.

[Whereupon, at 1:35 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, March 5, 1975.]